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Offshore Electricity Transmission: Statement on future generator build tenders

Policy Statement

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Contact: Philip Smith

Team: Offshore Enduring

Tel: 020 7901 7199

Email: offshore.enduring@ofgem.gov.uk

Overview:

During 2011 and 2012 we consulted on the generator build option for future tenders under the enduring regime.

This document summarises our key decisions relating to generator build, including those relating to the Offshore Transmission Owner (OFTO) licence under generator build.

Our decisions are informed by experience gained from running the transitional tender rounds and from stakeholder input into the regime, including responses to recent consultations. They also reflect changes to market conditions and the bidding market since commencement of the offshore transmission regime.

This document also gives an overview of the regulatory regime and the generator build tender process in advance of starting the first round of generator build tender exercises under the enduring regime, Tender Round Three (TR3).

Context

With the government setting an ambitious target that 15 per cent of the UK's energy needs to be met from renewable sources by 2020, a dynamic approach was needed to deliver the substantial investment required in transmission. In the case of offshore wind, the Department of Energy and Climate Change (DECC), together with Ofgem, established the competitive regulatory regime for offshore transmission in June 2009. Under the regime we run the competitive tender process to select and licence Offshore Transmission Owners (OFTOs).

The competitive regime was designed to be delivered in two parts, a transitional and an enduring regime. From the outset the offshore transmission regime has sought to encourage innovation and to attract new sources of technical expertise and finance, whilst ensuring that grid connections are delivered efficiently and effectively. Once we have granted OFTO licences for all projects in the transitional tender rounds it will bring total investment in offshore transmission to approximately £2.5bn.

The investment opportunity in the enduring regime is expected to be significantly larger and is likely to deliver billions of pounds of investment in offshore transmission over the next decade. The enduring regime is also operating in the context of the proposed development of increasingly complex, integrated and coordinated offshore grid networks in the UK and the European Union (EU).

Now that the Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2013 (the "2013 Regulations") are in force, we are ready to start running tender exercises under the enduring regime. This document confirms our decisions relating to generator build tenders.

Associated documents

The Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2013, February 2013

Letter on the Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2013, February 2013

KPMG report on Offshore Transmission: An Investor Perspective, December 2012

Offshore Electricity Transmission: Consultation on licence policy for future tenders, November 2012 (Reference number: 159/12)

Offshore Electricity Transmission: Updated proposals under the enduring regime, May 2012 (Reference number: 72/12)

Offshore Electricity Transmission: Consultation on tender exercises under the enduring regime, December 2011 (Reference number: 178/11)

Offshore Electricity Transmission: Implementing further refinements to the enduring regime, November 2010 (Reference number: 137/10)

Offshore Electricity Transmission: Further consultation on the Enduring Regulatory Regime, August 2010 (Reference number: 113/10)

Contents

Executive summary

This document summarises our key decisions relating to the generator build option under the enduring regime for offshore transmission. Under the generator build option, a developer will design and construct the transmission assets, and the OFTO will operate, maintain and decommission them. This document also gives an overview of the generator build tender process. The arrangements set out in this document will apply to the generator build tenders to be run within the first round of tenders under the enduring regime, TR3.

The generator build arrangements set out in this document are informed by our experience from running the transitional tender rounds and by stakeholder input into the regime. They also reflect changes to market conditions and the bidding market since commencement of the offshore regime.

Generator build tender process

This document provides an overview of the offshore transmission regulatory regime and summarises key developments in the enduring regime, including in relation to legislation and industry codes and standards, since commencement of the transitional regime in 2009. This document also gives an overview of the process we will follow when running future generator build tenders, and the key stages of that process.

The tender process for generator build will be largely similar to that used for tenders under the transitional regime. However, where we have decided to make amendments to the tender process, they are highlighted in this document. We have made minor amendments, for example, in relation to developer qualifying project requirements, tender entry conditions, tender disqualification and re-run events, in order to enable greater efficiency in running the tender process. We have also decided to introduce the option to run an enhanced pre-qualification stage (which we would run instead of separate pre-qualification and qualification to tender stages) in particular cases, where for example, a project is relatively straight forward in design.

OFTO licence under generator build

This document explains the purpose and key features of the OFTO licence under generator build. It also sets out our decisions relating to elements of the OFTO licence we consulted on in November 2012. We confirm below our key decisions in relation to the OFTO licence - where we plan to implement changes these will not apply to any licences granted under the transitional regime:

- We intend to introduce a **gain share mechanism** within the OFTO licence in relation to **refinancing of OFTO senior debt**. We believe that the more established and sophisticated nature of the OFTO funding market relative to that at the commencement of the transitional regime means that a refinancing gain share is now appropriate. The new gain share mechanism will apply to any refinancing that takes place after the OFTO has been granted a licence. This can therefore more explicitly ensure that any gains from any subsequent OFTO refinancing activity are shared. A share of that gain would be used to reduce OFTO revenue entitlement, ultimately leading to reduced costs to consumers. As the transmission assets will be transferred post construction - when the likelihood of

any subsequent refinancing is likely to be lower, and the associated refinancing gains are also likely to be lower than pre- or during construction - it is important that any refinancing gain share mechanism is simple, transparent, and proportionate. Our current thinking is therefore that refinancing gains will be subject to a 50/50 sharing mechanism. However, we will invite views on the draft gain share mechanism, including other potential options for sharing gains, as part of a consultation on the draft OFTO licence for TR3 in the autumn.

- We intend to introduce the option for **bidders to bid the proportion of their revenue to be indexed to inflation**. We believe this offers benefits for consumers under current market conditions through providing the flexibility for bidders to match their revenue profile more closely to their cost profile. This means bidders will be able to avoid hedging costs if they use nominal debt, as well as retaining flexibility to attract different sources of finance. In turn we believe these lower costs are likely to translate into lower overall revenues being sought by bidders through the competitive tendering process, and ultimately into lower costs for consumers. We will consult in the autumn on the parameters we will use to evaluate bids, as well as on the OFTO licence drafting to support implementation.

- We intend to update some of the detail of the **availability incentive**, to **introduce a capacity weighting mechanism** - although the underlying principles of the availability incentive will remain unchanged. The capacity weighting mechanism will weight outages based on the proportion of the transmission assets unavailable during a particular outage, in order to better reflect the larger, more integrated offshore network designs that are possible under the regime in the future.

- We intend to **maintain the current 20 year default revenue term**. This will minimise the risk of stranded assets where consumers would be funding a revenue term for assets that were no longer required. It will also maintain an appropriate payback period and provide for a wider range of funding solutions (including capital market solutions) than would be possible for a shorter revenue term.

- We do not intend to apply incentives on OFTOs in relation to transmission losses for generator build, but **will focus on the developer's approach to design and construction through the cost assessment process**.

- We do not intend to introduce controls on OFTO equity sales but **will seek to enhance equity return transparency using information requests through existing OFTO licence conditions**.

The above decisions are to be implemented in the next draft version of the generic OFTO licence, which we intend to consult on in the autumn. We encourage stakeholders to respond to that consultation, which will be published on our website.

Next steps

Finally, this document summarises the next steps that we will be taking regarding finalising the OFTO licence under generator build and the launch of TR3.

1. Introduction and overview of the offshore transmission regulatory regime

Chapter summary

This chapter outlines the purpose of this document. It also provides an overview of the regulatory regime for offshore electricity transmission.

Context and purpose of this document

1.1. At present we are expecting projects to come forward for tendering under the enduring regime for offshore electricity transmission from within over 20 sites or zones licensed by The Crown Estate, including the nine Round 3 zones. If all these projects are developed it could lead to a considerable increase of renewable energy being delivered from offshore wind sources. As part of the government's recent publication of draft Contracts for Difference (CfD) strike prices, they estimated that these projects could support 8 to 16 gigawatts (GW) of offshore wind capacity by 2020[1]. As a result, billions of pounds of transmission assets could be tendered under the enduring regime between now and 2020.

1.2. Later in 2013, and depending on progress of the underlying wind farm developments, we anticipate launching Tender Round 3 (TR3), which will be the first tender round under the enduring regime. We expect TR3 to comprise of projects to be tendered under the generator build option.

1.3. The purpose of this document is to summarise our key decisions relating to the **generator build option,** including those relating to the OFTO licence under generator build. This document also gives an overview of the generator build tender process. **The arrangements set out in this document will apply to generator build tenders to be run as part of TR3**.

1.4. The generator build arrangements set out in this document build upon the successes of the current transitional regime and are informed by experience gained from running the transitional tender rounds and from stakeholder input into the regime.

1.5. Arrangements for the **OFTO build option** are **outside the scope of this document**, although many of the arrangements set out in this document are also likely to apply to an OFTO build tender. Over the last few months we have been engaging further with offshore developers on the detail of how an OFTO

[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/209361/Levy_Control_Framework_and_Draft_CfD_Strike_Prices.pdf

build tender would work for particular projects. 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. Before commencing an OFTO build tender, we also intend to consult on the OFTO licence under OFTO build, which will differ from the OFTO licence under generator build in some areas due to the different risk profile of OFTO build.

Document structure

1.6. This document has four chapters. Whilst each chapter can be read independently we recommend that you read the entire document as this will provide you with greater clarity and put individual chapters into perspective.

- This chapter outlines the purpose of, and background to, this document and gives an overview of the offshore transmission regulatory regime, including relevant legislation and industry codes and standards.
- Chapter 2 provides an overview of the generator build tender process.
- Chapter 3 explains the purpose and key features of the OFTO licence under generator build. It also sets out our decisions on the licence following our November 2012 consultation.
- Chapter 4 sets out the next steps that we will be taking regarding finalising the OFTO licence under generator build and the launch of TR3.

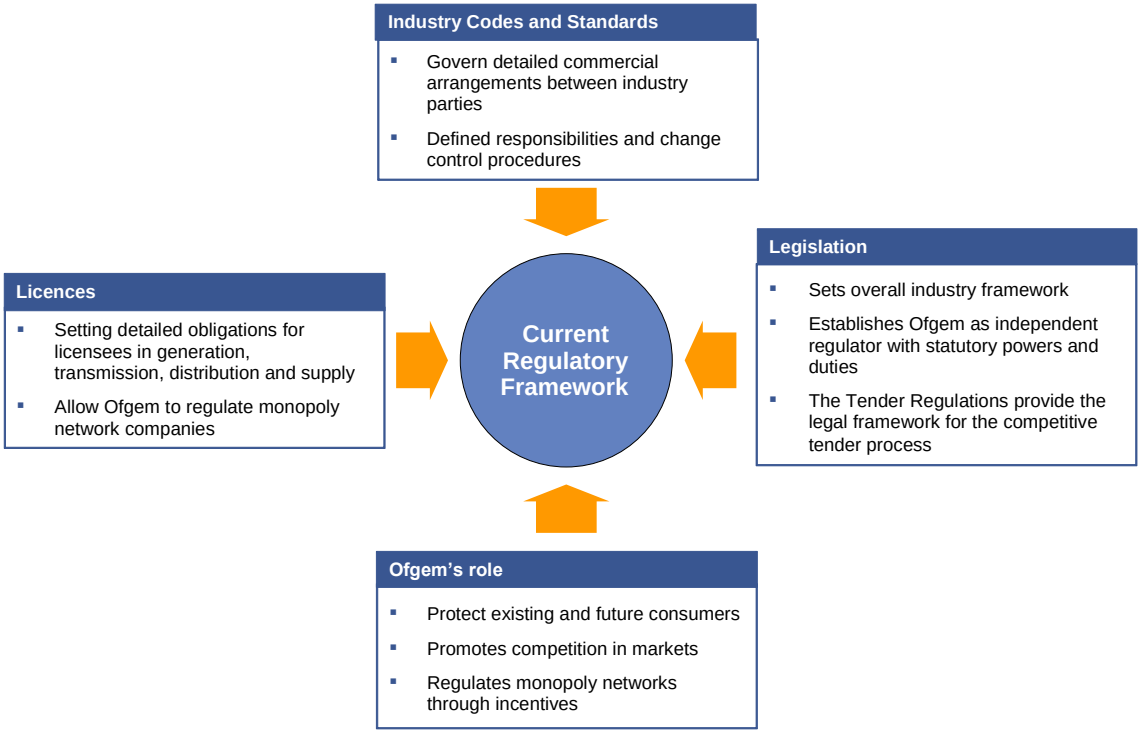
1.7. Additional information is available in the appendices, including a summary of responses to our November 2012 consultation: "Offshore Electricity Transmission: Consultation on licence policy for future tenders"[2].

Regulatory regime

1.8. The figure overleaf illustrates the offshore transmission regulatory framework.

[2] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=98&refer=Networks/offtrans/pdc/cdr/2012

Figure 1: Offshore transmission regulatory framework



1.9. The regulatory regime for offshore transmission was implemented under the transitional regime and has been developed to facilitate the enduring regime.

1.10. Under the enduring regime a developer that chooses the generator build option will transfer ownership of the completed transmission assets to a licensed OFTO at a transfer value set by us. We set this transfer value following an assessment of the economic and efficient costs that ought to have been incurred in connection with the development of the assets. The OFTO will operate and maintain the assets in accordance with the requirements of their offshore transmission licence. The licence grants a set of obligations, incentives and entitlements upon the OFTO. This includes the right to a fixed term regulated revenue stream in return for providing transmission services.

Development of the generator build option within the enduring regime

1.11. The generator build option within the enduring regime was first documented in the joint Ofgem/DECC open letter on providing additional flexibility in the enduring regulatory regime for offshore electricity transmission, July 2010[3].

[3] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=16&refer=Networks/offtrans/pdc/cdr/Cons2010

Following a period of consultation we decided, in December 2010, to introduce the generator build option[4].

1.12. Since this decision we have undertaken a number of consultations in order to provide clarity on positions on generator build and to gain stakeholder feedback so that these positions could be further developed. In December 2011 we consulted on tender exercises under the enduring regime, which included proposed changes to the generator build option relative to the approach taken for transitional tender exercises.

1.13. In our consultation on updated proposals under the enduring regime, May 2012, we provided further clarity on our minded to positions for generator build. This was followed by our November 2012 consultation on licence policy for future tenders, which focused on the OFTO licence under generator build.

Legislation

1.14. Section 6C of the Electricity Act 1989 permits the Authority[5] to make regulations to run a competitive tendering process in order to determine who will be granted OFTO licences. Under this power, the Authority has issued both the Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2010 (the "2010 Regulations") and more recently the Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2013 (the "2013 Regulations"). The 2013 Regulations set out the Authority's role in relation to the tender process, which includes to:

- determine whether the projects (i.e. transmission assets) qualify for an individual tender exercise and a tender round
- run competitive tender exercises in order to determine the entity that will be granted an offshore transmission licence for each qualifying project; and
- calculate the economic and efficient costs that ought to be, or ought to have been, incurred in connection with developing and constructing the transmission assets for each qualifying project.

1.15. Transitional tender exercises are governed by the 2010 Regulations[6]. All projects qualifying for tender exercises after 31 March 2012 fall under the

[4] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=97&refer=Networks/offtrans/pdc/cdr/Cons2010

[5] Ofgem is governed by The Gas and Electricity Markets Authority (the "Authority").

[6] Projects seeking to qualify for tender exercises under the transitional regime were required to meet the qualifying project requirements set out within the 2010 Regulations, by 31 March 2012. Transitional tender exercises being run under the 2010 Regulations will remain subject to the 2010 Regulations, except for the West of Duddon Sands project where the pre-qualification (PQ) Stage was carried out under the 2010 Regulations and the remainder of the tender exercise will be carried out under the 2013 Regulations.

enduring regime and will be subject to the 2013 Regulations. These regulations came into force on 23 February 2013 and set out the tender process framework for granting an offshore transmission licence under both generator build and OFTO build.

1.16. In addition, various changes have been made to the industry codes and licences for the purposes of offshore transmission (commencing with the initial "Go Active" amendments in 2009) through powers of the Secretary of State under the Energy Act 2004.

Energy Bill: Generator Commissioning Clause

1.17. The current Energy Bill includes a technical change to the Electricity Act 1989 - the Generator Commissioning Clause. The Generator Commissioning Clause is designed to ensure that, following full commencement of the offshore transmission regime, developers can lawfully commission offshore transmission assets under the generator build option prior to transferring those assets to an OFTO.

1.18. The proposed measure provides an exception to the prohibition on transmission without a licence during generator commissioning activities and during the 18 month period leading to OFTO licence grant, which is triggered by a completion notice issued by the NETSO ("the commissioning period").

1.19. In order to implement these changes, Ofgem is working with National Grid Electricity Transmission (NGET) to identify code and licence changes needed to give effect to the clause. This work is running in parallel with the parliamentary process for the purposes of timely implementation. We anticipate that Royal Assent for the Bill is likely to be given towards the end of 2013 with the change coming into force two months later. Therefore, we intend to consult on the proposed code and licence modifications in the coming months. We expect this document will also set out how the new arrangements may apply to projects in flight[7].

Certification under the European Union's Third Package

1.20. The Third Package is a package of EU legislation on European electricity and gas markets. It has been implemented into domestic legislation through the Electricity and Gas (Internal Markets) Regulations 2011 ("the GB Regulations")[8].

[7] "In flight" refers to those projects where operational activities have passed the point at which a completion notice would be issued, but where the transmission assets have not yet transferred to the licensed OFTO.
[8] http://www.legislation.gov.uk/uksi/2011/2704/contents/made

1.21. All OFTOs have to be certified by the Authority as complying with the ownership unbundling requirements of the Third Package. Ownership unbundling is the separation of gas and electricity transmission (ownership and operation) from generation, production and supply.

1.22. To date we have certified the OFTOs or preferred bidders for eight out of the nine transitional tender round one (TR1) projects. We have also certified preferred bidders for two out of the four transitional tender round two (TR2) projects. Copies of the certification decisions are available to view on our website[9].

1.23. We encourage existing and prospective tender participants to prepare for the certification process early and to speak to our certification team about individual applications. Further guidance on the certification process is published on our website[10] and the European Commission's website[11].

Property transfer scheme

1.24. Under Schedule 2A of the Electricity Act 1989[12], we have the power to make a "property transfer scheme". This is a last resort mechanism designed to give generators and successful bidders an avenue for ensuring the transfer of assets where commercial agreement cannot be reached. We have not had to use the powers to date but they help provide certainty and reassurance that there is a last resort avenue for ensuring the transfer of property in a fair and effective manner.

1.25. The original expiry date for our property transfer scheme powers was May 2013. DECC has recently extended the powers to apply until May 2025 so that they will cover future generator build projects[13].

Industry codes and standards underpinning generator build

1.26. In order to implement the generator build option and to ensure a robust regulatory framework across all build options under the enduring regime, changes were required to the industry codes that underpin the electricity market. In late 2010, changes were made to the Connection and Use of System Code (CUSC) and Grid Code to implement the generator build option. In March 2013, Ofgem approved the necessary changes to the System Operator-Transmission Owner Code (STC).

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[9] www.ofgem.gov.uk/offshore
[10] http://www.ofgem.gov.uk/Europe/Documents1/111110%20Open%20letter%20on%20Certification%20post%20legislation.pdf
[11] http://ec.europa.eu/energy/gas_electricity/interpretative_notes/doc/implementation_notes/swd_2013_0177_en.pdf
[12] http://www.legislation.gov.uk/ukpga/1989/29/contents
[13] The Electricity (Extension of Transitional Period for Property Schemes) Order 2013 (2013 No. 968)

1.27. The Grid Code was amended to set out the technical arrangements that apply to offshore transmission assets constructed by an offshore developer. In the CUSC the connection process was amended to provide flexibility in the scope of works the offshore developer undertakes under either OFTO build or generator build.

1.28. The Grid Code requires developers to ensure the Offshore Transmission System Development User Works comply with certain technical, design and operational requirements and standards. An OFTO is also required by its licence to comply with relevant technical codes and standards. However, there may be occasions when some requirements placed upon an OFTO may result in an inefficient outcome, either in the short or longer term, because of design and construction issues. The OFTO licence provides that the Authority may issue directions (known as 'derogations') relieving the licensee of its obligation to comply with the relevant requirements of the codes. In making decisions on whether to grant a derogation[14] we will consider the impact of non-compliance on the wider transmission system and other users, any mitigating measures that might be adopted and appropriate allocation of relevant costs.

1.29. Under the transitional regime, we have granted derogations to OFTOs from compliance with specific requirements under codes and standards on projects that were designed and constructed prior to the implementation of the offshore transmission regime, and prior to the modifications to the STC. Under the enduring regime, we expect that parties designing and constructing an offshore transmission system should be more able to adequately plan and design the assets to be compliant with the particular requirements for such works as set out in the codes, prior to asset transfer. However, if there are any remaining derogation requests, they will be assessed on their own merits.

Associated work areas

Framework to enable coordination of offshore transmission

1.30. 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.

1.31. We have now published a statement[15] in which we set out our view of the way forward and next steps for the first two categories of investment upon which

[14] http://www.ofgem.gov.uk/Networks/Techn/TechStandds/Derogtns/Documents1/090119DerogationsGuidance.pdf
[15] http://www.ofgem.gov.uk/Networks/offtrans/pdc/cdr/2013/Pages/index.aspx

we consulted. Policy work on the third category of investment (non developer-led Wider Network Benefit Investment) is ongoing.

Integrated Transmission Planning and Regulation (ITPR) project

1.32. In parallel to our coordination policy work, colleagues in Ofgem have been undertaking the ITPR project to review the current GB electricity transmission arrangements for system planning and delivery that currently apply to onshore, offshore and interconnector assets. Our coordination policy work focuses on enhancing the existing offshore regulatory framework to enable greater coordination in offshore transmission. This will look to support coordination in nearer term offshore projects, whereas the ITPR project is looking at potential additional changes in the longer term to support an integrated GB system as a whole.

1.33. We published a consultation on our emerging thinking on 5 June 2013[16]. This consultation closes on 2 August 2013.

[16] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=ITPR_emerging_thinking_consultation.pdf&refer=Networks/Trans/ElecTransPolicy/itpr

2. Generator build tender process

Chapter summary

This chapter provides an overview of the generator build tender process.

Purpose of the tender process

2.1. The generator build tender process is designed to ensure that we identify competitively the most appropriate party to operate and maintain the transmission assets for each qualifying project.

2.2. The objectives of competitive tenders for offshore transmission licences are:

- the delivery of transmission infrastructure to connect offshore generation
- provision of certainty and best value to consumers through the competitive process, and
- attracting new entrants to the sector.

2.3. The tender process is summarised below.

Project qualification for a generator build tender

2.4. A developer who wishes us to run a generator build tender exercise for their project will need to comply with a series of qualifying project requirements and tender entry conditions, as set out in the 2013 Regulations. For example, the developer will be required to demonstrate that it has secured all necessary consents and financing, and entered into all the necessary construction contracts, for the transmission assets.

2.5. Once a developer believes they can demonstrate that they meet both the qualifying project requirements and the tender entry conditions they should trigger a tender exercise by writing to us to request the commencement of a tender for their project. In doing so they must notify us of the build option that they have chosen in their Bilateral Connection Agreement (BCA) with the NETSO.

2.6. It is the developer's responsibility to request the commencement of a generator build tender within a timescale that allows the tender exercise to be run, and an OFTO to be appointed, consistent with the delivery of the transmission infrastructure and its contracted connection date.

2.7. We will notify developers and other tender participants of timings relating to a specific tender exercise. Whilst we expect the timings for, and duration of, tender stages to be similar to those for transitional tender exercises, the actual timings will be dependent upon the particular circumstances of the projects involved. Based on previous experience we estimate that the period between commencement of the pre-qualification stage and appointment of a preferred bidder will be approximately 12 months. We expect the preferred bidder announcement for a project to be no earlier than the first generation date.

2.8. Where we receive multiple requests to commence generator build tender exercises we will seek to group tender exercises within tender rounds, as we did for transitional tender exercises. Our decision on whether to group tenders will be subject to whether it is feasible and efficient to do so, based on the projects' delivery timescales. We do not intend to limit the number of tender rounds per year. The number and frequency of tender rounds will be dependent on the number of projects coming forward to be tendered.

Generator build tender stages

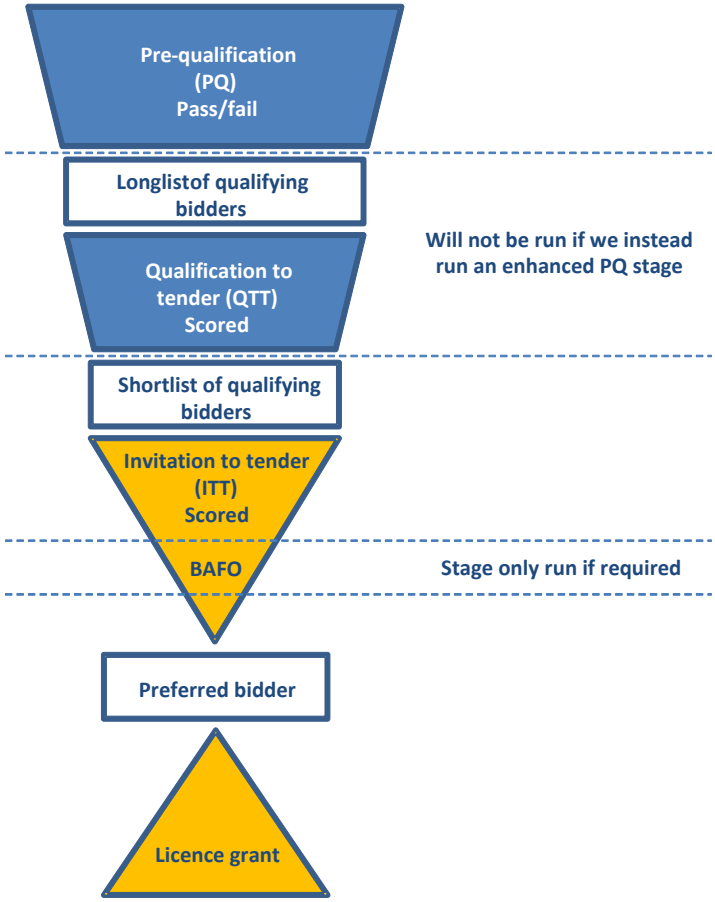
2.9. The design of the generator build tender process is broadly consistent with the process that we ran for transitional tender exercises. However, following responses to our consultations, and our own further analysis, we have built a number of enhancements into the process. These changes, detailed in the "Changes to the tender process" section later in this chapter, will enable greater efficiency over how the process is run.

2.10. The tender stages are as follows:

- pre-qualification (PQ)
- qualification to tender (QTT) (will not be run if we run an enhanced PQ stage instead)
- invitation to tender (ITT)
- best and final offer (BAFO) (if required)
- preferred bidder (PB) through to successful bidder, standstill and licence grant.

2.11. The figure overleaf illustrates the order of the stages in the tender process.

Figure 2: Overview of the generator build tender process

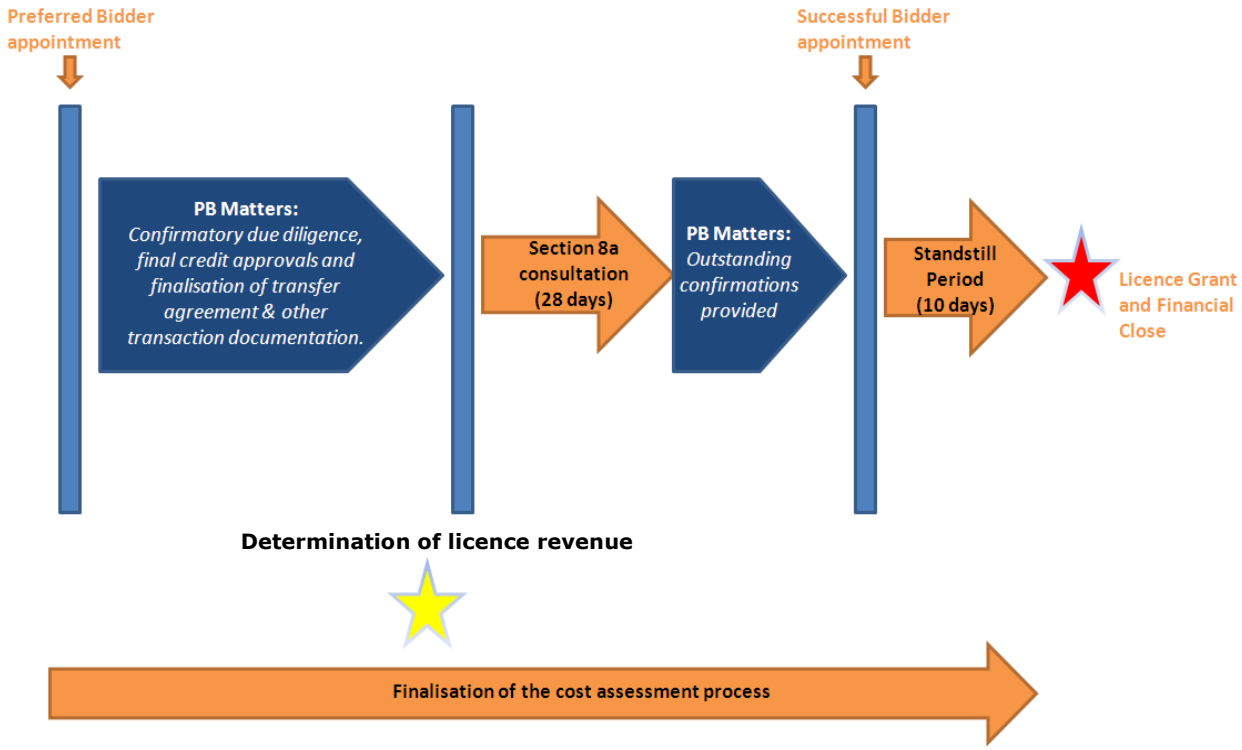


2.12. The stages of the generator build tender process are designed to identify interested parties, then filter bidders to a point where we can identify the single most appropriate party to be appointed as the preferred bidder for each project.

2.13. We will issue a notice to the preferred bidder setting out the matters (the PB Matters) which must be resolved by the preferred bidder to the Authority's satisfaction, as required under the 2013 Regulations, in order for them to become the successful bidder. This is likely to include, for example, finalising all commercial arrangements with third parties and securing final funding agreements. The preferred bidder must satisfy the PB Matters, including by liaising directly with the developer and other relevant third parties, within certain timeframes before becoming the successful bidder. For further examples of the PB Matters, see the "Guidance on the Process to Asset Transfer and Licence Grant for the Second Transitional Tender Round"[17].

[17] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=42&refer=Networks/offtrans/rttt

Figure 3: An indicative high level diagram setting out the generic process to asset transfer and licence grant[18].



2.14. While we will continue to set the Final Transfer Value (see the cost assessment section in this chapter) we will otherwise expect agreement to be reached on the transfer of assets between a developer and the preferred bidder through commercially negotiated terms of transfer. These will be contained within a transfer agreement prepared by the developer (shortlisted bidders will be given access to the draft transfer agreement during the tender process). Where issues arise in the process to asset transfer we expect that most will be for resolution on a commercial basis between the preferred bidder, the developer, and any other relevant parties.

2.15. Once we have received certain confirmations from the preferred bidder required under the PB Matters, and once we have determined the final tender revenue stream (TRS) for the project, we will commence a Section 8A Licence Consultation. This statutory public consultation, on the proposed modifications to each OFTO licence, will run for at least 28 days. The modifications are required in order to incorporate the OFTO-specific provisions into the licence, under Section 8A of the Electricity Act 1989 (see Chapter 3 for further details on the licence).

[18] This diagram is provided for information purposes only and is based on the anticipated process to asset transfer as at the date of publication of 'Guidance on the Process to Asset Transfer and Licence Grant for the Second Transitional Tender Round'; Dec 2012.

2.16. Following the Section 8A Licence Consultation, and once we are satisfied that the preferred bidder has resolved all the PB Matters, they will become the successful bidder for the project. We will then notify:

- the bidder that they have been successful; and
- each unsuccessful bidder of our determination to grant a licence to the successful bidder.

2.17. A standstill period of 10 working days will then be observed and as soon as reasonably practicable after the end of the standstill period, we will confirm the granting of a licence to the successful bidder.

2.18. Licence grant will be coordinated alongside financial close, the process by which the OFTO draws down the funding to enable it to make payment for purchase of the transmission assets from the developer and fund its own activities. This process culminates in the transfer of the transmission assets to the new OFTO. Following licence grant, the OFTO is a regulated entity subject to the regulatory regime we administer.

Tender rules

2.19. We will set out detailed requirements, expectations and obligations for participants in the relevant tender documentation for specific tender rounds, in particular within the tender rules. We will publish the tender rules before each tender round. Their purpose is to inform tender participants, developers and other interested parties about the detailed arrangements for how we intend to conduct the tender round. Developers and tender participants must comply with these rules and material failure to do so could lead to disqualification from the tender round, in accordance with the disqualification arrangements set out in the 2013 Regulations.

2.20. The tender rules cover the following areas:

- Overview of the tender process
- Participation rules
- Information exchange
- Qualifying projects and tender entry
- Tender stages that apply for that tender round.

2.21. For an example of the most recent tender rules please see those published for TR2 projects[19].

Data and confidentiality

2.22. Qualifying bidders and the developer are required to sign a confidentiality agreement prior to receiving the relevant Information Memorandum about the project.

2.23. We operate a secure access online portal to provide access to information on projects and to enable interested parties to participate in a tender. It provides a channel for both communication and data exchange at all stages of a tender.

2.24. The developer is required to upload any information or data relating to their project into a Data Room. The Data Room is a secure electronic data storage area that will be made available to relevant bidders, through the portal, at the final bidding stage (invitation to tender). Examples of the information provided by the developer include information relating to contracts, leases, warranties, assets and liabilities, operating plans, sea-bed surveys and evidence of compliance with all applicable legislation and regulations. The purpose of the information in the data room is to enable bidders to make an informed investment decision for each transmission asset and to enable a competitive tender to take place.

Bid evaluation

2.25. Under a generator build tender exercise we will evaluate submissions made by bidders at each stage of a tender exercise against evaluation criteria in the following broad areas; economic and financial standing, management and technical capability and expected TRS bid.

2.26. All decisions in all stages of a generator build tender exercise, including selection of a preferred bidder and granting a licence to a successful bidder, will be taken by the Authority. As has been the approach to date for transitional tender exercises, we will set out the approach to evaluation, as well as detailed evaluation criteria, ahead of each stage of a tender exercise.

Cost assessment process

2.27. In December 2012 we published guidance on the cost assessment process[20], which provides an overview of the process used in the transitional tender

[19] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=51&refer=Networks/offtrans/rttt

[20] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=53&refer=Networks/offtrans/rtt

rounds. This guidance is also intended to form the basis of our cost assessment approach for generator build projects.

2.28. We will continue to undertake a cost assessment process as part of each generator build tender exercise, to calculate the economic and efficient costs which ought to be, or ought to have been, incurred in connection with developing and constructing the transmission assets for a qualifying project. This will include estimating the Indicative Transfer Value (ITV) at the ITT stage and determining the Final Transfer Value for a qualifying project prior to granting an OFTO licence to a successful bidder.

2.29. Under the transitional regime, cost guarantees were available to projects. These guaranteed that the transfer value payable by the OFTO would reflect the higher of 75% of the ITV of costs likely to be incurred or 100% of the economically and efficiently incurred outturn costs. As confirmed in our December 2011 publication[21], we will remove the current cost guarantees for generator build tender exercises. Parties will nonetheless receive 100% of the transfer value which we determine as efficiently and economically incurred costs as assessed prior to asset transfer.

2.30. Reducing transmission losses overall is an important consideration in the delivery of efficient transmission systems – although there are many other and sometimes more significant factors that will inform design and procurement options, such as planning constraints and reliability of the assets. As detailed in our November 2012 consultation, our analysis, supported by our advisers, Arup[22], shows that the most effective way to control transmission losses is through the design of the transmission assets. Through the generator build option, there is no way to incentivise this behaviour through the OFTO licence, as the assets will already be operable when the licence is granted. We therefore do not intend to apply incentives on OFTOs in relation to transmission losses for generator build, but will focus on the developer's holistic approach to design and construction through the cost assessment process.

2.31. We are currently reviewing whether to develop the cost assessment process to more clearly set out the expectations for both developers and Ofgem. We expect to consult on the cost assessment process over the coming months, with a view to considering whether revisions to the process are appropriate in the first quarter of 2014. As part of this, we will consider how any changes might work, if appropriate, with our proposals for coordinated investments. For more information see the 'Framework to enable coordination of offshore transmission' section in Chapter 1.

[21] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=42&refer=Networks/offtrans/pdc/cdr/Cons2011

[22] http://www.ofgem.gov.uk/Networks/offtrans/pdc/cdr/2012/Documents1/Arup%20-%20Technical%20Support%20for%20the%20Enduring%20Regime.pdf

2.32. We are also currently reviewing interest during construction (IDC). IDC is the allowance for the cost of financing the development and construction of transmission assets under generator build. We published an open letter on 24 May 2013 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 transitional tender process.

Changes to the tender process

2.33. In developing the generator build tender process we have made a number of enhancements to the tender process that we ran for transitional tender exercises. Key changes are listed below.

Developer tender entry conditions

2.34. Within the 2013 Regulations we have introduced a new tender entry condition for the generator build (and OFTO build) option. The developer is now required to provide us with updated information on the generating station and qualifying project's development. This is intended to facilitate the efficient running of a tender exercise, for example by ensuring that we have an understanding of any delays to a qualifying project's timeframe and can consider how these might affect tender timings.

Project disqualification arrangements

2.35. We have amended the disqualification criteria for participants in generator build tender exercises. The 2013 Regulations clarify that where a disqualification event arises the relevant party may be either disqualified from the specific tender exercise to which the matter relates, or from the whole tender round. For example, this would occur where the event in question is likely to have a material impact on the tender round as well as the specific tender exercise.

Enhanced PQ stage

2.36. Following feedback to our May 2012 consultation, we have decided that certain project specific circumstances may mean that it is more efficient and effective not to run the QTT stage; for example, where the project is relatively straight forward in design. The process is designed to reduce tender timescales, enabling all parties in the tender process to better manage resources, which may assist with reducing costs. In such circumstances we will run an enhanced PQ stage to identify an appropriate shortlist of bidders to take forward to the ITT stage (see figure 2). We will take the decision on whether to run an enhanced PQ stage on a case by case basis for each project and will communicate that decision before the start of the tender exercise.

BAFO stage

2.37. We have made minor revisions to the conditions under which a BAFO stage can be run. The 2013 Regulations clarify that the Authority will continue to decide whether to hold a BAFO stage in accordance with the criteria set out in the ITT documentation for a particular qualifying project. Reasons for running a BAFO stage will reflect project specific circumstances, such as when the evaluation outcome is too close to enable a decision on appointing a preferred bidder to be made.

Re-run event

2.38. We have added an additional event to the list of events that would result in a tender exercise being re-run. Where a developer introduces a material change to a qualifying project we may choose to re-run the whole or part of that tender exercise to ensure bids reflect the revised project circumstances. In the event of such a re-run leading to the cancellation of the tender exercise, the developer is at risk of forfeiting the whole or part of its security payment. In addition, they may not be entitled to be repaid any payment made in relation to the costs we incur in running the tender exercise. The updated tender re-run process is clarified within the 2013 Regulations.

Generator commissioning and tender timings

2.39. We are considering whether it is necessary to align the tender process for generator build projects with timings appropriate to the anticipated Generator Commissioning Clause in the current Energy Bill if and where appropriate. We will keep this under review as the generator commissioning work progresses. For further detail on the anticipated Generator Commissioning Clause, see the relevant section in Chapter 1.

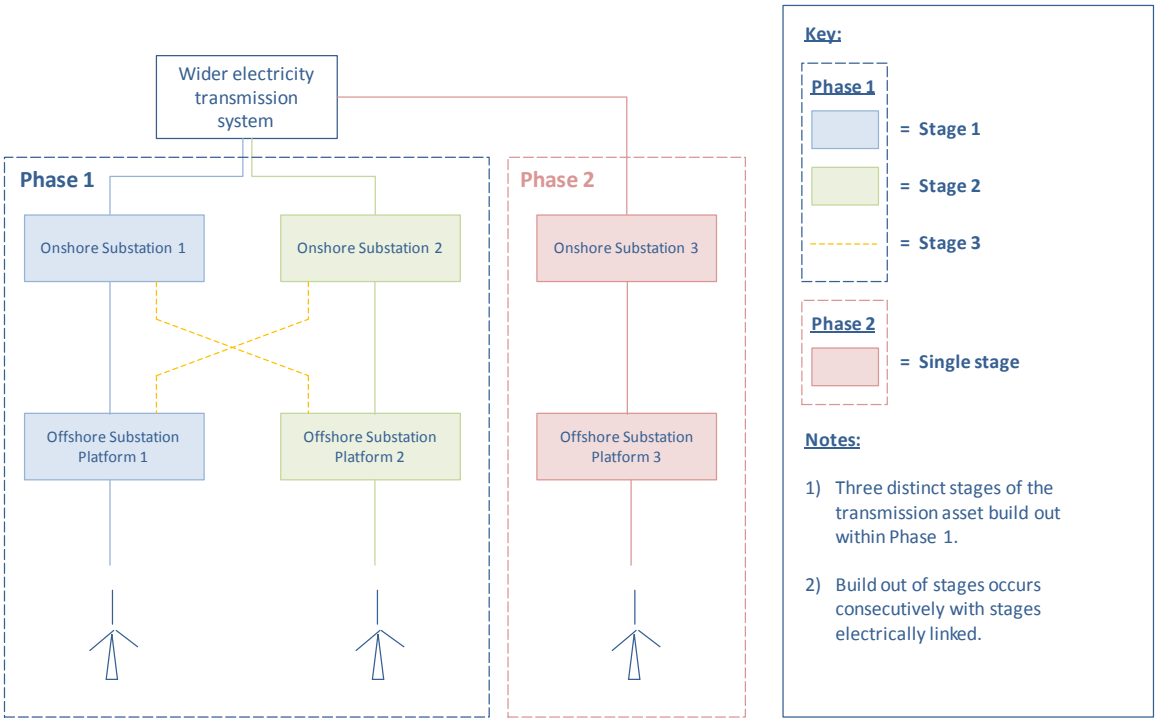
Phased and staged projects

2.40. A project may comprise multiple phases and/or stages. The following definitions clarify what we mean when we are referring to a 'phase' or a 'stage' of a project.

- *Phase:* a phase consists of transmission assets with a shared level of certainty and timing of build out, and within a discrete location. For example, we would anticipate a single phase to comprise transmission assets with a shared investment decision and/or shared key contractual commitments.

- *Stage:* within a phase, assets may be constructed incrementally in discrete groups. We use the term 'stage' to refer to each discrete group of assets.

Figure 4: Example of a project with stages and phases



2.41. As we have previously stated, our key overarching principle on tender arrangements for **phased projects** is to link the scope of a tender exercise to a committed project phase[23]. We will determine the scope of transmission assets within a tender exercise through the qualifying project requirements in the 2013 Regulations. We therefore anticipate that we will run separate tender exercises and grant separate OFTO licences for each committed project phase.

2.42. We confirm that the arrangements set out in this document will apply to all generator build qualifying projects. This is regardless of whether the project has one or multiple phases associated with it. Tenders will be run at appropriate times for the transmission assets that are most certain to be taken forward and needed.

2.43. This approach is most likely to realise the benefits of greater competition among OFTO bidders, with bids based on the most certain financial terms and least contingency. It will also reduce the possibility of tender exercises being run for transmission assets that are subsequently not needed, or only needed much later than originally planned. The combination of the arrangements set out in this document and the underlying industry codes and frameworks, provide the practical arrangements to facilitate running a separate tender

[23] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=45&refer=Networks/offtrans/pdc/cdr/2012

exercise for each generator build project phase. We consider that they are also appropriate for responding to circumstances where there may be different OFTOs per phase within a wider offshore project.

2.44. We will keep this approach to generator build phases under review to ensure it achieves maximum benefits for consumers on an ongoing basis. However, we do not anticipate introducing any significant changes for generator build phased projects from the arrangements set out in this document.

2.45. As we stated in our May 2012 consultation, for a **staged project** (where those stages are all within one phase), we will include all the stages/relevant assets within a single tender exercise. This is because for a staged project we will have sufficient certainty, at the point of commencing the tender exercise, that all the transmission assets will be taken forward and are needed.

3. OFTO licence under generator build

Chapter summary

This chapter explains the purpose and key features of the OFTO licence under generator build. It also sets out our decisions on licence policy following our November 2012 consultation.

Summary of how the licence works

3.1. All transmission licensees have duties, under the Electricity Act 1989, to "develop and maintain an efficient, co-ordinated and economical system of electricity transmission". This overarching duty is built upon by specific obligations in the OFTO licence, through the licence terms, and standard and amended standard conditions.

- *Terms:* these set out, among other things, the geographical area in which the licence applies and its duration.
- *Standard conditions:* these are made up of five sections, A to E. They apply to all transmission licensees but only sections A and E are relevant to OFTOs. These conditions cover their obligations including reporting and compliance requirements as well as the obligation to provide transmission owner services.

  More specifically the standard conditions for an offshore transmission licensee include:

  - a requirement to provide regulatory accounts
  - restrictions on some financial activities (e.g. prohibition of cross subsidies)
  - a requirement to have an investment grade issuer credit rating, or investment grade instrument credit rating in particular circumstances, or otherwise an Authority approved alternative financial arrangement
  - an obligation to comply with the STC
  - an obligation to provide transmission services
  - an obligation to provide connection offers
  - a prohibition on purchasing or acquiring electricity without Authority consent for purposes of selling electricity or other disposal

  - a requirement to notify the Authority of changes which may affect eligibility for certification

  - arrangements for appointing an OFTO of Last Resort.

- *Amended standard conditions:* These conditions apply to an individual licensee albeit are similar across all OFTOs with some project specific alterations. The amended standard conditions set out how the revenue and performance incentives are calculated and reported to the Authority. They also include business separation requirements and a map and circuit diagram of the OFTO assets.

Key features of the licence

3.2. In summary the OFTO licence for TR3 will have the following key features:

- *A default 20 year term revenue stream*[24] with limited regulatory intervention. This is the same principle as applied to the transitional regime.

- *An availability incentive* with a cap on penalties of 10% of one year's base revenue in any given year[25], which incentivises the OFTO to minimise outages, whilst also appropriately limiting the OFTO's exposure, to ensure its financial stability. This is the same as the availability incentive in OFTO licences for TR1 and TR2. For TR3 we are building on the TR2 incentive by introducing a capacity weighting mechanism.

- *Pass through costs.* The licence contains a number of pass through items such as network rates and lease fees. These allow the OFTO to recover the actual cost of an event through its annual revenue. We will continue to use the pass through costs used in TR1 and TR2.

- *A refinancing gain share mechanism*. This will be introduced for TR3 and will split senior debt refinancing gains between the OFTO and the consumer. TR1 and TR2 projects will not be affected.

- *Up to 100% of revenue indexed to the Retail Prices Index (RPI)*. This is an amendment to the transitional approach where 100% of base revenue was indexed to RPI. During a generator build tender process the bidder will state the proportion of their base revenue they would wish to have indexed for the duration of the revenue period. TR1 and TR2 projects will not be affected and will continue to have their revenue fully indexed to RPI.

[24] All licences granted under the transitional tender rounds have had a revenue term of 20 years, except TC Barrow OFTO Ltd which has an 18.5 year revenue term.
[25] The OFTO can accrue a penalty of up to 50% of one year's base revenue. This would be paid over five years. The OFTO can also accrue an annual bonus of 5% of base revenue for exceeding the availability target.

- *Incremental capacity adjustment.* The OFTO has an opportunity to provide additional capacity to developers with a value of up to 20% of the original Final Transfer Value.

Licence decisions

3.3. We consulted on various elements of the licence in November 2012. The following sections confirm our decisions on these elements as well as other elements of the OFTO licence under generator build. Where we plan to implement changes these will not apply to any licences granted under the transitional regime.

Revenue term

3.4. We consulted on whether the default 20 year revenue term used in the transitional regime remains appropriate given developments in the design and technology of offshore transmission and generation assets. The 20 year term was set to align with the forecast life of the wind farm to minimise the risk of stranding of the OFTO assets.

3.5. Analysis undertaken with input from our financial advisers, Ernst and Young, and our technical advisers, Arup, indicated that there is no additional degree of certainty that the generation assets would be operational significantly beyond 20 years. This would mean that there is a chance that the transmission assets would no longer be required past this point even if the assets themselves were still capable of operating. Although it would be possible to finance and operate the transmission assets beyond 20 years, the analysis did not indicate that a term longer than 20 years offers a significant value for money benefit.

3.6. Supported by this analysis, we also believe that shortening the revenue term would not be beneficial. This is because the 20 year period is in line with other arrangements for infrastructure investment, gives an appropriate payback period to support offshore wind generation and provides for a wider range of funding solutions (including capital market solutions) than would be possible for a shorter revenue term.

3.7. Respondents were largely supportive of keeping the default revenue term at 20 years. Some respondents requested further clarity on how the revenue term would be structured for phased projects.

3.8. Based on our analysis and responses to the consultation, we have concluded that keeping the default revenue term at 20 years is most appropriate at the current time. This will minimise the risk of stranded assets where consumers would be funding a revenue term for assets that were no longer required. We do not expect any significant changes to our outlined approach for phased projects but we are keeping this under review and will provide details on any possible refinements in due course.

3.9. We note that while the most appropriate default term is 20 years, it is possible that the transmission assets will be required in excess of this time period. To address this we have previously set out options such as retendering the assets, or extending the revenue term, that could apply at the end of the initial 20 year term. These options are discussed in further detail in the 'end of revenue term policy' section later in this chapter.

3.10. We also noted in the November consultation that a 20 year term may not be appropriate for integrated networks where there may be a lower risk of stranding due to multiple sources of generation. Our analysis of the appropriate revenue term for integrated networks is ongoing. We expect to outline further detail on this before tenders commence for such projects.

Refinancing of senior debt

3.11. The transitional regime policy for refinancing is for there to be no refinancing gain sharing post-licence grant. This can put bidders under competitive pressure to price any future refinancing gains into their bid. Additionally, the transitional projects are relatively low in value. Therefore the potential for OFTO refinancing gains post-licence grant, along with the value of any associated gains, is likely to be low.

3.12. We consulted on refinancing policy in November 2012. This policy applies to refinancing of senior debt. We outlined two main options:

1. Retain the transitional regime policy of no refinancing gain sharing post-licence grant, or

2. Introduce a refinancing gain share policy in which any refinancing gain post licence grant would be shared between the OFTO and the consumer according to a pre-defined sharing mechanism. Refinancing losses, should they arise, would remain an OFTO risk.

3.13. Responses to the consultation were mixed, with differing views on the impact of the transitional regime policy and the potential impact of a gain share mechanism. Some respondents specifically stated that they did not believe a refinancing gain share would harm investor appetite and others commented on the importance of allowing capital to be recycled.

3.14. At the time the transitional regime was introduced no OFTOs existed and investment decisions were being made in the context of the recent financial crisis. As such there was a need to provide sufficient incentive for investment in the regime and to provide confidence that there would be appetite for competition for OFTO licences.

3.15. We believe that the establishment of the OFTO as an attractive asset class via the transitional regime now provides additional incentive for investment in the enduring regime and also provides additional confidence that there is an established competitive market for future OFTO licences. Additionally, future

projects under the enduring regime are generally likely to be of higher value than transitional projects, and may therefore be more likely to allow an OFTO to realise larger gains from any potential refinancing post licence grant. Given the above **we have decided to introduce a refinancing gain share mechanism** within the licence for TR3. This policy of explicitly sharing refinancing gains will apply to any refinancing taking place after the OFTO has been granted a licence.

3.16. Under a gain share mechanism, if an OFTO refinances its senior debt, and in doing so realises a gain, a share of that gain would be used to reduce revenue entitlement, ultimately leading to reduced costs to consumers. As the transmission assets will be transferred post construction - when the likelihood of any subsequent refinancing is likely to be lower, and the associated refinancing gains are also likely to be lower than pre- or during construction - it is important that any refinancing gain share mechanism is simple, transparent, and proportionate. Our current thinking is therefore that refinancing gains will be subject to a 50/50 sharing mechanism. However, we will invite views on the draft gain share mechanism, including other potential options for sharing gains, as part of our consultation on the draft OFTO licence for TR3 in the autumn.

Indexation of revenues

3.17. The transitional regime policy for indexation was that revenues would be fully index linked to RPI. This was appropriate for the transitional tender rounds because it was simple and easy to understand and evaluate. It has also helped establish a very competitive market for OFTO senior debt. Now that the offshore transmission regime is more established and the financing market has evolved, it is appropriate to consider if alternative approaches could offer more flexibility and wider consumer benefit.

3.18. The November consultation set out three options for indexation policy:

1. Retain the transitional regime policy of full indexation
2. Index a fixed proportion of the revenue stream
3. Allow bidders to bid what proportion of the revenue stream they would like to have indexed ("biddable indexation").

3.19. Responses were mixed although there was some consensus amongst developers in favour of full indexation. Several developers noted a preference for full indexation due to its greater simplicity, whilst others noted the availability of index linked debt and the applicability of RPI as an inflation measure. Some respondents noted the importance of having appropriate procedures in place to evaluate bids robustly. One respondent noted the strong appetite in the investment market for index linked incomes but also identified the potential greater flexibility offered by biddable indexation. Other respondents noted the benefits offered by biddable indexation and how it may be more appropriate for larger projects.

3.20. Having considered the consultation responses, our consultant's analysis and after analysing the risks and benefits, **we have decided to adopt a policy of biddable indexation for generator build**. We believe this offers benefits for consumers under current market conditions through providing the flexibility for bidders to match their revenue profile more closely to their cost profile. This means bidders will be able to avoid hedging costs if they use nominal debt, as well as retaining flexibility to attract different sources of finance. In turn we believe these lower costs are likely to translate into lower overall revenues being sought by bidders through the competitive tendering process, and ultimately into lower costs for consumers.

3.21. In determining our approach, we noted that there are several significant factors which are material to justifying this approach to indexation of revenue as a specific part of the offshore regime. There are already significant differences between the onshore and offshore regimes, which are designed for transmission assets with different characteristics. We do not consider that this change in indexation within the offshore regime sets a precedent for the onshore regime.

3.22. We have considered carefully how we would evaluate bids with differing proportions of revenue subject to indexation. This evaluation will require bids to be discounted to net present costs. We will consult in the autumn on how to determine the parameters that we will use to discount bids into present value terms as well as the OFTO licence drafting to implement biddable indexation.

Availability incentive

3.23. The availability incentive is designed to incentivise OFTOs to maximise system availability and repair faults promptly. The OFTO licence under generator build will include an availability incentive which will build on the incentive used in TR2. The availability incentive for generator build will retain the following features:

- *Penalty and bonus cap.* It is important that the availability incentive mechanism keeps the OFTO incentivised to minimise outages, whilst also appropriately limiting the OFTO's exposure, to ensure its financial stability. The availability incentive will continue to cap penalties for outages occurring in a given year at 50% of one year's base revenue, spread over up to 5 years. The maximum penalty that the OFTO can suffer in any one year is 10% of base revenue. The availability incentive will also reward the OFTO with a bonus of up to 5% of base revenue for availability above the annual target.

- *Target availability.* The target availability will continue to be 98%. This will be calculated on an annual basis. We believe this target is appropriate for projects using HVAC (High Voltage Alternating Current) equipment. As projects are constructed further offshore they are more likely to make use of HVDC (High Voltage Direct Current) technology. This equipment may have different expected availability compared to the HVAC cables that have been used on projects to date. We are not

expecting any HVDC assets to be included within TR3 projects, but we will keep the target availability under review for future projects where HVDC technology may be used.

- *Availability not utilisation.* The incentive will be based on asset availability, not asset utilisation, meaning that the OFTO is not exposed to any risk of low wind farm output.

- *Seasonal weighting.* The seasonal weighting incentivises OFTOs to take outages during the summer months when generation is usually at its lowest. The average of the seasonal weightings over the year is one, to ensure that the annual target availability remains at 98%. The values of the seasonal weightings will continue to be specific to each project.

Planned and unplanned outages

3.24. As part of the development of the availability incentive for generator build we consulted in November on differentiating between planned and unplanned outages by penalising unplanned outages more heavily. This would be in order to encourage the OFTO to maintain their assets in a good condition using appropriate planned outages. We have considered this further, including in the context of input from our technical consultants, Arup, as well as feedback from the consultation. We believe that there is no value to consumers at this stage in introducing a mechanism to differentiate between planned and unplanned outages as it would have a potentially limited impact on OFTO behaviour, while adding unnecessary complexity and administrative burden.

Transmission Entry Capacity (TEC)

3.25. For TR3 we will continue to calculate the maximum transmission system availability using the lower of:

1. the aggregate TEC; and

2. the maximum system availability for that month that is capable of being delivered by the licensee by providing transmission services to the normal capability limits.

3.26. Using this method is appropriate for transmission assets as seen in TR1 and TR2 because the TEC is often similar or the same as the maximum rated capacity of the export cable. We are expecting transmission assets in TR3 projects to be of similar design.

3.27. In future tender rounds, where projects may adopt more integrated designs and/or have greater cable redundancy, TEC may no longer be an appropriate measure of availability. We will continue to review the use of TEC for future projects where such designs may be used.

Changes to the availability incentive - capacity weighting

3.28. The availability incentive used in TR1 and TR2 calculates penalties and bonuses based on the maximum unavailability in Megawatt hours (MWh) of the outage. This is calculated by multiplying the capacity of the outage by the duration of the outage. The outage is then weighted using the seasonal weighting values.

3.29. In November 2012 we consulted on whether to introduce a capacity weighting mechanism to the availability incentive. The capacity weighting mechanism was our preferred option from a number of proposed availability incentive amendments consulted on in May 2012. The majority of respondents supported the proposal to introduce the capacity weighting to the availability incentive mechanism.

3.30. **We have decided to introduce a capacity weighting mechanism to the availability incentive for generator build.** This will be in addition to the seasonal weighting mechanism. In making this decision we have considered responses to previous consultations and analysis undertaken by our technical consultants, Arup, in their November 2012 report[26].

3.31. This mechanism aims to encourage OFTOs to take smaller capacity outages where possible. This should maximise the amount of electricity a developer can export because, at any one time, the amount of electricity generated by a wind farm is normally lower than the maximum capacity of its export cables.

3.32. OFTOs are potentially able to take relatively smaller capacity outages where they have a multi-cable transmission system and/or some redundancy in their system. This is more likely to be the case on larger, future projects than the projects we have seen during the transitional rounds. Therefore the capacity weighting mechanism will only apply to projects in TR3 onwards.

3.33. The capacity weighting mechanism will weight outages based on the proportion of the transmission assets unavailable during a particular outage, with higher capacity outages penalised more heavily. This will mean that, for a two export cable system, for example, the OFTO would incur lower availability incentive penalties if it took each cable out for one hour in sequence than if it took both cables out for one hour simultaneously.

3.34. We intend to consult on the licence drafting of the capacity weighting mechanism, including the extent to which the mechanism will weight outages, in the autumn, ahead of the ITT stage of TR3. The calculation for the capacity weighting will be added to the existing availability incentive calculation.

[26] http://www.ofgem.gov.uk/Networks/offtrans/pdc/cdr/2012/Documents1/Arup%20-%20OFTO%20Availability%20Incentive.pdf

Pass through costs

3.35. In order to avoid the OFTO pricing in large contingencies for uncertain costs, which it is not able to control or not best placed to manage, the licence contains a number of pass through items which allow the OFTO to recover the actual cost of an event through its annual revenue.

3.36. The OFTO is expected to use reasonable endeavours to minimise any increase in costs through the pass through terms. Pass through costs can be positive or negative in value, resulting in either an increase or a decrease to the TRS.

3.37. We have decided to include all the pass through items used in the TR2 licence in the TR3 licence.

Incremental capacity incentive

3.38. The Incremental Capacity Incentive Adjustment (ICA) remunerates OFTOs who make additional capacity available to new or existing developers, following a request from the NETSO. The OFTO is only obliged to offer terms for incremental capacity where capital costs incurred in providing the additional capacity do not exceed 20% of the original investment cost in respect of the OFTO's transmission system. The ICA term used in TR1 and TR2 includes two separate remuneration mechanisms: The Additional Capacity Incentive Adjustment (ACA) and the Incremental Capacity Utilisation Adjustment (ICUA).

3.39. The ACA requires the OFTO to submit a notice to the Authority setting out its costs for providing the additional capacity. The Authority then determines the revenue adjustment to cover efficient costs incurred. In TR1 and TR2 the ACA is intended to be used where significant capital expenditure is required.

3.40. The ICUA is a formula which derives a £/kW value for providing the extra capacity. In TR1 and TR2 the intention is to use the ICUA where the OFTO provides additional capacity using its existing assets and incurs only minor capital expenditure.

3.41. **We have decided to remove the ICUA from the OFTO licence under future generator build tenders.** All remuneration for incremental capacity will now be calculated using the ACA. This will mean that the change in OFTO revenue will always be specific to the capacity extension undertaken by the OFTO. We believe this change is necessary for future projects as they will generally be larger than transitional projects and therefore will potentially be able to provide more additional capacity to developers under the incremental capacity adjustment. Given the increase in the maximum value of incremental capacity, we believe a standard calculation is no longer a suitable method for calculating revenue adjustment. Using the ACA allows us to take into account project-specific considerations when deciding on the revenue adjustment, which it is not possible to do using a generic equation.

3.42. In November we also consulted on other possible changes to the ICA. This included the potential introduction of an absolute monetary limit on incremental capacity investment (currently the limit on incremental capacity investment is expressed as a proportion, 20%, of the original investment cost) and the possibility of adapting the incremental capacity so that the developer would build the additional capacity and transfer it to the incumbent OFTO. We are continuing to consider both these areas and will provide more details on any further changes to the incremental capacity incentive in due course.

Other areas

Common ownership of OFTOs

3.43. In November we also sought high level views on the relevant considerations associated with OFTOs coming under common ownership. Responses were mixed as to the advantages and disadvantages of common OFTO ownership. Several respondents noted the benefits, such as reduced cost of capital, which can be achieved through an active secondary market for equity. Respondents also noted the potential realisation of a number of synergies, including managerial, operational and financial, due to common ownership. However, concerns were expressed by some respondents that larger OFTOs could have a detrimental effect upon the competitiveness of future tenders.

3.44. We noted in November that in relation to onshore networks, Ofgem will "advise the merger authorities and government on any relevant mergers based on the relevant factors surrounding the merger in question". We intend to apply a similar principle to the treatment of any possible future OFTO mergers, in line with our statutory duties and our objectives for the offshore regime.

Transparency and equity returns

3.45. We have considered how to ensure we enhance transparency on OFTO equity returns. We already obtain a significant amount of detail about financing arrangements, including equity distributions, through regulatory reporting as well as the initial tender and transaction processes. The licence also requires ultimate controlling parties to provide an undertaking to the licensee that they will provide whatever information is required by the Authority in discharging its various statutory duties. Additionally, we intend to introduce a refinancing gain share (as detailed earlier in this chapter), which would ensure greater transparency on equity returns than is possible under existing arrangements.

3.46. At present we do not believe introducing controls on OFTO equity sales would be in consumers' interests since both the primary and secondary funding markets for equity in OFTO projects appear competitive and they remain relatively well tested. We also believe that seeking to regulate equity sale proceeds is unnecessary given the efficient equity market. We therefore do not intend to introduce controls on OFTO equity sales but will seek to

maximise equity return transparency using information requests through existing OFTO licence conditions.

OFTO of Last Resort

3.47. The aim of the OFTO of Last Resort mechanism is to minimise the risk of an offshore developer becoming stranded from, or delayed in connecting to, the onshore electricity network. It may be necessary to appoint an OFTO of Last Resort where:

- an existing OFTO business fails or is unable to continue with its obligations and their licence is revoked, or
- we are unable to appoint an OFTO following a generator build tender exercise.

3.48. The OFTO of Last Resort process would broadly be the same regardless of the trigger.

3.49. The OFTO of Last Resort mechanism provides certainty to all stakeholders that, once appointed, an OFTO would be in place for the entire period of the original 20 year revenue term. The flexibility of the OFTO of Last Resort mechanism is intended to enable a seamless transition of obligations throughout the 20 year term.

3.50. The OFTO of Last Resort mechanism also provides certainty to developers that they will not be left with transmission assets they are unable to transfer to an OFTO following the failure of a generator build tender exercise.

3.51. To appoint an OFTO of Last Resort, we expect we would invite proposals from transmission licensees. Based on their proposals, we expect we would appoint the most appropriate transmission licensee as the OFTO of Last Resort. We envisage that we would firstly look to appoint an existing OFTO (there are currently seven such OFTOs in place), but if there is not an appropriate OFTO, we would look to appoint an onshore transmission licensee. The OFTO of Last Resort's responsibilities would broadly be the same as the incumbent OFTO's responsibilities (where an incumbent is in place).

3.52. Where an existing OFTO business fails or is unable to continue with its obligations and their licence is revoked, we expect that we would seek to ensure that both the incumbent OFTO and the OFTO of Last Resort are fairly remunerated. We expect that the incumbent OFTO would receive a transfer value reflective of the net asset value after depreciation. In return, we envisage that the OFTO of Last Resort would receive an annual revenue stream sufficient to fund an efficiently operating business and to meet the cost

of purchasing the assets. For more detail please refer to the OFTO of Last Resort guidance[27].

End of revenue term policy

3.53. Some transmission assets may have a useful life in excess of the 20 year revenue period. In such circumstances the Authority will make a decision at the relevant time about any ongoing regulation of the transmission assets based on the ongoing demand for them and in the context of the Authority's statutory duties. This decision is expected to be made before the initial revenue period has lapsed. There are three possible approaches the Authority might adopt, with the choice of approach dependent on the individual project circumstances:

1. *Decommissioning and revocation.* To revoke the incumbent OFTO's licence – this would be in the event that there was no ongoing demand for the asset demonstrated by the incumbent, or other parties. Decommissioning of the transmission asset would need to occur prior to revocation of the licence.

2. *Extension.* To extend the revenue period with a revised revenue stream for the incumbent OFTO.

3. *Re-tender.* To undertake a further tender exercise to appoint an OFTO with a new revenue stream.

[27] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=39&refer=Networks/offtrans/rttt

4. Next steps

Chapter summary

This chapter clarifies the next steps that we will be taking regarding finalising the OFTO licence under generator build and the launch of TR3.

OFTO licence under generator build

4.1. We intend to consult in the autumn 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 licence used in TR1 and TR2 and will include drafting to implement decisions set out in Chapter 3 of this document.

4.2. The consultation will provide an opportunity to comment on the detailed generic licence drafting before it is finalised ahead of the ITT stage of TR3. We encourage stakeholders to respond to the consultation, which will be published on our website.

TR3 launch

4.3. Later in 2013, and depending on progress with underlying wind farm developments, we anticipate launching TR3.

4.4. At the present time we anticipate that the tender round will comprise one or more generator build projects.

4.5. 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.

Appendices

Index

Appendix 1 - Summary of responses to 'Consultation on licence policy for future tenders', November 2012

Introduction

A1.1. 'Offshore Electricity Transmission: Consultation on licence policy for future tenders, November 2012' set out our policy proposals for updating the offshore transmission licence for future tenders. It focused on the OFTO licence under generator build for projects qualifying from 2013 onwards. The consultation built on the current regime and took into account experience gained from the initial tender rounds. The responses period ran from 30 November 2012 to 22 February 2013.

A1.2. This appendix provides an overview of the key themes from the responses. Copies of all non-confidential responses are available on the Ofgem website[28].

Chapter 2: Revenue framework

Q2.1 Do you agree that the 20 year revenue term is still appropriate for point to point systems?

A1.3. Respondents generally agreed that for point to point systems, the 20 year revenue term is still appropriate. However, a common theme among respondents was that clarity and flexibility is needed on options available for shared assets at the end of the 20 year revenue term. A few respondents thought flexibility should be agreed for the end of term on a case-by-case basis.

Chapter 3: Refinancing

Q3.1 What do you think are the advantages and disadvantages of each refinancing policy option? Please explain why.

A1.4. Respondents provided a range of responses, with two in favour of the status quo, three favouring the implementation of a refinancing gain sgere mechanism and five expressing no particular preference.

A1.5. Those in favour of the status quo indicated that the introduction of a refinancing gain share mechanism would inhibit the banks' ability to recycle

[28] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=98&refer=NETWORKS/OFFTRANS/PDC/CDR/2012.

capital freely, thus increasing the cost of debt. Concerns were also raised over the implications that a refinancing gain share mechanism may have upon TNUoS charges.

A1.6. Responses that indicated no particular preference were generally in agreement with the advantages and disadvantages as outlined within the November 2012 consultation. In addition, it was suggested that while light touch regulation appeals to investors, the length of the revenue term would allow for the implementation of a refinancing gain share mechanism.

A1.7. Those parties in favour of the implementation of a refinancing gain share mechanism expressed a belief that a gain share would be more appropriate and effective in securing benefits for the consumer. However, it was noted that any mechanism should also provide a suitable incentive for the OFTO, to ensure that they pursue refinancing wherever possible.

Q3.2 Are there other refinancing policy options that you think we should also consider?

A1.8. In the event of an OFTO build project, one developer suggested that such a mechanism would place some risk upon the OFTO, due to the significant construction risk taken on during the OFTO build process.

A1.9. Two other respondents indicated that a refinancing gain share mechanism would be necessary within any OFTO build projects, in order to claw back any gains arising once the construction period is over. Eight respondents had no comment on this question.

Q3.3 What are the benefits of OFTOs coming under common ownership and what are the associated issues that Ofgem should consider? To what extent should we capture any gains from OFTOs coming under common ownership?

A1.10. Overall, the responses demonstrated mixed opinions as to the advantages and disadvantages of common OFTO ownership.

A1.11. The primary benefit identified was that of the potential realisation of a number of synergies, including managerial, operational and financial. Regarding the allocation of such realised benefits, opinion was divided. Developers indicated that they would expect derived benefits to be split between the consumer and the developers, whereas the bidders indicated that they would expect those undertaking the risk to gain, to cover, in part, the costs associated with the bidding process.

A1.12. Concerns expressed by two developers suggested that larger OFTOs could have a detrimental effect upon the competitiveness of future tenders, while another indicated that larger OFTOs would impose increased risk upon the developer. An expectation that Ofgem would consider the impact of any OFTO merger was also noted.

Chapter 4: Indexation

Q4.1 What do you think are the advantages and disadvantages of each indexation policy option? Please explain why.

A1.13. Responses were mixed, with regards to the advantages and disadvantages of each indexation policy, with a slight majority in favour of retaining the status quo.

A1.14. Two developers were in favour of retaining the 100% indexation of revenues, due to continuity, as well as the additional complications that might be expected under biddable or fixed indexation. Two further developers indicated that they believed the index-linked nature of the revenue stream to be an important factor in attracting potential investors.

A1.15. Two respondents expressed a preference towards adopting biddable indexation, considering the method to be more beneficial to consumers, as well as allowing bidders to tailor their bids. Further considerations were raised by respondents that the level of indexation should more accurately reflect the proportion of costs that are linked to inflation, rather than including elements such as the transfer value within the TRS.

A1.16. In addition, it was noted by several respondents that in the case of biddable indexation, Ofgem's choice of discount rate, when evaluating bids, would be key.

Q4.2 Are there other indexation policy options that you think we should also consider?

A1.17. Two developers indicated a preference for adopting the Consumer Prices Index (CPI) as the accepted method of indexation, in favour of RPI. One suggestion was that CPI is more likely to be used for offshore Contracts for Difference, whereas the other suggested that RPI's inclusion of council tax and housing costs within its calculations made it inappropriate for OFTOs.

A1.18. It was also suggested by two developer respondents that, should biddable indexation be favoured, developers should be the party to indicate the preferred level of indexation within the revenue stream.

Chapter 5: Revenue incentives

Q5.1 Do you agree with our proposal to introduce the capacity weighting mechanism to the availability incentive mechanism?

A1.19. The majority of respondents supported the proposal to introduce capacity weighting to the availability incentive mechanism. One bidder saw the benefit in principle, but had reservations about the potential complexity. One bidder did not agree with the proposal, due to limited benefit and added complexity.

Q5.2 Do you agree with our proposal not to introduce a penalty differential between planned and unplanned outages to the availability incentive mechanism at this time?

A1.20. Six out of eight respondents to this question agreed that it would not be beneficial to introduce a maintenance type weighting at this time. Some respondents highlighted that all outages impacted the developer, and therefore should be equally discouraged. It was also highlighted that if unplanned outages were penalised more, there was an increased risk that the OFTO could hit the 50% penalty cap sooner, which could dampen the incentive. Two developer respondents did not agree with the proposal, as their view was that a maintenance type weighting could deliver benefits. One developer stated that the types of outage were not difficult to differentiate, and therefore the mechanism would be relatively straightforward to implement.

Q5.3 Are there any further issues that you feel we should consider as part of our enhancements to the availability incentive? If so, why?

A1.21. A variety of different issues were raised in response to this section. Some respondents highlighted the link between the availability incentive and the cost assessment process, arguing that the cost assessment process should ensure the most efficient design of assets overall, taking into account availability performance. There was broad agreement for both the target availability and the penalty cap levels, with respondents suggesting that these could be reviewed in future to take into account practical experience and the development of the regime. One bidder argued that further changes to the availability incentive mechanism should be avoided where possible to provide the most consistency and clarity to the market.

Q5.4 Going forward do you think that the use of TEC for the maximum availability will remain appropriate? If not, what project designs might TEC not be appropriate for and what alternative would there be?

A1.22. Most respondents agreed that TEC was appropriate as the measure for maximum availability. However, nearly all respondents noted that TEC will potentially not be suitable for coordinated assets. Of the couple of respondents that didn't agree with TEC as an appropriate measure, one suggested a cable's maximum rated capacity was more appropriate.

Q5.5 Do you agree with our intention to remove the ICUA term and only use the ACA cost assessment term to calculate the remuneration required for providing additional capacity?

A1.23. Developer respondents agreed with our proposal to remove the ICUA term from the incremental capacity incentive adjustment calculation. Bidder respondents generally disagreed with our proposal, with one stating that the removal of the ICUA term could lead to an increased regulatory burden if all incremental capacity was subject to a cost assessment under the ACA term.

Q5.6 Do you agree with our intention to not introduce greater flexibility in relation to remuneration for incremental capacity at this time?

A1.24. The majority of respondents were happy with the existing mechanism but several respondents, both developers and bidders, noted that there may be benefits to introducing increased flexibility in future, particularly for phased projects.

Q5.7 Do you believe that adding an absolute threshold for incremental capacity would be beneficial? If so, what should the value of the threshold be?

A1.25. Two developer and two bidder respondents were in favour of an absolute cap on incremental capacity investment set on a project by project basis. Bidders felt this would be beneficial for investor certainty. One developer proposed setting a cap high enough to allow for additional project phases to be built using the incremental capacity mechanism.

A1.26. Three developer respondents were against an absolute cap on incremental capacity because they felt that the mechanism should retain sufficient flexibility to cover any project where incremental capacity provides better value for money than running an additional tender to appoint an OFTO.

Q5.8 What are the benefits, drawbacks, risks and considerations in adapting the incremental capacity mechanism to allow generator build of subsequent phases?

A1.27. Bidder respondents were against extending incremental capacity to cover generator built assets and stated that they believe that additional assets should be built by the OFTO in all cases. Developer respondents were in favour of extending incremental capacity to cover generator built assets for reasons including reducing the number of OFTOs operating in one zone and reducing the risk to the developer of late delivery of transmission assets.

Chapter 6: Next steps and interdependencies

Q6.1 What further areas relating to your planned or potential future projects do you think that Ofgem should consider in order to help facilitate the efficient delivery of the OFTO build model?

A1.28. Some developers highlighted that they were concerned about risk caused by uncertainty of the deliverability of assets. One developer suggested that this risk could be mitigated by features such as liquidated damages, greater developer involvement in design, procurement, evaluation and flexibility for the developer to be a partner/sub-contractor during construction.

A1.29. Bidders remain advocates of OFTO build, with one bidder stating that it is open to considering suggestions in all of the areas identified above.

Q6.2 Do you have any comments on the relevance of changes to the RIIO licence on the OFTO licence?

A1.30. There was only one response to this question. The respondent stated that there should be consistency between onshore and offshore regimes where possible. In particular they mentioned conditions B22 (Data Assurance Requirements) and B23 (Requirement for Sufficiently Independent Directors) which have been added to the onshore licence.

Miscellaneous comments

Cost assessment

A1.31. A general theme was that there should be more upfront engagement with developers at a project design stage. One respondent said more emphasis should be placed on cost assessment to determine whether the expected lifetime costs of offshore transmission provide value for money for consumers.

Transmission losses

A1.32. There was a suggestion that excluding transmission losses from the developer's business case has the potential to skew investment in favour of technologies that might not offer the most efficient transmission solution; and may therefore undermine value for money for the consumer. It should be noted that this is not Ofgem's stated policy.

Appendix 2 - Glossary

A

ACA

Additional Capacity Incentive Adjustment.

Authority

The Gas and Electricity Markets Authority, which governs Ofgem.

B

BCA

Bilateral Connection Agreement.

BAFO

BAFO means the "best and final offer" that may be requested by Ofgem from some or all of the qualifying bidders.

C

Connection and Use of System Code (CUSC)

The Connection and Use of System Code is the contractual framework for connection to, and use of, the National Electricity Transmission System.

Coordination

The term coordination refers to the work we are undertaking to support the development of an integrated onshore-offshore transmission system where appropriate, to ensure the most economic and efficient outcome for consumers. This is achieved by identifying and delivering improvements to the network planning process and designing a framework for investment in coordinated network development to underpin the enduring regime.

Crown Estate Round

The Crown Estate has leased areas of the UK seabed to offshore renewable energy developers in 'leasing rounds'. Developers are asked to bid for exclusive rights to develop offshore renewable generation within identified zones.

D

DECC

The Department of Energy and Climate Change.

Developer

The 2013 Regulations define the 'developer' as 'any person within section 6D(2)(a) of the Electricity Act 1989' (the 1989 Act) or within a developer group (where 'developer group' means two or more persons acting together for the purposes of developing a qualifying project). Section 6D(2)(a) of the 1989 Act defines such person as 'the person who made the connection request for the purposes of which the tender exercise has been, is being or is to be, held'. In practice, such person is also the entity responsible for the construction of the generation assets and, under generator build, the transmission assets.

Distribution Network Operator (DNO)

Distribution Network Operator means an entity that operates an electricity distribution network, which includes all parts of the network from 132kV down to 230V in England and Wales. In Scotland 132kV is considered to be a part of transmission rather than distribution so their operation is not included in DNOs' activities.

E

Electricity Act

Means the Electricity Act 1989, as amended from time to time.

Enduring regime

The regulatory regime for projects qualifying for offshore transmission tender exercises afther 31 March 2012.

Energy Act

Means the Energy Act 2004.

Enhanced PQ Stage

Certain project specific circumstances may mean that it is more efficient and effective not to run the QTT stage for future generator build tenders. In such circumstances Ofgem will run an enhanced PQ stage to identify an appropriate shortlist of bidders to take forward to the ITT stage. Ofgem will take the decision on whether to run an enhanced PQ stage on a case by case basis for each project and will communicate that decision before the start of the tender.

EU

European Union.

F

FID

Final Investment Decision

Final Transfer Value

In relation to the generator build option, the Final Transfer Value means Ofgem's assessment of the economic and efficient costs which ought to have been incurred in connection with the development and construction of the relevant transmission assets.

G

Generator build

Under the generator build option, the developer will take responsibility for all aspects of preliminary work, procurement and construction of the transmission assets. A prospective OFTO will bid their approach to the financing, operation, maintenance and decommissioning of the transmission assets, and a Tender Revenue Stream value that includes the costs associated with carrying out these activities.

GB

Great Britain.

Grid Code

The Grid Code covers technical aspects relating to connections to, and the operation and use of, the National Electricity Transmission System.

GW

Gigawatt.

H

HVAC

High Voltage Alternating Current.

HVDC

High Voltage Direct Current.

I

ICA

Incremental Capacity Incentive Adjustment.

ICUA

Incremental Capacity Utilisation Adjustment.

Indicative Transfer Value

In relation to the generator build option, the Indicative Transfer Value means Ofgem's estimate of the economic and efficient costs which ought to be incurred in connection with the development and construction of the relevant transmission assets.

In flight

In flight refers to those projects that have passed the point at which a completion notice (that would trigger the final 18 month period to complete commissioning activities) would be issued and where the transmission assets are operational but have not yet transferred to the licensed OFTO.

Integrated Transmission Planning and Regulation Project

The Integrated Transmission Planning and Regulation Project (ITPR) was launched by Ofgem in March 2012 to review the existing GB electricity transmission arrangements. It is looking at how the system is currently planned and delivered, assessing whether any changes are appropriate to facilitate a future integrated system. This is in response to the longer term challenges arising from the move to a decarbonised energy system.

The project's focus is on whether the separate regimes for onshore and offshore transmission and for interconnection can continue to ensure the efficient, coordinated and economic development of the overall network over the longer term.

Invitation to Tender (ITT) stage

The stage of a tender exercise during which bidders have the opportunity to put forward their detailed proposals for providing transmission services. Its purpose is to enable Ofgem to identify the preferred bidder.

K

kW

Kilowatt.

L

Licence Grant

Licence Grant means the grant of the Offshore Transmission Licence by the Authority to the successful bidder, pursuant to section 6C of the Electricity Act 1989.

M

March 2012 consultation

Offshore Transmission: Consultation on potential measures to support efficient network coordination, March 2012, Ref (26/12).

May 2012 consultation

Offshore Electricity Transmission: Updated proposals under the enduring regime, May 2012, Ref (72/12).

MW

Megawatt.

MWh

Megawatt hour.

N

National Electricity Transmission System Operator (NETSO)

The entity responsible for coordinating and directing the flow of electricity over the national electricity transmission system.

National Grid Electricity Transmission (NGET)

NGET owns and maintains the onshore high-voltage electricity transmission system in England and Wales. It is also the NETSO.

November 2012 consultation

Offshore Electricity Transmission: Consultation on licence policy for future tenders, November 2012, Ref (159/12).

O

Ofgem

Office of Gas and Electricity Markets.

OFTO

OFTO or Offshore Transmission Owner means the holder of an Offshore Transmission Licence, granted by Ofgem.

OFTO build

Under the OFTO build option, the developer would obtain the connection offer and undertake high level design and preliminary works. A prospective OFTO would bid their approach to the procurement, financing, construction, operation, maintenance and decommissioning of transmission assets, and the costs associated with carrying out these activities.

OFTO of Last Resort mechanism

The mechanism used to appoint an OFTO in the unlikely event that a developer would otherwise be stranded. The aim of the OFTO of Last Resort mechanism is to

minimise the risk of a developer becoming stranded or delayed in connecting to the onshore electricity network.

OFTO licence

The licence awarded following a tender exercise, allowing an OFTO to operate the offshore transmission assets. The licence sets out an OFTO's rights and obligations as the offshore transmission asset owner.

O&M

Operations and maintenance.

P

Phase

A phase consists of transmission assets with a shared level of certainty and timing of build out, and within a discrete location. For example, we would anticipate a single phase to comprise transmission assets with a shared investment decision and/or shared key contractual commitments.

Preferred bidder or PB

Preferred bidder means, in relation to a qualifying project, the qualifying bidder determined by Ofgem, in its sole discretion and following its evaluation of the bids received, as the qualifying bidder to which it intends (subject to the satisfaction of the conditions specified by Ofgem) to grant the Offshore Transmission Licence.

Pre-Qualification or PQ stage

Pre-qualification stage means the period starting from the publication of the pre-qualification documentation, including the preparation, submission and evaluation of pre-qualification submissions and ending once Ofgem has published the longlist of qualifying bidders who have pre-qualified for the qualification to tender stage.

Q

Qualification to tender or QTT stage

Qualification to tender stage means the period starting from Ofgem publishing the confidentiality agreement in relation to the qualification to tender stage. It includes the publication by Ofgem of the longlist of qualifying bidders who have pre-qualified for the qualification to tender stage, the preparation, submission and evaluation of qualifying bidder's responses to the qualification to tender documentation. It ends once Ofgem has notified the qualifying bidders of its selection of qualifying bidders to be invited to participate in the invitation to tender stage.

Qualifying bidder

A qualifying bidder means a bidder or bidder group invited to make a QTT submission or an ITT submission, or if applicable, a BAFO submission.

R

2010 Regulations

The Electricity (Competitive Tenders for Offshore Transmission Licences) 2010.

2013 Regulations

The Electricity (Competitive Tenders for Offshore Transmission Licences) 2013.

Retail Prices Index (RPI)

RPI measures the aggregate change in consumer prices over time and is therefore a measure of inflation. It differs from the Consumer Prices Index (CPI) in that it measures changes in housing costs and mortgage interest repayments, whereas CPI does not. They are calculated using different formulae and have a number of other more subtle differences.

S

Section 8A Consultation

This statutory public consultation on the proposed modifications to each OFTO licence will run for at least 28 days. The modifications are required in order to incorporate the OFTO-specific provisions in the licence, under section 8A of the Electricity Act 1989.

Senior Debt

In the context of this document the term senior debt is referring broadly to debt which is provided by a non-related third party.

SPV

Special Purpose Vehicle.

Stage

within a phase, assets may be constructed incrementally in discrete groups. We use the term 'stage' to refer to each discrete group of assets.

Successful Bidder

A successful bidder means a preferred bidder to which Ofgem has determined to grant an offshore transmission licence.

System Operator – Transmission Owner Code (STC)

The STC defines the high-level relationship between the National Electricity Transmission System Operator and a Transmission Owner.

T

TEC

Transmission Entry Capacity.

Tender Regulations

The Tender Regulations underpin the competitive tender process run by Ofgem to select and licence OFTOs under the regulatory regime. The regulations currently in force are the Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2013.

Tender Revenue Stream (TRS)

The payment an OFTO receives over its revenue term.

The Crown Estate

A property portfolio owned by the Crown. The Crown owns the UK seabed out to the 12 nautical mile (nm) limit and the The Crown Estate has the right to lease areas of the UK seabed for renewable energy projects.

Third Package

The term 'Third Package' refers to a package of EU legislation on European electricity and gas markets that entered into force on 3 September 2009.

Transmission assets

Transmission assets are defined in Paragraph 1 (3)(a) of Schedule 2A to the Electricity Act 1989 as, '*the transmission system in respect of which the offshore transmission licence is (or is to be) granted or anything which forms part of that system*'. The transmission system is expected to include subsea export cables, onshore export cables, onshore and offshore substation, and any other assets, consents, property arrangements or permits required by an incoming OFTO in order for it to fulfil its obligations as a transmission operator.

Transmission Entry Capacity (TEC)

The contractually agreed maximum amount of electricity a developer can export onto the National Electricity Transmission System.

TNUoS charges

Transmission Network Use of System charges.

TR1

Transitional Tender Round 1.

TR2

Transitional Tender Round 2.

TR3

Tender Round Three. The first tender round to be held under the enduring regulatory regime for offshore transmission.

Transmission Owner (TO)

An owner of a high-voltage transmission network or asset.

U

UK

United Kingdom.

Z

Zone

The transmission assets within a zone licensed by the Crown Estate, in relation to Crown Estate Round 3.

Appendix 3 - Feedback questionnaire

A.3.1. We are keen to consider any comments or complaints about this document. In any case we would be keen to get your answers to the following questions:

1. Do you have any general comments about this document?
2. Do you have any comments about the overall tone and content of this document?
3. Was the document easy to read and understand, could it have been better written?
4. To what extent did the document provide a balanced view?
5. To what extent did the document provide reasoned explanations for the decisions reached?
6. Please add any further comments?

A.3.2. Please send your comments to:

Andrew MacFaul
Consultation Co-ordinator
Ofgem
9 Millbank
London
SW1P 3GE
andrew.macfaul@ofgem.gov.uk