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Dear Steve,

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

***About RWE***

RWE is a leading energy player with four main operating companies, of which three are active in the UK, including the newest subsidiary RWE Renewables, which is one of the world's leading renewable energy companies and the second largest offshore wind developer in the world.

In the UK, RWE employs over 2,600 people with a diverse operational portfolio of onshore wind, offshore wind, biomass, hydro and gas - generating enough electricity to power 10 million homes. The UK plays a key role in RWE's strategy to grow its renewables business and to become carbon neutral by 2040. This includes the Triton Knoll offshore wind farm currently in construction off the coast of Lincolnshire (857MW, RWE share 59%) and the Sofia offshore wind farm in development (1.4GW, RWE share 100%). RWE and its project partners also recently signed Agreements for Lease with the Crown Estate to extend the existing offshore wind farms Gwynt y Môr, Galloper, Greater Gabbard and Rampion. We were also recently successful in securing Preferred Bidder status for two further offshore sites amounting to 3,000MW in the recent Round 4 Leasing Round by The Crown Estate.

We have set our sights high, envisaging RWE will play a key role in developing the energy world of tomorrow and driving progress towards the UK's net-zero ambitions.

***RWE's response***

1. Generally it is noted that extending the life of existing wind farms could be a cost effective contribution towards net zero carbon emissions by 2050. However, the economic position of wind farms at the end of their life time will be marginal, as the market support mechanism period will have expired. It is

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crucial that the OFTO's allowed revenue only reflects the actual costs of extending the lifetime of the transmission assets, taking into account the wind farm economics at the time, and should not result in windfall profits for the OFTO.

2. It is noted that Ofgem's preference is to maintain a competitive process for the allocation of future regulatory revenues.
  - a. RWE would like to highlight that the OFTO is expected to have made the return assumed in their initial tender bid at the end of the initial licensing period. This will in particular include having repaid the loan that funded the capital investment. From an economic point of view, the transfer value has been fully repaid via the Local Offshore TNUoS charges paid by the generator. The basis for the Local Offshore TNUoS charging methodology is that it is cost reflective i.e. the charges paid by the generator are calculated to reflect the development and construction of the transmission assets. It follows that the only charges permissible for an extended licence term are operational costs and those required for maintenance and any necessary upgrade of the assets. It is not acceptable for a further TRS charge to include capital costs for an asset that has already been paid for.
  - b. A competitive process is inappropriate where there is limited price to be competed.
3. The business case for the wind farm will be marginal at the end of the initial TRS term and the technical feasibility / required level of investment will vary substantially between assets. Thus a flexible process is required on a site by site basis to enable the most cost effective outcome for consumers, OFTOs and generators.
4. It is the generator that bears the risk of any adverse economic consequences arising from an extension of the TRS term for the OFTO assets in relation to both the generation and OFTO assets. Whereas the OFTO receives an agreed revenue that covers extension related costs .
5. As the generator will ultimately pay for the investments into the OFTO assets, it should be involved in the approval of any investments to the transmission assets.
6. A holistic view will be required to enable efficient and aligned decision making regarding the future of both generation and transmission assets. A generator can only decide on investments into the generation assets if the lifetime situation of the OFTO assets is known.

### **Consultation questions**

- 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 alternative timelines and reasoning.**

RWE considers generators should be in the driving seat for life extensions, which apart from the technical capability will equally depend on the commercial situation – which will differ for each generating offshore wind farm. If a generator does not intend to extend the life of a wind farm, there is no point conducting a health review of that wind farm or its OFTO assets. Where a generator wishes to explore life extension options it is appropriate that it conducts the initial health review on the wind farm assets and that the subsequent OFTO health review aligns with the wind farm health review, addressing specific queries as required. We agree that it will be critical for generators to have access to the health review of the relevant OFTO assets to determine if they wish to proceed with a life extension.

As opposed to the OFTO asset health review commencing five years prior to the end of the initial TRS term, we consider both the wind farm and OFTO health reviews should be completed at least five years prior to the end of the TRS term. Asset life extension is a significant decision and where upgrading and/or replanting is proposed substantial lead time is required. The process should be flexible to allow for the particular needs of each wind farm.

Further, the earlier a decision is made on whether or not to extend the TRS term, OFTO maintenance strategies can be adapted/put in place to ensure the OFTO assets are maintained to achieve their full design life (which for some components, may have a design life of between 25 and 40 years).

- 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.**

The OFTO is a separate legal entity. The generator would have no legal right to conduct the review without the consent of the OFTO.

The generator will, however, require full visibility of the health review of the OFTO assets to decide if it wishes to invest in the generation assets. Thus, a

holistic view of the wind farm and OFTO assets will be required to enable efficient and aligned decision making.

To this end it would make sense that the same contractor is procured to conduct both the wind farm and OFTO health reviews. It is essential that the studies are coordinated so that the developer's concerns are addressed and it has the information it requires to make sensible decisions.

**Q3. Should generators pay for their own health reviews and those of the associated transmission assets? Please provide reasons for your response.**

Where the OFTO assets are to be transferred to the generator, we consider it appropriate that the generator conduct the health review of the transmission assets at its own expense. However, where the OFTO assets are to remain with an OFTO (and the incumbent OFTO will benefit from an extension to the TRS term) we consider the OFTO should fund the health review, which should be informed by the generator and Ofgem.

**Q4. What sort of confirmation/guarantee/representation of the intention to extend would developers envisage giving? What would this be subject to?**

The profitability of lifetime extensions is expected to be marginal and very much dependent on required investment levels at that point in time due to the market support mechanism periods having expired. Flexibility and close collaboration between the owners of the OFTO assets and wind farm assets is needed in order to jointly take lifetime extension decisions that align on timing and, in relation to the transmission assets, nature of works and level of expenditure. The generator needs to have the visibility of and input in such decisions to allow holistic decision making.

We would not recommend to have a fixed term for all extension periods, as the level of technical and commercial risk taken for such a term would differ between projects and the marginal business case would not justify taking substantial investment risks in some cases.

Any period of extension must be formally agreed and committed to by both the generator and OFTO, whether commercially, via the OFTO Licence or otherwise. We understand Ofgem's concern that any extension to the OFTO Licence provides a fixed TRS to the OFTO for that period whether or not the wind farm continues to generate. Similarly, the generator will have contractual commitments for any extension period (such as maintenance

contracts and PPAs) and therefore it is as essential that the OFTO is required to maintain and operate the transmission assets for the entire period of the agreed extension, including a requirement to repair any cable faults unless otherwise agreed.

**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 owner of the transmission assets should be responsible for any further investment required to enable the lifetime of the transmission assets to persist beyond the TRS period. This would be recovered under the allowed revenue for the extension period on a cost plus administration basis. However, upgrades must be distinguished from maintenance requirements, which must continue where the intention is to extend the life of the assets.

Notably, such a proposal lends itself to the incumbent OFTO remaining in situ for short periods of extension beyond the current TRS period.

Where significant investment is required, we consider the transmission assets should be transferred to the generator to upgrade the assets at its own expense, and to subsequently own and operate the assets.

If the works were undertaken by the OFTO, the costs would need to be economically and efficiently assessed by Ofgem and generators would require some form of indemnity, or a compensation mechanism in its licence equivalent to the Exceptional Event mechanism, where outages have resulted from the OFTO's failure to take steps consistent with good industry practice when upgrading the assets.

**Q6. Should the retender revenue period be extended with the incumbent OFTO, or licence retendered through open competition?**

As a matter of principle the process should be flexible to take into account specific circumstances on a case by case basis. Competition for competition's sake is unlikely to demonstrate good value for the consumer and so should be avoided where it does not represent the most efficient way to extend the life of the transmission and generation assets.

For shorter term extensions we consider in most cases it will be most efficient and cost effective for the incumbent OFTO to remain in situ. In such circumstances an allowed revenue calculated on cost plus administration

would be appropriate. To this end we note Ofgem's statement in the ITT documents that "Qualifying Bidders should assume the Regulatory Asset Value of the transmission assets at the end of the initial 20-year revenue term will be zero". In addition, running a tender exercise is costly (approximately £3m) and inefficient (takes two years) and therefore not in consumers interests for the majority of extensions and certainly not those that are five years or less.

Longer term extensions are likely to require more significant upgrades to the infrastructure and as the generator is best placed to do this we consider the transmission assets should be transferred to the generator to upgrade, own and operate. The cost of the development and construction of the transmission assets has been fully repaid by the developer via Local Offshore TNUoS at the end of the initial TRS term. This would be the most cost effective solution for consumers as it maximises extension opportunities at least cost.

**Q7. Do you consider that there is a threshold to be met to determine which approach to be taken (if there is 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?**

We do not consider there should be any explicit thresholds in the end of life policy as all projects should be taken on a case by case basis. There may be circumstances where an incumbent OFTO does not want to own and operate its asset beyond its agreed TRS term and/or where the generator does not want the OFTO to continue in light of its poor performance over the initial term where a tender exercise may be necessary. However, for the majority of cases we do not consider it will be cost effective to tender the transmission assets for a further TRS term irrespective of the length of the term or value of the TRS.

A tender exercise costs in the order of £3m and will take approximately two years. In addition there are substantial costs outlaid by the parties involved in the tender.

The purpose of a tender process is to obtain a competitive price. However, where the TRS for an extension period is based on costs plus an administration fee there is limited, if any, benefit to be gained from the tender process. It is likely to be an inefficient expense for consumers. Instead of a TRS, the OFTO should recover an "allowed revenue" for the additional period based on costs incurred plus an administration fee.

The incumbent OFTO is likely to want to exploit what it will perceive as residual value in the transmission assets. However, this is contrary to the direction contained in the Invitation to Tender documents issued by Ofgem to date, which state: “Qualifying Bidders should assume the Regulatory Asset Value of the transmission assets at the end of the initial 20-year revenue term will be zero”.

Further, generators will have paid in full for the transmission assets at the end of the initial TRS term via TNUoS at a price determined by Ofgem. It is neither fair nor reasonable to expect generators to pay for the same assets again, including freehold property and leases that exceed the initial TRS term. Such a policy would also be inconsistent with the Offshore Local TNUoS charging methodology, which is premised on cost recovery.

**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.**

As noted above, where retendering takes place it is not acceptable for generators to pay for the same assets twice. Thus, the assets must be transferred to the incoming OFTO at no cost, with the exception of any upgrading works that have been done for the purpose of enabling the lifetime of the transmission assets to persist beyond the initial TRS term and any new costs incurred.

The principle of the developer not paying twice includes in relation to land costs. Where freehold land, and leases and easements that exceed the initial TRS term, have been transferred to the OFTO, the full cost of these land transactions (including for the extended term) have already been paid for by the generator. The generator has had the forethought to procure the land to include the period beyond the initial TRS term, which will save the consumers millions of pounds, it is not acceptable for generators to pay for land costs again.

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

Ofgem proposes to run a further tender four years before the end of the initial TRS term and announce the successful OFTO two years before the end of the initial OFTO term.

Where a new OFTO is to be appointed there is the potential for a two year hiatus at the end of the initial TRS term where nothing is done on the aging transmission assets: the existing OFTO is not incentivised to maintain the assets beyond the initial TRS term and the incoming OFTO is unable to undertake any necessary upgrade work to maximise the efficient lifetime of the asset beyond the initial TRS.

Changing the OFTO is costly, inefficient, is potentially harmful for the operation and life of the assets.

**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?**

We consider that the duration of the transmission asset's operational lifetime beyond the initial TRS period needs to be flexible and will differ from project to project determined by the economic and asset conditions for each site. For some assets the lifetime extension will be based on substantial investments being undertaken, in which case a longer period needs to be granted. In other cases this will be a "drive by sight" strategy with potentially multiple extensions of shorter periods.

**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?**

We believe that the best mechanism will be a cost plus based approach, with the caveat that the generator must approve any substantial investments to the transmission assets as such investments directly impact the wind farm's economic case for extending the asset life. Only by this approach, we see it feasible to have a holistic decision making that maximises the lifetime of the wind farm whilst allowing economically efficient decision making. Other charging mechanisms might lead to inefficient decision making, where overall it would have been beneficial for the consumer to extend the lifetime, but due to the charging mechanism the generator might have to decide to decommission.

**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?**



On a project by project basis, as only this will allow efficient decision making and ensures maximising value to consumers.

**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?**

We would suggest that the regulatory revenues should be cost based, where the OFTO is making a proposal for an investment plan, which is reviewed by Ofgem and ultimately decided for by the generator (we expect the generator has to carry the costs via future Offshore Local TNUoS charges, so should be the ultimate decision maker). Any further regulated revenue period should be for recovery of an “allowed revenue” for the additional period based on costs incurred and an administration fee only i.e. the ‘building blocks’ approach.

**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?**

The entire investment of the OFTO has been repaid at the end of the licence period and the OFTO is expected to have made the return that its bid was based on. The assets will have been fully depreciated on the OFTO’s balance sheet and all loans will have been repaid. Going forward, the OFTO should be recompensed on the basis of costs incurred plus a cost based management fee and some form of availability mechanism is included to ensure the OFTO is appropriately incentivised/penalised for asset availability .

As noted above, the Local TNUoS Charging Methodology is based on the principle of cost reflectivity. It is unacceptable to pay for the same assets twice. The only residual value the transmission assets would have (with the exception of scrap metal and property) is if Ofgem allow for a secondary OFTO market. Such a market would be inconsistent with the Charging Methodology and the treatment of onshore generators.

**Q15. Do you agree that decommissioning funds and liability should be transferred across in full to any new OFTO?**

The funds need to sit with whichever party will ultimately be paying for the decommissioning. If a transfer of the assets takes place then the decommissioning funds and liabilities should be transferred in full, if agreed with both parties at the time.

**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?**

We expect the costs to be of a similar nature, as ultimately the main components remain the same. The only difference expected is from ongoing inflation, which might partly be offset by increased efficiency over time.

**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?**

Yes – any availability liabilities should be paid by the OFTO at the end of the original term. The life extension period should allow a reset as there would likely be a number of changes e.g. new revenue terms/liabilities etc.

Notably the OFTO Licence has a mechanism that provides for the accrual of funds during the remaining five years of the licence to ensure availability liabilities are covered. This mechanism should be used as intended for the initial licence term and included in any subsequent term, along with an availability mechanism for the OFTO to ensure it remains incentivised to maximise availability of the transmission assets. It is inappropriate to carryover liabilities for what are discrete revenue terms.

More generally RWE is concerned about the impact of Revenue Services Reductions during an extended licence term given that the assets are potentially less reliable and/or where the OFTO has failed to upgrade the assets as required. Under the current OFTO Licence, the OFTO is protected for outages that are beyond the reasonable control of the OFTO. In an extended licence term the responsibility for the availability of the transmission assets sits more squarely with the OFTO and where outages arise as a direct result of the OFTO's failure to take steps consistent with good industry practice, generators should be compensated for their loss revenue. This is consistent with other European regimes.

As noted above, RWE's preference is for the generator to take over the transmission assets where a life extension requires considerable upgrade or repowering of the assets and is for a longer duration. In such circumstances the liability and impact of the upgrade will remain with the generator, including insurance responsibility.

In addition, given the increased risk of Transmission Services Reductions for aging assets, the generator's preference is to manage the assets as it is best placed to mitigate the occurrence and duration of Transmission Services Reductions with local operations and maintenance teams.

**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?**

We are continuing to see a reduction in capacity offered in both the insurance and reinsurance markets creating an extremely challenging environment to place insurance. We are not aware of any instances of the reinstatement of LEG3 insurance for an OFTO and do not consider this is likely in the current market place.

**Q19. Noting the difficulty 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?**

This will be determined on a case by case basis. Relevant factors will include the results of the 'health report' on the particular assets, the claims history and market conditions more generally.

**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?**

Not all assets will have LEG3 insurance and therefore it would not be appropriate to prescribe LEG3 insurance as a minimum requirement. Any insurance requirements must contain sufficient flexibility to accommodate situations where the prescribed level of insurance is not available on all or part of the transmission assets on commercially reasonable terms.

Where insurance is not available on such terms, Ofgem must ensure that bidders have the financial ability to repair all faults that could arise on the transmission assets during the course of the OFTO's agreed extended term (including multiple faults). To this end bidders will need to hold appropriate reserves, loan facilities and/or obtain parent company guarantees to ensure they remain compliant with their OFTO Licence obligations including to provide transmission services and minimise the effect and duration of any Transmission Services Reduction. Ofgem is concerned with developers' commitment to generating for the full extended term but equally developers'

require an assurance that the OFTO will maintain and operate the transmission assets for the full extended period, including, as required, the repair of material faults.

Any assumption that developers will indemnify the OFTO for risks that would otherwise be covered by a LEG3 insurance policy, including latent defects, is unacceptable. Alternative arrangements must reflect standard commercial divisions of responsibility as noted at paragraph 3.8 of Ofgem's IAE Policy Decision document dated 28 November 2018:

*“The overarching premise of the offshore regime, in relation to the generator build model, is that the developer bears the risks associated with the construction of the transmission assets. In contrast, the OFTO is responsible for owning and operating the transmission assets from the point of asset transfer, and for the associated risks arising from ownership of the assets. The offshore regime was not designed to insulate OFTOs from all risks, such as a latent defect, that could be traced back to the construction of the assets.”*

**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?**

More detail is required in order to assess such an option. With a relatively small pool of OFTOs the cost may be seen as too high, particularly as OFTOs that are able to obtain LEG3 insurance are unlikely to participate.

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

Such terms would need to be agreed between the relevant parties on a case by case basis. Where the developer is required to invest in the wind farm assets to extend their life, such an option would not be acceptable. As stated at question 20 above, developers' require an assurance that the OFTO will maintain and operate the transmission assets for the full extended period, including the repair of material faults.

**Q23. Are you currently exploring or investigating any other potential models or approaches to insurance that may be appropriate for an OFTO asset during any further revenue period?**

No.

We would be happy to discuss our response.

Yours sincerely,

(by email)

Diane Mailer

OFTO Transaction Manager

RWE Renewables