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6 September 2007

Our ref. ghm
Doc. No.
Project No.

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Dear Mr Green,

Offshore Electricity Transmission - A Joint Ofgem/BERR Policy Statement

Thank you for the opportunity to comment on this consultation as issued on 25 July 2007. This response is made by DONG Energy.

DONG Energy was founded in 2006 as the result of a merger of six Danish energy companies – DONG, Elsam, ENERGI E2, Nesa, Copenhagen Energy's power activities and Frederiksberg Forsyning. DONG Energy is a major European energy company with extensive interests across the energy supply chain. 15% of the company's electrical output is from renewable sources, predominately wind power. DONG Energy has been a pioneer in the establishment and operation off offshore wind farms and today the company is a world leader in wind energy.

In the United Kingdom, DONG Energy is a 50% shareholder in the Barrow Offshore Wind Farm (now in operation) and holds sole or shared interests in six other UK offshore wind farms in varying stages of development. By 2012 it anticipates having an "equity" interest in excess of 1,300 MW from UK offshore wind farms. It is also a 50% shareholder in a small onshore wind farm development and is actively seeking to extend its interest in the on-shore sector.

DONG Energy has been supportive of the proposals to introduce an offshore transmission regime but is growing increasingly concerned about the complexity and costs associated with it. Additionally, the latest proposals appear likely to introduce significant delays to the deployment of offshore renewable.

This comes about firstly because the proposals envisage an "annual" tender process and secondly because the development will need to be "sufficiently

certain" to underwrite the costs of the tender process. The proposals also propose a "substantial" application fee which would presumably be in addition to the fees and security obligations currently charged by the GBSO for the onshore connection. User commitments (expected to be £1/kW per year) are also likely from the current proposals for the future replacement of the "final sums liability" system.

We therefore see the proposals leading to the development of the power station and offshore transmission system becoming sequential activities rather than running in parallel, for instance it is stated that "we would also require the generator to have some consents in place for the project to proceed [to the tender for offshore connection]". Elsewhere, it is stated that a period of up to 12 months may be needed to tender for and appointment of an offshore TO. Together this implies a material extension to development time periods. In addition, we note the absence of an offshore TO of last resort, this means that otherwise viable projects may not go ahead because of a lack of willing transmission owners (although in practice projects that have reached this stage would presumably be re-tendered the following year with the developer having to submit its own bid to be offshore TO).

We welcome the increased emphasis on transitional arrangements but question if there will be sufficient time to tender for and appoint the TO's between the proposed "Go Active" and "Go Live" dates (October 2008 and October 2009 respectively). We note there is in this case a proposal for the developer to be the offshore TO of last resort. This is to be welcomed, but we believe that the proposals should also allow for the developer to step in where there are no reasonable or economic proposals by bidders, for example where a sole bidder requires a disproportionately high required revenue. We note that this risk exists in the enduring process but in that case the developer can always abandon the project; in the case of operating or under construction projects, the developer could be a hostage to the bidding process. Depending on the charging rules there may therefore need to be a "reserve price" quoted by the developer, and such a system might usefully be used in the enduring regime as well.

We note there are now proposals for dealing with distribution-connected generators going forward. This is also to be welcomed. However we continue to be concerned about the compulsory and retrospective imposition of the offshore TO scheme to the Round 1 projects (e.g. Barrow and Gunfleet) that connect at 132kV and the potential loss of a material economic benefit (by being licence exempt and "embedded" in a distribution system) with no guarantee that the offsetting benefit of the offshore TO will outweigh this loss. They will also be at a competitive disadvantage vis-à-vis other Round 1 projects connecting at 33kV. We therefore consider that the BSC/CUSC should recognise that licence exempt generators "embedded" in a DNO system should continue their existing economic treatment in respect of embedded benefits.

All of the above will be discussed further in our specific answers as attached.

Yours sincerely

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Annex: List of Questions and Answers

CHAPTER: Three

Question 1: Do you agree with our proposals for the design of the regulatory regime as outlined in this chapter? In particular, we would welcome your views on - the role of the OFTO and the obligations that it would undertake;

- the regulatory and contractual framework, including the duration of (and what happens at the end of) the revenue stream, predefined adjustment mechanisms, transfer arrangements, and business separation requirements;

- the form and quantum of performance incentives;
- dealing with changes to generator requirements; and
- the allocation of risk.

DONG Energy agrees with the approach in principle but is concerned that it now appears highly bureaucratic and theoretical, great care needs to be taken to avoid making it overly complex and costly so as to reduce or negate any benefits from having a competitive transmission owner inserted into the process.

The charging proposals later in the document propose using an asset life aligned to the offshore wind farm life as opposed to the life of the transmission assets. Whilst there can be a debate about an appropriate life for the transmission assets, the approach itself is perverse, and although it is argued that there is a risk of stranding of the assets at the end of the wind farm's life, in actual fact the most likely outcome is that the wind farm would be replaced and/or repowered using technology of the time. As the transmission assets will have already been fully paid for, and the OFTO will have provided for decommissioning, there needs to be a way of utilising the written down assets, most likely by the wind farm owner if he has already paid for the infrastructure through his charges. In any event the offshore generator needs to be assured that it will be able to use the assets beyond the period of the OFTO licence. It can be noted that for equivalent generating connection on shore there has never been a suggestion that the assets need to be amortised over the life of the generator, even where they use fossil fuels and there is a real possibility that such fuel might no longer be available at the end of the stations life.

Question 2: Do you feel that there is any aspect of the design of the regulatory regime that we have not considered sufficiently?

Once the design has been sufficiently developed (including as to charging) we think there would be merit in reworking the cost-benefit assessment to confirm that the proposal remains cost effective.

CHAPTER: Four

Question 1: Do you agree with our proposals for the enduring competitive process as outlined in this chapter? In particular, we would welcome your views on:

- the use of an annual tender application window;
- the design of the tender process, and the stages we have outlined;
- recovery of tender costs; and
- running the tender process.

DONG Energy can see the logic of having an annual tender window but notes that this will inevitably lead to delays in the development of the offshore system. More significantly, the proposals appear to require that the offshore project will have first obtained its section 36 consent before applying for the offshore connection. Even if this was not a regulatory requirement (and the text of the documents suggest that it will be) the proposed "substantial fee" for making an offshore connection application, combined with the anticipated user commitment charges for the onshore element (£1/kW for each of the first three years from offer acceptance) mean that developers will not want to proceed down this path until certain that their project will go ahead. This is discussed further in the response to chapter six below.

We also see from the proposals that the period of tendering, bidding and appointing an offshore TO is estimated at one year, and if a project misses the annual tendering window, it could be up to nearly twice that. This means the current development timescales for offshore projects will be materially extended. A project starting now (assuming a crown estate lease option was available) would require one to two years for environmental assessments, one to two years for section 36 (with onshore grid consent being applied for in parallel or before), one year for the OFTO appointment then two to three years for construction. His implies a five to eight year development period from crown estate lease terms being agreed.

DONG Energy believes that the process needs to be adapted to allow the parallel development of the offshore connection and the power station to prevent such an extended development period. Where the advance work is done by the developer or an actual or prospective OFTO, there needs to be a means of recovery of costs should the project go ahead.

Question 2: Do you feel that there is any aspect of the enduring tender process that we have not considered sufficiently?

In the event that connection and/or use of system charges are charged back to the developer at a rate related to the winning bidder's revenue stream, the process needs to include a mechanism to protect the developer from paying more for its connection than it would have to be it developing and paying for its connection itself. As drafted, the proposal would require all developers to submit their own bids priced at their own cost of capital and with their own maintenance estimates, to ensure that if all other bids are more expensive, they would be chosen to be OFTO. A simpler approach would be to allow the developer to specify a minimum revenue stream or "reserve price" above which it would prefer to be OFTO itself. This would protect it (and other users of the transmission system) from any situation where there is limited competition for the OFTO role.

CHAPTER: Five

Question 1: Do you agree with our proposals for the transitional arrangements as outlined in this chapter? In particular, we would welcome your views on:

- the pre-conditions for qualifying transitional projects;
- the tender process for transitional projects, and whether they capture the potential projects that will require adoption;
- the transfer of assets; and
- interaction with the enduring regime.

DONG Energy notes the principle set out in paragraph 5.25 that OFTO's would be expected to adopt development work incurred prior to Go Active and that the developer would be compensated for efficiently incurred third party costs. Companies that do the work "in house" should not be penalised, and the key criteria should be that the costs are efficiently incurred, and not that, that should also be incurred by a third party. This principle should be adopted for the enduring process generally.

Question 2: Do you feel that there is any aspect of the transitional arrangements that we have not considered sufficiently?

Will there be sufficient time between the planned Go Active and Go Live dates to complete the first round of OFTO tenders and appointments?

The proposals acknowledge that the developer may be the OFTO of last resort should there be no bidders, however this does not address the possibility of all prospective OFTO's bidding unreasonably high prices, or at least prices above which the current owner is prepared to continue as OFTO under the new regime. As with the enduring process noted above unless the process allows for the owner to nominate a reserve price, it will need to submit its own bid priced

at its own cost of capital and with its own maintenance estimates, to ensure that if all other bids are more expensive, it would be chosen to be OFTO.

The proposal envisages the handing over of assets to the OFTO once complete. This seems to overlook the likely need for the assets to be operated i.e. to transmit electricity in order to complete the commissioning of the equipment. From the legislation it would appear that a transmission licence or exemption would be needed for such operation, therefore the developer would need to have either a licence or (more likely) exemption in order to commission the offshore network before handing it over to the OFTO designate. Such provisional exemption needs to be allowed for.

Consideration also needs to be given to the consequences of the OFTO failing to comply with its obligations close to the date of hand over of the assets. In the worst case there could be financial failure of the OFTO, but also matters such as failure to pay the developer the consideration for the assets, or the licence fee to Ofgem, could derail the process. Clearly the developer would not wish to be penalised (and at worst, being prevented from generating) for an event outside its control.

CHAPTER: Six

Question 1: Do you agree with our proposals for the connection application process as outlined in this chapter? In particular, we would welcome your views on:

- the pre-application process;
- the indicative offer process (stage 1);
- the final offer process (stage 2); and
- the roles of the generator, the GBSO, and the OFTO in this process.

The description of the "Stage 1" offer in section 6.7 is that there will be an "indicative assessment of the necessary contingent transmission reinforcement works onshore". Whilst it is understood that the offer from the GBSO at the indicative offer stage cannot be firm as to the arrangements offshore, the onshore part of the application needs to be "firm" in that onshore TEC rights should be guaranteed once the offer is accepted. Otherwise the developer will face the risk of paying for the offshore tender process only to find that the onshore TEC has been lost due to changes in the contracted background (for instance to an onshore developer who does not need to go through the additional offshore tender stage).

DONG Energy is concerned that the process now envisages National Grid, as GBSO, having a significant coordinating role including the commissioning of "Advanced Service Works" which under the current arrangements would in effect be managed by the developer. We would like assurances that National

Grid will be undertaking this work with due focus on the developer and its requirements, presenting a more responsive and customer-focussed attitude than sometimes seems the case from its existing on-shore monopoly position.

Question 2: Do you feel that there is any aspect of the connection application process that we have not considered sufficiently?

The process described will materially extend the development process my making the offshore wind turbine development and the offshore network development sequential processes. It is also unclear whether this will work in terms of environmental impact assessment and the application for consents.
It is understood that as a rule for onshore power station development it is expected that the requirements for section 37 consents should be assessed at the "pre-application" stage for section 36 (see the section entitled "Good practice tips for pre-application stage" in the recent BERR consultation "Guidance On The Consenting Process For Onshore Generating Stations Above 50 MW In England And Wales"). This implies that an offshore generator will need to obtain its stage 1 connection agreement, and then make its section 36 application (with any indicted requirements for section 37 at the same time). Only after the award of the section 36 will the developer and GBSO move to the second stage application i.e. the tendering and appointment of the OFTO.

Question 3: We outline two options for annual tender application windows. Which of the following options do you think are appropriate?

- Option 1: A mandatory annual tender application window, to be incurporated into the offshore connection application and tender process; or
- Option 2: To rule out an annual tender application window and allow generators to realise cooperation benefits independently and optionally.

DONG Energy believes that it is too early decide whether the benefits of annual tender windows outweigh the potential delays if projects miss the window. The first two tenders will in any event be on an annual basis (i.e. immediately after "Go Live" and "Go Active" respectively). Experience gained in these two rounds should inform the decision as to whether the process should be repeated annually or undertaken on an ad-hoc basis.

CHAPTER: Seven

Question 1: Do you agree with our proposals for connection via distribution networks as outlined in this chapter? In particular, we would welcome your views on:

- comparable types of connection;
- charging arrangements; and
- connection application processes.

An alternative form of comparable connection would be a Distribution connected Medium Power Station, but we would agree that basing the model on that of a Large Power Station may be more appropriate.

The project developer needs to be involved in the decision as to whether to connect via a DNO or direct to the onshore transmission system to the extent that it may be affected in terms of cost, timescales or security.

The connection process should be designed so that it will take no longer to process applications for connections via a DNO than for those direct to the on-shore transmission system.

Question 2: Do you feel that there is any aspect of connection via distribution networks that we have not considered sufficiently?

DONG Energy continues to be concerned about the compulsory and retrospective imposition of the offshore TO scheme to the Round 1 projects (eg Barrow and Gunfleet) that connect at 132kV and the potential loss of a material economic benefit (by being licence exempt and "embedded" in a distribution system) with no guarantee that the offsetting benefit of the offshore TO will outweigh this loss. They will also be at a competitive disadvantage vis-à-vis other Round 1 projects connecting at 33kV. We therefore consider that the BSC/CUSC should recognise that licence exempt generators "embedded" in DNO systems should continue their existing economic treatment in respect of embedded benefits.

CHAPTER: Eight

Question 1: Do you agree with our proposals for charging, access and compensation as outlined in this chapter? In particular, we would welcome your views on:

- the development of charging arrangements;
- access products; and
- compensation proposals, particularly whether there should be a penalty only regime in place for the OFTO.

The high level principles and process for developing the charging system appears appropriate but DONG Energy would question some aspect of detail. In particular the proposals to base the charges on the life of the power station rather than the life of the asset appears discriminatory and not cost reflective unless the persons meeting the charges will have access to the written down assets at the end of the licence period. We would also note our view that comparability with the on-shore regime should lead to the boundary of the connec-

tion assets and infrastructure assets to be at the LV side of the bus bar on the offshore platform.

Question 2: Do you feel that there are any aspects of charging, access and compensation that we have not considered sufficiently?

The treatment of losses in the offshore network needs to be discussed and consideration given to applying the onshore approach of recording the generators exports at its connection to the transmission system.

As the proposal are developed there needs to be clarity on any linkages between the proposals for awarding the OFTO licence (which discusses the bidding of a revenue stream) and the charging regime (which discusses cost of assets). There are both pros and cons to the use of generic cost structures (and implicit discount rates) for offshore assets and the design of the system needs to be taken further before a definitive view can be offered on the most appropriate approach.

CHAPTER: Nine

Question 1: Do you agree with our proposals for technical rules as outlined in this chapter? In particular, we would welcome your views on:

- security standards; and
- the recommendations for developing technical rules.

As an experienced offshore wind developer DONG Energy would have wished to have been more involved in the development of standards and requirements.

We are concerned that the proposal to deem any offshore wind farm of 10MW or more to be "Large" was made without any supporting argument other than a purported risk to operating the offshore network and that individual projects might be divided into numerous small units (which presumably is a risk for the onshore network should there be any material benefits in doing so). Such a radical suggestion needs to be properly justified.

Question 2: Do you feel that there is any aspect of technical rules that we have not considered sufficiently?

Not as far as we can see at this stage.

CHAPTER: Ten

Question 1: Do you agree with our proposals for implementation as outlined in this chapter? In particular, we would welcome your views on:

- changes to licences; and
- changes to codes.

No comments

Question 2: Do you feel that there is any aspect of implementation that we have not considered sufficiently?

Not as far as we can see at this stage.

CHAPTER: Eleven

Question 1: Do you agree with our proposed work programme as outlined in this chapter? In particular, we would welcome your views on our proposed approach to industry engagement.

As the work is now being spread across number working groups and committees, there is a greater need for more regular external communication sessions that draw all the threads together. Consideration should be given to making these more comprehensive, with dates published well in advance and sited in larger venues to ensure that all interested delegates can attend.

Question 2: Do you feel that there is any aspect of our proposed work programme that we have not considered sufficiently?

Not as far as we can see at this stage.