SCOTTISH OFFSHORE WIND LEASING – REVIEW OF PRICING STRUCTURE

STRATHCLYDE UNIVERSITY REPORT

Centre for Energy Policy Advisory Note on ScotWind Leasing - Addendum March 2021

At the time of writing our previous advice in April 2020, significant uncertainty remained around the market appetite for offshore wind leasing in both Scotland and England and Wales. As noted in our advice – "*the timing and likelihood of the transition from a 'buyers market' to a 'sellers market' is difficult to judge"* (p.1). We described the ability to effectively gauge market demand as one of the key advantages of the open auction approach being taken forward in Round 4 in England and Wales. The announcement of winning developers in Round 4, where the successful sites have attracted unexpectedly high annual option fees[1], has somewhat fulfilled that role and signals a clear 'sellers market' where developers' ability and desire to bid high to acquire the most attractive sites is now established. High bids may have been driven by an accelerated desire from oil and gas companies in particular to transition into new markets, due to the impact of the coronavirus pandemic, and more generally as a result of the rapidly strengthening 'net zero' policy environment being signalled by both UK and Scottish Governments particularly in the last 6 months.

However, without knowing the value and range of unsuccessful bids across all locations in Round 4, it remains difficult to understand the full market picture, most notably for less desirable sites. This is especially true for Scottish sites where the established development hurdles noted in our previous advice remain. BP, who in partnership with EnBW won 2 of 6 development sites, stated in a media response that '*location, location, location'*[2] was the key to ensuring that developments were worth the high option fee and could deliver the expected returns of 8-10%. It therefore remains somewhat uncertain as to whether Scottish sites could attract similarly high option fees (for those able to bid in the current ScotWind process). This is important given that understanding market demand remains one of the key components in considering whether the advantages of an open auction approach would outweigh those associated with a capped auction – as described in our original advice.

However, the desirability of Scottish sites may be higher than previously thought for a number of reasons. One criticism[3] of the Round 4 process is that the acreage made available was too limited, which goes some way to explain the unexpectedly high bids. With new emerging market players - notably a number of oil and gas companies - bidding aggressively and securing sites, while some established developers missed out, it is likely that demand for limited leases remains high. Given that ScotWind presents the next opportunity for aspiring developers to enter the UK offshore wind market, some may now consider paying more than once anticipated for attractive sites in Scotland. Sites suitable for floating offshore wind may also remain attractive to oil and gas companies looking to utilise their significant skills and expertise, already well embedded in the Scottish economy, in operating in an offshore environment, and

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1 https://www.thecrownestate.co.uk/en-gb/media-and-insights/news/2021-offshore-wind-leasing-round-4-signals-major-vote-of-confidence-in-the-uk-s-green-economy/

2 https://www.thetimes.co.uk/article/bp-splashes-out-with-huge-bet-on-wind-farms-in-the-irish-sea-jx508ln6c

3 https://renews.biz/66319/orsted-windeurope-issue-round-4-cost-warnings/

where changes to the CfD process may create more certainty around a route to market.

Given these points, and the magnitude of the annual options fees seen in the winning sites in Round 4, it is likely that the capped auction fees presented in the initial ScotWind offering do indeed underestimate the market value of sites in Scotland. The capped 'one off' option fees proposed for ScotWind and the 'annual' nature of option fees secured for Round 4 also significantly increase the difference between the cumulative leasing fees to be received in each jurisdiction. If the capped auction approach is to be retained, we recommend that Crown Estate Scotland explore whether the gap between cumulative fees expected in each jurisdiction can be reduced so that the option fees paid in Scotland represent figures closer to the expected market value. Moreover, efforts should be made to further understand the range of fees proposed for unsuccessful bids in Round 4 to aid in this process.

However, as noted in our original advice, one key advantage of the capped auction approach is that it allows the relevant administration to scrutinise development plans while selecting a preferential bidder. We reiterate our recommendation to ensure that life cycle benefits and returns to the Scottish tax payer are maximised. It is also important to note that the commercial viability remains important to all bidders. Thus, further analysis should be undertaken to understand the extent to which increasing option fees may impact the overall commercial viability and competitiveness of projects in Scotland, and, crucially whether increased option fees could lead to a risk of higher consumer energy prices. **–** [Redacted] 3rd March 2021