RWE npower renewables

Regulation and Policy

Name Jeremy Gummow
Phone 01793 474859
E-Mail Jeremy.gummow@rwe.com

Hannah Evans
Offshore Transmission
0203 263 2739
Offshore.Enduring@ofgem.gov.uk

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Offshore Electricity Transmission: Consultation on the generic Offshore Transmission Owner (OFTO) licence for Tender Round 3

Dear Hannah,

Thank you for the opportunity to comment on your consultation in relation to implementation of the generic OFTO licence for Tender Round 3. We are very pleased to be able to provide our perspective on the commercial as well as the technical implications of the proposed solution. This response is provided on behalf of RWE npower renewables limited a fully owned subsidiary of RWE Innogy GmbH.

We broadly support the proposals to improve the TR3 licensing regime compared to TR2. However, we strongly believe that sections two and three of this proposal require further consideration and improvement in order to be fit for purpose as an enduring regime.

We have previously raised the issue that the risks of the offshore transmission regime are heavily weighted on the generator. The success of the TR1 and TR2 regimes indicates that the existing proposals are sufficiently beneficial and low-risk (for the OFTO) to attract OFTO investors. Therefore, we deem it inappropriate to offer yet further benefits to the OFTO in the TR3 regime, by nature of unplanned gains through refinancing and reduced penalties from responsible outage management.

We support the principle of the capacity weighting mechanism to encourage smaller outages, but anticipate that this proposal is rewarding the OFTO for what should be best practice. Further, given that impact of this proposal is strongly linked to the number of cables for the wind farm, we propose implementing different values of a for each wind farm. This would depend on the number of installed export cables and follow a principle that outage penalties should be standardised on a single cable outage, rather than the entire capacity of the wind farm export capacity.

The principle behind the refinancing gain share is similarly well received and it is appropriate that the consumer receives a significant share of any benefits gained, whilst making sure that there is sufficient incentive on the OFTO to undertake the financing. We are concerned that these proposals risk over-compensating the OFTO, particularly in the case of re-financing following OFTO-build. As raised at the workshop on the 14th October, we recommend that further analysis is

RWE npower renewables

Auckland House
Lydiard Fields
Great Western Way
Swindon
Wiltshire SN5 8ZT

T +44 (0)8456 720 090
F +44 (0)1793 474 841
I www.npower-renewables.com

Registered office:
RWE Npower Renewables Limited
Auckland House
Lydiard Fields
Great Western Way
Swindon
Wiltshire SN5 8ZT

Registered in England
and Wales no. 2550622

required to determine the extent of the share such that the OFTO does not receive an inappropriately high benefit from the re-financing to the detriment of the consumer.

The detail of how the re-financing costs are considered in the gain-share needs further consideration. Further, with all refinancing costs subtracted from the gain, the OFTO is not necessarily incentivised to undertake the refinancing efficiently. One solution could be for the re-financing gain share to exclude consideration of the OFTO's cost (whilst accepting that the OFTO would have a higher share than if costs are removed).

Please do not hesitate to contact me if you require any further information in relation to our response.

Yours sincerely,

Jeremy Gummow
Grid Regulation Manager
RWE npower renewables

RWE responses to individual questions

Chapter: One

Question 1.1: Are there any other options or implications that you think we should consider in determining the parameters to use for implementing biddable implementation?

No. We support this proposal for increased optionality for a proportion of the OFTO income to be indexed to inflation on the premise of more efficient and lower financing costs and reduced overall cost to the consumer.

Question 1.2: Do you agree with the rationale we set out for adopting the parameters identified in paragraph 1.6 as minded-to positions?

No comment.

Question 1.3: Do you agree that using the breakeven inflation, calculated in accordance with the method described in paragraph 1.15, is a suitable market implied inflation figure to use in evaluating biddable indexation bids?

No comment.

Question 1.4: Are there any other options we should consider when selecting a market implied inflation figure?

No comment.

Question 1.5: Do you agree with the proposed amendment to the calculation of base transmission revenue (BR) to implement biddable indexation?

No comment.

Chapter: Two

Question 2.1: Are there any other options of implications you think we should consider in determining the parameters to use for implementing a refinancing gain share?

We welcome Ofgem's proposals to introduce a gain-share principle for re-financing of the OFTO assets. We are concerned that there is insufficient analysis at this stage to determine the appropriate extent of the gain share – particularly given the difference in expected benefits for OFTO-build compared to generator build – which may risk over-compensating the OFTO to the detriment of the consumer. We also have concerns over the mechanics of cash flow for the OFTO's refinancing costs against the proposed gain-share. This could be resolved by not subtracting the OFTO's re-financing costs when determining the gain, given that the OFTO may receive a higher share than if costs were subtracted from the gain.

We strongly request that further analysis is completed to determine the proportion of the gain share between OFTO and consumer alongside the mechanics of the re-financing. It should be clarified whether different parameters should be applied for OFTO-build and generator build.

Question 2.2: Do you agree with the rationale we set out for adopting the parameters identified in paragraph 2.3 as minded-to decisions?

We agree that the re-financing gain share should be made on the same basis as the re-financing (i.e. lump sum or annual adjustment) in a case-by-case assessment.

The share (which is proposed at 50:50) requires further analysis to ensure that the OFTO is not over-benefited to the detriment of the consumer. The consultation offers no evidence in support of awarding the OFTO as much as 50% of the gain plus a refund of their costs as opposed to awarding this market-related gain to the consumer.

Question 2.3: Do you think the scope of the refinancing gain share, and in particular the definition of the debt to which is will apply, is appropriate?

We note a fundamental difference between OFTO-build and generator-build re-financing and the probability/extent of benefit in each case, whilst the proposals do not make a distinction between these cases. The suitable definition of debt in each case alongside a fair split of the gain may both be different for each case.

Question 2.4: Do you have any views on the proposed licence drafting for the refinancing gain share set out in amended standard condition E12-J13 (Restriction of Transmission Revenue: Allowed pass-through items) of the Licence (Appendices 5 and 6)?

Comments to the drafting apply as per our responses to 2.1-2.3 (above).

Chapter: Three

Question 3.1: Do you have any views on the drafting of the capacity weighting mechanism in the generic OFTO licence?

We strongly support the principle of the capacity weighting mechanism in the generic OFTO regime to encourage smaller capacity outages. However, the proposed drafting offers yet further benefit to the OFTO (by means of penalty reduction) in a regime where the risks are heavily weighted on the generator.

The consultation proposal is for ‘higher capacity outages to be penalised more heavily’ (section 3.1), which is contrary to the detail of the proposal, reducing penalties for smaller outages. A standard outage and associated penalties should be normalised to a single cable being taken out of service and for greater penalties to be incurred when additional cables are taken out simultaneously.

We therefore propose that the drafting should be corrected to normalise penalties for a single export cable to be removed from service, rather than normalised against 100% capacity of the assets. This can be achieved by increasing the value of *a*.

Question 3.2: Do you agree with our rationale for setting the proposed values of *a* and *b* at *a = 1* and *b = 1.3*?

Excepting the issues raised in answer 3.1, we agree with the rationale of the proposed values of a and b. Increasing the value of b should incentivise smaller capacity outages, yet risks misalignment with operational benefits if the value of b exceeds 1.5. Therefore, we support the proposed value of 1.3.

As mentioned in answer 3.1, the current proposal detail is not consistent with the aims of the incentive proposal. Re-calibration of the capacity weighting to a single cable outage rather than setting it on the full capability of the wind farm will avoid over-rewarding the OFTO. This is achieved by increasing the value of a, depending on the value of b and number of installed export cables.

Question 3.3: Do you agree with our proposed approach to use the same values of a and b for all projects in TR3?

The risks and benefits of this proposal for each OFTO and generator are related to the number of export cables. Therefore, whilst the value of b should remain the same for all projects in TR3, the value of a should vary according to the number of export cables.

For example, in the case where b=1.3, the value of a should vary for different projects as follows:

1 export cable:	a = 1.00
2 export cables:	a = 1.23
3 export cables:	a = 1.39
4 export cables:	a = 1.52

Chapter: Four

Question 4.1: Do you agree with our proposed requirements for the credit rating of the financial institution holding the financial security?

Your proposed requirements for credit rating seem to be reasonable.

Question 4.2: Do you agree with our proposal to increase the value of the financial security in line with base transmission revenue?

Yes.

Question 4.3: Do you have any views on the licence drafting proposed in Part B of amended standard condition E12-J4 (Restriction of Transmission Revenue: Annual Revenue Adjustment)?

No comment.

Chapter: Five

Question 5.1: Do you agree with our decision to introduce a reporting requirement of SF_6 emissions?

We support the proposals for SF_6 reporting requirements for OFTO assets.

Question 5.2: Do you have any views on the licence drafting of amended standard condition E12-J12 (Sulphur Hexafluoride Reporting Requirements)?

No comment.

Question 5.3: Do you have any views on the proposed approach to reporting emissions?

No comment.

Chapter: Six

Question 6.1: Do you have any views on the licence drafting changes made to the generic OFTO licence for TR3?

No comments.