

# Decision

## OFTO End of Tender Revenue Stream Consultation – First Decision Document

**Publication date:** 23 July 2021

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### Overview

This document sets out a first group of decisions that we have taken in connection with the Offshore Transmission (**OFTO**) regime, after considering feedback from stakeholders, including that submitted in response to our consultation issued March 2021.

These decisions are a first step in establishing an economic and efficient process for extending, where appropriate, regulatory revenue periods within the current OFTO regime. They cover 10 of the 23 questions raised in the March 2021 consultation. We are not seeking further responses on this document from stakeholders at this stage.

We are continuing to review the detail, format and process for extensions and intend to consult further on the remaining policy elements in November 2021 (see Appendix 1 to this document). A further decision document will then be published in spring 2022.

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## Foreword

The efficient delivery and operation of transmission assets for offshore wind energy projects forms a core part of the strategy for achieving the UK Government's target of 40GW of offshore wind by 2040.

The present regime for constructing and operating these assets, the Offshore Transmission Owner (**OFTO**) regime, has operated successfully since June 2009. Under the regime, Ofgem runs a competitive tender process to select and licence OFTOs. There are 21 operational OFTOs now in place, comprising an investment of circa £5.7 billion in offshore transmission. Nine of these OFTOs are reaching the midpoint of their current revenue periods and, under the current regime, would be subject to decommissioning requirements from 2030 onwards.

In 2020, we therefore decided to undertake a specific review of the OFTO regime to understand how it could be further optimised to continue to play its part in reaching the 40GW offshore wind objective, by ensuring that assets which are economically viable remain in operation. Our initial consultation in March 2021 set out 23 questions in relation to three areas: whether there is a need for an extension to the regulatory revenue period; extension options; and how the tender revenue stream should be set for any future regulatory periods.

This document sets out a first group of decisions that we have now taken in connection with the OFTO regime. These address 10 of the 23 questions raised in the March 2021 consultation, and we will consult on the remaining policy elements in November 2021.

**Jourdan Edwards, Head of OFTO Regime, Networks, Ofgem**

## 1. Introduction

### Context and related publications

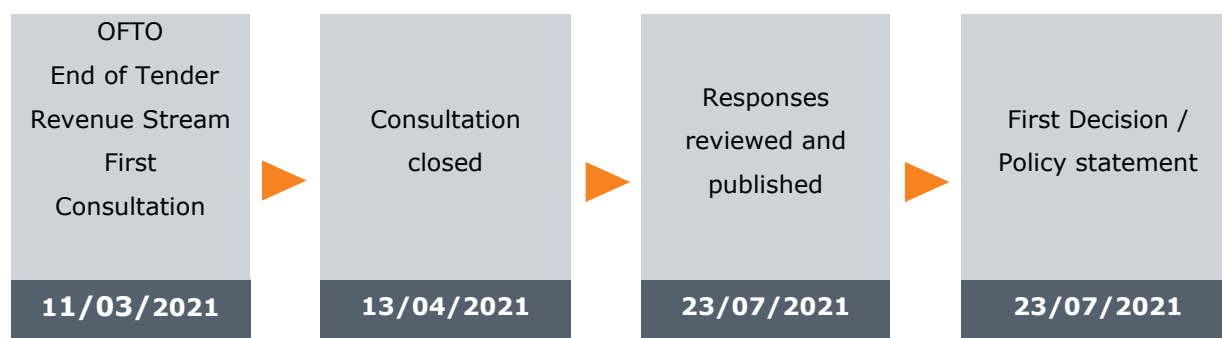
- 1.1. The OFTO regime has been in existence for over ten years, during which time it has become a mature market. To date we have licensed 21 OFTOs across six tender rounds, financed with a highly competitive cost of capital.
- 1.2. Our key objectives of the OFTO regime, in running competitive tenders for offshore transmission licences, are to:
  - deliver transmission infrastructure to connect offshore generation on a timely basis, and ensure that OFTOs are robust and can deliver transmission services successfully over the licence period;
  - provide certainty and best value to consumers through the competitive process;
  - attract new entrants to the transmission sector; and
  - undertake streamlined and efficient tender processes.
- 1.3. Projects are becoming larger and more complex, with developers using newer technology on projects or contemplating how they will use this in the medium to longer term future.
- 1.4. With these technological developments, it is becoming possible to further extend the lifetime of offshore assets and thus an opportunity for Ofgem to look for ways to extend the regulatory revenue period to ensure best value to consumers. As assets approach the midpoint of their revenue periods, we have decided to review formally the OFTO regime for the possibility of revenue period extensions, to ensure that it continues to meet our objectives.

### Our decision-making process

- 1.5. During 2020 we engaged with stakeholders to understand any concerns they had about the tender revenue stream of OFTO assets coming to an end and the need for the offshore transmission assets to be decommissioned. Based on these discussions we identified several issues that needed consideration.

- 1.6. We then published our consultation on the End of Tender Revenue Stream on 11 March 2021<sup>1</sup>.

**Figure 1: Decision – Making Stages**



- 1.7. We intend to publish a second consultation document in November 2021, with a final policy decision in spring 2022.

## Scope of the consultation

- 1.8. Our consultation in March 2021 looked at several items relating to the extension of the regulatory revenue period including: the timeline and responsibility for asset health reviews; the process for extending or retendering OFTO licences; establishing a new tender revenue stream for the extension period; and issues connected with the decommissioning fund and insurance in the extension period.

## Scope of the decision

- 1.9. This document sets out Ofgem’s decision on 10 of the 23 questions that we asked in our March 2021 consultation. We have taken decisions on the timing and responsibility for asset health reviews; the possibility of multiple extensions; and on the settlement of availability liabilities. We will consult further on the remaining policy elements in November 2021.

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<sup>1</sup> <https://www.ofgem.gov.uk/publications/offshore-transmission-owner-ofto-end-tender-revenue-stream-consultation-concerning-policy-development>

## Your feedback

1.10. We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this report. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall quality of this document?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Are its conclusions balanced?
5. Did it make reasoned recommendations?
6. Any further comments?

1.11. Please send any general feedback comments to [jennifer.mcgregor@ofgem.gov.uk](mailto:jennifer.mcgregor@ofgem.gov.uk)

## 2. Timing

### Section summary

We have made a decision on the appropriate timescales by which health reviews of the OFTO and generator assets must be carried out. These reviews will then inform the decisions on whether extensions to the regulatory revenue period would make economic sense for consumers and the wind farm generators in each case.

### Relevant consultation questions:

**Question 1: should asset health reviews be carried out on generator assets no later than five years before the end of the revenue stream, with the health review for the offshore transmission assets following shortly after that? If no, please set out alternative timelines and reasoning.**

**Question 9: are the timelines proposed practical? Do any of the timings need to be extended or reduced, and if so, why?**

## Our decision

### Background

- 2.1. Stakeholders had indicated to Ofgem previously that there would need to be sufficient time prior to an extension decision for the generation and OFTO asset health to be evaluated and commercial decisions made. Time would therefore need to be allocated in the process to allow:
  - 2.1.1. generators to submit extension proposals based upon the level of additional investment and works needed to continue to operate; and
  - 2.1.2. Ofgem adequate time to evaluate those proposals.
- 2.2. Should an extension be approved by Ofgem, further time would then be needed to procure equipment, and schedule and perform the required works on both the generation and OFTO assets.



## Stakeholder views

- 2.3. There was general agreement that it is important to carry out the asset health reviews well before the end of the revenue stream period, and that the timetable proposed by Ofgem in March 2021, with the review of generator assets no later than five years before the end of the revenue stream, and with offshore transmission assets reviewed shortly after that, was sensible. However, five respondents suggested that the timeline be brought forward to allow greater time for discussions between generators and OFTOs, and to secure the investment needed to make licence extensions possible.
- 2.4. A number of generators and OFTOs responded that Ofgem’s proposal – to announce our decision on the OFTO who will operate the assets during the extension period, two years before the end of the initial revenue stream – should be brought forward by one year (to three years prior to the end of the regulatory revenue period). This would allow greater time for generators and OFTOs to make the investment needed, and would avoid any clash with the requirement for a review of the decommissioning programme and costs two years before the end of the regulatory revenue period, as outlined in the current BEIS Guidance<sup>2</sup>.

## Decisions

- 2.5. Q1: Ofgem has decided that, based on stakeholders views and professional technical judgement, health reviews on the generator assets should be completed no later than six years before the end of the OFTO regulatory revenue period, and that health reviews on the offshore transmission assets should be completed no later than five years before the end of the regulatory revenue period.
- 2.6. Q9: Ofgem has also decided that it will announce who will operate<sup>3</sup> the OFTO assets during the extension period three years before the end of the initial revenue stream period.

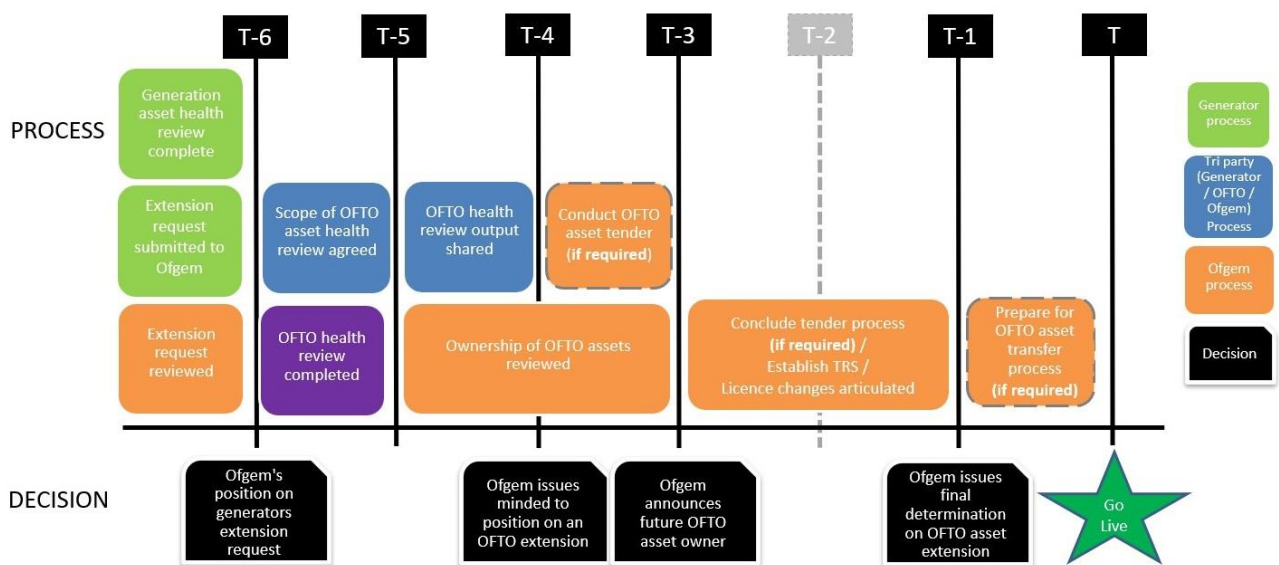
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<sup>2</sup> <https://www.gov.uk/guidance/oil-and-gas-decommissioning-of-offshore-installations-and-pipelines>.

<sup>3</sup> In the case of an extension being competitively tendered, a tender will be carried out in the fourth year before the end of the tender revenue stream and Ofgem will aim to announce the preferred bidder at T-3 years.

2.7. Figure 2 provides an overview of the main processes and decisions that will be made by Ofgem prior to the end of the regulatory revenue period ('T'). Further guidance will be developed, including the criteria we will use to assess whether an OFTO extension will be competed, and published in spring 2022 to support the overall extension process.

**Figure 2 OFTO Extension Timetable**



## 3. Roles and Responsibilities

### Section summary

We have decided that generators and OFTOs should be responsible for the health reviews of their own assets. We will require OFTOs to make their health reviews available to Ofgem and to make relevant sections of the reviews available to generators.

### Relevant consultation questions:

**Question 2: should generation and transmission health reviews be carried out by the generators, but informed and agreed by OFTOs and Ofgem, given that generation is likely to be the main driver for any extension? If not, please provide reasons.**

**Question 3: should generators pay for their own health reviews and those of the associated transmission assets? Please provide reasons for your response.**

**Question 5: should the incumbent OFTO or the generator be responsible for any further investment required to enable an extension of the regulatory revenue period?**

## Our decision

### Background

- 3.1. We proposed that generators should commission and fund the health review of both the wind farm assets and the offshore transmission assets.
- 3.2. It was also identified that additional investment in the OFTO assets identified by the health reviews could be: delayed and included in any future revenue stream in the extension period; paid for by the incumbent OFTO and recovered through an adjustment to the revenue stream in the remaining regulatory revenue period; or paid for directly by the generator concerned.

## Stakeholder views

- 3.3. Many respondents, including generators and OFTOs, told us that each party should be responsible for the health review of their own asset. However, there remains a need for the key information to also be made available to Ofgem and for some limited OFTO information to be made available to the generator as well.
- 3.4. Most generators responded that OFTOs should pay for the health review of the transmission assets. However, three generators accepted that incumbent OFTOs should be reimbursed through the regulatory revenue stream or by the new OFTO following a tender process.
- 3.5. OFTOs proposed that they should be reimbursed for the cost of the health review, as well as for the availability lost during that review, as these are additional costs that were not factored into their original tender revenue streams.
- 3.6. Most generators suggested that OFTOs should be responsible for the additional investment needed to enable an extension. However, two generators accepted that if the OFTO makes this investment, they should be reimbursed through the regulatory revenue stream as pass-through items. OFTOs responded that the existing revenue stream does not cover the additional investment needed beyond what would be required to maintain the OFTO assets to the end of the regulatory revenue period agreed at licence grant.

## Decisions

- 3.7. Q2: Ofgem has decided that each party should be responsible for commissioning the review of its own assets. The output of the OFTO health reviews will however need to be made available to Ofgem and, as necessary, the generator, to ensure an economic and efficient investment decision can be made for each OFTO asset.
- 3.8. Q3: Ofgem has decided that unforeseen costs that are economic and efficiently incurred by the OFTOs in carrying out the requirements of the asset health review should be reimbursed. We have also decided that OFTOs should be able to claim for availability lost as a direct result of carrying out the reviews; OFTOs will be required however to make best endeavours to coordinate with planned outages.

- 3.9. Q5: Ofgem has decided that where investment is needed within the current revenue term to facilitate an extension, that this investment should be made by the current OFTO<sup>4</sup> and that they should be recompensed for the economic costs incurred, which are beyond the scope of the current revenue stream. However, if investment can be deferred until the extension period, this option will be exercised, and the costs will be factored instead into the revenue stream set for the extension period or subject to competition, as appropriate.

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<sup>4</sup> Ofgem is currently exploring suitable options to assess and reimburse the further OFTO investment and will seek views in November 2021.

## 4. Extension Options: Procedures and Process

### Section summary

The process to extend the regulatory revenue period must start with confirmation from the relevant connected generator that they require an extension. Several subsequent processes and procedures are then required to be carried out.

### Relevant consultation questions:

**Question 7: do you consider that there is a threshold to be met to determine which approach to be taken (if there is to be any further regulatory revenue period at all)? For example, the extension period is above a certain number of years, or the tender revenue stream is above a certain value?**

**Question 10: should there be only one extension period granted, or do you think that if the process is established, that more than one extension could be possible for the same OFTO asset?**

## Our decision

### Background

4.1. Ofgem commissioned engineering consultancy Arup to complete a report in August 2012,<sup>5</sup> including a chapter on the lifespan of wind farm assets and transmission assets. The overall conclusions were:

- transmission assets are very likely to last up to 25 years, with several components (such as cables) having lifespans of at least 40 years;
- wind farms are likely to need significant investment or replanting after 20 years;

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<sup>5</sup> <https://www.ofgem.gov.uk/sites/default/files/docs/2012/11/arup---technical-support-for-the-enduring-regime.pdf>

- for both sets of assets there are several lifecycle items (for example battery systems, communications software, and protection and control systems) which have a lifespan of less than ten years.

### **Stakeholder views**

- 4.2. Respondents expressed a range of views on whether and how Ofgem might set a threshold for determining whether to retender the OFTO licence or not. Some proposed that tenders should only be required for extensions longer than five or ten years, while others said that tenders should be required above a set revenue stream level or the additional net present value.
- 4.3. Most generators and OFTOs responded that more than one extension should not be ruled out, but it was noted that it would be more economic and efficient to only carry out the extension process once.
- 4.4. Ofgem acknowledges that a range of options may be available for each project and that future policy will need to accommodate a range of possible outcomes, to ensure that as many OFTO projects can continue to operate as possible, so that the right economic outcome is achieved and generation assets are not stranded unnecessarily.

### **Decisions**

- 4.5. Q7: Ofgem has decided that no specific threshold will be set and that each OFTO project is sufficiently unique that it must be considered on its own merits in conjunction with the relevant generator.
- 4.6. Q10: Ofgem has decided that further extension periods will be possible. The key factor determining whether a revenue extension should be granted for OFTO assets will be a rigorous assessment of relevant asset information and the willingness of the generator to continue to generate electricity.

## 5. Tender Revenue Stream

### Section summary

Ofgem has decided that the cost mechanisms for determining the tender revenue stream within the extension period will be set on a case by case basis. We do not believe it will be possible to set one detailed mechanism that could be used for all projects. However, we have not yet decided which of the proposed mechanisms will be used to set the tender revenue stream. Ofgem has decided that incumbent OFTOs should be required to settle any availability liabilities due at the end of the original revenue term, before being permitted to withdraw any balance that is due from the performance reserve.

### Relevant consultation questions:

**Question 12: should there be a set cost mechanism for determining the TRS for any future regulatory revenue period across all projects? Or should the cost mechanism be determined on a project by project basis, depending on the required extension length and risk profile?**

**Question 13: are there any additional cost elements that you think should be considered when Ofgem is calculating the tender revenue stream for a further regulatory revenue period?**

**Question 17: do you agree that, in the event of an extension, the incumbent OFTO should pay any availability liabilities due at the end of the original regulatory revenue period?**

## Our decision

### Background

- 5.1. The tender revenue stream (**TRS**) under existing licences largely reflects the cost of purchasing the offshore transmission assets and the need to repay the lenders that financed the asset purchase. Other factors contributing to the TRS include operations and maintenance costs of the assets and insurance.
- 5.2. Two different cost mechanisms could be used in any further regulatory revenue period. The first mechanism is the 'building blocks' mechanism which would involve



allocation of costs to such items as: the operation and maintenance of transmission assets; insurance; and actions required to extend the lifetime of the assets for the whole extension period. The second mechanism is a 'cost plus' method, where costs forecast and agreed by Ofgem would be reimbursed plus an agreed measure of return. The cost plus method would allow greater flexibility to vary revenue return and take account of any unforeseen positive or negative.

### **Stakeholder views**

- 5.3. Most respondents believed it should be possible to set a base mechanism for determining the revenue stream, although this would need to be flexible enough to take account of issues specific to each project.
- 5.4. A number of additional elements for the extension period were identified by respondents including the need to cover asset failures; whether the availability incentive target should remain at 98%; the purchase of additional spare parts; and the recovery of losses incurred in the original revenue period.
- 5.5. There was general agreement that the incumbent OFTO should pay any availability liabilities due at the end of the original term.

### **Decisions**

- 5.6. Q12: Ofgem has decided that the cost mechanisms for determining the TRS for any extension period will be set on a project by project basis depending on the unique extension requirements, including risk.
- 5.7. Q13: Similarly, Ofgem has decided that although common cost elements will be used across all OFTOs, it would not be possible to set one detailed mechanism that could be used for all projects. Key considerations for Ofgem in setting the TRS will be the level of identified risk, future uncertainty and the length of time that an extension is required.
- 5.8. Q17: Ofgem has decided that incumbent OFTOs should be required to settle any availability liabilities due at the end of the original revenue term, before being permitted to withdraw any balance that is due from the performance reserve. This position makes no change to the current licence requirement.

## Appendix 1

Table 1 provides an overview of the questions which have been answered in the current document.

**Table 1: Summary of March 2021 Questions and Decisions**

| Question  | Decision               |
|---|------------------------|
| Q1: should asset health reviews be carried out on generator assets no later than five years before the end of the revenue stream, with the health review for the offshore transmission assets following shortly after that? If no, please set out alternative timelines and reasoning.          | Para 2.5               |
| Q2: should generation and transmission health reviews be carried out by the generators, but informed and agreed by OFTOs and Ofgem, given that generation is likely to be the main driver for any extension? If not, please provide reasons.  | Para 3.7               |
| Q3: should generators pay for their own health reviews and those of the associated transmission assets? Please provide reasons for your response.   | Para 3.8               |
| Q4: what sort of confirmation/guarantee/representation of the intention to extend would developers envisage giving? What would this be subject to?  | No decision currently. |
| Q5 – should the incumbent OFTO or the generator be responsible for any further investment required to enable an extension of the regulatory revenue period?   | Para 3.9               |
| Q6 – should the tender revenue period be extended with the incumbent OFTO, or licences retendered through open competition?   | No decision currently. |
| Q7 – do you consider that there is a threshold to be met to determine which approach to be taken (if there is to be any further regulatory revenue period at all)? For example, the extension period is above a certain number of years, or the tender revenue stream is above a certain value? | Para 4.5               |
| Q8 – where retendering takes place, what safeguards or mitigations would need to be implemented to enable bidders to be comfortable about the level playing field between incumbent OFTOs and other bidders?  | No decision currently. |

|   |                        |
|---|------------------------|
| Q9 – are the timelines proposed practical? Do any of the timings need to be extended or reduced, and if so, why?  | Para 2.6               |
| Q10 - should there be only one extension period granted, or do you think that if the process is established, that more than one extension could be possible for the same OFTO asset?  | Para 4.6               |
| Q11 – we would welcome your views on which of the proposed cost mechanisms (“building blocks” or “cost plus”) you consider would be more appropriate for establishing a revenue stream for the extension period, or if an alternative should be considered?             | No decision currently. |
| Q12 – should there be a set cost mechanism for determining the TRS for any future regulatory revenue period across all projects? Or should the cost mechanism be determined on a project by project basis, depending on the required extension length and risk profile? | Para 5.6               |
| Q13 – are there any additional cost elements that you think should be considered when Ofgem is calculating the tender revenue stream for a further regulatory revenue period?   | Para 5.7               |
| Q14 - what market value (if any) do you think the OFTO assets will represent at the end of the regulatory revenue period? What are the component parts of this value?   | No decision currently. |
| Q15 – do you agree that decommissioning funds and liability should be transferred across in full to any new OFTO?   | No decision currently. |
| Q16 – do you expect decommissioning costs to be higher after the period of an extension or similar to those expected after the initial regulatory revenue period?   | No decision currently. |
| Q17 – do you agree that, in the event of an extension, the incumbent OFTO should pay any availability liabilities due at the end of the original regulatory revenue period?   | Para 5.8               |
| Q18 – are there any indications that insurers are willing to reinstate LEG3/06 exclusion clauses or equivalent (where this has been removed) after a period without further failure events? If so, how long might that period be?                                       | No decision currently. |
| Q19 – noting the difficulty of forecasting the insurance market, what are your views on the likely availability and cost of LEG3/06 exclusion clauses (or equivalent) for the period of any further revenue period?   | No decision currently. |

|   |                        |
|---|------------------------|
| Q20 - is there a need to move away from LEG3/06 (or equivalent) insurance clauses in any further revenue period due to the age, suitability, and specific nature of this type of cover for ageing assets?                     | No decision currently. |
| Q21 - do you consider that a more centralised solution for cable insurance risk might be required? Why? Would this bring confidence back to the insurance market and attract new investors to the OFTO extension asset class? | No decision currently. |
| Q22 - would operating the OFTO assets with minimal insurance to first failure be a viable option for higher risk assets with uncertain futures?   | No decision currently. |
| Q23 - are you currently exploring or investigating any other potential models or approaches to insurance that maybe appropriate for an OFTO asset during any further revenue period?  | No decision currently. |