

Stephen Taylor
Ofgem
10 South Colonnade
Canary Wharf
London
E14 4PU

13 April 2021

Dear Stephen,

Offshore Transmission Owner (OFTO) End of Tender Revenue Stream – Consultation concerning policy development

I am writing to you on behalf of Transmission Capital Partners (“TCP”) in response to the Consultation dated 11 March 2021 which seeks to consult on the possibility of extending the regulatory revenue period and how any such process should be operated.

TCP is an established and proven consortium comprising INPP and Transmission Capital Partners LP, which provides the necessary skills, capabilities and experience to succeed in the takeover and operation of offshore transmission assets. TCP currently owns and operates seven OFTOs, including Robin Rigg, Gunfleet Sands, Barrow, Ormonde, Lincs, Westernmost Rough and Dudgeon. TCP is also preferred bidder on three further OFTOs, including Rampion, Beatrice, and East Anglia One. Through its proactive approach to managing these assets, over the cumulative 52 OFTO-year operating history to date, TCP has achieved availability in excess of 99.9%. TCP has been involved in the OFTO regime from the original Ofgem consultation to set up the OFTOs back in 2009 and has since participated in every subsequent OFTO tender process.

When bidding the competitive revenue streams for the initial revenue period for its OFTOs assets, TCP placed considerable importance to the fact that it was the owner of the transmission assets and would benefit from transmission life extensions should the generation assets extend beyond their original stated life expectations. Prior to entering OFTO competitive tenders back in 2009/10, TCP carried out detailed analysis of OFTO assets and their useful economic life, which was set out in TCP’s response to the ITTs. In its responses to OFTO Tender Round 1 bids, TCP clearly stated the estimated economic life of OFTO assets to be in the order of 30-40 years. In its bids, TCP stated that it expected to benefit from an extension of its revenue stream to continue making available and maintaining the OFTO assets in accordance with good industry practice for the ultimate benefit of the consumers.

TCP recognises the value in the Crown Estate lease which allows for a significant period of operation beyond that of the initial revenue term. As such, TCP acquired the OFTO assets on the basis of a continued use beyond expiry of the initial revenue term and has prudently managed operations and maintenance in order to maximise the working life of its transmission assets.

We believe that TCP’s proactive approach to asset management sets it apart from other industry operators and we hope this approach and continued investment is recognised and valued by Ofgem. This approach is supportive of Government’s Net Zero target should allow for the maximum possible life to be achieved from the transmission assets under TCP’s management.

As a long-term investor, TCP derives confidence from a stable and visible regulatory regime - this is considered necessary to maintain high levels of financial commitment and investment. As such, TCP would be strongly opposed to the possible introduction of legislation which had the intention of removing the OFTO assets from TCP’s ownership without our consent. We believe that any such move would be contrary to the stability that has characterised UK regulation over the years and which enabled TCP to deliver such high levels of OFTO availability at very competitive pricing levels since the creation of the regime back in 2009. As has been well documented, the approach has significantly benefited the consumer. TCP’s view is therefore that it would not be economical or in the best interests of consumers to retender the TR1 OFTO licences. In line with TCP’s bid, TCP expects that the incumbent is most suited to continue to operate and maintain their existing OFTO assets in a safe and reliable manner.

We have set out our responses to the questions raised in the consultation in Appendix A and Appendix B. The confidential responses set out in Appendix B relate to current on-going bids and hence must not be made available to other industry participants. Please do not hesitate to contact me if any of our responses are unclear or require further elaboration.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Chris Veal', with a stylized, cursive script.

Chris Veal

Director

APPENDIX A – NON-CONFIDENTIAL RESPONSES

Question	Response
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.	<p>Early knowledge of the regulatory framework for extending the life of transmission assets beyond 20 years is key, with clarity needed as early as possible. TCP's four OFTO assets covered by this consultation have a remaining revenue term ranging from 9 to 11.25 years. In the absence of future extension and regulatory certainty, plant availability will be maintained but there would be little incentive for longer term planning around extending the life of transmission assets (for example major painting campaigns to prevent corrosion would likely not be carried out in the remaining 6 or 7 years left of the initial revenue period). This uncertainty may negatively impact the availability levels, or increase maintenance costs, during the life extension periods given certain investment decisions and/or maintenance regimes will need to be tailored to the expected extension and will need to be based on clear decisions.</p> <p>TCP believes the stated timeframe for the generator asset health review is too close to the end of the initial revenue period and the asset health review should be carried out sooner than envisaged to allow sufficient time for all stakeholders to plan well ahead of the implementation of the extended OFTO regime. The OFTO asset health review should either be performed shortly after the generator review (say within 6 months) so that it can take into account the likely life extension required following the generator asset health review.</p>
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.	<p>Whilst TCP recognises that the generation asset owners are likely to be the main driver of any extension, TCP believes that the asset health reviews should be performed by the respective owners / operators.</p> <p>The OFTO as owner and operator of the transmission assets is best placed to facilitate any transmission asset health review. We do not believe any generator would have sufficient knowledge of the transmission asset configuration and operational history to be able to perform this function appropriately.</p>
Q3: should generators pay for their own health reviews and those of the associated transmission assets? Please provide reasons for your response.	<p>The generator should pay for its own asset health review.</p> <p>So far as possible, the OFTO asset health review should align to the current Modification Application process whereby the generator requests modification following its own asset health review. The OFTO should then be able to recover the costs and application fees from the ESO under the pass-through items included in the licence.</p>
Q4: what sort of confirmation/guarantee/representation of the	TCP is unable to comment on what confirmation/guarantee/representations generators would envisage giving.

intention to extend would developers envisage giving? What would this be subject to?

However, the perspective of all stakeholders and in particular the consumer, TCP would recommend a mandated requirement for generators to consider a life extension beyond the initial revenue term.

In order to best facilitate the economic and efficient extension, TCP believes that early certainty will lead to greater cost efficiency and ultimately lower customer bills. The current onshore transmission network review period of 5 years is considered to work well. From an OFTO perspective, TCP expects that a 5-year extension would be the minimum acceptable term to drive appropriate incentives and behaviour to maximise availability of the transmission assets. An OFTO typically needs to contract certain services (vessel / first response) with contractors and finds that 5-year agreements provide a suitable balance between long term incentive and level of service.

Q5 – should the incumbent OFTO or the generator be responsible for any further investment required to enable an extension of the regulatory revenue period?

The incumbent OFTO should be the only party responsible for any further investment associated with assets owned by the OFTO. The transmission assets are operated (safety / access etc.) by the OFTO and TCP must retain full control over any activities that may impact its short term and long-term performance (availability, Capex vs Opex).

TCP believes that ownership separability must be maintained to allow for the continued efficient operation of transmission assets. Ownership and control boundaries must continue to be maintained and be definable. Co-mingling of OFTO owned and generator owned assets is expected to complicate interfaces between parties, unnecessarily disrupt a defined regime that currently works well, and would add complexity to any availability incentive mechanism.

The cost of any OFTO investment should be recovered under its licence from the ESO, who would then recover these costs through the normal routes of connection charges (if applicable) and transmission network use of system charges. This would maintain the unbundled status of the generation and transmission assets.

Q6 – should the tender revenue period be extended with the incumbent OFTO, or licences retendered through open competition?

[Confidential response]

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?

Open competition and licence tendering is a complex, lengthy and costly process that requires information symmetry to maintain a level playing field.

On at least two occasions, Ofgem has previously decided that it would not be appropriate to require the transfer of transmission assets between parties. In respect of multi-purpose projects (MPP), Ofgem's draft conclusion to its Integrated Transmission Planning Regulation project proposed that no change of ownership should be required. Furthermore, in respect of CATOs, Ofgem has consistently proposed to only compete "completely new" projects. The rationale for this was also set out in the draft conclusion to its Integrated Transmission Planning Regulation project.

Ofgem has set criteria for determining whether competitive processes should be used in the delivery of onshore transmission assets. Typically, these have been set at reasonably high levels as the costs of tendering to deliver transmission assets are significant.

TCP would expect the cost of bidding an OFTO period extension would be similar to bidding for the delivery of onshore transmission assets. The scope for savings would depend on how the tender was run, although it is likely to be limited given the nature of the requirement (transmission capacity between two predetermined points, probably involving conventional HVAC equipment of the same type as currently employed).

If there is very limited new investment required then the scope for savings would be limited. However, the transaction costs of running a tender and then requiring transfer of existing assets from the current OFTO to a new OFTO would still be very significant (circa £5m in aggregate). It is difficult to see how this cost could be justified by future financing and operating cost savings alone.

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?

TCP does not consider retendering to be a viable option due to the high level of information asymmetry between the incumbent and the potential bidders. As a result, it is unlikely that a level playing field can be established.

Furthermore, the relatively short term (5-10 years) of TRS extension, relatively low value and high bidding cost are not expected to attract substantial bidding tensions.

Q9 – are the timelines proposed practical? Do any of the timings need to be extended or reduced, and if so, why?

TCP does not agree that issuing final decisions on extension issues two years before the end of the existing regulatory revenue period is appropriate. As noted in our response to Question 6, this would cause adverse implications resulting from the uncertainty over future policy developments. The stated timeframe is not appropriate and should be addressed as soon as possible in order to drive the best behaviours and long-term incentive in respect of OFTO assets availability.

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?

TCP believes that more than one extension period is possible but, in order to provide best value, any period of extension should be for a minimum of 5 years.

Setting allowances over a 5-year period, still provides incentives on companies to plan, develop and to find innovative ways to reduce cost and improve performance whilst at the same time providing value for customers. Should the asset health review provide certainty on operations above a 5-year period then Ofgem should be open to setting allowances for certain projects over a longer period.

In addition, longer extensions are expected to provide an opportunity to arrange long term finance which will tend to drive better value for money for the consumer. For example, two 5-year period are expected to be more expansive to finance than one 10-year extension (e.g. arrangement fees).

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?

Although as part of Tender Round 3, Ofgem introduced new wording in respect of the OFTO regulated asset base at the end of the initial revenue, TCP believes that, in line with other regulated networks, the OFTO regulated asset base should take into account its useful economic life and not be arbitrarily set to nil. Whilst the majority of the notional OFTO regulated asset base would be amortised during the initial revenue period, the TRS level during the initial revenue period reflects the terminal value assumptions adopted by OFTO bidders and, in the case of TCP, transparently disclosed in all of its bids.

In TCP's view, following the end of the initial revenue period, the OFTO regime should naturally transfer to the RIIO price control cycles. The RIIO price control parameters (including RAB, cost of capital, capex, controllable opex etc.) should be considered using the OFTO assets useful economic life, remaining life, maintenance regimes and other structuring items supporting the critical nature of these network links (reserve accounts etc.)

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?

To determine an appropriate TRS after the initial revenue period, TCP would expect Ofgem to first collect formal notice from the wind farm owner/operator in respect of the envisaged maximum economic life of the generation assets as well as potential modification requirements to the OFTO assets in the event of reconfiguration of the wind farm. Such notice will naturally inform the length of revenue extension and potential capex required.

The cost recovery mechanism should be determined on a project by project basis and should - in respect of the term – be guided by the generation assets that the OFTO assets are connected to.

To determine an appropriate level of TRS, TCP would expect Ofgem to consider:

- Conditions of the OFTO assets as determined by the health review;
- The applicable cost of capital and level of investment required to continue maintaining and operating the OFTO assets in accordance with good industry practice;
- The cost of building an alternative transmission system;
- The level of risk transfer sought during the extension period (e.g. availability targets / operating risk and associated working capital for large repair);
- O&M and insurance costs for the extended period;
- Impact on decommissioning costs (if any – see our response to Question 16); and
- The starting transfer value (see our response to Question 13 below).

A co-ordinated plan for extending the life of the windfarm is expected to drive substantial savings to consumers. For that, Ofgem should consider making appropriate licence changes earlier than near the end of the current revenue period. If a longer life leads to a lower TRS than during the initial revenue period, the benefits could be shared by the windfarm owner and consumers (lower transmission charges), and the OFTO (a longer revenue period) with the ability to extend repayment of capital over the extended period.

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?

[Confidential response]

Q14 - what market value (if any) do you think the OFTO assets will represent at the end of the

It is by nature difficult to determine the market value of the OFTO assets without knowing whether the wind farm owner envisages any life extension of its generation assets. Nevertheless, the fundamental factors influencing OFTO assets market value after the initial revenue period are:

regulatory revenue period? What are the component parts of this value?

- OFTO's title over the onshore substation land and ownership of fixtures (i.e. transmission assets);
- The remaining term of the Crown Estate leases of the seabed;
- The perpetual nature of the offshore transmission licences;
- The costs of building a new transmission link to the wind farm seeking to extend its economic life or the replacement costs of a new renewable energy installations with similar output characteristics;
- Historical performance of the OFTO assets (e.g. availability track record); and
- The condition of the transmission assets (asset health / historical issue).

The incumbent OFTO's current approach to ongoing maintenance is also expected to have an impact on the market value. It could be expected that a retendering would lead to the destruction of the value that the OFTO regime has brought to the consumer

TCP believes significant cost savings benefiting the UK consumer can be achieved if a pro-active and joined up approach is adopted by all stakeholders well ahead of any extension.

Q15 – do you agree that decommissioning funds and liability should be transferred across in full to any new OFTO?

TCP does not believe transferring both decommissioning funds and liabilities to a new OFTO would create the right incentives at the time of the original tender of the transmission assets. Enabling such a transfer would create a perverse incentive for the first owners to minimise decommissioning funds so far as possible in the hope that the liability would be borne by the subsequent OFTO owner.

TCP notes that the Secretary of State/BEIS would need to consent to the transfer of the liabilities and hence this process should be undertaken only on a uniform and equitable basis.

Any new OFTO should be required to determine their own decommissioning plan, agree this with BEIS, provide suitable financial security, and indemnify the incumbent OFTO in respect of future decommissioning liabilities.

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?

TCP expects no material difference in the real decommissioning costs for existing assets following a period of extended operations. Should further investment be required, and new assets added to the existing OFTO then decommissioning costs may rise.

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?

TCP agrees that liabilities associated with the availability regime applicable during the initial revenue period should be settled at the end of the original regulatory revenue period.

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?

[Confidential response]

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?

It is not possible to precisely predict the state of the insurance market 10 years in the future. TCP sees no reason why LEG3/06 cover should not be available for assets which do not have a poor claims history, however the probability of seeking to claim for design, materials or workmanship defects 20+ years after initial asset transfer seems vanishingly small. TCP would therefore consider that LEG3 / design cover insurance should not be necessary on 20-year plus assets.

TCP also notes that the generic OFTO licence does in theory provide protection for latent defects of this type through the IAE term if they are uninsurable. However, the licence drafting in respect of events which would not fall into the definition of Force Majeure leaves too significant discretion to Ofgem as to whether to treat an event as an IAE or not. An underwriter would have much less discretion under an insurance policy on whether to pay out or not.

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?

See our response to Question 20.

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 comment.

Q22 - would operating the OFTO assets with minimal insurance to first failure be a viable option for higher risk assets with uncertain futures?

This would be a credible option but would require protection against uninsured events written into the transmission licence (see our response to Question 19 in respect of the protection required).

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?

[Confidential response]