Sam Cope
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Ofgem E-Serve
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12 February 2010

Dear Sam,

Offshore Electricity Transmission: consultation on the Enduring Regime

EDF Energy welcomes the opportunity to respond to this consultation and have included our detailed response to the consultation questions in the attachment to this letter.

The key points we wish to make with regard to this regime are as follows:

- Regulatory stability and transparency

Regulatory stability and transparency of both the tender process and information provision are very important and clearly necessary to aid participants in evaluating an individual project's long term viability.

In particular, EDF Energy notes that, while 20 years is an appropriate price control period for a licence, it does involve some mismatch with the Crown leases being granted (these range from 22 years in Round 1 to 50 years in Round 3). It is recommended that the lease and licence period should mirror each other to remove this mismatch.

Regulatory stability applies equally to onshore as to offshore. Therefore it is important to ensure that any regulatory change or impact on onshore participants, caused by any changes to the OFTO regime and the drive for offshore development, is kept to a minimum.

- Commonality

There should be as much commonality as possible between offshore and onshore networks, although the OFTO regime is likely to change in the future as more experience of the utilization of offshore networks is gained.

The transparent provision of information for the efficient functioning of the market will be aided by the application in the OFTO licence of the onshore regime when possible. The use of onshore methodologies will keep to a minimum any additional complications inherent in offshore networks, and has the advantage that all current participants are familiar with its working. It can therefore easily be integrated into participants' current systems.

Notwithstanding the above, EDF Energy believes that there are a number of changes to the proposed regime which would assist in the provision of a workable offshore transmission regime, and these are as follows:

- Interconnection

EDF Energy seeks to highlight the fact that OFTOs may seek to connect to renewable generation outside UK waters, and possibly with other countries. This possibility is not currently being adequately considered within the regime. To extract the most value from offshore transmission systems EDF Energy believes that the regulators should:

a) provide a neutral and non discriminatory environment for cross-border trading;
b) consider integration of OFTO policy into the proposed interconnection regimes at the European and national levels;
c) consider exploitation of offshore networks as interconnectors if they are not so connected at present.

- Treatment of Losses

EDF Energy believes that the most suitable option is to set the loss level at that specified in the OFTO bid. The option of a generic level of losses would place individual OFTOs in the position of having windfall gains/losses according to their individual loss levels. This will disincentivise participants from bidding on projects which have losses higher than the generic number, as they will be forced to pay compensation from their revenue for the additional losses. Given this, it would seem most appropriate for the OFTOs to specify the predicted losses in the bids, and for this to be one of the factors by which the bid is judged.

In addition we also believe it is beneficial to put a mechanism in place to incentivise OFTOs to minimise losses beyond the appropriate loss number (by means of a payment to the OFTO). This would assist in the efficient operation of the network, minimising losses, and thereby keeping down costs of the associated generation to the consumer. This may also assist other goals such as the promotion of wind power and the consequent reduction in carbon emissions.

- Greater Flexibility in OFTO appointment

Different organisations in the wind industry have differing needs and strategies, and by this means the market will be able to determine the most effective business model. An inflexible approach will discriminate against certain participants, and may reduce the range of solutions presented.

The current regime does not include the option for late or very late appointment of an OFTO (the razor thin OFTO model), which gives wind developers the ability to retain control of the grid connections for as long as possible. This option would give the regime the flexibility needed to allow developers the option to design and construct their own grid connection before transferring it to an OFTO. In turn this would ensure that the delivery of a windfarm project is not unduly delayed.

Currently there is also a mismatch between the OFTO process and the requirements to deliver offshore windfarms that do not fall into the transitory regime. The trigger process for an OFTO cannot effectively begin until the windfarm project has achieved consent. This is likely to add at least two years of regulatory uncertainty when no investment decisions can be made (at least not without significant risk), as the details of the costs and timeline of the OFTO will be unknown. This also means that the Round 2.5 programme (up to 3GW) cannot be delivered before the Crown Estate deadline of 2016.

An appropriate solution would be to extend the transitional regime for a further period of two or three years, or until the enduring regime is bedded in. This would run in parallel with the enduring regime. Another solution would be to extend it indefinitely where again the two regimes run in parallel. This would give the developers the choice of the regime under which they wish to build their connections. This additional flexibility will bring forward projects and grid connection orders with the supply chain, as industry begins to deliver Round 3.

- Anticipatory Investment

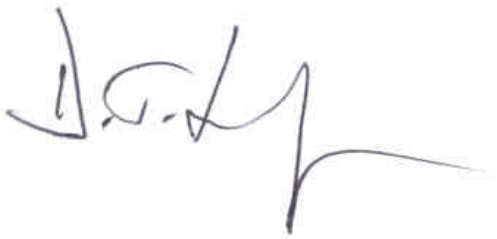
Anticipatory investments should be incentivized for later phases of multi-stage investments. Planning for known or projected generation will allow the overall network to be constructed as efficiently as possible, and will provide cost savings compared with the alternative model of simply building individual networks when needed on a stand-alone basis.

- Co-ordination

Offshore networks clearly need to connect to the onshore grid in order to fulfil their function. It is vital that the construction of the onshore connections is properly co-ordinated with the corresponding offshore connections. Onshore works may have major planning and consenting risks in addition to National Grid's obligations in respect of onshore users. Furthermore, some areas of the onshore grid in particular may require more reinforcement and upgrades than others.

If you have any queries on this response or would like to meet to discuss it further, please do not hesitate to contact Rob Rome on 01452 653170 or myself.

Yours sincerely,



Denis Linford
Corporate Policy and Regulation Director

Attachment

Offshore Electricity Transmission: consultation on the Enduring Regime

EDF Energy's detailed response

- Triggering the Tender

Do you agree with the proposed approach to initiating the tender process?

Overall the approach contained in the minded to position would seem to be the most sensible and practical option. This is because the generation project developer(s) are the ones taking the commercial and construction risks associated with a new build power project. Given this it seems logical to allocate a level of flexibility as to the timing of the tender request to fit in with their commercial timetable and project developments.

Should there be an earliest or latest point (relative to the connection agreement held by the generator) at which the generator should be required to request an OFTO appointment and when should that be?

EDF Energy believe that different developers may have different financial models which require the determination of costs at different stages, by restricting the timing of a tender request there is a risk that certain companies would be discriminated against. Clearly the individual companies will need to take account of the timescale required for the tender process.

Do you agree with the proposed amendments to the qualifying project pre-conditions and tender entry conditions for the enduring regime?

EDF Energy agree, however, this is with the exception of the possible requirement that the developer's project has an energisation date which is with a fixed number of years from the developer's date of application to the tender process. Some developers may wish to secure longer term projects and connection. Arbitrarily fixing a required energisation date may discriminate against these developers business models and thereby deter them from entering the market. For example a developer my have a project to be implemented in 4 phases over a number of years whereby you may have 4 linked connection and construction tenders.

Do you have views on the time of year at which a tender window should be held?

EDF Energy agrees that the tender process would need to conclude at a time when any consequential work is possible.

Do you have views on the best method of dealing with contingency costs?

It seems sensible to separate out the contingency requirements from the core elements. This allows the contingency items to be examined individually and also allows different parties' approach to the contingency problems to be considered on a case by case basis and may allow a more thorough and robust comparison of competing bids.

What is your view on the capping of the contingency and any associated incentives?

Further to section 4.25, it is agreed that participants should use the appropriate markets to hedge their financial exposures wherever possible (for example, exchange rate, interest rate,

or commodity prices). This would give the developers the most certainty regarding their future revenue streams. It also minimises the risks that developers may seek to categorise adverse price movements as contingencies whilst retaining the benefit of any advantageous prices movements.

Regarding the capping of contingency costs, in supplying their contingency figures the developers should by definition put in their forecast of worse case scenario for the individual cost (the different between the anticipated cost and contingency cost being the contingency amount). Any amount over and above this contingency amount should be made subject to Ofgem's approval on a case by case basis.

Which items do you consider should be defined as pre-construction costs (and why)?

In theory these should include the reasonable costs incurred in bringing the project to a state when construction can commence. Whilst there are general aspects such as easements and surveys being common to most projects, each project will also have its own specific requirements.

- **The Scope of the Tender**

Do you consider that an Ofgem defined, standard pre-construction works transfer agreement is the appropriate vehicle for managing the transfer and payment of pre-construction costs?

They should be recouped this would seem an appropriate mechanism to enable for this transaction to be done on an individual basis.

Do you agree that the tender specification should be based on the connection application, with information also being provided relating to any pre-construction works undertaken?

EDF Energy agrees that this mechanism would seem to provide the most scope for innovation, by allowing participants the maximum flexibility in the shaping of their individual tender submissions. Clearly the information regarding pre-construction works will be relevant to the costing of any tender and should therefore be provided.

Do you agree that bidders should be given flexibility to respond to this specification as they see fit?

Please see above; this is likely to encourage innovation and will be of benefit to the market and consumers.

Do you agree with our suggestion not to incorporate capacity oversizing into the enduring regime (unless financial commitment is provided for that capacity)?

It is agreed that it is not appropriate to incorporate capacity oversizing into the enduring regime as it is hard to argue that the consumer should be required to pay for infrastructure which is not expected to be utilised in the near future. However, should individual participants wish to construct such over capacity on a commercial basis at their own risk there seems to be little reason to prevent them from doing so.

- **Facilitating Competition**

Do you consider that supply chain exclusivity should be permissible under the enduring regime? If not, do you have proposals for enforceable measures for precluding it?

EDF Energy do not support supply chain exclusivity as this will severely restrict the ability of new competitors to participate in the tender process. We believe that no new enforceable measures are required as this already governed by existing EU competition law as per section 6.3 which precludes companies from effectively excluding others from the market.

Do you consider that the option of bidding on the basis of indicative costs and tendering after appointment has merit?

EDF Energy believe it is hard to see how this would be viable as parties would be asked to bid without having a firm number on which to base their bids. This may lead to a rise in costs as bidders are likely to be forced to include an element of risk premium in their bids.

Do you support our minded to position that explicit steps to facilitate new entry should not be included in the enduring regulatory regime?

EDF Energy supports this position on the basis that any form of discrimination is likely to impede the efficient operation of the tender process and thereby increase the costs to consumers.

Should we include provisions in the enduring regime to ensure that access to offshore cable capacity and to offshore cable routes is made available? If so, what form should those provisions take?

EDF Energy agrees that OFTO's should be required to offer non-discriminatory terms for access to their transmission systems. A licence provision to this effect should suffice. Further this would have the added advantage of treating offshore and onshore the same. Likewise access to cable routes should be provided to ensure competition is maintained.

- **Tender Timings**

Do you support, or have alternative, proposals for amending the key stages of, or otherwise stream lining, the tender process?

Given the increased complexity under the enduring regime it seems logical that the timescales will need to be increased.

- **Bid Evaluation**

In which areas should we allow variant bids?

Variant bids could be allowed only when they can be demonstrated to deliver a tangible benefit to consumers.

How should variants be treated in evaluation?

They should be considered in conjunction with the other bids and should be treated on their own merit as the party proposing them should be allowed to benefit from their innovation. Should a variant bid be accepted it is not envisaged that the variant bid itself should be resubmitted to tender

- **Revenue stream and Incentive Mechanisms**

What is your view of the inclusion of a re-financing claw back mechanism?

In line with our views on contingency costs, parties should be encouraged to hedge their interest rate risk out as far as possible. A refinancing clawback mechanism without a corresponding top up mechanism would essentially involve socialising the profits for a favourable interest rate move whilst privatising the losses. Such a scenario clearly shifts the risk/reward basis and would be likely to deter new participants and raise the cost to consumers by leading to a requirement for additional risk premiums.

Do you have evidence of insurance market volatility that suggests that an incentive would be in the interests of consumers?

EDF Energy have no evidence, however it is likely that any incentive would have to be paid for by the consumer and subsidising one element of the construction costs will distort the tender process and hinder its efficient operation.

EDF Energy
February 2010