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Offshore Electricity Transmission – A Joint Ofgem/BERR Policy Statement July 2007

Dear Colin,

We welcome the opportunity to comment on the matters raised in this joint policy statement. This response reflects the views of RWE npower, the UK based business of RWE Trading GmbH and RWE npower renewables.

GENERAL COMMENTS

The additional clarity and detail provided for the design of the proposed enduring and transitional regimes is helpful. It is also important that the roles and responsibilities of all affected parties, as set out in the contractual framework, have been confirmed. While these represent a reasonable balance of risk between the parties, we do have specific concerns in some areas. We endorse the “thick” Offshore Transmission Owner (OFTO) model that has been suggested in the policy document. The thick model allows more innovation as the OFTO can offer standard and variant designs, but the bid assessment process will, of necessity, be much more complex. We are concerned that the assessment criteria will not be transparent and that variants will fall outside the main regime.

As an existing offshore developer, we welcome the provisions of the transitional arrangements and in particular the recognition that projects will be at different stages in their development life cycle, whenever the “go-active and “go-live” dates are set. Additionally, extending the pre-qualification criteria for determination of generation projects that qualify for the transitional arrangements may add certainty for some developers. However, we are concerned that a “one-size-fits-all” approach to transitional arrangements may significantly disadvantage certain developers/projects. The use of “financial close”, however, is too prescriptive for some

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developers and in our case, where it is likely we could build projects such as Gwynt y Môr on balance sheet, there will not necessarily be a single date that could be described as “financial close”.

The non-exclusive approach is predicated on the assumption that there will be a number of competing bidders in each tender. In our view, the fundamental weakness of the approach is the situation where either an OFTO cannot be appointed or one does not come forward at all or the price submitted is not acceptable to OFGEM. In this situation the generator is legally unable to generate or transmit electricity, with the effect that projects cannot progress. We would ask that this point is evaluated and solutions are provided within the regime should such situations arise. The non-exclusive approach creates uncertainty and delay in the appointment of an OFTO and it is not clear how amendments to applications or subsequent offers will be managed under the enduring regime in a way that does not delay projects.

As indicated we welcome the consultation, as it is the first clear indication of how the regulatory regime will be structured. However, we believe it is now critical that scenario analysis work is undertaken to trial effectively the proposals for a number of projects, both under development and for examples of future projects to identify the uncertainties, pitfalls and improvements necessary to the proposed regime. In this regard we would gladly assist Ofgem & BERR by providing information about our own projects as examples for study.

Although we recognise and support the overall policy objectives of designing a regulatory and commercial framework that will support the efficient development of transmission networks for connecting offshore generation to the onshore grid, we still have concerns. Indeed, we remain to be convinced that the complexity of a regime based on a non-exclusive model will provide an attractive investment framework for prospective OFTOs and generators.

We hope these views are helpful and would be happy to discuss them further.

Yours sincerely,

By email so unsigned

Charles Ruffell
Economic Regulation

SPECIFIC CONSULTATION QUESTIONS

Chapter 3: Design of Regulatory Regime

1. In our view, the non-exclusive approach proposed for the enduring regime introduces significant risk for offshore developers and OFTOs alike. Arguably, by introducing tender windows and pre-application stage(s) or creating cable corridors, Ofgem is attempting to replicate a level of co-ordination that would be a natural feature under an exclusive licensing approach. Attempting to impose these features not only dilutes the logic for competitive appointment of the OFTO, but also creates a very complex tendering processes. We also believe these proposals are discriminatory when compared with the existing onshore regime. It is also likely to give rise to offshore connections being disadvantaged, due to inherent process delays, against onshore generators.
2. Limiting the price control revenue stream to 20 years is a new proposal and we would like Ofgem to explain further their thinking for imposing this restriction. Our preference would be to retain the flexibility in the initial proposals such that the OFTO bid duration could match the required access life required by the generator. Alternatively, the duration could be left to the discretion of bidders as it could provide a competitive pricing opportunity under the tender process. We believe that this approach is consistent with the requirement of the OFTO to finance its investment and could create greater cost competitiveness for consumers.
3. As part of the OFTO obligations, the “defined power transmission capacity” should reflect the access product in operation at the time of the regime, which at this time is TEC. The TEC value should reflect the TEC of the generator at the interface with the regulated network, which for offshore should be the Offshore substation LV busbar.
4. We do not agree with the proposals for sharing of risk as indicated within Appendix 3, particularly in regards to: D. Operational Phase: Availability/Outages; and E. Post Price Control Regime: Residual Asset Value + use/stranding. In our view, these risks are clearly either under the control of the OFTO and/or their management responsibility.
5. We support the proposed incentives and performance regime to ensure performance by the OFTO, although we recognise that there are difficulties in defining performance measures for the OFTO, not least because of the relative newness of the business.
6. As a future generator we do not agree with the proposals for lack of compensatory events, nor the proposals for generators who wish to vary requirements above or below the minimum standard would be dealt with outside the regime. It has been indicated that an n-0 SQSS standard should be the minimum, where (under CAP048) compensatory payments are not applicable. This discriminates against offshore generators as they cannot elect to go to a lower standard and are automatically not eligible to compensation (CAP048). Additionally, if they elect for an n-1 standard, the consultation proposes that this would be outside the regime and thus be ineligible to compensation.
7. With an n-0 standard, from a generator’s perspective, availability and losses are the key issues. An availability target will be necessary, because offshore connections will not be provided with redundancy and generators face the risk of lost revenues without compensation. The OFTO can maximise availability by:
 - Designing the system to minimise planned outage requirements;
 - Designing the system to minimise the likelihood (and impact) of unplanned outages; and
 - Providing facilities to minimise return-to-service times in the event of unplanned outages.

8. Rather than specify a maximum number of unplanned interruptions, as suggested in the document, the performance obligations could be based on:
 - A maximum level of unavailability due to planned outage requirements of, say, 2%; effectively a 98% availability; with
 - A maximum return-to-service time for certain defined unplanned outage events (e.g. 2 months for a sub-sea cable fault). For losses, a generic target may be unsuitable as losses will tend to increase with distance offshore and any targets should reflect this.
9. A scheme for penalty payments on an OFTO is a necessity. The level of any penalty should be sufficient to incentivise the OFTO, and also should reflect all losses incurred by the generator; particularly where the generator has no control over situations of loss of transmission.
10. We support the proposal that revenue should be passed through to the generator and agree that the correct contractual relationship is via the GBSO, rather than the OFTO to generator.
11. We can see both sides of the argument for a predefined adjustment mechanism and believe the issue to be finely balanced. Should an adjustment mechanism be put in place, then the trigger should be set at a high level, analogous to the Income Adjusting Event. At this stage, additional analysis is required to understand the issue more fully.
12. Additionally, as the generator is not directly involved in the appointment of the OFTO, there is a danger that their preferences and priorities will not be successfully communicated to potential OFTOs. To avoid this risk, it would be sensible to develop a form listing those parameters over which the generator is allowed to exercise some choice, and showing the "default" values for these parameters. The generator would use this form to indicate for each parameter whether they want to opt for the default or use a different value. Should tender variants arise they should be reflected in the connection agreement and not be subject to bilateral contracts.
13. Where an OFTO licence has been revoked, the rules need to ensure continuity of access for the generator until a new appointment or else compensation should be payable.
14. We do not agree that a generator should meet the costs of the OFTO bidders and the costs of Ofgem in respect of the tender process, whether or not the generator withdraws its application. Such costs are not incurred in the onshore regime and in addition the costs, liabilities and timeline for an offshore connection will not be known until a generator receives the final offer, following completion of the tender. It is unreasonable to expect the generator to be able to know during the tender if a final offer is acceptable and therefore the generator should not be expected to cover costs of the tender process.

Chapter 4: Enduring Competitive Framework

15. Our earlier comments on the non-exclusive approach notwithstanding, we recognise the merits of implementing effective and efficient tender arrangements that are streamlined and reduce administrative burden and potential costs.
16. The key issues from the generator's perspective include how they interface with the tender process, given that it is a critical element of the overall connection application process; consistency with the connection application timings; co-ordination between the onshore and offshore elements of the bid and assurance of non-discriminatory access to the onshore transmission network; clarity of bid assessment criteria; and information provision obligations.

17. We believe the use of an annual tender application window, whilst streamlining the tender process, may disadvantage offshore connections compared with those onshore. It will create delays for projects (between acceptance of indicative offers and commencement of tenders) and may give rise to an offshore grid “queue”. However, we do recognise the benefits such as window can provide spatially in terms of offshore network design and onshore connection points. We believe some scenario analysis is required to better understand the implications of such windows.
18. The document confirms Ofgem’s role in the tender evaluation process, but we still believe that there is a potential conflict as they will be managing the tender process and hearing appeals from developers over subsequent connection offers. We also require additional clarity about how Ofgem will determine whether a tender is competitive and should this happen, what will happen next. We are concerned about potential delays caused by this element.
19. The decision not to pre-licence bidders introduces potential additional risk for developers if the pre-qualification criteria are not properly defined. In our view, Ofgem must set these to ensure that potential OFTO’s are both financially and technically competent and if this achieved, the removal of the pre-licensing stage should reduce time delays in the bid approval process.
20. The idea that the *Expression of Interest* might cover the assets for more than one generation project seems sensible and the logic must surely be that even greater benefits would be delivered where a single OFTO for a defined geographic area was appointed, i.e. an exclusive approach. A number of questions arise:
 - Who decides when this would be advantageous?
 - How would any substantive differences be managed, such as where the two generators have different priorities?
 - Should the tender process take more than 12 months, what happens in the situation where a further connectee applies, whilst the previous tender is still running?
21. We do not agree with the proposal for the selection of the preferred bidder. The document indicates that Ofgem will decide whether to approve the OFTO’s revenue stream after the generator has accepted the final connection offer from the GBSO. However, under this approach, the GBSO could find itself unable to meet its contractual commitments to the generator because Ofgem fails to approve the OFTO’s proposal. In our view, Ofgem must approve the OFTO’s proposal before the GBSO provides the final connection offer to the Generator. In addition, awaiting regulatory approval should not be allowed to delay the process.
22. A further significant risk is the lack of an “OFTO of last resort” in the enduring regime, although it must be recognised that the generator will not necessarily create a special purpose vehicle as a potential OFTO. In the event of an OFTO not being appointed or forthcoming it is suggested that the project would be re-tendered, possibly with some modifications to specifications. Again as a developer we have significant concerns in the delays and technical risks such a situation creates.

Chapter 5: Transitional Arrangements

23. Notwithstanding our general comments on the Transitional Arrangements with respect to Gwynt y Môr, we welcome the revised proposals that reflect the reality that projects will be in different stages of development and the potential that tender process itself may be protracted. These should meet a number of the concerns we expressed in responses to previous consultations and in one-to-one meetings. As a consequence the risk that some projects may

be delayed to avoid incurring development costs that are subsequently stranded has been reduced.

24. However, we still require further clarification of the definition and requirement for “financial close” and would argue that financial close will vary depending on the financial structure of individual projects. The definition should reflect this and not be overly restrictive. We would again request that some scenario analysis work be done to assess both the financial close issues and the practicalities of when transitional projects apply or tenders are run. This is particularly the case for those projects that have already accepted a grid connection offer; and we need to understand how the novation of such offers will be managed.
25. We are still concerned that the non-exclusive regime will limit appropriate spatial planning and provisions for expansion or future capacity. However we recognise that the suggested use of tender windows and cable corridors is an attempt to include some major benefits of an exclusive approach in to the non-exclusive approach.
26. We believe the provisions of Crown Estate Leases needs to be discussed with the Crown Estate, for both Transitional and Enduring arrangements.
27. The policy statement confirms the intention to use both an ex-ante and ex-post assessment of capital costs. We do not believe that it is appropriate for Ofgem to ascribe such a low value as 75% to the ex-ante costs, given the commercial pressures already faced by developers. This introduces a significant risk for developers. In our view, Ofgem should use actual costs, as these will have been efficiently and economically incurred. Therefore we believe for the Transitional Arrangements the 100% ex-post costs should be used.
28. The tender process places obligations on the developer for providing certain information and a data room. We seek confirmation that these form part of the legitimate costs that can subsequently be included in the adopted assets.
29. Ofgem has made an overly simplistic assumption that a generator will be willing and able to be the “OFTO of last resort”. The business separation requirements are onerous and transmission is not a core business of many developers. We have commented on this weakness in the design of the regime elsewhere in this response and we urge Ofgem to develop an alternative approach for both the transitional and enduring regimes. In addition, we are concerned with the consultation comments regarding compensation mechanisms due to decisions of the developer; given that some of these decisions have been made prior to the proposals for an offshore regime.

Chapter 6: Connection Application Process

30. As set out in our comment on Chapter 4 above, this is a key area for developers and we agree that, as far as practicable, existing processes should be retained and adapted where necessary.
31. It is our view that the proposed tender will create significant delays due to the likely time required to complete the process. The consultation provides little indication of the timescales involved, but it is likely to take 12-18 months and this would be required for each connection application. When combined with the successful bidder then concluding a final connection offer, this creates excessive delay for a generator between their application and receipt of final offer. There is obviously significant delay between the generator submitting an application and the commencement of construction of the offshore network.

32. It is critical that the generator, upon receipt of the initial offer, has security of access to the onshore network and capacity in the timescale specified in their application. Subsequent offers to third parties, be they onshore or offshore should not impact on this access.
33. We note that it is proposed that the generator should be accountable for both an application fee and for the costs associated with the tender activities. We believe this discriminates between the offshore and onshore connection process and we consider such costs (tendering) should be borne directly by the consumer. The tender process has been determined to be the most cost-effective solution for the consumer, as opposed to a model based on the onshore regime.
34. We welcome the proposals for the GBSO to publish relevant information as part of its SYS. However alongside this, Ofgem should consider, in conjunction with the Strategic Environmental Assessment identification process, strategic spending on the identified onshore connection points to ensure the onshore capacity is available in a timely manner.
35. We do not agree that the “pre-application” feasibility study should be a precursor requirement of the application process. The onshore model should be adopted offshore, whereby the generator, if they wish, can elect to undertake a feasibility study prior to application; or take the approach that such work should be undertaken within the Stage 1 process.
36. We believe the Option 2 model should be adopted, ruling out an annual tender application window. This is consistent with arrangements onshore and allows generators to realise co-operation benefits independently and optionally.
37. Further analysis is required on: the status of indicative NGET offers; provision of further clarity of the security of access, capacity and timeline; the form of “user-commitment”; and at what stage (and with what costs) can generator walk-away.

Chapter 7: Connection via DNOs

38. We generally support the proposals in this area, but do not think that there should be differential treatment depending on the connection type. There needs to be appropriate incentives on DNOs to provide a reliable network connection for anyone connected to their system.

Chapter 8: Charging, Access and Compensation

39. We have already indicated our support, in principle, for a OFTO “penalty” regime. This is particularly important, as a lower offshore security standard will mean that CAP048 compensation arrangements will not be available to offshore generators; which in our view unfairly discriminates against offshore generators. As previously noted, availability of the OFTO network is our key area of concern any incentive must be at a level that ensures faults are rectified quickly.
40. Current industry initiatives notwithstanding, in principle notwithstanding our view on compensatory events, network access and charging arrangements should be common to all those accessing the network. On this basis, we support extending the onshore access product and the charging methodology offshore. Our only concern is that sufficient time to consider offshore issues needs to be built into the work programmes of the existing industry groups considering these issues and that any developments are promulgated to the wider community, who may not be directly involved or be part of the proposed new work groups.

41. We recognise that discussions on the range of access products available onshore is ongoing, and once these are concluded it may be necessary to revisit the access proposals for offshore.

Chapter 9: Technical Rules

42. We agree with the approach set out for developing offshore security standards and for reflecting the technical rules into industry codes. We also support establishing a group to consider development of the STC to accommodate OFTOs.
43. We believe further more detailed work is required on the technical design of offshore networks, including both the physical and technical access arrangements for offshore substations.

Chapter 10: Implementation Issues

44. We agree with the approach set out for implementing the policies being developed under this process and also support modifying existing licenses codes and agreements to incorporate specific changes required for offshore. We note Ofgem has suggested that additional arrangements may need to be put in place to ensure that the enduring and transitional tender process can be implemented and function effectively and we would welcome further explanation of what these arrangements might include.

Chapter 11: Works Programme

45. The document sets out an indicative timetable, as well as key consultations and other publications, required to meet the 1st October 2008 go-active target date. There are aspects of the regime design that are yet to be agreed, as well as a considerable amount of detailed rule development to be completed. Although we would wish to see the regime introduced as soon as possible, it does appear that this is a challenging timetable. We do welcome the recognition that there needs to be industry engagement to make progress and as a company we are committed to remaining involved in both existing and the new working groups.