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Offshore Transmission Owner (OFTO) End of Tender Revenue Stream – 2nd Policy Development Consultation

Consultation response: Vattenfall

CC: offshorelicensing@ofgem.gov.uk

Dear George,

Vattenfall is a leading European energy company with approximately 20,000 employees across Northern Europe and growing numbers in the UK. For more than 100 years we have electrified industries, supplied energy to people's homes and modernised our way of living. We now want to make fossil-free living possible within one generation.

We have been investing in the UK for more than ten years, and with £3.5bn invested, we have grown our wind business from one project in 2008 to eleven today and now operate more than 1GW of wind and solar power capacity, with around 5GW in the pipeline including one of the UK's largest offshore wind zones and a commercial scale joint venture floating offshore wind project.

Vattenfall welcomes the opportunity to respond to the Ofgem consultation 'Offshore Transmission Owner (OFTO) End of Tender Revenue Stream – 2nd policy development consultation'. We believe that extending the operational life of offshore transmission system assets and the associated wind farms could help to efficiently utilise operational assets, continue decarbonisation of the UK's electricity system and benefit bill payers.

As Vattenfall is a major UK offshore wind developer and operator, the end of Tender Revenue Stream (TRS) policy is of particular relevance to our Tender Round 1 Thanet and Ormonde wind farms, as well as our offshore wind development pipeline.

We would like to highlight the following key points, in addition to our full response below:

General policy

- Clarity on the End of TRS policy is vitally important for Vattenfall's Tender Round 1 (TR1) offshore wind projects and our Norfolk zone, and we welcome Ofgem's continued work on the policy development. Vattenfall needs certainty on all TRS policy aspects by Dec 2023 to make key decisions on the next steps for Ormonde and Thanet. In addition, we would welcome the opportunity to kick off EoTRS earlier than the 6 year programme in line with asset technical reviews we have planned for the sites.
- There is a feedback loop between the EoTRS process and the decisions to life extend, particularly where business cases are marginal. Therefore clarity on aspects like asset condition, grid costs and extension lengths will be key when exploring the life extension case for the wind farm.
- Overall we believe that Ofgem should look to extend the initial TRS length closer to the full asset life of an offshore wind farm.

Tender approach

- Generally we agree that Ofgem's proposed approach to the EoTRS tender seems sensible. However, as indicated in our response to the first EoTRS consultation, we believe there may be circumstances where the offshore grid could revert to the generator. For instance if OFTOs do not wish to operate

the grid assets (instead of utilising the OFTO of last resort process), where generator ownership could be proven to tip the balance in a marginal business case for life extension, or where the OFTO bids are deemed too expensive and there is clear rational the generator could perform the service in a more economic and efficient way.

- We believe that clear and transparent data rooms reviewed and approved by the OFTO, the generator and Ofgem could go some way to ensuring a fair and transparent process for all parties. The information should capture the full and transparent asset life cycle information to enable optimum decisions to be made by all parties
- We note that Ofgem intend to consider a NAV transfer between the incumbent OFTO and a new OFTO. Generally we believe that this value should be based on the book value of the asset depreciated over the TRS length (less a justified residual value i.e. scrap), unless Ofgem have a clear rational to use another metric (for example refurbishment required to extend the life of the grid or another justifiable adjustment). We note that the generator has already paid for the capital costs of the grid via the Initial TRS and would caution against any TNUoS double charging for capital infrastructure, Ofgem could look at TNUoS split between offshore substation and wider TNUoS to limit or remove any double charging.
- We believe that Ofgem need to be clear on how they intend to begin benchmarking the incumbent offer, as part of Competition public interest test and note that this is likely to be an iterative approach as tenders run.

Grid costs, connections and availability

- We believe that grid costs should be based on an ex-anti (with transparent adjustments) approach. This will provide the generator with the certainty required to formulate the life extension business case and seek the required approvals. We believe that ex-post could lead to unexpected costs for the generator which could harm the case for life extension.
- We believe that there is a clear unlevel playing field between offshore and onshore generation regarding grid outages. Where onshore wind farms (with firm connections) are compensated for grid outages, this point could be key to both EoTRS policy (where asset availability might be less clear) and coordination where more than one wind farm could rely on the same grid connection.
- In terms of asset availability we recommend Ofgem considers a 98% default unless there is clear evidence to increase/decrease the metric.
- We believe that assurance of the availability in the extension period could be key, this includes:
 - Considerations such as purchasing and storage of critical spares (e.g. transformers) and reviewing fast respond plans
 - Ensure adequate insurance covers unexpected outages, or
 - Review of OFTO capital adequacy to ensure fast and high quality repairs

We look forward to engaging further in the End of TRS policy development in the future, in particular on the asset reporting, insurance and decommissioning aspects.

If you have any queries on our response, please feel free to contact me.

Yours faithfully,

Alwyn Poulter

Public and Regulatory Affairs Manager

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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?

We believe that Ofgem has broadly captured the regulatory and commercial context for EoTRS policy, and we welcome the work done to date in this area. The EoTRS is vitally important for the continued operation of early offshore wind farms, including tender round 1 sites. We aim to start asset reviews on these projects during 2023 and therefore require certainty on the EoTRS policy by the end of 2023.

We believe the process could take place earlier than five years before the regulatory revenue period ends, and we welcome to decision to share asset health information between the generator and the OFTO.

We welcome Ofgem's intent to consult on asset health reviews, insurance and decommissioning later in the year and believe these aspects are also key to the EoTRS policy landscape. We note that the asset health reviews will be key to driving commercial decisions around EoTRS and asset life extensions. These need to be reliable and shared between all parties.

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 broadly agree with the proposals put forward by Ofgem and believe they are generally appropriate.

Generally we agree that Ofgem's proposed approach to the EoTRS tender seems sensible. However, as indicated in our response to the first EoTRS consultation, we believe there may be circumstances where the offshore grid could revert to the generator. For instance if OFTOs do not wish to operate the grid assets (instead of utilising the OFTO of last resort process), where generator ownership could be proven to tip the balance in a marginal business case for life extension, or where the OFTO bids are deemed too expensive and there is clear rational the generator could perform the service in a more economic and efficient way.

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?

Vattenfall agrees with the approach towards using competition to secure the best value ERS. We have confidence that the incumbent OFTO will be in a good position to deliver the operation and maintenance of the assets in the extension period. We agree that having the ability to initiate a competitive tender as part of the ERS process, will encourage the incumbent OFTO to provide the most competitive offer, securing value for money for the wind farm and consumers.

The competition assessment should not just be focussed on racing to the bottom economically, but a strong weighting on the performance of the incumbent OFTO Vs a new OFTO's capability to deliver the O&M and licence obligations.

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

The ERS drivers outlined in figure three capture the main building blocks to determining the ERS. It is expected that the asset transfer value would be considerably lower as the initial capex will have been repaid by the

recovered incumbent OFTO's TRS in the initial period. We believe that the definition of "remedial works" needs to be expanded upon to provide additional clarity, it is unclear whether the definition considers asset replacement, reconditioning and refurbishment. Ofgem might also wish to consider the funding costs as an ERS drivers, for example if any further investments need to be made and what will the equity or debt costs would be to fund these.

Critically the wind farm needs to be notified by the OFTO about the investments that need to be done to assure the extended operation. Clear guidance needs to be given on how the investment will be recovered should the most efficient approach be that the investment needs to be made during the initial TRS period.

In addition, we would recommend that financial robustness of the OFTOs is considered as part of the evaluation (either liquidity, guarantees or insurance) to ensure that system fault can be rectified quickly.

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?

The bids submitted by the incumbent OFTO and possible prospective owners should, as far as possible, be based on the same revenue model (i.e. extension period) and transfer value to ensure a fair basis for choosing the future asset owner. Thus it is important that the extension period revenue model be defined before requesting the incumbent OFTO's extension period offer. This allows a simple comparison between bids from the incumbent and other bidders, and reduces the scope for the incumbent to revise its bid following any competition.

However, if the OFTO sees an opportunity to offer a better value for money bid based on another revenue model, this could be discussed between the OFTO, Ofgem and the generator. Ofgem could allow the OFTO submit a variant bid along with a compliant bid (we note that different tender lengths could impact on the wind farm life extension case so there needs to be transparency here). Ofgem could have discretion to evaluate any variant bid in line with its objectives for the EoTRS policy. An area in which variant bids could add value is by providing a TRS for different extension periods, not just fixed lots - we note Ofgem may offer more than one extension which could then align the wind farm and OFTO life extension cases (however Ofgem may need to be careful to prevent delaying investment or gaming by the incumbent OFTO). To fairly evaluate variant bids, there needs to be an effective mechanism to compare them with compliant bids and appropriate evaluation criteria. These criteria should be declared to all bidders. The extension period should ultimately be agreed between the wind farm, OFTO and Ofgem and may well be asset specific. We welcome extensions to the extension if required.

The most important aspects of the revenue model to confirm are:

- The period of life extension of the wind farm and the default period for the extension TRS
- The estimated transfer value and decommissioning cost, and the mechanism for adjusting bids if these values change
- Which costs will be set ex-ante and which, if any, set ex-post, and the associated TNUoS impact
- The arrangements for indexing bids and the extension TRS (including pass through costs)
- The arrangements at the end of the extension period, e.g. the probability of a further extension or decommissioning
- The key incentive and uncertainty mechanisms applied during the extension period including the availability incentive

It will also be important to provide the incumbent and generator with clarity on the how Ofgem will make a decision following the 'competition public interest test' and the timeline for the extension process.

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?

The extension timetable in Figure 1 suggests that the incumbent OFTOs offer will be expected to remain valid for 5-3 years. We expect that the OFTO will be best placed to advise on the length of validity to manage risk exposure. However, an indicative offer needs to be provided to the wind farm much earlier in the process. This will enable the wind farm owner to make a reasonable assessment of life extension of the wind farm, as understanding the wind farms future TNUoS is a determining business case component, uncertainty could limit the appetite to extend the life. Perhaps a clear indexation formula would help this process.

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?

We recommend the use of pre-defined uncertainty mechanisms to help extension period offers remain valid. This will provide the wind farm with the certainty required to assess the impact of end of TRS TNUoS on the life extension business case – which is likely to be one of the largest cost drivers. It is important that these mechanism are transparent to the generator so business case runs can be optimised.

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?

Ensuring that the incumbent OFTOs offer for extension is reasonably priced and delivers the best value for the wind farm and consumers is key to the success of OFTO life extension. To ensure that this offer is competitive initially and remains competitive throughout the tender process, the offer must remain valid. The offer should be held during the competitive re-tender, however if new information presents itself during the tender phase, that could affect the ERS offer, the incumbent should also be given the opportunity to adjust their offer accordingly, again clear indexation and adjustment parameters could help with this process.

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?

If Ofgem elect to run a competitive re-tender process, it can only be attractive to new bidders if it is understood that the bidders will be on a level playing field with the incumbent OFTO. This could be challenging given the incumbents history and experience operating and maintaining the assets for 20 years. Ofgem can encourage competition and ensure that the assessments are fair by ensuring the bidders are provided with sufficient information to be able to make a credible bid. Ensuring bidders are given access to a clear, well structured, transparent and detailed data room will enhance the information that is available. Technical due diligence reports that provide detail on the condition and integrity of the assets, should be made available to bidders. To give bidders further confidence in the information such as technical due diligence, it should be written and signed off by credible independent third party appointed by the OFTO or Ofgem. Bidders may want to conduct site visits and inspections, with or without their own appointed expert advisors, it is advised that provisions should be made where possible. All historical data that can be recovered on the detail of the assets should also be provided, this could include maintenance reports, inspection reports, asset health reviews and details of any remediation works. Allowing wind farm developers to feed into and review the data room process might help with transparency here. We recommend the generators reviews all documents (within confidentiality requirements) and section of the data room is dedicated to the generator input.

Ofgem should consider how to consider qualitative aspects, like the performance of the incumbent OFTO during the initial TRS should or could be assessed in relation to an extension.

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?

Whether it is appropriate to invite the incumbent OFTO to update its extension offer depends on how old the offer is, whether any new information has become available and what services are being tendered. If the bid is old and significantly beyond the 'hold period' agreed with the incumbent, or material new information becomes available it will reduce risk and so improve value for money to provide the incumbent with an opportunity to update.

If the tender is effectively only for O&M on existing assets without significant additional Capex or major operational changes then there are only limited circumstances in which an update to the incumbent's offer is appropriate.

However, if significant additional capex will be required during the extension, then it would be appropriate to invite the incumbent to update its offer as a result of material, unexpected and hard to-manage changes. Risks which are economic to hedge or could be passed on to a third party may not warrant an update of the offer. Significant changes in the following may justify an opportunity to update:

- Interest rates
- The exchange rate between the pound and other currencies in which equipment is being bought
- Relevant commodity prices
- New significant findings or developments related to the technical state of the assets
- Material change in the revenue model

In our experience it is best to use BAFO's sparingly. While a BAFO usually leads to a reduction in TRS they are disliked by bidders for this reason and because they increase bidding costs. Potentially more damaging is bidders who expect a BAFO may not full optimise their initial bid to allow for a subsequent reduction later and hence the BAFO may not deliver value for money.

BAFOS are most appropriate, when two or more bids are very close or new information means that costs/risks have changed considerably and have significantly impacted on project economics.

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

While all bidders, including the incumbent, may take a view on aspects of the asset health review, the incumbent should not have privileged access to information that could alter the bid price and becomes know after the final asset health review is finalised or is otherwise excluded from the asset health register. Ensuring early access to transparent and comprehensive asset health information is critical to a level playing field for the tender and to encouraging parties to bid in the tender, we recommend that this is reviewed (and challenged) by Ofgem and the generator and compiled by an credible third party.

Bidders may decide to take a calculated risk in their bid in order to improve their chance of winning. Allowing this opportunity to the incumbent as well as participants in any tender helps to deliver value for money for consumers. However, the incumbent should take into account in their bid all critical investment in repairing or replacing equipment and in ensuring there are adequate stocks of critical spares. To encourage alignment with the asset health review in this respect, the incumbent's bid, and other bids, should set out clearly how critical recommendations in the asset health review are reflected in their bid and the rationale for their approach. Perhaps, as a further safeguard, this part of the bids could be reviewed by the author of the asset health review, the generator and Ofgem and the result fed into the decision on whether or not hold a tender.

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?

Generally we believe that all OFTO asset information should be shared with the generator, this will allow wind farm operators to take all risks into account when considering the life extension opportunities. We also believe the generator should input into the data room and query reports/assumptions where required.

We believe that a shared understanding of the OFTO's O&M strategy, concept and set up during the extended period should be shared between parties. This might also help to optimise work and outages between the OFTO and the generator.

We believe that risks and risk mitigation measures on each side should be shared, including insurance coverage if applicable.

As the generator faces a much later risk of long duration outages we believe that sharing and understanding the fast response plans in place for the extended operational period could be important too.

Competition public interest test

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

While the potential for a competitive re-tender incentivises the incumbent to propose a low extension revenue stream (ERS) and provides scope for bidders to innovate in their offer, a re-tender could be a costly, and could have a wider impact on competition in the wider OFTO programme. The competition public interest test is a sensible tool for assessing if a competitive re-tender is warranted, e.g. that is likely that there will be a big enough saving in ERS to justify the re-tender costs for Ofgem and bidders.

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

The two parts of the competition public interest test, deliverability and the net benefit of a competitive re-tender are sensible.

When making the assessments the original design life of the transmission assets may be significant. For example, if a developer chose a 20-year design life, the risk and additional capex associated with an extension might be quite different to where a 30-year design life was selected.

An additional consideration which is relevant for the early competitive public interest tests is whether a competitive re-tender will enhance the OFTO regulatory process by providing more data for benchmarking. For the initial EoTRS processes, Ofgem, incumbents, other bidders for the OFTO extension and the wind farm developers will have little or no benchmark data to guide decision making. A competitive re-tender would provide additional benchmarking data as more potential OFTOs will estimate costs during the extension period. This additional price discovery information will deliver value for money by helping to uncover and spread commercial best practice in OFTO extensions. However we would caution tendering as a data collection exercise if the value for money case is not clear from the outset.

In addition, in this assessment the performance (not just cost) of the incumbent OFTO and how this compares with others should be considered. For example, if performance has been poor and costs are high compared to Ofgem's benchmarking then public interest is much more likely to be advanced by a competition.

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 key to ensuring that any re-tender attracts competitive bids is assuring all bidders that this is a transparent, timely and cost-effective process. In particular, potential bidders will ask if they can compete with the incumbent and a high quality, comprehensive and authoritative asset health review and due diligence data room will be critical. Ideally bidders will want to be able to reply upon the asset health review and to be confident that they will be provided with full and timely information about any significant changes to the assets or the character of the extension after the review is published.

Bids which can be held through to asset transfer can be encouraged by:

- Appropriate transparent indexation of the ERS
- Where bids involve substantial capex and hence include debt finance, a market interest rate adjustment mechanism similar to that used for OFTOs currently
- A transparent and fair pass through of significant costs which are hard to manage or accurately forecast (bear in the mind the generator needs to accurately calculate the TNUoS costs)

If bids are not deemed competitive Ofgem could consider returning the asset to the generator if both parties feel this is in the consumer interest.

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 believe that the timing of the public interest is important and an early decision is better than a late decision. This decision should be shared with all interested parties. We suggest that clear programme and timelines are published out and kept to throughout the process.

We believe that the overall programme should be dictated by the wind farm and to align with the business plan, this is particularly important for the tender length so both the wind farm and grid assets can align accordingly.

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

We recognise that benchmarking costs in incumbent OFTO extension offers is important for the competition public interest test and that it will be challenging initially. We suggest the benchmarking process should include:

- Using Ofgem's established methodologies to allow for differences in project size, distance from shore and technology
- An allowance for the age of certain transmission assets such as transformers as for some old equipment it may be expensive and difficult to get the necessary spare parts and consumables
- An adjustment for the extra cost of keeping an asset in good condition for the whole extension period as compared to spending the minimum to keep the asset working till the end of the initial TRS period (including spares)
- Using as much as possible comparable cost data from onshore transmission assets, interconnectors and older offshore transmission elsewhere in Western Europe

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?

Assessing the profit/return element of an incumbent OFTO extension offer is an important part of the competition public interest test as a lower profit/return can result in a significantly lower ERS. Ofgem should take advantage of its transferable experience estimating the cost of capital for electricity transmission projects including for onshore electricity transmission, interconnectors and Interest During Construction for offshore transmission. A key driver of the estimated cost of capital will be the perceived risk profile which is influenced by technical factors, regulatory risk and political risk. The perceived risk can be gauged by talking to investors and comparisons with returns on comparable investments. The perceived risk can be managed down by reassuring potential investors that the regulatory regime is supportive and stable, and that large risks can be managed (i.e. credible and reliable insurance and fully covered and audited decommissioning liabilities).

Assessing the profit/return element will require a balanced judgement considering the novelty of acquiring 20 year or more old offshore transmission assets which may have to be decommissioned at the end of the ERS, the current immaturity of the regulatory regime for OFTO extensions and the relatively short-term cash flow – the ERS may be paid for around five years as compared with 20 or 25 years for the TRS. Significant commercial risks include what happens if the extension period changes, the protection offered to the OFTO by Ofgem if things go wrong, the availability of the insurances required by Ofgem and lenders and spares. Sound technical due diligence underpinning the investment plans will reduce investor risk. Given these investment characteristics, OFTO extensions might be attractive to new classes of investors such as publicly quoted infrastructure funds.

Appropriate, and fully assessed decommissioning plans and securities could be key to ensuring a fair return is bid by the OFTO as this could be one of the larger liabilities.

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?

To the extent that the assets to be transferred from the incumbent to a new OFTO have real value the incumbent should be fairly compensated. The prospect of a fair transfer value would avoid discouraging economic investment in the transmission assets during the initial TRS period. However to protect value for money for generators and consumers, Ofgem should ensure that the transfer value is economic and efficient. Thus a cost assessment process similar to that applied to assets transferred by the wind farm developer to the incumbent may be required. For this purpose, assets should be defined in the broad sense to include (potentially) freehold land and ongoing land rights/obligations as well as asset management systems.

In addition, we propose that the transfer value be funded by consumers through wider TNUoS. Due to initial TRS calculations there is risk that wind farm pays for the capital (or other) infrastructure twice and this should be avoided.

In order to submit an extension offer the incumbent (and other potential bidders) will need to know the transfer value so that in its business plans it can compare being the OFTO for the extension with handing over the OFTO. It is also likely that the OFTO will model competing bids including their financing and tax position and for this it will need an estimate of the transfer value.

- There should not be an asset transfer value based on the assets within the initial TRS period
- Only value should be given to future investments and any additional value given to life extension of assets through refurbishment or reconditioning.
- The incumbent OFTO should have an estimated value for refurbishment/reconditioning that would sit outside the initial TRS period, this should be approved by a third party. This figure could be used as an indicative transfer value, it is expected that this will be a low figure compared with initial capex.
- Wind farm developers should not double pay for initial TRS capital equipment or other costs.

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?

In estimating the ERS savings from competitive tendering, the biggest challenge is likely to be estimating the difference in cost of capital between the incumbent and other potential bidders. Ofgem should be reasonably placed to estimate the O&M cost although estimating the additional capex and insurance may be more challenging. In this regard it is helpful that the additional capex should be quite low bearing in mind the size of new offshore assets and historic insurance costs should be a reasonable guide to costs for the extension period.

Estimating the differential cost of capital for the incumbent versus another bidder will depend significantly to the expected difference in perceived risk. If for example the incumbent perceives risk to be significantly lower than other bidders who do not have “inside knowledge” of the OFTO, then the incumbents cost of capital could be significantly lower. It will be tricky to accurately estimate the difference in risk perception which for projects with significant additional capex and a long extension period will be a key driver of the differential ERS.

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 objective, to ensure that the incumbent OFTO is incentivised to continue operation and deliver responsible asset management practice, even if assets are transferred to a new 3rd party. Creating a premium value above the NAV as laid out in the principles, would provide such an incentive. However, it should be highlighted that this is already an obligation within the OFTO license conditions that covers this element.

Ofgem may also need to consider the value that could be attributed to non-transmission assets, such as the land the assets sit on, operational staff that could be TUPEd, unused spares that have been maintained for use, storage facilities, operational and logistics services contracts, and the grid interface with the TSO.

It must be made clear how Ofgem intends to determine the ERS proportion of the NAV + any premium that will be recovered. The initial TRS received by the incumbent OFTO has already recovered and paid for the initial capex investment (or other costs) the OFTO made when paying the wind farm developer the FTV. The TRS has already been recovered by the TNUoS payments made by the wind farm and consumers, the majority being recovered by the wind farms local offshore circuit and substation TNUoS payments. Therefore, it would be unfair for the wind farm to have to again bear the cost for NAV and any premium, as these costs have already been paid for during the initial TRS period. Careful consideration needs to be given to the potential CUSC modifications that could be required.

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

To the extent that assets to be transferred from the incumbent to a new OFTO have real value the incumbent should be fairly compensated. The prospect of a fair transfer value would avoid discouraging economic investment in the transmission assets during the initial TRS period. However to protect value for money for consumers and generators, Ofgem should ensure that the transfer value is economic and efficient.

This asset transfer value could be based on the net book value of the asset depreciated to the end of the TRS period. In general this value will be residual value (which should include supporting evidence) of the assets

plus any investment the incumbent has made to extend the life of the OFTO . Unless there is clear evidence that indicates Ofgem should use a different NAV.

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?

To the extent that assets to be transferred from the incumbent to a new OFTO have real value the incumbent should be fairly but not excessively compensated. We see the strongest case for covering the cost of additional assets, for example economic and efficient investment in the transmission system made by the incumbent OFTO.

We do not support a high NAV unless it can be clearly evidenced and justified.

If the wind farm has already paid for these assets via the initial TRS the generator should not be double charged.

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?

Our view is that any "additional assets" were to be included in the EoTRS asset transfer value should be assessed as economic and efficient by Ofgem and include:

- Spares, storage facilities, etc which will be transferred to any new OFTO
- The cost of reconditioning and proactive asset replacement

We note that decommission liabilities should be fully assessed prior to an extension.

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?

We recognise that an adjustment within the EoTRS asset transfer value could provide a basis on which to reward/penalise the incumbent for continuing to maintain the assets appropriately up to the asset transfer date. For example, the incumbent OFTO would receive a positive adjustment to the NAV subject to the physical transmission assets remaining consistent with the initial asset health review, subject to force majeure events. Penalties could also be levied if the offshore transmission assets have not reached a minimum standard by the end of the regulatory revenue period. However we note that licence conditions could also be utilised to drive appropriate behaviour.

These rewards/ penalties could be carefully calibrated so that they provide a large enough incentive to influence the OFTO's behaviour and also be linked to the value to the wind farm and consumers of improved reliability / longevity of the transmission assets. Consideration will be given on how these are charged. We think this approach would require more consideration from Ofgem to prevent unintended consequences and additional consultation to ensure it is appropriate.

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?

In our view, the value of the transmission assets at the end of the TRS should be determined based on the specifics of the project and particularly the condition of the assets.

The net book value of the asset depreciated to the end of the TRS period could be used as a check on the reasonableness of the NAV, unless Ofgem have clear evidence to use a different value. A residual value review might also be appropriate.

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

We recommend that the starting point for determining the EoTRS asset transfer value is the net book value of the asset depreciated to the end of the TRS period. We expect this be approximately, the residual value of the assets plus any economic and efficient investment by incumbent to extend the life of the OFTO .

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

We favour Ofgem working with the OFTOs and their bankers to develop an efficient asset transfer value payment structure which reduces the ERS. If the bidding OFTO's cost of capital is lower than that of consumers / generators then it would be most efficient for the EoTRS asset transfer value to be paid in a single instalment.

We recommend additional engagement with OFTOs on this point.

Performance incentives

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

It would seem more appropriate to have a single incentive in an extension period for clarity. However, the chosen option must include flexibility to enable targets to reflect the particular project characteristics such as:

- Condition of the assets
- Performance of the assets during the original revenue period
- Characteristics of the project for example length of offshore and onshore cables, number of circuits and technology type

Fundamentally the requirement is for the highest possible availability incentive commensurate with asset condition, project characteristics, duration of the extension and what availability can be economically delivered. We recommend 98% unless there is clear evidence to adjust this figure.

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

During an extension it is likely that the preparation and delivery of potential upgrade/replacement works will be critical for the financial viability of the wind farm and the delivery of affordable green power to consumers.

The operating plans of the OFTO will be a key element for review but the engagement and cooperation with the wind farm is also a performance aspect worthy of incentivising. It will be particularly valuable to co-ordinate refurbishment work on the transmission assets and the wind farm to minimise the time during which the wind farm is not generating. The OFTO's plans for co-ordinating with the wind farm could be a key criteria when assessing bids.

We note that wind farms are not compensated for grid outages, which creates an unlevel playing field between onshore and offshore generation. Ofgem should assess this situation, especially where major works could leave wind farms without a physical route to market for a long period (which would also need to be

factored into the life extension). In addition this could reduce some of the barriers facing coordinated offshore grids.

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?

During an extension, the balance of risks between the generator and the OFTO need to be optimised to achieve the best outcomes for consumers and the return/penalty mechanisms have to reflect this. Therefore we propose:

- The availability bonuses / penalties being a fixed value similar to current levels to ensure they are not too small to get and retain the attention of the OFTO
- Introducing a balloon payment – i.e. a part of the incentive bonuses earned are paid at the end of the extension period to maintain the impact of the incentives to the end of the extension period
- Assessing the financial resilience of the OFTOs during the tender process could help with these risks, ensuring capital adequacy to deal with large one off events or close to end of life works

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

Given that offshore wind farm life expectation has increased significantly in recent years, life extensions to OFTOs are critical to the ongoing success of the offshore wind industry and hitting the long term targets for offshore wind capacity.

The extension to the tender revenue stream is therefore key and there are some more general incentives that would benefit all stakeholders:

- 98% should be deemed the default availability incentive, unless project specific availability incentives can be evidenced and justified. For extensions the condition and performance of the assets also becomes crucial to consider. If offshore wind farm were compensated for grid outages it would make a stronger case for asset specific availability incentives based on system characteristics.
- OFTO's licence conditions are linked to their performance in managing assets for example being able to demonstrate "Good Industry Practice" in maintaining the assets during the licence period, therefore this should act as an incentive
- Quality of records and documentation available to support potential extensions of the OFTO TRS period. High quality record keeping is also very helpful for rapid rectification if the transmission system breaks down and this could be key to extension tendering