

Consultation

Offshore Transmission Owner (OFTO) End of Tender Revenue Stream – 2nd Policy Development Consultation

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Following our end of tender revenue stream (**EoTRS**) consultation in March 2021, we are further consulting on the proposed positions in connection with the end of tender revenue stream policy for offshore transmission owners (**OFTOs**). We expect this will lead to a decision in Autumn 2022 setting out details of the OFTO extension process.

We are consulting on how the process of an extension to the regulatory revenue period should operate. We are seeking views from people with an interest in offshore wind, network coordination, and offshore coordination. We particularly welcome responses from consumer groups, charities, new entrants to the industry, other interested parties, and the public.

This document outlines the scope, purpose, and questions of the consultation and how you can get involved. Once the consultation is closed, we will carefully consider all responses. We want to be transparent in our consultation and will publish the non-confidential responses we receive alongside a decision on next steps on our website at [Ofgem.gov.uk/consultations](https://www.ofgem.gov.uk/consultations). If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

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Foreword

Great Britain currently has around 10GW of offshore wind generation connected to the electricity system. In March 2019, the government announced its ambition to put in place 30GW of offshore wind by 2030 as part of the Offshore Wind Sector Deal, and in October 2020 this ambition was raised to 40GW by 2030. Finally in 2022, a further 10GW (50GW total) has been added to the ambition of the UK Government. The Committee on Climate Change (**CCC**) has also indicated that to become a net zero economy could require 75GW by 2050.¹ The efficient delivery and operation of transmission assets for offshore wind projects forms a core part of the strategy for reaching these objectives in the most cost-effective manner.

The Department of Energy and Climate Change (**DECC**)² together with Ofgem³ developed a regulatory regime to facilitate the construction and operation of offshore transmission assets when it was an emerging sector. Under the regime, Ofgem runs a competitive tender process to select and licence Offshore Transmission Owners (**OFTOs**).⁴ Since establishing the legal framework in June 2009, we have awarded 23 OFTO licences, comprising a total investment of circa £6.8 billion in offshore transmission. The regime has been highly effective in driving competition to provide excellent value for money for consumers.

For each project to date, the offshore wind farm developer originally designed and built the associated offshore transmission assets. Following a rigorous tender process, they were transferred to the successful OFTO, which is responsible for the operation, maintenance and decommissioning of the assets in exchange for their tender revenue stream (**TRS**). The TRS is guaranteed for a fixed period, known as the regulatory revenue period; this is set when Ofgem grants the OFTO licence.

We are now considering the policy framework and process for the end of the regulatory revenue period, whether extensions to the regulatory revenue period should be granted, whether assets could be re-tendered, and the principles of establishing a new revenue stream. This consultation

¹ See: <https://www.theccc.org.uk/wp-content/uploads/2019/05/Net-Zero-The-UKs-contribution-to-stopping-global-warming.pdf>

² Now the Department for Business, Energy, and Industrial Strategy (**BEIS**).

³ The Office of the Gas and Electricity Markets Authority (the **Authority**) is the regulator of gas and electricity markets in Great Britain. Ofgem is the Office of Gas and Electricity Markets, which supports the Authority in performing its statutory duties and functions. For ease of reference, Ofgem is used to refer to Ofgem and the Gas and Electricity Markets Authority in this document.

⁴ This process is run by Ofgem under the Electricity Act 1989 (the **Act**) and regulations made under the Act which underpin the regime.

looks at the further elements to be considered in developing this policy framework and the processes we will need to establish. This consultation also builds on the policy decisions that have already been made by Ofgem and published in July 2021.

The scope of this consultation complements our ongoing work on the Offshore Transmission Network Review (**OTNR**) that was launched by the Department of Business, Energy and Industrial Strategy (**BEIS**) in July 2020. As part of that review, Ofgem is looking at whether and how offshore wind connections could be done with a view to finding the appropriate balance between environmental, social and economic costs. We recently closed the consultations on our minded to position for two work streams (Early Opportunities⁵ and Multi-Purpose Interconnectors (MPI))⁶ and are now reviewing the comments of stakeholders'. The consultation on our minded to position for a further work stream (Pathway to 2030⁷) is currently live on the Ofgem website. These are part of a programme of work in which we are considering what changes are necessary and appropriate to make to the existing frameworks to facilitate greater coordination in the interests of consumers. We do not consider that any of the proposals set out in this consultation would negatively impact upon our parallel work to develop coordinated infrastructure.

George Cobb, Head of OFTO Regime

⁵ [Offshore Coordination - Early Opportunities: Consultation on our Minded-to Decision on Anticipatory Investment and Implementation of Policy Changes | Ofgem](#)

⁶ [Offshore Transmission Network Review – Multi-Purpose Interconnectors: Minded-to Decision on interim framework | Ofgem](#)

⁷ [Minded-to Decision and further consultation on Pathway to 2030 | Ofgem](#)

Executive summary

The first round of offshore transmission licences tendered (TR1) will reach the end of their regulated revenue streams between 2030 and 2034. We expect some of the wind farms they connect will want to continue to operate for longer. As such, we have consulted on our EoTRS policy, and in July 2021 we published a first round of decisions on roles, responsibilities and timings.

The regulatory and commercial context for OFTO extension periods has similarities with our initial tender processes, but there are additional issues our EoTRS policy will need to address. We consider these issues justify new objectives specific to our EoTRS policy, building on our objectives for the OFTO regime as a whole. These new objectives have guided the proposals in this consultation and include: (i) maximising the operating life of transmission assets where it is economic and efficient to do so; (ii) securing balanced Transmission Network Use of System (TNUoS) charges for wind farms and consumers; (iii) ensuring good asset stewardship and conduct by transmission assets owners; and (iv) establishing proportionate EoTRS regulation.

Our EoTRS policy development is split into separate workstreams (generator extension initiation, offshore transmission asset health review, insurance and decommissioning) to allow interested parties to engage more effectively in specific areas of interest. This consultation focuses on the regulatory financial arrangements for the regime, addressing key topics in the following areas:

- use of competition to determine future OFTO licencees and regulated revenues;
- offshore transmission asset valuation; and
- design of performance incentives.

We are seeking the views of interested parties across these areas through targeted questions on the principles, approaches and policy options we set out.

Role of competition

Our OFTO tenders and regulatory framework have created value for money for wind farms and electricity consumers by using competitive tender processes to set regulated income streams for OFTOs. For extension periods, the context is different, and we have the options of setting regulated revenues through bilateral negotiation with an incumbent OFTO as well as launching

a competitive re-tendering process, similar to the process we adopt for new offshore transmission assets.

Competitively tendering the opportunity to own and operate the offshore transmission assets in an extension period could result in the assets and licences being transferred to a new successor OFTO. As a consequence, a decision on the appropriate transfer value from the incumbent OFTO is needed.

We believe that reserving the option to re-tender the transmission assets until after we have received a firm offer from the incumbent OFTO should help us secure best value for money. This approach will require us to be clear on the extension period's revenue model early in the EoTRS process and has implications for how we manage the flow of information between the generator, the incumbent OFTO and potential bidders in a tender process.

We propose to decide whether to launch competitive re-tenders on a project-by-project basis with a test to decide whether retendering of that offshore transmission asset is in the public interest (competition public interest test). The test will consider the potential for lower regulated revenues, but also the feasibility of running a successful tender process and impacts on the wider OFTO market. We are consulting on both the principles and the process for the proposed competition public interest test.

OFTO asset value

If a competitive re-tender is held and the incumbent OFTO is unsuccessful, the successor OFTO will need to pay the incumbent OFTO for the transmission asset. Ofgem will determine the transfer value of the transmission asset for an extended period.

We consider that, at a minimum, the EoTRS asset transfer value should seek to cover the net alternative value (**NAV**) of the tangible transmission assets in the absence of an extension. We also seek views on including the value of other transferrable assets and/or adjustment payments in the EoTRS asset transfer value, as well as payment structures.

Performance incentives

Under the current OFTO licences, OFTOs are held to an availability-based performance incentive which pays the TRS on meeting 98% availability, with penalties and bonuses applied where there is deviation below and above the target, respectively.

We consider it appropriate to adapt the current performance incentive to reflect the different context for offshore transmission asset owners in an extension period, including their asset health, remaining economic life and other considerations related to their regulatory financial treatment. As such, we are consulting how on we might refine the current single target availability-based approach for extension periods or potentially move towards a multiple target approach, similar to a balanced scorecard.

Areas for future consideration

The regulatory financial issues discussed in this consultation are central to our EoTRS approach but form just part of the process we outlined in July 2021. Other policy areas we will continue to develop separately to this consultation include: (i) the process for generators to request an offshore transmission asset extension; (ii) asset health review requirements; (iii) insurance requirements; and (iv) decommissioning arrangements. We have considered how issues in those areas may affect our proposals in this consultation, but we exclude their detailed development from the scope of this consultation. We will be seeking stakeholders' views on these aspects in over the next 6 months.

1. Introduction

- 1.1. Ofgem issued nine OFTO licences between March 2011 and November 2014 as part of our first transitional tender round (TR1). Eight licencees were awarded 20-year regulatory revenue periods; one licencee was awarded an 18.5-year period.
- 1.2. Four of the nine TR1 licencees have reached the halfway point of their regulatory revenue period, with the first expiring in 2030.⁸ As such, we are considering how to decide if extensions to the regulatory revenue periods ('extension periods') would be appropriate and how our supporting processes should work.
- 1.3. We issued our consultation on OFTO EoTRS policy in March 2021⁹ and first associated decision paper in July 2021.¹⁰ We are now looking to provide the next level of detail on the OFTO extension process.
- 1.4. Our EoTRS policy development is split into separate workstreams to allow different interested parties to engage more effectively. This consultation focuses on the regulatory financial arrangements for the regime, addressing key topics in the following areas:
 - use of competition to determine future OFTO ownership and regulated revenues;
 - OFTO asset valuation; and
 - design of performance incentives.
- 1.5. These regulatory financial issues are central to our EoTRS approach but form just part of the process we outlined in July 2021. Other policy areas we will develop separate to this consultation include: (i) the process for wind farms' initial OFTO extension requests; (ii) asset health review requirements; (iii) insurance requirements; and (iv) decommissioning arrangements. We have considered how issues in those areas may affect our proposals in this consultation, but we exclude their detailed development from

⁸ Barrow is the first OFTO is due to be the first project reach the end of regulatory revenue period. It was the third OFTO to be awarded a licence but was granted an 18.5-year regulatory revenue period, rather than the 20 years granted to other TR1 OFTOs.

⁹ [Offshore Transmission Owner \(OFTO\) End of Tender Revenue Stream – Consultation concerning policy development | Ofgem](#)

¹⁰ <https://www.ofgem.gov.uk/publications/end-tender-revenue-stream-decision>

the scope of this consultation. Section 6 provides more information on next steps in those areas.

Role of competition

- 1.6. In Section 3 of this consultation, we explain how we propose to use competition to secure a competitive extension offer from incumbent OFTOs and decide whether to use a competitive re-tender process to determine revenues and asset ownership for an extension period. We are seeking the views of interested parties through targeted questions on the approach we set out.

OFTO asset valuation

- 1.7. Ofgem will need to determine a financial valuation of the offshore transmission assets at the end of the initial regulatory revenue period to facilitate a possible asset transfer to a new owner which has been selected through a competitive re-tender process. We set out options for how we could approach EoTRS asset valuation in Section 4 and welcome feedback on what would be an appropriate approach.

Designing performance incentives

- 1.8. Section 5 presents additional work we have carried out to identify if it could be appropriate to change the OFTO performance incentive model for extension periods.
- 1.9. We are consulting on two alternative approaches that seek to ensure OFTOs in extension periods continue to meet agreed availability levels and fulfil their repair and maintenance obligations, while recognising potential changes in their operational requirements and wider regulatory financial framework. We are seeking feedback on these options and any other incentives that may be appropriate for the EoTRS regime.

Related publications

- 1.10. Respondents to this consultation may find it useful to refer to the related publications listed below:

OFTO Tender Process March 2018 Consultation For Future Tender Rounds

https://www.ofgem.gov.uk/sites/default/files/docs/2018/04/ofto_tender_process_consultation_for_future_tender_rounds.pdf

EoTRS March 2021 Consultation (<https://www.ofgem.gov.uk/publications/offshore-transmission-owner-of-to-end-tender-revenue-stream-consultation-concerning-policy-development>)

EoTRS July 2021 Decision Document (<https://www.ofgem.gov.uk/publications/end-tender-revenue-stream-decision>)

OTNR July 2021 Consultation (<https://www.ofgem.gov.uk/publications/consultation-changes-intended-bring-about-greater-coordination-development-offshore-energy-networks>)

OTNR April 2022 [Offshore Coordination - Early Opportunities: Consultation on our Minded-to Decision on Anticipatory Investment and Implementation of Policy Changes | Ofgem](#)

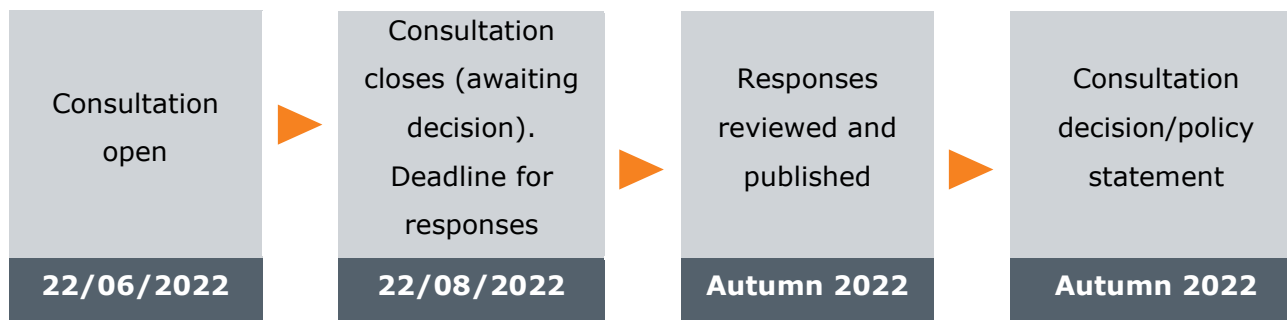
OTNR April 2022 [Offshore Transmission Network Review – Multi-Purpose Interconnectors: Minded-to Decision on interim framework | Ofgem](#)

OTNR May 2022 [Minded-to Decision and further consultation on Pathway to 2030 | Ofgem](#)

Consultation stages

- 1.11. This consultation closes on **22 August 2022**. All responses should be sent by this date to offshorelicensing@ofgem.gov.uk. We expect to publish summaries of the non-confidential feedback we receive and any updates on the issues covered in a further publication in **Autumn 2022**. We will continue to engage with the interested parties throughout this period and would welcome further bilateral meetings with interested parties.
- 1.12. Our expectation is that in **Autumn 2022** we will publish supporting guidance on the final end of tender revenue stream policy framework that we expect to use going forward for the OFTO extension process prior to the end of TRS for when OFTO licences reach the end of their tender revenue streams from 2030.

Figure 1: Consultation stages



How to respond

- 1.13. We want to hear from anyone interested in this consultation.
- 1.14. We have asked for your feedback in each of the questions throughout. Please respond to each one as fully as you can.
- 1.15. We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations.

Your response, data, and confidentiality

- 1.16. You can ask us to keep your response, or parts of your response, confidential. We will respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.
- 1.17. If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.
- 1.18. If the information you give in your response contains personal data under the General Data Protection Regulation (Regulation (EU) 2016/679) as retained in domestic law following the UK's withdrawal from the European Union (**UK GDPR**), the Gas and

Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations in Appendix 2.

- 1.19. If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

General feedback

- 1.20. We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:


1. Do you have any comments about the overall process of this consultation?
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. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Any further comments?

Please send any general feedback comments to stakeholders@ofgem.gov.uk

How to track the progress of the consultation

1.21. You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website. [Ofgem.gov.uk/consultations](https://www.ofgem.gov.uk/consultations).


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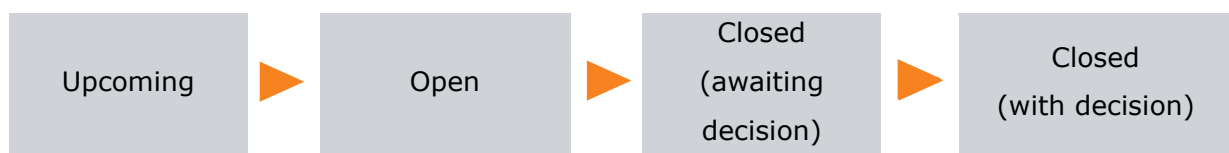
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Once subscribed to the notifications for a particular consultation, you will receive an email to notify you when it has changed status. Our consultation stages are:



2. Background, context and policy objectives

Section summary

The first round of offshore transmission licences we tendered will reach the end of their regulated revenue streams between 2030 and 2034, but we expect some of the wind farms they connect will want to continue to operate for longer. We have started consulting on our EoTRS policy, and published a first round of decisions on roles, responsibilities, and timings in July 2021.

The regulatory and commercial context for OFTO extension periods has similarities with our initial tender processes, but there are additional issues our policy will need to address. We consider those issues justify new objectives specific to EoTRS policy: (i) to maximise the operating life of the transmission assets where it is economic and efficient to do so; (ii) securing balanced TNUoS charges for wind farms and consumers; (iii) ensuring good asset stewardship and conduct by transmission assets owners; and (iv) proportionate EoTRS regulation.

- 2.1. Since launching the OFTO regime in 2009,¹¹ we have run tendering processes to transfer wind farms' offshore transmission assets to successful bidders. As part of that process, Ofgem has determined sale prices (transfer values) for transmission assets based on forensic assessments of development and construction costs, and interest during construction (**IDC**) assessments. Tender Revenue Stream (**TRS**) bids (together with a robust assessment of financial and technical capability) have been used in our competitive tender processes to identify a successful bidder, who will own and operate the tendered asset, and set their regulated revenue stream for a fixed duration, known as the regulatory revenue period.
- 2.2. As the offshore transmission assets approach the end of their regulatory revenue periods, we will decide if an extension period is justified. We will also determine via the end of tender revenue stream process who should own and operate the offshore transmission assets and what level of regulated revenue they will be entitled to.

¹¹ Ofgem (2009), Pre-Qualification Document 2009 Transitional Tenders, July.

- 2.3. The ownership of the transmission assets and their existing regulated revenue streams will have been determined as part of one of our earlier competitive tender processes, however, we may need a different approach for extension periods, potentially one that allows more case-by-case customisation.
- 2.4. In this section we summarise: (i) key aspects of our July 2021 EoTRS decision paper that set the framework for the issues discussed in this paper; (ii) our understanding of key contextual issues that our EoTRS approach must consider; and (iii) our proposed objectives for the EoTRS policy outlined in this consultation.
- 2.5. We welcome feedback on whether there are any further regulatory or commercial issues we should consider as part of developing our policy in this area, or whether we should revise our proposed EoTRS policy objectives.

Policy background

- 2.6. We consulted on our EoTRS approach in March 2018, setting out two broad options that could apply where the generator wishes to continue generating beyond the OFTO's regulatory revenue period:¹²
- extend the revenue term of the incumbent OFTO with a new revenue stream based on the costs relating to operating the offshore transmission assets after the end of the TRS; or
 - re-tender the offshore transmission assets for an additional regulatory revenue period.
- 2.7. Following that consultation, we decided to extend the default regulatory revenue period from Tender Round 6 (**TR6**) onwards from 20 years to up to 25 years and stated we would take forward EoTRS policy as a future area of work where we would consult as appropriate.¹³ We launched a full consultation on EoTRS policy development in March 2021.¹⁴

¹² Page 32, Ofgem (2018a), OFTO Tender Process – Consultation for Future Tender Rounds, March.

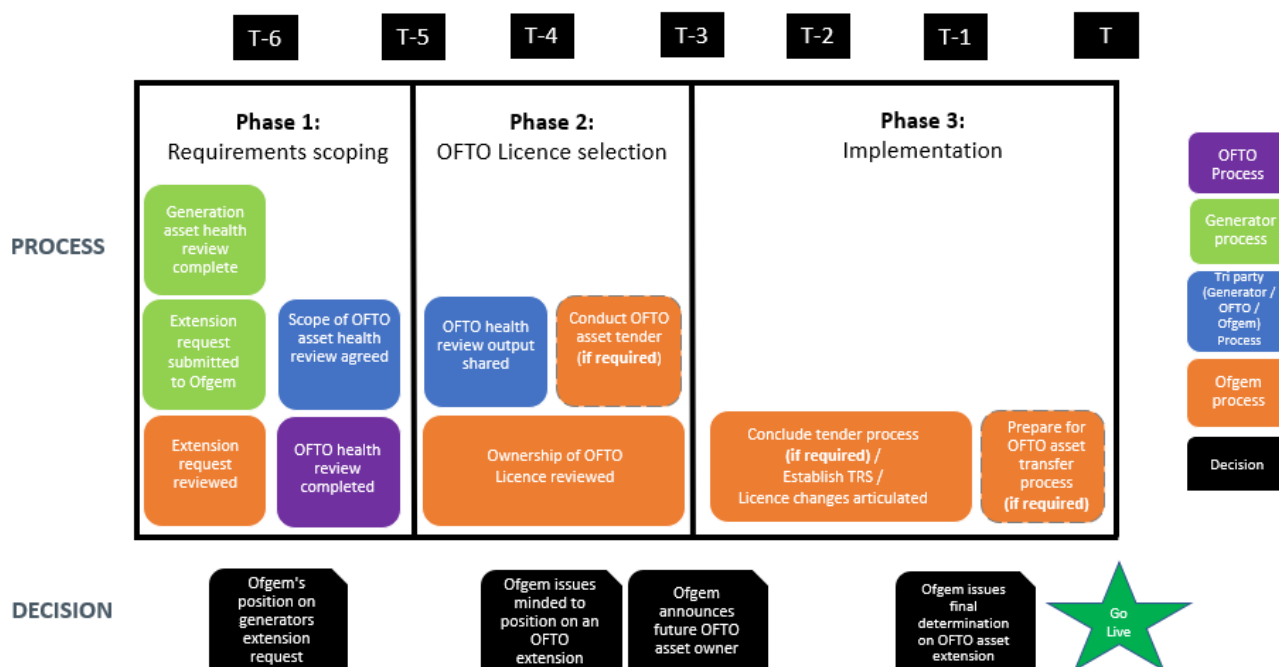
¹³ Page 26, Ofgem (2018b), OFTO Tender Process Changes for Future Tender Rounds implemented for Tender Round 6 onwards – Decision, November.

¹⁴ [Offshore Transmission Owner \(OFTO\) End of Tender Revenue Stream – Consultation concerning policy development | Ofgem](#), Offshore Transmission Owner (OFTO) End of Tender Revenue Stream – Consultation concerning policy development, March

2.8. The March 2021 EoTRS consultation raised questions about the introduction of an extension period and associated extension revenue stream (**ERS**). That consultation was followed by a first decision document in July 2021 with an initial round of policy decisions to clarify roles and guide planning.¹⁵

2.9. The July 2021 decision document set out the high-level timeline for the EoTRS process, covering at least seven years before the end of any regulatory revenue period. Figure 1 below reproduces the timeline shown in that document.

Figure 1: OFTO Extension Timetable with Phases



Source: Page 10, Ofgem (EoTRS Decision July 2021), adapted

2.10. The timetable shown in Figure 1 above can be split into three main phases:

Phase 1: Requirements scoping (5-7 years before regulatory revenue period ends)

- The extension process starts with a request from the generator accompanied by an asset health review of the generation assets.

¹⁵ <https://www.ofgem.gov.uk/publications/end-tender-revenue-stream-decision/>, End of Tender Revenue Stream First Decision Document, July.

- Ofgem must receive the extension request in time to review it and publish a position on it at least six years before the regulatory revenue period ends.¹⁶
- If Ofgem approves the extension request, it will direct the OFTO to commission a transmission asset health review to be completed no later than five years before the regulatory revenue period ends.
- The health review of the offshore transmission assets will be provided to the generator for comment and to inform its decision to continue in the extension process.
- The OFTO will be reimbursed through the licence for the economic and efficient costs incurred in completing the transmission asset health review. The OFTO may also claim for availability lost as a direct result of carrying out the review.¹⁷

Phase 2: OFTO licence selection (4-5 years before regulatory revenue period ends)

- Once transmission asset health reviews are complete, Ofgem will determine whether there will be a competition based on objective criteria and issue a minded-to position on the extension period.
- Ofgem's minded to position will cover a decision on whether or not a competitive tender process will be used to determine the OFTO licensee and owner of the offshore transmission assets. At this point Ofgem may also decide that no extension will be granted and decommissioning of the offshore transmission assets is more appropriate.
- Ofgem will issue a minded-to position on the extension no later than four years before the end of the regulatory revenue period.
- Following the consultation on the minded-to position, Ofgem will, either run any necessary tender process and announce the preferred bidder for the OFTO licences or agree an extension revenue stream with the incumbent OFTO, no later than three years before the initial regulatory revenue period ends

Phase 3: Implementation (last 3 years before regulatory revenue period ends)

- Following the notification of the future preferred bidder for the OFTO licences, Ofgem will establish the applicable regulated revenue stream and draft the necessary licence changes. Such changes may include, but not be limited to, updates to the 'Closing Relevant Year' definition, revisions to the allowed revenue formula and definition of any new performance incentives and/or cost adjustments.¹⁸ A similar process will also be adopted by Ofgem when the outcome is for an incumbent OFTO to retain the licences in the extension period.

¹⁶ We will provide guidance on the timeline for the extension request process separate to this consultation.

¹⁷ A consultation will be published shortly to modify OFTO licences to facilitate these changes.

¹⁸ The content and process of necessary licence changes for an extension period will be considered by Ofgem in the future, separately from this consultation.

- We will issue a final determination (successful bidder) on the OFTO asset extension at least one year before the end of the regulatory revenue period. The extension licence provisions will come into force at the end of the initial licence period.
- In the final year of the regulatory revenue period, Ofgem will ensure all arrangements are in place if a transfer of transmission assets to a new OFTO licence is required.

2.11. The July 2021 decision document also included a further set of decisions:

- Each revenue extension decision will be made on its own merits in conjunction with the relevant generator. There will be no fixed minimum or maximum threshold for the length or regulated revenue level value for an extension, however there may be shorter lengths that would not meet the objectives that Ofgem considers as part of the extension decision. Multiple extension periods may be allowed.
- Ofgem will set the extension period regulated revenue stream on a project-by-project basis depending on the specific extension requirements of the generator, including risk, the asset health review and costs associated with extension.
- If investment is needed to facilitate an extension, it will be deferred to the extension period, if possible. If such investment cannot be deferred until then, the investment should be made by the incumbent OFTO, which would be reimbursed through the licence for the economic costs incurred beyond the scope of the existing TRS. The lost availability as a result of carrying out the investment works may also be claimed through the licence.
- Incumbent OFTOs must settle any availability liabilities at the end of the original revenue term before withdrawing any funds from the performance reserve.

2.12. This consultation paper seeks to build on those decisions and address certain questions from the March 2021 EoTRS consultation where we did not present a final decision in July 2021.¹⁹

¹⁹ Appendix 1 of the July 2021 decision paper provides an overview of the questions from the March 2021 consultation where a decision had been made or if the issues remained open.

Regulatory and commercial context

2.13. The main regulatory and commercial context for an extension period may be complex. We highlight below a selection of points that we consider relevant for our EoTRS policy to consider specifically:

- consumer underwriting of OFTO revenues;
- wind farm commercial viability;
- wider impacts on the OFTO regime; and
- creating an investable EoTRS asset class.

2.14. We briefly discuss each point in turn, explaining its relevance for our EoTRS approach.

Consumer underwriting of OFTO revenues

2.15. OFTO licencees receive their regulated revenue streams from the National Electricity Transmission System Operator (**NETSO**). They do not contract directly with wind farms. The NETSO funds those payments with transmission network use of system (**TNUoS**) charges following an Ofgem-approved methodology set in the Connection and Use of System Code (**CUSC**).²⁰ TNUoS charges are made up in a large part by payments made by generators through £/MW 'local' charges. The remainder is from 'residual' charges that suppliers recover (and pay to NETSO) from customers' bills. Therefore, the connecting generator indirectly funds the majority of the TRS.

2.16. This charging allocation is set out in network codes and may need to be adapted for an extension period. However, if they remain substantially unchanged, Ofgem will have an important role in protecting consumers' interests by ensuring the ERS levels represent value for money. Ofgem will also need to ensure extension periods have an appropriate duration, recognising that generators' interests may not always fully align with those of consumers.

²⁰ The CUSC is the contractual framework for connecting to and using the National Electricity Transmission System (NETS).

Wind farm commercial viability

- 2.17. Commercial viability of wind farms will be an important consideration for the EoTRS process. For an EoTRS extension process to be worthwhile, we will need to be confident the generator will continue to operate during the extension period and expect generators to only make extension requests where they can reasonably demonstrate the ongoing commercial viability of the offshore wind farm.
- 2.18. All wind farms requesting an extension will have paid local TNUoS charges based on the incumbent OFTO's TRS. However, the context for wind farm commercial viability is different at the point of extension: (i) debt raised to finance the construction of wind farm assets should have already been repaid;²¹ and (ii) renewable energy support schemes which supported wind farm commercial viability during the initial regulatory revenue period will have come to an end.²² As such, we will need to consider how our EoTRS approach affects wind farms' decisions to continue commercial operations and what other factors may affect that decision.

Wider impacts of EoTRS policy on the OFTO regime

- 2.19. Ofgem has been clear for each OFTO competitive tender that any bidder assumption regarding residual value at the end of the initial regulatory revenue period is entirely at that bidder's own risk.
- 2.20. Our EoTRS policy decisions should help to clarify what our future treatment of the transmission assets will be and accordingly affect the potential residual value at the end of the initial regulatory revenue period. As such, we will need to consider how our decisions in this area might affect future TRS bid levels and incumbent OFTOs' asset management strategies as they approach the end of their initial regulatory revenue periods.

²¹ Pre-development and construction costs will have represented the majority of the wind farm's levelised cost of energy. For example, see the BEIS estimates of the cost breakdown for future offshore wind projects on Page 26, BEIS (2020), Electricity Generation Costs, August.

²² The earliest offshore wind farms were supported by the Renewable Obligation Certificate (**ROC**) scheme, lasting 20 years; later projects have secured 15-year Contracts for Difference (**CfD**).

Legal basis for asset transfer

- 2.21. Under the 'Generator-build' model, ownership of the transmission assets starts with the wind farm that designs and builds them. We then facilitate the transfer of ownership of the transmission assets from the generator to the successful bidder in a competitive tender process under the Electricity Act 1989.
- 2.22. We will review prevailing procurement law and regulation as part of any decision to launch a competitive re-tender process and if an asset transfer to a successor OFTO is required at the end of the initial regulatory revenue period, we will ensure that process complies with all relevant legislation. We will also need to ensure clarity on the scope of property, rights and liabilities that will be transferred, and what will not.

Investability of the EoTRS asset class

- 2.23. We are considering how we can use competition to improve value for money of the regulated revenues needed to support ongoing transmission asset availability.²³ To ensure adequate interest in competitive re-tendering, we intend to create a regulatory framework that could attract new investors to the sector.
- 2.24. Transmission assets in an extension period have the potential to become a new investment asset class of their own. However, that may require changes to the regulatory and commercial arrangements that have to date made the initial offshore transmission assets highly investable.
- 2.25. The OFTO regime has been effective in attracting highly competitive offers from a range of bidders, but we recognise that new approaches in the future may be needed to ensure an appropriate allocation of risk and reward between incumbent OFTOs, potential competitors, wind farms and electricity consumers.

²³ Ofgem will consider the design of the competition at a later date. This may involve adaptations to the existing model (e.g. single versus multiple stage process), as well as rules around participation, with a view to deliver an efficient process for both Ofgem and participants whilst maximising the investability of the offshore transmission assets in an extension period.

Policy objectives

- 2.26. Our objectives of the OFTO regime, in running competitive tenders for OFTO licences are to: (i) deliver transmission infrastructure to connect offshore generation on a timely basis; (ii) ensure OFTOs are robust and can deliver transmission services successfully over the licence period; (iii) provide certainty and best value to consumers through the competitive process; (iv) attract new entrants to the transmission sector; and (v) undertake streamlined and efficient tender processes.²⁴
- 2.27. We will apply those objectives to EoTRS policy, where relevant. However, we propose to supplement them with four further objectives to reflect the regulatory and commercial context for EoTRS determinations:
- (i) **Maximise the operating life of transmission assets where it is economic and efficient to do so.** We want to ensure regulation allows the transmission assets to continue be available to transmit wind farms' low carbon electricity output to market until it is better for those assets to be decommissioned or put to a different use.
 - (ii) **Value-for-money TNUoS charges for wind farms and consumers.** In securing the ongoing use of the transmission assets, we want to ensure regulated revenues continue to be based on the economic and efficient cost of delivering transmission services.
 - (iii) **Good asset stewardship and conduct by transmission assets owners.** We want to ensure incumbent OFTOs manage their assets responsibly, whether they are retained or where assets will be transferred to a successor. We will monitor each extension transaction and offshore transmission project to ensure that there is no evidence of anti-competitive behaviour and/or breaches of licence obligations. We will also take very seriously any indication of behaviour by any party that seeks to hinder the effectiveness of the EoTRS process to the detriment of our policy objectives or electricity consumers' interests.²⁵

²⁴ Page 5, Ofgem, End of Tender Revenue Stream First Decision Document, July.

²⁵ Ofgem has concurrent powers with the Competition and Markets Authority (CMA) under the Competition Act 1998 and consumer protection laws. We also have powers under the Enterprise Act 2002 to conduct market studies or to make a market investigation reference to the CMA where we have reasonable grounds for suspecting that any feature or combination of features prevents, restricts, or

- (iv) **Proportionate EoTRS regulation.** We want to ensure our work focuses where it will have the most impact, considering the direct and indirect costs of regulation.

2.28. We have used these four objectives to inform the EoTRS proposals set out in the remaining sections of this consultation.

Questions

Question 1: Have we captured the regulatory and commercial context for EoTRS policy appropriately? Are there other key contextual issues we need to bear in mind?

Question 2: What are your views on the EoTRS policy objectives we propose? Are they appropriate in the context of the decisions we propose to take?

distorts competition in the gas and electricity markets. See page 7, CMA and Ofgem (2016), Memorandum of understanding between the CMA and the Gas and Electricity Markets Authority – concurrent competition powers, January.

3. Role of competition

Section summary

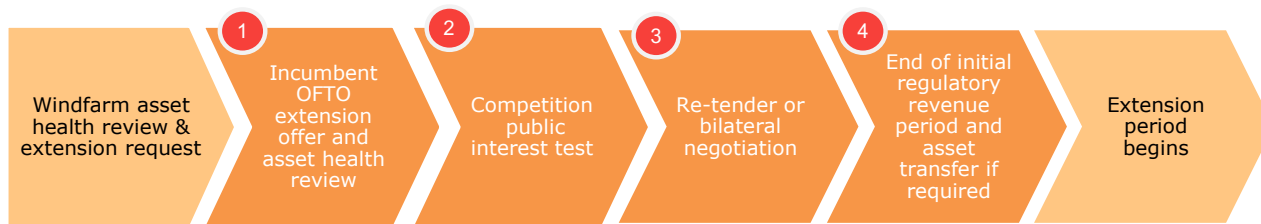
Our OFTO tenders and regulatory framework have created value for money for wind farms and electricity consumers by using competition to set OFTO regulated revenues.

For extension periods, Ofgem would set regulated revenues for an incumbent OFTO. However, we believe that maintaining the option to re-tender the transmission assets until after we have received a firm bid from the incumbent OFTO might help us secure best value for money.

We propose to decide whether to launch competitive re-tenders on a project-by-project basis with a 'competition public interest test.' The test will consider the potential for lower regulated revenues, but also the feasibility of running a successful tender process and impacts on the wider OFTO market.

- 3.1. Since launching the OFTO regime, we have used competitive tender processes to appoint OFTO licencees and set regulated revenue streams. However, for extension periods, we have the choice of either allowing the incumbent OFTO to continue with an amended ERS or launching a new competitive tender to determine whether the transmission assets should be transferred to a new licencee.
- 3.2. We expect all incumbent OFTO owners to be suitably positioned to continue to operate and maintain the transmission assets during any extension period. However, we consider that in some situations competitive tendering (or the ability to initiate such a process) may help secure better value for money for wind farms and electricity consumers.
- 3.3. We propose to achieve that outcome by following the approach outlined in this section and the EoTRS process characterised in Figure 2 below, which seeks to maintain pressure on incumbent OFTOs to make competitive extension offers from the start of the EoTRS process.

Figure 2: Role of competition in the EoTRS process



3.4. In this section we set out the basis for using competition in the EoTRS process and provide further detail on the ‘competition public interest test’ we propose to conduct if we receive an incumbent’s extension bid.²⁶ This process allows us to maintain the option to test incumbent bids through open competition, and to transfer the OFTO licences to a successor if they can bid better value.

3.5. We are seeking the views of interested parties through targeted questions in relation to the principles and proposals set out below.

Basis for competition

3.6. Maintaining the option to launch a competitive tender process offers a powerful consumer protection tool in the EoTRS regime. The benefit of that approach may be even greater if it encourages competitive offers from incumbent OFTOs from the outset.

3.7. To achieve that outcome, we expect to run an EoTRS process where we:

- clarify the ‘revenue model’ for the extension period early in the process;
- request the incumbent OFTO to submit a bid we could later test through a competitive re-tender process; and
- facilitate appropriate information flow between the incumbent, market entrants and the related wind farm.

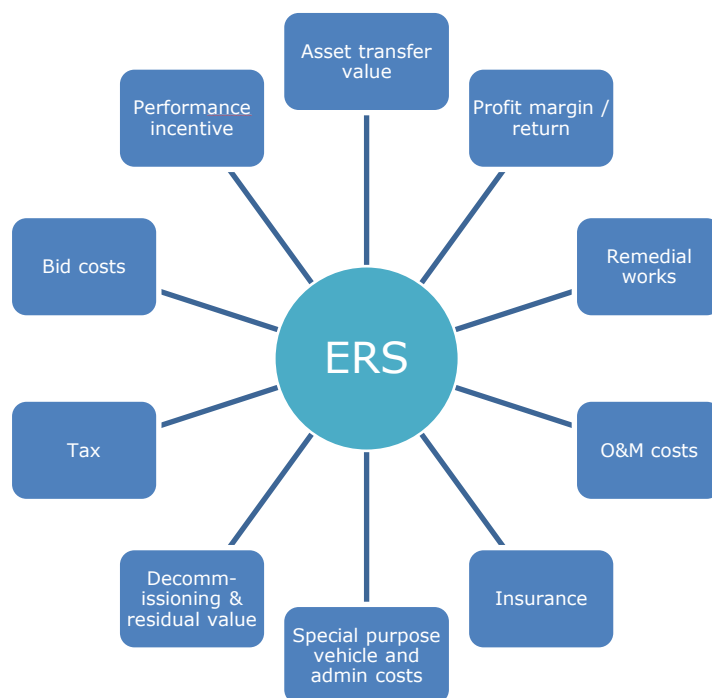
3.8. We discuss these requirements below.

²⁶ If no incumbent offer is received and the asset health reviews of generation and transmission assets can facilitate an extension, Ofgem will consider the merit and benefit of moving directly to a competitive process for the OFTO licences rather than the alternative of decommissioning operational assets.

Revenue model selection

3.9. Figure 3 below shows the main factors we expect to drive the level of the ERS.

Figure 3: ERS drivers



3.10. Bilateral negotiation with the incumbent OFTO will be our initial default approach for Ofgem setting the ERS. We will request an incumbent OFTO bid based on a regulatory model determined by Ofgem, which will be the basis for setting the regulatory allowances by Ofgem. Ofgem will determine the regulatory model on a project-by-project basis, following predominantly a 'cost-based' approach that addresses the areas highlighted above in Figure 3.²⁷

3.11. Regulatory allowances may be set up front for the duration of the extension period (an 'ex-ante' approach), or more regularly based on efficiency reviews of costs incurred in the extension period (an 'ex post' approach).

²⁷ Ofgem will seek to utilise the 'cost-based' approach for the majority of elements to be included in an extension bid but due to the length of time a bid may be held for by an incumbent, certain elements may be better established via an alternative regulatory cost process (Cost plus or profit margin / return)

- 3.12. Both ex-ante and ex-post approaches could be compatible with competitive tenders. For example, the current OFTO tenders take the former approach, with bidders proposing fixed TRS bids²⁸; our regulation of the Smart Meter Communication Licence takes the latter approach, with bidders proposing profit margin requirements in an incentive framework where Ofgem determines cost allowances that can be recovered from regulated revenues through an ex-post review.²⁹
- 3.13. We may be able to apply a range of approaches for setting revenues, even for different cost components of a single project, but we envisage that the approach will need to be clear ahead of requesting the incumbent OFTO to submit a bid, and certainly before launching any competitive tender process. Where a competitive tender process is launched the bids submitted by the incumbent OFTO and possible prospective owners should, as far as possible, be based on the same chosen revenue model and transfer value³⁰ to ensure a fair basis for choosing the future asset owner.
- 3.14. The revenue model we adopt should ideally be suitable for the incumbent OFTO to reasonably hold its offer through to the start of any extension period. Holding the incumbent OFTO's offer firm over that period avoids needing to invite it to present an updated bid after the point competition for the market has been ruled out. However, it will be important that this is done in a way that does not expose the incumbent OFTO to a level of risk that it could not reasonably manage.
- 3.15. In that context, we expect there may be a role for:
- cost-plus approaches (e.g., where offers include a proposed profit margin on costs later assessed by Ofgem); or
 - pre-defined uncertainty mechanisms for updating revenue stream bids in the EoTRS regime (e.g., where certain cost categories are updated mechanistically based on published cost indices or only after outturn costs move outside a defined range).
- 3.16. Such approaches may be important because of the incumbent OFTOs' ability to adapt to uncertainties that arise during the EoTRS process (or even during the extension period)

²⁸ Subject to indexation

²⁹ See Ofgem (2021), DCC Price Control: Processes and Procedures, June.

³⁰ Transfer value will be discussed in detail in the next section. Ofgem will determine the asset transfer value that is to be used as part of the competitive tender process.

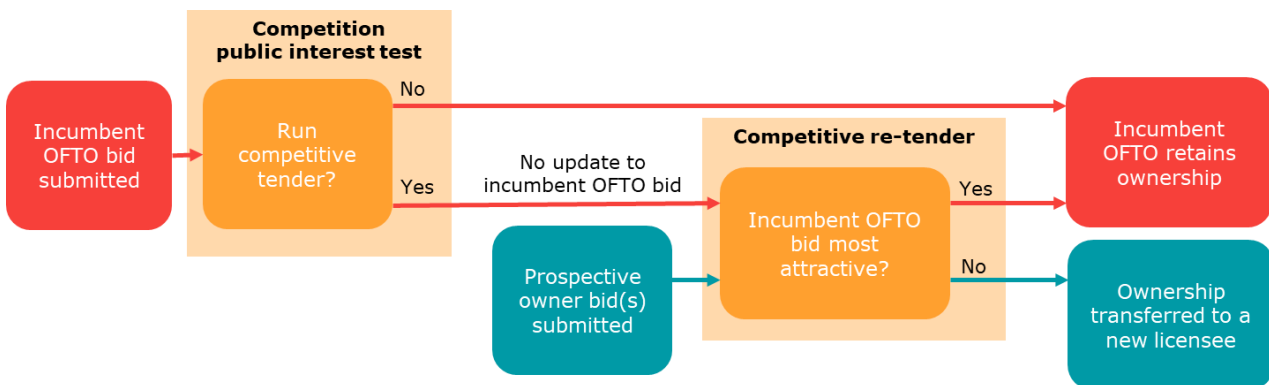
and may improve the ability of the incumbent OFTO to hold firm other aspects of its offer (e.g., profit margin/return).³¹

Competitive tension

3.17. We propose to follow an approach that would use competitive tension to encourage the incumbent OFTO to make an attractive extension bid from the start³². To do this, we propose to: (i) invite the incumbent OFTO to present its extension proposal before our competition public interest test; and (ii) place strict limits on the incumbent OFTO updating its offer (e.g., only as part of a BAFO or for certain cost items affected by a material change in circumstances).

3.18. Figure 4 below illustrates the sequence for how our proposed approach might work.

Figure 4: EoTRS bidding sequence and routes to ownership



3.19. We consider that the approach outlined above could be effective because if the incumbent OFTO does not put forward a competitive offer, it faces the risk that we launch a re-tender process and find a better offer and transfer the assets to a successor. It also gives us the option to avoid running a potentially costly competitive re-tender process.

3.20. Because the incumbent OFTO would not yet know if we will test its offer in an open competition, we can use its offer to improve our position in bilateral negotiations should

³¹ We discuss exceptional events later in this section (paragraph 3.25).

³² The additional costs for the incumbent OFTO holding their bid for a longer period of time will be considered separately to ensure a fair comparison can be made between the incumbent bid and competitive bids received for the tender.

we determine not to launch a competitive re-tender process. Holding the incumbent to its initial offer as far as possible maintains the benefits of competitive tension once it is no longer credible to re-tender.

Information flow

- 3.21. We will seek to secure the transparency needed to run a fair competitive re-tender process and obtain access to more than a decade of operating records for the transmission assets. Ofgem will work with the incumbent OFTO to recover economic and efficient costs in providing the required information in a secure data room format.
- 3.22. Comprehensive asset health reviews are a key requirement for information transparency. We consider it necessary that the manner of commissioning and scope of such reviews does not inhibit their accuracy, comprehensiveness or transparency and will be closely monitored and scrutinised by Ofgem.
- 3.23. As we develop the detail of our EoTRS process, we will need to consider carefully:
- (i) if the incumbent OFTO's extension offer should be delivered alongside its asset health review, or shortly thereafter; and
 - (ii) how to treat the prospect of additional relevant information becoming available after asset health reviews are published.
- 3.24. Requiring the incumbent OFTO to submit its extension offer alongside or shortly after its asset health review will help ensure the two are aligned. This could be important for creating a level playing field between the incumbent OFTO and potential competitors in a re-tender process as the asset health review would be a key document forming the basis of third parties' understanding the present and future health of the OFTO assets.
- 3.25. Preventing the incumbent OFTO from revising its extension offer once a competitive re-tender process has been launched helps ensure its offer is as strong as possible from the start. However, it should also help ensure changes to its offer are not influenced by private information on the health of the transmission assets that emerges after the asset health review but is not shared with others. We will need to consider in what cases it could be appropriate to allow for updates, including how to consider public domain information that arises following the asset health review; for example, related to an exceptional event claim.

Questions

Question 3: What are your views on our proposed approach to use competition to improve the value-for-money of ERS offers?

Question 4: Are there any specific issues we should consider when considering the ERS drivers outlined in this section?

Question 5: Do you agree that we should define the extension period revenue model before requesting the incumbent OFTO's extension period offer? What will be the most important aspects to confirm? What could be left to later?

Question 6: How long is it reasonable to expect the incumbent OFTO to hold its extension period offer valid? How might we adapt our approach to extend that period or ensure the incumbent OFTO is not exposed to unmanageable risk?

Question 7: Should we consider the use of cost-plus methods or pre-defined uncertainty mechanisms to help extension period offers remain valid? What should we consider when designing any such arrangements?

Question 8: What are your views on asking incumbent OFTOs to hold their extension offers throughout a competitive re-tender process? If we did not do that, how could we ensure incumbent OFTOs present the most attractive extension offer possible?

Question 9: What arrangements would we need to put in place to ensure we can compare on a fair basis the incumbent OFTO's extension offer and those received from other parties in a competitive re-tender process?

Question 10: In what circumstances would it be appropriate to invite the incumbent OFTO to update its extension offer? When might a best-and-final-offer ('BAFO') invitation be appropriate?

Question 11: What measures should we take to ensure incumbent OFTO extension offers are aligned with the findings of their asset reviews?

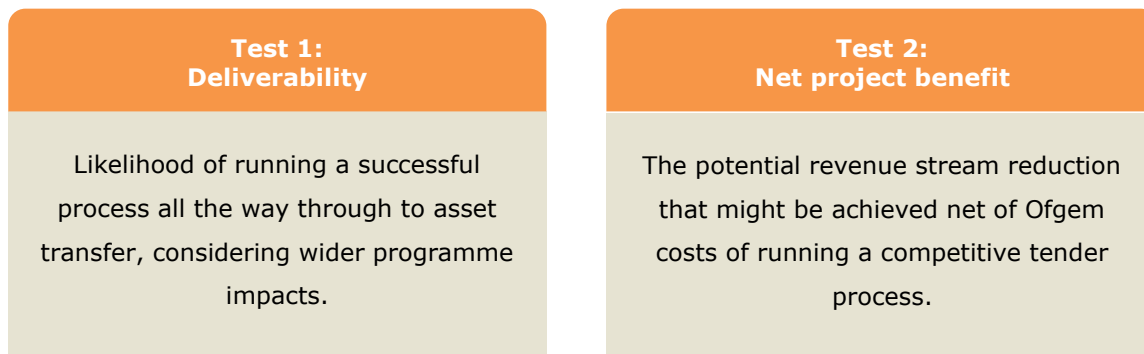
Question 12: What information might it be suitable (or unsuitable) to share between the wind farm, incumbent OFTO or participants in a competitive re-tender process?

Competition public interest test

3.26. Contestability is an important feature of the current OFTO regime. However, as described in Section 2, we recognise that the context of tenders relating to an extension period is different to those we run for the initial regulatory revenue period. As such, we propose to decide whether to launch a competitive re-tender process based on a 'competition public interest test'.

3.27. As shown in Figure 5 below, we intend to base our competition public interest test on two assessments.

Figure 5: Competition public interest test assessments



3.28. We explain each assessment in further detail below.

Test 1: Deliverability assessments

3.29. Our first proposed assessment in the competition public interest test is to assess the likelihood of running a successful competitive re-tender process all the way through to asset transfer.

3.30. We will take steps to strengthen the deliverability of our competitive re-tender processes. Nonetheless, we consider this assessment to be important as the re-tender process may have significant costs associated with it, as well as wider implications for future extension tender processes and incumbent OFTO's asset management practices.

3.31. To assess the likelihood of running a successful process through to the appointment of preferred bidder we expect to run early soft market testing with other OFTO licencees and potential market entrants to gauge their interest. We recognise that participation in competitive tender processes is voluntary, with bidders choosing to take part based on the potential attractiveness of the opportunity (e.g., transaction size and risk/reward profile), costs of participating in the process and chances of success.

3.32. If we consider it reasonable that we would be able to successfully appoint a preferred bidder, we will also consider the likelihood of successfully reaching asset transfer based on an assessment of the risks that might lead to the process failing.

3.33. As part of this test, we will also consider whether launching a competitive process could have wider delivery impacts on the EoTRS programme. For example, we would seek to ensure interest in participating in subsequent EoTRS processes is not undermined by bidders experiencing tender processes that have been negatively affected or cancelled due to significant asset health issues emerging or material uncertainty about the generator's decommissioning plans.

Test 2: Net project benefit assessments

3.34. If we consider there to be a reasonable likelihood of running a successful competitive re-tender process (Test 1), we propose to assess the potential revenue stream reduction that running a competitive re-tender process might achieve, net of Ofgem costs.

3.35. We propose to normally complete this assessment following the receipt of a firm bid from the incumbent OFTO. Also, as discussed earlier in this section, keeping open the option to trigger a competitive re-tender process may encourage the incumbent OFTO to propose an ERS at such a level a competitive re-tender would be unlikely to reduce the ERS any further.

3.36. At the point of commencing the competition public interest test, we will not have firm bids against which we can assess the incumbent offer. As such, we propose to assess the incumbent OFTO's offer based on:

- **Benchmarking of ongoing costs.** Where possible, we will use recent cost reporting data from incumbent OFTOs and other comparable projects (e.g., interconnectors) to identify if the proposals are within the range normally expected by a company with strong incentives for cost efficiency.
- **Step assessments.** We will check if proposed steps up or down in costs and activity levels relative to those reported recently are well justified and, where relevant, linked to asset health reviews.
- **Information quality assessment.** We will assess whether the incumbent has provided information of the quality and comprehensiveness needed to understand the rationale for its proposals.
- **Assessment of return/profitability requirements.** We will also assess profitability requirements against other sectors we regulate to test if the incumbent OFTO's bids are in line with other regulated opportunities with a similar risk profile and well justified based on the risks the project faces, where

appropriate, we will include in our assessment the potential reductions we might be able to secure through bilateral negotiation.

- 3.37. In assessing the scope to secure revenue reductions through a competitive tender process, we will need to take care that we approach the issue of OFTO asset valuation appropriately. As noted above, we will need to consider that a successor OFTO would need to cover the cost of financing an asset transfer value in their extension offers. As such, we will need to have an indicative transfer value prepared before we undertake the competition public interest test. It may be appropriate for us to provide that assumption to the incumbent OFTO before it submits its extension offer. Section 4 has further detail on how we might approach EoTRS OFTO asset valuation.
- 3.38. Ofgem administrative costs can be assessed based on our experience with initial OFTO tenders to date, updated for the specific characteristics of EoTRS tenders. We will also consider ways of reducing the evaluation costs for EoTRS competitive tenders compared with initial regulatory revenue period tenders.

Questions

Question 13: Do you agree with the concept of the competition public interest test?

Question 14: Do you agree with the two proposed assessments in the competition public interest test? Are there any additional areas we should cover?

Question 15: What steps should we take to ensure any re-tender process attracts competitive bids that can be held through to asset transfer?

Question 16: What wider impacts on the OFTO programme should we consider as part of the competition public interest test? What would be most important to consider?

Question 17: How should we best compare ongoing cost components of incumbent OFTO extension offers against cost reporting information and recent tenders?

Question 18: How should we consider if any profit/return element of an incumbent OFTO extension offer is appropriate and in line with opportunities with a comparable risk profile?

Question 19: How should we consider incoming licencees would need to pay an asset transfer value? Will we need to set an indicative transfer value before the incumbent OFTO submits its extension offer?

Question 20: Could it be possible to potentially estimate the regulatory revenue stream savings from competitive tendering even before receiving an offer from the incumbent OFTO? If so, how could we best approach that assessment?

4. OFTO asset value

Section summary

If a competitive re-tender is held and the incumbent OFTO is unsuccessful, the successor OFTO will need to pay the incumbent OFTO for the transmission asset. Ofgem will determine the transfer value of the offshore transmission assets at the end of the initial regulatory revenue period, for the extended period.

We consider that, at a minimum, the EoTRS asset transfer value should seek to cover the 'net alternative value' (NAV) of the tangible transmission assets in the absence of an extension. We also seek views on including the value of other transferrable assets and/or adjustment payments in the EoTRS asset transfer value, as well as payment structures.

- 4.1. In our initial OFTO tenders, we determine a final transfer value (**FTV**) paid from the new licensee to the generator wind farm. The FTV has an important impact on the level of the TRS as it dictates the amount of finance that must be raised to cover the purchase price of the asset; the cost of finance is then recovered through the TRS.
- 4.2. We expect any EoTRS asset transfer value will have a similar impact on a successor OFTO's revenue requirement and so we must take care that our approach to valuing the assets does not distort competition between the incumbent OFTO and potential successors. It will also be important to consider the implications of our asset valuation approach on the incumbent OFTO, our competition public interest test and EoTRS policy more widely.
- 4.3. In this section, we explain what we consider to be suitable principles for EoTRS asset valuation, present a potential approach to setting that value, and raise for consultation feedback how transfer values might be paid to incumbent OFTOs if we determine the transmission assets should transfer to the successful bidder in a competitive re-tender process.

Valuation principles and approach

- 4.4. Building on the EoTRS policy objectives presented in Section 2, we propose the following principles to guide our EoTRS asset valuation process:

- Secure value-for-money TNUoS charges for wind farms and electricity consumers through the EoTRS asset valuation approach.
- Fair market value remuneration for incumbent OFTOs given the circumstances in which the assets were acquired and the conclusions of the asset health review.
- Incumbent OFTO is incentivised to continue good asset stewardship to the end of the existing revenue term.
- Support smooth ownership transitions by ensuring incumbent OFTO benefit from an extension period being secured, even if the transmission assets transfer to a successor OFTO following a retender process.
- Proportionate valuation approach, consistent with recognised/ good industry practices.

4.5. Given these principles, we consider that a suitable EoTRS asset valuation approach would: (i) seek to at least capture the net realisable value of the transmission assets in an alternative use—a 'net alternative value' ('NAV'); and (ii) potentially include a further premium above the NAV.

4.6. The NAV of an asset can be defined as the realisable value from the alternative use of the asset, net of the costs incurred to realise that value. Alternative use might constitute scrap value or the reuse of the transmission assets, for example to connect other generators or customers, reducing the need to build new transmission assets.

4.7. We consider covering the NAV (at a minimum) in the EoTRS asset value should help ensure a fair market value for the incumbent OFTO in the case ownership passes to a successor OFTO and avoids scenarios where the incumbent OFTO may prefer no extension period at all even if there remains value to society for the wind farm and electricity consumers from an extension period. We expect it would normally be difficult to justify an EoTRS asset value below a NAV level.

4.8. A low EoTRS asset value should benefit wind farms and electricity consumers by allowing third parties to propose lower regulated revenue streams in a competitive re-tender process. However, we expect it could be appropriate to allow the incumbent OFTO a premium on top of the NAV to ensure it has a clear incentive for the transmission assets to continue in operation, even if it might not retain ownership. Such a premium may support good asset management practice and help smooth any transition process between owners, consistent with the principles we set out above.

4.9. We consider that there are two forms of premium that might be appropriate to apply in the EoTRS asset transfer value above NAV:

- (i) **Additional assets in current use.** The EoTRS asset transfer value could potentially include the value of certain assets that should or could be transferred to the successor OFTO, but which are not part of the physical transmission assets. This could be limited to items that would be costly for a successor OFTO to put in place and would have no value in a decommissioning scenario. Transferring such items could ease the transfer of the asset to a successor OFTO, reducing barriers to competition. We are seeking feedback on what types of assets might reasonably fit within this definition.

- (ii) **Asset value extension adjustment.** Including an 'adjustment' within the EoTRS asset transfer value could provide a basis on which to reward/penalise the incumbent for continuing to maintain the assets appropriately up to the asset transfer date. For example, the incumbent OFTO would receive a positive adjustment to the NAV subject to the physical transmission assets remaining consistent with the initial asset health review, subject to force majeure events. Penalties could be levied if the offshore transmission assets have not reached a minimum standard by the end of the regulatory revenue period. We would welcome feedback on ways in which we could suitably set the size of any such adjustment.

4.10. Should either (or both) of the above be implemented, we will need to carefully consider if there could be a case for either type of premium to be funded directly through TNUoS as an incentive payment, rather than as a payment from the successor OFTO. This could be relevant as the successor OFTO licences may not wish to receive all of the assets (e.g., it may wish to use its own IT systems) and the 'positive adjustment' would be on top of the fair market value for the assets. We would also wish to avoid creating any artificial bias towards the incumbent OFTO in either the competition public interest test or any subsequent competitive re-tender process.

4.11. In setting out our potential approach to asset valuation, we note that in this context we do not consider it would be appropriate to use the transfer value as the basis for a regulatory asset base (RAB) to set regulated revenues as we do for some other sectors we regulate—additional capital may be required to support the ongoing operations of an OFTO business.

4.12. For the initial TR1 projects, it may be difficult to set a NAV with precision without evidence from projects having been decommissioned. We welcome input on how we might estimate the values introduced above, but we are also considering whether it

could be appropriate to apply a set of standard assumptions to simplify the process. We could look to improve the accuracy of our approach over time as transmission assets are decommissioned and greater information becomes available.

Payment structures

- 4.13. Initial OFTO asset transfers are made as a single payment to the developer. However, we are interested in exploring if alternative payment structures could be appropriate for EoTRS asset transfers.
- 4.14. We welcome respondents' views on different approaches we might follow, potentially drawing on those used in other contexts for the transfer of operational assets; for example, for the acquisition of operational wind farms. Such options could include delaying part of the transfer value upfront (a 'deferred consideration') or linking part of the payment to the later performance of the OFTO (an 'earn out').

Questions

Question 21: Do you agree with the principles/objectives for the EoTRS asset valuation that we have proposed? What alternative or additional principles and issues do you consider we should take into consideration?"

Question 22: Do you agree that at minimum, the EoTRS asset transfer value should seek to cover the NAV of decommissioned tangible assets?

Question 23: What is your view on setting the EoTRS asset transfer value higher than the NAV? If so, do you think this increase should cover "additional assets", a positive adjustment, or both?

Question 24: If "additional assets" were to be included in the EoTRS asset transfer value, what types of assets do you believe should be included, if any?

Question 25: If an adjustment was to be added to the NAV, do you have any feedback regarding approaches to set the positive or negative adjustment size?

Question 26: What standard assumptions might be appropriate to apply when determining NAV for assets in early tender rounds? What project-specific adjustments might need to be made?

Question 27: Do you have any suggestions for alternative approaches to determine the EoTRS asset transfer value?

Question 28: Do you have any suggestions regarding payment structures for the EoTRS asset transfer value?

5. Performance incentives

Section summary

Under the current OFTO licences, OFTOs are held to an availability-based performance incentive which pays the TRS on meeting 98% availability, with penalties and bonuses applied where there is deviation below and above the target, respectively.

We expect it could be appropriate to adapt the current performance incentive to reflect the different context for OFTOs in an extension period, including their asset health, remaining economic life and other considerations related to their regulatory financial treatment. As such, we are consulting how on we might refine the current approach for extension periods or potentially move towards a 'balanced scorecard' approach.

Extension period performance requirements

- 5.1. The existing availability incentive is a combination of obligations and an incentive: the obligations require the OFTO to repair and maintain the assets; and the incentive encourages behaviour to maintain asset availability.
- 5.2. Though the definition of good performance in the initial and extended regulatory revenue periods are broadly aligned, the condition of the asset is likely to differ, the regulated revenue stream in any extension period is likely to be much smaller than the initial regulatory revenue period, and the asset management behaviours required to maintain good availability may differ.
- 5.3. At present, we can only speculate what would constitute a good level of availability in the extension period for a given asset, but it could be appropriate to consider if the availability target should be changed from the current 98%.
- 5.4. Where there are more significant changes in asset health and/ or risk, an alternative performance incentive might also be warranted to encourage OFTOs to adopt behaviours to maintain asset availability.

- 5.5. Finally, we note basing revenue on availability as the central metric of performance is only valuable insofar as the windfarm continues to operate. We may explore additional mechanisms to protect consumers in such cases.

Performance incentive options for an extended period

- 5.6. We have identified two options for the performance incentive mechanism in an extension period, as discussed below, and are seeking the views of stakeholders on their merits in principle for extension periods only.

(i) **Option 1: Availability-based mechanism**

This approach would follow the existing OFTO regime performance incentive mechanisms and would require a pre-determined level of transmission availability to be maintained by the OFTO.

The existing 98% target should remain appropriate where a long extension to the revenue period is to be granted with little or no long-term asset health concerns. In other instances, and for the extension period only, the availability incentive target within each OFTO licence would be set based on the asset health assessment, potentially below the current 98% target.

(ii) **Option 2: Balanced scorecard**

Similar to arrangements for the onshore transmission network, this approach would link a number of performance measures to financial incentives, not just transmission availability.

Careful consideration would need to be given to the number, complexity, and type of performance incentives to be introduced in the extension period.

- 5.7. We have provided a few examples of possible areas where incentives could be introduced under Option 2 to help understand interested parties' views on the make-up of a 'balanced scorecard' for an OFTO in an extension period:

- (i) Performance metrics similar to those used in the onshore regulatory regime:
- Overall environmental impact reductions

- Carbon dioxide reductions
- Stakeholder and customer satisfaction levels
- Health and Safety statistic improvements

(ii) Aspects of performance noted by stakeholders for OFTOs:

- Timely completion of maintenance
- Completion of a set number of inspections or surveys

5.8. Under both options proposed above, we would consider adopting alternative mechanisms relating to penalty and bonus payments, as follows:

(i) Changing how the value of availability penalties or bonus payments are calculated. For example, by no longer being linked to a percentage of an annual regulated revenue value (which may be significantly lower in an extension period) but instead being a fixed value similar to current levels (i.e., linked to the level of the TRS for the initial regulatory revenue period).

(ii) Adjusting how the performance incentives are paid; for example, introducing a balloon payment – i.e., all or part of incentive bonuses earned are paid at the end of extension period, or alternatively an upscaled bonus where target availability is maintained over an extended period.

5.9. Our decision on the most appropriate type of performance incentive for a particular OFTO would be based on careful consideration of the overall risk and return requirements of individual extension projects, including other components of the regulatory revenue stream; for example, the level of profit/return, insurance and licence protections.

Questions

Question 29: Do you consider it appropriate to have more than one option for creating a performance incentive?

Question 30: Are there any additional performance incentive approaches you believe we should consider for the extension period?

Question 31: Do you think that the alternative return / penalty mechanisms discussed here should be applied in the extension period? Are there any further return / penalty mechanisms you think we should consider, and why?

Question 32: Are there any specific incentives that you would like to see introduced into the OFTO regime? Please explain.

6. Areas for future consideration

- 6.1. The rationale for delaying our discussion on decommissioning is that we need to carry out further analysis with BEIS and The Crown Estate / Crown Estate Scotland which cannot be carried out until policy views have been expressed following the mid-period decommissioning reviews. Further reviews are expected in 2022 and we believe that a further 12-month delay will provide invaluable insight into future policy positions.
- 6.2. Regarding insurance, it is the view of both Ofgem and stakeholders that an alternative approach to insurance in the extension period may be required. At this time, a solution has not been developed and thus no further views are currently being sought. Ofgem will however continue to engage with The Crown Estate and interested parties via workshops and bilateral discussion to articulate a solution ahead of the deadline for deciding whether competition is required (T-3 years) for an OFTO extension. In that context, we expect to make a decision on EoTRS insurance closer to the asset health reviews commencing in 2024.
- 6.3. This consultation closes on **22 August 2022**. All responses should be sent by this date to offshorelicensing@ofgem.gov.uk. We will publish summaries of the non-confidential feedback we receive and any updates on the issues covered in a further publication in **Autumn 2022**. We will continue to engage with the interested parties throughout this period and would welcome further bilateral meetings with interested parties.

Appendices

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Appendix 1 – Consultation question summary

This Appendix collates all the questions upon which we are seeking views as part of this consultation.

Policy objectives

- **Question 1:** Have we captured the regulatory and commercial context for EoTRS policy appropriately? Are there other key contextual issues we need to bear in mind?
- **Question 2:** What are your views on the EoTRS policy objectives we propose? Are they appropriate in the context of the decisions we propose to take?

Role of competition

- **Question 3:** What are your views on our proposed approach to use competition to improve the value-for-money of ERS offers?
- **Question 4:** Are there any specific issues we should consider when considering the ERS drivers outlined in this section?
- **Question 5:** Do you agree that we should define the extension period revenue model before requesting the incumbent OFTO's extension period offer? What will be the most important aspects to confirm? What could be left to later?
- **Question 6:** How long is it reasonable to expect the incumbent OFTO to hold its extension period offer valid? How might we adapt our approach to extend that period or ensure the incumbent OFTO is not exposed to unmanageable risk?
- **Question 7:** Should we consider the use of cost-plus methods or pre-defined uncertainty mechanisms to help extension period offers remain valid? What should we consider when designing any such arrangements?
- **Question 8:** What are your views on asking incumbent OFTOs to hold their extension offers throughout a competitive re-tender process? If we did not do that, how could we ensure incumbent OFTOs present the most attractive extension offer possible?
- **Question 9:** What arrangements would we need to put in place to ensure we can compare on a fair basis the incumbent OFTO's extension offer and those received from other parties in a competitive re-tender process?
- **Question 10:** In what circumstances would it be appropriate to invite the incumbent OFTO to update its extension offer? When might a best-and-final-offer ('BAFO') invitation be appropriate?
- **Question 11:** What measures should we take to ensure incumbent OFTO extension offers are aligned with the findings of their asset reviews?

- **Question 12:** What information might it be suitable (or unsuitable) to share between the wind farm, incumbent OFTO or participants in a competitive re-tender process?

Competition public interest test

- **Question 13:** Do you agree with the concept of the competition public interest test?
- **Question 14:** Do you agree with the two proposed assessments in the competition public interest test? Are there any additional areas we should cover?
- **Question 15:** What steps should we take to ensure any re-tender process attracts competitive bids that can be held through to asset transfer?
- **Question 16:** What wider impacts on the OFTO programme should we consider as part of the competition public interest test? What would be most important to consider?
- **Question 17:** How should we best compare ongoing cost components of incumbent OFTO extension offers against cost reporting information and recent tenders?
- **Question 18:** How should we consider if any profit/return element of an incumbent OFTO extension offer is appropriate and in line with opportunities with a comparable risk profile?
- **Question 19:** How should we consider incoming licencees would need to pay an asset transfer value? Will we need to set an indicative transfer value before the incumbent OFTO submits its extension offer?
- **Question 20:** Could it be possible to potentially estimate the regulatory revenue stream savings from competitive tendering even before receiving an offer from the incumbent OFTO? If so, how could we best approach that assessment?

OFTO asset value

- **Question 21:** Do you agree with the principles/objectives for the EoTRS asset valuation that we have proposed? What alternative or additional principles and issues do you consider we should take into consideration?"
- **Question 22:** Do you agree that at minimum, the EoTRS asset transfer value should seek to cover the NAV of decommissioned tangible assets?
- **Question 23:** What is your view on setting the EoTRS asset transfer value higher than the NAV? If so, do you think this increase should cover "additional assets", a positive adjustment, or both?
- **Question 24:** If "additional assets" were to be included in the EoTRS asset transfer value, what types of assets do you believe should be included, if any?
- **Question 25:** If an adjustment was to be added to the NAV, do you have any feedback regarding approaches to set the positive or negative adjustment size?

- **Question 26:** What standard assumptions might be appropriate to apply when determining NAV for assets in early tender rounds? What project-specific adjustments might need to be made?
- **Question 27:** Do you have any suggestions for alternative approaches to determine the EoTRS asset transfer value?
- **Question 28:** Do you have any suggestions regarding payment structures for the EoTRS asset transfer value?

Performance incentives

- **Question 29:** Do you consider it appropriate to have more than one option for creating a performance incentive?
- **Question 30:** Are there any additional performance incentive approaches you believe we should consider for the extension period?
- **Question 31:** Do you think that the alternative return / penalty mechanisms discussed here should be applied in the extension period? Are there any further return / penalty mechanisms you think we should consider, and why?
- **Question 32:** Are there any specific incentives that you would like to see introduced into the OFTO regime? Please explain.

Appendix 2 – Privacy notice on consultations

Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, “Ofgem”). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. i.e., a consultation.

3. With whom we will be sharing your personal data

4. For how long we will keep your personal data, or criteria used to determine the retention period.

Your personal data will be held for six months after the final policy has been issued.

5. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete
- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data

- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3rd parties
- tell us your preferred frequency, content, and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at <https://ico.org.uk/>, or telephone 0303 123 1113.

6. Your personal data will not be sent overseas.

7. Your personal data will not be used for any automated decision making.

8. Your personal data will be stored in a secure government IT system.

9. More information

For more information on how Ofgem processes your data, click on the link to our "[Ofgem privacy promise](#)".