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09 June 2022

Ørsted Response to Ofgem's Minded-to Decision on Anticipatory Investment and Implementation of Policy Changes

Our ref. OTNR Early Opportunities AI

Dear Offshore Coordination Team,

The Ørsted vision is a world that runs entirely on green energy. Ørsted develops, constructs and operates offshore and onshore wind farms, solar farms and energy storage facilities, bioenergy plants and provides energy products to its customers. Headquartered in Denmark, Ørsted employs 6,500 people, including over 1,000 in the UK.

We welcome the opportunity to comment on Ofgem's consultation on Anticipatory Investment (AI) for Early Opportunities projects. It is right for Ofgem to focus on developing a mechanism to help de-risk projects and incentivise behaviours to deliver a coordinated approach for projects under development, as well lay the groundwork for those coming online in or around 2030 and beyond.

We are hopeful that an AI mechanism, in some form, will provide benefits to local stakeholders and consumers – both in terms of cost efficiencies feeding through to bills, but also to help reduce the broader impacts of development – allow for innovative concepts to come to fruition and accelerate the energy transition. We do, however, have some minor reservations with the positions put forward in the consultation and are keen to engage and collaborate with Ofgem to find effective solutions.

We wish to highlight some areas of focus in our response, whilst our more detailed responses to the questions outlined in the consultation can be found in the Annex.

Anticipatory Investment is required

Ørsted is committed to clean, efficient and fair priced power, and in principle, supports Ofgem's minded-to position that anticipatory risk should be shared. The risk of development cannot solely be placed on Generators, as commercial entities. As the consultation document states, the current framework disincentivises Generators from participating in anticipatory investment – as well as shared

development – and as such we can foresee a significant challenge in bringing forward coordination without an apportioning of risk in some form.

However, we note that any AI mechanism will need to be well designed for investment to be brought forward. Whilst the “minded to” position will address some of the barriers to AI, we are concerned that it will only do so to a limited degree as currently set out and will not create positive incentives for companies to innovate and invest for the future.

Level playing field

It's important that a level playing field across developers is retained. This will be of greater importance within the anticipated regulatory regime for projects connecting in and around 2030, however it is worth considering potential commercial difficulties at this early stage.

When considering the practicalities of development risk, of key concern is the interaction with the Contracts for Difference (CfD) scheme, notably how individual offshore wind projects competing in auctions for CfD subsequently build coordinated offshore transmission assets (that have benefits for future projects). Ørsted would want to see that all projects can compete within the CfD without compromise i.e., projects that are able to coordinate or integrate connections should not be placed at a disadvantage to radially connected projects in the CfD process. It is therefore imperative that the full range of impacts are teased out and worked through at this initial stage of policy development.

Energy Security and Net Zero must be considered

The ambition to deliver 50GW of offshore wind by 2030, as announced in the UK Government Energy Security Strategy¹, emphasised the need to bring forward renewable energy both quickly and efficiently. In Ørsted's view, it is vital that this ambition, as well as wider targets relating to net zero, are accounted for when policy is being set.

In the case of AI, we see a significant role for Ofgem, as the energy regulator, in determining which costs are deemed to be efficient and therefore allowable. With the security strategy in mind, there is merit in considering investment cases against this mandate – as well as net zero. As a result, we would hope that cost-benefit assessments are evaluated based not (solely) on the lowest cost to consumers, but the lowest cost to society for reaching net zero and meeting the ambitions as set out by UK Government. Further to this, when considering baseline assumptions, comparisons should also be made between the cost of the additional investment to the cost of the potential later construction of an innovative or novel solution – which may be disallowed under normal circumstances.

Please do not hesitate to reach out (07768 288836, jamjc@orsted.com) should you have further questions about our response.

¹ <https://www.gov.uk/government/publications/british-energy-security-strategy/british-energy-security-strategy>

Yours sincerely,

James Jackson
Regulatory Affairs Advisor

Annex I

Anticipatory investment – consumer sharing

Question 1: Do you agree that consumers should underwrite the risk of the AI Cost Gap by funding the AI Cost Gap until the later user starts paying TNUoS charges?

Yes, we believe this proposal benefits both consumers and Generators. Projects will have the reassurance required to utilise AI and consumers will benefit through the reduction of demand charges from the lower onshore substation CAPEX. We also anticipate that AI should deliver wider benefits beyond economic considerations, with risk sharing helping to drive coordination and reduce some of the associated impacts of development.

However, there are issues. Firstly, we would appreciate additional clarity from Ofgem as to why projects will only be eligible for the AI mechanism if they fall within different CfD rounds. Although we acknowledge that commercial agreements can be utilised – outside of the more formal process proposed – it would be useful to understand the basis for the decision.

Secondly, we have some concerns regarding potential unintended consequences, most notably in relation to transparency of the CfD bidding process. In our view, there is a potential scenario in which rival bidders in an allocation round would be able to determine the capacity of one (or more) projects that are utilising a shared transmission connection. This is likely to be of greatest risk where projects are in different CfD rounds, as the capacity of the later user could be ascertained by deducting the capacity of the first developer from that of the overall transmission capacity.

With transparency in mind, it would also be helpful to further explore the practicalities of entering the AI process. As currently set out, developers would have to disclose the allocation round that they intend to enter – this could be anti-competitive given that developers may prefer to avoid competing directly with one another.

We acknowledge that BEIS has committed to review the CfDs and evaluate the changes that may be required to facilitate coordination². However, we believe that given the likelihood of complexity, and importance of the CfD regime, this is something that Ofgem should also examine.

Furthermore, we note the intention that projects will also only be eligible to access the AI process if assessed through the CION process. Ørsted would be keen – and would be happy to engage with Ofgem – to explore further solutions beyond those assessed via the CION process, that may be able to aid decarbonisation and help achieve the objectives of the OTNR.

² Available at: [Offshore Transmission Network Review: update on early opportunities \(publishing.service.gov.uk\)](https://publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/674442/Offshore-Transmission-Network-Review-update-on-early-opportunities.pdf)

Ultimately, due to the speculative nature of project development and the lack of an incentive (other than some CAPEX sharing if such costs are allowed by Ofgem) exposure to AI risk arising from transmission will otherwise remain uncommercial for many Generators unless the issues are addressed.

Question 2: Do you agree with the proposal to recover the AI Cost Gap from the later user if the later user connects? If so, do you agree that this should take place over the period of the relevant OFTO licence, starting from the date that the later user starts to pay TNUoS charges?

We agree with the proposal to recover the AI Cost Gap from the later user if the later user connects. However, we have some concerns regarding the potential for developers to have misaligned project lifetimes, as well as misaligned intentions for decommissioning. We would therefore welcome clarity on this and the interaction of the proposed AI process with the OFTO licence and Tender Revenue Stream (TRS) duration.

For example, if both projects within an integrated transmission system have the same anticipated project life, then there may also be a risk of a “cost gap” at the end of the lifetimes. At present, it is not clear how the OFTO licencing period will work for multiple projects utilising a single transmission system, and whether the (existing) 25-year TRS period will begin when the first project that connects is commissioned. If this is the case, the TNUoS liabilities for the later user seem uncertain, as well as responsibilities and obligations regarding decommissioning i.e., would the later user be required to wind down their operations earlier than optimal, to account for the needs of the initial user.

Furthermore, we would welcome further detail from Ofgem as to when and how the AI Cost Gap would be recovered from the later user. Without clarity we’d be concerned that the later user could be disincentivised from entering a coordinated development.

Question 3: Do you agree that, save for any amounts recovered under user commitment arrangements, AI costs should be recovered from consumers if the later user fails to connect?

Yes, we support the approach proposed. However, we note our response to Ofgem’s Early Opportunities consultation from 2021, in which we stated, “that any investment mechanism is able reallocate the costs and risk appropriately to those benefitting from the shared infrastructure, with a focus on meeting the objectives of the OTNR”.

Our position on this remains, and we would hope that the initial results emerging from the Holistic Network Design (HND) will be accounted for when developing the mechanism. This will be of particular importance if the analysis indicates that the cost of developing coordinated transmission (when considered from a CAPEX

basis) is higher than that of the counterfactual radial solution, as well as whether alternative beneficiaries of shared connections are identified.

Question 4: Do you agree with our assessment that policy option 3 better meets the aims of the Early Opportunities workstream of the OTNR?

Based on the options outlined in the consultation, Ørsted agrees that option 3 best meets the objectives of the OTNR. However, as outlined in our response to question 2, further exploration of project timelines is required to ensure consistency, alignment and a level playing field.

Question 5: Do you have views on the modelled assessment of capital cost savings? Please provide any additional quantitative analysis and any further information.

No comment.

Anticipatory investment – early-stage assessment

Question 6: Do you agree with the introduction of the proposed early stage assessment process?

In principle, yes. Ørsted agrees that engagement with Ofgem ahead of the Cost Assessment phase of the formal AI process could mitigate cost disallowance risk before costs are sunk and improve on the ability for developers to deploy innovative solutions and bring them into business-as-usual.

We are, however, aware of some potential parallel issues regarding the proposed AI mechanism and barriers to innovation within the existing OFTO framework. Although the early-stage assessment may reduce some of the disallowance risk, we are concerned that without a focus on net zero, the national ambition for offshore wind delivery, as well as the objectives of the OTNR, that novel designs may be prevented from reaching the market. We would be happy to discuss this point in greater detail with Ofgem, in order to work through any barriers.

Question 7: Do you think the information sought as part of the early stage assessment process is appropriate?

In our view, it's unlikely to be practical to provide all the information suggested. For example, developers may not be comfortable with providing the full range of detailed information outlined in point 3.9.5 as it could potentially change the competitive dynamic of a CfD auction for coordinated projects. Furthermore, a detailed timeline – as proposed in point 3.9.6 – may also be difficult to provide until after the award of a CfD.

We would welcome further engagement with Ofgem to better define the appropriate information required for the assessment, whilst noting that an overly prescriptive approach may be difficult to bring forward in practice.

Question 8: Do you have any views on the timing of the early stage assessment process?

Ideally, we would want to see the early-stage assessment process take place at a very early stage in the project development cycle, though we anticipate the need for some flexibility on a project specific basis. We would also hope that the assessment process could be treated as an ongoing dialogue, rather than a one-off isolated process. The development of offshore wind farms, and their transmission systems, can often be iterative and prone to alteration and as such there should be sufficient flexibility in the assessment process to cater for this.

Question 9: Is there any other information which you believe should be included in the confirmation to developers?

No comment.

Minimising AI risk with user commitment

Question 10: Do you agree with the proposed extension of user commitment arrangements to the potential later user of offshore transmission infrastructure which has been funded by AI?

Yes, Ørsted agrees that some form of user commitment makes sense in order for a reasonable level of development liability to be maintained. However, Ofgem will also need to consider if, and how, the potential later user of shared transmission infrastructure can have comfort that the initial user will not fall away or experience delays in the build of assets for which the later user is reliant. The second project in this scenario would still have CfD, and other, risks to consider.

Question 11: Do you have any views on the manner in which the user commitment should be calculated

Care will need to be taken into order to avoid perverse disincentives being created. For example, the design of the commitments should ensure that they avoid ratcheting up too early. This may otherwise act as a disincentive to coordination.