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Nick Everitt

[nick.everitt@nationalgrideso.com](mailto:nick.everitt@nationalgrideso.com)

07866 982328

[www.nationalgrideso.com](http://www.nationalgrideso.com)

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10<sup>th</sup> October 2022

**National Grid ESO response to Offshore Transmission Owner (OFTO) End of Tender Revenue Stream – 2nd Policy Development Consultation.**

Dear George,

Thank you for the opportunity to respond to your Offshore Transmission Owner (OFTO) End of Tender Revenue Stream – 2nd Policy Development Consultation

As the Electricity System Operator (ESO) for Great Britain, we are in a privileged position at the heart of the energy system, balancing electricity supply and demand second by second. As the UK moves towards its 2050 net zero target, our mission is to enable the sustainable transformation of the energy system and ensure the delivery of reliable, affordable energy for all consumers.

We use our unique perspective and independent position to facilitate market-based solutions which deliver value for consumers. The part that offshore wind capacity will play in helping the UK meet the 2050 net zero target cannot be overstated, without it, net zero would clearly not be possible.

To summarise our feedback:-

- We agree in broad terms with the principles and approach of the proposal.
- It is worth noting that consequential CUSC modifications may be needed due to impact that the extension period may have on the TNUoS tariff setting process. e.g. how to account for the impact on asset values which are used in Offshore Local TNUoS tariff setting when aged assets are upgraded/replaced.
- We believe further clarity is required around the incentive performance and how it is applied in cases where the OFTO transfers from one party to another.
- The competition public interest test seems sensible and reasonable, but it may be challenging to quantify in relation to the decision-making process.
- Logically the most efficient solution would seem to be one where the incumbent OFTO makes the best offer and consequently the need for the cost associated to a tender is avoided. This means that a method to encourage them to make a good offer is essential, as is an unbiased way of testing it.

We welcome the opportunity to discuss any of the points raised within this response. Should you require further information or clarity please contact Nick Everitt, Revenue Manager [nick.everitt@nationalgrideso.com](mailto:nick.everitt@nationalgrideso.com) in the first instance. Our response is not confidential.

Yours sincerely

Nick Everitt

Revenue Manager – Tariff Setting & Change Management

## Appendix 1 – Consultation Question Responses

Please note that we have only provided responses to questions where we believe we can make an appropriate contribution, therefore there is not a response for every question within the consultation.

### Policy objectives

**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 that it would seem efficient to use existing assets, where possible, rather than building new ones in order to drive value for money.

Also, it makes sense to assess the value that an OFTO Transfer process can bring before undertaking it, to avoid a potentially inefficient and expensive process in the situation where the incumbent OFTO may already be working as efficiently and responsibly as possible.

### Role of Competition

**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?

Yes, it seems fair and reasonable that they should know in at least broad terms what they are bidding for before they must bid. We believe that it would be more appropriate for OFTOs to say what are the most important aspects to confirm before they make an offer.

**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?

If there are ways to help the OFTOs maintain an offer, then yes that would make sense; it may be more appropriate for OFTO's to say what arrangements should be considered.

**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?

As a principle we agree that it would be a more efficient process if the incumbent OFTOs offer was to be held rather than being subject to change throughout the process. However, it depends on the length of the process and how the process is designed (i.e., what information is shared with other competitors and at what stage with respect to the incumbent OFTO's offer to ensure that the competition is fair).

**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?

We believe that it would be more appropriate for the OFTOs to answer this but would like to highlight that it will be important to implement a way of comparing submissions since the incumbent OFTO will have additional information at their disposal and therefore their offer may not look like the best but could be more well founded.

### Competition public interest test

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

Yes – and agree that a cost benefit analysis of the tender process is needed to ensure the process is efficient and fair to the incumbent OFTO and generator.

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

This sounds reasonable, the incumbent OFTO needs to be working from the same basis as any other competitors for it to remain a fair competition, not its own assumptions of value.

**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?**

On the face of it, this seems like it could be problematic to implement. It is unclear how you could judge potential savings without making assumptions about the incumbent OFTO's offer before it has been made, which would not appear fair or unbiased.

Logically, the most efficient solution would be one where the incumbent OFTO makes the best offer and the need for the cost associated to a tender is avoided. Consequently, a method to encourage them to make a good offer is essential, as is an unbiased way of testing it.

## **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?**

We agree with the proposed principles. Additionally, we would like to highlight that asset value is currently used to determine proportions of revenue to collect from offshore local TNUoS tariffs (which are paid for by the relevant Offshore generator). If we were to use the asset values from this proposed process it will represent aging assets that may need upgrading/replacing – if there are plans included to replace such assets, we will need a new way of identifying asset category proportions to ensure the correct users are paying the right proportions of OFTO revenue.

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

Yes, this sounds reasonable. It would be difficult to justify an EoTRS asset value below a NAV level.

**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?**

Presumably, the successor OFTO would be expected to pay for this premium upfront and would then get it back via their revenue stream – we would question whether it is fair for the successor OFTO to pay a premium to cover an incentive for the incumbent OFTO? It would need to be clear what benefit they are getting for this additional money spent.

**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?**

Any, or all, assets that could have potential value to the successor OFTO would seem a logical place to start, but it would also seem appropriate to consider putting limits in place to prevent the incumbent OFTO including a large number of very small assets that have little or no intrinsic value. As a principle, the ESO supports

minimising the loss of any value when assets are transferred but understands that there must be a balance between this and the overheads required to administer such a process.

**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?

If there is potential for the adjustment to be negative, it would seem appropriate to set a minimum value that the EoTRS transfer value should not fall short of. For example, it may be appropriate to set a minimum transfer value based on the scrap value of the assets, with any asset recovery costs removed from the total. It would not seem fair if any adjustments were to take the transfer value that the incumbent OFTO receives below the value that they would receive in the scenario that the assets were scrapped.

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

It would seem reasonable that the payment structure for the initial OFTO asset transfer process would also be an option for this process, taking into account any feedback that may be received from existing OFTOs and generators as to how this process may need to be adapted.

In the event that there is uncertainty regarding the EoTRS Transfer Value, or an agreement cannot be reached between the Incumbent and Successor OFTOs, then an earn out approach (based on the successor OFTOs performance) may be suitable. Otherwise, it would not seem appropriate for the value that the incumbent OFTO receives to be linked to the performance of the successor OFTO. Alternatively, if the payment were to be linked to the performance of the incumbent OFTO in the period between the decision to transfer the assets to a successor OFTO and the asset transfer date where the successor OFTO takes on the responsibilities for the offshore network, then it may provide an incentive for the incumbent OFTO to continue to operate in a reasonable manner.

## Performance incentives

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

Yes, to implement an appropriate incentive, it seems appropriate to consult on multiple options and to refine and develop the option(s) based upon the feedback and ideas received from all parties affected by the incentive.