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# Crystal ball gazing: Calmer waters ahead for the offshore energy sector?

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Challenges ahead for world energy sector – will the offshore wind sector calm down and bank moves from oil and gas investment continue?

*Photo: Adobe Stock*

# What lies ahead for the offshore energy sector in 2024? Two lawyers, Tracy London and Eimear Murphy, both at Bracewell, examine prospects for the offshore wind sector. The latter also addresses trends in the oil and gas sector, focusing on upstream mergers and acquisitions (M&A) activity and financing.

This year, 2023, was a perfect storm for the offshore wind industry across the globe. Permitting delays, grid connection hurdles, inflation and supply chain challenges led to some developers wanting to renegotiate previously agreed offtake deals or end deal commitments with payment of fines. We saw an uncapped negative bidding auction in Germany’s 7 GW wind auction. And, in the UK, **no offshore wind projects** were awarded contracts for differences (CfDs) in Round 5.

So, what lies ahead for 2024?

Five key themes look set to impact the offshore wind sector.

**Bigger wind turbine generators (WTGs)**
First, cost pressures played havoc with renewable project economics across the globe. In the fast-growing offshore wind market, increasing WTG nameplate capacity per turbine offers the opportunity for developers to reduce the cost of installation, operation and maintenance.

However, the push for ever larger WTGs is very painful for the supply chain. The costs per megawatt are correlated to WTG size, but will require bigger

foundations, bigger blades, bigger factories and larger installation vessels. Given that some of the subcontractors are making close to zero profit margin, bigger won't necessarily be better if there isn't an industry which can support the WTGs, nor vessels available for transportation and installation of bigger WTGs in offshore locations.

In 2024 we hope to see an easing of the pressure for creating even larger nameplate capacity than the current 12–15 MW WTGs and focus on standardisation. However, China has already installed a 16 MW WTG in an offshore wind project, and a Chinese manufacturer recently announced a 22 MW offshore version in development.

**Developers consolidate current portfolios**

Second, there was consolidation. In 2H2023, Vattenfall put its 1.4 GW Norfolk Boreas project in the UK **on hold**; Ørsted, Shell/Ocean Wind and Iberdrola **shelved** some of their projects in the US, paying a penalty to release them from their lease commitments; while other developers declared renewables impairments to their portfolios.

In 2024 we will see developers taking a more cautious approach to consolidate their current portfolios.

Although Vattenfall, Shell/Ocean Wind, Iberdrola and Ørsted's decisions occurred around a similar time, some of the impacts of inflation and overambitious tender for auction bids plus supply chain issues may not manifest immediately. The market is not predicted to witness a host of projects being shelved. But it may cause delays to some projects, and the need for developers to campaign to relevant government agencies or attempt to put more squeeze on the supply chain.

**Increased M&A activity and new market entrants**

Third, review of developers' portfolios is likely to lead to increased M&A activity in the offshore wind market as developers reassess their portfolios

and seek to divest some of their assets to free up capital for earlier stage development projects. Some developers will consolidate their portfolios. Other will seek to sell down interests to share the risk/reward, reconfigure partnerships and rebalance capital commitments in the offshore wind sector.

We also expect to see new entrants to the market. For example, Octopus Energy recently launched a fund aiming to invest £3bn in offshore wind by the end of the decade. We expect that some of the other infrastructure funds will widen their portfolios with green credentials via offshore wind investments.

**OEMs and the supply chain squeeze**

Fourth, all the major western own equipment manufacturers (OEMs) reported consecutive quarterly losses in their wind segments in the past year. Costs have increased by 40% this year as most components have been touched by inflation-busting price rises.

In the past, developers have squeezed suppliers. In 2024 we expect that the supply chain will not only wish to pass on the big increases in raw materials but also try to recover their margins. The shift in market dynamics may be like the early days of offshore wind projects, where OEMs held a much greater degree of power in dictating which projects they will want to be a part of – creating more of a 'reverse auction' environment for developers depending on the global location, ie UK, Europe and the US in particular.

**Pressure on government agencies**

Fifth, there is mounting pressure on governments. On 16 November 2023, the UK government announced very welcome news, increasing the subsidies available to offshore wind developers by up to two-thirds to revive new projects in a sector that is struggling with surging costs. The maximum price available in next year's auction to build offshore wind farms will be 66% higher than in the 2023 bidding round and next year's offshore wind contracts will have a **maximum strike price** of £73/MWh and for floating offshore wind farms, the price will be £176/MWh, up from £116/MWh.

Whilst in the US, the Bureau of Ocean Energy Management (BOEM) continues to issue approvals and meet pre-approval milestones for projects. Various US states are beginning to co-ordinate their solicitations activity better. Together with the favourable taxation guidance on the Inflation Reaction Act, the government story in 2024 looks to continue to be favourable even as markets adjust.

In line with recent developments with government agencies around the globe, there will be continued pressure to overhaul or refine the relevant auction process, linked with high inflation costs and supply chain issues.

In summary, there may have been stormy waters in the offshore wind market in 2023, but 2024 is expected to be filled with 'interesting', though not necessarily calmer, developments around the globe.

> ***The real issue for how big a wind turbine generator will be available for post-2030 projects is not what is technically feasible, but what is economically sustainable for the market.***

## What's driving increased M&A activity in oil and gas for 2024?

**Eimear Murphy, Energy & Power Lawyer at Bracewell, looks at the key trends in upstream oil and gas M&A and financing for 2024.**

First, we have seen an uptick in M&A activity this year and expect this to continue in 2024. A continuing trend is the **majors** seeking to rebalance their large portfolios, by prioritising core assets and jurisdictions and exiting non-core operations. This has triggered **sale processes** by the majors across the globe. In addition, there are a number of macro-drivers bolstering M&A activity. High commodity prices have inflated asset values and made an attractive time for sellers to divest their assets.

The US Energy Information Association (EIA) forecasts that Brent crude oil prices will increase to an average of $93/b in 2024. High commodity prices seem set to continue. Cutback on exploration and production (E&P) activity has meant that M&A has become a way for some E&P companies to increase their reserves, leading to further consolidation in the market. This is particularly prevalent in the North Sea, where there have been a number of recent takeovers. We are also seeing some of the private equity backed energy companies which acquired oil and gas assets reaching the sell-point of their financial cycle, which has prompted a number of sales processes.

**Shrinking liquidity**

Second, there is a shrinking pool of liquidity for oil and gas. Raising equity for E&P companies remains very challenging. On the debt side, it is also difficult to raise capital. In 2023, we saw a number of commercial banks exit the upstream financing sector, such as BNP Paribas, with other banks announcing they will no longer provide financing to new clients in the oil and gas sector or directly finance new greenfield oil and gas developments. We expect this trend to continue.

Banks are under significant pressure from their stakeholders to reduce commitments to fossil fuels and are increasingly more selective in the clients and the projects they are willing to finance, with a preference towards borrowers with gas rather than oil-weighted portfolios. Over the last few years, we have seen traders fill the liquidity gap by providing

financing in order to secure the offtake. Of late, funds are joining lender syndicates as returns on upstream financings have been increasing over the years with rising margins and interest rates.

**ESG impact**

Third, environmental, social and governance (ESG) skills are a significant driver of a shrinking commercial bank pool. ESG covenants are increasingly prevalent in upstream financing documentation and typically involve a margin ratchet, to reward borrowers for achieving a number of ESG key performance indicator (KPI) targets, and penalising those who failed to do so – the so called 'carrot and stick' approach.

**Public narrative change**

Fourth, we are witnessing a change in the public narrative as we grapple with the energy trilemma. Following the invasion of Ukraine and the recent conflict in the Middle East, there has been some shift in the public narrative, with greater focus on the energy trilemma. Given the need to secure reliable, sustainable and affordable energy, energy security has become a key concern. And there seems to be an understanding that oil and gas will need to be part of the energy mix as part of the energy transition for some time to come.

In the UK, Prime Minister Rishi Sunak, has **committed** to future oil and gas licencing rounds. Analysis showed that domestic gas production had around one quarter of the carbon intensity of imported LNG. This is coupled with a recent drive to make the UK more energy independent. Regulatory approval for the development of the **Rosebank field** was granted in September, and it is expected that other developments, such as Cambo, may receive regulatory approval in 2024.

In the North Sea, the imposition of the Energy Profits Levy, which imposes a 75% tax rate on oil and gas producers, coupled with the prospect of a new government coming into power, has seemed to cool

investor sentiment in the North Sea. There's a lot of uncertainty regarding the North Sea. Investors need personal, fiscal and regulatory certainty to make investment decisions. The current punitive fiscal regime and potential change in political governance has resulted in buyers having a reduced appetite for acquisitions in the North Sea unless there are specific tax advantages to be unlocked.

Over the last few years, the UK has had more changes in its fiscal policy than many pan-African countries. It's made it a very difficult environment to make investment decisions.

Overall, we expect 2024 to be an active year of M&A upstream activity, with new sales processes coming to market and a number of existing deals set to close, subject to receipt of regulatory consents. Notwithstanding the shrinking pool of liquidity, upstream deals continue to be done. But financing remains a key challenge for many upstream market participants.