

Warwick Energy Limited

Comments on Ofgem Proposals for Revised Availability Incentives for OFTO Regime 28th March 2011

Scope

This document summarises Warwick Energy Limited's (Warwick's) early response on the Ofgem letter dated 28th March 2011 regarding "*Changes to the Offshore Transmission Owner (OFTO) availability incentive*".

Warwick is in the process of reviewing the main proposals however in view of the specific request for early responses by 8th April 2011 this document provides our initial view on some of the key issues raised. Warwick will continue to review the consultation document and if appropriate submit further comment in due course.

The present response should be considered along with the associated covering letter and comments already submitted by Warwick in response to earlier Ofgem consultations on Offshore Transmission.

General Comments

Reward of OFTO for Exceeding Availability Target

There are a number of basic issues with the TR1 incentive that should be addressed by any proposed modifications. These include:

- The availability target of 98% is time based. Warwick believes that to provide correct signals to OFTOs the incentive regime should be linked to lost generation production / revenue. This would provide the correct incentive to target maintenance at low wind periods. It would also ensure that OFTOs include flexibility in planning to shift outages where possible to coincide with periods of low export / low generator revenue;
- Analysis presented by SKM in the workshop of 4th April indicates that target availability should be higher – a value of 98.7% being estimated by SKM as the average value for TR2 projects;
- The above figure included outages for all reasons – i.e. planned maintenance and faults - however Warwick believes that loss of output for planned maintenance should be extremely small as set out below;
- The target level of availability is in any case low given that:
 - The OFTO is expected to require only a few days per year for planned maintenance;
 - Typical offshore network designs include a level of redundancy. For example a design with 2 circuits each rated at 50% output is capable of exporting the entire generator production on a relatively large number of days in the year with a single circuit out of service. This is due to natural variation in wind speed and thence generator output reducing output below the critical rating;
 - The above means that OFTOs should in most cases be able to eliminate lost production due to planned maintenance. This is simply by including flexibility to vary plans in real time to match low wind periods. In other words in the absence of faults it should be practical for OFTOs to eliminate lost production;

- OFTOs are rewarded for outperforming the 98% target by up to 5% of revenue on an annual basis, and credits may be accrued over a number of years. However matching maintenance timing to periods of low production should be viewed as expected of a responsible network operator. The OFTO should therefore require no financial incentive for performance to “*business as usual*” standards;
- In the event that the OFTO underperforms in a given year the loss in revenue for the generator is permanent and cannot be recovered. However according to the incentive scheme the OFTO may recover any lost revenue by outperforming the availability target in previous or subsequent years. This effectively means the generator can be penalised twice for poor OFTO availability – once due to lost revenue and a second time by paying higher TNUoS charges. This feature of the incentive scheme is strongly biased in favour of the OFTO and should be revised;
- The OFTO may choose to neglect maintenance of assets in order to achieve higher availability than target. Such a strategy, if pursued at the start of the license period could have a significant adverse effect on future reliability. Similarly the OFTO is incentivised to minimise maintenance at the end of the license period since this maximises revenue and reduces costs. The adverse effect of neglect may not become apparent until after the license expires and therefore there is potentially no downside for the OFTO.

Based on the above considerations Warwick sees no merit in providing a financial incentive to OFTOs for exceeding the availability target. Such performance should be expected from a responsible network operator in the absence of major faults. As such the incentive simply drives up OFTO profit margins and cost for generators and wider consumers.

If a new license period is granted then consideration should be given to mechanisms to penalise previous licensees if neglect of assets is apparent.

Penalties for Poorly Performing OFTO

There is no clear definition or process by which a poorly performing OFTO can be dealt with. One possibility is license revocation – however it is not clear how this is supposed to work or its timing / trigger point in relation to poor performance. This creates a significant risk for generators that in turn impacts on cost of the generator project financing. Clarification of this process is required to give transparency to all parties.

The limit on OFTO exposure for prolonged outages means there comes a point when there is no incentive for an OFTO to repair a fault more quickly. This is especially true where poor performance occurs in successive years. This aspect of the incentive scheme should be reviewed.

Since license revocation is a drastic measure with wide ranging impacts on generator, OFTO regime and wider consumers it is likely to be very much a measure of last resort. As such other punitive measures should be considered against poorly performing OFTOs. These could include – increasing financial exposure of OFTO revenue stream in the event of repeated poor performance, revenue stream re-openers, impact on the revenue stream from other license areas held by the same OFTO, barring of the OFTO and parent companies from future tender rounds.

Co-operation between OFTO and generator will be key in minimising lost generation output – measures should be put in place to assess the extent and success of such co-operation. Poor performance by the OFTO in this area could then be penalised. Such a measure would also help provide early warning of future problems to the benefit of all parties.

Step in Rights for Generators

In the event that an OFTO performs very badly or fails financially then there could be considerable disruption to the connected generation. Warwick would therefore propose that to minimise negative impacts that generators be given step in rights under these circumstances. These rights would be granted by Ofgem and allow the generator to operate the transmission assets on a temporary basis while a tender round is run to appoint a new OFTO, or the OFTO of last resort is appointed.

Step in rights would also require some form of temporary license or derogation to be issued to allow the generator to operate the transmission assets. The means of achieving this would need to be clarified.

Reactive Power Incentives

Under the recent National Grid consultation for reactive power payments it was proposed that generators would not be paid for reactive capability provided by OFTO reactive compensation equipment. As noted in consultation response by others this proposal needs to be revisited since the OFTO reactive equipment is wholly funded by the generator under TNUoS charges.

Given the above and the basic principle that generators should receive a revenue in return for investment (as would occur for onshore installations with reactive compensation fitted), then the incentive scheme should reflect this. There is currently no penalty against the OFTO for non-availability of reactive compensation equipment – except indirectly if real power export is affected. In any case Warwick notes that OFTOs may be able to reach agreement with National Grid to continue to export real power in case of significant failure of reactive compensation equipment if this does not have significant impact on network operations – hence it is possible that an OFTO may avoid penalty for poor performance with regard to such equipment.

Warwick believes that the provision of reactive power by OFTO's should be reviewed and that the incentive scheme should be modified to account for this.

Responses to Detailed Questions

Question 1

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

Answer 1

Targets should be aligned against expected production and value of lost production. The most realistic means of calculating this would be on a daily basis. The target for availability could then be set in total lost production weighted by energy price. The overall penalty could then be calculated to align with National Grid's charge setting requirements so any penalty would be recovered by the generator in the next year's TNUoS charges.

Question 2

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

Answer 2

Yes. The design of the incentive scheme should return to the original Ofgem design of being asymmetric. Warwick believes that credit banking should not be included in the regime. In particular the OFTO should not be rewarded for behaviour of exceeding availability targets - which should be an obligation on responsible network operators. See also comments above.

If incentives are included then these should be accrued and not paid out for a period of time (for example 5 years has been used in TR1). Warwick disagrees with the assertion that this creates a perverse incentive to bank credits – since if the credits are paid in cash terms then this is money banked in a real sense and therefore acts as a perverse incentive to neglect maintenance. This is especially so in:

- Early years where accrual of credits acts as an insurance for the OFTO against fault outages;
- Later years close to the end of the license period when the increased risk of future failure may not fall on the OFTO accruing the benefit due to the finite license period.

Question 3

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

Answer 3

It seems preferable to initially calculate the availability charge on a yearly basis such that the information can be provided to National Grid for TNUoS calculations during January. The financial year for OFTO's could be aligned to this timescale thus removing the need for complex accruals. Alternatively a reconciliation process to cover the period from January to end March could be applied part way through the following year.

Question 4

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

Answer 4

Maintenance outage strategy should be jointly agreed between OFTO and generator – it should be a license condition on the OFTO to liaise with the generator. It should also be a requirement that OFTOs build flexibility into planning outages to coincide with low production periods – i.e. circuit outages for maintenance should be co-ordinated with periods of low wind and flexibility should be built in to ensure this can be achieved in real operational timescales.

Information regarding planned NG and DNO outages that could affect system availability should be made available to both generator and OFTO alike to inform the planning process.

Question 5

How can we best ensure that the incentive is maintained for the length of the revenue stream?

Answer 5

As mentioned elsewhere neglect of assets during one license period may adversely affect any subsequent license and performance in years after the initial 20 year license period. A claw-back re-opener should be included as part of the incentive mechanism. This could penalise the original OFTO for neglect of assets if this becomes apparent in the early years of the next license period.

Question 6

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

Answer 6

Under transitional rounds Warwick understands that handover of assets to the OFTO would not occur until after commissioning and compliance testing is complete. This leaves the obvious question of whether it is acceptable for a generator to own and operate the assets pending completion of compliance testing. Clarification is required on this point – and it is particularly relevant to staged projects or projects which commission across more than a single summer season.

In the event that handover occurs before compliance process is complete then this should be a major factor in the penalty regime. This is because wind farm output is normally restricted by the National Grid compliance and Interim Operational Notification (ION) system. It is therefore extremely important both to generator commissioning / construction program and generation revenue from power exports that the OFTO commissioning, compliance testing and ION conditions are met in a timely manner to avoid delays. These aspects should be considered for the enduring regime and any relevant transitional rounds.