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20 April, 2011

Dear Sam,

**Changes to the Offshore Transmission Owner (OFTO) availability incentive –
Questions 3 to 6**

Further to our initial response of 8 April to questions 1 and 2 in the above document, please find below our responses to the remaining questions 3 to 6.

Question 3 – what are the advantages and disadvantages of aligning availability payments to the end of March?

Clearly, aligning payment years (referred to as “relevant years” in the scheme) and incentive years, so that both run from April to March, makes the incentive easier to understand. However, if charges to generators are set in January then, as recognised in the consultation, the performance in February and March has to be managed in some manner. If the payments associated with the OFTO performance in those months are simply rolled over to the following payment year then there seems to be little issue. However, if an adjustment is to be made retrospectively within the existing year then this creates a financial risk for generators and presumably also OFTOs if their revenue is adjusted in a similar manner.

Generators and suppliers have already experienced midyear changes in TNUoS charges as a result of the delayed implementation of the OFTO regime, which has caused a fair degree of concern within the industry. Additionally, National Grid and Ofgem appear reluctant for cost adjustments of this nature to be rolled over to a future year as has been

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suggested by a number of users and as described above. Therefore, although the misalignment of incentive and payment (relevant) year is a little confusing when trying to understand the scheme, for financial planning purposes it may be the better option and therefore be retained. Any confusion could be addressed by a guidance note being issued.

Question 4 – can we improve the flow of information about outages to developers within the existing industry framework?

Although, CUSC, Grid Code and STC requirements formally require most communications between a User and a Transmission Owner to be undertaken through the NETSO, it is common practice for significant issues to be addressed through more direct communication, such as through meetings involving all three parties. There is little experience at this moment as to how well the arrangements work in respect of the offshore transmission assets. Therefore, we wouldn't advocate any changes being made at this point. However, in due course it may be necessary to propose a change to one or more of the codes in order to improve communications, should the current arrangements be seen to be falling short.

Question 5 – how can we best ensure that the incentive is maintained for the length of the revenue stream?

There is a general risk towards the latter part of the incentive that, should a significant outage occur, an OFTO may be inclined to default on its licence rather than to incur the cost to rectify the relevant fault. Clearly, we would expect that generally OFTOs will be reputable companies, perhaps with multiple sites or wider business interests, who will take who will be concerned with reputational risk and honour their licence commitments. However, arrangements need to be in place to ensure that the incentive to provide a reliable network is not diminished for all possible scenarios. If the cost of holding a performance bond is deemed to be too high, then an alternative approach needs to be found. However, we do not have a better suggestion at this time than holding a bond as security.

Of course the issue arises as to under what circumstances this bond would be called. It is probably not necessary to hold the bond for the life of the scheme, but it does need to be brought in some time ahead of the period during which it could be called at a point in time where there is still a relatively high incentive remaining on the OFTO. This would help prevent a situation whereby such an OFTO defaults prior to being required to provide the bond. We believe that an on demand bond should be provided, with the licence describing the circumstances under which it could be called upon. One approach would be to set a trigger date when the provisions would become active, such as from 5 years before the end of the scheme, and a trigger level of performance below which the bond would be called.

However, the performance bond seems to be an escalation measure to be used when the normal incentive scheme fails to address a particular situation. The scheme itself could perhaps be adjusted to ensure that it is more effective prior to getting to the point where calling the performance bond is necessary. It is certainly clear that the incentive scheme will not be as sharp at the end of the scheme, as less than 50% annual revenue will be

recovered when the remaining years left on the scheme drops below 5. This can be addressed however by adjusting the annual cap in these years.

One way of doing this is as follows. If the target is not reached in a particular year then the cap would be adjusted for that year and subsequent years to ensure that the full 50% could be recovered. The table below shows how this would work.

Year	Years Remaining	Availability Cap
16	5	4.0%
17	4	5.0%
18	3	6.7%
19	2	10.0%
20	1	20.0%

The table shows how the cap would be adjusted if the target was not met in a particular year. The cap that is being shown here is the 4% unavailability over the availability target TA which results in the cap of 10% annual revenue in being hit. That is, it is the unavailability over the 2% allowed unavailability, which adds up to the 6% cap (ACAP) expressed in the licence. Clearly, a similar table could be drawn up relating to ACAP and the 30% (TCAP) parameter used in the licence.

If the target was not met in year 16, then there are sufficient years left on the scheme to recover a maximum of 50% so the cap stays as 4%. If the target is missed in year 17, there are only 4 years left to recover 50%, so the cap for that year and all subsequent years ratchets up to 5% (5 years of 4% divided by 4). The cap then ratchets up in subsequent years depending on whether the target is missed or not in that year. Although this ratchet mechanism may be more difficult to express in the licence, it would ensure that the incentive is kept up on the OFTO for the entire length of the scheme.

Question 6 – how can we account for testing of transmission assets during wind farm commissioning?

Clearly, the wind farm developer will want the Offshore Transmission Network to be available on its expected connection date, so the availability incentive should cover a delay which prevents the station from generating from this date. However, as we mentioned in our response of the 8 April, we believe the scheme should be flexible enough so that, if both the developer and OFTO agree, then the target can be adjusted so as not to penalise the OFTO. We had initially suggested this in the context of the scheduling and coordination of planned outages. However, it would seem to be applicable in this instance too.

Further escalation matters

At Ofgem's seminar on 4 April, many industry participants questioned what would happen if a significant underperformance were to occur, which the relevant OFTO was incapable or not interested in addressing. The concern was that the timescales required for following the licence revocation process and/or the mechanism for appointing any OFTO of last resort, would be such that the relevant generator could be exposed to a significant level of lost revenue in the meantime. We believe there would be benefit in a walkthrough of this process to ensure that it works over a range of scenarios. Although we are sure that such a walkthrough has been undertaken internally within the Offshore Transmission project, carrying out a similar exercise with the industry would not only provide a wider perspective, but would be a useful educational exercise for market participants and may help to make them more comfortable with the arrangements as they stand.

I hope the above comments prove helpful. Should you wish to discuss this further please do not hesitate to call me on the above number.

Yours sincerely

Paul Jones
Trading Arrangements