

All interested parties

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Dear Colleagues

Key developments in offshore transmission policy

The purpose of this letter is to provide an overview of key developments across offshore transmission over the coming year. We are publishing this letter alongside two policy statements that set out how the offshore transmission regime will operate in certain key areas going forward¹:

- Statement on future generator build tenders (the “generator build statement”)
- Statement on the proposed framework to enable coordination: An update to our December consultation (the “coordination statement”).

To date, we have run, or are in the process of running, 13 competitive tenders for offshore transmission owner (OFTO) licences under the transitional offshore transmission regime². We have granted seven OFTO licences and appointed a further four preferred bidders. We have already seen about £660m invested in offshore transmission through the competitive tenders, with up to a further £1.8bn expected from the remaining transitional regime tenders.

In addition, as part of a separate process, we have also certified existing or prospective OFTO entities for eight of the nine Transitional Tender Round 1 (TR1) projects and two of the four Transitional Tender Round 2 (TR2) projects³.

Over the past 18 months, we have consulted on refinements to the offshore transmission regime to ensure that it remains fit for purpose. This has taken into account experience from transitional tenders to date, changes to market conditions, anticipated changes to the scale, design and complexity of future offshore transmission projects and the wider subsidy support regime for offshore wind. This includes the continuing development of coordination between offshore projects, which could potentially generate significant savings as projects become larger and farther from shore.

¹ <http://www.ofgem.gov.uk/Networks/offtrans/pdc/cdr/2013/Pages/index.aspx>

² Under the transitional regime developers construct transmission assets which are then transferred to an OFTO appointed through the competitive tender process run by Ofgem. Projects seeking to qualify for tender exercises under the transitional regime were required to meet the qualifying project requirements by 31 March 2012.

³ All OFTOs have to be certified by Ofgem as complying with the ownership unbundling requirements of the European Union Third Package. Ownership unbundling is the separation of gas and electricity (ownership and operation) from its generation, production and supply. The Third Package has been implemented into domestic legislation through the Electricity and Gas (Internal Markets) Regulations 2011

(<http://www.legislation.gov.uk/ukxi/2011/2704/contents/made>)

Later in 2013, and depending on progress with the underlying wind farm developments, we anticipate launching Tender Round 3 (TR3), which will be the first tender round under the enduring regime⁴. We expect TR3 to comprise of projects to be tendered under the generator build option. We will publish relevant tender documentation ahead of commencement of TR3, including the tender rules, cost recovery methodology, and stage-specific tender documents. We also plan to hold a launch event in the coming months, before commencement of TR3.

Over the next year, we will continue to develop policy for the offshore regime across a number of other areas:

- **generator build (including cost assessment and generator commissioning)**
- **OFTO build**
- **coordinated network development.**

Generator build

Generator build statement

The generator build option for tender exercises under the enduring regime was consulted upon throughout 2011 and 2012. The supporting legislative framework is set out in the Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2013 (the '2013 Regulations'), which came into force in February 2013. The generator build statement summarises our key decisions relating to generator build, including those relating to the OFTO licence under generator build. It also gives an overview of the regulatory regime and the generator build tender process, in advance of commencement of TR3.

OFTO licence under generator build

The transmission licence granted to an OFTO comprises standard conditions and amended standard conditions. The standard conditions apply to all OFTO licensees, whereas the amended standard conditions are specific to each project and set out the methodology for calculating the OFTO's annual revenue.

In the autumn, we intend to consult on the amended standard conditions of the generic OFTO licence under generator build, for use in TR3 onwards. This will build on the existing generic OFTO licence used in TR1 and TR2 and will include drafting to implement decisions set out in the generator build statement.

The consultation will provide an opportunity to comment on the detailed generic licence drafting before it is finalised for TR3 projects.

Interest During Construction (IDC) methodology

IDC is the allowance for the cost of financing the development and construction of electricity transmission assets under generator build. We last consulted on IDC in July 2011 and indicated we would undertake a periodic review. It is now time for such a review, prior

⁴ All projects qualifying for tender exercises after 31 March 2012 fall under the enduring regime. Under the enduring regime, developers may choose either the generator build option or the OFTO build option. Under the generator build option, a developer will design and construct the transmission assets, and the OFTO will operate, maintain and decommission the transmission assets. Under the OFTO build option the OFTO will undertake the detailed design work and procurement and deliver the build programme, as well as being responsible for the operation, maintenance and decommissioning of the assets.

to the start of the enduring regime. We published an open letter on 24 May which asked for initial views, including those on the scope of the review. Following consideration of the responses, we intend to carry out further analysis and consult on our minded-to positions in the autumn, before publishing a final decision in late 2013. Any changes to the IDC will be applied to all relevant future projects, and subject to timing, could apply to select projects currently going through the tender process.

Cost assessment methodology

In December 2012, we published a cost assessment guidance document⁵. This document stated our intention to consult on our cost assessment approach for future projects under the enduring regime. We expect to commence this consultation over the coming months, with a view to considering whether revisions to the process are appropriate in the first quarter of 2014. Any resulting changes that are made to the cost assessment approach will only apply to tenders for projects that follow the decision.

Implementation of the generator commissioning clause

The generator commissioning clause in the current Energy Bill⁶ is designed to ensure that, under the enduring regime, generators can lawfully transmit electricity to commission offshore transmission assets under generator build prior to transferring those assets to an OFTO. The proposed measure provides an exception to the prohibition on transmission without a licence during generator commissioning activities and during the period leading to OFTO licence grant ("the commissioning period"). The measure is aimed at ensuring that generators transfer the transmission assets to the OFTO in a timely manner. This is by way of a 'completion notice' being issued by the system operator to the Authority, which triggers the final 18 month period in which to complete commissioning activities and transfer the assets to the OFTO.

The draft bill was published on 22 May 2012 and since then some amendments have been made to address issues identified during consultation. The final Energy Bill was laid in parliament on 29 November 2012 and includes some key changes made since the May draft, including:

- the 12 month period post issue of the completion notice has been increased to 18 months;
- this 18 month period may be reduced to 12 months by the Secretary of State between 2 and 5 years after the clause initially comes into effect;
- adjustments were made to the section of the clause relating to how generator developers are defined and how associated ownership structures are captured; and
- powers have been included in the Energy Bill to enable the Authority to modify relevant industry codes to give effect to the generator commissioning clause after consultation. Such consultation can be prior to enactment of the Energy Bill. Any associated necessary licence changes would be taken forward through normal governance processes.

In order to implement these changes, Ofgem is working with National Grid Electricity Transmission (NGET) to identify the code changes needed to give effect to the commissioning clause. This work is running in parallel with the parliamentary process for the purposes of timely implementation. We intend to consult on the proposed code and licence modifications in the coming months.

⁵ <http://www.ofgem.gov.uk/Networks/offtrans/pdc/cdr/2012/Documents1/Cost%20Assessment%20Guidance.pdf>

⁶ The most recent iteration of the Energy Bill can be found here:

<https://www.gov.uk/government/organisations/department-of-energy-climate-change/series/energy-bill>

OFTO build

OFTO build tender and licence policy

In May 2012, we published a consultation on updated policy proposals for the enduring regime, which included minded-to positions on tender policy for OFTO build. Those policy positions were subsequently reflected within the 2013 Regulations. Since then, we have been engaging further with offshore generators on the detail of how an OFTO build tender would work for particular projects. This engagement has considered whether there may be value in clarifying and/or refining the detail of current arrangements for risk sharing, tender processes and timings, and underlying industry codes and standards. We intend to publish an open letter in the autumn to provide a more detailed update on OFTO build and how this work has progressed.

Coordinated network development

Statement on the proposed framework to enable coordination: An update to our December consultation

In December 2012, we consulted on a proposed framework to enable the coordination of offshore transmission. The consultation included three categories of investment, relating to the development and construction of coordinated offshore transmission assets. Such investments might relate to assets which are oversized to cater for specific project developments or include assets expected to provide wider network benefit. In the coordination statement we set out our view of the way forward and next steps for the first two categories upon which we consulted. The third category - non developer-led Wider Network Benefit Investment - will be taken forward separately (see below).

Non Developer-led Wider Network Benefit Investment

We are continuing to explore options in relation to the delivery of non developer-led Wider Network Benefit Investment (WNBI). As we stated in our December 2012 consultation, our lead option is for onshore TOs to undertake the preliminary works for these assets, followed by an OFTO build tender to identify a party to construct and own the resulting transmission system. We consider that further policy development is required. Subject to the outcome of this policy development work, we currently plan to carry out further consultation later this year.

Integrated Transmission Planning and Regulation (ITPR) project

Our coordination policy work focuses on enhancing the existing regulatory framework to enable greater coordination in offshore transmission. In parallel, colleagues in Ofgem have been undertaking the ITPR project to review the current GB electricity transmission arrangements for system planning and delivery onshore, offshore and cross-border, in order to determine whether they are appropriate to achieving a long-term, efficient network. We published a consultation document⁷ on 5 June outlining our analysis of the issues and our emerging thinking on potential options to address them. The deadline for responses to this consultation is 2 August.

We will consider developments in the ITPR project alongside the evolution of the offshore regime where appropriate.

⁷ <http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/itpr/Pages/index.aspx>

Further information

For further information on offshore transmission, please visit our webpage⁸. If you have queries about any areas covered by this letter, please email offshore@ofgem.gov.uk.

Yours sincerely

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⁸ <http://www.ofgem.gov.uk/NETWORKS/OFFTRANS/Pages/Offshoretransmission.aspx>