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Dear Giedre,

**Offshore Electricity Transmission: Consultation on tender exercises under the enduring regime. A response from The Crown Estate**

**1. The Crown Estate**

The diverse portfolio of The Crown Estate comprises marine, rural and urban properties across the whole of the United Kingdom valued in total at £7 billion (2011 figures). Under the 1961 Crown Estate Act, The Crown Estate is charged with maintaining and enhancing both the value of the property and the revenue from it consistent with the requirements of good management. We are a commercial organisation guided by our core values of commercialism, integrity and stewardship. The Crown Estate's entire revenue surplus is paid directly to HM Treasury for the benefit of UK citizens; in 2011 this amounted to around £230 million.

Our marine estate comprises virtually the entire UK seabed out to the 12 nautical mile territorial limit, in addition to the sovereign rights to explore and make use of the natural resources of the UK continental shelf, with the exception of oil, coal and gas. We own around half of the foreshore and beds of estuaries and tidal rivers in the United Kingdom. Our expertise includes marine resource management (e.g. marine aggregate extraction, marine renewable energy installations, seabed infrastructure, aquaculture and new activities such as gas storage and carbon capture and storage) and its interplay with other marine activities such as defence, energy, navigation and marine safety. We have a strong understanding of the needs of a broad range of coastal and sea users, as commercial partners, customers and stakeholders.

**2. Context for The Crown Estate response**

By 2020, the UK must generate 30% of its electricity from renewable sources. Offshore generation is expected to make a significant contribution to meeting this target, and DECC's Renewables Roadmap indicates that offshore wind could have an installed capacity of between 11 and 18 GW by 2020. This burgeoning industry is set to become a major UK manufacturing activity, bringing significant new inward investment, businesses and jobs. To help make sure this industry realises its full potential, The Crown Estate is taking a proactive approach. This ranges from co-investment in the consenting of projects to positive engagement with statutory and non-statutory bodies, regulators, trade associations, local and national governments and representatives of the shipping, aviation and fisheries industries.

The OFTO regime is a key part of regulatory framework and the transitional arrangements introduced in 2009 have been shown to deliver tangible benefits, such as introducing new entrants to the sector and delivering savings for customers. As these arrangements are for a finite number of offshore projects, it is essential that the detail of the enduring regime is now established as quickly as possible so that developers and other stakeholders can take necessary decisions in respect of their projects with as much certainty as possible about how the associated transmission infrastructure will be treated and delivered. The delivery of transmission infrastructure is increasingly being seen as on the critical path for projects and addressing areas of uncertainty in the OFTO regime will be key to help parties manage such risks through the life cycle of developing a project. Having said this, we do recognise that the OFTO regime is still in relative infancy, and is constantly evolving as all stakeholders understand more about its dynamics. As such, we welcome the consultation on the design of the enduring regime and we are grateful for the opportunity to provide a response.

Given our position in the market, we do not feel appropriate to comment on the specific questions asked in the consultation, but nevertheless have some more general comments to make on the enduring OFTO regime informed, in part, by our ongoing dialogue with developers of offshore generation projects and other stakeholders. We are also taking this opportunity to highlight some specific issues which we believe need to be considered further to ensure that the enduring OFTO regime is fit for purpose for connecting significant volumes of offshore generation, and does not in any way present a barrier to the expected level of the deployment of offshore generation.

### **3. General comments on the enduring OFTO regime**

#### ***OFTO Build vs. Generator Build***

We note that the consultation focuses heavily on the OFTO Build model, with less emphasis on Generator Build. We agree it is important that a robust OFTO Build model is developed for the long term success of the OFTO regime. However, over the short to medium term our understanding is that the majority of transmission infrastructure for offshore generation will be developed by offshore developers and transferred to an OFTO under the Generator Build model. As such, it is important that robust arrangements are established for Generator Build in the first instance, with arrangements for OFTO Build to follow once all stakeholders have greater experience of the dynamics of the regime, particularly how larger and more complex projects are treated, which will undoubtedly raise new challenges across stakeholders compared to those experienced to date. This does not mean that OFTO Build should not be progressed – we believe it should be progressed – but we also believe that developing a robust Generator Build model should be prioritised over the coming months.

We do note however your expectation that the Generator Build model will closely resemble the transitional regime, which we agree is a logical progression from the current arrangements. It will be important that the legal framework to enable Ofgem to run Generator Build tenders is established as soon as practicable.

#### ***Interaction with wider regulatory framework***

As the offshore transmission regulatory regime evolves, it will be increasingly important that detailed consideration and clarity is afforded as to how it interacts with other parts of the regulatory and legal framework for electricity transmission. From our review of the consultation document, it is clear that some of the key issues

are being considered. However, in order to provide the necessary confidence in the regime going forward, we believe that further clarity and review is required in a number of areas including:

- how the issue of who is legally able to commission transmission assets at 132kV and above – we welcome confirmation in the consultation that this is being addressed between Ofgem and DECC. Resolution of this as quickly as possible will be vital to provide the necessary confidence to all stakeholders on how the prohibition on transmission will work in practise,
- optimising incentive structure – a number of stakeholders have commented in recent years on the relative imbalance of the risk exposure generators face versus OFTOs through the availability incentive. Our general position is that generators should not be unduly exposed to unavailability of the transmission assets, and incentives should be sufficiently sharp to minimise risk of prolonged periods of asset unavailability. We note that further information will be published on incentives for both OFTO Build and Generator Build later in spring, so we will reserve specific comment until that time. However, we would suggest that this issue be kept under review over the longer term, particularly as and when more integrated transmission systems develop (which would logically lead to greater system security), and that experience is drawn from how incentive structures are evolving for onshore network companies, and
- regulatory treatment of different classes of subsea transmission assets – providing clarity on the regulatory treatment of different types of subsea infrastructure and how they interrelate will increasingly become an issue as the potential for more integrated (and innovative) transmission infrastructure are brought forward. For example, under current regulatory arrangements, interconnectors, reinforcements to the onshore transmission system taken offshore and offshore transmission assets are treated differently in terms of issues like how they are remunerated, how incentives are structured and access arrangements. By itself this is not a significant issue as the assets have different purposes and have developed with different histories. However, key will be clarifying the inter-relationships between these within the wider stakeholder community. Given the number of visions that have been put forward for integrated grid offshore, for example in the North Sea and more locally in the Moray Firth, it is vital that regulatory regimes evolve so that potential opportunity (e.g. in terms of deployment of offshore generation or international trading) can be maximised, which would likely be in the best long term interests of consumers.

Whilst these issues are not limited to Generator Build, they will be first experienced under Generator Build and so we believe further clarification is needed early on as to how these will be concluded for the longer term success of the OFTO regime.

### ***Asset life vs. cost recovery period***

In our recent response to the Ofgem consultation on transmission charging (which closed on 14 February), we noted that it was not clear why the costs of offshore transmission assets were recovered over 20 years, when 50 years is standard for onshore assets and other subsea power cables. Whilst 20 years is consistent with the standard regulated revenue period within the OFTO licence, we consider it should be possible to construct a transmission charging regime which reflects the expected lifespan of the transmission assets (which are likely to be significantly longer than 20 years). An effect of recovering costs of 20 years is that the offshore local tariff generators face as part of their TNUoS charges is relatively more expensive than those faced by their onshore

counterparts. We believe this issue, and the over-recovery issue (which we also raised in our response to the charging consultation) could present an unnecessary barrier to maximising the deployment of offshore generation projects. It also does not chime well at a time when industry is looking at ways of reducing the cost of offshore wind to £100/MWh by 2020<sup>1</sup>.

#### **4. Specific comments on proposals**

In addition to the general comments on the enduring OFTO regime set out above, we also have specific comments on some of the issues raised in the consultation. For simplicity, believe that these can be characterised as:

- Cost assessment guidance,
- OFTO arrangements for coordinated offshore transmission and anticipatory investment, and
- Treatment of phased projects and projects with partial FID

Our comments on each of these are set out below.

##### ***Cost assessment guidance***

We are aware that a key concern among the developer community is uncertainty over how capital and other cost items will be remunerated for developing transmission assets. The proposal to remove the cost guarantee for developers in the Generator Build model adds to this uncertainty. We note that this risk has been alleviated to some extent through the publication of cost assessment reports for each of the offshore projects where an OFTO has been appointed; the information contained in these reports is helpful in understanding decisions on costs allowed, and as importantly where costs have been disallowed. However, by their nature these reports are largely focussed on the specific issues associated with the project in question and do not constitute general guidance on approach.

Against this backdrop, we welcome the commitment in paragraph 4.19 to develop more general guidance on cost assessment. We would recommend that this is developed as soon as possible in order to reduce uncertainty and risk in this area so that developers can take their necessary project design/development decisions against a more informed framework. We would also recommend that you consult on key aspects and a draft of this guidance in the same way that you have done for related issues, such as on interest during construction. Adopting this approach should have a dual effect of facilitating the development of more robust guidance at the outset following a constructive dialogue process as well as providing greater confidence in the decision-making process thereafter.

##### ***OFTO arrangements for coordinated offshore transmission and anticipatory investment***

As you know, offshore transmission infrastructure to date has typically been developed on a point-to-point (or radial) basis, reflecting the characteristics of the early generation projects (such as those developed under our

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<sup>1</sup> See UK Renewable Energy Roadmap, DECC, July 2011. The Crown Estate is currently leading a major industry project to identify pathways toward this target.

Round 1 and Round 2 leasing rounds) as well as other factors such as technology constraints. Going forward, it is likely that some offshore transmission infrastructure will be developed in a more integrated or coordinated way, and the recent consultant reports published as part of the DECC/Ofgem coordination<sup>2</sup> project illustrate this.

It will be vital that the enduring OFTO regime remains sufficiently flexible to accommodate the features of enabling such a coordinated approach. An obvious issue is the treatment of anticipatory investment. In particular, the enduring OFTO regime needs to enable scenarios such as where a developer seeks to develop an over-sized transmission link (e.g. 1 GW) because it is the most efficient solution, but is only able to take the initial financial investment decision (FID) on the first 500MW project (with the FID on the second project taken at a point in the future). The recent TNEI and Redpoint reports for the coordination project have demonstrated that there are likely to be cost savings from such anticipatory investment, but this behaviour needs to be appropriately facilitated. We note that Ofgem is due to consult on these matters shortly as part of the coordination project, so we will respond in further detail on these issues through that document.

Others issues include the regulatory interfaces between OFTOs and interconnectors (as referenced above), how the regime caters for coordinated connection offers<sup>3</sup> and the ability for OFTOs to develop additional transmission infrastructure once appointed above the existing 20% cap to meet the future needs of generation projects. We are cognisant that the coordination project has not yet concluded, and that this consultation is happening in parallel. Nevertheless, we believe it is important that key base principles for how these types of issues will be practically treated under the tender process framework are proposed and consulted on as soon as possible. Doing so will provide greater confidence to industry on how the regime will cope with the step changes that are expected if a more coordinated approach to offshore transmission is to be realised.

### ***Treatment of phased projects and projects with partial FID***

We note that section 5 of the consultation seeks views on how Ofgem should treat projects and phases of projects for the purpose of defining the package of what will be tendered. We acknowledge it is important within the OFTO tender process to distinguish between more and less certain projects, and indeed this will be vital to the effectiveness of attracting a strong bidding field. However, we do not believe that the process should be overly prescriptive unless all eventualities can be accounted for. Referring to the diagram on page 48 of the consultation document, we note a ‘phase’ has been defined by reference to FID for the transmission assets, and may include all ‘stages’ included in the ‘phase’. We understand it is more likely in practise that a FID case will be made for a single ‘stage’ initially plus the transmission assets, but that these transmission assets may be sized to accommodate future stages (if this is the most efficient solution). This issue may be characterised as ‘anticipatory investment’ or ‘oversizing’. As per our comments above, we will respond in further detail on these issues through the consultation on the coordination project. However, we do consider these terms should be defined to reflect how projects are currently being developed.

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<sup>2</sup> “TNEI/PPA Energy: Asset Delivery Workstream – Final Report” and Redpoint Energy: “Offshore Transmission – assessment of regulatory, commercial and economic issues and options”, both published 15 December 2011

<sup>3</sup> We are aware that NGET has been making coordinated connection offers to some offshore developers (i.e. where the transmission infrastructure is often in excess of that needed to connect an individual project)

As such, we would recommend that the criteria used to determine a project for the purpose of a tender takes into account the specific circumstances of the project and, where appropriate, adjacent projects so that the most optimum transmission networks are enabled in all cases. Extending this principle, we do not believe that the potential for appointing an OFTO for a zone should be ruled out, if that is the most efficient structure.

## **5. Further development of the enduring regime**

We noted the proposal outlined at the stakeholder event on 9 February to establish working groups to consider detailed issues with the development of the enduring OFTO regime. Given our position in the market, we believe we are well placed to contribute constructively to these working groups, and would be willing to participate accordingly.

## **6. Conclusions**

We trust that you find these comments helpful in developing the arrangements for the enduring OFTO regime. Whilst many of our comments are outwith the specific questions asked in the consultation document, we consider that they are sufficiently important to raise at this point given the context of the review against wider industry uncertainties.

We would be willing to provide additional information on any of the points we have raised in this response, and would be happy to discuss these matters with you further. Please contact my colleague Richard Clay on 020 7851 5336 or [richard.clay@thecrownestate.co.uk](mailto:richard.clay@thecrownestate.co.uk) as necessary in the first instance.

Please note that all of this response may be put into the public domain.

Yours sincerely,



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