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Offshore Transmission Networks
Ofgem
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Dear George

**OFFSHORE TRANSMISSION OWNER (OFTO) END OF TENDER REVENUE STREAM
– 2ND POLICY DEVELOPMENT CONSULTATION**

We welcome the opportunity to respond to the above consultation. We have set out our detailed response to the consultation questions in Annex 1.

We would highlight a point we make in response to Question 4 about double counting of costs paid by the generator. As a generator, our main concern is that, in order to continue operating during the extension period, there should be material commercial value and a business case to do so. The extension revenue stream (ERS) will have an important bearing on the commercial viability for the generator primarily in terms of the costs that are recovered through the generator's transmission network use of system (TNUoS) charges. In this context, it is important to ensure the generator is not paying for costs it has already paid for during the original OFTO tender revenue stream (TRS), for example, asset value and decommissioning costs. We understand it is Ofgem's policy intent that such duplication is to be avoided and we wait to see this reflected in the guidelines and approach for determining the ERS from either the incumbent OFTO or the winning bidder in any retender.

Please do not hesitate to contact me or my colleague Deborah MacPherson (Deborah.MacPherson@scottishpower.com) if you would like to discuss our response.

Yours sincerely,



Richard Sweet
Head of Regulatory Policy

**OFFSHORE TRANSMISSION OWNER (OFTO) END OF TENDER REVENUE STREAM –
2ND POLICY DEVELOPMENT CONSULTATION - SCOTTISHPOWER RESPONSE**

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?

In principle, we agree with Ofgem's decision to consider each OFTO on a project-by-project basis. This allows for flexibility in finding the most appropriate solution. However, a project-by-project approach could also increase the costs incurred and resources required from Ofgem. As a consequence, we would expect Ofgem to demonstrate such an approach will not detract from the end of tender revenue stream process. In particular, the generator involved should have sufficiently early access to information regarding the OFTO extension on which to base robust investment decisions. In this respect, it is imperative that by the point in the extension process that a generator is expected to commit financially, it has had detailed information regarding the proposed extension to understand future costs (in particular transmission charges).

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?

We agree with the policy objectives set out in paragraph 2.27 of the consultation namely:

- i) Maximise the operating life of transmission assets where it is economic and efficient to do so.
- ii) Value-for-money TNUoS charges for wind farms and consumers.
- iii) Good asset stewardship and conduct by transmission asset owners.
- iv) Proportionate EoTRS regulation

We agree that in the context of Net Zero, it is important that offshore windfarms are able to maximise their operational lifetimes where economic to do so. In relation to regulation of the EoTRS it is important to ensure costs are proportionate and to ensure any OFTO extension delivers net value to consumers, the generator and the OFTO. We do not object to inclusion of good asset stewardship by OFTOs as an objective, however we consider this already well incentivised under the current OFTO TRS regulatory design.

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?

The proposed approach seems reasonable since competition should improve value-for-money. However, the extension with the incumbent OFTO will often minimise risks for the generator. If it is the case that the costs of running the public interest competition and potential subsequent re-tender exercise are to be recovered through TNUoS payment, the generator would need to make sure these provided a saving overall, i.e., net project benefit (paragraph 3.27). We agree that the option of a public interest competition could be a strong consumer protection tool by incentivising incumbent OFTO to submit a value for money ERS.

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

From the generator point of view, the ERS should be based on the efficient costs required (if any) to upgrade the system to last the extended period and on the O&M costs incurred during this new period.

Of particular importance is the need to avoid double counting of costs already paid for by the generator, when calculating the ERS. For example, the asset transfer value has already been paid through the original licence and therefore should not be factored again into the generator's TNUoS charges via the ERS. Similarly, we note the inclusion of decommissioning as one of the ERS drivers in figure 3. We would expect the decommissioning funds to simply transfer from the incumbent OFTO's TRS to the ERS, noting that the generator has already paid for these funds as part of its TNUoS charges during the OFTO TRS.

Another key issue for the generator is around the health assessment. Therefore, further guidance is sought in relation to the monitoring and assessing of any remedial works, the basis the associated costs are recovered and from which party.

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?

We agree the revenue model should be defined before requesting the incumbent OFTO's extension period offer. However, we are concerned about the impact on the TNUoS which is based on the revenue model. From the generator point of view, if the revenue model differs on the areas, we have highlighted in our response to question 4, these should be defined as a priority before requesting the extension period offer from the OFTO. It is essential in evaluating the generator's business case to have a clear understanding of what parts of the revenue model are to be funded through generator TNUoS and what parts are socialised with consumers. As previously mentioned, it is of particular importance to ensure the generator is not paying for costs already paid for (such as the transfer value and decommissioning). Section 3.10 talks about a regulatory model on a project-by-project basis and it is important that the same principles are applied in all cases. For example, Ofgem must ensure all generators are charged on the same basis for ERSs and there is no distortion of competition in this respect.

It is also essential to have the OFTO health review assessment undertaken within a standard framework so that the results are clear and unambiguous in relation to the extension period. Revision of the health assessment later, i.e., during the ERS, is a risk to the revenue model and by extension the generator business case.

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?

As a generator, we are not in a position to answer this question.

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?

The generator needs to have visibility of the arrangements (e.g., define indexes to be used) that will be applied to the incumbent OFTO offer, to allow generators to fully understand the impact it can have on the ERS and generator costs.

We can see value in introducing an element of flexibility through the above approach. However, we would highlight (in Section 3.12) that we support an ex ante approach, with bidders proposing fixed bids to give certainty for a business case over the life of extension, rather than mid-extension reviews which could have the potential to make the extension period uneconomical.

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?

Holding the extension offer throughout the competitive re-tender process is a good idea for the OFTO to present an attractive offer. However, we would ask that Ofgem provide clarity on whether or not the incumbent OFTO would be allowed to change the offer to equalise with the lowest bid? With this approach, risks would be minimised as it still protects the consumer and provides the least disruption in operation, provided the generator has a successful working arrangement with the OFTO throughout the original licence period.

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?

To have a fair basis comparison between the incumbent OFTO and the offers from other parties, we think it is particularly important to have visibility on the differences in the ERS drivers. Particularly for the NAV and decommissioning costs in the respective bids, on the basis that the incumbent OFTO already has been paid for these items.

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?

We believe that the incumbent OFTO should have the opportunity to update the offer after the health review at T-4 (figure 1), or as a minimum, before the generator must make a final decision on the extension. From the generator point of view, the BAFO invitation would be appropriate 12 months after the re-tender launch. The criteria to define the BAFO invitation depends on how long the handover process may take between OFTOs in order not to compromise the timeline.

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

The key aspect to ensure the incumbent OFTO offers are aligned with the health review results is to consider the adequacy of timing. As stated in section 3.23, from generator point of view, the incumbent OFTO's offer should be delivered shortly after the health review, to ensure it is an informed bid.

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?

The health review is key and needs to be reviewed independently as it will have an impact on all the parties. New information arising after the health review assessment has been shared should be communicated to all stakeholders. The health review must follow the regulatory requirements as well as include an economic and efficient test. Additionally, there is a need to share the scope of works and it to be agreed by the generator

Competition public interest test

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

We agree with the concept of the competition public interest test, provided the key parameters and timescales are clearly set out and established in advance. It is imperative that the benefits of running such a test materially outweigh the cost of running such a competition, which will be driven by factors such as extension duration and the asset health review. For shorter extension periods, it would be difficult to justify a comparatively expensive retender exercise. The costs of carrying out a tender process would be prohibitive compared to the limited revenue stream that will be available as a result of the shorter residual asset life, including the potentially larger maintenance and operation costs that are likely to apply during the extension period. Therefore, a threshold should be set for proposed extension periods so that extension requests below the threshold would be treated as an extension of the current period with the incumbent OFTO.

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

We agree with the deliverability test and net project benefit test being proposed in Section 3.27. However, we would like to understand the circumstances under which the outcome of the test is deemed not to be in the public's interest. We would also expect the competition guidelines to explain how material value is judged to be derived from the incumbent OFTO when they are defined as the only bidder. Going forward, we would also like to understand how lessons learned, and evaluation of previous extensions are taken into account. For example, where a positive value was determined for both stages of the test, but not necessarily realised in practice.

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

The incumbent OFTO holds the advantages in terms of competitive position, as they have operated the transmission assets through the original licence period. We would welcome further clarification on a situation where the generator is keen for an extension but neither the incumbent nor potential bidders come forward to submit an ERS offer. How do Ofgem propose this would be resolved?

We also question whether there would be any appetite amongst bidders to enter any sort of competitive process where one of the bidders is the incumbent OFTO. For the shorter licence extension periods and where more limited works are proposed following the asset health review, the inherent advantage of the incumbent OFTO is difficult to remove and, in this respect, probably inefficient to attempt to do so. It will be interesting to observe whether the smaller schemes and associated ERSs in the first tender rounds attract market interest.

Clarity should also be available to all market participants about how potential subsequent extensions will be dealt with, would Ofgem proposed restarting the whole processor would there be an option for a rolling renewal where the Generator and OFTO on the terms of this? We would welcome Ofgem's clarity in these points.

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?

We would begin with the question: with respect to the costs involved in the cost recovery stage, how does Ofgem propose they be recovered? For example, does Ofgem believe there is a benefit to consumers in circumstances where the outcome suggests that there is no benefit to running a competition? We believe there should be a defined materiality criteria against which proposed extensions that don't reach a minimum threshold are deemed to be an extension to incumbent OFTO.

We would consider in the circumstances where the generator wishes to continue operations of the windfarm but there are no bids to extend the licence period from incumbent or new OFTOs that there are then alternative ownership models considered to align with Net Zero policy and extend the life of the assets. These being returning the transmission assets to the generator. Whilst recognising hurdles would need to be overcome, not least a need for legislature changes, the treatment of the potential TNUoS costs to be defined. These should not be barriers to a windfarm continuing operation for the good of consumers beyond the original licence period.

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

In paragraph 3.36: if benchmarking is to be used, the benchmarks need to be fully understood by all stakeholders to make sure it is in the best interest of the consumer. In addition, generators need to understand the relevant costs that may be subject to indexation in step assessments and what indexes Ofgem is proposing to use to quantify steps up or down in costs. Further, information quality assessments are critical in, not only understanding the incumbent OFTO bids, but also for the Competition Public Interest test and potential re-tender exercise thereafter.

With respect to the assessment of return/profitability requirements, we would expect these to be fair and consistent with other regulated opportunities. Please see our response to Q18. We believe Ofgem could implement a similar process (between the OFTO and Ofgem) to the costs assessment process currently undertaken in respect of the generator costs. This would ensure that the ERS submitted by the OFTO is based on efficient and economic assumptions.

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?

As a first step we think Ofgem should consider ERS rates of return relative to the original TRS. For example, whether risk is materially reduced in a shorter extension period. Secondly, we would expect Ofgem to assess appropriate comparator rates of return. In this context, we would consider that onshore transmission (TOs) would set the upper bound of any range of applicable rates of return for the ERS.

Question 19: How should we consider incoming licensees 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?

We would expect asset transfer values to be established up front and in line with the current OFTO regime under which transfer value funds would be payable on transfer. This would create a clean transaction date from the incumbent OFTO to a new OFTO. If the asset transfer payment is to be paid in instalments, it would be important to ensure any additional interest or compensation payable to the incumbent OFTO does not offset value to consumers.

We believe an indicative transfer value should be set beforehand as the value lost through the extension period will require to be recovered. We note that the incumbent OFTO would need to include the difference between the NAV at the beginning of the period and the NAV at the end of the extension period in their bid.

Generators pay to design and build offshore transmission assets and receive a payment from the OFTO as compensation. Over time, the value of the assets depreciates and the CAPEX is paid off. However, if a new OFTO pays an asset transfer value, care must be taken that this is set to capture the residual value of the assets only. In other words, the OFTOs should not be rewarded twice.

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?

As a generator we are not in a position to answer this question.

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?"

Yes, we are in agreement with the objectives proposed for the EoTRS asset Valuation. We would ask Ofgem to note the following:

- Is the addition of a transfer value in the form of a NAV, onto potential OFTO successor, of demonstrable value to consumers versus an incumbent OFTO ERS which wouldn't have this cost?
- We agree with paragraph 4.8 that a low EOTRS value should benefit windfarms and consumers by allowing 3rd parties to propose lower regulated revenue streams in a competitive retender, provided this value is not offset by the costs of the retender itself.
- We consider the original incumbent OFTO's TRS already provides sufficient incentives for good asset stewardship and therefore this should be included as a consideration in the principles regarding determination of the EoTRS asset valuation.

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

We consider that the residual value of the decommissioned assets should equate to the EoTRS asset transfer value. This is to ensure the incumbent OFTO will receive, as a minimum: i) the fair market value of their assets and, ii) is incentivised and, iii) where

possible, and subject to the asset health review, to continue operation of their asset beyond original licence period.

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?

As stated in our answer to Question 21, the incumbent OFTO is already well incentivised on good asset stewardship and there is no need for positive adjustments to asset values in this respect. We would seek more clarity on what Ofgem means by "additional assets" which are presumably outside of the OFTO assets originally transferred (see Q24).

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?

The transfer of additional assets must be justified as economic and efficient and representing value for money to consumers.

We would ask Ofgem to provide further information as to what types of additional assets they envisage? For example, would this include machinery for opex work or operational spares? In any case, the ownership of "additional assets" should be subject to a separate agreement and should not form part of the EoTRS.

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?

As stated previously in response to Q21, we are of the view that there should be no positive adjustment to the NAV and, in the answer to Q22, the minimum value of NAV should equal the residual value after decommissioning.

In referring to the NAV as being (as a minimum) equal to the residual value, we expect Ofgem to have their own view with regards to the residual costs and to define whether to include them in the NAV or in the residual value. Therefore, we believe it is important that Ofgem determines the NAV.

We would question that if OFTOs claim that there is significant value tied up in the existing transmission assets, does this mean they will get more money as a result? We would therefore also ask how such events would be independently verified?

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?

We are unfamiliar with the specifics of projects in the early tender rounds and as such do not have a view on this question.

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

No.

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

The payment structure to the OFTO from another OFTO are not a generator issue. We therefore have no comments.

Performance incentives

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

We support a broader approach to incentivising OFTO's in an extension period. The options proposed reflect a positive step in this direction. However, it would seem appropriate to consider applying these approaches to existing TRS periods and not just the extension period

We agree the 98% target in Option 1 (para 5.6) should be retained for all extension periods. The reason for this is that generator availability is crucial, and availability should not be depleted in an extension period and should not be reduced below 98% due to asset health assessment or any other reason. The OFTO should be appropriately incentivised to achieve this level of availability throughout the extension period.

Should asset health concerns be identified during the assessment period, then the TRS should be appropriately scaled to enable a future OFTO to resolve the issues. Additional funding for this, if required, should not come from TNUoS, but from penalties applied to the incumbent OFTO.

We support a balanced scorecard approach and the performance metrics proposed in para 5.7(i). However, for those listed in para 5.7(ii), it would be important to apply a qualitative element to assessing performance rather than just a volume-based assessment. This is important to avoid over-reporting and the diminishment in effectiveness of inspections and maintenance activities

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

Ofgem should give consideration to asset health-based incentives similar to the Network Asset Risk Methodology (NARMS)¹ applied to onshore transmission owners.

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?

We consider the principle of balloon payments in para 5.8(ii) would not be as powerful in driving effective behaviours as annual based incentives.

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

We have no additional incentives to propose.

ScottishPower
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¹ https://www.ofgem.gov.uk/sites/default/files/docs/2021/02/narm_handbook_v1.3_1.pdf