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Dear Colin,

Offshore Electricity Transmission – A Joint Ofgem / BERR Policy Statement

Thank you for the opportunity to comment on this policy document. This response is submitted on behalf of ScottishPower Energy Wholesale, which includes the UK energy businesses of ScottishPower, namely ScottishPower Energy Management Ltd, ScottishPower Generation Ltd and ScottishPower Renewable Energy Ltd.

The offshore electricity transmission regime is critical to offshore wind farm operators, developers and the supply chain currently working on projects, but also to the plans for future offshore wind farms and for fulfilling the potential of wave and tidal stream generation.

As a generator, we wish to see a regulatory regime that is low cost and efficiently delivered so that it can be up and running with as little complication and delay as possible. Generators require a regime that will give them access to a market that is consistent and competitive with the rest of the electricity market.

The Government decision of 29 March 2007 that offshore licences should be non-exclusive was contrary to ScottishPower's support for the "exclusive multi-zone approach", which, we believe, would have delivered effective co-ordination of projects within each area, ensuring efficient solutions and delivering maximum MW, in the shortest possible timeframe. We do not wish to delay the consultation process in what is already an ambitious programme but would seek a comparison of the end to end process and costs under both the exclusive and non-exclusive regimes to enable demonstration of the advantages claimed by the non-exclusive approach.

Chapter 3 Design of Regulatory Regime

Answer 1: We do not believe that the regulated income stream should be limited to a fixed period of 20 years but should be negotiated flexibly between the generator and OFTO to reflect the anticipated useful life of the generation assets. The connection offer could then better reflect the offshore windfarm leases which are generally 40 or 50 years. A longer period may also be a more attractive investment to some potential OFTOs and would be more consistent with the onshore charging methodology. However, an income stream longer than 20 years may require a price review at the 20 year point.

At the end of the 20 year period, the OFTO should be permitted to bid a further regulatory revenue stream for the remaining life of the connection assets. If this is acceptable to both the generator and the Authority then no tender process should be required otherwise a tender process should be initiated.

Exclusion of predefined adjustment mechanisms, while providing certainty over costs to developers, will result in the OFTO building in a risk premium to cover just such eventualities. This premium will be passed through to the generator in the form of increased charges and may result in the project being unviable. Allocation of risk should be negotiable between generator and potential OFTOs during the tender process and the generator should be involved in the selection process to ensure that no commercial issues are introduced. Based on experience in the onshore process, there is also significant merit in involving the generator in negotiations between the GBSO and potential OFTOs.

While it is preferable to achieve business separation, in the event that no OFTO is forthcoming to provide the offshore transmission assets, the developing generator should be permitted to apply for an OFTO licence and to provide the offshore connection assets required. Notwithstanding, Generator and OFTO activities should be ring-fenced and operated within separate legal entities. In addition, there may be a requirement for the appointment of an OFTO of last resort in the event of insolvency or revocation of OFTO licence.

The form and quantum of performance incentives and generator compensation payments should be the subject bilateral negotiation between the OFTO and offshore generator. Generic obligations may not be appropriate for each unique offshore connection but may be used to set a minimum level.

The generator should be able to change requirements (above and below the minimum security standard). These should be dealt with outside the regulatory regime and the generator should benefit from the full cost or benefit.

Payment security should be provided by the offshore generator in the same manner as onshore through the provision of security for the current year's charges and termination amounts.

In the bid phase, bidders' costs should be explicitly included within the bidders' controlled revenue stream and should not be recoverable in addition to the revenue stream.

The risk associated with the decommissioning phase has not been discussed in this chapter but is critical to determining project viability. The liabilities on the generator of a sub tenant must be clarified for all stages of the project timeline, up to and including decommissioning. The policy statement does not appear to reflect the requirements of the ongoing BERR consultation on decommissioning for offshore windfarms. The liabilities associated with sub-leasing of the sea-bed should be clarified with the Crown Estates to establish where the decommissioning risk and cost would lie, i.e. with the OFTO or the generator. In addition, we require clarity on how Crown Estates will treat any “residual liability” in respect of the Generator and the OFTO to establish where this risk will lie.

A detailed process for modification of the connection offer should be considered as part of the development of the process.

For the avoidance of doubt, the OFTO licence should include a non-discrimination obligation.

Chapter 4 Enduring Competitive Framework

Answer 1: On balance, the proposed process appears to allow developers to progress discussions with GBSO ahead of the window but achieve the benefits of co-ordination through permitting applications throughout the year and having a “tender window”.

The process stages outlined appear to be sufficient to achieve a measured and fair outcome, however, at each stage efforts should be made to accelerate the process to provide the developer with a connection offer as early as possible.

We are pleased to note that it has been recognised that the GBSO is not the appropriate person to conduct the tender process. Neither should the GBSO be allowed to manage the data room during the tender process.

The generator should be involved in the selection process to ensure no commercial issues are introduced (e.g. the inability of parties to work together because of existing legal disputes). Based on experience in the onshore process, there is also significant merit in involving the generator in negotiations between the GBSO and potential OFTOs.

A balance has to be achieved between ensuring that developers do not make speculative connection applications thus imposing costs on other users and requiring such a large financial commitment that it becomes a barrier to entry. The level of commitment should be reflective of the costs incurred by the GBSO in running the process and should be recovered from the developer and those tendering for the OFTO licence. Where the developer carries out environmental impact assessments and seabed surveys for the cable route in advance of the connection application, these costs should be remunerated by the successful OFTO.

If the Authority does not scrutinise the revenue stream until after the generator has signed the final connection offer then the generator should incur no liability under the final offer between the date of signing and the date of approval by the Authority.

The process should also specifically state whether the initial indicative and final offers may be referred to the Authority for determination.

We believe that the GBSO should be procuring the seabed and environmental survey work in the interest of efficiency and to avoid duplication although it is not clear how such costs should be underwritten. It is clearly unfair for the generator to fully underwrite such costs when it is unclear what the final connection costs will be and how they will affect the viability of the overall project.

Answer 2: We question the value of the “initial indicative connection offer” from the GBSO. As the costs indicated in this offer will not be binding, there is a risk that a developer may be encouraged to proceed into the expensive tender stage by an unrealistically low indicative offer only to be faced by unacceptable costs in the final offer and responsibility for the costs of the tender process. It may be possible to introduce a “cap” on increases between the initial and final offer to reduce this risk to the developer with some of the risk of tender costs shared by the GBSO. This would incentivise the provision of realistic initial cost estimates.

Chapter 5 Transitional Arrangements

Answer 1: As far as possible the tender process for transitional projects should follow the enduring process to avoid the expense of developing separate processes. We support the acknowledgement that the generator must be permitted to become the OFTO of last resort in order to allow the project to operate legally post “go-live”.

We also welcome the recognition that demonstration of unconditional parent company support would be appropriate to qualify for the transitional arrangements as demonstration of financial closure.

It is SP’s view that where Financial Close has been achieved, the contract prices constitute the best prices that could have been achieved in the market. Therefore, 100% ex-ante guarantee of investment is appropriate in these cases. A review, following completion, of any difference between contract price and final outturn price could be conducted to ensure that it was economically and efficiently incurred given market pressure at that time. Clarity on the definition of Financial Close is required.

We accept that the cost of assets procured by the generator which exceed the minimum technical rules (e.g. providing a higher level of security) should be met by the generator as a one-off cost. However, should a subsequent developer connect into this line, the treatment of the cost of the additional assets should be reviewed

Within the pre-conditions, the financial model and data to be provided to Ofgem should only cover the connection assets and not the generation assets. Similarly, the engineering audit report on functional performance should only be for the offshore transmission assets and would not cover the associated generation assets. Clarity is required on the level of information required for data rooms and appropriate fees to cover tender costs .

The independent engineering audit report on the functioning and performance of the connection assets should be funded by potential OFTOs as the developer will already have carried out this work as part of the development. Following completion of the engineering audit, design and construction risk should pass to the OFTO who will have had access to all the necessary data when bidding his regulated income stream.

OFTO capability should not be assessed purely on financial strength. Capability and experience to deliver and manage the connection is crucial including the management of any sub-contractors. The generator should be involved in the selection process to ensure no commercial issues are introduced (e.g. the inability of parties to work together because of existing legal disputes). Based on experience in the onshore process, there is also significant merit in involving the generator in negotiations between the GBSO and potential OFTOs.

Chapter 6 Connection Application Process

Answer 1: The cost of any works carried out to facilitate an offshore connection should be secured on the same basis as an onshore connection in reflection of the intention to extend the onshore charging regime offshore.

It is not clear how costs of work procured by the GBSO in support of the tender process (e.g. environmental survey work) should be underwritten. It is clearly unfair for the generator to fully underwrite such costs when it is unclear what the final connection costs will be and how they will affect the viability of the overall project.

Discussion between the generator and the GBSO during the pre-application process should be conducted on a commercially confidential basis. We are concerned that projects discussed at this stage should not be reflected in the SYS. However, the identification of potential onshore connection sites and connection corridors by the GBSO would be advantageous to both potential offshore generators and OFTOs.

We support a process (Option2) whereby generators could make a competent application at any time of the year subject to tenders taking place a fixed point. This flexibility allows generators to progress discussions with the GBSO while achieving the benefits of co-ordination in the tendering process.

Chapter 7 Connection Via Distribution Networks

Answer 1: We agree that it is more appropriate to define the contractual arrangements for connection of offshore transmission networks via distribution networks in the distribution licensee codes and agreements (DCUSA / Distribution Code). It is not clear how the overall offer timescale of 3 months can be met where the GBSO and DNO each have 3 months to provide their part of the connection offer. This may require coordination similar to that contained within the SO / TO arrangements.

We should not underestimate the complexity of coordination of the interaction between the various codes.

Chapter 8 Charging, Access and Compensation

Answer 1: We agree that the existing TEC product should be adapted for offshore to reflect the fact that TEC is a commercially firm product and offshore connections will predominantly be at a lower level of security and commercial firmness. This will require development of an appropriate charging mechanism to reflect the asset cost savings achieved in delivering the lower level of security.

Compensation proposals should be designed to incentivise the OFTO to deliver agreed reliability and availability parameters. This could be achieved by using a sliding scale whereby the generator is compensated up to a specified level of service followed by a reward to the OFTO for performance beyond this level. This would be appropriate as the offshore access product will not be as commercially firm as TEC. The levels of service will be unique to each development and will need to be negotiated between the generator and the OFTO.

Chapter 9 Technical Rules

Answer 1: We agree that the development of rules for connection of offshore wind generation should build upon the rules being developed for onshore wind. However, full recognition should be taken of any impact of the scale and potential limitations of the technology deployed offshore. Technical rules should be applicable to all available offshore technologies (not just wind) and must be developed through consultation with developers through the normal industry channels.

Chapter 10 Implementation Issues

Answer 1: We agree that it will be necessary to amend the existing transmission standard licence conditions. However, modification of existing industry codes will have to be centrally co-ordinated by Ofgem to ensure consistency in implementation and objectives across each of the codes. Without resort to curtailing industry consultation, a firm timetable will be required to ensure that each code is ready for the “go-live” date.

OFTO licences will require specific terms and special conditions particular to the individual offshore connection.

It is not clear why the holder of an onshore transmission licence should not hold an offshore licence even if the two areas are not electrically or geographically contingent. Rigorous application of the tender process should ensure that all potential OFTOs are treated in a consistent manner.

Chapter 11 Work Programme

Answer 1: The programme outlined in this chapter is ambitious and anticipates no slippage. However, the industry is keen to see the uncertainty surrounding the regulatory framework removed to allow development to proceed in line with the government’s environmental targets and will co-operate fully in progressing the necessary code changes.

In order to deliver this ambitious timetable, Ofgem will require to co-ordinate carefully the changes required to ensure that all code changes can progress simultaneously. Ofgem should continue to engage closely with industry on each issue through the existing industry workgroups and encourage active participation at all levels of the process.

I hope you find these comments useful. Should you have any queries on the points raised, please feel free to contact us.

Yours sincerely,

James Anderson
Commercial & Regulation