

To all with an interest in offshore electricity transmission

Promoting choice and value for all gas and electricity customers

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Dear Colleague,

Providing additional flexibility in the enduring regulatory regime for offshore electricity transmission: Initial joint decision statement

On 26 August, Ofgem and DECC opened a further consultation on the enduring offshore transmission regime. As part of this consultation, we set out our proposal to include an additional 'generator build option' as part of the enduring regime. We proposed this option as we considered it a pragmatic response to calls from stakeholders to extend the flexibility in the enduring regulatory framework, which had not previously allowed such an option.

The consultation proposed that a generator would be able to choose whether they, or an Offshore Transmission Owner (OFTO), undertake the work associated with construction of offshore transmission assets. Specifically, the consultation proposed the addition of a generator build option. Under this model the generator would undertake all design and construction works. A competitive tender process would be run by Ofgem to appoint an OFTO to adopt the transmission assets from the generator upon their completion. The economic and efficient costs of construction, as determined by Ofgem, would be paid to the generator by the OFTO at the point of asset transfer.

The consultation also sought further views on our proposed approach to 'OFTO build models'. Under OFTO build it will be the responsibility of an OFTO, appointed through a competitive tender, to undertake the construction of the offshore transmission assets. In addition, we also invited views on how the offshore regime might deliver co-ordinated development of the offshore transmission system.

The proposed additional flexibility in the enduring regulatory regime has been welcomed by the industry and the overwhelming majority of responses to the consultation have expressed strong support for our proposal to include a generator-build option in the enduring regime. Given this strength of support, and following decisions by the Authority and Government, this joint Ofgem/DECC open letter announces our intention to implement the changes necessary to deliver a generator build option. This decision has been taken on the basis of the generator build model being implemented in a manner that ensures that a level playing field of requirements and obligations is maintained across all the 'build options' being proposed. We also intend to implement further refinements to provide additional clarity on the OFTO build options under the enduring regime.

Stakeholders also supported the principle of a co-ordinated approach to offshore network development and the benefits that this may deliver. As such, this letter also outlines our

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intention to further consider how best to facilitate co-ordinated development of the offshore transmission system through the offshore regime that has been put in place.

Providing additional flexibility

Ofgem and DECC have worked together over the past five years to develop a regulatory regime for offshore electricity transmission which provides flexibility and supports the delivery of significant volumes of offshore generation, while protecting the interests of present and future consumers. The success of the first transitional tender round has shown the significant savings that can be achieved by competitively appointing licensed OFTOs for transmission assets that have been designed and built by generators. This tender round has resulted in overall forecast savings of £350 million on the first £1.1 billion of network assets for offshore wind farms and, ultimately, consumers.

The August consultation set out our proposals to enhance the choices available to offshore generators on the allocation of design and construction responsibilities between the generator and OFTO. Specifically, we invited views on allowing generators the additional option of designing and constructing the transmission infrastructure themselves. This approach would be similar to the transitional regime, in that the transmission assets would then be transferred to an OFTO once constructed. However, we noted that there would be important differences between the transitional arrangements and an enduring generator build model.

We received non-confidential responses to the August consultation from 35 stakeholders, who welcomed the additional flexibility set out in the consultation. Most responses expressed strong support for the inclusion of a generator build option on an enduring basis. However, the existing transmission operators and potential OFTOs have expressed more limited support, setting out different views on the most appropriate longer-term approach.

In light of the consultation responses, we consider that there is merit in allowing a generator build option under the enduring offshore transmission regime. We propose that this option should be based largely on the existing transitional arrangements, further enhanced by:

- introducing obligations for developers to comply with common obligations and technical standards for the design and construction of offshore transmission assets;
- implementing appropriate ring-fencing arrangements for transmission and generation costs; and
- stringent assessment of procurement processes and benchmarking of costs when assessing the transfer value.

We have consistently set out that we are seeking to create a regulatory regime which reflects the flexible needs of generators, while protecting the interests of present and future consumers and facilitating the delivery of offshore generation. We consider that the enduring regime should now provide a robust framework that can be applied consistently regardless of how design and construction responsibilities are allocated between generator and OFTO. As such we will shortly be consulting on the implementation of the generator build model.

Implementing the 'generator build' option

We consider that significant changes to aspects of the industry codes will be necessary to implement the generator build option within the enduring regime. We are currently working with code owners to develop draft industry code modifications, which will form the basis of an implementation consultation that we intend to publish at the end of October.

Most respondents to the August consultation supported the use of the Secretary of State's existing powers to implement the relevant industry codes changes. Nonetheless, several responses noted that the timetable for developing and implementing industry codes

changes before these powers lapse on 18 December 2010 will be extremely challenging. Ofgem and DECC are committed to delivering a generator build option in a robust and timely manner. We intend to develop and implement changes this year, if feasible. It is important that the changes are sufficiently robust and we are mindful of the need to consult the industry and consider views. We reiterate the importance that stakeholders engage constructively and respond early to the next consultation with material comments to support the delivery of these changes in a timely manner. In addition to changes to the industry codes, robust implementation of a generator build option will require further development of the licensing framework, competitive tender process and associated tender regulations. We expect to develop changes in these areas over the coming months to be implemented early next year.

Further refinement of the 'OFTO build' options

Following the implementation of the offshore transmission regime in June 2009, Ofgem has identified and consulted upon a number of detailed policy issues relating to:

- the allocation of responsibilities between developer and OFTO under an OFTO build option and the transfer of property rights from developer to OFTO;
- the design and scope of the tender process, including cost recovery mechanisms with respect to pre-construction works and the use of contingencies; and
- ensuring the timely delivery of the offshore transmission assets.

The August consultation invited views on these detailed aspects of the enduring regime. Respondents broadly supported our proposals on OFTO build, although a spectrum of views was expressed at a detailed level. Several stakeholders commented that mechanisms should be flexible and warned of being overly prescriptive in our approach as each project will have inherent issues that make it distinct.

We consider that robust OFTO build arrangements are necessary to provide effective choice to generators. We consider that there is merit providing further clarity on the OFTO build options to ensure that generators make informed commercial decisions. In light of the responses to the August consultation, we are working with code owners to identify and implement further industry codes changes to provide this additional clarity. This is being progressed in parallel to the work on the generator build option and further details will be set out in the forthcoming consultation.

Co-ordinated development of the transmission system

We recognise the importance of developing a coordinated offshore and onshore transmission network and the benefits this can bring. This was a major driver in the decision to create the NETSO by extending National Grid Electricity Transmission's onshore System Operator responsibilities offshore and placing a licence obligation on the NETSO to develop an Offshore Development Information Statement (ODIS).

The August consultation invited views on whether the offshore transmission regime provided appropriate opportunities for co-ordinated development of offshore transmission infrastructure. We also invited views on whether there were circumstances where additional offshore infrastructure development would be in the wider interest of the NETS and whether there are any issues in respect of interoperability or standardisation which may prohibit the co-ordinated delivery of transmission assets. Stakeholders have expressed strong support for the principle of a long term co-ordinated approach to offshore network development and recognised the additional benefits that co-ordination can bring. Most respondents were of the view that while the offshore regulatory regime would not create barriers to coordination, nor are current incentives sufficient to bring about significant levels of coordination in practice. Several respondents commented that a lack of incentives to encourage anticipatory investment was a material factor. A number of responses also supported the appointment of a single party responsible for the design of a co-ordinated offshore transmission system. Nevertheless, most respondents did not

provide detailed proposals on what the further steps required to deliver co-ordination might look like. Those who did differ in views as to the best approach.

On the basis of the responses received, Government and Ofgem intend to undertake further work to consider whether additional measures will be required to deliver co-ordinated networks through the offshore transmission regime and, if so, what these measures might look like in practice. We envisage further consulting on this issue in 2011.

Third Package compliance

The EU Third Energy Package will be implemented by March 2011. A key requirement of the Third Energy Package is ownership unbundling and consequently it specifies the roles and responsibilities of transmission owners in terms of network operation, maintenance and development. The unbundling provisions of the Third Energy Package seek to achieve separation of transmission interests (ownership and operation of transmission systems) from generation activities.

The UK Government must comply with the requirements of the Third Package and work is already underway to implement the Directive in to UK law. Ofgem and DECC continue to work together to ensure that the offshore transmission regime is fully compatible with these requirements.

Next steps

This letter has set out our intention to include a generator build model in the enduring regime and to make further refinements to the OFTO build option. It has also set out our intention to seek to implement the necessary changes to the industry codes to deliver the enduring regime using the Secretary of State's powers, which expire on 18 December 2010. Therefore, we are working towards the following timetable:

Implementation consultation opens:	Late October
Implementation consultation closes:	Mid-late November
Decision document published:	Mid December
Secretary of State's Energy Act 2004 powers expire:	18 December

We encourage industry parties to actively participate in the forthcoming consultation process so that changes to the enduring regime can be implemented in a timely manner, including by providing comments of a material nature as early as possible during the consultation.

Should you wish to discuss the issues raised in this open letter ahead of the forthcoming consultation, please contact Sam Cope (Ofgem) on 020 7901 7239 or at Sam.Cope@ofgem.gov.uk or Kristina Dahlström (DECC) on 0300 068 5113 or at Kristina.Dahlstrom@decc.gsi.gov.uk.

Yours faithfully,



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