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Dear Colleague

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

This letter highlights how the introduction of revised Tender Regulations will impact upon current and future competitive tenders to determine Offshore Transmission Owners (OFTOs).

Introduction

The Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2013 (the "2013 Regulations") have now been published and will come into force on 22 February 2013. They can be found on the Legislation.gov.uk website¹. The 2013 Regulations set out the tender process framework for granting an offshore transmission licence, including how Ofgem will run future tenders under both the generator build and OFTO build options².

A key part of the regulatory regime for offshore electricity transmission, introduced by Ofgem³ and the Department of Energy and Climate Change in June 2009, is that licences are granted to an OFTO following a competitive tender process run by Ofgem. This regime is being delivered in two parts: a transitional regime and an enduring regime for future offshore projects⁴.

The transitional regime, which has been taken forward under two rounds of competitive tenders for the grant of OFTO licences, is governed by the Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2010 (the "2010 Regulations"). Under the transitional regime, there has already been over £450m of investment across six licensed projects, with a further £2bn of investment expected for the remaining seven projects.

The enduring regime for future offshore projects is expected to be taken forward under a number of subsequent tender rounds to deliver billions of pounds of additional investment over the next decade. The first competitive tender round in the enduring regime, which we will refer to as 'Tender Round 3 (TR3)', is expected to commence in the second half of 2013.

¹ <http://www.legislation.gov.uk/ukxi/2013/175/contents/made>.

² Under generator build, the OFTO will operate, maintain and decommission the transmission assets. Under OFTO build, the OFTO will also deliver the build programme, as well as being responsible for the operation, maintenance and decommissioning of the assets.

³ The Office of the Gas and Electricity Markets Authority is the regulator of gas and electricity markets in Great Britain. Ofgem is the Office of Gas and Electricity Markets, which supports the Authority in performing its statutory duties and functions. For ease of reference, Ofgem is used to refer to Ofgem and the Gas and Electricity Markets Authority (The Authority) in this document.

⁴ Projects falling under the transitional regime were required to meet the qualifying project requirements set out in the 2010 Regulations by 31 March 2012.

The 2013 Regulations are a key milestone in the delivery of the enduring regime. In the build up to TR3 we will be publishing more documentation which will provide additional detail on how we will run the process.

Regulatory framework

Section 6C of the Electricity Act 1989 (the "Act") empowers the Authority to make regulations which enable it to determine on a competitive basis the entity to whom an OFTO licence is to be granted. OFTO licences are subsequently granted in accordance with section 6(1)(b) of the Act, which provides the Authority with the power to grant electricity transmission licences.

The first set of Tender Regulations came into force in June 2009, after consultation with stakeholders in July 2008 and March 2009. Following further stakeholder consultation in 2009, the 2010 Regulations came into force. The 2013 Regulations were made on 30 January 2013 and will come into force on 22 February 2013.

Future tender exercises (ie tender exercises for projects qualifying from 22 February onwards) will be subject to the 2013 Regulations. Current tender exercises being run under the 2010 Regulations will remain subject to the 2010 Regulations, except for the West of Duddon Sands project, which will be subject to the 2013 Regulations from 22 February onwards⁵.

The 2013 Regulations

The key changes from the 2010 Regulations include:

- The development of arrangements for an OFTO build tender exercise. This is the most substantial change to the 2010 Regulations. It reflects policy on how Ofgem will run an OFTO build tender process going forward and introduces greater choice and investment opportunity into the regime.
- Refinements to arrangements for generator build tender exercises to reflect lessons learned from the regime to date, including the introduction of mechanisms to facilitate the process leading up to licence grant.

The 2013 Regulations were finalised following consultation in September 2012. The Annex to this letter summarises the key issues raised by respondents during the consultation and sets out the main changes that have been made since the consultation. These are mostly changes to terminology and definitions of terms in order to clarify drafting.

Next steps for the offshore transmission regime

We published a consultation document on licence policy for future tenders in November 2012, with a focus on the OFTO licence to be granted following a generator build tender⁶. Following the close of this consultation (on 22 February), responses will be analysed and further work carried out to assess how the policy proposals will be taken forward and implemented through the OFTO licence. We expect to publish a position paper in spring 2013, which will summarise the arrangements for future generator build tenders and confirm our positions on areas of licence policy consulted on in November 2012.

⁵ In accordance with regulation 2 of the 2013 Regulations, where the Authority has not given notice in relation to payment for the ITT stage of a tender exercise by 22 February 2013, the process for grant of an OFTO Licence for that qualifying project will be subject to the 2013 Regulations. For West of Duddon Sands, this means that the PQ stage is carried out under the 2010 Regulations and that the remainder of the tender is carried out under the 2013 Regulations.

⁶ Offshore Electricity Transmission: Consultation on licence policy for future tenders, November 2012
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=98&refer=Networks/offtrans/pdc/cdr/2012>.

We also expect to publish detailed drafting for the 'generic' OFTO licence for generator build tenders in mid to late-2013, to ensure that the licence is ready before the commencement of the Invitation to Tender stage for TR3.

Currently we expect the first projects in TR3 to be tendered under the generator build option. We expect that future OFTO build tenders will deliver consumer benefits into the long term, through enabling greater competition and attracting new entrants across the supply chain and the bidding community. We have previously consulted on our approach to OFTO build, and the tender framework for this is reflected within the 2013 Regulations. The 2013 Regulations allow flexibility however in how the commercial framework for OFTO build could apply and we intend to continue discussions with interested parties over the coming months to determine how that framework might be applied to particular projects.

We are currently consulting on a proposed framework to enable coordination of offshore transmission⁷. We intend to publish further detail on policy for future projects that involve multiple phases of asset development and/or coordinated network design, later in the year.

If you have any queries in respect of this letter, please direct them to James Norman (James.Norman@ofgem.gov.uk, 0207 901 7420) in the first instance.

Yours faithfully,

Stephen Beel
Associate Director, Offshore Transmission

⁷ Consultation on a proposed framework to enable coordination of offshore transmission, December 2012
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=101&refer=Networks/offtrans/pdc/cdr/2012>

Annex: Summary of key issues raised during consultation on 2013 Regulations and the main changes since consultation

1. Consultation on the 2013 Regulations

We consulted most recently on the tender policy for the enduring regime, and the policy that would apply for future tender exercises, in December 2011 and May 2012. In our September 2012 open letter (the "September Consultation"), we confirmed our final policy positions on issues that required implementation through the Tender Regulations and consulted on the resultant changes to the 2010 Regulations in the form of draft Regulations.

The September Consultation sought views on all aspects of the 2013 Regulations and, particularly, whether our final policy positions had been given proper effect in the 2013 Regulations. We received eight responses to the consultation. The non-confidential responses can be found on our website⁸. We set out below the key responses raised in relation to the 2013 Regulations.

Use of term 'transitional tender exercise'

The draft 2013 Regulations referred to 'transitional tender exercises' when referring to generator build tender exercises. A number of respondents highlighted that this was confusing. Taking into account this feedback, we have removed references to transitional tender exercises and introduced a definition for a 'generator build tender exercise' in the 2013 Regulations.

Definition of preliminary works

As highlighted in the September Consultation, the 2013 Regulations introduce the term 'preliminary works' for OFTO build tender exercises. It was suggested that there could be ambiguity as to what exactly the preliminary works are. We have since reviewed this definition and have provided examples in the 2013 Regulations of what such works may include, although these examples are intended to be neither prescriptive nor limiting.

Definition of developer group

In the draft 2013 Regulations, we introduced a new definition of 'developer group', following stakeholder feedback that the existing definition of 'developer' was potentially too restrictive for some future project arrangements, where multiple developers could be involved. Respondents welcomed this introduction, but some questioned whether the 2013 Regulations should be clearer about how obligations would apply to the individual members of developer groups. We have since reviewed this definition but consider that it is wide enough so that obligations can apply to any members of a developer group as appropriate depending on the circumstances of a particular project. However, we have clarified in the 2013 Regulations how responsibilities in relation to developer payments apply to particular members of developer groups.

It was also suggested that the 2013 Regulations might not be able to accommodate the share sale of an offshore transmission Special Purpose Vehicle to an OFTO. We have reviewed the Regulations and do not consider that they currently restrict the type of sale that can be conducted when transmission assets are transferred to a Successful Bidder.

⁸ Open Letter: Draft Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2012 for consultation
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=73&refer=Networks/offtrans/pdc/cdr/2012>.

Definition of 'available' for use of transmission of electricity

During the cost assessment process, we calculate the economic and efficient costs that have been incurred in relation to the development and construction of a transmission asset. As set out in the Regulations, where a transmission asset is "not available for use for the transmission of electricity", this calculation will be based on an estimate of the economic and efficient costs that ought to be incurred. One respondent suggested that 'available', in this context, should be defined in the 2013 Regulations. We do not consider it appropriate to define 'available for use' in the 2013 Regulations, as the point at which assets are 'available for use' will depend on the circumstances of a specific project.

Bid evaluation

One respondent suggested that the 2013 Regulations should explicitly allow for developer engagement in the evaluation of bids and that the documentation released at each stage of a tender exercise should detail the identity of any third party involved in evaluation. We can confirm that all decisions in all stages of a tender exercise will always be taken by the Authority. However, the Regulations do now require the developer to undertake to assist the Authority during any evaluation at the Invitation to Tender (ITT) and best and final offer stages of an OFTO build tender exercise, where this is deemed appropriate. This is consistent with the policy position set out in our May 2012 consultation. We will provide further clarity around a developer's role in OFTO build evaluation in the Tender Rules for OFTO build and in relevant stage specific documentation for an OFTO build tender.

Another respondent called for the weightings applied during bid evaluation to be included in the 2013 Regulations. As set out in our December 2011 and May 2012 consultations, and in accordance with the 2013 Regulations, we will set out the bid requirements and evaluation criteria against which we will evaluate all bids in the tender documentation published at each stage of a tender exercise.

Preferred Bidder matters

In the draft 2013 Regulations, we set out the arrangements a Preferred Bidder must have in place for it to become the Successful Bidder during an OFTO build tender exercise. This includes the arrangements necessary for the construction of the transmission assets. One respondent called for further detail in the Regulations on what these necessary construction arrangements would entail. Another respondent called for the Regulations to be more explicit about any requirements for a Preferred Bidder to have sufficient funding in place. As with previous tender exercises, we will confirm the detail of the matters that a Preferred Bidder must satisfy in accordance with the Regulations at the start of the Preferred Bidder stage. This allows us to take account of specific project circumstances.

One respondent suggested that there should be obligations on the Preferred Bidder to ensure it resolves its matters in a timely manner. The Preferred Bidder is already required under the Regulations to resolve the Preferred Bidder matters by a date specified by Ofgem. In the event it fails to meet this obligation, Ofgem has the right to discontinue the tender exercise with the Preferred Bidder and go to the Reserve Bidder. We do not consider that any additional requirements in this regard are necessary.

Cost assessment

The 2013 Regulations introduce arrangements for the cost assessment of preliminary works for OFTO build tender exercises. One respondent suggested that there should be a mechanism in the 2013 Regulations providing a Successful Bidder with the ability of recourse to Ofgem and the developer in the event that the preliminary works do not meet its quality expectations. As the cost assessment arrangements for OFTO build mirror the cost assessment arrangements for generator build tender exercises, and are consistent with policy previously consulted upon and finalised, we do not consider this to be an appropriate introduction.

Another respondent called for the Regulations to contain a provision requiring Ofgem to conduct cost assessments in line with published cost assessment guidance, suggesting that this would increase transparency. We recently published guidance on our approach to cost assessment and the general cost assessment process⁹. The 2013 Regulations set out a clear framework under which we carry out cost assessments for both a generator build tender exercise and an OFTO build tender exercise. The guidance document does not in any way change the arrangements prescribed in the Regulations; it is rather designed to assist developers in preparing for the cost assessment process.

Business separation requirements

One respondent called for the 2013 Regulations to be more precise about the business separation requirements developers and bidders need to have in place during a tender exercise. As part of the Tender Entry Conditions, a developer must demonstrate that it will put in place and maintain appropriate internal information barriers in the event that it forms part of a bidder group bidding for its own assets. We consider that the details of what is 'appropriate' should be agreed on a project specific basis. As part of current stage specific documentation, a bidder must also demonstrate how any conflicts of interest would be managed.

The respondent also suggested that the 2013 Regulations should allow a bidder to be disqualified in the event it fails to comply with such business separation requirements. However, we consider that Schedule 9 of the 2013 Regulations sets out a range of events that could lead to the disqualification of bidders under similar circumstances, such as the engagement in any anti-competitive behaviour between participants, a bidder contacting any officer of a developer outside of the channels provided in the tender exercise framework and the material breach of any rules particular to a stage of a tender exercise.

Arrangements in the event of a failed tender exercise

A couple of respondents referred to the importance of being able to manage a situation in which a tender exercise fails and questioned whether the process for ensuring a replacement bidder can be put in place should be set out in the Regulations. The Regulations currently set out the process for the re-run or cancellation of a tender exercise and the role of the Reserve Bidder in relation to this. We consider the Regulations provide sufficient certainty and clarity about the arrangements for such circumstances.

One respondent also called for an OFTO of Last Resort mechanism to be incorporated in the Regulations. The Regulations provide the framework for a tender exercise. The OFTO of Last Resort process sits outside of the tender process and is therefore implemented by separate arrangements¹⁰.

Timings of tender exercises and processes

Some respondents called for the Regulations to provide further clarity about the timings of a tender exercise and tender exercise processes, including the timing of the ITT stage relative to other milestones and the time provided for developers to respond to requests for information by Ofgem. The Regulations set out the arrangements by which Ofgem will notify developers and participants of timings relating to a specific tender exercise. However, the actual timings will be dependent upon the particular circumstances of the projects involved.

⁹ Offshore Transmission: Guidance for Cost Assessment, December 2012

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=102&refer=Networks/offtrans/pdc/cdr/2012>

¹⁰ For more information on the OFTO of Last Resort Mechanism, please see: 'Guidance on the Offshore Transmission Owner of Last Resort Mechanism, October 2012'

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=39&refer=Networks/offtrans/rtt>

Cost recovery

One respondent requested further information on the developer payment and security arrangements for future tenders. In accordance with the 2013 Regulations, these will be provided in the Cost Recovery Methodology published for the relevant tender round, as has been the arrangement for the transitional tender rounds. This is to ensure that the costs are reflective of the specific project circumstances to which they apply.

Further information was also requested on which costs would be included in the 'bid costs' which can potentially be reimbursed to bidders during an OFTO build tender exercise. We have stated in our previous policy consultations that these would relate to the design associated with submitting a tender, and further detail would be published for the relevant tender exercise in order to reflect the specific circumstances of the project arrangements.

2. *Summary of main changes to Tender Regulations since consultation*

Following the September Consultation and consideration of the consultation responses, we have undertaken a further detailed review of the 2013 Regulations. This resulted in a number of drafting amendments that are intended to provide greater clarity to the process and to ensure the drafting is reflective of the policy intent. The key changes are as follows:

- **Definition of a generator build tender exercise** - we have removed references to transitional tender exercises and introduced a definition for a 'generator build tender exercise' in the 2013 Regulations.
- **Definition of preliminary works** - following stakeholder feedback, we have provided examples in the 2013 Regulations of what such works may include, although these examples are intended to be neither prescriptive nor limiting.
- **Definition of a tender round** - under the 2010 Regulations and the draft 2013 Regulations, the term 'tender exercise' was used to refer both to instances where the regulation related to multiple qualifying projects and where the regulation related to a tender exercise for a specific qualifying project. We consider that this is potentially unclear and conflicts with general understanding of the term 'tender exercise' as used in primary legislation. We have therefore introduced a definition for a 'tender round', which may relate to one or more tender exercises. As a consequence, references to a 'tender exercise' now relate to a single qualifying project, which is consistent with primary legislation.
- **Qualifying requirements for generator build** - we have amended the qualifying requirement for generator build relating to a developer's bilateral agreement so that this now mirrors the same requirement for OFTO build. This is to have entered into a bilateral agreement with the National Electricity Transmission System Operator (NETSO). Previously, under generator build, a developer was permitted to have either entered into a bilateral agreement with the NETSO or entered into an agreement or accepted an offer of an agreement with a Distribution Network Operator. This was to cover the specific circumstances in place for some of the first transitional projects and is no longer consistent with our policy intent. The amendment takes away the risk of a developer of a qualifying project causing delays or expense to other parties during a generator build tender exercise, as it seeks to secure a bilateral agreement with the NETSO.
- **Developer payments** - we have clarified in the 2013 Regulations that developer payments must be made by the person within section 6D(2)(a) of the Act, ie the entity who holds the connection offer or the benefit of that connection offer, or subsequent agreement is vested in that entity rather than other entities within the developer group. This flows from the requirements prescribed in the Act.

- **Disqualification arrangements** - we have clarified that where a disqualification event is occurring, the relevant party may be either disqualified from the specific tender exercise to which the matter relates or from the whole tender round, for example where the event in question is likely to have a material impact on the tender round as well as the specific tender exercise.
- **Re-run events** - we have made an express re-run event to provide clarification that where a developer introduces a material change to a qualifying project we may choose to re-run the whole or part of that tender exercise to ensure bids reflect the revised project circumstances. In the event of such a re-run leading to the cancellation of the tender exercise, the developer is at risk of forfeiting the whole or part of its security payment and may not be entitled to be repaid any payment made in relation to Ofgem's tender costs.
- **Tender entry conditions** - the 2013 Regulations introduce a new tender entry condition, for both generator build and OFTO build, relating to the developer undertaking to provide Ofgem with updated information on the generating station and qualifying project's development. This is to help ensure the efficient running of a tender exercise. Following stakeholder feedback that the drafting of these clauses was not clear enough, we have amended the wording of these conditions since the September Consultation, to make clear that they relate to information on both the transmission assets and the relevant generating station.