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Offshore Electricity Transmission: Consultation on tender exercises under the enduring regime

Consultation

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Overview:

This document sets out proposals to help realise investment in offshore transmission, drive down costs of offshore wind, reduce costs to consumers and help achieve government's low carbon targets.

It consults further on the enduring offshore transmission regime, building upon joint Ofgem/DECC consultations of August and November 2010, as well as the government response to the consultations of December 2010. The document sets out the proposed approach to the Offshore Transmission Owner (OFTO) build option which is expected to underpin the enduring regime and therefore to play a key role in delivering future transmission assets. The consultation also covers proposed changes to the Generator build option where it differs from the approach taken for transitional tender exercises.

We welcome responses to this consultation by 17 February 2012. We expect to hold a stakeholder workshop on issues raised in this consultation in early 2012.

Context

Offshore wind energy represents a key pillar of the government's target of providing 15 per cent of the UK's energy needs from renewable sources by 2020. Delivery of transmission assets for offshore wind energy projects forms an integral part of the strategy for reaching this objective in the most cost effective manner. Ofgem[1] and the Department of Energy and Climate Change (DECC) have therefore developed a regulatory regime for offshore electricity transmission. A key part of the regime is that offshore electricity transmission licences will be granted to an Offshore Transmission Owner (OFTO) following a competitive tender process run by Ofgem. The legal framework for the offshore electricity transmission regime was established in June 2009 and the current Tender Regulations came into effect in July 2010[2]. The regime is being delivered in two parts: a transitional and an enduring regime. Ofgem is currently appointing OFTOs under the transitional regime[3], for transmission assets valued at ca £3bn.

This consultation document focuses on tender exercises under the enduring regime. It has been developed in the context of the significant upcoming investment opportunity of up to £14bn presented by the assets likely to qualify for such tender exercises between now and 2020, and also in the context of the broader development of coordinated offshore grid networks both in the UK and in Europe.

Specifically, this document sets out our proposed approach to running OFTO build and Generator build tender exercises under the enduring regime. Under the OFTO build option, OFTOs appointed through a competitive tender process would undertake the construction of transmission assets in addition to operation, maintenance and decommissioning of those assets. Under the Generator build option the transmission assets would be constructed by generator developers, with ownership of completed assets transferred to the OFTO appointed through a competitive tender process. We expect that both options, and the proposed OFTO build option in particular, will support the upcoming investment opportunity and broader network development by encouraging new entrants and new sources of finance, while also enabling innovation in asset construction.

[1] For ease of reference, Ofgem is used to refer to Ofgem, Ofgem E-Serve and the Gas and Electricity Markets Authority (The Authority) in this document.
[2] The Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2010.
[3] Transitional projects must meet the qualifying project requirements set out by the Tender Regulations by 31 March 2012. Projects that do not meet these requirements by this date will be subject to the enduring regime.

Associated documents

- Offshore Electricity Transmission: Consultation on the Enduring Regime, December 2009 (Reference number 157/09)
- Offshore Electricity Transmission: Further consultation on the Enduring Regulatory Regime, August 2010 (Reference number 113/10)
- Providing additional flexibility in the enduring regulatory regime for offshore electricity transmission: Initial joint decision statement, October 2010
- Offshore Electricity Transmission: Implementing further refinements to the Enduring Regime, November 2010 (Reference number 137/10)
- Government response to offshore transmission consultations, December 2010 (Reference number 157/10)
- The Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations, 2010
- Offshore Electricity Transmission: Tender Rules, September 2010
- Transmission Licence Standard Conditions
- Generic Offshore Transmission Owner (OFTO) Licence (Version 1.2), December 2011
- Guidance on the Offshore Transmission Owner Licence for Transitional Tender Round 2, December 2011
- The Electricity and Gas (Internal Markets) Regulations, 2011

N.B. Prior to the publications listed above, Ofgem and DECC consulted extensively on the regime. All documents relating to those consultations are available on the Ofgem website.

Contents

Executive summary

In July 2009 Ofgem commenced the first transitional tender round for nine qualifying projects with transmission assets worth £1.1 billion linking 2.1GW of capacity. This first tender round attracted almost £4 billion of investment appetite, demonstrating strong industry and investor confidence in the offshore transmission regulatory regime. The second transitional tender round commenced in November 2010 and is expected to connect a further 2.6GW of capacity. Going forward, transmission assets within over 20 sites or zones licensed by the Crown Estate are likely to qualify for the enduring regime, delivering up to 30GW of additional capacity, with an indicative value of up to £14bn (see Appendix 2 for a list of possible future tender exercises under the enduring regime). This offers a significant investment opportunity as well as a chance for the industry to participate in a growing and innovative market.

The tendering regime for offshore transmission represents an innovative approach to delivering infrastructure assets via a robust and transparent competitive process within a strong regulatory framework. Our experience with transitional tender exercises has confirmed that there is strong investor interest in the offshore transmission opportunity due to a number of factors, including:

- a long-term, low risk, regulatory regime
- a defined risk profile with limited counterparty and energy risk
- an availability-based revenue stream with Retail Price Index (RPI) indexation
- an established tender process
- defined performance incentives, including upside potential
- defined end-of-term arrangements.

Our enduring regime proposals are designed to provide certainty for developers in offshore windfarms as well as transmission developers, helping to drive down the overall costs of offshore windfarms, reducing costs to consumers and helping to achieve government low carbon targets.

Construction of offshore transmission

Given the scale and complexity of transmission assets likely to be constructed under the enduring regime, and given that generators are prohibited from owning transmission assets, it is necessary to ensure that the regime which underpins their delivery is fit for purpose and meets the needs of generators, OFTOs and consumers. It will be important to ensure that construction activities and risks can be effectively addressed by our tender process and regulatory framework.

This consultation therefore builds on lessons learnt through the transitional tender exercises, as well as reflecting our ongoing engagement with stakeholders in order to set out our proposed approach to the OFTO build option, which we expect to play a key role within the enduring regime going forward. We also consult on elements of the Generator build option and set out our proposals for running tender exercises for transmission assets constructed in phases or stages.

In appraising the policy options available, we are guided by the need to build on the success of the offshore regime to date (including in bringing down the cost of offshore wind generation); provide certainty to industry participants; listen to

stakeholder feedback; facilitate new entrants and innovation in the market; and deliver consumer savings.

Delivering savings through OFTO build

The OFTO build model is central to the enduring regime. Based on industry feedback received to date the consultation focuses on an approach whereby OFTOs would be appointed after completion of the planning consent process; the consultation seeks stakeholders' views on whether the early OFTO build option (whereby OFTOs would also undertake pre-construction works) merits further development. Under the proposed OFTO build option, the generator will carry out pre-construction works, with a competitive tender process determining the OFTO responsible for procuring, constructing, operating, maintaining and decommissioning the transmission assets. We set out that fixed priced bids are expected to be possible for most, if not all, cost items; however, the consultation seeks views on whether some areas of risk may be more efficiently managed for consumers through a risk sharing mechanism.

The tender process will be similar to that applied to transitional tender exercises; however, we are considering options around introducing additional flexibility into the process in order to achieve the optimum balance between process efficiency and enabling OFTOs to price their bids with sufficient certainty. We also explore the extent to which the tender process needs to take into account potential supply chain constraints associated with the manufacture and delivery of some key offshore transmission assets, while bearing in mind the importance of facilitating access for new entrants and delivering savings in the supply chain. We confirm that we will undertake a cost assessment to determine the economically and efficiently incurred costs of the generator's pre-construction works and the value of these works when transferred to the OFTO. We believe the key benefits of the proposed OFTO build option include:

- reduced capital expenditure required from generators for delivering projects
- ensuring time-critical pre-construction works are not delayed
- reduced transmission construction risk for generators, allowing them to focus on the generation aspects of their projects
- a streamlined tender approach to allow timely OFTO appointment by overlapping the consenting, procurement and tendering processes
- significant scope for innovation, including in asset design, procurement, construction, financing of projects and risk management
- enhanced scope to attract new sources of capital
- enhanced scope for new market entrants (for example, amongst bidders and the supply chain).

In short, we believe the proposed OFTO build option will enable the industry (including generators, the OFTO community, suppliers and manufacturers) to benefit from the significant investment opportunity offered by enduring tender exercises, while ensuring value for money for consumers via timely and effective delivery of offshore transmission assets. Importantly, it also encourages private sector innovation and facilitates access for new entrants. Finally, we hope that the proposed OFTO build model will facilitate innovation in construction and operational financing solutions which may, for example, include project finance, institutional investments and project bonds.

Generator build option

The Generator build option is now included in the regime as a result of industry feedback in late 2010. The consultation document focuses on those aspects of this option that may differ from the approach we are currently taking to running transitional tender exercises, although in all cases the document builds on the experience gained to date and seeks stakeholders' views as to whether the proposed changes adequately translate lessons learnt.

Phased or staged construction of transmission assets

Transmission assets within many of the sites and zones licensed by the Crown Estate that are likely to be tendered under the enduring regime are currently due to be constructed in phases over the course of several years. We set out our initial views within this document on how we propose to run tender exercises for these assets.

1. Introduction

Chapter Summary

This chapter outlines the purpose of, and background to, the consultation document. It sets out the scope of issues that we are consulting on in this document.

Purpose of this document

1.1. Ofgem and DECC have successfully established a robust regulatory regime for offshore electricity transmission. The legal framework for this was established in June 2009 and Ofgem has been working within that framework to appoint Offshore Transmission Owners (OFTOs) through competitive tenders for offshore transmission licences under the transitional regime. To date the regime has secured more than £250m of investment from both the European Investment Bank and other new commercial and funding entrants. This demonstrates confidence that the regime can deliver sound investment opportunities while lowering the cost to developers and consumers.

1.2. Building on the existing framework, we are now consulting on proposed refinements to the enduring regime to ensure sustained investment and lower costs of delivering energy from renewable sources, while maintaining sufficient flexibility to meet the evolving requirements of offshore transmission users.

1.3. Specifically, within this document we are developing the OFTO build and Generator build options to ensure the enduring regime offers new design and construction opportunities, is robust for each build option, and provides for timely and efficient delivery of offshore transmission. In addition, we set out proposals on how the enduring regime would operate for transmission assets within larger Crown Estate sites or zones that are due to be constructed in phases.

Background

Commencement of the regime

1.4. In June 2009, following extensive consultation, the Secretary of State for Energy and Climate Change commenced powers to enable modifications to be made to the relevant industry codes and licences for the purpose of offshore transmission (Go-Active). This enabled Ofgem to begin the process of identifying OFTOs through competitive arrangements under Tender Regulations[4] approved by the Secretary of State. This framework also extended National Grid's system operator function offshore.

[4] The Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2010 (Tender Regulations) facilitate the appointment on a competitive basis of the person

1.5. The legal framework for the offshore electricity transmission regime was established in June 2009 and the current Tender Regulations came into effect in July 2010. Ofgem is currently working within that framework to appoint OFTOs through competitive tenders for offshore transmission licenses.

1.6. The regime is being delivered in two parts: a transitional and an enduring regime. The transitional regime applies to assets constructed, or currently under construction, by generator developers and allows these developers to transfer ownership of completed transmission assets to a licensed OFTO, appointed through a competitive tender process. Projects seeking to qualify for tender exercises under the transitional regime must meet the qualifying project requirements set out within the Tender Regulations by 31 March 2012. Projects that do not meet these requirements by this date will be subject to the enduring regime.

1.7. The enduring regime envisages OFTOs undertaking the financing and construction in addition to the operation, ownership and maintenance of offshore transmission assets under an OFTO build option. Following extensive industry consultation, a joint Ofgem/DECC statement in October 2010 expanded the scope of the enduring regime by adding a Generator build option, therefore providing generators with the flexibility to choose between an OFTO build or Generator build option with regards to each transmission project.

1.8. In July 2009, Ofgem commenced the first transitional tender round for nine qualifying projects with transmission assets worth £1.1 billion linking 2.1GW of capacity. This first tender round attracted almost £4 billion of investment appetite, demonstrating strong industry and investor confidence in the offshore transmission regulatory regime. Of the nine projects, five are fully operational. Four of the nine projects have a licensed OFTO in place and the remaining five have identified preferred bidders. We expect to grant licences for the remaining five projects over the coming year.

1.9. The second transitional tender round commenced in November 2010 and is split into two tranches with three projects in each tranche. These projects are valued at £2.1 billion in total and will connect a further 2.6GW of capacity. Tenders for all three Tranche A projects are currently underway; the Invitation to Tender (ITT) stage for Lincs and London Array has commenced and is expected to begin for Gwynt y Môr in 2012. The tender process for Tranche B projects is also expected to begin in 2012.

1.10. Transmission assets within over 20 sites or zones licensed by the Crown Estate are likely to qualify for the enduring regime between now and 2020,

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to whom an offshore electricity transmission licence is to be granted.

with those assets valued at up to £14bn[5]. These include transmission projects relating to the nine Crown Estate round 3 zones. Most of these projects have bilateral connection agreements in place with the National Electricity Transmission System Operator (NETSO) to deliver up to 30GW of additional capacity.

Previous correspondence on the enduring regime

1.11. This consultation builds on a series of consultation documents dating back to 2008 aimed at developing the enduring regime. For ease of reference we focus below on the most recent correspondence. DECC and Ofgem published a joint consultation in August 2010 ('the August 2010 consultation') setting out further refinements to the enduring regime. As part of this consultation we set out our proposal to include an additional Generator build option as part of the enduring regime as well as seeking further views on proposed approaches to OFTO build.

1.12. Following this consultation and as a result of industry feedback, DECC and Ofgem issued a joint statement on 21 October 2010 setting out our decision to include a Generator build option within the enduring regime and to provide further clarity on the OFTO build options. This statement also set out DECC and Ofgem's intention to undertake further work during 2011 to consider whether changes are needed to better facilitate the coordinated development of the offshore transmission system. This work has been carried out through the joint DECC and Ofgem Offshore Transmission Coordination Project, which will be concluding early next year (described in more detail in chapter 2, paragraphs 2.20 to 2.25).

1.13. Following the joint DECC/Ofgem consultation of November 2010 ('the November 2010 consultation'), on 15 December 2010 Ofgem and DECC published details, within Government response to offshore transmission consultations, December 2010 ('the December 2010 publication'), of the changes to be made by the Secretary of State to the Connection and Use of System Code (CUSC) and Grid Code to implement the Generator build option. The changes took effect on 31 December 2010. The changes place obligations on generators wishing to undertake activities otherwise undertaken by the OFTO to design and build offshore transmission assets that meet the minimum standard of offshore transmission system performance and design.

1.14. The government also set out the changes it expected to be made to the System Operator-Transmission Owner Code (STC) to implement Generator build, together with plans for National Grid Electricity Transmission (NGET) to undertake a consistency check of the CUSC and Grid Code changes being implemented.

[5] Sources: National Grid, Briefing Note: 2011 Offshore Development Information Statement (June 2011); Department of Energy and Climate Change.

1.15. NGET has since undertaken a consistency check of the CUSC and Grid Code and has identified minor changes to both. NGET submitted change proposals to the Grid Code Review Panel of 17 November 2011[6] and to the CUSC Panel of 25 November 2011[7]. NGET has also identified changes to the STC to implement Generator build and submitted a change proposal to the STC Committee of 20 November 2011[8]. We expect these change proposals to come to Ofgem in early 2012.

Structure of this document

1.16. Each chapter in this document sets out for comment our proposed approach and questions on particular areas where views are being sought from stakeholders. This document has six chapters.

- Chapter 2 sets out the objectives and overview of the enduring regulatory regime for offshore electricity transmission.
- Chapter 3 sets out our proposed framework for the OFTO build option.
- Chapter 4 sets out our proposed framework for the Generator build option.
- Chapter 5 considers transmission assets within Crown Estate sites or zones that are likely to be constructed in phases and/or stages.
- Chapter 6 sets out next steps.

1.17. Additional information is also available in the appendices.

Responding to this document

1.18. We would welcome comments from respondents on all issues in this consultation, although particular issues on which we are seeking feedback are highlighted in the relevant chapters. We would also be happy to discuss the issues raised in the document with stakeholders and interested parties.

1.19. Responses should be received by **17 February 2012**. We expect to hold a stakeholder workshop on issues raised in this document in early 2012. All responses should be sent to: Offshore.Enduring@ofgem.gov.uk.

[6] http://www.nationalgrid.com/uk/Electricity/Codes/gridcode/reviewpanelinfo/2011/17+November/
[7] http://www.nationalgrid.com/uk/Electricity/Codes/systemcode/Panel/2011/130_25Nov/index.htm
[8] http://www.nationalgrid.com/uk/Electricity/Codes/sotocode/Committee/2011/index.htm

2. The enduring regulatory regime for offshore electricity transmission

Chapter Summary

This chapter provides a summary of the enduring regulatory regime for offshore electricity transmission as developed to date, as well as a high level overview of latest developments in the design of the regime. These are discussed in more detail in the subsequent chapters of this document.

Question box

Q2.1 Do you have any views on the approach outlined in paragraph 2.8, namely to focus on a single OFTO build option and not to develop the early OFTO build option further at this stage?

The objectives of the enduring regulatory regime

2.1. We have consistently set out that the objectives of competitive tenders for offshore transmission licences are to:

- deliver fit for purpose electricity transmission infrastructure to facilitate the connection of offshore generation and realisation of significant carbon savings
- provide best value to consumers
- attract new entrants and sources of finance to the sector.

2.2. The transitional regime has attracted new entrants to the energy sector and delivered significant levels of investment, as well as establishing a well-defined and proven tender process. The enduring regime, which is already established, is set out in further detail within this document, and aims to build on the transitional framework by offering greater asset design, procurement, and construction opportunities in respect of the division of responsibility for the delivery of high voltage assets. The enduring regime aims to provide the framework supporting the connection of larger offshore projects, while protecting the interests of present and future consumers, and promoting the development of innovative network solutions.

Overview of the enduring regulatory regime

2.3. As detailed in the December 2010 publication, the enduring regime involves a series of common features, irrespective of the point at which an OFTO is appointed under Generator build or OFTO build.

- OFTOs will be appointed and granted a transmission licence through a competitive tender process run by Ofgem under the Tender Regulations.

- Codes and technical rules require the development of infrastructure to a consistent set of standards.

- OFTOs will be required, through licence obligations and industry codes, to develop and operate systems efficiently.

- Long term revenues and incentives will be provided under the OFTO licence to provide certainty for industry participants. Project-specific licence conditions, including any performance obligations, will be determined by Ofgem as part of each tender exercise.

Overview of the stages of transmission asset development

2.4. Both OFTO build and Generator build options are based on a common process, operating under the existing framework of industry codes and technical rules, for the development and construction of transmission assets.

2.5. The broad stages of transmission asset development are summarised below, and are also shown in Diagram 1 overleaf.

- **Connection offer:** any generator wishing to connect to the National Electricity Transmission System (NETS) must make an application in writing to NETSO, under the CUSC. When an offshore generator seeks connection to the NETS, it will be given a Generator build offer, unless it indicates a preference for an OFTO build offer.

- **High level design:** the generator will produce a high level performance specification as part of their pre-construction works. This will set out the outputs required based on the generator's user requirements and the connection agreement with NETSO, and will reflect the views of NETSO and Ofgem (where appropriate). Under the OFTO build option this would form the tender specification against which bidders would develop their detailed asset design (see paragraph 3.13).

- **Pre-construction:** refers to the works undertaken by the generator before construction of the transmission assets, including the environmental impact assessment, land acquisition and acquiring necessary property rights and consents. These activities are described further in chapter 3.

- **Procurement:** refers to agreement with the supply chain on the specification for works, securing manufacturing capacity and negotiating and signing construction contracts with suppliers.

- **Construction:** refers to the manufacture of transmission assets following procurement of suppliers, and the period through to completion of construction of the transmission assets. It also includes commissioning of those assets, which refers to a set of tests and

related activities to demonstrate that the transmission assets are compliant with relevant industry codes (and any site specific contractual specifications agreed with NETSO), and fit for use as a transmission system or part of a transmission system.

- **Operation and maintenance:** refers to the ongoing operation, maintenance and, eventually, decommissioning of the transmission assets.

Overview of build options

2.6. We set out in the December 2010 publication that there would be three build options available to generators under the enduring regime.

- Early OFTO build (where the OFTO would be appointed following initial scoping work by the generator, and would be responsible for all aspects of pre-construction, consenting, procurement, construction and operation of transmission assets).

- Late OFTO build (where the OFTO would be appointed to deliver the procurement of the transmission assets and construction elements of the build programme, after a generator has obtained the necessary consents for the transmission works).

- Generator build (where a generator would design and construct the transmission assets, with a transfer of ownership to an OFTO after the generator had completed construction).

2.7. We gathered feedback from meetings with a wide range of stakeholders (including generators, potential bidders, and funders) over the last year in order to inform continued development of the OFTO build options. This feedback suggested that there is currently little appetite for the additional flexibility of the early OFTO build option whereby an OFTO would be responsible for all aspects of pre-construction and consenting of the transmission assets. The main concerns within the feedback centred on the potentially higher bid prices and increased costs of financing the early OFTO build option due to:

- the higher uncertainty and risk as to whether a project would go ahead at the point at which a tender would be required (ie in advance of pre-construction activities, and therefore potentially seven to eight years before operation of the assets)

- the difficulty in defining the basis of bids in relation to the tender specification, due to the higher uncertainty on high level project design and bid component prices during the bidding period

- uncertainties in costs and timing which would mean that participants may not compete on a like for like basis, which may reduce the benefits of competition

- inefficiencies and potential delays associated with consenting of generation and transmission assets being undertaken by separate parties.

2.8. We believe that it is key to offer fit for purpose, deliverable Generator build and OFTO build options in advance of the first expected enduring tender exercises. Based on our understanding of the low level of current interest in an early OFTO build option from both generators and OFTOs, we do not propose to develop the early OFTO build model further at this stage. We have therefore focused attention within this document on a single OFTO build option, which refines the late OFTO build option, and which we believe will ensure clarity on roles and responsibilities, while allowing sufficient flexibility for OFTOs to be involved at different points for different projects and supporting the timely delivery of fit for purpose transmission assets. Chapter 3 sets out details of the single OFTO build option we are proposing within this document. For ease of reference, the remainder of this document refers to this option as 'OFTO build'.

Q2.1 Do you have any views on the approach outlined in paragraph 2.8, namely to focus on a single OFTO build option and not to develop the early OFTO build option further at this stage?

2.9. Diagram 1 below illustrates the indicative stages in the development of transmission assets and shows in broad terms how the tender processes for OFTO build and Generator build relate to these stages.

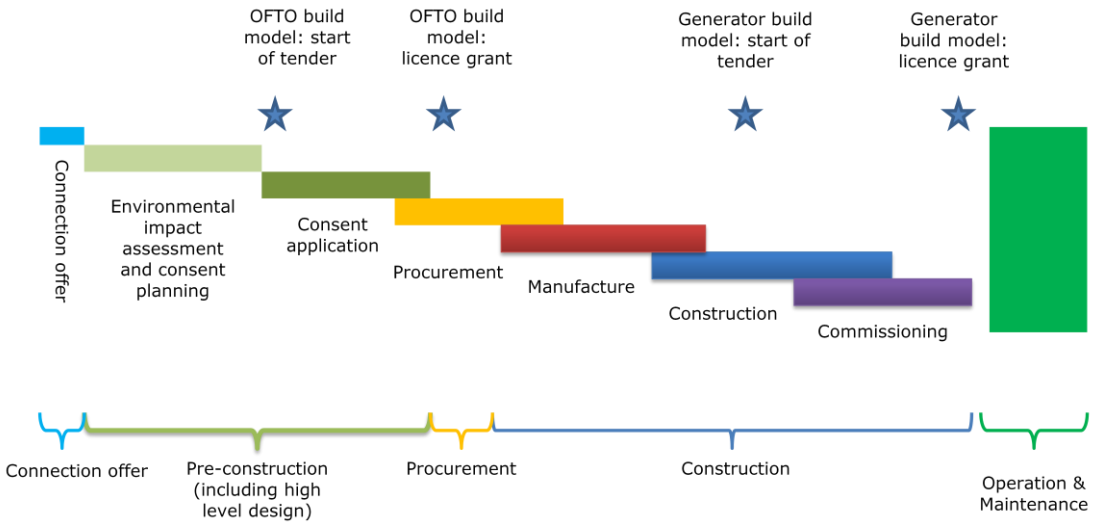


Diagram 1 - Indicative stages in the development of the transmission assets

- **OFTO build** – Under the OFTO build option, we propose that the generator will obtain the connection agreement and undertake high level design and pre-construction activities. The OFTO (appointed via competitive tender) will procure suppliers, negotiate and finalise construction contracts, and deliver the build programme. The OFTO will operate and maintain the transmission assets.

- **Generator build** - The Generator build option is similar to the approach taken for the transitional tender exercises. The generator will obtain the connection agreement and take responsibility for all aspects of design, pre-construction, procurement and construction (in accordance with a series of common standards) of the transmission infrastructure, with a transfer of ownership to an OFTO (appointed via competitive tender) taking place after the generator has completed construction. The OFTO will operate and maintain the transmission assets. Chapter 4 sets out details of the Generator build option.

Interdependencies

Onshore transmission

2.10. In parallel to this consultation, we are also consulting on implementing competition in onshore electricity transmission. That consultation sets out the first steps we intend to take to put in place a regime allowing third parties a greater role in onshore electricity transmission.

2.11. In March 2011 we set out our initial thoughts on the legislative and regulatory framework together with the process for enabling competition, where appropriate, in new onshore infrastructure development[9]. The current consultation responds to the feedback received from stakeholders and sets out the timeline for the next consultations and when aspects of the new regime will be implemented. It also seeks views on the critical path activities, such as:

- modifying the industry codes (and other key industry documents) to recognise third parties
- amending existing licences as part of the Revenues, Incentives, Innovation and Outputs (RIIO) process by stipulating the pre-construction outputs that should be delivered
- clarifying the potential licensing arrangements for third party Transmission Owners (TOs).

2.12. Please see our website for further details.

[9] Providing a greater role for third parties in electricity transmission – Early thinking, March 2011;
http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=thirdpartyrole.pdf&refer=Networks/Trans/PriceControls/RIIO-T1/ConRes; and
Decision on strategy for the next transmission price control - RIIO-T1;
http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/T1decision.pdf

EU Third Energy Package

2.13. Government has implemented the EU Third Energy Package into GB legislation, through the Electricity and Gas (Internal Markets) Regulations 2011 (the 'Regulations'). The measures of the package aim to ensure that the benefits of a competitive energy market can be realised, and as such its objectives are well aligned with those of the enduring regime for offshore electricity transmission. A key requirement of the Third Package is ownership unbundling – the separation of transmission interests (ownership and operation of transmission systems) from generation, production and supply activities - and consequently it specifies the roles and responsibilities of transmission owners in terms of network operation, maintenance and development.

2.14. Under the Regulations, electricity transmission, gas transportation and electricity and gas interconnector licensees will be required to be certified as complying with the ownership unbundling requirements of the EU Third Energy Package. The Regulations designate Ofgem as responsible for processing applications for certification. More information on the intended procedure for processing applications for certification under the ownership unbundling requirements can be found in the open letter[10] issued by Ofgem and dated 10 November 2011.

Commissioning and full commencement

2.15. Government has amended key definitions in the Electricity Act to extend the offshore transmission regulatory regime to all projects conveying electricity from GB offshore waters at or above 132kV, including projects in the Renewable Energy Zone (REZ). The amended definitions are partially commenced and currently apply to projects conveying electricity from offshore at or above 132kV from the point of asset transfer to an OFTO.

2.16. Government intends to commence the regulatory regime in due course to apply it to all OFTO and generator built assets at or above 132 kV and extend the territorial extent of the regime into the REZ. As a result, the class exemption order that applies to offshore distribution will no longer apply to an offshore line that conveys electricity generated offshore at 132 kV.

2.17. In the December 2010 publication, we noted an issue raised by respondents to the August and November 2010 consultations relating to the commissioning and testing of transmission assets by generators under the Generator build option following full commencement of the offshore regime. Concerns were expressed that part of the generator developer's

[10]Certification of transmission system operators (TSOs) under the ownership unbundling requirements of the Third Package: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=95&refer=Europe

commissioning process would require energy to flow over the transmission system for testing purposes, prior to completed transmission assets being transferred to a licensed OFTO. Respondents were concerned by the possibility that this activity might, following full commencement of the regime, be considered to be in breach of the prohibition on transmitting electricity offshore at voltages of 132kV and above.

2.18. We recognise the importance of clarity on this matter to provide market certainty on the build options under the enduring regime and to provide confidence to all parties that the assets being transferred are fit for purpose.

2.19. Ofgem and DECC are working closely to develop a solution to this issue and to consider the appropriate timing for further commencement of the regulatory regime. In doing so, we are mindful of the preference for generators to have the ability to commission the transmission assets under the Generator build option prior to transfer to the OFTO. We are also having regard to the need for a smooth transition from the current arrangements for projects that are part of the transitional tender rounds, and the implementation of the EU Third Energy Package.

Coordinated network development

2.20. It is important that the overall GB transmission network is developed in the most efficient and economic way to minimise costs for present and future consumers. This means ensuring that a coordinated approach is taken across the onshore and offshore networks where this offers savings. For most offshore projects to date, the most efficient approach has been to connect to the onshore network via point-to-point lines. However, with the greater scale and distance from shore of future offshore wind developments, in some cases it is likely to be more efficient to have more integrated network connections. We anticipate that the majority of any such developments will be constructed under the enduring regime.

2.21. DECC and Ofgem committed to undertaking further work to consider how best to facilitate coordinated development of the offshore transmission system in a joint statement in October 2010, and formally set up the Offshore Transmission Coordination Project ('the Coordination Project') in early 2011. The objective of the Coordination Project is to consider whether changes may be required to the offshore transmission regime to realise the potential benefits of more integrated future offshore network connections, while ensuring that the regime continues to deliver value for consumers and supports the timely connection of offshore generation. The Coordination Project has undertaken a significant body of work to assess the case for coordination and whether there is a need for supportive changes to the regulatory framework. It is feeding its findings into Ofgem's ongoing development of the enduring regime.

2.22. The Coordination Project has been supported by two consultants, TNEI/PPA Energy and Redpoint Energy, whose reports were published on the Ofgem website on 15 December[11]. The consultants' combined analysis suggests that there could be cost savings of 8-15% (£0.5-3.5bn) from greater coordination of offshore network development across a selection of future generation scenarios.

2.23. TNEI/PPA Energy has undertaken a technical analysis of different network configuration options. This suggests that there could be significant benefits from coordination, including capital cost savings and environmental benefits. Their report also suggests that there are also potential risks to coordination, including the risk of stranded assets, so it will be important to assess future coordination opportunities in specific areas on their merits.

2.24. Redpoint Energy's work has focused on the commercial and regulatory aspects of coordination. Their report suggests that coordination could be achieved under the current regime but there are some potential barriers to this. In particular, they highlight anticipatory investment (including for pre-construction works) as a key element to enabling coordination, and highlight the case for a clearer process for handling anticipatory investment within the offshore regime.

2.25. We are considering the issue of anticipatory investment alongside the other suggestions in the reports, and plan to publish a joint Project Conclusions Report with DECC early next year. This will be accompanied by an Ofgem consultation document, which will set out proposed changes to the offshore regime to ensure a coordinated approach is taken where this can help deliver value for consumers and cost-effective and timely connection of renewable generation. We expect the proposals in the Coordination Project consultation document will be complementary to the positions set out in this document. However, it may be necessary to amend the approach set out in some instances given the different characteristics and issues associated with assets that are not just for the use of a sole generator.

[11] http://www.ofgem.gov.uk/Networks/offtrans/pdc/pwg/OTCP/reports/Pages/reports.aspx

3. OFTO build option

Chapter Summary

This chapter sets out proposals on how we intend the OFTO build option to work under the enduring regime. It outlines proposed key arrangements and considerations relating to a range of areas, including pre-construction works, supply chain and procurement, the basis of bids, tender stages and timings, and the OFTO licence and revenue entitlement. It also discusses potential alternative approaches in some areas, and the implications of these approaches.

Question box

Q3.1 What are your views on the proposed arrangements for triggering a tender exercise?

Q3.2 What are your views on whether our proposal on generator security will ensure the appropriate level of commitment from a generator?

Q3.3 Do you agree with our proposed approach to the tender specification for an OFTO build tender exercise?

Q3.4 Are the proposed arrangements for pre-construction works the most appropriate for investors and generators?

Q3.5 What other information, if any, in addition to that referred to within the tender specification and pre-construction works sections, would be needed within the data room for the project?

Q3.6 What do you think would be the best approach to ensuring bidders have access to and confidence in a seabed survey undertaken by the generator?

Q3.7 With reference to the approach to seabed surveys outlined within paragraph 3.22, what might be the best approach to developing an independent generic survey specification that would be acceptable to both generators and potential bidders?

Q3.8 Do you agree that ensuring procurement is undertaken by the OFTO through the tender process would be the most economic and efficient approach?

Q3.9 What are your views on whether there are supply chain constraints associated with the manufacture and delivery of some key offshore transmission assets? If there are constraints, do these vary significantly in relation to project design?

Q3.10 What are your views on the examples of alternative approaches for supply chain engagement under OFTO build outlined in this chapter?

Q3.11 Are there any other approaches we should consider under OFTO build to enable the supply chain to be engaged in time to ensure project delivery timescales are met, whilst maximising opportunities for competition through the tender process?

Q3.12 Should there be any restrictions on interactions between parties, either before or during a tender exercise in order to ensure fair and effective competition and best value for consumers?

Q3.13 Do you agree that the current 20 year revenue stream provides the best value to consumers under the enduring regime (OFTO build or Generator build)? If not, what alternatives should we consider?

Q3.14 What are your views on our proposed treatment of risk relating to:
- delay to licence grant?
- weather delay?

Q3.15 Are there other areas of risk which would be more efficiently managed (for consumers) through a risk sharing mechanism rather than factored into bidders' TRS bids? If so, can you suggest how these risks might be shared?

Q3.16 Is the current approach to recovering bid costs appropriate for OFTO build? If not, what alternative approach to recovering bid costs would you recommend?

Q3.17 Are there any aspects of the current transitional arrangements or within the proposals for OFTO build, including revenue term, bid requirements and risk profile, which may prevent access to certain sources of finance in the enduring regime?

Q3.18 Do you have any comments on the issues associated with incorporating a refinancing gain share mechanism and how such a mechanism could be structured?

Q3.19 Do you have any preferences from amongst the options outlined for how the PQ stage should operate?

Q3.20 Are there any other ways that a PQ stage might operate in order to meet the objectives set out at the start of the 'Tender stages and timings' section?

Q3.21 Do you have any preferences from the options outlined for how the ITT stage might operate?

Q3.22 Are there any other ways that the ITT stage might operate to ensure its efficiency and effectiveness?

Q3.23 What are your views on the proposals for involving generators in evaluation of bids? In particular, what key technical aspects of bids would be most important for generators to evaluate?

Q3.24 What are your views on the proposals for involving NETSO in evaluation of bids? In particular, what key technical aspects of bids are most important for NETSO to evaluate?

Q3.25 Are there areas on which you think allowing variant bids under OFTO build would add value to the process and to consumers?

Q3.26 What are your views on generators recovering efficiently incurred pre-construction costs at the point at which the transmission construction works are completed?

Q3.27 Do you have any early views on the appropriateness of design incentives for transmission asset lifecycle design, eg transmission availability, quality of installation and transmission losses?

Q3.28 What are your views on whether the current approach to indexation, and in particular the proportion of the TRS subject to indexation, provides the best value to consumers? How might any alternative approaches be managed?

Q3.29 Do you agree that additional delivery incentives for OFTOs are not necessary?

Q3.30 What are your views on what approach to decommissioning of assets would provide best ongoing value to consumers?

High level construct

3.1. Under the proposed OFTO build option, 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. The OFTO's costs would be paid through a tender revenue stream (TRS), based on a 20 year revenue period.

3.2. Appendix 3 outlines the high level construct for OFTO build. The remainder of this chapter focuses on the key arrangements and considerations for each of the areas within this high level construct.

Tender process

3.3. Under the legal framework for the offshore electricity transmission regime, Ofgem runs a competitive tender for the appointment of OFTOs and we intend to continue to do so under the enduring regime[12]. We set out at the start of chapter 2 that the objectives of competitive tenders for offshore transmission licences include providing best value to consumers through the competitive process and attracting new entrants to the sector. Consistent with the objectives set out at the start of chapter 2, we are seeking, through our approach to the enduring tender process, to promote competition and attract new entrants:

- throughout the supply chain (including equipment suppliers, construction contractors)

[12] Please note that, as detailed in chapter 2, Ofgem is in parallel consulting on implementing competition in onshore electricity transmission. That consultation sets out a proposed approach to appointing transmission asset operators via a competitive process in specified circumstances. The specifics of the proposals fall outside the scope of this consultation document.

- throughout the bidding community (including the composition of bidding consortia and the sources of bidder finance).

3.4. In addition to the objectives set out in paragraph 3.3 a key objective of the tender process will be to select and retain robust and effective OFTOs to construct and operate the transmission assets.

Triggering the tender and commitment to a tender exercise

3.5. As set out in the December 2010 publication, a generator may make a written request to Ofgem to commence a tender exercise for their project. We propose that in order to inform the type of tender exercise to be run, such a request must include notification to Ofgem of the build option the generator has opted for in their bilateral connection agreement with NETSO.

3.6. A generator should make its request 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. We therefore propose that there should be a project linked date by when the generator must make a written request to Ofgem to commence an OFTO build tender exercise for their project, and that this date should be no later than three months before the date at which the generator expects to submit its planning consent application, unless otherwise agreed with Ofgem. This notice period is needed to provide sufficient notice for Ofgem to start planning a tender exercise and preparing necessary tender documentation.

3.7. We are aware however of the need to consider the interaction between a generator's financing decisions in relation to the overall offshore wind project and commitment to a tender exercise. It is possible that certainty on financing arrangements may not align with the point at which the generator notifies Ofgem of the build option in relation to the transmission assets. As part of this consultation exercise we propose continuing to engage with generators on a confidential basis to consider how the arrangements set out in this section may relate to their project(s).

3.8. Finally, there may be a case for flexibility in the process for triggering a tender exercise where the assets involved would not just be for the use of a sole generator. These issues are being considered further in the Coordination Project, and will be covered in further detail in a consultation document early next year.

Q3.1 What are your views on the proposed arrangements for triggering a tender exercise?

Commitment to a tender exercise

3.9. In order to run the most efficient tender exercise with the best outcome for consumers, we believe that bidders and other interested parties will

need sufficient certainty not only that the tender exercise and the project will go ahead, but that the generator will not change its build preference for the transmission assets (for example from OFTO build to Generator build) during a tender exercise.

3.10. Under the current tender process for transitional tender exercises we require a generator to provide Ofgem with security in the form of a letter of credit or a cash deposit, before a tender exercise commences for its qualifying project. We propose that a similar arrangement will apply for OFTO build tender exercises. Under our proposed arrangement, if the generator were to seek to change its build preference during the course of a tender exercise, they would be liable to forfeit a proportion of their security based on the costs incurred during the tender exercise up to that point. We will determine and set out the appropriate level of generator security required in advance of the first OFTO build tender exercise.

Q3.2 What are your views on whether our proposal on generator security will ensure the appropriate level of commitment from a generator?

Qualifying project requirements and tender entry conditions

3.11. A generator who wishes Ofgem to commence an OFTO build tender exercise will need to comply with the qualifying project requirements and tender entry conditions under the Tender Regulations.

3.12. We set out in the December 2010 publication that we may consider making changes to the current qualifying project requirements and tender entry conditions. It is currently our intention to address any such changes within a consultation on revised Tender Regulations in 2012.

Tender specification

3.13. For OFTO build, we propose that the tender specification would reflect the generator's high level performance specification, based on the generator's needs, but taking into account input from NGET (in their role as NETSO) and Ofgem (as appropriate). The generator would therefore provide the high level design requirements of the project within the tender specification. Bidders would submit their proposals for the detailed design of the assets, providing opportunity for innovative asset design solutions.

3.14. We propose that the tender specification should be informed by:

- **the bilateral connection agreement** (including the construction agreement), as agreed between the generator and NETSO. This will include the level of capacity the generator wishes to connect and the timescales for delivery of the connection. The bilateral connection agreement will specify the anticipated connection point and interface point, details of necessary onshore reinforcement and any assumptions made about offshore works

- **the design requirements set out within the planning consent submission**. This will ensure that bidders are aware of the generator's plans in terms of what has been submitted for planning consent approval, and can submit a bid proposal appropriate to the project's needs

- **the pre-construction works being carried out by the generator**. As detailed within the December 2010 publication, we recognise the link between the scope of pre-construction works and the tender specification. The tender specification will therefore also be informed by the pre-construction works being carried out by the generator, and will vary on a case by case basis depending on the nature and extent of pre-construction works carried out by the generator (see the 'Pre-construction' section for further details).

3.15. The tender specification will be defined in the documentation associated with each tender exercise. We expect that the tender specification would be finalised no later than the project-specific stages of a tender exercise so that it can be made available to bidders.

Q3.3 Do you agree with our proposed approach to the tender specification for an OFTO build tender exercise?

Pre-construction works

3.16. The December 2010 publication set out that pre-construction works should be limited to the below list set out in the August 2010 consultation, namely:

- carrying out environmental impact assessments and stakeholder consultation in relation to the OFTO works

- obtaining necessary planning permissions

- obtaining necessary landowner consents (leases, easements, wayleaves, etc)

- carrying out engineering surveys (onshore and offshore) in relation to the OFTO works (these could include sea-bed geophysical and geo-technical surveys and metocean surveys)

- the high level engineering design needed prior to undertaking the activities described above

- any economic analysis in support of this high level engineering design.

3.17. We believe that the above list provides clarity to parties, but is sufficiently broadly defined to include some of the activities raised by respondents to the August 2010 consultation, namely necessary land rights, land

acquisitions, crossing agreements and applications for Compulsory Purchase Orders (CPOs). We are aware of generator concerns on the extent to which they are able to take advantage of compulsory purchase and wayleave powers and we are working with DECC to provide clarity on this issue in early 2012.

3.18. As detailed in the previous section, the pre-construction works will inform the tender specification made available to bidders. We therefore expect that the generator will make all information relating to the pre-construction works available via the data room for that project. Shortlisted bidders will be provided with access to a fully populated data room at the ITT stage for the project for which they have been shortlisted to inform their bids - see paragraph 4.14 for more information on how the data room operates currently.

3.19. We propose that it would be the responsibility of the generator to obtain all planning permissions, consents and permits needed prior to construction and to ensure these can be transferred to the successful bidder (for further details see the 'Asset transfer' section). It may be necessary however for the OFTO to acquire other permissions, consents and permits once construction commences.

3.20. We detailed in the December 2010 publication that generators will be able to recover the efficiently incurred costs of certain pre-construction works - for further details see the 'Cost assessment' section.

Q3.4 Are the proposed arrangements for pre-construction works the most appropriate for investors and generators?

Q3.5 What other information, if any, in addition to that referred to within the tender specification and pre-construction works sections, would be needed within the data room for the project?

Seabed surveys

3.21. Bidders will need access to a robust seabed survey and to have confidence in it in order to develop the most efficient bids. We do not believe it is cost effective or practical for each bidder to undertake their own survey during a tender exercise. Therefore we expect that the generator would procure the seabed survey and place it in the data room ahead of the project-specific stages of the tender exercise for their project.

3.22. We are interested in your views on how to best address the above requirements. An option could be for an independent party to produce a comprehensive generic survey specification, which is then agreed by generators and potential bidders. A generator would then undertake the seabed survey for an individual project, based as a minimum requirement on the agreed specification. The resulting survey would be included in the data room for bidders to consider at the project-specific stages of a tender exercise. Subject to agreeing a viable option whereby bidders would have confidence that generators have undertaken a robust survey, bidders

would then be required to accept the survey at the project-specific stages of a tender exercise.

Q3.6 What do you think would be the best approach to ensuring bidders have access to and confidence in a seabed survey undertaken by the generator?

Q3.7 With reference to the approach to seabed surveys outlined within paragraph 3.22, what might be the best approach to developing an independent generic survey specification that would be acceptable to both generators and potential bidders?

Supply chain and procurement

3.23. As detailed in previous correspondence, we believe that the best outcome for consumers will result from efficient and effective procurement practices that maximise opportunities for competition in the supply chain, whilst also ensuring that the supply chain is engaged in time to ensure project delivery timescales are met.

Preferred option

3.24. We believe that the outcome set out in paragraph 3.23 is most likely to be realised by an approach where all procurement is undertaken by the OFTO through the tender process, as this is likely to introduce innovative procurement methods and maximise opportunities for competition in the supply chain. Our strong preference for OFTO build is therefore for all procurement to be undertaken by the OFTO, which we believe would result in procurement costs being efficiently incurred.

3.25. Under such an approach shortlisted bidders would negotiate potential construction contracts for the transmission assets with the supply chain, against the high level engineering design developed by the generator as part of the tender specification, before submitting their bids at the ITT stage. This would also include securing manufacturing capacity with relevant suppliers where necessary. The OFTO would finalise all relevant contracts upon appointment.

Q3.8 Do you agree that ensuring procurement is undertaken by the OFTO through the tender process would be the most economic and efficient approach?

Further considerations

3.26. We seek your views however on whether the tender process for OFTO build may need to take into consideration potentially long lead times associated with the manufacture and delivery of some key offshore transmission assets (eg the export cable, or offshore sub-station), particularly in relation to high voltage direct current (HVDC) technology. We seek your views on whether this is a legitimate supply chain

constraint, and if so, whether it would apply to all projects, or only those using HVDC technology for example.

Q3.9 What are your views on whether there are supply chain constraints associated with the manufacture and delivery of some key offshore transmission assets? If there are constraints, do these vary significantly in relation to project design?

3.27. In light of the potential constraints highlighted within paragraph 3.26, it may be appropriate to consider the viability and appropriateness of alternative approaches for OFTO build projects where there are likely to be supply chain constraints, whereby the generator could undertake some early non-exclusive and non-binding supply chain activities to enable equipment suppliers to prepare for potential contracts. Under any such options we would seek to determine the efficiently incurred costs of any activities undertaken by the generator.

3.28. A response received during the August 2010 consultation proposed that there should be flexibility under the OFTO build option for the generator to procure the supplier(s) and finalise contracts before transferring these contracts to the OFTO.

3.29. Under our preferred approach the risks associated with the procurement, construction and operations stages of a transmission project are managed in an integrated way by the same party. The approach set out in paragraph 3.28 does not achieve this and as a result could lead to complicated third-party contracting issues which in turn could result in the following inefficiencies:

- potential failure to deliver the assets within the required project delivery timescales
- assets that do not meet the required performance criteria
- higher overall costs
- an increase in interface issues, risks, costs and delays at asset transfer.

3.30. We do not believe there is value for consumers in considering this option as it is likely to result in significantly reduced competition in the supply chain. As a result of the issues set out in paragraph 3.29, we are therefore minded not to consider such an approach under OFTO build.

3.31. Another potential approach may be for the generator to carry out pre-marketing with suppliers in order to gain a level of comfort that suppliers would be willing to offer terms for the project. Under such an approach shortlisted bidders would negotiate potential construction contracts for the transmission assets with the supply chain, consistent with our preferred approach set out in paragraphs 3.24 and 3.25.

3.32. This approach would have the advantages of being likely to introduce innovative procurement methods and maximise opportunities for competition in the supply chain; however we recognise that in some instances it may not sufficiently mitigate any constraints caused by supply chain lead times.

3.33. To mitigate any such constraints it may be appropriate in some instances for the generator to seek high level indicative terms from a range of potential suppliers. Such an approach could operate as follows:

- the generator would seek a set of high-level indicative terms for the transmission assets from a range of available suppliers able to deliver against the high level engineering design that informs the tender specification. The generator could also reserve non-binding, non-exclusive options on manufacturing capacity with the suppliers if necessary;

- the generator would upload these indicative terms to the relevant project data room before the project-specific stages of a tender exercise for that project;

- the bidders would negotiate with suppliers in order to select their preferred supplier(s) and finalise their bids during the ITT stage of a tender exercise; and

- the OFTO would finalise all relevant contracts upon appointment.

3.34. If this approach were to be followed, there would be no obligation on bidders to negotiate with the suppliers that submitted indicative terms.

3.35. This approach retains competition in the supply chain through the tender process while also initiating early engagement with the supply chain. However, it may be relatively complex to implement and would place higher resourcing demands on generators. Additionally, reserving non-binding, non-exclusive options on manufacturing capacity with suppliers may not be feasible or practicable and/or may have significant cost implications.

3.36. As part of this consultation exercise we propose continuing to engage with generators on a confidential basis to consider how the arrangements set out in this section may relate to their project(s).

Q3.10 What are your views on the examples of alternative approaches for supply chain engagement under OFTO build outlined in this chapter?

Q3.11 Are there any other approaches we should consider under OFTO build to enable the supply chain to be engaged in time to ensure project delivery timescales are met, whilst maximising opportunities for competition through the tender process?

Q3.12 Should there be any restrictions on interactions between parties, either before or during a tender exercise in order to ensure fair and effective competition and best value for consumers?

Basis of bids

3.37. A prospective OFTO will bid their approach to the construction, financing, operation, maintenance and decommissioning of the transmission assets, and a TRS value that includes the costs associated with carrying out these activities. All bids must be consistent with required technical codes and standards.

3.38. We propose that the appointed OFTO would bid on the basis of a 20 year TRS under OFTO build. This 20 year period reflects the design life of the generation assets based on the original specification, and also reflects the existing recognised approach for transitional tender exercises. We recognise, however, that there may be benefit to consumers from reviewing the appropriateness of a 20 year period, for example to enable new sources of finance to be brought forward. In addition, we may wish to take into consideration that some transmission assets such as the subsea cable and the onshore transmission substation may have a useful life in excess of the current 20 year TRS period. We would welcome your views, therefore, on whether a 20 year revenue stream period for an OFTO appointed following a tender exercise provides the best value for consumers under the enduring regime.

Q3.13 Do you agree that the current 20 year revenue stream provides the best value to consumers under the enduring regime (OFTO build or Generator build)? If not, what alternatives should we consider?

3.39. We anticipate that bidders will bid a fixed TRS amount at the ITT stage, given the level of certainty the bidder will have by then on the development of the project (as described earlier in this chapter). However, as under the transitional regime, we expect there to be some potential costs permissible as pass throughs under the OFTO licence. Appendix 4 sets out the current pass throughs under the transitional regime.

3.40. We recognise that there are some other areas of risk which may be more efficiently managed (for consumers) through a risk sharing mechanism to allow adjustments to the successful bidder's TRS value rather than being factored into bidders' TRS bids. We consider that it may be appropriate to allow adjustments for costs arising from potential delays to licence grant and weather delays. We therefore propose the approaches detailed below to managing these risks.

Delay to licence grant

3.41. We consider that bidders should be able to provide fixed capital costs in their bids. However, we recognise that for some items there may be a price validity date, with fixed costs for these items only being valid up to this date. As such there may be value from having a risk sharing

mechanism whereby, in the event of a delay to licence grant which results in licence grant occurring after the price validity date, certain items may be adjusted using an indexation mechanism agreed at the ITT stage. For the avoidance of doubt, the price validity date would need to be a date no earlier than the anticipated licence grant date. Additionally, any delays during the construction period would remain the OFTO's risk.

Weather delay

3.42. Under exceptional circumstances in which weather constitutes a Force Majeure, the CUSC and STC currently allow parties to suspend their obligations for the period of the Force Majeure and also set out how parties will resume their operations after the event.

3.43. We could however consider introducing an additional contingency mechanism for delay to the construction works caused by 'weather-related delay' - where we define 'weather-related delay' as a delay to the construction works caused by adverse weather conditions offshore where, in accordance with recognised industry standards, the contractor is unable to carry out the scheduled construction works. Under such a mechanism:

- bidders would include in their TRS bid a number of 'allowable' days for 'weather-related delay'

- any 'weather-related delay' to the completion of the transmission assets over and above the bid number of days would be subject to a cost sharing mechanism between the OFTO, generator and ultimately consumers, for example, so that part of the increased costs might be borne by the consumer through a change to the OFTO's TRS.

Q3.14 What are your views on our proposed treatment of risk relating to:
- delay to licence grant?
- weather delay?

Q3.15 Are there other areas of risk which would be more efficiently managed (for consumers) through a risk sharing mechanism rather than factored into bidders' TRS bids? If so, can you suggest how these risks might be shared?

3.44. We intend to confirm our position on risk sharing mechanisms in spring 2012. In order to retain flexibility in approach and ensure that the OFTO build option can best address future needs, we reserve the right however to determine contingencies and uncertainties on a case by case basis before the commencement of each tender exercise. Any associated risk sharing mechanisms, and their impact on the OFTO revenue stream, would operate through the OFTO licence. Specific licence conditions will be determined by Ofgem and will be consulted on ahead of licence grant for each project.

Cost recovery

3.45. For transitional tender exercises, only the successful bidder recovers the fees to Ofgem associated with participating in a tender exercise. This is through a pass through in the OFTO licence. This remains our position for Generator build. Under OFTO build we propose that the same principle would apply. However, we recognise that bidders are likely to incur higher costs because of the greater complexity and levels of information required from bidders at the ITT stage. We would welcome your views, therefore, on whether the current approach that only the successful bidder is able to recover bid costs is appropriate for OFTO build, or whether an alternative approach might be appropriate, such as, for example, all bidders who submit bids at the ITT stage receive a reimbursement of a proportion of their ITT related costs.

Q3.16 Is the current approach to recovering bid costs appropriate for OFTO build? If not, what alternative approach to recovering bid costs would you recommend?

Sources of finance

3.46. We wish to ensure that the enduring tender process does not favour any particular funding approach, nor that the process restricts bidders from accessing certain types of funding. We would be interested to learn whether you consider the existing Tender Regulations, tender rules and/or contractual structure create any barriers to accessing certain funding solutions, both in terms of enabling solutions to be put forward and for alternative funding solutions to be evaluated fairly alongside each other. Similarly, we invite views on whether you believe any of the proposed or considered changes identified in this consultation document could create any such barriers.

3.47. For transitional tender exercises, the OFTO bears the full risk and reward of any refinancing. However, under OFTO build the OFTO will be undertaking both construction and operations. In addition, there is currently significant volatility and uncertainty in the financial markets. Given these factors, we recognise that a refinancing gain share mechanism may be required to deliver optimum benefits for the consumer under OFTO build. We consider the question of refinancing relevant to ensure that consumers are able to benefit from the most economic source of finance. In particular there is potential for the OFTO to realise a benefit from refinancing both due to:

- the existence of construction risk and the impact this has on the financing packages available before and after construction completion
- external factors, for example, a general reduction in the costs of available financing.

3.48. We would welcome your views on the issues associated with incorporating a refinancing gain share mechanism and on how such a mechanism could be structured to ensure the greatest benefit to consumers.

Q3.17 Are there any aspects of the current transitional arrangements or within the proposals for OFTO build, including revenue term, bid requirements and risk profile, which may prevent access to certain sources of finance in the enduring regime?

Q3.18 Do you have any comments on the issues associated with incorporating a refinancing gain share mechanism and how such a mechanism could be structured?

Tender stages and timings

3.49. As detailed in the December 2010 publication, we believe that the tender stages and timings for OFTO build should provide flexibility to best address individual project needs (for example by ensuring that consenting timescales, tender timescales and timings for delivering other elements of a project are aligned). Our aim is for the tender stages and timings to be structured so as to provide an efficient process and deliver optimum benefits to the consumer through a robust competitive process. The tender process should not cause project delays but should provide appropriate levels of certainty to bidders at each stage of the process. As a result, it is likely to be run close to the project development critical path. There may be benefits in ensuring that timescales for tender exercises for multiple projects align to reduce the level of resource commitment required by bidders (and Ofgem).

3.50. We also set out in the December 2010 publication that where we receive multiple requests from generators for OFTO build tender exercises, we will seek, where it is feasible and efficient to do so, to group projects in a tender round, as appropriate to project delivery timescales. However, a number of factors need to be taken into account in order to determine the optimum solution to realise the above objectives. We have therefore set out below various options for undertaking key stages of a tender exercise and seek your views on the viability and appropriateness of each option.

3.51. Diagram 2 below illustrates the stages of a tender exercise as run under the transitional regime. The proposed overall sequence of tender stages for OFTO build is consistent with this, with the exception (as detailed in the December 2010 publication) that we have suggested that the Qualification to Tender (QTT) stage could be made optional for OFTO build tender exercises. The detail of what is required from participants at each stage may also differ from the transitional regime. The options in relation to each stage and our questions relating to these options are set out in the remainder of this section.

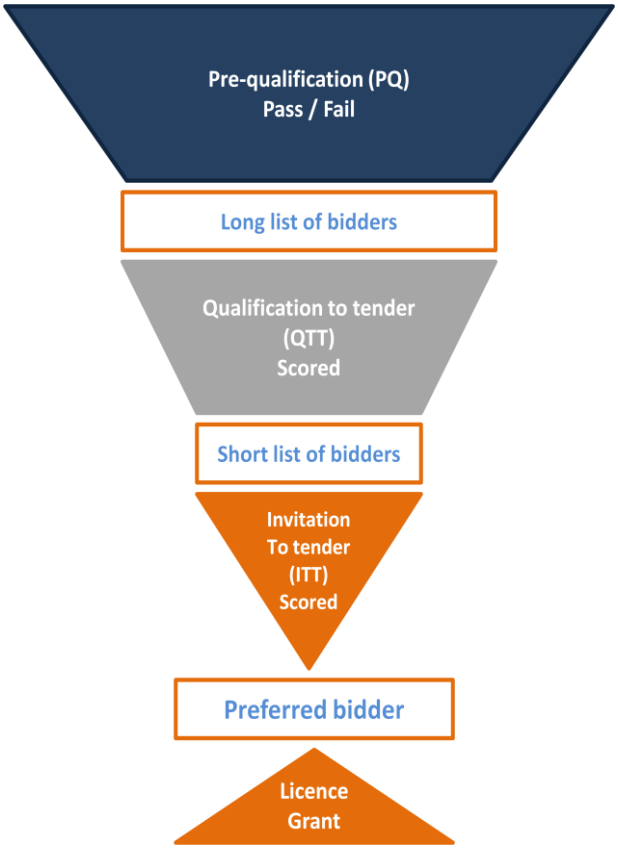


Diagram 2 - Stages of a tender exercise as run under the transitional regime

Pre-Qualification (PQ) stage

3.52. We are considering three broad options for the PQ stage, two of which involve a generic PQ stage. Under the transitional regime, the PQ stage is run as outlined under option 2 below.

- Option 1: Generic PQ stage to be run in tender windows with pre-qualification being valid for a defined time period.
- Option 2: Generic PQ stage to be run after a group of projects have qualified for tender round.
- Option 3: PQ stage to be run on an individual project basis.

3.53. Option 1 is consistent with the December 2010 publication, in which we proposed that a generic PQ stage could occur in annual tender windows. This PQ stage and window would relate to pre-qualification of bidders, not projects, ie a project could qualify for a tender exercise at any point in time, either before or after the pre-qualification of bidders (subject to meeting the qualifying project requirements within the Tender Regulations).

3.54. Under this option, assuming annual tender windows, the generic PQ stage would run once a year and would identify a panel of qualified bidders entitled to submit bids for projects that qualify for a tender round commencing within that year. Participation in the project-specific stages of the tender round would be limited to those qualified bidders. Under such an approach Ofgem would only run the generic PQ stage if there was certainty that the project-specific stage of at least one project would commence within that year.

3.55. We believe that this option could reduce costs and administrative burden on bidders (and Ofgem), and could help ensure that the project-specific stages of tender rounds are run on a timely basis. In order to further minimise costs and administrative burden, there may be value to considering variations to this option where the tender windows do not occur annually. However, in order to maintain ongoing competition across the bidding community, we believe that pre-qualification would need to be limited to no longer than a year. A potential disadvantage of running tender windows every two years for example, would be that it may limit competition across the bidder community and make it harder for new entrants to qualify.

3.56. Under option 2 Ofgem would run a generic PQ stage as and when required after a group of projects have qualified for a tender round (as currently occurs for transitional tender exercises). In this way pre-qualification would be limited to certain projects rather than a certain time period. This could potentially promote competition across the bidder community by grouping projects into tender rounds, as the competition would be opened up to all bidders every time a new PQ stage is run. However this approach could make additional demands on resources, and would be reliant on Ofgem having access to regularly updated information on project delivery timescales in order to group projects within tender rounds most effectively. Another potential disadvantage of limiting the qualified bidder panel to projects could be the relative complexity of administering such a process, particularly if there was significant change to project delivery timescales.

3.57. We do not consider it likely that option 3 would be our preferred option for the majority of projects. However, it may be appropriate for certain project circumstances, for example, where projects are being grouped together under option 2 but a tender exercise is triggered for another project which has not been included in the current tender round and needs to be tendered before the next tender round is due to commence. This approach could assist Ofgem in managing changing project delivery timescales and ensure a tender exercise is run on a timely basis for each project. A disadvantage of this approach is that it is more resource intensive at the PQ stage, for both bidders and Ofgem, than either option 1 or 2.

Q3.19 Do you have any preferences from amongst the options outlined for how the PQ stage should operate?

Q3.20 Are there any other ways that a PQ stage might operate in order to meet the objectives set out at the start of the 'Tender stages and timings' section?

Qualification to Tender (QTT) Stage

3.58. As detailed in the December 2010 publication, we have proposed that the QTT stage that is currently compulsory for transitional tender exercises could be made optional for OFTO build tender exercises. Project-specific circumstances could result in it not always being necessary or optimal to run separate PQ and QTT stages, for example, to minimise tendering costs where we are running a project specific PQ stage (option 3 above). If we were to decide not to run a QTT stage, then we would expect that an enhanced PQ stage would be required in order to ensure the PQ stage is rigorous enough to shortlist bidders to an appropriate number in advance of the more resource intensive ITT stage.

3.59. As set out in the December 2010 publication, we will determine the timing and structure of the tender for each project on a case-by-case basis and will publish documentation at the start of each tender exercise confirming the structure and timing of the tender exercise for a particular project.

ITT stage and subsequent stages

3.60. As detailed in the December 2010 publication, we believe that the best outcome for consumers under OFTO build will result from aligning the project-specific stages of a tender exercise with timings for delivering projects, such as achieving planning consents. We therefore proposed in the December 2010 publication linking the project-specific stages of a tender exercise to milestones within the planning process to provide greater certainty to bidders, and proposed that the ITT submission could be made shortly after planning consent decision (as reflected in option 1 in paragraph 3.62).

3.61. However, a number of factors are relevant to determining our preferred final approach, including:

- the benefits of keeping the period between preferred bidder selection and licence grant to a minimum;
- the benefits of starting the ITT stage as late as possible to provide more certainty to bidders and funders;
- our aim of maximising supply chain competition; and
- our aim of ensuring the tender process does not cause delays to overall project delivery timescales.

3.62. As a result we are considering two additional options for running the ITT stage from that outlined within paragraph 3.60. All three options are summarised below and covered in more detail in the subsequent paragraphs.

- Option 1: Single ITT stage with bidders having a maximum of one month post planning consent decision to submit their ITT bid.

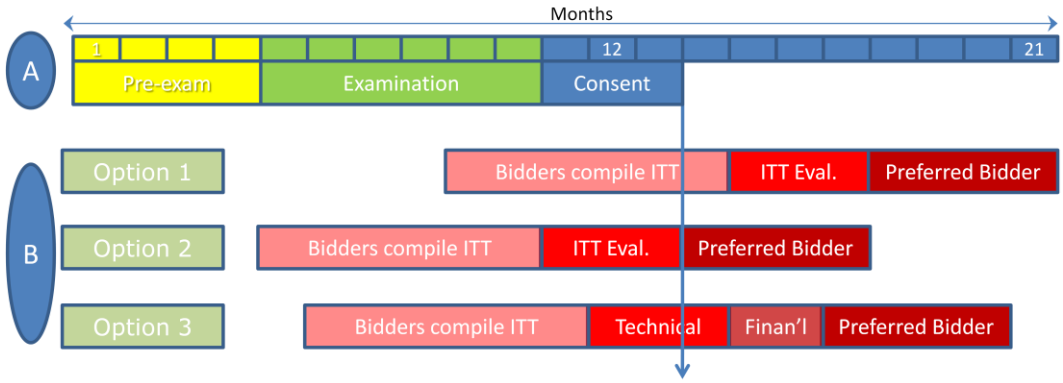
- Option 2: Single ITT stage with bidders submitting ITT bids no earlier than three months before anticipated consent decision. Preferred bidder appointment would occur no earlier than the date of planning consent decision.

- Option 3: Split ITT stage. Technical proposals would be submitted before the planning consent decision, while the TRS bid would be submitted post planning consent decision. Evaluation of the technical proposals would commence prior to the planning consent decision.

3.63. 'Planning consent decision' above is defined as the decision by the planning authority to either approve or reject the planning application. A period for legal challenge follows this decision. Therefore, under each of the options above, the ITT bid would be submitted before the expiry of the challenge period (assuming a challenge period of 3 months).

3.64. Diagram 3 sets out indicative timescales for the three ITT options above; these are shown alongside an indicative timeline for a planning consent submission to the Infrastructure Planning Commission (IPC). Note that in this example, the PQ stage and QTT stage have not been included[13]. Also note that Diagram 3 is included for ease of reference only and should not be viewed as a factual representation of the expected time-scales.

[13] The QTT stage would occur directly before the ITT stage if required. The PQ stage would be likely to occur immediately before QTT stage if a project-specific PQ is run. If either option 1 or option 2 in paragraph 3.52 is adopted for the PQ stage there may be a longer time gap between PQ and QTT.



A Timeline for the IPC planning consent process

B OFTO Build tender process

This diagram shows the Tender option timelines in relation to the planning consent decision (blue arrow, above).

Note:
Indicative current timescales for the final planning consent decision are 3 months (blue box, above), where consent is determined by the IPC, or 6 months, where determined by the Secretary of State (3 months shown above).

Diagram 3 – Indicative timescales for options in relation to the ITT stage

3.65. Under all three options set out above, the preferred bidder selection would be based on evaluation of both the technical and financial elements of the bid, with preferred bidder selection occurring post planning consents decision. However, if preferred bidder selection occurs before the end of the challenge period or while a challenge is being addressed, the generator would continue to carry out the work necessary to achieve planning consent during the Preferred Bidder stage.

3.66. An advantage of option 1 is that clearest pricing is likely when bidders have greatest certainty that the project is likely to go ahead (ie after planning consent decision) and therefore firm prices are best sought after planning consent approval. Another advantage is the relatively high price certainty inherent in the bid compared to option 2.

3.67. A disadvantage of option 1 is the potentially relatively short time period between preferred bidder appointment and start of construction, with licence grant expected to occur approximately nine months after planning consent decision. We expect to complete the Preferred Bidder stage of the tender process and progress to licence grant prior to the expected construction commencement date. However, a protracted preferred bidder stage could cause delays to the project delivery timetable as licence grant needs to occur before construction commencement.

3.68. Under option 2 the ITT stage would start earlier and it is proposed that the following broad parameters would apply:

- the ITT bid would be submitted on the basis that planning consent will be achieved and any associated assumptions would need to be included within the submission

- ITT bids would be scheduled for a date no earlier than three months before anticipated consent decision (in order to ensure that preferred bidder decision does not precede planning consent decision)

- if there are planning conditions attached to the planning consent with significant cost consequences, there would be an agreed mechanism to amend the bid to take these into account within the TRS

- preferred bidder appointment would not occur prior to the planning consent decision.

3.69. The key advantage of option 2 is that it brings the tender process forward, reducing the possibility of the tender process causing delays to the project delivery timetable. However, a disadvantage of option 2 for the consumer is the relative price uncertainty due to the potential for the planning authority to impose planning conditions which could then trigger a change to the TRS (in accordance with the agreed mechanism) following the planning consent decision. A further disadvantage is that if planning consent is rejected by the planning authority, both the bidders and Ofgem will have incurred higher tender costs than under the other options on a project which is unlikely to proceed.

3.70. The rationale for option 3 would be primarily to reduce time between consent decision and OFTO licence grant, while maintaining the price certainty achieved under option 1. Under this option splitting the ITT stage would enable some evaluation to be carried out earlier and could also reduce the time for bidders to submit financial proposals post consent decision. Both of these factors could potentially reduce Ofgem's evaluation time post consent decision. Specifically on the evaluation:

- elements of the evaluation that could be carried out earlier include qualitative elements such as technical and contractual structuring

- the submission and evaluation of the price element of the bid would be delayed until post consent decision.

3.71. Although option 3 could bring forward the preferred bidder decision relative to option 1, the benefit may be limited. In addition, a disadvantage of option 3 is that the two step bid submission and evaluation process could increase costs.

3.72. Regardless of which proposed option is chosen, we would seek to mitigate the risk of delays to the planning consent decision process impacting on a tender exercise by requiring generators (through a tender entry condition in the Tender Regulations) to keep Ofgem informed of progress of their planning consent submission. Ofgem would then retain the option to delay

a stage of the tender exercise until a point where there is more clarity on the timescale for a decision on the planning consent submission, ie if consent is delayed, selection of the preferred bidder would be deferred until consent is obtained.

3.73. Note that we expect that an unsuccessful planning consent submission or a successful challenge to the planning consent is likely to lead to the cancellation of a tender exercise for that project.

3.74. In addition to the options for ITT stage timings set out above, we are considering the detailed nature of the ITT stage itself as we recognise that the practical differences between an OFTO build tender exercise and a Generator build tender exercise could mean that some amendments to the process may be beneficial to deliver optimum benefits for the consumer. For example, the approach to determining the capital costs will differ between the two build options and the nature of information available to bidders will differ due to the earlier timing of the ITT stage under OFTO build. We would welcome views on what amendments, if any, might assist in delivering optimum benefits for the consumer.

Q3.21 Do you have any preferences from the options outlined for how the ITT stage might operate?

Q3.22 Are there any other ways that the ITT stage might operate to ensure its efficiency and effectiveness?

3.75. As is currently the case for transitional tender exercises, we will consider on a case by case basis whether there is a need for an optional Best and Final Offer (BAFO) stage, depending on the circumstances of the project being tendered. We propose to retain the flexibility to run a BAFO stage if needed; however, we recognise that any such stage would need to be short in order to minimise the period during which the tender process might be on the project development critical path.

Bid evaluation

3.76. We will set out the approach to evaluation in the tender documentation ahead of each stage of a tender exercise. We expect to follow a similar approach to that used for transitional tender exercises by evaluating both financial and technical aspects of bids, but will tailor our evaluation criteria as appropriate for OFTO build tender exercises. For example, we expect to evaluate the robustness of bidders' proposals to deliver construction of the transmission assets and may take factors such as transmission losses into account, as set out in our August 2010 consultation. There we said that losses would be considered alongside other elements of the bid, including operations and maintenance and capital costs.

3.77. The August 2010 consultation set out that we considered there to be a potential role for the generator in the evaluation of the bids as this may assist in ensuring a robust tender exercise under OFTO build. We are therefore considering asking generators to comment on certain key

technical aspects of all bids received at the ITT stage for their project so as to inform our evaluation. We would ensure under any such approach that all information received by generators would be anonymous and subject to a confidentiality agreement, and would not include any cost information. The key technical aspects of bids should relate to areas of most importance to the project that would assist in delivering optimum benefits and savings to the consumer and the generator.

3.78. We would like your views on what those key aspects might be for OFTO build, but in broad terms suggest that they might include proposals relating to the overall build programme, the construction of the offshore substation, the interface points between generator and OFTO assets, and the operations and maintenance proposals for the transmission assets – where these fall within the limitations of any potential conflicts of interest.

3.79. In the August 2010 consultation, we set out that Ofgem is able to request information and views from NETSO to inform a tender exercise. NETSO is required to provide this information through Standard Licence Condition 25 of their transmission licence. We propose asking NETSO to comment on certain key technical aspects of all bids received so as to inform our evaluation. We would ensure under any such approach that all information received by NETSO would be anonymous and subject to a confidentiality agreement, and would not include any cost information. The key technical aspects of bids should relate to areas of most importance to their role as system operator that would assist in delivering optimum benefits and savings to the consumer.

3.80. We would like your views on what those key aspects might be, but in broad terms suggest that they might include proposals relating to the construction of the onshore substation, the technical design of the transmission assets and compliance of proposals with relevant industry codes and standards.

Q3.23 What are your views on the proposals for involving generators in evaluation of bids? In particular, what key technical aspects of bids would be most important for generators to evaluate?

Q3.24 What are your views on the proposals for involving NETSO in evaluation of bids? In particular, what key technical aspects of bids are most important for NETSO to evaluate?

3.81. Regardless of the involvement of generators and/or NETSO in evaluation, decisions in all stages of a tender exercise, including selection of a preferred bidder and granting a licence to a successful bidder, will be taken by Ofgem alone.

Bid submissions and flexibility

3.82. In general our preference is to maximise certainty through the tender process and therefore our expectation is for fixed price firm bids wherever possible. However, we wish to ensure that innovation is not restricted and

therefore expect to retain a degree of bidding flexibility through the process.

3.83. As detailed within the August 2010 consultation, we do not propose to allow parties to submit variant bids for a project where there is a substantial change in design that undermines the tender specification developed by the generator, as it could lead to delays in connection. An example might be a design proposal which would require further consents to be acquired. However, there may be advantages to allowing some variant bids on selected elements *within* the scope of the tender specification. A variant bid could therefore, for example, include design variations, providing such variations remained within the scope of the tender specification.

3.84. We anticipate setting out further information on this in spring 2012 but we would welcome your early comments on the best approach to variant bids in light of the arrangements for OFTO build detailed within this chapter.

Q3.25 Are there areas on which you think allowing variant bids under OFTO build would add value to the process and to consumers?

Cost assessment

3.85. As detailed in paragraph 3.20, generators will recover efficiently incurred pre-construction costs. We propose to establish the costs associated with undertaking pre-construction works in order to inform bids at the ITT stage of a tender exercise for a project, and will assess the economic and efficient costs of undertaking these works before licence grant in order to determine the transfer value of the pre-construction works.

3.86. We propose that generators will recover efficiently incurred pre-construction costs at the point at which the transmission construction works are completed, as this aligns with the point at which the OFTO revenue stream would commence (see the 'Revenue entitlement' section, paragraph 3.93). We would however welcome your views on whether this is an appropriate approach.

Q3.26 What are your views on generators recovering efficiently incurred pre-construction costs at the point at which the transmission construction works are completed?

3.87. In line with the December 2010 position for Generator build tender exercises (see also chapter 4), under OFTO build we will not provide generators with a cost guarantee for pre-construction costs. Additionally, we propose that generators would not recover any costs associated with pre-construction works in the event that their planning consent submission is unsuccessful and leads to cancellation of the project from a tender exercise.

3.88. Our joint work with DECC on the Coordination Project has highlighted that certainty over the process for dealing with anticipatory investment, including how this relates to the cost assessment process for pre-construction works, is a key aspect in enabling a more integrated approach to offshore network development. We will be publishing a coordination project conclusions report with DECC early next year. Alongside this, Ofgem will publish a consultation document setting out measures that we believe are warranted to address the potential barriers to coordination that have been identified through the Coordination Project.

Asset transfer

3.89. As detailed in the 'Pre-construction' section, under the OFTO build approach it would be possible for the generator to undertake pre-construction works and transfer these works to the successful bidder. We expect the following assets obtained during pre-construction to be included within the transfer: all consents and permissions associated with the works to be undertaken, and all land acquisitions.

3.90. We continue to believe that a transfer agreement provides an appropriate vehicle through which to progress discussions over transfer of pre-construction works. We will however look to learn from ongoing experience from the transitional tender exercises on the mechanisms that facilitate asset transfer, and expect to publish asset transfer guidance reflecting this in advance of the first OFTO build tender exercise.

OFTO licence

3.91. We have consulted extensively on the OFTO licence under the transitional regime. The OFTO licence granted under OFTO build will build on the licence granted for transitional tender round 2 projects, but will include a new section of conditions relating to the period during which the OFTO would be constructing the transmission assets.

3.92. We anticipate setting out further information on the OFTO licence and incentives for OFTO build in spring 2012. A number of issues that have been raised through our stakeholder engagement programme are set out in the paragraphs below. We would welcome your early views on these and also on the appropriateness of design incentives for transmission asset lifecycle design, eg transmission availability, quality of installation and transmission losses.

Q3.27 Do you have any early views on the appropriateness of design incentives for transmission asset lifecycle design, eg transmission availability, quality of installation and transmission losses?

Revenue entitlement

3.93. We propose that the revenue stream would commence once the transmission construction works are completed and the completion date provided for in the TO Construction Programme has been reached.

3.94. The current mechanism for indexation applies an uplift to the full TRS, in April of each year, based on the RPI increase from the base date to the September immediately preceding the April in which the uplift applies. It is expected that the base date for all licences will reference the September in the tender relevant year[14]. We would be interested in your views on whether this approach provides best value to consumers given the different types of funding sources available to OFTOs and the inflation risk being taken by the consumer, and if not, what other approaches we might consider.

Q3.28 What are your views on whether the current approach to indexation, and in particular the proportion of the TRS subject to indexation, provides the best value to consumers? How might any alternative approaches be managed?

Delivery incentives

3.95. We recognise that one of the key risks faced by generators under the OFTO build option is delays by the OFTO which could have an impact on project delivery timescales, and in particular generation timescales. This risk may be mitigated by the following incentives for OFTOs which are currently in place:

- The revenue stream would only become payable to the OFTO once construction works are completed and the completion date provided for in the TO Construction Programme has been reached. This places a significant incentive on the OFTO to complete construction on time.

- Under the industry codes, OFTOs are liable, in certain circumstances, to pay liquidated damages to NGET in the event of construction delay. This places an additional incentive on the OFTO to complete construction on time.

- OFTOs are currently required, within the terms of the STC, to secure a proportion of construction costs, either by meeting NGET's credit rating requirements or by procuring a security arrangement (letter of credit or security bond). The security would be drawn down in the event that the OFTO could not complete construction and a replacement OFTO is

[14] This mechanism was introduced for tender exercises within the second transitional tender round.

required. The construction security places an incentive on an OFTO to ensure the OFTO does not abandon the project.

3.96. Given the above incentives we do not consider that any additional delivery incentives for OFTOs are necessary; however, we seek your views on this.

Q3.29 Do you agree that additional delivery incentives for OFTOs are not necessary?

Decommissioning

3.97. We recognise that some transmission assets such as the subsea cable and the onshore transmission substation may have a useful life in excess of the 20 year licence period. For transitional tender exercises, bidders are required to price decommissioning costs within their bids. In 2008 we set out some options for how the assets may be dealt with beyond 20 years on the assumption that there would be value beyond 20 years[15]. However, some uncertainty remains, particularly in relation to which, if any, assets will still be useable and if there will be ongoing demand for them. This uncertainty has the potential to impact on our eventual policy in at least three areas:

- treatment of decommissioning costs, if decommissioning is needed
- consideration of residual value, if applicable
- ways in which we can ensure any incentives are still effective in the final years of the revenue period.

3.98. Particular policy positions that may be affected by the above considerations include whether decommissioning costs are best dealt with as pass through costs within the OFTO licence, or by some other means, and what 'default' residual value assumption, if any, we should invite bidders to make.

3.99. We anticipate setting out further information on these issues in spring 2012 but would welcome any early views you may have on decommissioning issues for either OFTO build or Generator build.

Q3.30 What are your views on what approach to decommissioning of assets would provide best ongoing value to consumers?

[15] Offshore Electricity Transmission – A Further Joint Ofgem/DECC Regulatory Policy Update, November 2008. Available at: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=81&refer=Networks/offtrans/pdc/cdr/cons2008

4. Generator build

Chapter Summary

This chapter considers the key elements of the Generator build option under the enduring regime. We anticipate that Generator build will closely resemble the approach successfully developed and implemented for transitional tender exercises. However, we recognise that many enduring projects are likely to be larger and more complex than those seen under the transitional regime. This chapter therefore proposes some refinements to the existing approach to ensure it is as efficient as possible and provides best value for consumers.

Question box

Q4.1 What are your views on whether there are benefits under Generator build to the generator undertaking the seabed survey against a comprehensive generic survey specification agreed by industry?

Q4.2 Do you agree with the approach that Ofgem continues to run tender rounds for groups of projects, not necessarily limited to one per year, or would you recommend an alternative approach?

Q4.3 Do you think there are further efficiencies we could make to the tender process and the transaction procedures for Generator build which would increase their efficiency and provide greater certainty to bidders and funders?

Q4.4 Are there any changes to the information supplied in the data room which would improve the efficiency of the process for Generator build?

Q4.5 What are your views on the benefits of involving generators in evaluation of bids as outlined in this section?

Q4.6 Do you have any suggestions on amendments which would improve the efficiency of the process for finalisation of transfer documentation and which would maximise value to consumers?

Q4.7 What do you consider might be the implications of a share sale approach as opposed to a transfer of assets as has been seen to date?

Q4.8 Do you agree that the current split between costs priced into the TRS and those allowed as pass throughs provides best value for consumers?

Q4.9 Are there any aspects of the current arrangements for transitional tender exercises or within the changes we have proposed above, including revenue term, bid requirements and risk profile, which may prevent access to certain sources of finance under Generator build?

Q4.10 Do you have any comments on the issues associated with incorporating a refinancing gain share mechanism for Generator build and how such a mechanism could be structured?

High level build construct

4.1. The Generator build option further develops the approach successfully developed and implemented for transitional tender exercises. It also builds on proposals we set out in the August 2010 consultation and December 2010 publication for a Generator build option in the enduring regime. We issued a joint statement with DECC on 21 October 2010 setting out our decision to include a Generator build option within the enduring regime following feedback from industry and to provide greater flexibility to the regime.

4.2. Given the success of the approach for transitional tender exercises, we do not propose to make substantive changes for Generator build. However, many future projects under the enduring regime are likely to be larger and more complex than seen under the transitional regime. They are anticipated to involve higher levels of capital investment and have longer periods of time between first energisation and project completion. We are therefore proposing some refinements to reflect the scale of future projects and to incorporate feedback from stakeholders on their experiences under the transitional regime.

4.3. As set out in the August 2010 consultation, under the Generator build option the generator will take responsibility for all aspects of pre-construction, procurement and construction of the transmission infrastructure. A competitive tender exercise will be run by Ofgem to appoint an OFTO to acquire the transmission assets from the generator upon their completion. The OFTO will then maintain and operate the assets on an ongoing basis.

Triggering a tender

4.4. As discussed in the OFTO build chapter, we propose that the generator would be required to notify Ofgem of their preferred build option when requesting that Ofgem triggers a tender exercise for its project. A generator should makes its request 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.

4.5. A generator who wishes Ofgem to commence a Generator build tender exercise will need to comply with a series of qualifying project requirements and tender entry conditions as set out in the Tender Regulations. We intend to consult on these within draft revised Tender Regulations in 2012, but do not anticipate making significant changes for Generator build from the requirements within the current Tender Regulations.

Tender specification

4.6. The tender specification will provide the basis for bids within a Generator build tender exercise. A bidder will be able to propose a bid consistent with

the parameters within the tender specification. The tender specification will be developed by the generator based on their needs, but will need to take into account input from NGET (in their role as NETSO) and Ofgem (as appropriate).

4.7. Under Generator build, the transmission assets constructed by the generator will form the assets in the tender exercise for that project. The tender specification will be based on details of the transmission assets under construction and will be made available to bidders via a project data room.

4.8. In the OFTO build chapter (see paragraphs 3.21 and 3.22) we proposed that there may be benefits to industry agreeing a comprehensive generic survey specification and for the generator to undertake the seabed survey against that specification. We believe a similar approach may lead to benefits for consumers under Generator build and would like your views on this.

Q4.1 What are your views on whether there are benefits under Generator build to the generator undertaking the seabed survey against a comprehensive generic survey specification agreed by industry?

Tender stages and timings

4.9. Where we receive multiple requests to commence Generator build tender exercises, we will seek, where it is feasible and efficient to do so, to group tender exercises within tender rounds, as appropriate to their delivery timescales (as we have done for transitional tender exercises). We do not propose to limit this to a single tender round per year. The generator would notify us that they wished their project to be included in the next tender round subject to satisfying the qualification and entry requirements under the Tender Regulations. We would be interested to know whether you agree with this approach.

Q4.2 Do you agree with the approach that Ofgem continues to run tender rounds for groups of projects, not necessarily limited to one per year, or would you recommend an alternative approach?

4.10. We expect that the tender stages and timings will be similar to those operated to date for transitional tender exercises. We would therefore run a generic PQ stage for projects falling within a tender round, before moving to project-specific QTT and ITT stages in order to identify a preferred bidder - see Diagram 2 in the OFTO build chapter.

4.11. We recognise the benefits of keeping the period between preferred bidder selection and licence grant to a minimum. We understand the benefits of starting the ITT stage as late as possible in order to provide more certainty to bidders and funders. We would be interested to know whether you think there are further efficiencies we could make to either the tender process or the transaction procedures to achieve this.

Q4.3 Do you think there are further efficiencies we could make to the tender process and the transaction procedures for Generator build which would increase their efficiency and provide greater certainty to bidders and funders?

Basis of bids

4.12. As is the case for transitional tender exercises, a prospective OFTO will bid their approach to the financing, operation, maintenance and decommissioning of the transmission assets, and the costs associated with carrying out these activities. We propose that the appointed OFTO will receive a 20 year TRS, as under the transitional regime. We set out in the OFTO build chapter that there may be a benefit to reviewing the appropriateness of this period for enduring projects - see paragraph 3.38 and question 3.13 for further details.

Data room

4.13. Qualifying bidders will be provided with access to a fully populated data room at the ITT stage for the project for which they have been shortlisted. We wish to ensure that the information supplied in the data room enables the process to run as efficiently as possible and secures the best outcome for consumers. Under Generator build, we anticipate that generators will be required to populate the data room with broadly the same type and level of information required for transitional tender exercises. The data room would also include guidance and information from Ofgem and relevant third party information from NETSO, HMRC and the Crown Estate, as has been the case to date.

Q4.4 Are there any changes to the information supplied in the data room which would improve the efficiency of the process for Generator build?

4.14. Appendix 5 summarises the documentation supplied by the generator to the data room for transitional tender exercises.

Evaluation of bids

4.15. As has been the approach to date for transitional tender exercises, we will set out the approach to evaluation ahead of each stage of a tender exercise.

4.16. As set out in the OFTO build chapter, we are considering asking the generator to comment on certain key technical aspects of bids received for their project so as to inform our evaluation. These technical aspects should relate to areas of most importance to the project that would assist in delivering optimum benefits and savings to the consumer. We would ensure under any such approach that all information received by generators would be anonymous and subject to a confidentiality agreement and would not include any cost information.

4.17. We would like your views on what those key aspects might be for Generator build, but suggest that they might include proposals relating to operations and maintenance (including planned maintenance), and to decommissioning – where these fall within the limitations of any potential conflicts of interest. We think there may be benefit to seeking input from the generator early on in the evaluation process on these discrete areas. We would use this input to inform clarifications to be asked of bidders and to inform the evaluation outcome.

4.18. Regardless of the involvement of generators in evaluation, decisions in all stages of a tender exercise, including selection of a preferred bidder and granting a licence to a successful bidder, will be taken by Ofgem alone.

Q4.5 What are your views on the benefits of involving generators in evaluation of bids as outlined in this section?

Cost assessment

4.19. We have now published four project-specific cost assessment reports which include information on our general approach and principles relating to the cost assessment process. We intend to produce further guidance on the cost assessment process in due course.

4.20. Our cost assessment process will remain broadly the same as for transitional tender exercises. Namely, that we will estimate the economic and efficient costs, including lifecycle costs (which could for example reflect transmission losses), associated with the transmission assets in order to inform bids at the ITT stage and will assess the economic and efficient costs associated with transmission assets before licence grant in order to determine the transfer value. We will keep our cost assessment methodology under review to ensure that transfer values are economic and efficient.

4.21. As set out in the December 2010 publication, we will not provide generators with a cost guarantee for Generator build tender exercises under the enduring regime.

4.22. We recognise that one of the key priorities for generators is certainty over costs incurred for anticipatory investment. This is discussed in more detail in the OFTO build chapter ('Cost assessment' section, paragraph 3.88).

OFTO of Last Resort

4.23. As set out in the December 2010 publication, we believe it is necessary to have the safeguard of an OFTO of Last Resort for Generator build tender

exercises. Further information on the OFTO of Last Resort mechanism is available on our website.[16]

Asset transfer

4.24. We expect agreement between a developer and OFTO on the transfer of assets to be reached through commercially agreed terms of transfer, contained within a transfer agreement. We will however look to learn from ongoing experience from the transitional tender exercises on the mechanisms that facilitate asset transfer, and expect to publish asset transfer guidance reflecting this in advance of the first Generator build tender exercise.

4.25. We are aware of two potential approaches to transfer – a transfer of assets as has been done under the transitional tender exercises to date, or a share sale arrangement. We recognise that some generators have expressed interest in a share rather than asset sale arrangement. There may be advantages to either a share sale approach or a transfer or assets under certain circumstances, depending on which approach is deemed to provide better value for consumers. A share sale arrangement may have implications for some aspects of our tender process, for example how the tender specification is defined and the guidance we produce on asset transfer. It may also have implications on the current cost assessment arrangements, in that the OFTO would be purchasing a company which may have liabilities that may not be easily captured by the current cost assessment process.

4.26. We would not wish for any additional costs of a share sale relative to an asset sale to be passed to the consumer; however, if there are benefits of a share sale we would expect the consumer to share benefit from the transfer choice. We would welcome your views on the potential implications of a share sale approach on the tender process generally, and consumer benefits specifically.

Q4.6 Do you have any suggestions on amendments which would improve the efficiency of the process for finalisation of transfer documentation and which would maximise value to consumers?

Q4.7 What do you consider might be the implications of a share sale approach as opposed to a transfer of assets as has been seen to date?

[16] Guidance on the Offshore Transmission Owner (OFTO) of Last Resort Mechanism, July 2011, available at: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=18&refer=Networks/offtrans/rttt

Licence and revenue entitlement

4.27. We anticipate setting out further information on the OFTO licence and incentives for Generator build in spring 2012. However, we anticipate that licences granted under Generator build will be predominantly similar to those granted for tranche B projects within the second transitional tender round, recognising that some refinements may be required. We would welcome early views on how the licence may need to be developed to reflect enduring regime projects and we highlight a few specific areas of our focus below.

4.28. We continue to believe that the current split between costs priced into the TRS and pass through costs under the OFTO licence remains appropriate for Generator build and have summarised these pass throughs in Appendix 4. However, we would welcome your views on this position.

4.29. As discussed in the OFTO build chapter (paragraph 3.47), for transitional tender exercises the OFTO bears the full risk and reward of any refinancing. Although under Generator build the OFTO does not bear construction risk, we believe the question of refinancing may be relevant to Generator build projects under the enduring regime because supply and demand for different sources of finance will inevitably change making certain sorts of finance more attractive and thereby potentially incentivising refinancing. A refinancing gain share mechanism may provide a means of ensuring consumers benefit from any value created through a refinancing exercise and also has the potential to benefit consumers by allowing a greater range of financing options to be used. We would welcome your views on the issues associated with incorporating a refinancing gain share mechanism into Generator build and on how such a mechanism could be structured to ensure the greatest benefit to consumers.

4.30. We also think there may be benefit in re examining the current arrangements in relation to the application of indexation to the TRS. Please see the discussion on indexation in the OFTO build chapter, paragraph 3.94 and question 3.28.

Q4.8 Do you agree that the current split between costs priced into the TRS and those allowed as pass throughs provides best value for consumers?

Q4.9 Are there any aspects of the current arrangements for transitional tender exercises or within the changes we have proposed above, which may prevent access to certain sources of finance under Generator build?

Q4.10 Do you have any comments on the issues associated with incorporating a refinancing gain share mechanism for Generator build and how such a mechanism could be structured?

Decommissioning

4.31. Please see the discussion on decommissioning in the OFTO build chapter, paragraphs 3.97 to 3.99 and question 3.30.

Full commencement and commissioning

4.32. Please see the discussion in chapter 2, paragraphs 2.15 to 2.19.

5. Phased or staged construction of transmission assets

Chapter Summary

This chapter defines key terms likely to be associated with many enduring projects, including 'phases' and 'stages'. It sets out our initial views on how we propose to run tender exercises for transmission assets constructed in phases or stages under the enduring regime.

Question box

Q5.1 Are you satisfied with the practical relevance of our definition of the terms 'phase' and 'stage'?

Q5.2 What are your views on the measures we propose to determine whether a stage or phase within a site/zone qualifies for a single tender exercise?

Q5.3 What are your views on whether running a separate tender exercise for each phase within a site/zone would best meet the objectives of the enduring regulatory regime?

Setting the context

5.1. We are aware that transmission assets within many of the sites and zones licensed by the Crown Estate that are likely to be tendered under the enduring regime are currently due to be constructed incrementally in phases and/or stages over the course of several years. Due to their size and planned construction period, many of these sites or zones are likely to be subject to two or more discrete Final Investment Decisions, planning consent submissions and/or bilateral connection agreements. We are therefore seeking to provide certainty to bidders and generators on how we propose to run tender exercises for transmission assets constructed in phases or stages under the enduring regime. This chapter sets out our proposed approach.

5.2. We define below some key terms associated with the construction and tendering of such projects. We appreciate that a variety of definitions will continue to be used, perhaps interchangeably, by stakeholders; therefore the terms defined here are so defined solely for the purposes of this document (these terms are illustrated in Diagram 4).

- We use the term 'site/zone' to mean: '*the transmission assets within a site or zone licensed by the Crown Estate*'[17].

[17] We refer to both sites and zones within this term because enduring tender exercises are likely to be required for transmission assets within both sites (in relation to Crown Estate round 2 sites, round 2.5 and Scottish territorial waters), and zones (in relation to Crown

- We use the term 'phase' specifically to mean: *'a grouping of transmission assets to be built out over a period of time, where the grouping is defined by certainty on build out; where certainty relates to a Final Investment Decision and key contractual commitments'.* A phase may include stages.

- We use the term 'stage' specifically to mean '*transmission assets built out incrementally in a discrete group within a phase*'.

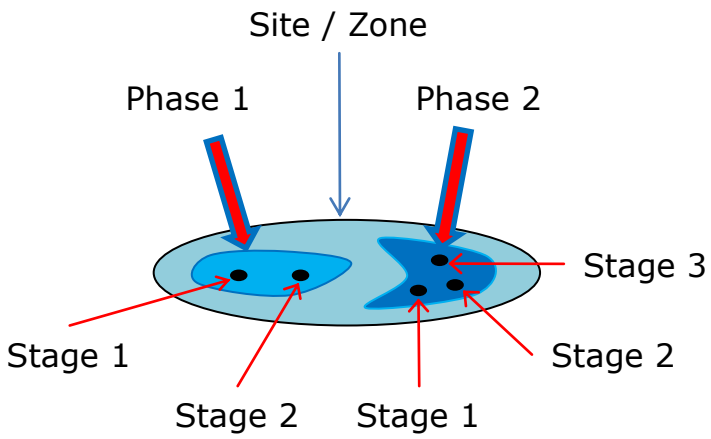


Diagram 4 – Representations of phase, stage and site/zone. This diagram shows a single site/zone, with two phases. Phase 1 includes two stages, whereas phase 2 includes three stages.

5.3. 'Phases' and 'stages' therefore relate to the high level design of the transmission assets within a site/zone. Decisions on the high level design of the transmission assets will be the responsibility of the relevant generator, as informed by their bilateral connection agreement with NETSO, their agreement for lease with the Crown Estate, and their planning consents submission.

Q5.1 Are you satisfied with the practical relevance of our definition of the terms 'phase' and 'stage'?

5.4. We use the term 'qualifying project' to mean '*those transmission assets for which Ofgem determines that the generator has met the qualifying project requirements described in the Tender Regulations*'.

5.5. A 'qualifying project' therefore relates to the scope of the transmission assets for which we run a tender exercise. The qualifying project

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Estate round 3).

requirements in the Tender Regulations set out the *maximum* scope of what assets are included in a tender exercise; however, we can include fewer transmission assets within a tender exercise where we decide that the objectives of the offshore regime[18] are better served by doing so (see paragraphs 5.8 and 5.9).

5.6. For transitional tender exercises the qualifying project requirements are set out in paragraphs 2 and 3 of Schedule 1 to the Tender Regulations. For enduring tender exercises, these requirements are currently set out in paragraph 1 of Schedule 1 to the Tender Regulations. Note however that we may propose revisions to the qualifying project requirements for enduring projects in the revised Tender Regulations we intend to publish for consultation summer in 2012.

Treatment of stages and phases within transitional tender exercises

5.7. Within the transitional regime we have run tender exercises for transmission assets within sites that include either phases, stages, or both.

5.8. For sites that included more than one phase, each phase represented the maximum scope of what could be included in a qualifying project under the Tender Regulations. We consequently tendered such sites by running a separate tender exercise for each phase.

5.9. For sites that included a single phase, but that included stages within that phase, we determined on a case by case basis whether the objectives of the offshore regime were better served by grouping all the stages within a single tender exercise, or by dividing the stages into separate tender exercises in the transitional regime. For example, for a two-staged site of high asset value, where the stages were electrically separate but constructed to similar timescales, we determined that the best value for consumers was likely to result from running a separate tender exercise for each stage. However, for another site, where the stages were constructed to different timescales and were electrically linked, we determined that running a single tender exercise for both stages would be more economic and efficient.

Treatment of stages and phases under the enduring regime

5.10. For enduring tenders, we propose using the following criteria to determine whether a stage or phase within a site/zone qualifies for a single tender exercise (these measures would apply equally to both OFTO build and Generator build tender exercises):

- the qualifying project requirements in the 2012 Tender Regulations

[18] See paragraphs 2.1 and 2.2 for details of these objectives.

- our objectives for competitive tenders for offshore transmission licences
- the high level design of the stages or phases (eg the time period between construction and operation of the stages/phases, and/or the extent to which stages/phases are electrically separate)
- the degree of certainty that a stage/phase will go ahead (as measured for example by the Final Investment Decision(s) a generator intends to make in respect of their site/zone, or the planning consents submissions it intends to make).

Q5.2 What are your views on the measures we propose to determine whether a stage or phase within a site/zone qualifies for a single tender exercise?

5.11. Given the very long timescales expected for some windfarm developments, we believe that the objectives of the offshore regime will best be met by running a separate tender exercise (as determined by the criteria above) for each committed phase (or potentially phases, if they are concurrent) within a site/zone. This would ensure an ongoing competitive process for determining an OFTO, with each tender exercise attracting favourable funding terms and best value bids by being run once there is increased certainty of the transmission assets within the site/zone either being consented (under OFTO build) or constructed (under Generator build).

Q5.3 What are your views on whether running a separate tender exercise for each phase within a site/zone would best meet the objectives of the enduring regulatory regime?

6. Next steps and implementation

Chapter Summary

This chapter sets out the next steps and further refinements we expect to undertake following responses to this consultation in order to implement the enduring regime.

Tender process development and implementation

6.1. Following consideration of responses to this consultation document, we expect to publish our latest position on Generator build and OFTO build options under the enduring regime in spring 2012. This would also set out how any proposed changes impact on the standard industry framework and what amendments (if any) may need to be considered in order to fully implement the enduring regime. In addition, we anticipate that a number of associated documents will need to be refined to ensure implementation of the enduring regime, including: the Tender Regulations, tender process documentation and the OFTO licence. The broad nature of any amendments to these documents are summarised briefly below.

Tender Regulations

6.2. We are committed to updating the Tender Regulations to ensure that they fully reflect the policy objectives and implementation requirements of the Generator build and OFTO build options under the enduring regime. This is likely to necessitate changes to the current Tender Regulations, particularly the qualifying project requirements and tender entry conditions. We intend to develop draft Tender Regulations for enduring tender exercises for consultation in summer 2012 and intend the Tender Regulations to come into force in autumn 2012.

Tender documentation

6.3. We expect to publish a number of documents associated with running tender exercises under the enduring regime. These documents are likely to include tender rules, a generic preliminary information memorandum, a cost recovery methodology and various stage-specific documents. We will publish such documents after the Tender Regulations for enduring tender exercises come into force.

Incentives and OFTO licence

6.4. As detailed earlier in this document, we anticipate setting out further information on certain aspects of the incentives and OFTO licences for Generator build and OFTO build in spring 2012.

Offshore Transmission Coordination Project

6.5. We will publish the conclusions of the Offshore Transmission Coordination Project jointly with DECC early in 2012. This will be accompanied by an Ofgem consultation document, which will set out proposed changes to the offshore regime to ensure it is able to achieve savings from coordination where this is the most economic outcome.

Appendices

Index

Appendix 1 - Consultation response and questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

1.3. Responses should be received by 17 February 2012 and should be sent to:

Giedre Kaminskaite-Salters
Offshore Enduring
9 Millbank, London, SW1P 3GE
020 7901 7493
Offshore.Enduring@ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document(s) to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. Any questions on this document should, in the first instance, be directed to:

Giedre Kaminskaite-Salters
Offshore Enduring
9 Millbank, London, SW1P 3GE
020 7901 7493
Offshore.Enduring@ofgem.gov.uk

With the exception of the questions outlined below, there are no questions in relation to other chapters in this document.

CHAPTER: Two

Question 1: Do you have any views on the approach outlined in paragraph 2.8, namely to focus on a single OFTO build option and not to develop the early OFTO build option further at this stage?

CHAPTER: Three

Question 1: What are your views on the proposed arrangements for triggering a tender exercise?

Question 2 : What are your views on whether our proposal on generator security will ensure the appropriate level of commitment from a generator?

Question 3: Do you agree with our proposed approach to the tender specification for an OFTO build tender exercise?

Question 4: Are the proposed arrangements for pre-construction works the most appropriate for investors and generators?

Question 5: What other information, if any, in addition to that referred to within the tender specification and pre-construction works sections, would be needed within the data room for the project?

Question 6: What do you think would be the best approach to ensuring bidders have access to and confidence in a seabed survey undertaken by the generator?

Question 7: With reference to the approach to seabed surveys outlined within paragraph 3.22, what might be the best approach to developing an independent generic survey specification that would be acceptable to both generators and potential bidders?

Question 8: Do you agree that ensuring procurement is undertaken by the OFTO through the tender process would be the most economic and efficient approach?

Question 9: What are your views on whether there are supply chain constraints associated with the manufacture and delivery of some key offshore transmission assets? If there are constraints, do these vary significantly in relation to project design?

Question 10: What are your views on the examples of alternative approaches for supply chain engagement under OFTO build outlined in this section?

Question 11: Are there any other approaches we should consider under OFTO build to enable the supply chain to be engaged in time to ensure project delivery timescales are met, whilst maximising opportunities for competition through the tender process?

Question 12: Should there be any restrictions on interactions between parties, either before or during a tender exercise in order to ensure fair and effective competition and best value for consumers?

Question 13: Do you agree that the current 20 year revenue stream provides the best value to consumers under the enduring regime (OFTO or Generator build)? If not, what alternatives should we consider?

Question 14: What are your views on our proposed treatment of risk relating to:
- delay to licence grant?
- weather delay?

Question 15: Are there other areas of risk which would be more efficiently managed (for consumers) through a risk sharing mechanism rather than factored into bidders' TRS bids? If so, can you suggest how these risks might be shared?

Question 16: Is the current approach to recovering bid costs appropriate for OFTO build? If not, what alternative approach to recovering bid costs would you recommend?

Question 17: Are there any aspects of the current transitional arrangements or within the proposals for OFTO build, including revenue term, bid requirements and risk profile, which may prevent access to certain sources of finance in the enduring regime?

Question 18: Do you have any comments on the issues associated with incorporating a refinancing gain share mechanism and how such a mechanism could be structured?

Question 19: Do you have any preferences from amongst the options outlined for how the PQ stage should operate?

Question 20: Are there any other ways that a PQ stage might operate in order to meet the objectives set out at the start of this section?

Question 21: Do you have any preferences from the options outlined for how the ITT stage might operate?

Question 22: Are there any other ways that the ITT stage might operate to ensure its efficiency and effectiveness?

Question 23: What are your views on the proposals for involving generators in evaluation of bids? In particular, what key technical aspects of bids would be most important for generators to evaluate?

Question 14: What are your views on the proposals for involving NETSO in evaluation of bids? In particular, what key technical aspects of bids are most important for NETSO to evaluate?

Question 25: Are there areas on which you think allowing variant bids under OFTO build would add value to the process and to consumers?

Question 26: What are your views on generators recovering efficiently incurred pre-construction costs at the point at which the transmission construction works are completed?

Question 27: Do you have any early views on the appropriateness of design incentives for transmission asset lifecycle design, eg transmission availability, quality of installation and transmission losses?

Question 28: What are your views on whether the current approach to indexation, and in particular the proportion of the TRS subject to indexation, provides the best value to consumers? How might any alternative approaches be managed?

Question 29: Do you agree that additional delivery incentives for OFTOs are not necessary?

Question 30: What are your views on what approach to decommissioning of assets would provide best ongoing value to consumers?

CHAPTER: Four

Question 1: What are your views on whether there are benefits under Generator build to the generator undertaking the seabed survey against a comprehensive generic survey specification agreed by industry?

Question 2: Do you agree with the approach that Ofgem continues to run tender rounds for groups of projects, not necessarily limited to one per year, or would you recommend an alternative approach?

Question 3: Do you think there are further efficiencies we could make to the tender process and the transaction procedures for Generator build which would increase their efficiency and provide greater certainty to bidders and funders?

Question 4: Are there any changes to the information supplied in the data room which would improve the efficiency of the process for Generator build?

Question 5: What are your views on the benefits of involving generators in evaluation of bids as outlined in this section?

Question 6: Do you have any suggestions on amendments which would improve the efficiency of the process for finalisation of transfer documentation and which would maximise value to consumers?

Question 7: What do you consider might be the implications of a share sale approach as opposed to a transfer of assets as has been seen to date?

Question 8: Do you agree that the current split between costs priced into the TRS and those allowed as pass throughs provides best value for consumers?

Question 9: Are there any aspects of the current arrangements for transitional tender exercises or within the changes we have proposed above, including revenue term, bid requirements and risk profile, which may prevent access to certain sources of finance under Generator build?

Question 10: Do you have any comments on the issues associated with incorporating a refinancing gain share mechanism for Generator build and how such a mechanism could be structured?

CHAPTER: Five

Question 1: Are you satisfied with the practical relevance of our definition of the terms 'phase' and 'stage'?

Question 2: What are your views on the measures we propose to determine whether a stage or phase within a site/zone qualifies for a single tender exercise?

Question 3: What are your views on whether running a separate tender exercise for each phase within a site/zone would best meet the objectives of the enduring regulatory regime?

Appendix 2 – Possible future tender exercises under the enduring regime

The capacity and connection dates for each project below are taken from the National Grid Transmission Entry Capacity (TEC) Register, dated 5 December 2011.

Project		**Capacity (MW)**	**Connection Date (as stated in bilateral connection agreement)**
Crown Estate Round 2			
Docking Shoal		500	27/10/2011
London Array		370	31/10/2015
Triton Knoll	1	400	31/7/2018
	2	400	1/4/2019
	3	400	1/4/2020
Westermost Rough		175	2/4/2014
Crown Estate Round 2.5			
Burbo Bank Extension		234	31/10/2015
Galloper (Greater Gabbard Extension)		500	31/10/2015
Walney Extension		752	2/4/2016
Crown Estate Round 3			
Atlantic Array (Bristol Channel CE Zone 8)	1	302	31/10/2016
	2	404	31/10/2017
	3	404	31/10/2018
	4	405	31/10/2019
Dogger Bank (CE Zone 3)	1A	500	1/4/2016
	1B and 2A	1000	1/4/2017
	2B and 3A	1000	1/4/2018
	3B	500	1/4/2019
Firth of Forth (CE Zone 2)	1	1075	22/6/2015
	2	1825	31/8/2017
	3	790	31/8/2019
Hornsea (CE Zone 4)	1A	500	14/10/2014
	1B	500	14/10/2015
	2A	500	1/4/2017
	2B	500	1/4/2018
Irish Sea (CE Zone 9)	1	500	1/4/2017
	2	500	1/4/2018
Moray Firth (CE Zone 1)	1	120	31/10/2016
	2	300	31/10/2017
	3	360	31/10/2018
	4	360	31/10/2019
	5	360	31/10/2020
Navitus Bay (CE Zone 7)	1	400	12/9/2017
	2	400	21/10/2018

	3	400	19/12/2019
East Anglia (CE Zone 5)	1	300	31/5/2015
	2	300	31/1/2016
	3	300	31/5/2016
	4	300	30/9/2016
	5	1200	28/2/2017
	6	1200	31/7/2017
	7	1200	31/12/2018
	8	1800	31/1/2019
	9	600	31/1/2021
Scottish Territorial Waters			
Argyll Array	1	400	31/10/2018
	2	400	31/10/2019
	3	200	31/10/2020
Beatrice	1	400	31/12/2014
	2	400	31/10/2015
	3	400	31/10/2016
Neart na Gaoithe		450	31/12/2014

Appendix 3 – High level construct for OFTO build

Area	Approach	Rationale
Triggering the tender	A generator may make a written request to Ofgem to commence a tender. We propose that this request should include notification of the build option, and should be made no later than three months before the date at which the generator expects to submit its planning consent application, unless agreed otherwise with Ofgem.	To ensure the tender can be run efficiently to appoint an OFTO in time to meet project delivery timescales.
Tender specification	To be developed by the generator, informed by the relevant bilateral connection agreement, the design requirements set out within the planning consent submission and pre-construction works.	Provides appropriate and sufficient basis for a tender exercise.
Pre-construction	Pre-construction works to be responsibility of the generator. Pre-construction costs to be recoverable if economically and efficiently incurred.	Clear and effective delineation of responsibility between generator and OFTO.
Supply chain / procurement	Strongly preferred approach is that the OFTO undertakes all procurement. However, seeking views on whether the tender process may need to take potential supply chain constraints into consideration. Seeking views on viability and appropriateness of alternative approach whereby the generator could undertake some early non-exclusive and non-binding supply chain activities to enable equipment suppliers to prepare for potential contracts, but the OFTO would negotiate and finalise construction contracts.	OFTO undertaking all procurement likely to ensure most competitive and efficient outcome. However, some early generator engagement with supply chain may enable equipment suppliers to prepare for potential contracts for projects where there are supply chain constraints.
Basis of bids	Preference is for fixed price bids in all areas, but could consider risk sharing mechanisms in relation to some specific risks.	Should be sufficient certainty on project at point of bid submission to allow fixed price bids, but some risk sharing in certain areas may produce better outcome for consumers.
Tender stages and timescales	Consulting on several proposals for running the PQ and ITT stages. Preferred bidder appointment will occur post planning consent decision. Licence will be granted before construction.	Flexibility in tender process to match project needs. Best outcome for consumers is to determine preferred bidder once certainty that project will go ahead.
Licence and incentives	Proposing revenue entitlement for OFTO once construction works are completed and the construction date has been reached. Current delivery incentives on OFTOs are likely to provide sufficient incentive. Intend to set out further information on OFTO design incentives in spring 2012.	There should be sufficient incentive for OFTO to complete assets on time. Seeking views on whether design incentives may add value.

Appendix 4 – Pass throughs within the current OFTO licence

1.1 Under the current OFTO licence[19], the following areas are classed as pass throughs:

- *licence fee cost adjustment*: to cover changes to licence fee costs
- *network rates cost adjustment:* to cover changes to network rates
- *Crown Estate lease cost adjustment*: to cover changes to Crown Estate lease costs
- *tender fee cost adjustment*: to cover the fees paid to Ofgem for the costs of running the tender process
- *decommissioning cost adjustment* - the OFTO is liable for its decommissioning obligations, which are set by government. The value of the TRS is based on the legislative requirements on decommissioning in force during the tender process. However, the legislative requirements could change before the end of the revenue stream entitlement period, which could lead to additional decommissioning costs which the OFTO would not have been aware of during the tender process. If a change of law requires additional or reduced decommissioning obligations, the OFTO can pass through any increase in efficient costs, if agreed by Ofgem
- *income adjusting event (IAE)* - Certain other events or circumstances that were not predicted at Licence Grant may result in increased or decreased costs or expenses. The licence defines the circumstances which may be considered income adjusting events. An income adjusting event may arise from an event or circumstance that:
    - constitutes force majeure under the STC; or
    - results from an amendment to the STC; or
    - is considered and approved by Ofgem as an income adjusting event.

  The increase or decrease in costs and/or expenses must also exceed a threshold. For transitional projects the threshold is determined on a project basis and is driven by the capacity of the assets. The OFTO must give notice to Ofgem of an IAE. The licence sets out what the notice must contain and the process to be followed
- *temporary physical disconnection payment* - under the CUSC, NETSO makes payments to generators if an outage on the NETS interrupts a

[19] The Generic Offshore Transmission Owner Licence (version 1.2): http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=24&refer=Networks/offtrans/rttt

generator's connection. These are known as relevant interruptions. NETSO can require payment from the OFTO to cover compensation costs if the outage is on part of the OFTO's system. This pass through allows the OFTO to recover any compensation costs it is required to make to NETSO as a result of a relevant interruption.

- *Marine and Coastal Access Act 2009 cost adjustment* - this pass through provides protection for any additional costs of complying with additional obligations under the Marine and Coastal Access Act 2009 that did not apply to the OFTO at the time of bidding.

Appendix 5 – Documentation supplied by the generator to the data room for transitional tender exercises

1.1 Documentation supplied by the generator to the data room for transitional tender exercises has included:

- contract information relating to suppliers and sub-contractors
- bilateral connection agreements
- Crown Estate lease or agreement for lease; onshore land rights and any crossing agreements
- planning consents and environmental survey
- decommissioning information
- project status and timetable updates
- technical data, including maps, diagrams and drawings
- health and safety and environmental matters;
- information and communications technology details
- human resources issues, eg relating to employees, pensions and personal data
- insurance and taxation information
- liabilities
- competition such as restrictive covenants and exclusive agreements to which the land or transmission system is subject, and documents from any investigation by a competition or regulatory body
- transaction documents such as interface agreements, disclosure letters, Transfer Agreement, vendor due diligence and commercial offers.

Appendix 6 - Glossary

A

August 2010 Consultation

Offshore Electricity Transmission – Further consultation on the Enduring Regulatory Regime (Reference number 113/10)

Authority

The Gas and Electricity Markets Authority

B

BAFO

Best and Final Offer

C

Connection Point

The offshore substation which connects the generation assets to the transmission system

Coordination Project

The joint DECC and Ofgem Offshore Transmission Coordination Project

CPO

Compulsory Purchase Order

Critical Path

The timeline of individual activities on which the overall project timeline is dependent

CUSC

The Connection and Use of System Code

D

DECC

Department of Energy and Climate Change

December 2010 Publication

Government response to offshore transmission consultations (reference number 157/10)

Developer

The entity responsible for the construction of the generation assets and, under Generator build, the transmission assets

E

Electricity Act

The Electricity Act 1989

F

Force Majeure

Any event or circumstance which is beyond the reasonable control of any Party, as defined in the System Operator-Transmission Owner Code

G

Grid Code

The Grid Code covers technical aspects relating to connections to and the operation and use of the national electricity transmission system

Go-Active

The commencement of Sections 90 and 91 of the Energy Act 2004

GW

Gigawatt

H

Heads of Terms

Main agreed commercial terms and conditions

HMRC

Her Majesty's Revenue and Customs

HVDC

High Voltage Direct Current

I

IAE

Income adjusting event

Interface Point

The substation which connects the offshore transmission assets to the onshore transmission system

IPC

Infrastructure Planning Commission

ITT

Invitation to Tender

K

kV

Kilovolt

N

NETS

National Electricity Transmission System

NETSO

National Electricity Transmission System Operator

NGET

National Grid Electricity Transmission

O

October 2010 Statement

Providing additional flexibility in the enduring regulatory regime for offshore electricity transmission: Initial joint decision statement

Ofgem

Office of Gas and Electricity Markets

OFTO

Offshore Transmission Owner

P

PQ

Pre Qualification

Preferred Bidder

The bidder chosen to own the transmission assets following the Invitation to Tender stage of the tender process

Q

QTT

Qualification to Tender

Qualifying project requirements

The requirements a project must meet in order to be eligible for a tender exercise as defined in Schedule 1 of Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2010

R

REZ

Renewable Energy Zone

RIIO

Revenues Incentives Innovation Outputs

RPI

Retail Price Index

S

STC

System Operator – Transmission Owner Code

Successful Bidder

The preferred bidder becomes the successful bidder following the publication of a Notice under the Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2010 pursuant to regulation 23(2) of the regulations

T

Tender Entry Conditions

The requirements that a generator must meet before commencement of a tender process as listed in Schedule 2 of the Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2010

TO

Transmission Owner

TO Construction Programme

The agreed programme of works to be carried out by National Grid Electricity Transmission and the user as set out in their construction agreement

Transmission Assets

Transmission assets are defined in Paragraph 1 (3)(a) of Schedule 2A to the Electricity Act 1989 (the 'Electricity Act') 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

TRS

Tender Revenue Stream

Appendix 7 - Feedback questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments.

1.2. Please send your comments to:

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