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BWEA Response – Ofgem’s open letter on offshore enduring regime

Dear Sam,

Many thanks for setting out Ofgem’s thinking on its forthcoming enduring regime consultation. We have found this useful and we hope that it will be a productive exercise in allowing us to shape the consultation ahead of its publication.

As you know we have already written to you – on the 13 August and 12 October – on the need for further consultation on the enduring regime and with an outline of areas that we think should be addressed. We have also met with you to discuss these matters.

BWEA’s membership encompasses a broad range of perspectives on the overall offshore regime. For some there is frustration that the regime is not yet well enough defined for enduring projects and the uncertainty is the source of grave concern – this is most acute for those who have well progressed projects and where the regime is seen as a delaying factor in some already challenging timescales for completion. For others there is a desire to make the regime work not least because it could create as much uncertainty to pull back as to forge forward. Nonetheless they share concerns over the ongoing uncertainty and they feel that Ofgem could be more accommodating and flexible than they have been to-date.

Whilst BWEA welcomes your open letter and the anticipated consultation, we are disappointed that it does not mention all of the areas that we have raised with you. Even if you do not agree with our position it would be helpful to see all of our points addressed.

Our comments are split into those areas covered by your letter, followed by a brief re-iteration of issues raised by us in our 13 August letter but not covered by your letter.

The open letter

- **The nature of the OFTO (“timing of OFTO appointment” in your letter)**

Your letter talks of early or late appointment of an OFTO. For clarity we also view this in terms of whether the OFTO is “thick” or “thin” and the difference has also been characterised as the difference between the transitional or the enduring regime i.e. the transitional regime involves projects that are appointing very late or very thin OFTOs.

BWEA does not think that it is overly helpful to work on the assumption of a cut-off between one transitional regime and a new and fundamentally different enduring regime. There is a huge difference between appointing an OFTO to take over already-constructed assets and appointing an OFTO to design, procure, build and own the assets. The reality of the offshore industry is that there are a variety of projects at a variety of stages that do not neatly fit into one box or the other.

For instance, developers of Round 2 extensions are already worried that under the enduring (and early appointment and thick OFTO) regime, they will be too late to appoint the kind of OFTO envisaged for the enduring regime. The late (or thin) appointment will also not be possible, due to The Crown Estate requirement for full operation of the new installations by end of 2016. This risks their completion dates unless Ofgem can be more flexible on when the OFTO is appointed and the level of developer-incurred costs that can be recouped from the OFTO.

- **Anticipatory / strategic investments (covering issues in “recent developments”, “future capacity increases” and “risk management”)**

Your letter hints at the CE’s approach to developing zones could feed through into what would effectively be a zonal OFTO. We agree that this raises some interesting possibilities and that it is likely to cement working partnerships for the zones. We still feel that an OFTO would be better placed to take a strategic approach to a zone if there were some incentives to do so outside of and additional to any user commitment given by the development partnership of the zone. This is pretty fundamental to getting the infrastructure there on time.

BWEA also feels there is some discussion to be had around the form of a grid connection for a zone. The NETSO would benefit from foresight of developers plans as far ahead as possible, as would OFTOs bidding for the zone. Nonetheless it would stretch the current system to the limit for a Dogger-sized wind farm to apply in one grid application for its endgame capacity.

- **Treatment of pre-construction costs**

We welcome the definition of an “envelope” of costs that will be reimbursed.

BWEA also notes that the project development is unlikely to halt on commencement of the tender process – i.e. in reality pre-construction costs will be incurred during the tender process. It may even be more expedient for the developer to see through some work post-OFTO appointment (e.g. securing consents). Therefore there needs to be some thought around hand-over, ongoing responsibilities and the timing of developer reimbursements.

- **Treatment of future capacity increases**

BWEA is supportive of the need to explore issues outlined by your letter here and again feel it feeds into discussion on whether the OFTOs will be incentivised to undertake anticipatory investment. BWEA would also highlight the need to consider flexibility of the OFTO's revenue period, as raised by BWEA in previous letters.

- **Risk management and incentives**

BWEA has previously stated its concerns on the availability incentive and the fact that it exposes the generator to the risk of network failure. We were concerned about whether there would be appropriate incentives on the OFTO to rectify problems. Following some feedback from the transitional regime and the detailed design of the incentive, BWEA's concerns remain.

This is especially so around the different treatment of availability monthly credits and debits. This design can result in large outage periods with negligible penalty, gives greater value to banked credits than banked debits, and could create unintended consequences such as creating an incentive to plan outages in months in which additional debits have no impact. We understand you have had some representation on this subject – further detail is available on request.

Ofgem should also consider points previously raised on compensation through the CUSC and whether this should be updated for the offshore regime. At present we feel there is an unfair lack of equivalence with onshore generators.

Through the availability incentive and a generator's exposure to network failure, generators are also taking a risk on the technology chosen by the OFTO. This needs some careful thought where new technology is employed. It also very much strengthens the case for developer influence over the OFTO appointment and bid negotiations.

- **The role of the NETSO**

We agree with Ofgem that the role and responsibilities of the NETSO need some further consideration. In particular we are concerned that the OFTO regime has created an expectation that the process would be "generator-lead" and indeed the charging arrangements for offshore assets target the bulk of the costs directly onto the generator on the assumption that generators will chose the most cost-effective (for them) connection design.

However, the balance between what is best for customers, National Grid and the generator remains largely unexplored. Anecdotally we are very concerned that the generator may not in fact be in a position to exercise choice and by doing so control and minimise costs. In this context we would seriously question the rationale of a fully cost-targeted offshore connection which could lead to individual generators paying over the odds for a design that benefits UK plc.

Furthermore these issues are starting to surface before any involvement of an OFTO and any variances they might seek to introduce. The OFTO's involvement and the introduction of an additional party with its own ring-fenced incentives and drivers can only serve to exacerbate the problems around who and what is driving the design and costs of the offshore infrastructure.

There are also some questions around whether onshore works can be progressed on behalf of the offshore project, but in advance of OFTO appointment. BWEA's main concern is that the lengthy tender process should not create a hiatus in development of the onshore reinforcement works. Again this is also relevant to user commitment and anticipatory investment.

- **Qualifying project pre-conditions and tender entry criteria**

You note that developers are required to demonstrate to your "satisfaction" that they have met the tender entry criteria. Whilst BWEA appreciates that the transitional tenders will inevitably involve some learning by doing, we are uncomfortable where this creates difficult circumstances for tender participants. For instance, information requirements are evolving which is understandable to a degree, but this creates problems for generators if there is protracted uncertainty around tender qualification and little if any time or recourse to challenge unreasonable and / or unforeseen information requests.

- **User commitment (in your letter covered under "qualifying project pre-conditions and tender entry criteria")**

Ofgem comments that "*There may also be a need to review the effectiveness of the measures by which parties which are seeking to develop offshore generation signal their commitment prior to the commencement of the tender process.*" We are not sure what this is hinting at, especially as it goes on to talk of "*stranded assets*" in the context of tenders taking place well in advance of any spend on physical assets. It would be helpful if Ofgem were more explicit on this point.

We feel there is some thought required on the form and timing of user commitment for large, consortium-backed, phased projects. Again BWEA also considers that this is a question which also relates to whether OFTOs are incentivised to undertake anticipatory investment.

Furthermore it would also be helpful to consider the level of commitment from an early-appointed OFTO to seeing the project through and keeping to the terms of its bid.

- **Stages and timing of the tender process**

BWEA wholly concurs with Ofgem here – in particular we agree that enduring projects will almost certainly need a longer tender timeframe. Nonetheless the need to ensure an efficient timetable remains. With longer timeframes it becomes even more critical that the developer is able to accept the OFTO's proposals which in turn strengthen the case for developer involvement in the process.

Three quarters of the year-long process proposed by Ofgem is focussed on the QTT and PQQ stages and Ofgem's own evaluation. The opportunity for cost efficient design is limited to the actual tender period, during which there are also significant governance and sign-off processes. Any extension to the timescale needs to focus on this value adding step and where possible the duration of other parts of the process should be reduced to compensate.

We again urge Ofgem to consider running a number of staggered tender windows during each year for different geographic areas so as to reduce the peak workload on key resources across the industry. For example three separate windows for English North Sea, Irish Sea and Scottish Waters would help distribute the projects.

BWEA is also concerned that projects may risk 'marking time' if they narrowly miss a tender window – there needs to be some degree of flexibility in the project qualification process to avoid this.

BWEA would add that there are issues around the timing and arrangements for OFTO asset adoption for phased projects.

- **Assessment of the tender process**

BWEA agrees with Ofgem that it is appropriate to re-examine the assessment process for tenders. BWEA feels very strongly that an OFTO's experience, design capability and ability to secure the supply chain are very important. We would welcome a re-evaluation of the weighting given to these areas in scoring tenders. There is also a suggestion that OFTO's could develop a menu of prices to accommodate some future uncertainty, and this would obviously require some thought on the way in which this is assessed.

BWEA very much supports your proposal to "*consider the desirability of some proportionate involvement from developers in the process of selecting the OFTO.*" Our view is that enhanced developer involvement would be desirable.

Your letter does not acknowledge previously-expressed concerns around the reliability of IRR's bid some time in advance of actual procurement and construction of the assets. We feel this needs some further thought. This point is expanded upon below under our point on "competition philosophy."

- **Supply chain**

BWEA concurs that the question of exclusivity does need to be bottomed out. It may be less black-and-white as simply exclusivity or not. There should also be further consideration of the need to involve the supply chain in the tender process and to signal the need for equipment to secure the factory capacity. The GB offshore wind programme will require significant investment in new capacity across the supply chain and the ability to finance this investment depends in part on the ability of suppliers to form long term relationships with customers.

We note that offshore projects to date have mostly been contracted on a design and build basis and much of the expertise and ability to innovate is within the supply chain. The OFTO process needs to allow supply chain companies to contribute to projects from the earliest stages when there is greatest ability to reduce outturn costs.

Furthermore Ofgem should review the finance community's appetite for construction risk and whether this has a bearing on the transitional model going forward.

Other issues

There are a collection of issues that we have previously raised that are not covered in your open letter as follows:

- Embedded transmission
- The treatment of decommissioning costs
- Payment for reactive power services
- OFTO revenue re-openers
- OFTO licence tradability
- Regime monitoring (the need to define success before it is judged)

BWEA would also re-iterate the benefits of a scenario walk-through exercise.

Finally and as an expansion of previously expressed concerns, we have one further point on the main focus of the regime design, namely the competition-focused philosophy.

Many of the detailed proposals in the OFTO regime are based upon the concept that one off competition between OFTOs held at a specific point in a project's lifecycle will deliver cost effective connections. This assumes that at the point OFTOs bid they and their investors can take full account of all future risks without adding an undue premium to the price. We are concerned that this desire to maximise competition between OFTOs has become more of a focus than the main objective of delivering timely and efficient connections in a way that supports the development of offshore generation.

In order to achieve this one off competitive event, many other potential areas for competition and innovation are being lost. Generators lose control over the timing and design of the asset on which they will depend and the supply chain loses the ability to work directly with its customers to ensure capacity is available and solutions are buildable. In a natural competitive market developers would take a series of investment decisions representing a ramping up of commitment over several years. The tension between early and late OFTO appointment arises from the fact that risks change with time and some decisions that would be best taken at different stages of the project are forced to coincide.

The BWEA strongly supports competition as a means of delivering best value. There are many opportunities for competition and innovation throughout the development of a project. The degree of one off competition between OFTOs should be balanced by the potential benefits of engaging all parties in delivery. We urge Ofgem and DECC to consider this balance when deciding on the detail of the issues raised in this letter.

Yours sincerely

Peter Madigan
Offshore Wind Development Manager