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Dear Duarte and Robert

Offshore Electricity Transmission

Thank you for the opportunity to comment on your Regulatory Policy Update document as issued on 20 November 2008. This response is made by DONG Energy A/S and contains our immediate comments of greatest materiality. Whilst we have yet to read and digest the full implications of the Policy Update and its attachments, we remain concerned about the complexity and costs associated with the scheme, and the possibility that it will impede rather than facilitate connection of offshore wind farms. Whilst the arrangements may have benefits over the longer term, we see little to assist current projects, and question if the resource effort going into its development today is not becoming a distraction from progressing projects in an ever more challenging environment.

For existing operational and under construction projects which are licence exempt, embedded and 132kV connected offshore, loss of embedded benefits would mean a material cost for DONG Energy and other developers, that would likely far outweigh any possible savings from the OFTO regime. In addition this could undermine investor confidence in the stability of UK regulation generally and the consistent treatment of projects where investment decisions have already been made.

More generally, it appears that the policy decisions that have been made through the evolution of the scheme have undermined the expected benefits of OFTO. These policy decisions include the insistence on a 20 year capital recovery period; the inclusion of OFTO specific capital and financing costs in offshore generator's TNUoS charges; the proposed inclusion of substation costs in TNUoS charges; and the implied prohibition on developers and vertically integrated parties in the tender process, and potentially a prohibition on ownership over the long term. This regime seems to us now to be a long way from the one that was anticipated at the outset and we are concerned that there is not likely to be any benefits for today's developers.

In terms of our specific responses to the Policy Update we would like to comment on three areas: flexibility of tender rounds and process, implications of EU unbundling, and the treatment of licence exempt embedded windfarms.

Flexibility of Tender Rounds and the Enduring Process

DONG Energy has expressed its view on several occasions that for enduring projects it appears inevitable that there will be an extended development period to accommodate the tender process which we estimate to be a delay of 12 to 24 months, depending on the timing of consent in relation to annual tender rounds. Similar delays could be introduced to projects which just fail to meet the criteria for transitional projects. We have recently learned that the tender round process may be more flexible, at least in terms of transitional projects, and this is to be welcomed. Including all phases of a development within the transitional scheme would also be helpful where only the first phase has met the transitional criteria.

We remain of the view that under the enduring regime it should be open for the developer to design, tender and construct the offshore network and transfer it to an OFTO after completion. This would allow the tender to take place after financial close of the project and to remove this delay. It would be open for developers to tender under the currently envisaged approach should they believe there would be benefits from this, but we consider that our approach would be more attractive to many developers and OFTOs, retaining control of the process within the developer, rather than tendering ahead of financial close and having OFTOs take the construction risk.

Implications of EU Unbundling

We understand that some of the policy changes indicated in the Regulatory Policy Update are as a result of the proposed “Third Package” of reform being developed at an EU level, but we are concerned about the implications this has for the future development of UK offshore windfarms. As a developer, DONG Energy does not necessarily wish to be an OFTO over the longer term but sought to have the option of bidding in tenders for its own assets as this would ensure that it could bid with its own minimum requirements, in terms of cost and technical capability. This bid would then be considered by Ofgem as part of its tender evaluation, and if it subsequently emerged that an OFTO with a lower capital cost and return requirement (and being no less technically capable) was awarded the role, this would be to DONG Energy’s advantage.

If the developer is not allowed to bid, as implied in the Policy Update, it has no assurance that the successful bidder will demand a lower revenue stream than the developer had assumed in its business case and it could end up paying more through its TNUoS charges. Furthermore, if no developer or other entity with existing EU generation or supply interests is allowed to bid (again as implied in the Policy Update) the pool of potential OFTOs is limited to NGET, non-utility players such as banks and manufacturers, and non-EU utilities. Any currently vertically integrated entity, even if it intended to fully unbundle in time for the implementation of the Third Package, would also be prevented from bidding. This seems to be inappropriate at a time when the EU unbundling requirements have not yet been finally agreed at the EU level, nor transposed into national law.

DONG Energy therefore proposes that unless or until the unbundling requirements are actually in force (no earlier than the end of 2011) developers and other currently vertically integrated utilities should still be allowed to bid. However they would be doing so in the full understanding that when or if the Third Package is transposed into UK law they would either need to implement full ownership unbundling, or sell either the offshore generator or the OFTO.

Treatment of 132kV Connected Licence Exempt Offshore Generators

Finally at this stage we would draw attention to the unsatisfactory proposals for the treatment of embedded licence exempt windfarms with 132kV offshore assets. DONG Energy has repeatedly called for a policy statement and consultation on their treatment under the OFTO regime and the resulting economic impact. We note that in the Policy Update it is simply stated that such windfarms will become transmission connected and be liable for transmission charges (ie generation TNUoS). It is further noted that under current arrangements they would benefit from the small generators discount within the TNUoS tariff.

We have in our earlier submissions observed that the loss of “embedded benefits” (including in respect of TNUoS) would have a material impact on the economics of these projects. Whilst the Policy Update notes that such projects will be compensated by the “sale” of the offshore assets to the OFTO, this would then be offset by the asset specific TNUoS and maintenance charges they will then have to pay for the following 20 years, not to mention the costs of participating in the tender process and potentially further costs in complying with the new regime (subject to discussion on derogations). Whilst the small generators discount may go a long way to mitigating the “onshore” part of the generation TNUoS charge, such projects would also presumably lose the rebate of the demand TNUoS currently available, ie the “Triad” benefit. We would like to see the results of the impact assessment of the proposed policy on these generators and how the loss of benefit and increase in costs can be justified.

DONG Energy is also concerned that no consideration seems to have been given to the other benefits of being embedded and exempt, in particular avoidance of, and crediting with, BSUoS charges and transmission loss adjustments. These currently amount to a value of around £4/MWh so a 90MW Windfarm with a 35% load factor would lose in excess of £1.1m per year if these benefits are removed. Developers will have taken into account the availability of embedded benefits when making decisions on connection points and it would appear to be unjust to arbitrarily remove these from a certain set of generators but not others.

That said, we think it can be argued that licence exempt offshore windfarms will remain “embedded” in a distribution system (and in the corresponding GSP Group) even if certain assets between it and the distribution system are reclassified as “transmission”. Nothing technically will have changed in that the export from the generator will still enter the distributor’s system and offset demand in exactly the same way as it did pre-OFTO. We therefore do not see any rationale for removing these benefits. Furthermore, it appears that the existing drafting of the Balancing & Settlement Code is consistent with this interpretation. This arises because embedded benefits (other than in respect of TNUoS) arise because an exempt (or “exemptable”) generator (that is, an Exempt Export BM Unit) is included within the “Base Trading Unit” of the applicable GSP group. This is set out in BSC section K4.7.2b) which states that (except where otherwise requested by the generator) “each Exempt Export BM Unit in a GSP Group shall automatically belong to the Base Trading Unit for that GSP Group”. It is our view that where an Offshore Transmission System connects to a Distribution System, it would still be correct to say that the licence exempt generator attached to that Transmission System will still be “in” that GSP Group.

Whilst this is our current construction of the BSC it would be helpful if Ofgem and DECC could confirm this and/or ensure that the Secretary of State uses his powers of designation to make an explicit amendment to the BSC to clarify the position. For instance the BSC could be amended to say at the end of K4.7.2b) *"For the purposes of this paragraph, an Exempt Export BM Unit that is connected to an Offshore Transmission System, which is in turn connected to a Distribution System, is considered to be in the GSP Group that includes that Distribution System"*. If this was agreed it would go a long way to alleviating our concerns about the adverse affect of the OFTO regime on currently exempt embedded offshore wind farms connecting offshore at 132kV.

We trust you find these initial comments of value and we will make a fuller response before the deadline in January.

Yours sincerely

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