

Decision

OFTO End of Tender Revenue Stream – Second Decision Document

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This document sets out decisions related to the Offshore Transmission Owner (**OFTO**) regime that Ofgem has taken after considering feedback from stakeholders to our June 2022 consultation on the End of Tender Revenue Stream. We received 19 responses to the consultation, setting out a range of views from 10 generators or their representatives, 6 existing OFTO owners and the Crown Estate, National Grid ESO and SSEN. In the interest of transparency, where responses are not confidential, we have uploaded responses received alongside this decision paper.

These decisions are the next step in establishing an economic and efficient process for extending, where appropriate, regulatory revenue periods for offshore transmission assets under the OFTO regime. This document covers 19 of the 32 questions raised in the consultation. We are continuing to advance our work on the process for extensions. We intend to publish guidance on the scope and process for health reviews of generator and OFTO assets to inform life extension discussions by the end of 2024.

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Executive Summary

Under the Offshore Transmission Owner (OFTO) regime, Ofgem runs a competitive tender process to select and licence OFTOs which own and operate transmission assets for offshore wind farms. The regime has operated successfully since June 2009. There are 26 operational OFTOs now in place, comprising investment of around £9 billion in offshore transmission. Nine of these OFTOs have already passed the midpoint of their current revenue periods with several others following close behind. These OFTOs will start to reach the end of their current revenue periods, and become subject to decommissioning requirements, from 2030 onwards.

Since 2020, Ofgem has been engaging with stakeholders to understand any concerns they have about the tender revenue stream of offshore transmission assets coming to an end and the possibility that, under the current regime, assets that are still economically viable might need to be decommissioned, which would undermine delivery of the UK government's 50GW offshore wind target.

Following a first consultation in 2021 we made a number of decisions regarding the roles and responsibilities of OFTOs, generators and Ofgem in reaching life extension decisions, as well as the appropriate timescales for carrying out health reviews of the OFTO and generator assets. We then issued a second consultation in June 2022 covering four areas: overarching policy objectives, the role of competition, the approach to OFTO asset value and the performance incentive mechanism. This document sets out our decisions on 19 of the 32 questions discussed in the June 2022 document, and the work underway to consider certain issues further.

We are continuing to advance our work on the process for extensions. We intend to publish guidance on the scope and process for health reviews of generator and OFTO assets to inform life extension discussions by the end of 2024.

Introduction

Context and related publications

The Offshore Transmission Owner (OFTO) regime has been in existence for nearly fifteen years, during which time it has become a mature market. To date we have licenced 26 OFTOs across 8 tender rounds with a highly competitive cost of capital. The first round of offshore transmission licences will begin to reach the end of their regulated revenue streams from 2030 onwards. Since 2020, Ofgem has been engaging with stakeholders about potential ways to extend the regulatory revenue period for assets that are still economically viable, in order to avoid assets being decommissioned earlier than needed and help to ensure best value to consumers.

We published our first consultation document on End of Tender Revenue Stream (**EoTRS**) policy in March 2021¹, followed by a decision in July 2021² on roles, responsibilities and timings. Our second consultation in June 2022³ set out questions in relation to four areas: overarching policy objectives, the role of competition, the approach to OFTO asset value and the performance incentive mechanism. This document sets out our decisions following that consultation.

We issued a third consultation in November 2022⁴ setting out a number of proposed modifications to offshore transmission licences. We published our decision on those modifications in June and July 2023⁵, confirming among other things that OFTOs may claim revenue adjustments for the cost of carrying out Health Reviews of their transmission assets and any Investment Works needed to extend the lifetime of those assets.

We also note that the Department for Energy Security and Net Zero (DESNZ) has issued a Call for Evidence on the OFTO regime seeking responses by 9 February 2024⁶. We will reflect any outcome of this that has an impact on any of our proposals, as necessary.

¹ [OFTO End of Tender Revenue Stream – Consultation concerning policy development \(March 2021\)](#)

² [OFTO End of Tender Revenue Stream – 1st Decision document \(July 2021\)](#)

³ [OFTO End of Tender Revenue Stream – 2nd Consultation concerning policy development \(June 2022\)](#)

⁴ [Statutory consultation on proposed modifications to OFTO licences \(November 2022\)](#)

⁵ [Decision on proposed modifications to offshore electricity transmission licences \(June 2023\)](#) and [Decision on proposed modification to offshore electricity transmission licences \(July 2023\)](#)

⁶ [Offshore Transmission Owner Regime: DESNZ call for evidence \(November 2023\)](#)

Our decision-making process

This document sets out our decisions so far on 19 of the 32 questions set out in the consultation, and the work underway to consider certain issues further. We have taken these decisions after considering feedback from stakeholders, including that submitted in response to the consultation. Non-confidential responses are available to view on the consultation page⁷. We will engage further with industry on issues central to this consultation and additional areas that are not included here, as necessary and appropriate, in the coming year.

We recognise that generators and OFTOs need to make life extension decisions for the wind farm and related transmission asset a number of years in advance of reaching the end of the initial regulatory revenue period for each OFTO, and that clarity on the intended policy approach is essential to inform those decisions. However, sufficient time is needed to fully consider the complex licencing and practical issues related to life extensions, and to ensure that policy applications in the extension period are fit-for-purpose.

General feedback

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

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

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

⁷ [OFTO End of Tender Revenue Stream – 2nd Consultation concerning policy development \(June 2022\)](#)

1. Policy Objectives

Section summary

Ofgem will use the proposed EoTRS policy objectives to inform our decisions, although we will amend the first to make clear that the aim is to maximise the combined operational lifetimes of both generation and transmission assets.

Questions (set out in our June 2022 consultation)

- Q1. Have we captured the regulatory and commercial context for EoTRS policy appropriately? Are there other key contextual issues that we need to bear in mind?
- Q2. What are your views on the EoTRS policy objectives we propose? Are they appropriate in the context of the decisions we propose to take?

Our decision

Background

- 1.1. The OFTO regime's objectives in allocating licences via competitive tenders are to:
- (i) ensure OFTOs are robust and can deliver transmission services successfully over the licence period;
 - (ii) provide certainty and best value to consumers through the competitive process;
 - (iii) attract new entrants to the transmission sector; and
 - (iv) undertake streamlined and efficient tender processes.
- 1.2. These objectives continue to apply in the extension period where relevant. We also proposed that four further objectives be introduced to reflect the regulatory and commercial context for EoTRS determinations. These were:
- (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.

Stakeholder views

- 1.3. There was broad agreement that both sets of objectives should apply for the EoTRS process. Five generators noted that the first new objective proposed

should capture the operating lifetime of the generation and transmission assets together. Three generators noted that the economic position of wind farms in the extension period could be marginal due to lapsing subsidies and increased asset integrity risks. Generators asked Ofgem to consider transferring offshore transmission assets to wind farm owners in the extension period, stating that this would promote efficiencies and aligned decision-making on generation and transmission assets.

- 1.4. Five OFTOs believe that new OFTO projects are more likely to attract investment than EoTRS assets, and that a tender process is unlikely to attract new entrants. Two OFTOs noted that an incumbent OFTO might prefer to decommission the assets rather than accept the extension terms proposed. Another queried the legal route available to force a transfer of OFTO assets with a competitive tender. Two OFTOs asked that cost recovery be allowed in the extension period where OFTOs' performance had been lower than expected during the TRS period.

Decision

- 1.5. Ofgem agrees that the first objective should refer to "*maximising the operational life of transmission and generation assets where it is economic and efficient to do so*" and expects parties to work productively together to ensure joined-up extension decisions. We anticipate that securing competitive extension offers by incumbents – or bids from a number of OFTOs in the event of a tender process – will maximise the economic case for extending the life of the wind farms.
- 1.6. It would not be possible to transfer assets to generators without changes to legislation. The Department for Energy Security and Net Zero will consider the merits of this proposal, alongside other options being considered by Ofgem consistent with the existing OFTO regime, over the medium-term.
- 1.7. Ofgem does not accept that OFTOs should be allowed to recover unexpected costs that arose in the original licence term during the extension period. The licence framework already provides protection for unexpected costs for certain events.
- 1.8. If an incumbent OFTO wished to decommission their assets rather than accept the extension terms proposed, Ofgem would expect to initiate the competitive tender process as appropriate and in line with any relevant legislation and regulation. If necessary and appropriate, we may also consider other options including a property transfer scheme or an OFTO of last resort to prevent generator assets from being stranded.

2. Role of Competition

Section summary

Ofgem expects incumbent OFTOs to be well positioned to operate transmission assets in an extension period. Bilateral negotiation with the incumbent OFTO will be our initial preferred approach in deciding whether to grant the ERS to the incumbent. Decisions will be considered on a case-by-case basis and subject to OFTOs providing an acceptably competitive offer. Ofgem may initiate competitive tenders if it deems that a better outcome could be secured by another OFTO taking on the asset. We will consider further the guidance that may be needed in the event of any tender process.

Questions

- Q3. What are your views on our proposed approach to use competition to improve the value-for-money of ERS offers?
- Q4. Are there any specific issues we should consider when considering the ERS drivers outlined in this section?
- Q5. 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? *
- Q6. 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? *
- Q7. 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? *
- Q8. 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? *
- Q9. 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? *
- Q10. 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?
- Q11. What measures should we take to ensure incumbent OFTO extension offers are aligned with the findings of their asset reviews?
- Q12. What information might it be suitable (or unsuitable) to share between the wind farm, incumbent OFTO or participants in a competitive re-tender process?

**Questions with an asterisk have been deferred for further consideration*

Our decision

Background

2.1 Since launching the OFTO regime, Ofgem has used competitive tender processes to appoint OFTO licensees and set regulated revenue streams. For extension periods, our two main choices are either to:

- allow the incumbent OFTO to continue with an amended Extension Revenue Stream (**ERS**) where we have decided that a licence modification is appropriate; or
- launch a new competitive tender to determine whether the incumbent or a successor OFTO should be appointed licensee for the extension period.

Stakeholder views

2.2 There was broad agreement in principle that Ofgem should have the ability to initiate competitive tenders to encourage competitive ERS offers from incumbent OFTOs. However, a number of respondents queried the cost-effectiveness of such a process and suggested that this should only be instigated if material differences between Ofgem and incumbent OFTOs could not be resolved satisfactorily.

2.3 Three generators believed that the incumbent OFTO would be best placed to operate and maintain the transmission assets during the extension period. Five generators considered that a more efficient option would be for the transmission assets to be transferred to generators for the extension period.

2.4 OFTOs noted that the most effective outcome for consumers would be to leave the assets with incumbent OFTOs during the extension period. They also noted that neither OFTOs nor Ofgem were resourced to run multiple competitions in parallel; that there would be limited market appetite for ageing transmission assets; and that changing OFTO ownership would disrupt continuity of service.

2.5 There was general agreement from generators and OFTOs that the consultation captured the main building blocks for the ERS. Several generators flagged the need to avoid double-counting costs which had already been paid for through the current TRS, with the suggestion of basing ERS only on the operation and maintenance costs for the extension. Two generators noted that OFTOs would need to be sufficiently capitalised to deal with potential high-cost events in the extension period. Many respondents noted that a third-party review of incumbent

OFTO extension offers could help to ensure that the proposal submitted to Ofgem fully reflects required actions from the asset health review.

- 2.6 In the event of a tender, two OFTOs commented that incumbent OFTOs should be reimbursed for any tender process costs. Both generators and OFTOs agreed that the extension period revenue model should be defined as early as possible (with OFTOs asking that this occur before they put forward bids) to provide greater certainty for both sides and facilitate a more informed life extension discussion.
- 2.7 Generators considered that requiring incumbent OFTOs to hold their extension offer throughout the tender process was the most effective way of ensuring competitive offers upfront, with the caveat that the process should not exceed 12 months. Three generators noted the importance of a reliable, indicative offer from the OFTO early in the process to enable them to assess the case for wind farm extensions. OFTOs stated that being asked to bid a number of years in advance was unreasonable, with most suggesting they should be allowed to re-submit bids alongside prospective bidders – at least in the event of material change.
- 2.8 Four OFTOs – supported by two generators – considered that including a pre-determined uncertainty mechanism would be the most appropriate method to ensure the extension period offer remained valid, by mitigating risks over which they had no control. No new information was presented by respondents for when a ‘best-and-final-offer’ (BAFO) should be invited.
- 2.9 Respondents consistently noted that a complete data room which included due diligence and asset health review information - shared between all the key parties - would be required to ensure a level playing field. Two OFTOs suggested that the incumbent OFTO should populate the data room with all information which informed their bid, and that their bid should be discounted from the tender process if found to utilise information not included in the data room.

Decision

- 2.10 Bilateral negotiation with the incumbent OFTO will be our initial preferred approach when setting the ERS, where appropriate and in line with relevant legislation. Ofgem’s decision on whether to grant the revenue stream extension to the incumbent OFTO will be considered on a case-by-case basis and is subject to each OFTO providing an acceptable offer which will be assessed by Ofgem and challenged if deemed to be insufficiently competitive.

- 2.11 Ofgem may initiate competitive tenders if it deems that a better outcome for consumers could be secured with another OFTO taking on the asset. The ‘competition public interest test’ discussed in Section 4 will consider the potential value of running a tender process balanced against the costs thereof. In the event of a tender process, we anticipate that OFTOs would cover their own costs of participation in line with the current approach to tender processes.
- 2.12 Ofgem agrees that the ERS should cover the costs of operating and maintaining the assets in the extension period, plus any investment needed to extend the lifetime of those assets which has not already been paid for through the initial TRS. We agree that OFTOs will need to be properly funded (or protected via the licence where appropriate) so that they are able, for example, to respond quickly to failure events, make necessary repairs, and can make a reasonable return.
- 2.13 As stated in our July 2021 decision, the generator and incumbent OFTO will be required to share information with Ofgem during the review process – as well as relevant information with each other - to support extension decisions for each asset. As we develop our health review guidance, we will consider the potential role of industry experts in relation to the reviews and related outputs.
- 2.14 In the event of a tender process, Ofgem’s expectation is that the format of the data room would be similar in nature to that currently utilised for the initial ITT process. Based on consultation responses, we envisage that additional information to be captured in the data room might include:
- Asset drawings and relevant design reports;
 - O&M records, site responsibility schedules, and health and safety files;
 - Decommissioning programme and accumulated decommissioning funds (which would transfer to the successor OFTO in the event of a change in OFTO);
 - Legal documents including interface agreements, crossing and proximity agreements, land rights, and proposed novation of any leases; and
 - Any additional information required for any new OFTO to produce its bid.
- 2.15 We note for further consideration the suggestion that incumbents should be required to populate the data room with all information in their bid, and that their bid may be discounted if found to utilise material information not made available to other bidders. In relation to a best-and-final-offer (‘BAFO’), similar to Ofgem’s current process, a BAFO may be used in a retender process if bids are sufficiently close or we judge that further value can be obtained from a BAFO.

3. Competition Public Interest Test

Section summary

Alongside any bilateral negotiations with incumbent OFTOs about whether their extension offers are deemed by Ofgem to deliver good value for money, we will utilise a 'competition public interest test' to help Ofgem assess whether a wider competitive process is required to unlock better value for the consumer.

Questions

- Q13. Do you agree with the concept of the competition public interest test?
- Q14. Do you agree with the two proposed assessments in the competition public interest test? Are there any additional areas we should cover?
- Q15. What steps should we take to ensure any re-tender process attracts competitive bids that can be held through to asset transfer?
- Q16. 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?
- Q17. How should we best compare ongoing cost components of incumbent OFTO extension offers against cost reporting information and recent tenders?
- Q18. 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?
- Q19. 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?
- Q20. 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?

Our decision

Background

- 3.1 Ofgem proposed to conduct two assessments to inform our decision of whether to launch a competitive tender process, following bilateral negotiations with the incumbent OFTO. The first proposed assessment was to review the likelihood of running a successful competitive tender process to asset transfer, including whether other parties seemed likely to bid for the assets. The second was to estimate the potential revenue stream reduction that running a competitive tender process might achieve, net of relevant costs, relative to the revenue stream sought by the incumbent OFTO.

Stakeholder views

- 3.2 Stakeholders broadly considered the two proposed assessments in the competition public interest test to be reasonable. Two OFTOs commented that they are subjective in nature, and it would be difficult to predict if there is a market for older transmission assets due to their relatively unknown asset status beyond their initial life. It was suggested that the test should also capture generators' interests, and that examples of how the test would work in practice would be beneficial.
- 3.3 Five generators asked that, if there were no competitive bids or market for an OFTO's assets, they could be transferred to the generator to ensure that green generation could continue to flow into the electricity market. Four OFTOs thought it was unlikely that existing OFTOs would bid against incumbent OFTOs, or that new entrants would be willing to hold a price for a licence that would not start for 3 to 4 years. Concerns were raised about potential damage to the OFTO regime if OFTO assets were put out to tender and failed to attract competitive bids.
- 3.4 In terms of how best to compare ongoing cost components of incumbent OFTO extension offers against cost reporting information and recent tenders, three generators noted the value of using clear and established methodologies to challenge assumptions against comparable benchmarks. Two OFTOs questioned the possibility of finding a relevant comparison, as did one generator which noted that factors like the technology used and supplier constraints could be different.
- 3.5 To assess if any profit/return element of an incumbent OFTO extension offer is appropriate, two generators and three OFTOs noted that the ERS could potentially reflect a new investment class where assets have an increased risk profile reflecting technical factors in particular. One generator noted that onshore rates of return could be taken as the comparable upper bound.
- 3.6 In respect of the potential transfer value of the OFTO asset, four generators considered that there was no justification for any transfer value as the asset has been paid through the initial TRS. Two generators noted that the only potential value should reflect the residual or extended life. Six OFTOs stated that there would be an asset transfer value, with a number noting that it should be set prior to the incumbent's extension offer and paid in full at the time of the transaction.
- 3.7 Three OFTOs and one generator did not consider it possible to estimate regulatory revenue streams from competitive tendering ahead of receiving the

incumbent's offer. Two generators thought it might be possible by considering the counterfactual scenario of decommissioning the asset and bringing a new asset online elsewhere or by estimating the operation and maintenance costs.

Decision

- 3.8 Ofgem will utilise the Competition Public Interest Test for the extension period, together with other information, to support our decisions on when it may be necessary and appropriate to hold tenders. Alongside our review of incumbent OFTOs' extension offers, informed by benchmarking of comparable cost components with an eye to the risk profile of the asset, the assessment will also help us decide whether it is appropriate to proceed by licence modification for the incumbent. Ofgem will endeavour to provide clarity on the approach taken over time to counter any perception of the test being subjective in nature.
- 3.9 We consider generators' interests to be captured by the test given that its ultimate purpose is to maximise the life of wind farm and transmission assets by ensuring that the transmission system is delivered as efficiently as possible. We acknowledge concerns raised about risks to the regime should OFTO extended regulated revenue streams be tendered and fail to receive competitive bids. In the event of a tender process, we intend to engage with the market on individual projects to reduce this risk. Generators' request to be made eligible to take on transmission assets has been addressed in Section 2.
- 3.10 Ofgem agrees with the consensus view that it would not be possible to develop a reliable estimate of the potential savings from competitive tendering before receiving an offer from the incumbent OFTO. Rather, the estimation process will begin once the incumbent OFTO has submitted its offer (or, if the asset is deemed to be viable beyond the initial regulatory revenue period and the incumbent does not wish to continue to own the asset after the end of the initial period, then Ofgem expects to initiate the competitive tender process).
- 3.11 Ofgem will continue to develop its approach to cost assessment as well as challenges and negotiations related to extension offers, and clarify this in guidance as necessary. We will also specify any market-adjusting mechanisms (such as the existing Market Rate Adjustment) which may be applied into the bidding process to allow reasonable adjustments to successful OFTO bids ahead of completion, while ensuring fairness across bidders in the event of a tender process. Our current position on OFTO asset value is set out in Section 5.

4. OFTO Asset Value

Section summary

Ofgem will consider further (and in due course, as necessary and appropriate, consult on) the approach to OFTO asset value. We are mindful of the need to avoid double-counting of costs already paid for under the initial TRS. Stakeholder responses to the questions raised in the June 2022 consultation are summarised below for transparency.

Questions deferred for further consideration

- Q21. 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?
- Q22. Do you agree that at minimum, the EoTRS asset transfer value should seek to cover the NAV of decommissioned tangible assets?
- Q23. 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?
- Q24. 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?
- Q25. 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?
- Q26. 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?
- Q27. Do you have any suggestions for alternative approaches to determine the EoTRS asset transfer value?
- Q28. Do you have any suggestions regarding payment structures for the EoTRS asset transfer value?

Background

4.1 For initial OFTO tenders, Ofgem determines a final transfer value (**FTV**) which is paid from the new OFTO licensee to the wind farm developer. The FTV impacts on the TRS as it dictates the amount of finance needed to cover the purchase price of the asset; the cost of finance is then recovered through the TRS. If EoTRS assets are deemed to have transfer value, there would be a similar impact on a successor OFTO's revenue requirement and so we must take care that our approach does not distort competition between the incumbent OFTO and potential successors in this regard.

4.2 Ofgem proposed a number of principles for the asset valuation process:

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

Stakeholder views

- 4.3 There was broad agreement with the proposed principles. A number of generators challenged the need for the asset valuation to incentivise the incumbent OFTO to continue good asset stewardship, noting this was required as a licence condition, and emphasised the importance of not double-counting any costs or value captured in the initial TRS.
- 4.4 The majority of respondents agreed that the EoTRS asset transfer value should cover the net alternative value (**NAV**) of decommissioned assets, with a number highlighting scrap value as a minimum. One generator noted that the prospect of fair value transfer would avoid discouraging investment in transmission assets during the initial TRS period. Three generators disagreed with applying a NAV, noting the OFTO asset is fully depreciated and paid for by the TRS.
- 4.5 Generators uniformly disagreed with raising the NAV, stating that this was not merited and would be to the detriment of the consumers and generators who pay for it. Six OFTOs commented that there should be positive adjustments to the NAV. OFTOs noted that additional assets to be recognised could include any major components which have been replaced and have a lifetime beyond the asset purchase, and that the value of onshore land, scrap value and spares should also be recognised.
- 4.6 Two generators suggested including penalties or an appeal process through which the incumbent OFTO would be penalised if the health of the transmission assets at transfer did not align with what is represented in the health assessment (beyond wear and tear).
- 4.7 Two generators supported a project-by-project assessment based on the condition of the assets, with one suggesting that the net book value of the asset

depreciated to the end of the initial TRS period could be used as a check on the reasonableness of the NAV. Suggested alternative approaches to determining the EoTRS asset transfer value included the use of an independent third party to set the value following the asset health review, or valuing the residual economic life of the asset based on the health review.

- 4.8 Three OFTOs were in favour of a single payment on the asset transfer date, while two OFTOs noted the timing of the payments should match those had the project had been decommissioned. One generator suggested delaying part of the transfer value upfront or linking it to later performance of the OFTO to ensure the OFTO maintains good asset stewardship to the end of the initial TRS period.

No Decision currently

- 4.9 Ofgem will consider further (and in due course, as necessary and appropriate, consult on) the approach to OFTO asset value.
- 4.10 We are mindful of the need to avoid double-counting of costs already paid for under the initial TRS and intend to reflect this in principle ii above as follows *“Fair market value remuneration for incumbent OFTOs given the circumstances in which the assets were acquired and the conclusions of the asset health review, while being mindful of costs captured in the initial TRS”*.
- 4.11 We will consider respondents’ suggestions on scrap value and additional assets that might be recognised for certain OFTOs on a case-by-case basis.
- 4.12 We note that if the asset were to change hands, the decommissioning funds would be transferred to the successor OFTO to enable them to finance the decommissioning obligation for the asset.

5. Performance Incentives

Section summary

Ofgem is minded to retain the availability target, and existing penalty/bonus incentives, as the default performance measure in the extension period. This will be kept under review as more evidence on the health and performance of assets becomes available.

Questions

- Q29. Do you consider it appropriate to have more than one option for creating a performance incentive?
- Q30. Are there additional performance incentive approaches you believe we should consider for the extension period?
- Q31. 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?
- Q32. Are there any specific incentives that you would like to see introduced into the OFTO regime?

Our decision

Background

- 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. Though the requirements of good performance in the initial and extended regulatory revenue periods are expected to be broadly aligned, the condition of the asset is likely to differ, the revenue stream in any extension period is likely to be much smaller than that in the original period, and the behaviours required to maintain good availability may differ.

Stakeholder views

- 5.2 Five generators supported retention of the availability target at the present level of 98%. Another commented that the target should be 100%, aligned with generators' scheduled maintenance. Six generators also supported in principle the introduction of a balanced scorecard or a secondary measure although many noted that the potential benefits needed further evaluation and discussion on a case-by-case basis.

- 5.3 All OFTOs supported retention of the availability target; none supported a balanced scorecard, noting that this would be complicated and introduce too much uncertainty. Two OFTOs supported keeping the 98% target, with bonus payments linked to the current revenue stream (TRS) and penalties linked to the revenue stream set in the extension period (ERS). Four OFTOs suggested the target should be adjusted to reflected ageing assets, with three proposing that failure of assets in the last 25% of their technical lives should be excluded from the target, while two suggested applying different targets across different parts of the transmission asset.
- 5.4 Three generators proposed that generators should be reimbursed for revenue lost where the OFTO was offline in the extension period.
- 5.5 One generator expressed interest in the creation of a 'balloon payment' to maintain OFTO incentives up to the end of the extension period, while another – along with an OFTO - queried whether annual incentives would be more effective. Two OFTOs noted that the use of balloon payments could mean that funding would be unavailable for unexpected costs incurred during the extension period. Two OFTOs were concerned that a penalty could exceed the ERS in extreme scenarios. One generator disagreed with any performance incentives, noting that OFTOs have been remunerated for good asset stewardship through the initial TRS.

Decision

- 5.6 Subject to further policy development, Ofgem intends to retain the availability target and corresponding annual-based incentives applied in the initial regulatory revenue period for the extension period. This is a simple, predictable and effective measure that can be applied across all OFTO transmission assets. The appropriate level of the target and corresponding incentives will be kept under review as more evidence on the health and performance of the assets becomes available.
- 5.7 Ofgem does not consider the proposal to compensate offshore generators for lost revenues to be in line with our aims and operation of the OFTO regime. We intend to retain the principles of the present licensing regime for extension periods where possible.