

Offshore Transmission OFTO Revenue Report

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The government has set ambitious targets for both the deployment of renewable energy over the next decade, with a target of 15% of energy used coming from renewable sources by 2020, and for carbon emissions reductions of 80% by 2050, relative to 1990. Offshore renewable energy technologies, including wind power, will play a major part in meeting these targets and in maintaining secure energy supplies.

Background

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 2013 there were six OFTOs in operation. All six licences were granted under the offshore regime's first competitive tender, Transitional Tender Round 1 (TR1) and this report details the revenue achieved by each. This report is intended to help inform stakeholders interested in the performance of OFTOs.

Summary

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 2013 the OFTOs earned total revenue of £46.7 million. In the year to 31 March 2014 revenues for the OFTOs reviewed in this report, plus London Array, Sheringham Shoal and Greater Gabbard who have been granted licences since March 2013 are expected to be approximately £100 million. This compares to allowed annual revenue for the onshore transmission operators of £2 billion for the year to 31 March 2014.

Total system availability since the first licence grant to March 2013 is over 98%. Whilst system availability has been above 98%, the incentive bonus scheme is structured in such a way so that the incentives earned in the first incentive period (January-December) are not paid until the seventh revenue year (April-March). For this reason no amounts are yet shown against the Performance Adjustment term.



OFTO Revenue

The table below details the revenues for 2012/13 for each OFTO.

| Item | Transmission Capital Partners | | | | Blue Transmission | |
|--|-------------------------------|----------------|--------------|--------------|-------------------|--------------|
| | Barrow | Gunfleet Sands | Ormonde | Robin Rigg | Walney 1 | Walney 2 |
| OFTO | | | | | | |
| Financial year | 12/13 | 12/13 | 12/13 | 12/13 | 12/13 | 12/13 |
| Licence grant date | 27/09/2011 | 19/07/2011 | 10/07/2012 | 02/03/2011 | 21/10/2011 | 26/09/2012 |
| OFTO Allowed Revenue (OFTOt) Components | | | | | | |
| Base Revenue (BRt) (£000) | 5,070 | 6,294 | 7,700 | 7,153 | 11,537 | 5,798 |
| Pass Through (PTt) (£000) | 79 | 150 | 1,406 | 96 | 211 | 1,225 |
| Performance Adjustment (PAT) (£000) | 0 | 0 | 0 | 0 | 0 | 0 |
| Correction term (Kt) (£000) | 0 | 0 | 0 | (0) | (6) | 0 |
| Allowed Revenue (OFTOt) (£000) (BRt + PTt + PAT – Kt) | 5,149 | 6,444 | 9,106 | 7,249 | 11,753 | 7,023 |
| The below four items are the components that make up the Base Revenue figures above (BRt) | | | | | | |
| Tender Revenue Stream (TRSt) (£000) | 4,991 | 6,106 | 10,603 | 6,533 | 11,558 | 12,466 |
| Market Rate revenue Adj. Term (MRAt) (£000) | (172) | (123) | 0 | (34) | (592) | (651) |
| Retail Price Inflation rate (RPIt) (%) | 5.2% | 5.2% | 0.0% | 5.2% | 5.2% | 0.0% |
| Proportion of Revenue term (PRt) (%) | 100.00% | 100.00% | 72.62% | 100.00% | 100.00% | 49.08% |
| Key OFTO operational data¹ | | | | | | |
| Annual availability (%) | 100.00% | 99.88% | 100.00% | 99.89% | 97.47% | 100.00% |
| Generating capacity (MW) | 90.0 | 163.9 | 150.0 | 184.0 | 183.6 | 183.6 |
| Revenue reported in Regulatory Accounts² | | | | | | |
| Operating Income (£000) | 1,526 | 2,105 | 2,818 | 1,871 | 4,355 | 1,814 |
| Finance Income (£000) | 3,172 | 3,986 | 5,924 | 4,790 | 7,205 | 3,680 |
| Total Income per Regulatory Accounts (£000) | 4,698 | 6,091 | 8,742 | 6,661 | 11,560 | 5,494 |

¹ Source: National Electricity Transmission System Performance Report 2012-2013. Published by National Grid.
<http://www.nationalgrid.com/NR/rdonlyres/83A0A21D-4267-4983-8109-AA9A4E7B83FD/62630/NationalElectricityTransmissionSystemPerformanceReport20122013.pdf>

² Per Regulatory Accounts

Explanation of the figures

An OFTO's annual revenue is set out in its Licence and is based on the revenue figure included in their bid but will include various adjustments approved by Ofgem during the tendering process. The exact calculation of each year's revenue is determined by the licence which starts with the Tender Revenue Stream (TRS) and includes adjustments for:

- availability incentive bonuses or unavailability penalties
- the pass through of certain approved costs
- a correction factor term
- UK RPI inflation
- Incremental capacity income
- Market Rates on the day of financial close
- pro-rating the first year's revenue.

Base Revenue:

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. The Market Rate Revenue Adjustment (MRA) accounts for the difference in financial market rates, such as LIBOR, from those modelled in the bid and the actual rates at the date of financial close. For five of the six 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.

Pass Through items:

The licence permits the OFTO to recover certain costs that they are unable to control and they are reported under the Pass Through term. As an example, OFTOs are permitted to recover annual network rates.

Performance Adjustment:

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. 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) whereas as penalties will reduce this accrual or be charged directly against revenue on an annual basis. The net annual revenue adjustment is reported under the Performance Adjustment term.

Correction term:

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.

Allowed Revenue:

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

Retail Price Inflation:

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.

Proportion of revenue term:

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 pro-rata the revenue entitlement in these years.

Comparing Allowed Revenue and regulatory accounts

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.

Further Information

If you require further information about anything in this report please feel free to contact:

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