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Thursday, 21 April 2011

Dear Bob,

Re: Changes to the Offshore Transmission Owner Availability Incentive

Thank you for the opportunity to comment on the above open letter, this non-confidential response reflects the views of the Centrica group of companies excluding Centrica Storage and may be placed on the Ofgem website and in the Ofgem library.

This response is drafted in the context of relatively simple adjustments to the existing mechanism to be applied for TR2a. We also appreciate the confirmation that changes will not be applied to TR1 windfarms. However, we do believe that the availability incentive applicable under the enduring regime merits more detailed consideration, including the balance of risk between OFTO and developer.

We believe that there are two main issues that need to be addressed: firstly, whether the level of exposure of the OFTO is appropriate and secondly, how the incentive is maintained once the cap takes effect.

As we set out at the workshop this month, overall we feel that within the 10% of base revenue constraint, the incentive strikes a reasonable balance between short and longer term incentives on the OFTO to maintain availability. However, as we have previously stated, we continue to believe that the current availability incentive does not adequately reflect the balance of risk between the OFTO and the developer. We understand the incentive is not intended to compensate the developer, and we agree that given the relative scales, it is not practical for the OFTO to bear the full economic loss faced by the developer. Nevertheless we believe a more equitable balance of risk is needed going forward in order to adequately incentivise the OFTOs and minimise risk to developers and consumers alike.

In addition to the level of incentivisation, there are several specific issues associated with the current incentive. The main issues are that the relative impact of the incentive is much reduced for continuing poor performance in successive years and the structure of the incentive means that it only drives

export maintenance not overall asset quality. The overall effect of the two-way incentive is also unusual and not balanced: the relatively generous credit upside gives the OFTO the potential to recover its overall revenue position, an option which is not available to the developer.

Finally, it is clear that once the cap has been reached, either for the year or each five-year period, the developer is wholly reliant on licence mechanisms and/or the Authority for protection. We believe that it would be appropriate to provide a further option for the developer i.e. submission of an application to the Authority for increased OFTO exposure (via a licence re-opener), for continuing poor performance. This right of itself would operate as a further incentive and provide a genuine intermediate step between the incentive and licence remedies. The developer will also be well-placed to assess the physical state of the assets and their performance.

In terms of alternative options, a possible change to the credit banking mechanism would be to link the OFTO revenues at risk (RAR) in the subsequent year directly to the quality of performance in the year. So an on target performance in year t (currently 98%) would leave 10% RAR in t+1, conversely poor performance in year t would lead to increased RAR in t+1 and above target performance would lead to reduced RAR in t+1. The table below indicates how such a linkage might operate, all figures are indicative only at this point. We would envisage a cap/collar operating to limit the RAR and believe that it would also be possible to link RAR to an (capped) estimate of generator loss.

Table 1: Indicative impact of performance on Revenue at Risk

Year	Performance level %	Revenue at Risk %	comments
T	98	10	Initial year so default RAR to 10%, performance on target at 98%
T+1	99	10	RAR 10% due to on target performance in year T
T+2	97	[9]	RAR [9]% due to above target performance in year T+1
T+3	98	[11]	RAR [11]% due to below target performance in year T+2

Response to questions raised in the consultation:

Q1) Does removing monthly availability targets lead to a simpler and better targeted incentive?

We support the continuation of a weighted incentive on the OFTO, reflecting the months in which developers place a higher value on availability. We agree that where possible developers will plan outages in the months of lowest generation and that one weighting term, based on forecast revenues, should be sufficient.

Q2) Would the incentive better meet its policy intent if we replaced the credit banking mechanism?

We believe that the credit banking mechanism provides a potentially perverse incentive on the OFTO to accumulate credits for use against future penalties. In addition, it reinforces the imbalance of risk between the developer and the OFTO. Where there is a major outage, the developer faces economic loss far in excess of that faced by the OFTO, and this loss is a permanent loss to the developer with no possibility to recoup. Because of the upside potential of the incentive, an OFTO has the ability to recoup at least part of the loss associated with an outage in succeeding years.

We agree that the credit banking mechanism should be removed. If the principle of “earned” credits continues, then payment of any net credits in the relevant year is preferable to banking. However, we believe that it would be better to remove the upside mechanism, instead linking revenue at risk (RAR) in the succeeding year to in-year performance.

Q3) What are the advantages and disadvantages of aligning availability payments to the end of March?

We are generally supportive of aligning availability incentive payments, and agree that the potential uncertainty may be problematic. However, given the period concerned is short, we believe the risk should be manageable. The OFTO should be able to report at the end of March the outage figures and hence the impact on the subsequent year can be published well in advance.

If the adjustment figure (+/-) is fed into the succeeding year's K factor it will be important to ensure that there are no perverse incentives (in respect of interest) on the OFTO to over-forecast the impact of the two estimated months.

Q4) Can we improve the flow of information about outages to developers within the existing industry framework?

There are provisions in the STC procedures for OFTO to National Grid Notification and similar provisions in the CUSC to notify "as soon as reasonably practicable". Providing these provisions are fully complied with, we believe they should be adequate.

Q5) How can we best ensure that the incentive is maintained for the length of the revenue stream?
Our preferred approach of linking RAR to prior year performance reduces the impact of this issue.

Q6) How can we account for the testing of transmission assets during wind farm commissioning?

We agree with Ofgem that the availability incentive should be applied to the OFTO from the point at which the OFTO takes over the assets, this will include during commissioning. It is essential to the developer that it is able to rely on the assets being available during any commissioning period.

If there is deemed to be a particular risk associated with further testing of transmission assets, then the normal outage planning process should be used.

If there are any of the points raised in this response that you would like to discuss in more detail, I would be happy to help and can best be contacted on 07789 570046 or Alison.russell@centrica.com.

Yours sincerely,

By e-mail

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