

# Offshore Transmission Owner Revenue Report

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## Overview:

The government has set an ambitious target of 15% of energy used coming from renewable sources by 2020. Its target for carbon emissions reductions of 80% by 2050, relative to 1990, is equally challenging. Offshore renewable energy technologies, including wind power, will play a major part in meeting these targets and in maintaining secure energy supplies.

- It is estimated that offshore wind currently contributes to 5% of annual UK electricity requirements, with the UK generating more electricity from wind than any other country in the world.<sup>1</sup>
- To date, over £2 billion has been committed to the development of OFTOs (Offshore Transmission Owners).
- In the year 2014/15 the OFTOs enabled the transmission of over 9 TWh of electricity.
- 1 TWh can keep the UK National rail network moving for over three months.<sup>1</sup>

<sup>1</sup> <http://www.thecrownestate.co.uk/energy-and-infrastructure/offshore-wind-energy/offshore-wind-electricity-map/>

## Background

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As well as investment in the wind farms themselves, continuing the growth in offshore wind power will require significant investment in a new offshore transmission network.

To facilitate this, the government, in collaboration with Ofgem, established a competitive, asset-based regulatory regime for the sector. This ensures that new offshore renewable generation projects are connected to Great Britain's onshore electricity network economically and efficiently.

The regime, launched in July 2009, awards licences to Offshore Transmission Owners (OFTOs) through a competitive tender. The licence entitles the OFTO to a 20 year revenue stream indexed to UK Retail Prices Index (RPI) inflation.

The first licence was granted in March 2011 and by 31 March 2015 there were 12 OFTOs in operation. Nine of the licences were granted under the offshore regime's first competitive tender round, Transitional Tender Round 1 (TR1). Three licences were granted under the second competitive tender round, Transitional Tender Round 2 (TR2).

This report details the revenue achieved by each and is intended to help inform stakeholders interested in the performance of OFTOs.

## Summary

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The Allowed Revenue reported by each OFTO in the [OFTO revenue table](#) is in line with expectations.

All revenue items are independently reviewed by each of the OFTO's Auditors as well as being checked by Ofgem.

In the year to 31 March 2015 the OFTOs earned total revenue of £166.9 million. This compares to a total capital value of £2.26 billion.

Based on the operational performance of the wind farms in the year, the OFTOs enabled the transmission of over 9 TWh of electricity to the onshore network from the offshore wind farms. For wind farms where the OFTO licence was granted during the year, the figures only include the period after the licence grant.

The MWh output of the wind farms is subject to the availability of the offshore transmission assets, as well as operational factors such as wind conditions and turbine performance.

Total system availability since the first licence grant to March 2015 is over 99%. Whilst system availability has been above 98% (which is the standard availability target), the incentive bonus schemes are structured in such a way so that there is a time delay between when incentives are earned and when they are paid. The exact mechanism for paying the incentive bonus differs from TR1 to TR2.

# OFTO Revenue

The table below details the revenues for 2014/15 for each OFTO.

Item												
OFTO	TC Barrow OFTO Limited	TC Gunfleet Sands OFTO Limited	TC Ormonde OFTO Limited	TC Robin Rigg OFTO Limited	TC Lincs OFTO Limited	Blue Trans-mission Walney 1 Limited	Blue Trans-mission Walney 2 Limited	Blue Trans-mission Sheringham Shoal Limited	Blue Trans-mission London Array	Greater Gabbard OFTO plc	Thanet OFTO Limited	Gwyn y Mor OFTO plc
Licence grant date	27 Sept 2011	19 July 2011	10 July 2012	02 Mar 2011	04 Nov 2014	21 Oct 2011	26 Sept 2012	27 June 2013	10 Sept 2013	26 Nov 2013	17 Dec 2014	11 Feb 2015
OFTO Allowed Revenue (OFTO <sub>i</sub> ) Components												
Base Revenue (BR <sub>i</sub> ) (£000)	5,391	6,694	11,276	7,607	9,295	12,269	12,565	18,494	36,151	25,514	4,768	2,865
Pass Through (PT <sub>i</sub> ) (£000)	84	159	294	102	3,893	222	362	554	492	488	3,040	3,475
Performance Adjustment (PA <sub>i</sub> ) (£000)	0	0	0	0	0	0	0	0	926	0	0	0
Correction term (K <sub>i</sub> ) (£000)	0	1	0	0	0	0	(1)	124	(4)	0	0	0
<b>Allowed Revenue (OFTO<sub>i</sub>) (£000) (BR<sub>i</sub> + PT<sub>i</sub> + PA<sub>i</sub> - K<sub>i</sub>)</b>	<b>5,475</b>	<b>6,851</b>	<b>11,570</b>	<b>7,709</b>	<b>13,188</b>	<b>12,491</b>	<b>12,927</b>	<b>18,924</b>	<b>37,573</b>	<b>26,003</b>	<b>7,808</b>	<b>6,340</b>
The below four items are the components that make up the Base Revenue figures above (BR <sub>i</sub> )												
Tender Revenue Stream (TRS <sub>i</sub> ) (£000)	4,991	6,106	10,603	6,533	24,635	11,558	12,466	19,128	34,936	26,793	16,874	25,152
Market Rate revenue Adj. Term (MRA <sub>i</sub> ) (£000)	(172)	(123)	0	(34)	(600)	(592)	(651)	(1,180)	110	(2,032)	(326)	(958)
Retail Price Inflation rate (RPI <sub>i</sub> ) (%)	3.0%	3.0%	3.0%	3.0%	0.0%	3.0%	3.0%	3.0%	3.2%	3.0%	0.0%	0.0%
Proportion of revenue term (PR <sub>i</sub> ) (%)	100.0%	100.0%	100.0%	100.0%	38.7%	100.0%	100.0%	100.0%	100.0%	100.0%	28.8%	11.8%
Key OFTO operational data												
Annual Availability (%) <sup>1</sup>	100.0%	99.5%	99.9%	98.2%	100.0%	100.0%	100.0%	99.8%	99.9%	100.0%	82.5%	82.6%
Generating Capacity (MW) <sup>1</sup>	90.0	163.9	150.0	184.0	250.0	182.0	182.0	315.0	630.0	500.0	300.0	574.0
Wind farm MWh output	283,003	496,293	512,444	502,779	520,046	635,603	758,545	1,056,475	2,139,576	1,729,217	307,900	130,587
Revenue Reported in Regulatory Accounts <sup>2</sup>												
Operating Income	1,814	2,280	2,788	2,298	4,977	4,051	4,239	5,492	8,671	4,510	2,780	0.631
Finance Income	2,984	3,770	7,619	4,520	7,977	6,986	7,264	11,079	23,445	20,529	3,135	1.367
<b>Total Income per Regulatory Account</b>	<b>4,798</b>	<b>6,050</b>	<b>10,407</b>	<b>6,818</b>	<b>12,954</b>	<b>11,037</b>	<b>11,503</b>	<b>16,571</b>	<b>32,116</b>	<b>25,039</b>	<b>5,915</b>	<b>1.998</b>

<sup>1</sup> Source: National Electricity Transmission System Performance Report 2014-2015. Published by National Grid  
<http://www2.nationalgrid.com/WorkArea/DownloadAsset.aspx?id=43252>

<sup>2</sup> Figures agreed to regulatory accounts.

## Explanation of the figures

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An OFTO's annual revenue is set out in its Licence and is based on the Tender Revenue Stream (TRS) included in their bid but will include various adjustments approved by Ofgem during the tendering process.

The exact calculation of each year's revenue starts with the Tender Revenue Stream (TRS) and includes further adjustments for:

- Market Rate Revenue
- UK Retail Price Index (RPI) inflation
- proportion of revenue term
- pass through items
- performance
- a correction factor term.

### Market Rate Revenue Adjustment:

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The Market Rate Revenue Adjustment (MRAt) accounts for the difference in financial market rates, such as LIBOR, from those modelled in the Section 8A licence consultation and the actual rates at the date of financial close.

For ten of the twelve OFTOs covered by this report, the MRA has reduced the base revenue figure. For Ormonde there was no MRA because of the funding solution used and for London Array there was an increase to base revenue.

### Retail Price Index Inflation:

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Inflation figures, as published by the Office of National Statistics, are used to determine the annual change in revenue.

The formula included in the OFTO licence dictates how the figures should be used to calculate the inflation adjustment. Although the formulas under TR1 and TR2 both apply the change in RPI using arithmetic averages of full years, TR1 applies the relevant calendar years starting January, whereas TR2 applies relevant years starting September.

This results in inflation rates of 3.0% and 3.2% respectively. Three OFTOs were granted their licences during the regulatory year 2014/15; a rate of 0% therefore applies.

### Proportion of revenue term:

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The financial reporting year for OFTOs runs from April to March. This means that when the licence is granted the first financial year will not be a full year and as a result neither will the final year. The proportion of revenue term is used to prorate the revenue entitlement in these years.

## Base revenue:

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This is made up of the Tender Revenue Stream and the Market Rate Revenue Adjustment and then adjusted for inflation. In the first and final years the base revenue figure is pro-rated to reflect the portion of the year for which the OFTO operates the transmission assets.

## Pass Through items:

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The licence permits the OFTO to recover certain costs incurred for reasons outside their control; these are reported under the Pass Through term. For example, pass through items are typically high in the first year when OFTOs are permitted to recover the OFGEM tender fees; in addition network rates are recovered annually.

## Performance Adjustment (PA):

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The OFTOs are incentivised to make their transmission assets available as much as possible. Where they are able to exceed the monthly availability target (typically 98%) they accrue a bonus. Where they do not meet this target they are subject to penalty charges.

Under TR1, bonuses earned during one incentive period (January-December) accrue for a further 5 years and are then paid to the OFTO in the following revenue year (April-March). However, penalties will reduce this accrual or be charged directly against revenue on an annual basis.

In TR2, bonuses offset penalties in the same year; the net bonus earned or penalty incurred in one incentive period is paid in the following year. The net annual revenue adjustment is reported under the Performance Adjustment term.

Although London Array is not the first OFTO to earn a performance adjustment, they are the first to be paid an adjustment, due to the varying licence conditions between TR1 and TR2.

## Correction Factor term:

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When there is an under or over recovery of revenue by an OFTO this will be corrected in the subsequent year and will be reported under the correction term. Under or over recoveries typically arise due to forecasting error in respect of pass through costs. Large over recoveries incur penalty interest rates to prevent abuse.

To date, any under or over recovery has mostly been in respect of network business rates.

## Allowed Revenue:

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The sum of Base Revenue, Pass Through, Performance Adjustment minus the Correction term equals the annual Allowed Revenue for each OFTO.

## Comparing Allowed Revenue and regulatory accounts:

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The [OFTO revenue table](#) includes the income figures reported by each OFTO in their regulatory accounts, which they are required to prepare under the licence.

The differences between the Allowed Revenue and the income reported in the regulatory accounts are generally the result of two items.

1. Certain items included in determining the Allowed Revenue under the licence, such as some Pass Through items, are not reported as income in the regulatory accounts.
2. The accounting treatment adopted to report the amortisation of the transmission assets requires some complex adjustments which impact on the value reported for income. The result is generally that the income reported in the regulatory accounts will be less than the OFTO's Allowed Revenue.

As part of our annual regulatory checks we review the reconciliation of these two figures to confirm that the items detailed are acceptable and ones we would expect to see as reconciling items.

None of the reconciliations reviewed to date have given any cause for concern.