

# **Offshore Transmission Owner (OFTO) End of Revenue Tender Stream - 2<sup>nd</sup> Policy Development Consultation**

## **Response from The Crown Estate**

**August 2022**

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### **1. Summary**

Offshore wind is playing a major role in delivering affordable domestic energy as well as the UK's Net Zero emissions targets. To support the ongoing success of the sector, it is important that arrangements are put in place to not only secure the deployment of new capacity, but also to ensure that the fleet of operational projects is incentivised to produce clean electricity for as long as is economically and technically viable. The Crown Estate welcomes the publication of this consultation, as it provides further clarity to the offshore wind and offshore transmission industry on how OFTO revenue streams will be determined for periods beyond the initial regulatory revenue term.

The Government's ambition for the deployment of up to 50GW of offshore wind capacity by 2030 provides a clear line of sight to what is required through the remainder of the 2020s; and estimates of more than 100GW by 2050 indicate the challenge over the coming decades. The current operational fleet will play an important role in meeting our energy needs over both time horizons, and we consider that ensuring existing capacity remains operational for as long as it reasonably can is important in the context of both decarbonisation as well as ensuring domestic energy security. For example, we calculate that to extend the life of generation and transmission assets beyond the initial tender revenue stream (TRS) by five years would prevent the early retirement of around 4GW of offshore wind capacity on the UK seabed by the end of 2035. If that period were ten years, then this would be 7GW by the end of 2041.

Given the strategic importance of offshore wind, we consider that final decisions on End of the Tender Revenue Stream (EoTRS) policy should put the needs of the offshore wind generator at the forefront – with decisions on length of revenue extensions for transmission based on the requirements of the connected offshore wind generators. Furthermore, we consider policy decisions should be taken which support successful delivery of our collective Net Zero targets, which in this case would include incentivising generation to continue to operate. Our responses to the issues raised in the consultation bear these considerations in mind.

Our response to this consultation has been informed by significant engagement with both offshore wind operators and OFTOs. This includes webinars we ran in July 2022 as well as a survey last year (the outputs from which we have previously shared with Ofgem). We know from these interactions that early policy certainty is critical to asset life extension decisions, given the cost of transmission forms a significant proportion of a wind farm's operating cost base. Without this certainty, it can adversely influence the decisions that asset owners make on asset integrity, asset health outcomes, and the cost efficiency of life extension. It can also have the potential for premature decommissioning of the offshore generating fleet, earlier than its potential technical life span. Life extension also reduces the global pressure for the extraction of virgin raw materials and it has the potential to deliver low-cost energy to consumers.

We will continue to work with Ofgem, BEIS and our offshore wind generator and OFTO customers and stakeholders on this topic, to help create an environment that encourages offshore wind renewable energy life extension.

## **1. The Crown Estate**

### **1.1. Who we are**

The Crown Estate is a purpose-driven and unique business with a diverse portfolio. We manage the seabed and around half the foreshore in England, Wales and Northern Ireland, playing a fundamental role in the sustainable development of these important national assets and using our data and evidence to facilitate co-existence and greater spatial coordination between activities.

Over the past two decades we've played a key role enabling the development of a world leading offshore wind market. As the market for fixed foundation offshore wind matures, ensuring the sustainability of the existing capacity will be key. We believe this will be beneficial both from an environmental impact perspective, and more broadly from a materials perspective, i.e. sustaining existing generation and assets for as long as reasonably possible before needing to replace them with wholly new capacity.

Our ownership also includes a substantial rural portfolio, and the Windsor Estate, including the world-renowned Windsor Great Park. Alongside this, we operate some of central London's best places to work, shop and experience, as well as regional retail and leisure destinations across the country.

Established by an Act of Parliament, The Crown Estate works to create social, environmental and financial value, both now and for the future, for its customers, partners and the nation. We generate 100% of our net revenue profit for the benefit of the nation, contributing £3 billion to the public purse over the last ten years.

### **1.2. Our purpose**

As a business, we actively deliver against our purpose, which is to create lasting and shared prosperity for the nation. We believe we are well placed to create financial, environmental and social value holistically today and for future generations, by drawing upon our unique attributes to address long-term trends and national needs.

Combining our independence and scale of ownerships along with our ability to convene multiple stakeholders and take a long-term view with patient financial capital, we can play a significant role in creating and accelerating new opportunities where we believe we are well placed to add value.

We drive our purposeful activity through three strategic objectives, to:

- Take a leading role in stewarding the UK's natural environment and biodiversity
- Be a leader in supporting the UK towards a net zero carbon future
- Help create thriving communities and renew urban centres across the UK

### **1.3. Customer engagement**

Customers sit at the heart of everything we do; and we work in partnership to realise our shared ambitions. We foster strong relationships with our customers to drive customer satisfaction through regular and proactive engagement.

Our customers include those to whom we offer seabed rights, and we have undertaken a significant amount of engagement with customers and other stakeholders on issues associated with EoTRS policy over the last few years.

During 2020 we ran a series of dedicated engagement sessions with generators and OFTOs and a survey to gain insight into their issues. We were pleased to share the outcomes of this engagement with Ofgem (as well as participants) in January 2021.

Building on this, in October 2021 we held a further webinar for generators and OFTOs (and Ofgem), to review progress and socialise the key issues included in Ofgem's EoTRS policy decision document published in July 2021. More recently, we ran roundtable engagement webinars with generators and OFTOs during July 2022 to understand their views on the current consultation.

The insights gained from our customer engagement have been aggregated and used to inform our response, along with our own views on this consultation. Where appropriate, we have used customer feedback received to highlight issues and to support ongoing policy development.

## **2. Responses to issues raised**

We set out below overarching comments to issues raised in the consultation, informed where relevant by our engagement with customers. We then provide responses to those questions raised in the consultation which are most relevant to us.

### **2.1. Overview comments**

- 1) The Crown Estate supports the introduction of a framework for the extension of the revenue period for OFTOs, which will extend the asset life for these assets and enable the connected offshore wind generator to continue to operate. We broadly welcome the principle underpinning the policy, that the default position for considering extension periods will be bilateral negotiation by Ofgem with the incumbent OFTO for the setting of the EoTRS. Further, we believe the overall EoTRS approach needs to drive best value for the whole generation/transmission process to enable life extension and avoid premature decommissioning of renewable energy generation. Consideration should be given to the need for flexibility in the EoTRS reflecting the open market in which the generator will be operating in the post-subsidy period.

Notwithstanding the point above, from our recent engagement with our customers, we found a large majority of generator and OFTOs favour alternate arrangements, such as bilateral commercial agreements between OFTOs and generators (with Ofgem oversight). This is something that could be explored before initiating the EoTRS process and there could be proportionate benefits in delivering value for money for the consumer.

- 2) We note there is no discussion in the consultation regarding what happens if the incumbent OFTO does not want to continue, and an alternative OFTO is not found through the competitive retender process. We believe there needs to be a robust backstop arrangement in these circumstances to prevent a situation arising where generator assets that are economically viable become stranded and potentially decommissioned, if an OFTO hasn't been appointed through this extension process. The existing OFTO of Last Resort mechanism that allows Ofgem to appoint an OFTO outside of a competitive tender process would seem to be a suitable solution that could be utilised in these circumstances. We would hope that additional measures to secure a "backstop" (such as permitting generator operation of transmission assets) would be considered and implemented, should the OFTO of Last Resort mechanism not prove suitable.
- 3) The consultation suggests that certainty on the Extension Revenue Stream (ERS) may not be known until as late as one year before the end of the existing TRS. This timing means the resulting Transmission Network Use of System (TNUoS) charges will not be known with sufficient certainty to determine an economically feasible business case for asset life extension, which substantially impacts

operators' decisions to continue operating the wind farm. We understand that TNUoS charges will continue to represent a significant cost for operators, and this delay in understanding the final ERS is unhelpful. We would advocate that clarity is provided significantly earlier in the process.

Linked to this, from our engagement with customers we understand a key concern from both generators and OFTOs is that uncertainty of the future regime and potential for delays in critical information around the process being available, when it is needed, will hinder decision-making and could lead to either increased operating costs in extension or premature decommissioning to avoid risk. We would advocate clarifying the framework for the regime as soon as is practicable to reduce this uncertainty.

- 4) Finally, we note that Ofgem is considering issues of regulatory finance for OFTOs and the broader issues associated with asset life extension separately. However, we believe these are intrinsically linked and should be considered holistically as a package, in order to provide stakeholders with a comprehensive picture on the proposed regulatory arrangements and processes.

## 2.2. Regulatory and commercial context

We welcome the points raised in this section and on the legal basis for asset transfer, in respect of clarifying the scope of seabed property rights and liabilities for transfer, as cited at paragraph 2.22 of the consultation document.

The duration of OFTO leases and property interests granted for the seabed are designed to enable extended operating periods of up to 60 years, but that is not necessarily the case for onshore rights that may vary and could prove a limiting factor for life extension. Information or guidance that Ofgem could offer in a scenario, where operators are unlikely to obtain a lease renewal/extension of existing rights, should ideally be included in the overall outcome and guidance. We will work with Ofgem to clarify any of these matters.

We note the statement in paragraph 2.16 of the consultation: *"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"* and would welcome more detail on this and what an 'appropriate duration' means. We are concerned about periods of potential generation that do not fall within this definition and what transmission arrangements are envisaged to enable generation and avoid premature retirement of parts of the UK offshore wind fleet, even in a 'wind down context'.

We also understand that generators will need to have certainty on the length of the extension period, as this will directly influence their business case for life extension, including more specifically their immediate operations and maintenance (O&M) expenditure. For example, we understand from our engagement that generators would not want to incur costs to ensure integrity of their assets for an additional ten years, and then lose the ability to export after five years. Our engagement identified that OFTOs will wish to be similarly proportionate in their asset integrity spending. This is a key element of deciding to life extend and something that we've previously highlighted as early knowledge and regulatory certainty are important factors that enable assets to be managed in a more economic and efficient way.

### **Q1: Have we captured the regulatory and commercial context for EoTRS policy appropriately? Are there other key contextual issues we need to bear in mind?**

Response: We welcome the context as set out but would like to see more focus on the commercial business case and market environment for the generator in the evaluation process, including commercial context balanced with the need to perpetuate sustainable use of the UK seabed by maintaining existing low carbon

energy generation on it. We would not wish to see a wind farm needing to retire earlier than necessary because of limitations in the EoTRS process.

## 2.3. Policy Objectives

### **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?**

Response: The proposed policy objectives cover adequately the context for offshore transmission. However, they do not cover more fundamental points related to supporting the delivery of our collective Net Zero emissions targets, which will rely to a large extent on clean electricity from offshore wind. We would suggest that a new objective is added which derives from Ofgem's strategic vision for *"an electricity sector able to function without fossil fuels, with a growing share of low-cost renewables"*.

Whilst meeting national (public interest/price) and regulatory objectives, both parties (i.e. the generators and OFTOs) need their respective operational decisions to be based on a profitable business case. We feel that greater focus should be given to the wider and combined context, business case and implications of variable market exposure for generators and where flexibility is needed. Consideration will need to be given to factors which are outside of operators' control.

## 2.4. Role of competition

We welcome the principle underpinning the policy that the default position for considering extension periods will be bilateral negotiation by Ofgem with the incumbent OFTO for the setting of the ERS.

### **Q4: Are there any specific issues we should consider when considering the ERS drivers outlined in this section?**

Response: Yes, the consideration of the economics, market dynamics and business case of the generator are absent from those drivers; and we feel should be considered in more detail.

We feel consideration should also be given to whether a cost-based approach to evaluating the ERS drivers provides the right incentive to ensure life extension. It could potentially limit the level of O&M and decommissioning to the minimum rather than recommended level because of the incentive to reduce costs where possible.

### **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?**

Response: Yes, we feel it is important to provide as much clarity as possible early in the process. However, we highlight the point made above around exploring bilateral commercial agreements between incumbent OFTOs and generators and whether this might deliver an alternative, subject to competition public interest testing by Ofgem.

## 2.5. Competition public interest test

We note the tests proposed and welcome the principles around them. We believe Ofgem should be able to apply the net project benefit test using cost data from their previous tendering processes.

During our engagement with our customers, a point was raised by OFTOs relating to the benchmarking of comparable costs (paragraph 3.36 of the consultation) but it was considered that projects such as

interconnectors were not suitable comparable assets to OFTOs. A point was also made that each OFTO needs to be viewed carefully as they are not all comparable assets with varying histories and operating profiles.

We think it is also pertinent to raise the question of: What happens if the incumbent operator does not wish to continue, or the deliverability assessment is not successful? Would this mean an OFTO of Last Resort is appointed? We would encourage alternatives and scenarios to be explored further.

**Q13: Do you agree with the concept of the competition public interest test?**

Response: We broadly agree with the tests proposed. The competition public interest tests are limited to deliverability and net project benefit, but we question whether there are other tests which should also be applied such as social and environmental benefits including: sustaining employment; low-cost energy production; energy security; carbon emission avoidance; resource extraction avoidance/materials intensity (new vs old assets); and the data value of monitoring aging asset performance.

In respect of the net project benefit test, an allowance should also be made for:

- The cost savings for the potential bidders that would have gone through the competitive process, as these costs would ultimately be incorporated into the sunk cost of bids and socialised back to consumers.
- Cost savings on Asset Transfer Value, where an incumbent OFTO is bidding, which may not then need to be socialised to consumers to the same extent as for a new OFTO bidder.

The likelihood criteria of the deliverability assessment should also consider the implications of running a successful re-tender process, specifically the timing and resources to deliver the process in sufficient time ahead of the end of the initial TRS.

We would like to better understand and be able to discuss the details of the assessments being considered as part of the competitive public interest test, specifically how will the likelihood of running a successful tender process be assessed, how long the process will take and what are the wider programme impacts being considered.

**Q14: Do you agree with the two proposed assessments in the competition public interest test? Are there any additional areas we should cover?**

Response: We agree with the two tests proposed but subject to our comments at Q13 above.

**Q15: What steps should we take to ensure any re-tender process attracts competitive bids that can be held through to asset transfer?**

Response: The speed and robustness of the process is important. The more subjective or case-by-case elements in the process the more susceptibility to delay and/or challenge. This is important where externalities and macro effects can impact profitability models and the time limit on any associated lenders' offers.

Front ending and mandating bilateral discussions between the generators and the OFTOs ahead of the EoTRS process could reduce delays. This would be preferable to running them in parallel.

**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?**

Response: Please refer to our response to Q13.



## 2.6. OFTO asset value

### **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?**

Response: We broadly agree with the principles set out, but the overarching consideration is sustainable low-carbon generation on the UK seabed and delivering value to the consumer. On introduction of regulations, a costs assessment of the asset value is considered by Ofgem and a transfer value paid to the generator, with those assets capable of lasting for the life of the wind farm. The principles under consideration now, on the basis assets are retendered, introduce a further payment on transfer, ultimately socialised back to the consumer. This creates the possibility of a more costly system for the UK consumer, who could be burdened with the cost twice for the same technical assets serving a generation site.

We do however accept that:

- To ensure longer term asset integrity, the business case and parameters around the likely revenue model could have greater impact.
- A value premium or incentive could be helpful, based on independent or audited asset health reviews. These could be undertaken at mid-life then five and two years prior to the asset transfer.

Another consideration to keep in mind is that any alternative value assessment needs to comply with the underlying terms and conditions of the lease(s) and with legal requirements. Many may restrict use of the assets to a specific site or purpose, which can make valuing for alternative uses, such as repurposing, challenging. It may be worth consulting with bodies such as the Royal Institution of Chartered Surveyors (RICS) on appropriate valuation principles.

We believe standard assumptions for valuation will simplify the process, regardless of the basis of valuation.

### **Q22: Do you agree that at minimum, the EoTRS asset transfer value should seek to cover the NAV of decommissioned tangible assets?**

Response: We think as a minimum this should be covered but suggest considering seeking advice from a body such as the RICS. Valuing for alternative uses will depend on property and legal restrictions impacting the assets.

### **Q28: Do you have any suggestions regarding payment structures for the EoTRS asset transfer value?**

Response: It is worth considering the practice in other industries, such as a retention payment to follow any capital transfer based, for example on asset health check reliability.

## 2.7. Performance Incentives

We believe that it is key to retain focus on the practical requirements of generator with respect to availability. The transmission assets are a vital connection between the generating asset and the consumers. If OFTO performance incentives are set independently of generator requirements, this can create a disconnect with their business cases for life extension.

We understand from OFTO feedback that there is general discomfort with the proposed 'balanced scorecard' option and its applicability to offshore transmission.

Our view is that due consideration needs to be given to the allowances/exceptions which may be put in place when calculating OFTO availability in order to enable the transmission asset owners to be more incentivised. Retaining the 98% availability target in life extension could work, with certain exceptional allowances and any regard to the specific asset history.

Alternative approaches worth consideration may be around a commercial availability incentive agreed between generator and OFTO with more risk sharing, or a production-based availability incentive aligned to generator needs rather than a time-based availability incentive. Flexibility to the incentives approach over the extension period is also key, along with recognition for asset condition and performance. End of life failures are likely to occur and outside the OFTOs' control. How to handle these scenarios should be considered within the approach, particularly as assets age and spare parts market may become more challenging.

**Q29: Do you consider it appropriate to have more than one option for creating a performance incentive?**

Response: We think standardisation is helpful as much as possible in not over-complicating the offshore transmission system. The 98% availability incentive has worked sufficiently and could continue to. However, a more flexible approach in the life extension phase in respect of allowable events and read across to TNUoS charges for the generator could be helpful, incorporating standardisation where possible.

**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?**

Response: A production-based availability vs a time-based availability incentive could be agreed as a result of bilateral generator OFTO negotiations (please refer to our response at Question 5).

## **2.8. Areas for future consideration**

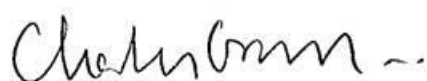
The life extension of offshore wind and transmission assets remains an important area for us. We wish to help create an environment that enables assets to continue to generate beyond their initial expected design life, with all the wider societal benefits that brings.

We welcome the statement in the consultation that Ofgem will work with others and ourselves on decommissioning and insurance matters. We remain willing and open to engage on these points and look forward to further discussion on these topics.

We trust that you will find our comments on the consultation constructive. We would be willing to provide additional information on any of the points we have raised above and be happy to discuss these matters with you further.

All of this response may be put into the public domain and there is no part of it that should be treated as confidential.

Yours Sincerely,



Charles Green  
**Senior Manager, Marine**