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# Offshore Electricity Transmission - Regulatory policy update

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**Overview:**

Ofgem and BERR are working together to implement a regulatory regime for electricity transmission networks offshore. This will enable significant volumes of offshore renewable generation to connect and will play an important role in increasing the amount of electricity generating from renewables in the UK. This document sets out our further proposals and clarification for the design of a **competitive offshore transmission regime**. It builds upon the Ofgem/BERR joint policy statement that was published in July 2007.

We welcome the continued engagement of industry stakeholders and other interested parties in the consultation process. The views and comments expressed in response to this document will inform an Ofgem/BERR joint final policy proposals document during 2008.

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## Context

This document forms part of the joint project of BERR and Ofgem to develop and implement a regulatory regime for offshore electricity transmission. It follows on from the Ofgem/BERR joint policy statement published in July 2007 and the Government response to that document published recently.

Offshore electricity transmission networks will be required to transmit electricity from offshore renewable generators to customers via the onshore transmission and distribution networks. Offshore renewables are expected to make an important contribution to the achievement of the Government's target to generate up to 20 per cent of Britain's energy from renewable sources. A 'fit for purpose' offshore electricity transmission networks needs to be developed to ensure consumers and generators do not face unnecessarily high charges and get quick connections at the lowest possible costs through technical innovation.

At present, there is very little electricity transmission network infrastructure installed offshore. The Government and Ofgem consider that allowing companies to compete for the right to build this infrastructure should lead to the best solution for customers and generators by encouraging efficient construction and operation and promoting technical innovation. This document sets out our updated proposals on the design and implementation of a competitive regulatory regime for offshore electricity transmission.

## Associated Documents

- Regulation of Offshore Electricity Transmission: Government response to Offshore Electricity Transmission - A joint Ofgem/BERR Policy Statement (BERR: URN 08/546)
- Offshore electricity transmission: Ofgem/BERR joint policy statement (Ofgem ref:189/07 BERR ref: URN 07/1096)
- Offshore electricity transmission - second scoping document (Ofgem ref: 58/07)
- Government response to the joint DTI/Ofgem consultation on licensing offshore electricity transmission (BERR ref: 07/634)
- Licensing offshore electricity transmission - a joint Ofgem/DTI consultation (Ofgem ref: 199/06 / BERR ref: 06/1952)
- Updated Regulatory Impact Assessment (BERR ref: 07/633)
- A security standard for offshore transmission networks - an initial joint DTI/Ofgem consultation (Ofgem Ref: 211/06)
- Offshore electricity transmission - scoping document (Ofgem Ref: 60/06)
- Regulation of offshore electricity transmission - a joint consultation by DTI/Ofgem (Ofgem Ref: 178/05)

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# Summary

The Government has stated that the development of offshore renewable energy generation will make a major contribution towards meeting its renewable energy targets. Up to 8GW of offshore renewable generation capacity (principally wind) will be seeking to connect over the next few years. Furthermore, the Government recently announced that further rounds of leases for offshore generation sites. These sites could allow companies to develop a further 25GW of capacity by 2020. Several billion pounds of new investment could be needed for the transmission infrastructure to carry this energy ashore. Ofgem and government are establishing a new regulatory and licensing regime for offshore transmission to deliver this investment. The Government's aim is that this new regime will commence as close as possible to December 2008.

In July 2007, Ofgem and the Government consulted jointly on initial proposals for implementing an offshore electricity transmission licensing and regulatory regime based on competitive tendering to award offshore electricity transmission licences. Policy proposals were outlined across a number of areas, in particular:

- that Ofgem would run a competitive tendering process to select an Offshore Transmission Owner, responsible for designing, building, financing and maintaining the transmission network required to connect each offshore generator; and

- that transitional arrangements would apply to tendering for offshore transmission networks that were existing, under construction or that the developer was financially committed to construction when the new regime comes into force.

The Government has confirmed the decision that Ofgem will run competitive tenders to appoint new licensed Offshore Transmission Owners to connect offshore generators under both enduring and transitional arrangements. The Government will seek additional powers in the Energy Bill to:

- allow Ofgem to recover its costs of running tenders from those participating in the tender process and enable Ofgem to require a financial commitment in the form of deposits and financial security from those parties; and

- enable Ofgem to make a property transfer to ensure that property, rights and liabilities are transferred from the developer to the successful OFTO. Ofgem will only have the power to make a scheme in certain circumstances and upon application (which it is envisaged will arise when commercial negotiations fail, in order to ensure that property is transferred from the developer to the successful Offshore Transmission Owner in a fair, timely and effective manner).

This document sets out Ofgem's updated policy proposals for the licensing and regulatory regime. Our proposals take account of responses to the July 2007 Ofgem/BERR joint policy statement, collective and bilateral meetings with industry participants, and the Government's response on the framework for the regulatory regime.

We think that our proposals, with long term revenue allowances and light handed regulation, will create the right framework for efficient investment and technical

innovation in offshore networks and faster connection times than under alternative arrangements such as a regulated offshore transmission monopoly.

We are seeking further views on the regime and the key regulatory policy areas that we have responsibility for. These are:

1. **The design of the regulatory regime** - we include further clarification on our view that an Offshore Transmission Owner selected by competitive tender should receive a regulated revenue stream for a fixed period of 20 years. We also set out how the revenue stream will be subject to performance incentives.

2. **The Offshore Transmission Owner tender process** - we provide further detail on our proposals for running a tender process. We set out proposals for how the process could work in practice, what the tender documentation should include, as well as how we will recover our costs of running the process. We also set out the interactions with the industry connection application process.

3. **Transitional arrangements** - we provide clarity for generators that will have constructed, will be constructing, or are committed to construction of their connections before the new regime comes into effect about how their investment can be recovered. We also confirm that we will tender to select Offshore Transmission Owners for transitional projects to assume responsibility for these assets once they are fully constructed.

There are many other detailed changes to key industry codes and agreements where work is being undertaken by industry and we provide updates in this document on the progress of these. We are not consulting on these issues through this document, but have provided information about the industry parties and fora that are considering the issues and the consultation processes that interested parties can use to express their views and contribute. The key areas outlined in this document are:

- **technical rules** – including development of the GBSQSS, the STC and the Grid Code**;**
- **charging, access and compensation; and**
- **connection via distribution networks.**

Those wishing to contribute to the development work of technical rules should register their interest by emailing offshoretransmission@ofgem.gov.uk by 21 January 2008. (See chapter 7 for further information)

A significant part of the implementation of the new licensing and regulatory regime will be made by the Secretary of State through changes to licences and codes. We set out the timetable for implementation based on the target dates set by the Government and propose how policy development and the making of regulations will fit in with this timetable.

Together with the Government we expect to publish further consultations on licences and, together with code owners, continue work with industry workgroups on proposed changes to industry codes. We will be producing our final policy proposals with Government during the course of 2008.

# 1. Introduction

**Chapter Summary:**

This chapter outlines the purpose and structure of this document. It also summarises the policy context, and implementation aspects, for the development of a licensed regulatory regime for offshore electricity transmission networks.

**Questions**

There are no specific questions in relation to this chapter.

## Policy context

1.1. The Gas and Electricity Markets Authority (the Authority) is the industry regulator for gas and electricity markets in Great Britain and has a number of objectives and duties set out in statute. Ofgem is the office that supports the Authority in performing its duties. Our principal duty is to protect the interests of gas and electricity consumers in Great Britain and we undertake this by encouraging effective competition wherever possible. Where effective competition is not possible, for example where natural monopoly network infrastructure providers exist, we regulate more directly. We also have a number of other relevant duties, including a duty to ensure sustainable development and to ensure that companies' regulated activities take due regard of environmental issues.

1.2. We have principally regulated existing monopoly networks through a price control method known as "RPI-X" which has encouraged those network providers to increase their efficiency, with the gains shared between the companies and their customers over time. As networks evolve and the demands placed upon them change we have sought to adapt and vary our regulatory process and approach to meet the new challenges. The regulation of offshore transmission networks is one challenge where innovation is required, although our core principles still apply.

1.3. We also need to consider the regulation of offshore electricity transmission networks within the context of the Government's overall energy and environmental policy. The Energy Review[1] and Energy White Paper[2] set out the Government's energy strategy and how it linked to its strategy for tackling climate change. It has an aim of reducing carbon emissions in the UK by 60 per cent by 2050. It views the development of renewable electricity generation as an important element in achieving its aim.

1.4. The Government has an aspiration that by 2020 20 per cent of UK electricity supply will be sourced from renewables. It believes that offshore wind energy can contribute significantly towards this target and recently announced a draft plan which could allow companies to develop a further 25 gigawatts of capacity by

[1] The Energy Challenge; Energy Review; A Report, July 2006
http://www.dti.gov.uk/energy/review/page31995.html
[2] Meeting the Energy Challenge: A White Paper on Energy, May 2007
http://www.dti.gov.uk/energy/whitepaper/page39534.html

2020. The Government believes the proposed regulatory regime for offshore transmission will help ensure these aims are met.

## Purpose of this document

1.5. This document forms part of the ongoing process of developing a regulatory framework for offshore electricity transmission networks. The Energy Act 2004 provides for broad powers to develop a regulatory regime to facilitate the transportation to the onshore system of electricity produced in offshore waters from renewable sources. Ofgem and the Department for Business Enterprise and Regulatory Reform (BERR) are working together to develop detailed policy proposals to implement the relevant sections of the Electricity Act 1989 (the Act).

1.6. This document complements the January 2008 Government response to the July 2007 Ofgem/BERR joint policy statement[3]. The joint policy statement set out initial proposals for the design of the new regulatory and licensing regime, and its implementation. The Government's response[4] takes into account feedback from stakeholders to the policy statement and sets out a key decision for the design of the offshore electricity transmission regime. It also identifies those areas where further work is required to develop and implement the detailed regulatory framework.

1.7. In summary, the key decision that the Government has confirmed is that the Authority will run competitive tenders to appoint new licensed Offshore Transmission Owners (OFTOs)[5]. Furthermore, the Government will seek powers in the Energy Bill to:

- allow Ofgem to recover its costs of running tenders and ensure sufficient commitment from parties participating in the tender process; and
- enable Ofgem to make a property transfer scheme in a transitional tender if normal commercial negotiations fail, in order to ensure that property is transferred from the developer to the successful OFTO in a fair, timely and effective manner.

1.8. We acknowledge the Government's decision that we should manage the tender process for the selection of offshore transmission licensees and have advised it that we are prepared to undertake this, conditional upon the necessary powers for tender cost recovery and transfer schemes being established through legislation, HM Treasury approval for us to recover and deploy these monies, and no material new issues emerging that affect our ability to develop and implement an effective regulatory regime. Given our other roles and duties as a regulator, we have advised that we must be held cost-neutral to the process. To this end, the Government is seeking powers through the forthcoming Energy Bill for us to recover the full costs of running the tender process from participants.

[3] Offshore Electricity Transmission - A Joint Ofgem/BERR Policy Statement; published July 2007; ref. 189/07 (Ofgem) and URN 07/1096 (BERR)
http://www.berr.gov.uk/files/file40629.pdf
[4] Government Response to Offshore Electricity Transmission - A Joint Ofgem/BERR Policy Statement; published January 2008; ref. URN 08/546
http://www.berr.gov.uk/files/file43555.pdf
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1.9. This document complements the Government response by consulting on a number of areas that will fall directly within the remit of the Authority. Principally these areas concern the way OFTOs will be financed and how the Authority should apply its power to make tender regulations. These matters are reserved to the Authority (although the tender regulations that the Authority makes will have to be approved by the Secretary of State). We are not consulting on areas where matters are reserved to the Secretary of State, for example on modifications to licence conditions and industry codes through powers under the Energy Act 2004. However, we provide some updates in these areas which should be of use to industry parties. In summary, this document:

- seeks views on the development of an appropriate regulatory regime for offshore electricity transmission which will be applied through special conditions to the licences of OFTOs;

- seeks views on how Ofgem should apply its power to make tender regulations. For information we provide an example of how we view the tender process could work in practice on an enduring basis. This includes further information on the key stages of the tender process, the expected roles of other stakeholders, including cost recovery and financial commitment mechanisms;

- seeks views on how transitional tender arrangements are applied to offshore transmission networks that are existing or under development when the new regime is commenced;

- provides updates for information on the technical issues outlined in the joint policy statement, specifically identifying our proposed approach for amending the relevant codes;

- provides updates for information on charging, access and compensation issues, specifically identifying ongoing industry work streams that are the fora for amending the relevant codes; and

- provides an overview of the areas of implementation that need to be completed for the regime to take effect.

1.10. This document builds upon previous consultations and decisions on the offshore electricity transmission regime. Principally, these are the decision in March 2006 that offshore transmission networks should be regulated by means of price control; in March 2007 that licences should be non-exclusive; and in January 2008 that the Authority should run the competitive tender process. The Government and Ofgem will consult on modifications it intends to make to electricity transmission licences and industry codes and agreements to implement the regime. The engagement of industry parties has been vital in the progress that has been made so far. In order to deliver an effective offshore regulatory regime it is important that industry continues to engage actively in the detailed development of the regime.

1.11. We outlined in the July 2007 joint policy statement our key proposals for the development of technical rules defined in the Great Britain Security and Quality of Supply Standard (GBSQSS) and Grid Code for offshore transmission and offshore generators connected to offshore transmission networks. We set out our further proposals for development of technical rules defined in the other industry codes. We also set out an update on the proposed approach to develop

change proposals for the existing industry codes to implement the new offshore transmission arrangements.

1.12. The Government response provides a detailed summary of respondents' comments and views on the July 2007 Ofgem/BERR joint policy statement. This document does not cover respondents' views in detail, but we address these views where relevant or where they are not covered in detail in the Government response.

## Introducing a new regime

1.13. The Government and Ofgem are working together to introduce a new regime for offshore electricity transmission. While we are co-ordinating our efforts, each has different powers and responsibilities with regard to the new regime. The simplest way to characterise this is to say that the Government has powers to introduce the new regime, while we will have the power to take decisions and run the regime on an on-going basis.

### The role of Government

1.14. In introducing the new regime, the Government will do a number of things. It will:

- Extend the prohibitions of the Electricity Act 1989 into the Renewable Energy Zone. In practice this means that unlicensed participation in the transmission of electricity in GB, the territorial sea adjacent to GB and the REZ will be prohibited, i.e. a licence will be required to transport electricity generated in offshore waters to shore.;

- change the definition of high voltage to a nominal voltage of 132 kilovolts (kV) and above. In practice this means that anyone who has an offshore electricity network of 132kV (a standard voltage, and one that is used by electricity distribution companies onshore) or above will require a transmission licence. There are a small number of generators operating close to shore who already use this voltage level, and so their connections will become transmission connections and will need to be licensed;

- provide us with a new power to issue licences by competitive tender. We will be given the power to make new regulations (which the Secretary of State must approve) to run a tender process for the award of transmission licences for specific offshore connections or groups of connections. This includes existing, currently unlicensed, connections;

- extend the remit of the Great Britain System Operator (GBSO) into offshore areas. In practice this means that the current GBSO, National Grid, will have its role as system operator extended to cover all offshore transmission connections as well as the current onshore transmission networks; and

- make modifications to licences, codes and associated agreements. This is explained further in the next paragraph.

1.15. Companies that are regulated by us are regulated through licences. Licences are issued for certain activities, including electricity transmission. Each

company has an individual licence, specific only to itself, which is made up of a number of conditions. Some of these conditions are referred to as "standard". Typically these refer to the obligations that the licence places upon the company and these conditions often apply to more than one licensee, and sometimes to all licensees. Standard conditions also establish "codes" - that is a requirement that an agreement should be established to govern the contractual and other relationships between different industry parties.

1.16. It is these types of conditions (and codes) that the Government will be modifying. For example, it will be establishing the obligations that will be common to each offshore transmission licensee, modifying the obligations on the GBSO and amending codes to reflect any changes necessary from the extension of arrangements into offshore areas and the entry of new transmission licensees.

**The role of Ofgem**

1.17. Other conditions of the licence are referred to as "special". These conditions typically apply only to a single licensee. Special conditions usually include such things as a limit on the geographical extent of the licence and also the way a company may receive its revenue (often referred to as a price control). It may also include things such as particular obligations that apply solely to that licensee. These conditions will be inserted into each individual offshore transmission licensee's licence by Ofgem each time that it grants a licence.

1.18. This document sets out the features we are considering for offshore electricity transmission licensees (the regulatory regime) that will be reflected in these special conditions. It also sets out how we will arrive at the decision of what to place in these special conditions - this will be informed by a competitive tendering route to reveal what prospective offshore licensees are willing to accept within the framework we are setting out.

1.19. Our role, specifically in respect of offshore transmission, is two-fold. Once the regime is introduced, we will grant licences to offshore electricity transmission companies (selected as part of a competitive process) to construct and run specific connections. We will also regulate the amount of revenue these companies can receive for providing this service and put financial incentives in place to ensure the service provided is of the required standard.

## Structure of this document

1.20. This document has 9 chapters:

- Chapter 2 sets out our updated proposals on the regulatory framework for offshore transmission and seeks views.
- Chapter 3 sets out our updated proposals on how we should establish a tender process and apply our power to make tender regulations, and seeks views.
- Chapter 4 sets out our updated proposals on transitional arrangements and seeks views.

- Chapter 5 provides an overview of the powers the Government is seeking through the Energy Bill to allow Ofgem to recover the costs incurred running the tender process, as well as explaining how we envisage using these powers.
- Chapter 6 provides an update on the process for developing changes to technical rules.
- Chapter 7 provides an update on the process for developing changes to rules for charging, access and compensation.
- Chapter 8 provides an overview of issues relating to connection via distribution networks.
- Chapter 9 provides an overview of the remaining steps needed to implement the new regime.

## Responding to this document

1.21. We welcome responses on any aspect of this consultation document and we particularly invite views from respondents on a number of our proposals set out in chapters 2, 3 and 4. Specific questions are highlighted in the "Questions" box at the start of each chapter. Where no questions have been specifically asked, we nevertheless would welcome comments from stakeholders. A summary of all the questions asked and details of how to respond can be found in Appendix 1. Written responses should be sent electronically to OffshoreTransmission@Ofgem.gov.uk by no later than 25 February 2008.

1.22. BERR and Ofgem will hold an external communication session on 25 January 2008 at the BERR Conference Centre, 1 Victoria Street, London, SW1H 0ET to discuss the Government decision and this consultation in more detail. Invitations have been issued, but if you would like to reserve a place please send an email to offshore.transmission@berr.gsi.gov.uk.

# 2. Regulatory framework

**Chapter Summary:**

This chapter sets out Ofgem's updated proposals on the design of the regulatory framework for offshore electricity transmission, taking into account the responses received to the Ofgem/BERR joint policy statement. It focuses on the following key issues:

- ➔ Period of the regulated revenue stream, including what happens after the end of the period;
- ➔ Adjustments to the regulated revenue stream;
- ➔ Performance obligations, incentives and penalties;
- ➔ Generator requirements and how these are reflected within the regulatory regime; and
- ➔ The allocation of risks.

**Questions:**

**Question 2.1:** Do you agree with our proposals for the design of the regulatory framework as outlined in this chapter? In particular, we would welcome your views on:

- our proposal that the period of the regulatory revenue stream should be 20 years;
- our proposed approach for dealing with the end of the regulated revenue stream;
- our proposed policies for dealing with potential adjustments to the revenue stream;
- our proposed policy on performance obligations, incentives and penalties;
- our proposals for reporting arrangements; and
- our proposed policy for addressing generator requirements. We would especially welcome any information from respondents that suggests there is justification for different arrangements to apply

**Question 2.2:** Do you feel that there is any aspect of the design of the regulatory regime that we have not considered sufficiently?

## Summary

2.1. The July 2007 Ofgem/BERR joint policy statement set out our initial proposals for the commercial and regulatory framework to be introduced for offshore electricity transmission. In developing those initial proposals we sought to adopt the commercial and regulatory arrangements that apply to transmission activities onshore, where appropriate to do so.

2.2. The key initial proposals set out in the July 2007 Ofgem/BERR joint policy statement were:

- An OFTO would hold a transmission licence granted by the Authority. The licence would contain standard and special conditions setting out the OFTO's obligations and how it will be remunerated. The licence would cover assets

necessary to provide a link between the offshore and onshore connection points.

- That a price controlled revenue stream would be granted to the OFTO for 20 years subject to the Authority being satisfied that the tender exercise was competitive. This revenue stream would be sufficient for it to meet its efficient costs of owning and operating the offshore transmission network. Prospective OFTOs would bid their desired price controlled revenue stream in a competitive tender process.

- There would be an incentives and penalties regime to address key performance criteria such as asset reliability and availability, as well as construction delivery.

- Generators would establish the specification for the offshore transmission assets. This may vary above what is required by the minimum security standard.

- Risk relating to transmission assets would be allocated amongst three key parties, namely the OFTO, consumers and the generator. The OFTO would be expected to bear and manage design, construction, operation, maintenance, financing and decommissioning risks. Consumers and network users, via the GBSO, would provide payment security. Consumers and network users would share stranding risk with the generator.

- That existing industry dispute resolution and arbitration procedures could be applied within the context of the offshore regulatory regime.

2.3. We have received varying levels of support from interested parties regarding these initial proposals. In relation to the initial proposals for the role of the OFTO and dispute and arbitration, there was general support from stakeholders. However, in most instances, respondents raised specific issues and concerns regarding detailed aspects of the initial proposals in respect of the period of the revenue stream, the proposed incentive framework and interaction with charging regime.

2.4. In this chapter, we set out further thoughts for the regulatory regime to apply to offshore electricity transmission. These have been informed by the views expressed by stakeholders in response to the July 2007 Ofgem/BERR joint policy statement, collective and bilateral meetings with industry participants, and the Government response to the July 2007 Ofgem/BERR joint policy statement.

2.5. In the light of comments received, we consider that our proposals in relation to the role of the OFTO and the approach to disputes and arbitration remain appropriate. As a consequence, we have not revisited these issues here. This chapter sets out our updated proposals in relation to:

- the period of the regulated revenue stream;

- adjustments to the revenue stream;

- performance obligations, incentives and penalties; and

- generator requirements.

2.6. Furthermore we have also developed our thinking about how risks might be allocated amongst the key stakeholders so as to clarify the proposed regime.

## Period of regulated revenue stream

### Initial regulated revenue entitlement

2.7. In the July 2007 Ofgem/BERR joint policy statement, we set out the initial proposal that an OFTO selected by competitive tender would receive a regulated revenue stream for 20 years, subject to the OFTO meeting its licence obligations, including performance incentives. The Government response reflects that mixed feedback was received to this proposal. One consistent feature of the feedback was that respondents felt that the period appeared arbitrary and that insufficient explanation and justification had been provided for it. The majority considered that a longer duration was preferable, with some arguing that it should be linked to the lifetime of the generation assets being installed offshore. Two responses suggested that increased overall flexibility in the duration of the regulated revenue stream should be considered on a case-by-case basis.

2.8. We accept the point that further explanation in this area is required. Our thinking in this area is informed by the principles which we are seeking to apply and this will lead to determining an appropriate period for a revenue stream. In considering the principles, there are many relevant factors that may be taken into account which will lead us to determine the revenue period. Such factors include the nature of the assets being regulated, the expected usable life of the assets, financing, and consistency with existing arrangements. We are seeking to balance these factors against our duty to protect consumers' interests. We do not intend to expose consumers to unnecessary risk by setting excessively long remuneration periods that potentially lead to them paying for assets that they do not benefit from.

2.9. The nature of offshore assets for the foreseeable future is that they will be single use assets serving either one generator or a small proximate group of generators, with no demand customers. In this way they will differ from a number of onshore assets which, in many cases, have many generation and demand customers as part of an integrated network. As a result, the life of the generation assets of the user of the network becomes a relevant factor to be considered. It may be the case that the life of the transmission assets is designed, as a minimum, to reflect the life of the generation assets since this is the sole reason for their existence. We have also obtained views from industry stakeholders, who anticipate the asset life for offshore wind generation to be between 18 and 23 years.

2.10. Financing is also a relevant factor to consider, since the financing structure for offshore networks is likely to be different to larger and more complex onshore networks. We have sought views from financial experts on appropriate periods for providing finance and the feedback we have received is that 20 years is a suitable period for financing this kind of investment. We have also obtained views from industry stakeholders, who anticipate that the expected financing arrangements for offshore wind projects to be of around 20 years.

2.11. In the light of these factors, we consider that the initial regulated revenue stream for a period of 20 years appears appropriate. We would welcome views

from interested stakeholders whether, in the light of our further explanation, they agree that both the methodology and conclusion are appropriate.

2.12. We propose to keep this policy position under review, taking account of all relevant factors and principles, including those set out in the rest of this section. In particular, as the offshore electricity market matures, we recognise that generating stations may be designed with longer lives and longer financing terms may become more certain. Alternatively, the risk of stranding may become higher if generation asset lives become shorter. As such, in considering our statutory duties with respect to future rounds of offshore transmission, we may conclude that a longer (or shorter) period over which regulated revenues are recovered may be appropriate in the future. Nevertheless, we are mindful that any change in policy on this issue may increase regulatory uncertainty and we would therefore need to ensure that any revised policy is fully examined and consulted upon – and an appropriate time-lag is provided – before being implemented. We would welcome respondents' views on this issue.

2.13. We acknowledge the views expressed by some stakeholders that the regulatory regime for offshore transmission should not provide barriers to the economic extension to the life of offshore generation projects. In the section below, we set out our proposals for dealing with offshore generation projects that go beyond the expected 20 year term.

**End of regulated revenue stream**

2.14. The July 2007 Ofgem/BERR joint policy statement set out that the transmission licence would initially be issued for a 20-year term, consistent with the period of the regulated revenue stream. In addition, we set out two options for consideration for arrangements at the end of the licence period: (i) That the licence could be re-tendered and; (ii) allowing the OFTO to extend its licence for a further period. Both approaches would provide an opportunity for an OFTO to earn a further regulated revenue stream to meet its future costs where it is able to demonstrate that the transmission assets would continue to be utilised.

2.15. Many respondents commented that leaving arrangements for the end of the licence period open-ended would increase project risks. A number suggested that it may well not be cost-effective to run a further tender and proposed that the existing OFTO be allowed to extend its licence provided it met certain criteria. Some responses requested further details on the basis of extending the licence.

2.16. An important factor is the need for regulatory certainty to ensure that adequate financing can be sought to ensure the development of offshore transmission. Another key factor is the basis on which onshore licences are issued and the appropriateness of this approach for offshore transmission licences. We also consider that the regime should not be inflexible to the changing needs of the offshore generator. In the light of this, we have given further consideration to the appropriate term of the licence and the period of the regulated revenue stream.

2.17. Under the existing onshore regime, transmission and distribution licences are considered to apply in perpetuity, subject to the terms of revocation[6] which

[6] Onshore network licences may be revoked by either the Authority or the licence holder but only with

require that appropriate notice of termination is given. In issuing a licence, the Authority has the power to determine the terms on which the licence is to apply, including the terms on which the licence might be revoked. In the light of the views expressed by stakeholders, we consider that it is appropriate to issue offshore transmission licences on similar terms to those licences awarded to onshore companies, but with the ability to revoke the licence at the end of 20 years. This would be subject to the Authority giving the licensee sufficient notice, such as a period of not less than 12 months, of its intent. It is expected that where there is no clear need for the assets toward the end of the 20-year revenue period that the Authority would seek to revoke the licence.

2.18. Where there is a demonstrable need for the continued availability of offshore transmission assets after the initial 20-year period of regulated revenues, it is important that the regulatory regime does not preclude their continued operation where it is economic to do so. Our default position is to tender for the award of a new licence for the period after the initial 20 years. This would require revocation of the previous licence. To ensure continuity of operation, we would also propose to commence the tender exercise at the point where the Authority notifies the licensee that it intends to revoke the licence. This would identify a subsequent regulated revenue stream for operation and maintenance of the assets, including the capital cost of any asset replacement, and ensure that a new OFTO is identified and appointed before the initial licence is revoked. We consider that this position provides adequate certainty to generators and OFTOs.

2.19. We are aware that there are a number of possible scenarios at the end of the revenue period where re-tendering the licence is unlikely to be suitable. Such scenarios include where the incumbent generator expects to continue generating for a short number of years only. Given that there may be a number of different scenarios to consider and that the timeframes are significant, we cannot be prescriptive as to how we would address these at this time. As such, we intend to take a view as to the most sensible course of action, taking account of the needs of the generator and our statutory duties at the time, when situations like this arise. For example, we might conclude that the existing licence should be continued and the incumbent OFTO's price control extended for a defined number of years to cover operation and maintenance costs for the assets, assuming the assets have been fully depreciated by this time.

## Adjustments to the revenue stream

### Incremental capacity increases

2.20. The July 2007 Ofgem/BERR joint policy statement set out our initial proposals that we would allow the appointed OFTO to undertake incremental investment up to a value of 20 per cent of the initial capital cost over the life of the offshore transmission systems without being subject to a further tender exercise. It was envisaged that such investments would be agreed between the OFTO and the generator on a bilateral basis. Moreover, we proposed that revenues for the recovery of the cost associated with that incremental investment could be treated outside of the regulated revenue stream. We also proposed that incremental investments of greater than 20 per cent of the lifetime value of the

sufficient notice, set out in the Terms of the licence.

project would be treated as a new scheme and therefore subject to a tender exercise.

2.21. There was a mixed response to these proposals. A number of respondents did not agree with the proposed cap of 20 per cent on additional incremental investment, arguing that it was too low and that this would reduce the potential for innovation and co-ordination. The means by which such changes should be achieved was also questioned, with a number suggesting that should a generator wish to change its level of transmission service, it should always have to go via the GBSO.

2.22. We consider that there are two broad scenarios where incremental investment above the level initially specified may be required. The first is during the period between the generator signing its final connection offer and the completion of construction of the offshore network, and the second is once construction has been completed.

2.23. In the case of changes to investment requirements that arise prior to construction, we consider that these are unlikely to be material and can be addressed by requiring the OFTO to quote firm prices for incremental works as part of its original bid. However, where the generator seeks significant levels of extra capacity at this stage, such that the connection agreement onshore also requires renegotiation, we would consider that the original tender process had not properly captured the required network and would therefore look to re-run the tender process. However, there are already significant disincentives through existing connection agreement arrangements for generators to adjust their required level of capacity and vary their connection agreement at this stage. Thus, we do not believe that this scenario is likely.

2.24. Where a generator requests additional capacity post-construction of the offshore connection, we propose that the arrangements that are currently applied onshore will also apply in these circumstances. It is possible that a requirement for additional capacity may trigger onshore reinforcement works which will be addressed through current arrangements, where the GBSO will provide a variation to the connection agreement that includes the costs of onshore reinforcements being guaranteed by the generator. This approach will also apply to incremental capacity requests offshore, unless the required capacity was sufficiently material that, for example, a new offshore transmission circuit was required offshore or that the equivalent of a new offshore generator was connecting. We expect that for a material increase in capacity requirements that a new tender process would be run. We consider that 20 per cent increase could be a suitable threshold. However we would welcome views on the level of materiality that should prompt a new tender exercise.

2.25. Where incremental investment arises without the need for a further tender exercise, we would expect to adjust the regulated revenue stream to reflect the economic and efficient costs of the incremental investment.

**Pre-defined adjustment mechanisms**

2.26. In the July 2007 Ofgem/BERR joint policy statement, we confirmed that where an OFTO had been awarded a licence as a result of a competitive tender process, we did not feel it was appropriate to provide for pre-defined mechanisms

to adjust the regulated revenue stream for changes in costs. A major concern was that such mechanisms were likely to increase uncertainty. We also noted that we expected that bidders would reflect anticipated gains from refinancing through their responses to the tender process. In most instances, we expected that many risks could be borne and managed by the OFTO without a significant increase in costs.

2.27. We also ruled out the use of pre-defined adjustment mechanisms to deal with exceptional events, noting that it is difficult to develop robust mechanisms to deal with such events in a satisfactory manner. Instead, we set out that we would consider exceptional events as they arise, in a way that is consistent with the manner in which the revenue stream was established and respond in a fashion consistent with our statutory duties and functions.

2.28. Some respondents expressed support for the use of a pre-defined adjustment mechanism, stating that without one an OFTO will build in a risk premium which in turn would be passed to the generator in the form of increased transmission charges. It has also been noted by respondents that it would be desirable to enable re-opening of the revenue stream in the event of an unforeseen external event on a case-by-case basis, potentially subject to meeting a materiality threshold.

2.29. We acknowledge the views that have been expressed in support of pre-defined adjustment mechanisms, but continue to believe that the potential distortion of pre-defined adjustment mechanisms is likely to outweigh the benefits. Having considered this issue further, we are content that we will continue to address exceptional events in a manner consistent with the licence issued and our duties at the time. However, we do not generally expect to be making adjustments to licensees' revenue entitlements once we have set the initial control, outside the incentive adjustments detailed in this chapter.

## Performance obligations, incentives and penalties

2.30. We consider that it is important that tender submissions are based upon clearly defined requirements for the offshore generator and that the successful OFTO provides an appropriate commitment to ensure that those specifications are delivered in an efficient and timely manner. To ensure that the appropriate commitment is provided, the July 2007 Ofgem/BERR joint policy statement proposed a range of performance obligations and incentives.

2.31. We proposed that the performance obligations would be set out in the transmission licence and set out requirements to comply with the industry's technical standards and codes, as well as meeting minimum outputs that were specified by the generator, for example minimum levels of availability. In addition to these obligations, we also considered that that a range of incentive mechanisms designed to encourage effective delivery and operation of the offshore transmission system should be introduced. We proposed that such incentives might include:

- a capacity delivery incentive – this would establish an agreed delivery date for offshore capacity and provide for penalties where capacity is delivered late;

- an availability incentive – this would penalise or reward based upon the level of capacity availability achieved. We consider that an availability level of around 97 per cent may be appropriate once assets are fully operational; and

- incentives for energy losses – to penalise or reward for performance of the offshore system against an ex-ante technical estimate of the likely level of losses.

2.32. Broadly, respondents were supportive of the inclusion of incentives in the regulatory regime. However, responses were mixed as to the balance of incentives and how they should be provided for in the regulatory framework. To that end, we are seeking further views on this issue ahead of finalising our policy position in this regard.

2.33. We operate incentive regimes for most types of networks that we regulate. Typically these incentive regimes are designed to improve the quality of service for consumers. Incentives are often asymmetrical - that is they penalise a company for poor performance, but do not reward it for over-performance. The reason for this is that poor performance is perceived to be detrimental to the interests of consumers, whereas over-performance does not always provide consumers with additional benefits. However, there are some areas where consumers may benefit from over-performance against a target (e.g. improved network reliability by electricity distribution companies or reductions in electrical losses). In such cases, symmetrical incentives that provide rewards to the regulated company may be set. The level of revenue which a company may be penalised by (or rewarded with) is often set as a percentage of its regulated revenue. For example, for onshore transmission networks, incentive regimes put up to 2 per cent of a company's annual regulated revenue at risk to encourage better performance.

2.34. Unlike onshore networks, offshore transmission networks will not have any directly connected demand customers. In the short to medium term, while there are few offshore transmission networks serving a small percentage of overall generation capacity, the material effect on demand customers of offshore transmission network performance is likely to be negligible. However, the effect on the attached generation customer is likely to be significant. Should 33GW of offshore generation be served by such networks, however, the material effect on demand consumers will become more significant.

2.35. Given the different nature of offshore transmission networks, we see merit in considering whether it is appropriate to adapt incentive and penalty regimes to reflect these differences. In the light of this, and given that responses to the joint policy statement were mixed, as set out above, we would welcome views from respondents on:

- whether it is appropriate to set performance incentives in the areas outlined in the joint policy statement or any further areas, and whether our suggested levels were appropriate or whether respondents have information that would suggest different levels are appropriate;

- whether such incentives should be asymmetrical (penalty only) or whether there is information to suggest that we should set symmetrical incentives (penalty and reward) in certain areas;

- whether the incentives should be based on longer term performance (perhaps over a number of years) rather than short term or annual targets; and

- whether a level of up to 2 per cent of a company's regulated revenue is appropriate to incentivise performance or whether respondents have information that suggests a different level would be appropriate.

**Adjusting revenue to reflect incentives**

2.36. Under existing arrangements for electricity transmission companies, penalties or rewards are reflected in an adjustment to the revenue that they receive from the GBSO. Separately, any compensation due to users owing to the quality of their service being below the levels expected are reflected in a reduction in the charges that they pay to the GBSO for use of the network.

2.37. In the July 2007 Ofgem/BERR joint policy statement we suggested that, since only generation customers would be connected to offshore transmission networks, it might be appropriate for them to directly benefit from penalty payments from the OFTO. On further consideration, we do not consider this to be appropriate. Rather, we consider it appropriate that any penalties incurred by OFTOs should be dealt with via an adjustment to their regulated income. We also intend that the benefit to users of these penalties would be reflected in reduced charges. In practice, the reduction in charges would be shared between all users, although as offshore generators will be paying the majority of the charges that reflect offshore transmission network usage, they will be the main beneficiaries of any such adjustment.

2.38. For any availability incentive, it is likely that adjustments to revenue would only be able to be made at year end or possibly even at the end of the following year to allow for the performance reporting feedback loop to work through. This is akin to the arrangements onshore in the electricity distribution quality of service incentive regime.

2.39. In order to enable these adjustments, we would need to adjust allowed revenues on a regular basis. This could be done annually, or it could be that any rewards and penalties are logged up and revenue adjusted on a less frequent basis, for example every five years. We would welcome views from respondents on the most appropriate means of reflecting the incentive regime in the regulated revenue.

**Generator Affiliates, financial ring fence and regulatory reporting**

2.40. In addition to considering performance incentive arrangements, it is also necessary to consider requirements for financial ring fencing and regulatory reporting.

2.41. As set out in the July 2007 Ofgem/BERR joint policy statement, offshore generator affiliates will be allowed to bid for offshore transmission licences subject to compliance with relevant EU legislation. We envisage that such companies should be separate businesses and appropriate ring-fencing should be put in place to ensure generation and transmission businesses are operated

separately. One reason for ensuring that appropriate ring fencing and business separation obligations exist is to enable special administration arrangements to function effectively in the event of OFTO financial failure.

2.42. We therefore propose that the OFTO should be established as a separate legal entity. Moreover, we propose that the OFTO will be subject to financial ring fence licence obligations similar to those that apply to existing onshore networks.

2.43. In addition to the ring fence obligations, we propose to establish a framework for regulatory reporting. We consider that this might be based upon the arrangements that have been developed for onshore transmission and distribution companies. Ofgem and industry participants have spent a number of years developing and refining the Regulatory Instructions and Guidance (RIGs) that determines the reporting obligations of the distribution network companies. This process has been followed to ensure that regulatory information is provided by these companies on a consistent basis.

2.44. The RIGs document is linked, but is subordinate, to a general reporting obligation of the electricity distribution licence, and details what and how activities (such as faults) should be recorded and presented to Ofgem. Failure to report in accordance with the RIGs is a breach of the licence.

2.45. We recognise that annual reporting against the requirements of the RIGs requires a significant resource commitment by Ofgem and companies alike. However, this approach is expected to deliver significant gains in terms of an ongoing process of 5 yearly regulatory reviews of the price controls of onshore network companies. As such, it is not clear that imposing a similar burden of detailed annual reporting upon offshore transmission companies is appropriate given our longer term approach to revenues.

2.46. It is important to ensure that the regulatory burden of such arrangements strike an appropriate balance between the need to monitor the regulatory regime effectively while ensuring that the reporting arrangements do not provide an onerous regulatory burden upon licensees. We would therefore welcome views on whether the principles of the RIGs,(i.e. that there should be standardised reporting on a consistently measured basis), would be appropriate for offshore transmission perhaps reported on a less frequent basis (e.g. bi-annually) or whether less onerous reporting arrangements would be more appropriate.

## Generator requirements

2.47. The July 2007 Ofgem/BERR joint policy statement set out that an OFTO would be remunerated on the basis that the offshore transmission system will meet the generator's functional requirements and be fit for purpose - in other words its meets the capacity requirements set out by the generator or generators which it is connecting to the transmission system. OFTOs are typically expected to build networks that reflect the minimum technical requirements set out in the GBSQSS and the System Operator - Transmission Owner Code (STC).

2.48. An OFTO may be asked by the GBSO (e.g. as a result of a generator application for additional transmission capacity in an area close to its existing offshore transmission system), to make available additional capacity or to provide

a number of other services beyond those that it is required to provide under its licence. This might include such things as redundant capacity to guarantee access to the network or for the OFTO to provide the earliest possible (rather than the most efficient) connection date.

2.49. We do not consider that there is any information to suggest that there is anything in the nature of offshore transmission that would necessitate different arrangements to apply for dealing with such requirements. As such we are minded to extend existing onshore arrangements offshore. We would welcome any information from respondents that suggests that there is justification for different arrangements to apply.

## Allocation of risk

2.50. In the July 2007 Ofgem/BERR joint policy statement, we outlined how the design of the regulatory regime needed to reflect the way that certain risks were allocated between the main stakeholders for offshore transmission i.e. the OFTO, the offshore generator, and consumers/network users (via the GBSO). We are seeking to design the regime so that the most appropriate stakeholder is responsible for bearing and managing risks for each of the following development phases of the enduring regulatory regime. In the joint policy statement, we considered the appropriate allocation of risks in four different periods:

- bidding phase;
- design and construction phase;
- operation phase; and
- post price control phase.

2.51. We received a number of responses on the high level risk matrix that we set out in the joint policy statement, with many requesting additional clarity on risk allocation. Whilst it would be inappropriate for us to attempt to identify and allocate all of the risks that are associated with offshore projects, we do recognise that further discussion and debate on risk allocation might provide confidence to stakeholders about how risks could be allocated and managed in the regulatory regime. To that end, we have been working with our financial advisors to develop a more detailed risk matrix. This is set out in Appendix 5.

2.52. This risk matrix is illustrative only and does not identify and allocate all of the risks that may arise in the development of an offshore project and as such, participants in the tender process should not rely on this. However, we consider it illustrates significantly more detail on the types of risks that are associated with offshore generation and transmission projects, and our current view about how they could potentially be assumed among the key stakeholders. Whilst we are not consulting on this risk matrix at this time, we intend to use this as a basis for discussion with stakeholders and develop it further over the coming months for use in the tender process documentation.

# 3. The competitive tender process

**Chapter Summary:**

The Government has confirmed that Ofgem will be running the competitive tender process for the selection of OFTOs.

This chapter sets out how we envisage running the process for awarding offshore electricity transmission licences on an enduring basis. It describes how we envisage the process working in practice; how we expect it will interact with existing industry processes, such as the connection application process; and provides a summary of the roles we expect other stakeholders to play.

**Questions:**

**Question 3.1:** Do you agree with our proposals for the design of the tender process as outlined in this chapter? In particular, we would welcome your views on:

- the point at which we propose the enduring tender exercise be triggered, including for those generators that already have a connection agreement in place;
- the roles and responsibilities of participants in the tender process;
- the financial commitments required from the preferred bidder; and
- whether the connection application and tender processes could be streamlined further

**Question 3.2:** Do you feel that there is any aspect of the tender process that we have not considered sufficiently?

## Summary

3.1. The July 2007 Ofgem/BERR joint policy statement set out a number of key proposals for the competitive tender process for the selection of OFTOs. In the light of the Government's decision that Ofgem should run the tender process, this chapter sets out our key objectives, provides an overview of the type of process we intend to introduce, and discusses the relationship between key stakeholders in the period up to the award of an OFTO licence.

3.2. There are a number of inherent differences for transitional projects - that is offshore generation projects that will be constructed, be partly constructed or be financially committed to construct at the time the offshore regulatory regime comes into effect. We intend to develop a modified approach, based on the enduring arrangements, to select OFTOs for those projects. We observe that the Government considers that the OFTOs for these transitional projects should be selected via a competitive tender process. Chapter 4 provides further detail on how we expect to deal with transitional projects.

### Original proposals

3.3. The key proposals set out in the July 2007 Ofgem/BERR joint policy statement were as follows:

- We will make regulations under section 6C of the Electricity Act 1989 (to be inserted upon commencement of section 92 of the Energy Act 2004) to prescribe a tender process for the selection of OFTOs. These regulations will be subject to the approval of the Secretary of State.
- There will be an annual tender process commencing from a 'window' in which the tender process for all qualifying schemes would start simultaneously.
- The tender documentation will be standardised as much as practicable.
- Each tender process within each 'window' will be undertaken over several stages.
- Generator affiliates will be allowed to bid to become an OFTO, but will be required to demonstrate that there is appropriate ring-fencing in place.
- There will be no OFTO of last resort for projects falling within the enduring regime.

3.4. Responses to the July 2007 Ofgem/BERR joint policy statement broadly supported these proposals, and as such, we propose to maintain our existing positions. In the light of this, we have developed our thinking on the form the tender process should take, which is set out in more detail below and in the appendices 6 to 8. Where appropriate, we have provided further clarification on particular issues raised in responses to the July 2007 Ofgem/BERR joint policy statement.

3.5. The area that attracted the most reaction from respondents was the proposal that there was to be no OFTO of last resort in the enduring arrangements, particularly given that this could be a feature of the transitional arrangements. Whilst we recognise the concerns and points raised by respondents in this regard, we remain of the view that this is not an appropriate feature of the enduring regime. This is considered later in this chapter.

## Tender process framework

### Introduction

3.6. Our key objective is to ensure that the tender process reveals efficient, fit for purpose offshore transmission investment solutions for offshore generation projects. We will manage this process in accordance with our statutory duties and powers, meaning that we will have regard to our primary duty to protect the interests of consumers in all decisions we make relating to the selection of licensees.

3.7. A general concern expressed by respondents to the policy statement was the potential complexity of the competitive selection process. In particular, respondents felt that this could lead to higher costs for the delivery of offshore developments and lead to longer connection times. We agree that the regulatory solution will have complexities, but complexity is an inherent feature of price control regulated solutions, so it would not be simple under alternative price control approaches such as regulated monopoly offshore transmission. However,

we are seeking to introduce a streamlined process that allows OFTOs to be selected in a robust way, whilst at the same time ensuring that the interests of consumers are protected.

**The tender process**

3.8. The joint policy statement provided an overview of how we saw the tender process working. We envisaged a four-stage process, to include:

- Expressions of Interest (EOIs) and pre-qualification;
- Invitation to Tender (ITT) and evaluation of bids;
- Best and Final Offer (BaFO - an optional stage); and
- selection of preferred bidder

3.9. Our high level process design received general support from respondents, who welcomed the reduction from an eight stage process which we outlined in our second scoping document. Given this, and the fact that it mirrors other selection processes for similar infrastructure projects, we propose to develop arrangements based on this approach.

3.10. As such, we propose that the four-stage process set out above is the appropriate model to adopt for the selection of OFTOs. This approach is used extensively in a range of tender exercises and will be recognisable to both current industry stakeholders as well as more widely, for example in the financial community.

*Initiating the tender process – new projects*

3.11. We propose to maintain the position set out in the joint policy statement that the submission of an appropriate connection application request to the GBSO by an offshore generator would signal that a tender process would be required. We consider this enables the introduction of an expedient process which sits alongside the existing connection application process. The application would specify details of the generation to be connected as well as the generator's requirements from a transmission connection (including expected capacity requirements). Each application would be accompanied by an application fee.

3.12. An appropriate financial commitment towards the cost of providing the connection would be required from the generator by the GBSO during the connection application process. GBSO would also be required to notify us of the receipt of this application which, in turn, will trigger the start of the EOI stage of the tender process. However, it is important that stakeholders have confidence in the tender process and we are therefore mindful that the generator will need to ensure an appropriate level of commitment to developing its offshore project in a timely manner. We recognise that speculative applications for connection may unnecessarily trigger the tender process, and where an indicative offer is rejected or disputed may have imposed costs unnecessarily on Ofgem and bidders. We would therefore welcome views on whether the proposed trigger for the tender exercise is appropriate or whether an alternative trigger might be adopted, for example when the offshore generator signs its initial connection offer.

*Initiating the tender process – projects with a connection agreement*

3.13. Whilst we consider that a trigger associated with the initial connection application is appropriate over the longer term, we note that many current projects that will be covered by the enduring regime have already accepted connection offers. We note that the introduction of the new regulatory arrangements for offshore electricity transmission will require changes to the current connection agreements between offshore developers and the GBSO or a distribution licensee. On balance, we consider that the tender process would begin for these projects at the time when variations to the terms of existing connection offers are sought. We would welcome respondents' views on this approach.

*Connection pre-application and annual tender windows*

3.14. We continue to believe that to in order to facilitate efficient connection applications, there is a need to develop a "pre-application" process. Whilst responses on this issue were mixed, we believe that it will provide an appropriate opportunity for interested parties to advise the offshore generator regarding the feasibility of the proposed application. The adoption of this process should mean that sufficient quality EOIs are forthcoming from potential OFTOs. We will be working with relevant parties and stakeholders over the coming months to develop this process further.

3.15. We also propose to maintain the proposal to use tender windows. We recognise that a number of respondents to the joint policy statement opposed the introduction of tender windows, with many suggesting that this could introduce delays into the process. However, whilst we have noted these comments, we continue to believe that using tender windows will help facilitate an orderly process and should not limit the time when an offshore generator can apply for a connection. We do not believe that this would introduce significant delays because the date when the window opened would be publicly available information and this would be scheduled for the same time each year. As such, developers should be able to factor this into their management of obtaining a connection agreement.

3.16. We intend to begin to evaluate all EOIs for qualifying projects as soon as is practicable, such that decisions on the EOIs are taken shortly after the tender window opens. Qualifying projects are defined as those generators that have signed their initial connection offer from the GBSO at least one calendar month prior to the window opening. For example, if the tender window opened on 1 October, all initial connection offers signed prior to 1 September would qualify for the tender process for that year. Invitations to tender would then be issued to those bidders who meet the pre-qualification criteria. An indicative timeline is provided in Appendix 8 illustrating how we expect the tender process to progress.

3.17. As set out in the Government response to the July 2007 Ofgem/BERR joint policy statement, we will review the benefits of using tender windows in the light of experience. As such, we will consider this further once we have been through the first few rounds of tenders.

3.18. A number of respondents requested more clarity on how the tender process would work in practice. To that end, the following section along with Appendix 6

explains in more detail the purpose of each stage of the process and the documentation that is likely to be associated with it. We would welcome further feedback from stakeholders on this before we draft the tender regulations which will encapsulate the process. The following section takes into account comments received in response to the joint policy statement, as well as further analysis and research we have undertaken since July.

**Stages in the process**

*Expressions of Interest and pre-qualification*

3.19. The purpose of the EOI stage is to stimulate sufficient interest in projects from as wide a range of applicants as possible and to select a short list of bidders to enter the ITT stage. For example, we could issue a high level advertisement in relevant national, international and industry specific publications setting out the intention to run a tender process for the award of a new transmission licence, with a link to the relevant EOI documentation. The advertisement would identify key information about the project that could be published, for example its size and proposed location, as well as the contact details at Ofgem.

3.20. We will need to assess and evaluate this in accordance with pre-defined pre-qualification criteria on receipt of the EOI documentation from interested parties. Among other things, we consider that applicants at this stage would need to demonstrate that they have the necessary technical ability and capacity and economic and financial standing to develop, fund and deliver the project. Appendix 6 provides an indication of what these criteria could include. Assessment would take place once the tender window opens.

3.21. We are considering whether the EOI stage should also include a request for a non-binding business case proposal detailing the high level design, building programme, long-term revenue stream and maintenance projections for the project, based on the information available at the time. This may help in the evaluation process and also raise any significant issues in terms of the data required to conduct an effective competitive tender process as early in the process as possible. We would welcome views on this suggestion, particularly whether respondents consider that this would streamline the process further, and enhance our ability to assess bidders' capabilities prior to our selection of bidders to enter the ITT stage. We would welcome views on this matter from interested parties.

*Invitation to Tender and evaluation of bids*

3.22. The purpose of the ITT stage is to identify a preferred bidder that the Authority considers would be capable of building and operating an offshore electricity transmission network in accordance with the OFTO licence, and whose solution is in the best interests of consumers. Where more than one preferred bidder is short listed following the evaluation of bids, it may be appropriate to require those short listed to submit a BaFO. This would be an optional stage which we may include in the tender process to provide those short listed with a final opportunity to improve their bids.

3.23. We intend that ITT documentation will be issued in respect of all projects in a particular year during the annual tender window. Bidders will then have a defined period of time (e.g. 3 to 6 months) to assess the documentation and submit a bid. We would welcome respondents' views on what the appropriate length of time should be for the submission of a formal bid under this process.

3.24. Typically, the ITT stage enables bidders to fully assess the technical, commercial and financial information in respect of a generation project that is seeking connection (including information in respect of the relevant onshore connection arrangements) and make detailed bids on the basis of this. It also provides the first opportunity for bidders to submit a comprehensive long-term revenue stream for the project in return for providing transmission services. This revenue stream should be reflective of the lifetime costs of providing the transmission assets, so covering operational as well as capital expenditure.

3.25. The information available to the bidders at this stage will include the ITT documentation, the information collated in the data room and other information which is publicly available. It is likely that we will use virtual data rooms (i.e. web-based with appropriate security). These will be managed and controlled by Ofgem.

3.26. As set out in chapter 2, we intend that bidders will quote prices for incremental works as part of their original bids for changes that arise pre-construction. In addition, bidders will be able to make variant bids (i.e. bids that meet the essential requirements but offer better value for money, for instance through technical innovation) as part of their bid. We would expect a bidder that intends to submit a variant bid to identify and discuss this with us before it is submitted so that we can assess, along with the developer, whether this would provide the offshore transmission services it requires.

3.27. We will need to assess and evaluate bids submitted in accordance with pre-defined criteria on receipt of the ITT documentation from bidders. Appendix 6 provides an indication of what these criteria could include.

*Best and Final Offer*

3.28. The July 2007 Ofgem/BERR joint policy statement set out that a BaFO stage is designed to allow the small number of short listed bidders a final opportunity to improve their bid if Ofgem considers it would be appropriate. A number of respondents questioned whether this stage was necessary. On balance, we feel that it should form part of the process and could add real benefit to some tenders, but should only be used where there is a need to do so. As such, we propose it remains an optional stage.

3.29. If used, we would expect BaFO documentation to be produced and issued to the short listed bidders together with a guide to the BaFO process and timetable. The BaFO documentation will be designed specifically for each project as and when the decision is made to include a BaFO stage and is therefore likely to vary in format and content. Essentially, the BaFO documentation, in respect of any project, will identify the areas that Ofgem expects the short listed bidders to refine their bids.

3.30. We would expect that the evaluation of the BaFO bids will be on the basis of the same evaluation criteria as set out in the ITT documentation.

*Selection of preferred bidder*

3.31. Whether or not the BaFO stage is used, the tender process will result in the selection of preferred bidder before an offshore transmission licence is awarded. This would trigger a period of final negotiations in respect of limited unresolved issues in the winning bid and facilitate the development of the final connection offer by the GBSO. We would also expect the preferred bidder to undertake a range of activities necessary for the development of an offshore transmission system. These may include, where appropriate, undertaking environmental impact assessments, seeking leases and consents, or the procurement of a detailed seabed survey. In some instances, these activities may be undertaken on the generator's behalf.

3.32. At the preferred bidder stage of the tender process, it is important that the preferred bidder demonstrates a commitment to proceed with the development of the offshore transmission system in a timely manner and that the costs of seeking consents and surveys are secured. In the light of this and the requirement for the GBSO to make a final connection offer to the offshore generator, we consider that it may be desirable that the preferred bidder enter in to agreements in principle with the GBSO to provide transmission services, and also to provide a financial commitment or guarantee against the cost of construction. We note that under the current arrangements, transmission owners offer a Construction Agreement to the GBSO which is used to develop the offer made by the GBSO to a party seeking connection to and/or use of the transmission system. We also consider that it may be appropriate that the generator provides security against the costs of consents and surveys. We would welcome views on the desirability of these types of commitment and security and the detailed form that it might take. Both of these issues will be considered further as part of our STC development work.

3.33. When the outstanding issues have been resolved, if any, the Authority will confirm the issue of the OFTO licence and approve the revenue stream. We would also expect the GBSO and generator to enter into a final connection agreement.

3.34. Once the OFTO's transmission licence has been awarded and contractual agreements are in place, the OFTO, offshore generator and GBSO would need to co-ordinate works to ensure the delivery of a usable offshore transmission connection. In addition, the OFTO would need to satisfy the "start up" provisions and other conditions in its transmission licence by the time the generator would be ready to generate and the OFTO would be ready to transmit electricity. These provisions would be individually tailored for each transmission licensee and would form part of the transmission licensee's special conditions. It would also need to satisfy certain conditions defined in the System Operator/Transmission Owner Code (STC) and/or other contractual arrangements with the GBSO. Such conditions would need to be satisfied before the OFTO could receive its regulated revenue stream.

**Managing the process**

3.35. The Government has decided that Ofgem should manage the tender process for the selection of OFTOs. This will be a new type of activity for Ofgem and we are currently developing a robust business plan mapping out the processes and resources that will be required to ensure that the process is managed effectively.

3.36. Our early thinking is that we would create an internal specialist team to manage the majority of the work associated with this process. This would be a dedicated and ring-fenced team within Ofgem that is responsible for ensuring that the tender process is managed effectively and enabling the costs associated with managing the tender process to be separately identified. We expect that this team would manage the day-to-day activities of each tender process including managing the external consultancy support, the liaison with bidders and other stakeholders as well as making recommendations to a Tender Panel[7].

3.37. We envisage that the remit of the Tender Panel would include approving all the tender documentation, steering and advising the work of the dedicated team within Ofgem and making key recommendations to the Authority on the award of OFTO licences and associated revenue streams. As is the case under the existing onshore arrangements, the Authority would be the final decision maker with respect to the award of transmission licences and price controls.

3.38. We would expect that the procedures for administering the tender process will be subject to review by our internal auditors as well as our Audit Committee. In addition, the procedures would be reviewable externally by the National Audit Office. Ofgem's management of the costs of the process will also be subject to scrutiny by Ofgem's external auditors.

**Involvement of other stakeholders in the tender process**

3.39. We propose that the trigger for the tender process is the generator requesting a connection from GBSO. As such, there is clearly a critical interdependency between the GBSO-offshore developer connection process and the OFTO tender process. This interdependency means there is likely to be varying degrees of contribution necessary from the GBSO and offshore developer in the OFTO selection process. This was an issue some respondents requested further detail on in response to the joint policy statement.

3.40. In the light of this, and to provide stakeholders with further information on the roles we envisage different stakeholders will play, we have provided a high level activity matrix in Appendix 7. This matrix describes our current thinking on the key activities of Ofgem, the GBSO and the offshore developer at each stage of the tender process.

3.41. In summary, we expect that the generator will play a key role through the provision of a detailed technical specification in respect of its project (provided to Ofgem by the GBSO when it confirms receipt of a connection application). This information will be provided to all bidders in the same way (including to an affiliate company bidder if necessary) by Ofgem. Further, we would seek to

[7] We envisage that the Tender Panel would be made up of a mixture of Ofgem staff, an Executive member of the Authority and independent (i.e. non-Ofgem and non-Authority) advisors.

discuss any variant bids received with the generator to ensure that the alternative design idea meets its specified requirements. We would also discuss any variant bids with the GBSO and seek confirmation that the bid allows the GBSO to fulfil its contractual obligations with the offshore generator.

3.42. We expect the key role of the GBSO to be the provision of necessary technical information to us. We expect to share this information with all bidders on the same basis (with the exception of notified commercially sensitive information) to ensure that no party is given undue advantage.

3.43. We welcome further views from stakeholders who will be participating in the tender process.

**Tender regulations**

3.44. The tender process will be set out in new tender regulations made by the Authority, and approved by the Secretary of State. These regulations will be established under section 6C of the Electricity Act 1989 (to be inserted upon commencement of section 92 of the Energy Act 2004). These regulations will be developed over the coming months in consultation with stakeholders.

## Clarity on other issues raised in responses

3.45. This section provides clarity on the key issues that respondents raised in response to the July 2007 Ofgem/BERR joint policy statement, and which are not covered above.

**OFTO of last resort**

3.46. We set out in the July 2007 joint Ofgem/BERR policy statement in the enduring regime there would be no OFTO of last resort if the tender process does not reveal an OFTO. A number of respondents questioned this approach, particularly given that we have accepted a need for an OFTO of last resort for those projects that fall into the transitional arrangements. Notwithstanding these comments, we remain of the view that a last resort provision is not an appropriate feature of the enduring regime. Under the proposed transitional arrangements, the developer is expected to develop its own transmission assets for adoption by an OFTO once constructed. It is therefore more appropriate that there is the protection of an OFTO of last resort, in exceptional circumstances, to ensure constructed assets are operable. In respect of the enduring regime, if the competitive process does not attract interest for the provision of offshore transmission services, this would suggest that the overall project is commercially unappealing in some way and would not be constructed in its proposed form. However, upon the request of the developer, we would envisage re-tendering the project, possibly following some modifications, for example to the offshore connection specification.

**EU procurement rules**

3.47. The July 2007 Ofgem/BERR joint policy statement set out that the tender process would not be subject to EU procurement rules for public bodies. This

point was questioned at the External Communications session we held jointly with BERR in August 2007. As set out at the time, we remain of the view that this tender process would not be subject to EU Directive 2004/18/EC (as implemented by the Public Contracts Regulations 2006). EU Treaty principles of non-discrimination and transparency, however, would be observed.

**Generator affiliates**

3.48. The July 2007 Ofgem/BERR joint policy statement confirmed that generator affiliates would be able to bid for offshore transmission licences, subject to compliance with EU legislation. We also set out that bidders would need to be separate legal businesses from the offshore generator seeking the offshore connection and appropriate ring-fencing should be put in place to ensure generation and transmission businesses are operated separately.

3.49. Those respondents that commented in this area broadly supported this proposal, although one did comment that if no OFTO was identified, the developer should be awarded the OFTO licence by default. As set out above, we do not consider that this is appropriate in the enduring regime, although we do recognise that there may be scope to allow this for transitional projects in a limited number of circumstances.

3.50. The July 2007 Ofgem/BERR joint policy statement noted that the European Union, in the context of the EU Strategic Energy Review, was considering a range of measures that might include unbundling. We continue to note that this remains a possibility and we intend to reserve our position in the light of any decision in this area.

**Interaction with the connection application process**

3.51. We acknowledge that it will take longer for the GBSO to make a firm offer of connection given the proposed two stage connection process and that the OFTO would be selected by a new competitive tender process. However, we consider that the proposed arrangements are an appropriate way of dealing with the particular complexities of the offshore environment. It is not our intention to introduce any unnecessary delays into the process and in designing the framework, we will seek to ensure that processes are co-ordinated effectively where possible. To that end, we have provided an indicative timeline for the tender process alongside the connection application process in Appendix 8. This timeline illustrates that we expect the tender process to take around 12 months to complete, although we consider that there may be scope for this to be reduced in the future as a result of improvements to – and efficiencies within – the process, and as experience of developing offshore electricity transmission infrastructure develops.

3.52. 3.52. We note that if the generator and the GBSO are unable to agree the terms of a connection agreement during the offer period, then the dispute may be referred to us for determination. We need to consider further the dispute provisions in respect of indicative connection offers to ensure that they can be dealt with transparently and expediently.

3.53. We welcome respondents' views on the connection application process and its interaction with the tender exercise, and in particular how, if at all, the proposed processes could be made more effective.

3.54. The July 2007 Ofgem/BERR joint policy statement set out clearly how we proposed the offshore connection process would operate. Most respondents concurred that the two-stage approach we described was pragmatic and workable[8]. However, there was some support for providing further clarification of how it would work in practice. We note that National Grid Electricity Transmission plc (NGET) is holding a workshop on the connection process for offshore connections in February 2008, and this should provide significant further information and clarity in this area[9].

**Consents and leases**

3.55. Some respondents to the joint policy statement suggested that the introduction of the tender process would lend itself to a sequential process that would likely add significantly to the timeframes for developing offshore generation projects. As well as the interaction with the tender process, one issue that a small number of respondents raised was how the process for obtaining the necessary offshore consents and leases would interact with the competitive approach.

3.56. At present, developers can seek the relevant consents and leases from the appropriate bodies (such as the Crown Estates and the Marine & Fisheries Agency). We do not see any reason why developers should not continue to take steps to obtain these, with a view to transferring these to the relevant OFTO when it has been identified through the tender process[10]. We would expect that, at least to the extent that this can be done on a commercial basis, the OFTO would remunerate the generator for necessary and efficiently incurred costs associated with gaining those consents, licences and leases. This would seem to be the most appropriate way to ensure that no unnecessary delays are introduced in this area.

[8] Under current onshore arrangements, NGET, in its role as GBSO, has a transmission licence obligation to make an offer of connection to the transmission system within 3 months of receipt of a connection application and up to one month to make an offer for use of system (unless construction works are required when up to three months is allowed) in accordance with the transmission licence. Following on from this, NGET allows parties up to 3 months to decide whether to accept the offer. The joint policy statement considered that these existing processes were appropriate for offshore connections, but that would need to be adapted to accommodate the specific features of offshore developments. In particular, the document proposed that the connection offer process could become a two-stage process, i.e. the preparation of an initial indicative and final connection offer, to take into account that some of the key information relating to the offshore connection would not be available at the 3 month stage. This would be similar to the adapted process used currently for connections in remote locations (e.g. the Scottish Islands). Under this adapted process, the first stage would consist of an indicative offer provided within 3 months (in parallel with the existing onshore process) which takes account of onshore reinforcements, a desktop exercise to identify required further offshore works and cost estimates of this work from affected parties. The second stage would be the firm offer which is provided on completion of the tender process and the appointment of the preferred OFTO. This would update the indicative offer to reflect the outcome of the tender process. This update would reflect the works required to provide an offshore transmission system and may amend the design of the connection to (and reinforcement works associated with) the onshore transmission system.

[9] Further information about this workshop can be found on NGET's website, www.nationalgrid.com/uk/Electricity/GettingConnected/gb_agreements/

[10] The Government response to the joint policy statement confirms that arrangements can be put in place to ensure that the relevant consents, licences and leases can be transferred to an OFTO or obtained by it with minimal delay.

# 4. Transitional arrangements

**Chapter Summary:**

This chapter confirms our broad proposals for transitional projects as set out in the joint policy statement. It also provides further clarity on a number of issues raised in responses to that earlier document particularly on guarantees on funding and on the OFTO of last resort.

**Questions:**

**Question 4.1:** Do you agree with our proposals for dealing with generators that will be subject to the transitional arrangements as outlined in this chapter? In particular, we would welcome your views on:

- our policy proposals for the OFTO of last resort provisions;
- our proposals for providing ex ante comfort on funding of capital costs; and
- our proposals for applying our anticipated powers for the transfer of assets

**Question 4.2:** Do you feel that there is any aspect of the transitional arrangements that we have not considered sufficiently?

## Summary

4.1. The July 2007 joint Ofgem/BERR policy statement set out the key issues surrounding the treatment of offshore transmission assets that will be constructed or partly constructed at the time the offshore regulatory regime comes into effect. This chapter confirms certain policy positions that directly concern Ofgem and, taking into account the responses received to that document and subsequent dialogue with stakeholders, provides further clarity in a number of areas.

### Original proposals

4.2. The key proposals set out in the July 2007 Ofgem/BERR joint policy statement were:

- Confirmation of the position first outlined in April 2006 that transitional projects that are able to satisfy certain pre-conditions by the 'go-active' date could apply to have an OFTO appointed under the transitional tender process. We clarified that these pre-conditions were that the developer had:
    - secured an onshore connection offer;
    - obtained all necessary property rights (e.g. leases and licences) and all environmental and planning consents for the offshore transmission assets to be constructed and maintained;
    - completed construction of, or entered into, all necessary construction contracts for the construction of the offshore transmission assets;
    - reached full financial close (or there is evidence of an equivalent financial commitment, such as demonstrable parent company commitment) for the construction of the offshore transmission assets;

  - provided its financial model and all other necessary financial and other data to Ofgem to enable the assessment of the efficient and economic cost of constructing the offshore transmission assets;
  - agreed to populate a data room with all the relevant data necessary for a prospective OFTO to be able to bid effectively;
  - committed to transfer the offshore transmission assets to the selected OFTO under the terms set out in its request for the appointment of an OFTO;
  - provided the appropriate fee to cover some of the costs of initiating the tender process; and
  - provided an independent engineering audit report on functioning and performance to Ofgem.

- Those developers that could not meet the pre-conditions set out above by the 'go-active' date would have two options: They could wait for the 'go-live' date to apply to be part of the second transitional tender process (provided they had met the pre-conditions by that date). Alternatively, they could choose to apply following the 'go-active' date for an OFTO to be appointed to design, build, operate, finance and maintain transmission assets through the enduring tender process.

- There would be a tender process to appoint an OFTO for transitional projects that would broadly follow the process for the enduring regime. This process would result in the award of an OFTO licence for the right to receive a regulated income for providing transmission services. However, the OFTO would only be financing the ongoing operation and maintenance of the assets post construction.

- That assets would only transfer to the appointed OFTO post-construction, regardless of when the OFTO was appointed.

- We would provide comfort to developers that they would be paid the greater of either 75 per cent of Ofgem's ex-ante estimate of the capital cost of the project or the full efficient ex-post view of the capital cost.

- In the event that there is no EOI at the initial stage of the tender process, we would run the process a second time. If there is no interest at this second invite, the developer would be awarded an OFTO licence. This effectively establishes an 'OFTO of last resort' regime.

4.3. Respondents to the July 2007 Ofgem/BERR joint policy statement broadly supported these proposals. However, the area that attracted the greatest attention was the proportion of costs that we would guarantee. A number of respondents suggested that we should guarantee a larger proportion of costs, with many suggesting that 100 per cent of the ex-ante valuation should be guaranteed. We have considered carefully responses in this area, as well as to the other proposals and, where relevant, we have provided further clarity below.

## Clarity on issues raised in responses

4.4. Responses to the July 2007 Ofgem/BERR joint policy statement did not bring forward any new information that has led us to change our policy position with respect to the transitional arrangements as set out in that document. As such, we remain of the view that:

- certain pre-conditions need to be met before projects will be considered for transitional arrangements;
- OFTOs should be selected by a competitive tender process[11];
- only as a last resort would we consider appointing an OFTO that has not successfully been identified through a tender process; and
- 75 per cent of our assessment of efficient ex-ante costs is an appropriate level of guarantee for projects.

4.5. However, in the light of some responses we accept that it would be beneficial for us to provide greater clarity on our position in these areas.

**Pre-conditions**

4.6. Few respondents commented in detail on the pre-conditions that need to be satisfied to facilitate the tender process. However, one specific area in which further clarification was sought was with respect to the requirement for full and unconditional financial close ahead of the 'go-active' date.

4.7. The joint policy statement recognised that the notion of full financial close might not be appropriate in all circumstances and indicated that other equivalent forms of financial commitment would be considered sufficient to enable projects to qualify for the transitional arrangements. We can reaffirm our position on this matter. For example, in cases where a developer has financed a project on a balance sheet basis, we would be willing to accept an unconditional parent company guarantee that sufficient funds will be available to finance the project. We will consider any equivalent arrangements on a case-by-case basis as and when they are presented to us.

**OFTO of last resort**

4.8. We set out in the joint policy statement that in the event that no EOIs were received during the tender for a transitional project then we would run one further public invitation for bidders to come forward. We said that where no bidders came forward to this second invitation, then we would award an OFTO licence to the developer. This would have the effect of establishing an 'OFTO of last resort' regime. Respondents to this proposal generally considered the notion of an OFTO of last resort as a positive development, and we note that the Government considers that this would be an important feature of the transitional arrangements.

4.9. However, we are mindful that an OFTO of last resort regime has the potential to undermine effective competition, leading to potentially inefficient outcomes and unnecessary costs being by consumers. Balanced against this, we are also aware that there are a very limited number of circumstances in which a developer might find its assets stranded through no fault of its own without a back-stop regime.

[11] We propose that the tender process for transitional projects broadly follows that as for the enduring arrangements, and as described in the July 2007 joint Ofgem/BERR policy statement.

4.10. In the light of this, it is important to re-iterate that the decision to award a licence, and to whom, is a matter reserved to the Authority. In considering whether the Authority should award an OFTO licence where no effective competition has taken place, we intend to take into account a number of factors. Whilst these are still being finalised, it is likely that they would include:

- whether the developer has acted in such a way as to deter bidders in order to ensure it is in a position to be considered as licensee of last resort; and
- whether the transmission assets are of sufficient quality to be likely to allow the licensee to fulfil its obligations without the requirement for extensive expenditure to maintain them to this standard.

4.11. In all circumstances, the Authority retains its right not to issue a licence (of any description) in circumstances where it does not consider that it would be in the best interests of consumers to do so. In applying this principle with regard to the issue of OFTO licences, we will consider whether the most efficient outcome would be for any existing assets that are not fit for purpose not to be adopted and for the project to pass into the enduring arrangements to tender for replacement assets. We will consider these issues on a case-by-case basis as and when they are presented to us.

**Comfort on funding**

4.12. The July 2007 Ofgem/BERR joint policy statement confirmed that we would issue comfort on funding to developers of transitional schemes. We reconfirmed our view that this would be limited to the greater of either 75 per cent of our ex-ante assessment of the capital cost of the project, or our full ex-post view of the efficient capital cost.

4.13. A number of respondents raised concerns with this proposal, with some seeking greater clarity on what the guarantee covered. We do not propose to move from the proposal set out in July as we continue to believe that this provides an appropriate balance of incentive and risk. However, having discussed this issue with stakeholders since the publication of the policy statement, we believe that there was a degree of misunderstanding about our proposals in this area.

4.14. This framework is designed to achieve an appropriate balance of incentives and risk - the key incentive for the developer being that all efficiently incurred costs will be remunerated through the revenue control and the key risk that any inefficient expenditure (i.e. in excess of our 75 per cent ex-ante estimate) is not guaranteed to be remunerated. This guarantee means that in cases where efficiently incurred ex-post costs exceed 100 per cent of our ex-ante estimate, these costs will still be remunerated. In addition, in cases where our 75 per cent ex-ante guarantee is greater than 100 per cent of the efficiently incurred ex-post costs, we will remunerate the larger of the two sums.

4.15. There also appeared to be confusion regarding the status of projects already constructed at the time the regime comes into effect. In such cases, no ex-ante assessment would be possible and we would guarantee 100 per cent of efficiently incurred costs at our ex-post assessment.

4.16. Our assessment of costs is for the purposes of providing a guide for bidders in a tender process, to establish an appropriate revenue stream for the successful OFTO, and to facilitate commercially negotiated arrangements for compensation for the value of the assets between the asset owner and the OFTO that adopts its assets. We expect to recover the costs of undertaking these assessments from the developer at the start of the tender exercise (subject to gaining the cost recovery powers set out in the Energy Bill and described in chapter 5).

**Other issues**

*Transfer of assets*

4.17. The issue of the transfer of assets did not receive significant attention in the responses to the joint policy statement. However, since the publication of that document, significant progress has been made in this area. We have been working with the Government to seek powers through the Energy Bill for a transfer scheme to ensure that property rights and liabilities are transferred from the developer to the successful OFTO. Ofgem will only have powers to use the scheme in certain circumstances and upon application (which it is envisaged will arise only when commercial negotiations fail.

4.18. We expect this to be a scheme of last resort and the parties should exhaust all possibilities to negotiate a commercial arrangement before applying. However, we acknowledge that provision needs to be put in place in case these commercial negotiations break down resulting in unnecessary disruption or delay to offshore generation development.

4.19. The proposed powers will need to go through Parliamentary process before being enacted and as such may be changed. However, set out below is a summary of the powers being sought (as currently drafted):

- It is proposed that the Energy Bill inserts a new Schedule (Schedule 2A) into the Electricity Act 1989. This new Schedule would grant the Authority the power, upon application by an eligible party, to make a scheme to transfer property, rights or liabilities from the existing owner to the successful bidder[12] selected pursuant to a competitive tender process. The scheme will take effect by operation of law.

- Applications for a property scheme must be made within 4 years of commencement of section 92 of the Energy Act 2004. However, the Secretary of State may by order extend the period for applications by a maximum of 3 years.

- In order to make a scheme the Authority must determine whether it is necessary or expedient for the purposes of enabling the successful bidder for an offshore transmission licence to carry out its licensed and statutory duties.

- Whereas Schedule 2A envisages that an application could be made in respect of a scheme before completion of the construction phase of the project, the scheme would not come into effect until after final completion

[12] This is a defined term in the proposed text of the transfer scheme

of the relevant assets and the offshore transmission licence has been awarded to the successful bidder.

- The scheme provides that the Authority may not set terms which adversely affects a third party unless the Authority determines that is necessary or expedient for the performance of the successful bidder's functions. Where such terms are included, the Authority must also consider provision for compensation to an adversely affected third party.

- The scheme incorporates rules for the provision of Notices of an application for a scheme. In particular, notice of application is given to the non-applicant (i.e. the developer or the preferred or successful bidder) and to third parties who may be affected by the transfer scheme. The Authority is required to publish notice that an application has been made. There will be a period for parties to make representations to the Authority. the Authority also has obligations to publish notice of the scheme when it is made. .

- The new Schedule 2A provides for any person affected by a determination of the Authority under Schedule 2A to have a right of appeal to the Competition Appeal Tribunal. The Tribunal has, among other things, the power to overturn, or amend the terms of a scheme in certain circumstances.

- the Authority has the power to make costs directions in certain circumstances. These include the power to require the successful bidder or asset owner or both to pay the Authority's costs in connection with the scheme.

# 5. Cost recovery

**Chapter Summary:**

The Government has confirmed that, subject to the Parliamentary process, Ofgem should be given powers through the forthcoming Energy Bill to allow us to recover costs of running the tender process from participants. We need these additional powers because our normal funding arrangements would not cover the costs incurred in undertaking this activity.

This chapter sets out the draft powers being sought through the Energy Bill, as well as setting out how we propose to use these to recover our costs.

**Questions:**

**Question 5.1:** Do you agree with our proposed approach for using the powers the Government is seeking through the Energy Bill?

## Summary

5.1. One of the Government's key decisions is that new powers are provided for in legislation that enable us to recover our costs of running the tender process. To that end, the Government is seeking powers through the forthcoming Energy Bill to ensure that the costs we incur through running the tender process are appropriately recovered. This chapter summarises those powers, as well illustrating how we might recover costs from those participating in the process.

5.2. The Bill is subject to the Parliamentary process and therefore the powers proposed as summarised below may be subject to change as a result. However, this summary represents our understanding of the current position.

## Relevant provisions in the Energy Bill

5.3. The proposed provisions of the Energy Bill (the Bill) will:

- insert in the Electricity Act 1989 a provision enabling the Authority to make regulations under section 6C of the Electricity Act 1989[13] to create new mechanisms to recover its costs in carrying out and administering the tender exercises (the Regulations); and
- insert in the Electricity Act 1989 a new Schedule (Schedule 2A) which grants the Authority the power, upon application by an eligible party, to make a scheme to transfer property, rights and liabilities from an existing owner of offshore transmission assets to the successful bidder. Further information about this power is set out in chapter 4 (Transitional Arrangements)

[13] Section 6C gives the Authority the powers to make regulations to enable it to run a competitive tender process and determine successful bidders

**Proposed Powers**

5.4. The new powers will enable the Authority to seek payments from the participants in a tender exercise to cover its tender costs (referred to as 'Payments' in this section). These participants are defined as being:

- a person who makes a connection request (i.e. the generator); and
- applicants for an offshore transmission licence (i.e. bidders).

5.5. The person who makes a connection request[14] will also be required to pay a deposit or provide such other security (e.g. a letter of credit) as approved by Ofgem. We may also accept such security or deposit from an approved third party (e.g. a parent company). This is referred to the 'Financial Commitment' in this chapter. The power is limited so that the aggregate of the Payments and Financial Commitment and any application fee cannot exceed the total costs incurred in carrying out the tender exercise.

5.6. In addition, the new powers extend into other specific areas. They will enable us to charge for costs arising as a result of undertaking any pre-qualification work (e.g. assessing whether a party can meet technical competence standards before a tender exercise takes place) and where we undertake ex-post cost assessments. This latter power is specific to transitional schemes, and enables us to recover the costs associated with this activity from the asset owner.

5.7. The proposed powers provide for the Regulations to include timing of payments and mechanisms to allow the Authority to refund or withhold relevant payments, deposits or security required from participants in the tender exercise. The powers also enable the Authority to include provision in the Regulations to address the consequences for a participant's failure to adhere to the requirements of the Regulations by for example, failing to make payments.

5.8. Any sums received by the Authority under the Regulations in respect of a tender exercise are to be paid into the Consolidated Fund, although we expect that the monies would be treated outside of Ofgem's core budget. As a result, all monies are covered by government accounting rules as set out in HM Treasury's publication Managing Public Money. Moreover, we intend to provide further transparency by reporting sums received under the Regulations as a separate line item in our annual accounts.

**Description of the proposed flow of funds through a typical tender process**

5.9. We set out below how we envisage using these cost recovery powers in practice. This process is based on the principle that each participant pays a fair proportion of our costs. We welcome feedback from respondents on this proposed approach.

[14] In summary the connection request addresses connection to a transmission system or, if a project connects to shore at 132 kV, a distribution system

*Trigger*

5.10. We propose to require the Financial Commitment from the developer at the point it has submitted a connection application to the GBSO. It is proposed that the Financial Commitment is obtained in advance of us incurring costs in commencing the tender process. As such, the receipt of a satisfactory Financial Commitment can be seen as part of the trigger for a tender process. The Financial Commitment would be required to secure the developer's potential liability for our tender costs if the tender process cannot be completed because of some act or omission on the part of the developer. It would also demonstrate the developer's commitment to the tender process.

5.11. We propose to request different amounts of Financial Commitment from the developer at different stages of the tender process. We expect that this will increase in line with increases in our costs, as subsequent stages will likely require more work on our behalf. For example, we would expect to incur higher costs at the ITT stage compared to the EOI stage.

*Expression of Interest*

5.12. It is clear that we will incur costs at the EOI stage, for example through advertising a particular project and preparing the necessary documentation. For cash flow purposes we would intend that the developer makes a Payment to cover these costs. The amount of the developer's Payment would be determined on a tender-by-tender basis, taking into account the peculiarities of each tender process.

5.13. We will also incur costs evaluating EOIs received from those interested in participating in the tender process. It is proposed that these costs be funded in the short term by the applicants to the EOI stage making Payments. The amount of the Payments by bidders would be determined on a tender-by-tender basis, taking into account the stage and individual circumstances of each tender process.

5.14. We propose that Payments made by unsuccessful bidders would be refunded. However, in the light of guidance from the HM Treasury, it is unlikely that this would be a full refund, given that these participants would have caused us to incur costs.

*Invitation to Tender*

5.15. At the ITT stage in the process, we are likely to incur significant costs associated with managing the competition, supporting the clarification process, evaluating bid submissions and possibly running a BaFO stage. In order to cover these costs in the short term, the powers will enable us to request additional Payments from the remaining bidders, as above.

5.16. Again, the amount of the Payments by bidders and the timing and mechanisms of Payments would be determined by us, taking into account the stage and specifics of the tender process. Also, as at the EOI stage, we propose that unsuccessful bidders would be refunded, but that this would only be partial given Treasury rules.

5.17. The powers also allow us to request that the developer increases its Financial Commitment at this stage to reflect our increased costs.

*Preferred Bidder*

5.18. It is likely we will incur further costs at the preferred bidder stage by, for example, carrying out final negotiations with the selected preferred bidder. To the extent needed, we may require the preferred bidder to provide a further Payment to cover these costs.

5.19. The powers also allow us to request that the developer increases its Financial Commitment at this stage to reflect the Authority's increased costs.

*Licence Award*

5.20. As set out above, once the final negotiations have been completed, we may award the successful bidder an OFTO licence. We may request a further Payment from the successful bidder at this stage to cover any differences between our total costs and Payments to date. This would be the final Payment expected from the successful bidder.

5.21. At the end of each tender process, it is expected that the Financial Commitment would revert to developer or the person who provided it. Depending on the form of the Financial Commitment provided to the Authority, it may be that a physical return of monies is required or that the commitment determines in accordance with its terms.

**Costs of the process**

5.22. In addition to how the costs of running tenders would be funded, we note that a number of respondents also wanted confirmation about the level of costs that participants might face. Whilst it is not possible to provide this level of detail at this stage, we agree it would be useful to provide an indicative high level estimate of the total annual costs we might expect to face in running tenders. To that end, the table below sets out our best estimate of the likely costs we will incur over the first 5 years of running tenders, based on the assumed number of tender exercises taking place.

| Year | Number of projects initiating tender | Ofgem tender assessment costs |
|---|---|---|
| 2008/09 | 6 | £1.8m [1] |
| 2009/10 | 6 | £2.8m |
| 2010/11 | 4 | £2.8m[2] |
| 2011/12 | 4 | £2.1m |
| 2012/13 | 4 | £2.1m |

Notes:

1. Anticipated costs of the tender process October 2008 to 31 March 2009
2. The year 2010/11 includes costs associated with projects triggering the tender process during the latter half of 2009/10

5.23. These costs are based on our current mid-case assumption of the number of tender exercises we will need to undertake. Clearly, these indicative costs will vary if more or less tenders are required. In addition to covering fixed costs, such as direct staff costs and overheads, our estimate also covers variable costs such as external consultancy support, which would be needed for the evaluation of bids. We would expect that over time, our reliance on external consultancy support would reduce as we become more familiar with running the tender process.

# 6. Technical rules

**Chapter Summary**

This chapter provides an update on the work to develop technical rules set out in the July 2007 Ofgem/BERR joint policy statement. These work streams are being taken forward with the assistance of NGET and industry working group. Where relevant, hyperlinks to papers on external websites are provided.

**Questions**

There are no specific questions in relation to this chapter.

## Summary

### Technical rules - STC

6.1. We note that respondents were generally supportive of our proposed approach for developing the STC to accommodate OFTOs and our proposals to establish a new working group to assist us with this development work.

6.2. One respondent believed that further consideration is needed of the technical design of offshore transmission networks. Another respondent acknowledged the value of ensuring that rules developed as part of the offshore transmission project are robust. An additional respondent stressed the need for representation from potential OFTOs at the new working group.

6.3. We established the STC Working Group which met in October 2007. The STC Working Group considered the scope of the role of an OFTO and reviewed the STC for changes which would be required to accommodate OFTOs. Existing transmission licensees and offshore developers provided nominations for and participated in the STC working group.

*Update*

6.4. We note that the STC Working Group made good progress in very short time scales. The STC Working Group has reported to us, making a number of recommendations. The working group's report is available on our website[15]. The main recommendations from the STC Working Group are that:

- The current STC framework should be extended to include arrangements for offshore electricity transmission;
- there is a need for a detailed evaluation of the STC clauses and detailed STC procedures (STCPs) to identify provisions which are applicable to offshore transmission;
- STC governance arrangements should be developed to provide for two OFTO representatives on the STC Committee;

[15] http://www.ofgem.gov.uk/NETWORKS/TRANS/OFFSHORE/STC/Documents1/STC%20Working%20Group%20on%20Offshore%20Electricity%20Transmission%20-%20Final.pdf

- current STC voting arrangements are not appropriate as the number of transmission licensees increase and that these should be developed;
- specific contracts between NGET and an OFTO should be developed that define the relationship, obligations and responsibilities during the enduring operational phase; and
- baseline technical criteria and minimum service quality standards should be defined for offshore transmission in the STC, along with the appropriate processes and allocation of responsibilities for demonstrating compliance with these criteria.

6.5. The STC Working Group was not able to make a single recommendation in respect of a preferred switching model for offshore transmission systems. The STC Working Group described three possible models:

- OFTO carries out all switching on the offshore transmission system in accordance with NGET's direction;
- NGET responsible for live switching on the offshore transmission system and OFTO responsible for safety switching; and
- NGET responsible for live and safety switching on the offshore transmission system.

6.6. The STC Working Group was unable to rule out any of these possible models in the timescales available. A copy of NGET's recommendation is available on our website[16].

6.7. As required by the terms of reference for the STC working group, NGET included its recommendation in the STC Working Group report. NGET recommends that NGET should be responsible for live switching on the offshore transmission system by remote control and the OFTO should be responsible for safety switching.

6.8. Following our initial review of the STC Working Group report we asked NGET to carry out additional STC assessment work. We asked NGET to:

- carry out a detailed assessment of the STC (on a clause by clause basis) assessing the impact on the STC of each of the possible switching models considered by the STC working group;
- identify STC clauses for which more detailed arrangements are defined in an STCP;
- develop proposals to amend the STC governance arrangements that could implement the STC working group's recommended changes to STC Committee representation;
- consider options for changes to the STC governance that are needed to accommodate additional STC parties and develop a recommendation;

[16] http://www.ofgem.gov.uk/Networks/Trans/Offshore/Sqss/Documents1/Demand%20Recommendation.pdf

- identify CUSC contractual obligations that NGET considers should be specifically backed off in a contractual arrangement between NGET and an OFTO; and

- develop proposals for new contractual arrangements under the STC framework based on the CUSC back-off requirements identified.

6.9. NGET has provided us with a timetable for this assessment work and supplied the majority of the requested information by the end of December 2007.

6.10. We are reviewing the STC working group's recommendation in conjunction with the detailed information supplied by NGET. It is very likely that we will need to reconvene the STC Working Group to develop some of the recommendations further, before we can issue STC drafting instructions to NGET. We consider that the impact of the STC working group's recommendations can only be fully assessed in light of the detailed rights and obligations defined in the associated legal drafting.

6.11. We expect that draft legal text developed by NGET will form the basis of a subsequent Ofgem/BERR consultation. Any interim changes to the STC under the normal governance arrangements will need to be reflected in the draft legal text that NGET prepares. As required, we would ask NGET to review the draft legal text prepared for the offshore transmission change proposal and make necessary changes to the drafting, where possible ahead of our consultation.

6.12. We consider that an early opportunity for other industry participants to contribute to the STC development work would be valuable. We also note that there may be parties other than those who participated in the STC Working Group who would appreciate an early opportunity to contribute to the STC development work. Please let us know by 21 January 2008 if you wish to directly participate in the STC development work ahead of our consultation.

**Technical rules - GBSQSS**

6.13. We note that respondents were generally supportive of our proposals to initiate further analysis work to develop the basis of the offshore security standard and to ask NGET to develop draft legal text for changes to the GBSQSS to implement the Government's decision that reduced minimum security requirements (eg an offshore cable circuit will not require redundancy) should apply offshore.

6.14. One respondent was concerned that transmission networks designed to the minimum requirements in the offshore security standard would not necessarily result in economic and efficient designs. Another respondent observed that a single circuit connection is unlikely to be commercially viable for most offshore generation projects. A further respondent considered that the analysis for the basis of the offshore security standard should be revisited if offshore generators will not receive compensation when the offshore transmission system is unavailable.

6.15. We do not consider that a minimum security standard should dilute the statutory obligation on transmission licensees to develop economic and efficient

systems of transmission. We also observe that the GBSQSS Sub Group[17] considered costs associated with energy curtailed as part of the cost benefit analysis that underpinned the recommended basis for the offshore security standard. We note that the analysis considered total costs that would be expected. We are unclear why the allocation of any of these costs should affect the basis for the offshore security standard.

6.16. One respondent raised concerns about the lack of a security standard for the design of offshore transmission connections to distribution networks. This respondent considered that the security requirements for connection of offshore transmission systems to onshore distribution systems should not be more onerous than the requirements that apply for connections of offshore transmission to the onshore transmission system.

6.17. We note that there is not a specific generation connection planning standard for connection of power stations to the distribution system in the current onshore arrangements. We note that under current arrangements, distribution licensees have been able to offer terms to offshore developers seeking 132kV connections for offshore generation projects to onshore distribution systems. We observe that the current absence of a specific generation connection standard has not prevented connections of offshore generators. As previously noted, we consider that the GBSO should identify security requirements in its connection application to a distribution licensee. We would not expect these requirements to be of a more onerous standard than the GBSQSS (unless specifically requested by the generator).

6.18. One respondent considered that the GBSQSS should not be developed separately from the Grid Code. We note the concern about possible interactions and observe that there was considerable overlap between the representation at the relevant sub groups. We also note that there are significant differences between the purpose and scope of the GBSQSS as compared to the Grid Code. We propose to check consistency between proposed changes to the GBSQSS and Grid Code as part of our assessment of the proposed arrangements for offshore transmission as a whole.

*Update*

6.19. As set out in the July 2007 Ofgem/BERR joint policy statement, we asked NGET to initiate some assessment work to identify minimum requirements for:

- security of connections for alternative generation technologies offshore i.e. gas fired generation;
- security implications when an offshore transmission system contains an onshore overhead line section;
- security at the interface between the offshore and onshore electricity systems;
- voltage step change limits on the offshore transmission system; and

[17] Established by the Offshore Transmission Expert Group.

- substation configuration and switching arrangements on the offshore transmission system.

6.20. NGET asked the Centre for Distributed Generation and Sustainable Electrical Energy (CDGSEE) to carry out cost benefit analysis work to ensure consistency with the Government's decision for the basis for an offshore security standard. NGET developed recommendations for additional security requirements based on the results of the cost benefit analysis.

6.21. In progressing the detailed analysis work, an issue was identified with the treatment of costs for energy curtailed during maintenance outages. Further investigation showed that this issue also applied to the analysis that underpinned the basis for the offshore security standard previously recommended. The methodology was amended to properly take account of the costs of maintenance outages and cost benefit analysis work undertaken. Relevant parts of the previous analysis were repeated and an assessment of the results identified a need to revisit the Government's decision in respect of the transformer capability required on the offshore platform. NGET has provided a revised recommendation to reflect the results of the cost benefit analysis work using the amended methodology. A copy of NGET's recommendations is available on our website.[18]

6.22. NGET has recommended minimum security requirements for each of the following sections of an offshore transmission system:

- Transmission equipment on the offshore platform (Offshore Platform);
- cable circuits from the Offshore Platform to the connection point with an onshore system (Cable Sections);
- overhead line circuits between a Cable Circuit and the connection point with an onshore network (Overhead Line Sections); and
- connection point between the offshore transmission system and the onshore transmission network (the Connection Point).

6.23. NGET's recommendations for minimum security requirements for an offshore transmission system are:

Offshore platform

- For connections of offshore wind farms of 90 megawatts[19] (MW) or greater, there should be a minimum of two transformers installed on the offshore platform. Each should have sufficient capacity that, following an outage (planned or fault) of a single transformer, there is a minimum of 50 per cent of the offshore transmission system capacity remaining.
- For connections of offshore gas fuelled generation of 90MW or greater, there should be a minimum of two transformers installed on the offshore platform, each with sufficient capacity that, following an outage (planned or fault) of a

[18] http://www.ofgem.gov.uk/Networks/Trans/Offshore/Sqss/Documents1/Security%20Recommendations.pdf
[19] This is a change from the previous recommendation from the GBSQSS Sub Group in respect of the basis for the offshore security standard.

single transformer, there is no loss of offshore transmission system capacity.

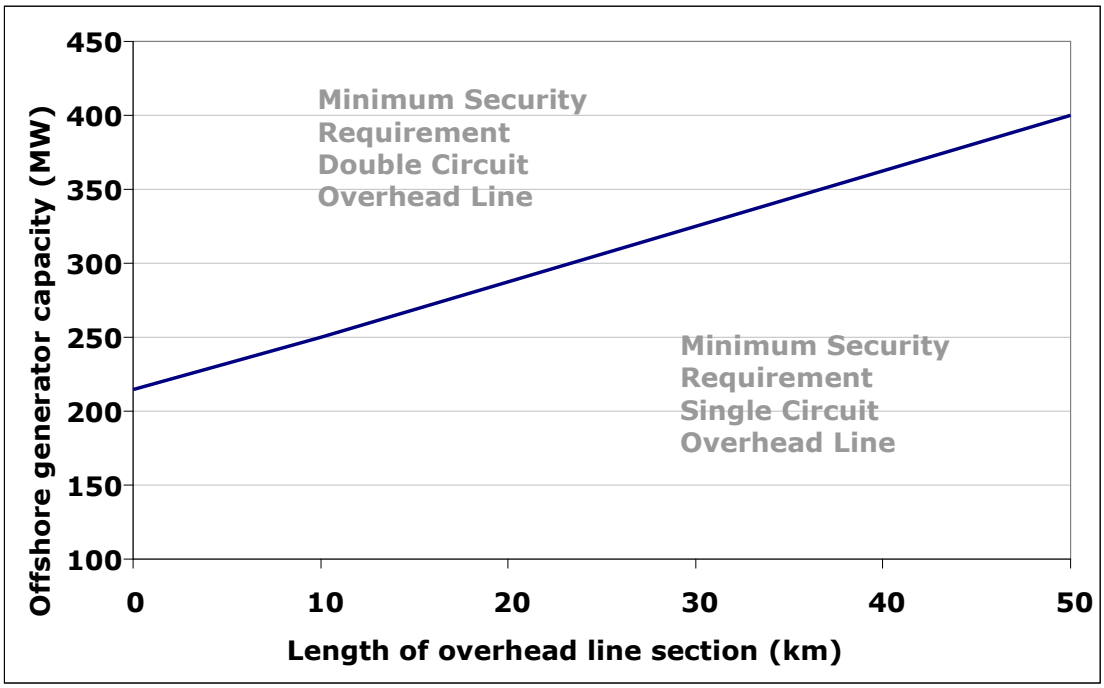
Cable sections

- For connections of offshore wind farms and/or offshore gas fuelled generation the loss of power infeed shall not exceed 1320MW for an outage (planned or fault) of a single Cable Section.
- Additionally, for connections of offshore gas fuelled generation, the loss of power infeed shall not exceed 1320MW for a fault outage of a single Cable Section during the planned outage of another single Cable Section.

Overhead line sections

- For connections of offshore wind farms and/or offshore gas fuelled generation up to 1250MW, Overhead Line Sections of 220kV and above shall be of at least single circuit construction.
- For connections of offshore wind farms and/or offshore gas fuelled generation, 132kV Overhead Line Sections shall meet the minimum requirement which is shown graphically below. The minimum requirement depends on the route length of the Overhead Line Section and the amount of offshore generation connected to the offshore transmission system.

**Minimum security requirement for 132kV overhead line sections**



Connection point

- For connections of offshore wind farms and/or offshore gas fuelled generation of 120MW or greater, the loss of power infeed shall not exceed 1000MW for an outage (planned or fault) of a single transformer at the Connection Point.

- For connections of offshore wind farms of 120MW or greater, there should be a minimum of two transformers at the Connection Point each with sufficient capacity that following an outage (planned or fault) of one transformer, there is a minimum of 50 per cent of the capacity of the offshore transmission system remaining.

- For connections of offshore gas fuelled generation, there should be a minimum of one transformer at the Connection Point.

6.24. NGET also reviewed the recommendation of the Grid Code Sub Group which recommended that steady state voltage limits of ±10 per cent should apply offshore and that voltage step change limits were not needed to apply offshore on the basis that demand connections to offshore transmission systems are not anticipated. NGET recommends that voltage levels in the GBSQSS must at all times remain below an upper limit of 10 per cent of nominal voltage.

6.25. In respect of the substation configuration and switching arrangement assumptions, NGET identified a requirement for offshore transmission systems to remain available to the offshore generator when maintaining transmission assets on the offshore platform. NGET recommended that substations connecting offshore generators should be of double busbar design. NGET advised of one exception to this recommendation proposing that a connection of a single gas turbine should be of a single busbar design.

6.26. We asked NGET to draft changes to the GBSQSS based on the Government decision on the basis for the offshore security standard and also to reflect the subsequent recommendations it had made. In progressing the drafting work, NGET identified areas where additional assumptions were needed in respect of limits to loss of power infeed that were not defined in the basis for the offshore security standard or NGET's further recommendations. NGET recommends that the following assumptions are adopted:

- For connections of offshore gas fuelled generation, the loss of power infeed shall not exceed 1320MW for the fault outage of a single circuit on the Offshore Platform during the planned outage of another transmission circuit on the Offshore Platform. This aligns with the Government decision taken in respect of connections for offshore wind farms.

- For a direct current (DC) offshore transmission system, the loss of power infeed for the outage (planned or fault) of the DC conversion facilities installed onshore should align with the minimum requirement defined for the Offshore Platform.

- For a DC offshore transmission system, the loss of power infeed shall not exceed 1320MW for the outage (planned or fault) of an Overhead Line Section. NGET considers that there is a low likelihood of an outage on an Overhead Line Section occurring when there is full output from the offshore generating station.

- For an offshore transmission system providing connection to more than one offshore power station of different fuel types, the design of the connection should meet both of the relevant sets of generation connection criteria. This aligns with the requirement in the current GBSQSS that where more than one set of criteria apply, the requirements of all relevant criteria should be met.

6.27. NGET also revisited a previous assumption that demand connection criteria did not need to be developed for offshore transmission systems whose purpose is to connect offshore generation projects. NGET observed that the GBSQSS recognises that there may be parts of the GB transmission system where more than one set of criteria apply and that in such places, the requirements of all relevant criteria must be met.

6.28. NGET advised that one example where more than one set of criteria applies arises where power station demand is supplied via the GB transmission system at a point local to the power station export onto the GB transmission system. Onshore, the generation connection criteria are more likely to drive the need for transmission system investment to provide the power station connection. Offshore it is less clear and for this reason NGET recommends that demand connection criteria are developed for offshore power station demand.

6.29. NGET has evaluated options for demand connection criteria based on an assumption that offshore power station demand requirements would in all cases be less than 12MW. NGET recommends that the onshore demand connection criteria for demand up to 12MW should be adopted for offshore power station demand, with increased emphasis on the option for the customer to request a 'Variation to the Connection Design'. A copy of NGET's recommendation is available on our website[20].

6.30. NGET has completed the initial stage of GBSQSS drafting work. We are currently reviewing NGET's recommendations and associated GBSQSS change proposal. We note that this includes a recommendation to change part of the previous Government decision in respect of the basis for the offshore security standard.

6.31. We expect that the additional recommendations and the draft legal text developed by NGET will form the basis of a subsequent Ofgem/BERR consultation. Any interim changes to the GBSQSS under the normal governance arrangements will need to be reflected in the draft legal text that NGET prepares. As required, we would ask NGET to review the draft legal text prepared for the offshore transmission change proposal and make necessary changes to the drafting, where possible ahead of our consultation.

6.32. NGET considers that the draft legal text is now suitable for wider consultation and has suggested that it is circulated to members of the previous GBSQSS Sub Group. We consider that an early opportunity for other industry participants to contribute to the GBSQSS development work would be valuable and agree with NGET's suggestion. We also note that there may be other parties who would appreciate an early opportunity to contribute to the GBSQSS

[20] http://www.ofgem.gov.uk/Networks/Trans/Offshore/Sqss/Documents1/Demand%20Recommendation.pdf

development work. Please let us know by close of play on 21 January 2008 if you wish to receive a copy of the draft legal text for the offshore changes developed to implement the Government's decision and NGET's further recommendations and assumptions.

**Technical rules – Grid Code**

6.33. We note that respondents were generally supportive of our proposals to seek further clarification of the recommendation for the new class of offshore large power station from the Grid Code Sub Group and to ask NGET to develop draft legal text for changes to the Grid Code that would implement the Grid Code Sub Group's recommendations.

6.34. One respondent considered that offshore rules should be kept separate. Another respondent considered that changes for offshore transmission should be simple, kept to a minimum and make use of existing industry processes.

6.35. We consider that changes needed for offshore transmission can be incorporated in the existing Grid Code and where possible, offshore requirements should align with current onshore requirements.

6.36. One respondent was disappointed not to have been directly involved in the development of requirements. This respondent raised concerns about the absence of supporting arguments for the Grid Code Sub Group's recommendation to define offshore generators of 10MW or above as large power stations.

6.37. We note that we published draft terms of reference for each of the groups that we have established to assist us with the development of offshore transmission arrangement. We also note that we invited nominations from interested parties including offshore developers. We asked the Grid Code Sub Group to clarify the intended scope of the recommendation. We acknowledge that the Grid Code Sub Group's recommendation was intended to address concerns about possible perverse incentives for offshore generators to separately register individual strings of wind turbines because such actions could adversely impact on security of supply. We also propose to initiate further assessment of the impact of the Large Transmission Connected Offshore Power Station recommendation.

*Update*

6.38. The Grid Code Sub Group provided us with clarification about the intended scope of the recommendation to create new generator categories of offshore large and offshore small power station in the Grid Code. The Grid Code Sub Group provided us with the clarification in a revision to the main recommendation report. The revised report is available on our website[21]. The Grid Code Sub Group advised that the new definitions were only recommended in respect of generators connected to an offshore transmission system. The Grid Code Sub Group explained that under the current arrangements, the thresholds in the definitions for large, medium and small power station are defined in terms of the

[21] Report available on our website at www.ofgem.gov.uk/Networks/Trans/Offshore/GridCode/Documents1/Grid%20Code%20sub%20group%20revised%20final%20report.pdf

transmission system to which the generator is connected to (directly or indirectly via a distribution connection). The Grid Code Sub Group confirmed that the recommended new definitions of large offshore and small offshore power stations were not intended to apply to offshore generators that connect to onshore distribution systems that are currently treated as medium power stations.

6.39. We issued drafting instructions to NGET to develop legal drafting for changes to the Grid Code (and consequential impact on the STC) that would implement the Grid Code Sub Group's recommendation. NGET progressed this drafting work mainly[22] using version 21 of the Grid Code as the baseline. We note that NGET invited comments from members of the previous Grid Code Sub Group. We also note that NGET received very few comments from Grid Code Sub Group members in respect of the draft legal text.

6.40. We provided many detailed comments to NGET during the initial drafting stages. NGET has now completed the initial drafting stage and has submitted draft legal text for our review. We are currently reviewing the Grid Code Sub Group's recommendation and associated Grid Code and STC drafting. We consider that the impact of the Grid Code Sub Group's recommendations can only be fully assessed in light of the detailed rights and obligations defined in the associated legal drafting.

6.41. We expect that this draft legal text will form the basis of a subsequent Ofgem/BERR consultation. We also note that there have been changes to the Grid Code under the normal governance arrangements which will need to be reflected in the draft legal text that NGET has prepared. We will ask NGET to review the text and make necessary changes to the drafting to incorporate these changes.

6.42. We acknowledge that there has been only very limited industry participation to the development of the Grid Code to incorporate offshore transmission. We consider that a further, early opportunity for other industry participants to contribute to the Grid Code (and consequential impact on the STC) development work would be valuable. We also note that there may be parties other than those who participated in the Grid Code Sub Group who would appreciate an early opportunity to contribute to the Grid Code (and consequential impact on the STC) development work. Please let us know by 21 January 2008 if you wish to receive a copy of the draft legal text for the offshore changes developed to implement the Grid Code Sub Group recommendations.

[22] Version 23 of the Grid code was used as the baseline for the General Conditions drafting

# 7. Transmission charging, access and compensation

**Chapter Summary**

This chapter provides an update on the work to develop offshore transmission charging arrangements, proposals for transmission access products for offshore generators and for compensation arrangements that should apply in the case of an access restriction set out in the joint policy statement. These work streams are being taken forward with the assistance of NGET and industry working groups.

**Questions**

There are no specific questions in relation to this chapter.

## Summary

7.1. The July 2007 Ofgem/BERR joint policy statement provided an overview of our key policy proposals for offshore transmission charging arrangements, access products for offshore generators and compensation arrangements in the case of an access restriction. This chapter provides an update on the recent developments in each of these areas.

7.2. The key proposals for transmission charging were:

- NGET, as onshore GBSO and offshore GBSO designate, would develop offshore transmission charging arrangements, using the current GB charging methodology as a basis for developing offshore arrangements; and
- the development of offshore transmission charging arrangements should not constrain the ongoing development of the onshore market (e.g. Scottish islands).

7.3. The key proposals for access were:

- the existing access product, Transmission Entry Capacity (TEC), will be assessed and adapted as necessary for offshore; and
- any further access products that are required to reflect features of intermittent generation will be progressed under normal governance arrangements.

7.4. The key proposals for compensation were:

- compensation arrangements will be aligned with the access product and level of infrastructure available, using the principles of cost reflectivity. Changes from onshore arrangements will be minimal, such that offshore connections with little or no redundancy were not expected to receive compensation for loss of access offshore; and

- offshore transmission networks would be subject performance incentives in order to incentivise OFTOs to maximise availability of offshore transmission networks for use by offshore generators (see chapter 2 of this document).

*Charging*

7.5. We note that the vast majority of respondents were supportive of our proposals for NGET to develop offshore transmission charging arrangements using the current GB charging methodologies and governance process as a basis for developing offshore arrangements. Several respondents supported the view that the offshore regime must not be considered in isolation.

7.6. Two respondents considered that offshore transmission charging should be kept separate from onshore transmission charging arrangements and supported the adoption of a connection and use of system boundary at the onshore access point. One respondent suggested that the residual charge should not be used to socialise higher costs of offshore platforms. We note that NGET is currently consulting on proposals for the development of offshore transmission charging arrangements.

7.7. Another respondent considered that changes to the Transmission Network Use of System (TNUoS) charging methodology to accommodate offshore transmission networks will increase the level of uncertainty over charges for access to and use of the offshore transmission system. It welcomed any progress that can be made in reducing this overall level of uncertainty.

7.8. We remain of the view that changes needed for offshore transmission can be incorporated within the existing charging methodologies and where possible, offshore requirements should align with current onshore requirements.

*Transmission access and compensation arrangements*

7.9. We note that all respondents were supportive of our proposals for NGET to extend and develop offshore access products that are consistent with onshore arrangements. There was also broad support for the proposal that compensation for access restrictions should be proportionate to the standard of connection and reflect the trade-off assessment associated with a less secure connection design between lower capital costs and greater risk of transmission connection fault.

7.10. We note that discussions on the range of access products available onshore is ongoing and note NGET's recent proposals build on the direction given within our July 2007 Ofgem/BERR joint policy statement that electricity transmission access offshore should be based on existing access products and should take account of the different levels of circuit redundancy likely to be installed offshore.

7.11. One respondent noted that further clarity is required on the treatment of reactive power and the connection conditions at the boundary between the OFTO and the offshore generator. We note that NGET is developing draft STC text to reflect the OFTO obligations in respect of reactive power that were recommended by the offshore Grid Code subgroup.

7.12. Another respondent was concerned that the extension of the onshore access arrangements will restrict the flexibility of users to build higher security connections as this option must be negotiated outside the standard contract form. We note that the current arrangements allow a user flexibility to request non-standard connections. We also note that to date this flexibility is more commonly used onshore to request a connection of a lower standard of security. We acknowledge the need to ensure that there is sufficient flexibility for a user to make specific requests in respect of the security of its connection to the transmission system.

7.13. One respondent suggested that offshore generators should receive compensation when loss of access is due to issues regarding the onshore network. We note that the curtailment of access rights for onshore users with connection that are compliant with the SQSS are handled either with administered payments for disconnection or balancing services for constraint. We note that this principle will be extended offshore. It is also important to note that the trade-off assessment of users when designing their connection was covered by the cost benefit analysis completed by industry expert group Offshore Transmission Experts Group (OTEG) and as such the generator should not receive compensation should the offshore circuit be made unavailable.

7.14. One respondent noted that, while it agreed with the approach to adapt the existing TEC product for offshore, the asset cost savings resulting from less secure connection designs must be reflected in charging arrangements. We note that NGET is committed to delivering an enduring solution by summer 2008 and, subject to the Authority's approval, expect that NGET will be in the position to implement the solution no later than 31 March 2009.

7.15. There was broad support for the principle of an OFTO performance incentive mechanism. However, there was broad consensus that the form and level of these performance targets along with the associated penalties needs further consideration. Two respondents suggested the use of a sliding scale whereby the generator is compensated up to a specified level of service followed by a reward to the OFTO beyond this performance. Another two respondents suggested that the current principles that underpin the administered payment mechanism set out in the CUSC[23] may be more appropriate but accepted that any incentive mechanism needs to be sufficiently strong to ensure that faults are rectified quickly and availability is maximised. We note that further detail on the performance obligations, incentives and penalties is set out in Chapter 2 of this document.

7.16. One respondent considered that there was a need to consider the treatment of losses on the offshore transmission network. This respondent stated that consideration should be given to recording the offshore generator's output at its connection to the transmission network. We note that the Balancing and Settlement Code (BSC) defines standard arrangements for metering for generator sites. We also note that alternative metering arrangements may be possible with the agreement of the BSC Panel.

[23] Mechanism was introduced by CUSC amendment proposal CAP048.

## Transmission charging

*Update*

7.17. NGET has been developing proposals for transmission charging arrangements for offshore transmission networks in line with its obligation to keep transmission charging methodologies under review.

7.18. NGET published a pre-consultation in July 2007 which was developed taking account of debate at various industry meetings (including the Transmission Charging Methodology Forum and Charging Issues Standing Group). This pre-consultation document set out three main issues that NGET considered would need to be addressed before the onshore charging arrangements could be applied offshore. The three main issues that NGET highlighted in the pre-consultation document were:

- offshore connection and use of system boundary;
- offshore expansion factors; and
- treatment of High Voltage Direct Current (HVDC) equipment.

7.19. NGET used the responses to this pre-consultation to develop proposals to modify the transmission network use of system charging methodology. Further information on NGET's work to develop use of system charging proposals for offshore transmission networks can be found on its website[24]. NGET proposes to present proposals to modify the transmission network use of system charging methodology to us in early spring 2008.

## Transmission access

*Introduction*

7.20. We asked NGET consider if current transmission access arrangements defined in the CUSC were appropriate to apply offshore. NGET has developed a number of proposals for transmission access products for offshore generators and for compensation arrangements that should apply in the case of an access restriction which were outlined at an industry workshop that NGET held on 3 December 2007.

7.21. NGET's proposals build on the direction given within our July 2007 policy statement that electricity transmission access offshore should be based on existing access products and should take account of the different levels of circuit redundancy likely to be installed offshore. NGET has also taken account of proposals that are being developed under the normal governance arrangements.

7.22. NGET considers that the treatment of onshore user connections that are not designed to have full redundancy for single circuit outage conditions is the most appropriate comparator for offshore transmission arrangements. NGET noted

[24] The use of system charging methodology amendment proposals area can be accessed through: http://www.nationalgrid.com/uk/Electricity/Charges/modifications/uscmc/

that the offshore security requirements for offshore transmission networks will not require full redundancy for single circuit outage conditions. NGET advised that currently it enters into a specific bilateral agreement with a user to define the treatment of access restrictions where the design of the connection varies from the standard generation connection criteria as defined in the GBSQSS.

7.23. NGET also noted that a CUSC amendment proposal has been raised (CAP149) that considers options for a transmission access product with restricted access rights. Further information on CAP149 can be found on NGET's website in the CUSC amendment proposals area[25].

7.24. We note that the principles of the CAP149 amendment proposal align with those that underpin the existing bilateral agreement arrangements and are that:

- a user can opt for a connection which does not meet the standard generation connection criteria defined in the GBSQSS as part of a connection or modification application;
- NGET can offer to enter into an agreement with the user provided that the requested connection meets the GBSQSS design variation criteria; and
- the agreement offered by NGET would set out the arrangements for the treatment of access restrictions arising from the user requested design variation.

7.25. NGET explained at its industry workshop that CAP149 is still at the proposal stage. However NGET considers that the underlying principles are an appropriate basis for offshore access arrangements. NGET proposed that access rights for offshore generators should reflect the level of redundancy of the offshore transmission system. NGET considers that comparison should be made with the onshore GBSQSS security requirements and that generators connected to offshore transmission systems with:

- a lower level of security should be offered a transmission access product with access restrictions; and
- an equivalent or higher level of security should be offered transmission access product without defined access restrictions.

7.26. NGET noted that the access restrictions could be applied via standard CUSC arrangements should CAP149 or one of its alternatives be approved or via bilateral agreements between NGET and a user if CAP149 is rejected.

7.27. NGET noted that the basis for the offshore security standard requires a lower level of redundancy than is required by the GBSQSS generation connection criteria that apply onshore. NGET expects that partial access restrictions will be more likely for offshore users than onshore. We also note that offshore, a partial access restriction may apply to a user's connection without the customer requesting it as a design variation.

[25] The CUSC Amendment proposals area can be accessed through http://www.nationalgrid.com/uk/Electricity/Codes/systemcode/amendments/currentamendmentproposals/

7.28. NGET also advised of a need to assess if current arrangements for sharing transmission capacity are appropriate for offshore. NGET considers that there is likely to be a need to develop more sophisticated arrangements for sharing transmission capacity between offshore users when the normal capacity of the offshore transmission network is restricted.

7.29. We note that current transmission access products define the arrangements that will apply if the user's access is restricted due to transmission network unavailability. There are two main types of compensation mechanism defined in the industry codes, each of which apply to different types of access restrictions. These are as follows:

- Administered payments if user access is restricted due to a notified or non-notified physical disconnection of the generator from the transmission system. Apart for the first 24 hours, these payments are a refund of a proportion of the TNUoS charges that the generator paid.

- Payments via the balancing mechanism or balancing services contracts when access is restricted due to actions that the system operator needs to take to ensure the safe and secure operation of the GB transmission system. These payments are based in the price defined by the generator as part of its bid-offer information or through negotiated prices under bilateral contracts.

7.30. NGET has considered the existing mechanisms and whether they are appropriate to apply offshore, in respect of an access restriction that has not been identified as part of an agreement with the user for a restricted transmission access product.

7.31. NGET considers that there is no reason why the compensation mechanism for access restrictions arising from physical disconnection of a generator (due to transmission network unavailability), should not apply where the offshore user has opted for a firm transmission access product.

7.32. NGET does not consider that a compensation mechanism based on balancing mechanism payments would be appropriate if the access restriction was caused by the equipment on the offshore transmission network. NGET stated the following reasons in support of its view:

- Offshore transmission networks are likely to be discrete, radial networks. NGET would have little or no scope to alleviate offshore constraints by network reconfiguration; and

- there would be little (if any) competition for provision of constraint services if access to the offshore transmission network was partially (or wholly) restricted.

7.33. NGET referred to the current proposal for transmission owners to be responsible for funding compensation payments arising from the temporary physical disconnection of a generator, that NGET is required to make to the user. We note that this proposal is still subject to consultation. NGET considers that this type of funding arrangement could form part of incentive arrangements for an OFTO.

7.34. NGET noted that further consideration is needed about the extent of TNUoS charge refund that should be payable in the event of an access restriction on the offshore transmission network which prevent the generator using the otherwise available onshore transmission system.

7.35. We agree that this needs to be considered further and assessed when proposals for transmission charging arrangements for offshore users have been further developed and within the context of any performance incentives. We also note the dependency on decisions taken in respect of the funding arrangements for the current onshore compensation arrangements that apply when access is restricted because of physical disconnection of the generator from the transmission network.

# 8. Connection via distribution networks

**Chapter Summary:**

This chapter updates stakeholders on the work we are taking forward with respect to embedded transmission, taking into account views of respondents to the joint policy statement.

**Questions**

There are no specific questions in relation to this chapter.

## Summary

8.1. We outlined in the July 2007 Ofgem/BERR joint policy statement an overview of our key policy proposals for connection of offshore transmission systems to onshore distribution networks.

8.2. Our key proposals were:

- the arrangements for embedded transmission connections should be consistent with the arrangements for distribution connected large power stations;
- there would be merit in developing a standard form of connection and use of system agreement for embedded transmission connections.

8.3. We note that respondents were generally supportive of our proposals to use existing arrangements for large embedded power station connections as the basis for the arrangements for embedded transmission connections. We note that most respondents agreed with our proposal to develop distribution licensee codes and agreements to define embedded transmission arrangements.

8.4. One respondent commented that current industry arrangements would need little change to implement arrangements for embedded transmission connections. One respondent agreed that the GBSO should be the single point of contact for offshore generators whose transmission connection is or will be provided via a distribution network.

8.5. We note the concerns of some respondents that offshore generators would receive a different service from an offshore transmission network that connects via a distribution network compared to one that connects directly to the onshore transmission system. One respondent stated that offshore generators whose offshore transmission connection is connected via a distribution network will be treated differently to those with a direct transmission connection. This respondent considered that offshore generators should be given the option to specify the type of connection required as part of its connection application to the GBSO. Another respondent did not consider that there should be differential treatment depending on connection type.

8.6. We note that there are differences between the design of transmission and distribution networks. We also note that distribution licensee processes allow for terms for large embedded power station to be specifically agreed with a generator. Therefore we consider that our proposal that the GBSO should specify requirements in the connection application it makes to a distribution licensee should ensure that differences in the service procured are minimised (unless requested by the offshore generator).

8.7. A number of respondents raised concerns about the impact of interactions between the industry codes. Some respondents also highlighted the need to ensure that arrangements defined in each industry code are properly co-ordinated.

8.8. We note that there are a large number of interactions between industry codes under the current framework. We consider that the split of obligations across industry codes can and has been adequately managed. We acknowledge that there have been issues with change co-ordination under the current arrangements. We have proposed to consider this in detail as part of our Industry Codes Governance Review[26].

8.9. One respondent did not consider that there was a need to extend the 3 month timescale for NGET to respond to a connection application from an offshore generator if an embedded transmission connection was being considered. Another respondent observed that the GBSO would not be able to meet its obligation to offer terms within 3 months unless there was a change to the distribution licensee obligation to offer terms within 3 months. Other respondents considered that reducing the 3 month timescale available for a distribution licensee to respond to a connection application would not be appropriate. One respondent was concerned that reducing the time available to a distribution licensee may prevent the most economic connection option being identified.

8.10. One respondent raised concerns about the impact on project viability of the new offshore transmission arrangements. This respondent was concerned about the erosion of embedded benefits. This respondent noted that there are a number of generators that connect to an onshore distribution network via offshore circuits that will in future be classed as offshore transmission.

8.11. Three respondents considered that the proposed charging arrangements were appropriate. Two respondents requested additional clarity about distribution charging arrangements.

*Update*

8.12. We have drafted terms of reference for a new working group (the Embedded Transmission Working Group) to assist us with our development of embedded transmission arrangements. We published these terms of reference[27]

[26] Ofgem Open Letter announcing review of industry code governance, 284/07 available at www.ofgem.gov.uk/Licensing/IndCodes/Governance/Documents1/Open%20letter%20announcing%20governance%20review.pdf

[27] Terms of reference for a working group to consider embedded transmission issues have been published and the group will meet in January 2008 to discuss how the current arrangements for large embedded power stations should apply to embedded transmission connections and whether any additional provisions are required. The Terms of Reference can be found at

which included a request for nominations for the Embedded Transmission Working Group. We are pleased to note the high level of interest in participating at this working group. The Embedded Transmission Working Group will meet in January 2008 to consider:

- how the current arrangements for large embedded power stations should apply to embedded transmission connections, and
- if additional provisions are required.

8.13. The Embedded Transmission Working Group is required to report to Ofgem by 5 February 2008.

www.ofgem.gov.uk/Networks/Trans/Offshore/GrpsWrkshops/Documents1/Embedded%20Transmission%20Working%20Group%20ToR%20-%20December%202007.pdf

# 9. Implementation issues

**Chapter Summary**

This chapter provides an outline of relevant pieces of legislation that need to be implemented for the offshore transmission regime to take effect.

**Questions**

**Question 9.1:** Do you agree with the proposed approach for developing changes to the licences and industry codes?

9.1. The offshore regime will be implemented largely through the commencement of a number of sections of the Energy Act 2004. We also expect that the forthcoming Energy Bill will provide further powers to facilitate the regime. In addition, there are a number of other operational areas where implementation arrangements are required.

9.2. The key high level milestones and currently anticipated dates are as follows:

| | |
|---|---|
| **January 2008** | Publication of this document and the Government response to the July 2007 Ofgem/BERR joint policy statement. BERR/Ofgem external communication session (25 January) . |
| **January 2008 to April 2008** | Consultations on draft licence conditions, codes and associated technical rules and agreements. |
| **April 2008** | Publication of final policy proposals. Consultation on draft tender regulations. |
| **June 2008** | Consultation on the full regime (subject to completion of consultations on draft licence conditions, codes and associated technical rules and agreements. |
| **July 2008** | Further consultation on draft tender regulations. |
| **September 2008** | Consultation closes |
| **December 2008**[28] | 'Go-active' (Secretary of State designation) – commencement of sections 90, 91 and 92 of the Energy Act 2004. |
| **December 2009** | 'Go-live' (subject to approval by Ministers and Authority) - commencement of sections 89 and 180 of the Energy Act 2004. |

9.3. It is important that the regulatory regime is implemented effectively through robust licence and code text. The timetable set out above will require significant engagement from industry stakeholders in the production of draft licence and code text within the proposed timescales. We would therefore welcome views regarding the proposed timetable and the resource burden on interested parties.

[28] The implementation date is dependent on the adoption of those powers which we expect to come into effect two months after Royal Assent of the Energy Bill

## Implementation of changes to licences and codes

9.4. The Government will implement those changes to the standard licence conditions and industry codes that it considers necessary to implement the offshore transmission regime by commencing section 90 of the Energy Act 2004. Before implementing those licence changes, we expect to follow adopt the following process:

- The creation of a licence drafting working group to engage in the development of licence text, publishing chapters of the licence for short consultation periods;
- the development of recommendations for code changes through industry working groups, followed by detailed drafting instructions that would be issued to the relevant code owners. This process will culminate in the production of draft code text;
- an ongoing process of pre-consultation on draft licence conditions and code changes; and
- a formal consultation of up to 90 days on final legal text for licence and code changes.

9.5. The Government may then commence section 90 of the Energy Act 2004 to make the appropriate modifications to the existing standard licence conditions of transmission and distribution companies and amend the industry codes.

## Extension of the GBSO role offshore

9.6. The Government will extend the role of the GBSO offshore by making appropriate modifications under section 91 of the Energy Act 2004. This will require some consultation on amendments to the GBSO licence before undertaking a formal consultation of up to 90 days.

## Implementation of the tender process

9.7. The Government will introduce the powers to the Authority to undertake tenders by commencing section 92 of the Energy Act 2004, as may be modified by the Energy Act 2008. This will allow the Authority to make tender regulations to implement the tender process for the award of offshore transmission licences. Before implementing the tender process, we expect to follow adopt the following process:

- An ongoing process of pre-consultation on draft tender regulations;
- the commencement of section 92 of the Energy Act 2004;
- Tender Regulations being submitted to the Secretary of State for approval; and
- implementation of the tender process once the regulations take effect.

## Other issues

9.8. In addition to modifications made by the Secretary of State under the Energy Act of 2004 some aspects of the regime may be implemented through other mechanisms, for example, some elements of the regulatory regime may be implemented through the insertion of special conditions into the licences of each OFTO. Ofgem intends to publish and consult upon model special conditions as a guide to the form that these might take. The implementation of relevant business systems for running the tender process will be undertaken by Ofgem and, where appropriate, NGET as GBSO.

# Appendices

## Index of appendices



[29] Offshore Electricity Transmission: Regulatory Policy Update (appendices), Ofgem Ref: 4a/08

# 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. (In particular, we would like to hear from parties interested in OFTO roles, as well as generator developers)

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 25 February 2008 and should be sent to:

Colin Green
Head of Offshore Transmission & Projects
Ofgem
9 Millbank, London
SW1P 3GE

Tel: 020 7901 7143
E-mail: OffshoreTransmission@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. Next steps: Having considered the responses to this consultation, Ofgem and BERR intends to develop final policy proposals for the regulation of offshore electricity transmission, which we expect to publish in April 2008. In addition, Ofgem and BERR expect to consult on the development of the offshore transmission licence and changes to industry codes over the coming months.

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

Colin Green
Head of Offshore Transmission & Projects
Ofgem
9 Millbank, London
SW1P 3GE

Tel: 020 7901 7143
E-mail: OffshoreTransmission@Ofgem.gov.uk

**CHAPTER: One**

There are no specific questions in relation to this chapter.

**CHAPTER: Two**

**Question 2.1:** Do you agree with our proposals for the design of the regulatory framework as outlined in this chapter? In particular, we would welcome your views on:

- our proposal that the period of the regulatory revenue stream should be 20 years;
- our proposed approach for dealing with the end of the regulated revenue stream;
- our proposed policies for dealing with potential adjustments to the revenue stream;
- our proposed policy on performance obligations, incentives and penalties;
- our proposals for reporting arrangements; and
- our proposed policy for addressing generator requirements. We would especially welcome any information from respondents that suggests there is justification for different arrangements to apply

**Question 2.2:** Do you feel that there is any aspect of the design of the regulatory regime that we have not considered sufficiently?

**CHAPTER: Three**

**Question 3.1:** Do you agree with our proposals for the design of the tender process as outlined in this chapter? In particular, we would welcome your views on:

- the point at which we propose the enduring tender exercise be triggered, including for those generators that already have a connection agreement in place;
- the roles and responsibilities of participants in the tender process;
- the financial commitments required from the preferred bidder; and
- whether the connection application and tender processes could be streamlined further

**Question 3.2:** Do you feel that there is any aspect of the tender process that we have not considered sufficiently?

**CHAPTER: Four**

**Question 4.1:** Do you agree with our proposals for dealing with generators that will be subject to the transitional arrangements as outlined in this chapter? In particular, we would welcome your views on:

- our policy proposals for the OFTO of last resort provisions;
- our proposals for providing ex ante comfort on funding of capital costs; and
- our proposals for applying our anticipated powers for the transfer of assets

**Question 4.2:** Do you feel that there is any aspect of the transitional arrangements that we have not considered sufficiently?

**CHAPTER: Five**

**Question 5.1:** Do you agree with our proposed approach for using the powers the Government is seeking through the Energy Bill?

**CHAPTER: Six**

There are no specific questions in relation to this chapter.

**CHAPTER: Seven**

There are no specific questions in relation to this chapter.

**CHAPTER: Eight**

There are no specific questions in relation to this chapter.

**CHAPTER: Nine**

**Question 9.1:** Do you agree with the proposed approach for developing changes to the licences and industry codes?

# Appendix 2 - The Authority's Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority ("the Authority"), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Act 2004, as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.[30]

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly[31].

1.4. The Authority's principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of consumers, present and future, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

1.5. The Authority must when carrying out those functions have regard to:

- The need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- the need to secure that all reasonable demands for electricity are met;
- the need to secure that licence holders are able to finance the activities which are the subject of obligations on them[32]; and
- the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.[33]

1.6. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

[30] entitled "Gas Supply" and "Electricity Supply" respectively.
[31] However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.
[32] under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.
[33] The Authority may have regard to other descriptions of consumers.

- promote efficiency and economy on the part of those licensed[34] under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity;
- contribute to the achievement of sustainable development; and
- secure a diverse and viable long-term energy supply.

1.7. In carrying out the functions referred to, the Authority must also have regard, to:

- the effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation[35] and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

[34] or persons authorised by exemptions to carry on any activity.
[35] Council Regulation (EC) 1/2003

# Appendix 3 - Glossary

**A**

Authority

Gas and Electricity Markets Authority

**B**

BaFO

Best and Final Offer

BERR

Department of Business Enterprise and Regulatory Reform

BSC

Balancing and Settlement Code

**C**

CDGSEE

Centre for Distributed Generation and Sustainable Electrical Energy

CISG

Charging Issues Standing Group

CUSC

Connection and Use of System Code

**D**

DC

Direct Current

DCUSA

Distribution Connection and Use of System Agreement

**E**

EOI

Expression of Interest

**G**

GBSO

Great Britain System Operator

GBSQSS

Great Britain Security and Quality of Supply Standard

GW

Gigawatt

**I**

ITT

Invitation to Tender

**K**

kV

Kilovolt

**M**

MW

Megawatt

**N**

NGET

National Grid Electricity Transmission plc

**O**

Ofgem

Office of Gas and Electricity Markets

OFTO

Offshore Transmission Owner

OTEG

Offshore Transmission Experts Group

**R**

RIGs

Regulatory Instructions and Guidance

**S**

STC

System Operator - Transmission Owner Code

**T**

TCMF

Transmission Charging Methodologies Forum

TEC

Transmission Entry Capacity

TnUoS

Transmission Network Use of System

# Appendix 4 - 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, or 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:

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