

Offshore Electricity Transmission: Updated Proposals for the Competitive Tender Process



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Target audience: All with an interest in renewable energy and offshore electricity transmission.

Overview:

We are working together with the Government to introduce a new regulatory regime for offshore electricity transmission. A key part of the proposals for this regime is that offshore electricity transmission licences would be granted on the basis of a competitive tender process. The Government has decided that Ofgem should manage this process.

This document updates our proposals for managing this competitive tender process. We are also consulting for the final time on the draft regulations that would provide the legal framework to enable this process.

This document contains a number of detailed appendices and annexes (published separately) that support the main consultation document.

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Context

Electricity generated from offshore renewable sources is expected to make an important contribution to the achievement of the UK's share of the EU's target of generating 20 per cent of energy from renewable sources by 2020. It is therefore necessary that fit for purpose offshore electricity transmission infrastructure is developed to transfer the electricity generated to the onshore network and ultimately to consumers. It is important that this infrastructure is developed in a timely and cost effective manner, whilst maintaining achieving best value for electricity consumers.

Ofgem has been working with the Government (the Department for Energy and Climate Change or DECC) to introduce and implement a new regulatory regime for offshore electricity transmission. A key part of the proposals is that offshore electricity transmission licences would be granted following a competitive tender process managed by Ofgem. This document updates our proposals for managing this competitive tender process. We are also consulting for the final time on the draft regulations (which would be made in accordance with section 6C of the Electricity Act 1989 when inserted) that would provide the legal framework to enable this process.

Specifically, this document consults on those issues where we are proposing to update our proposals for the design of the competitive tender process from those set out in our Competitive Tender Process consultation document published in October 2008. It sets out our updated approach to managing the tender process for those offshore transmission assets that have been or will be constructed by offshore developers, known as the transitional regime. We also confirm that the broad principles of this approach would be applied to tenders in the enduring regime, where the new transmission assets would be designed, financed and constructed by the offshore transmission owner. This document also sets out refined proposals on those issues we would expect to be resolved before a tender would commence.

We expect to commence the first round of tenders for the transitional regime this summer, shortly after the Go-Active date for the regime.

Associated Documents

- Offshore Electricity Transmission – A Joint Ofgem/DECC Regulatory Policy Update, November 2008, Ofgem ref: 153/08.
- Offshore Electricity Transmission - Competitive Tender Process, October 2008, Ofgem ref: 142/08
- Consultation letter for draft tender regulations, July 2008, Ofgem ref: 108/08
- Offshore Electricity Transmission - A Joint Ofgem/BERR Regulatory Policy Update, June 2008, Ofgem ref: 84/08

- Offshore Electricity Transmission - Regulatory Policy Update, January 2008, Ofgem ref: 4/08
- Regulation of Offshore Electricity Transmission: Government Response to Offshore electricity Transmission - A Joint Ofgem/BERR Policy Statement, January 2008, BERR ref: URN 08/546
- Offshore Electricity Transmission - A Joint Ofgem/BERR Policy Statement, July 2007, Ofgem ref: 189/07
- Offshore Electricity Transmission - Second Scoping Document, March 2007, Ofgem ref: 58/07
- Regulation of Offshore Electricity Transmission: Government Response to the Joint DTI/Ofgem Consultation on Licensing Offshore Electricity Transmission, March 2007, BERR ref: URN 07/634
- Licensing Offshore Electricity Transmission - A Joint Ofgem/DTI Consultation, November 2006, Ofgem ref: 199/06
- Offshore Electricity Transmission - Scoping Document, April 2006, Ofgem ref: 60/06
- Regulation of Offshore Electricity Transmission - A Joint Consultation by DTI/Ofgem, July 2005, Ofgem ref: 178/05

These documents are available to download at:

www.ofgem.gov.uk/Networks/offtrans/pdc/cdr/Pages/cdr.aspx

Table of Contents

Summary	1
Design of Competitive Tender Process	1
Enhancements to the Tender Process	2
First Round of Tenders for the Transitional Regime.....	3
1. Introduction	4
Introduction	4
Purpose of this document.....	4
Policy context	5
Development of the Offshore Electricity Transmission Regime	7
Design of the Competitive Tender Process.....	8
Objectives of the Competitive Process	8
Legal Framework	9
Other Relevant Legislation	10
Programme to Go-Active.....	10
Responding to this Document	11
2. Overview of the Regulatory Regime	12
Introduction	12
Overview of Regulatory Regime	12
The Revenue Stream.....	13
Revenue Entitlement	13
End of the Revenue Stream.....	13
Adjustments to the Revenue Stream	14
Performance Incentives	15
Standard Framework	16
Licences	16
Terms.....	16
Standard Conditions	17
Special Conditions.....	17
Industry Codes.....	17
System Operator-Transmission Owner Code (STC).....	18
Great Britain Security and Quality of Supply Standard (GBSQSS).....	18
Grid Code	18
Other Industry Documents	19
Risk	19
3. Update on Transitional Projects.....	20
Introduction	20
Developer Engagement.....	21
Update on Transitional Projects.....	22
First Transitional Tender Round	22
Second Transitional Tender Round	23
Next steps	24
4. Pre-Tender Requirements for Projects	25
Introduction	25
Pre-conditions	26
Previous Proposals	26
Pre-Conditions in the Transitional Regime.....	26

Updated Proposals	27
Qualifying Project Pre-Conditions	28
Tender Entry Pre-Conditions	29
Independent Engineering Audit Report.....	30
Financing Issues	30
Pre-Conditions in the Enduring Regime.....	31
Updated Proposals	32
Qualifying Project Pre-Conditions	32
Tender Entry Pre-Conditions	32
Terms of Transfer of the Assets	33
Previous Proposals	33
Updated Proposals	33
5. Tender Process for the Transitional Regime	35
Introduction	35
Previous Proposals	36
Updated Proposals	37
Pre-Qualification Stage.....	38
Two-stage Pre-Qualification	38
PQ Stage	38
QTT Stage.....	39
Consortium Changes	40
Selection Criteria and Process	41
PQ Stage	41
QTT Stage.....	42
Identifying Qualifying Bidders	43
Invitation to Tender Stage	44
Evaluation Criteria and Process	44
Information Available	44
Bidder Dialogue and Clarification	45
Bidder Dialogue	45
Bidder Clarification.....	46
Tender Documentation	47
Best and Final Offer Stage	47
Preferred Bidder and Licence Grant	48
Timing for Tenders in the Transitional Regime	48
Further Development of the Tender Process	48
6. Tender Process for the Enduring Regime	50
Introduction	50
Tender Process for the Enduring Regime.....	51
Key Features of the Tender Process for the Enduring Regime	51
Coordinated Network Development	53
The Crown Estate's Leasing Programme for Round 3	54
Role of NGET.....	55
Tender Windows.....	56
Remunerating Efficient Pre-Construction Costs	56
7. Other Tender Process Issues	58
Introduction	58
Disqualification of Bidders	58
Cancellation of Tenders	59
Advertising Tenders in OJEU	59
Standstill Period.....	59

Appeals	60
Recovering our Tender Costs	60
Energy Act 2008 powers	60
Cost Recovery Methodology	60
Costs and Indicative Charges	61
Bidder's Own Bid Costs.....	62
8. Tender Regulations.....	63
Introduction	63
Our Response to the July Consultation	64
Legal Framework for the Regulations	65
Key Amendments to the Draft Regulations.....	65
9. Next Steps	67
Implementing the Tender Process	67
Index of Appendices.....	68
Appendix 1 - Consultation Response and Questions	69
Appendix 2 – The Authority's Powers and Duties	72
Appendix 3 - Glossary.....	74
Appendix 4 - Feedback Questionnaire	78

Summary

Ofgem and DECC are working together to design and introduce a new regulatory regime for offshore electricity transmission to connect significant amounts of renewable offshore generation to the onshore electricity network. The regime will ensure connection to the onshore grid in a timely and cost effective manner, whilst maintaining the integrity of the system as a whole and achieving best value for electricity consumers. Currently, it is estimated that some £15 billion of offshore transmission investment will be needed to meet the Government's renewable energy targets.

The design of this regulatory regime has been consulted on since 2005. Over this time the Government has taken a number of decisions shaping its direction, including that offshore electricity transmission licences would be granted by way of a competitive tender process, and that the Authority would be the body that runs these tenders. A final joint DECC/Ofgem consultation on the regime is expected to be published shortly.

We consider that the regulatory regime we are putting in place provides a long term stable regulatory environment of relatively low risk, which we believe will make the new regime attractive to investors, including new entrants. This is particularly important in the current credit market conditions. Furthermore, this approach is likely to enhance the potential for offshore wind development by providing increased certainty to, and reducing the capital requirements of, offshore wind developers.

Design of Competitive Tender Process

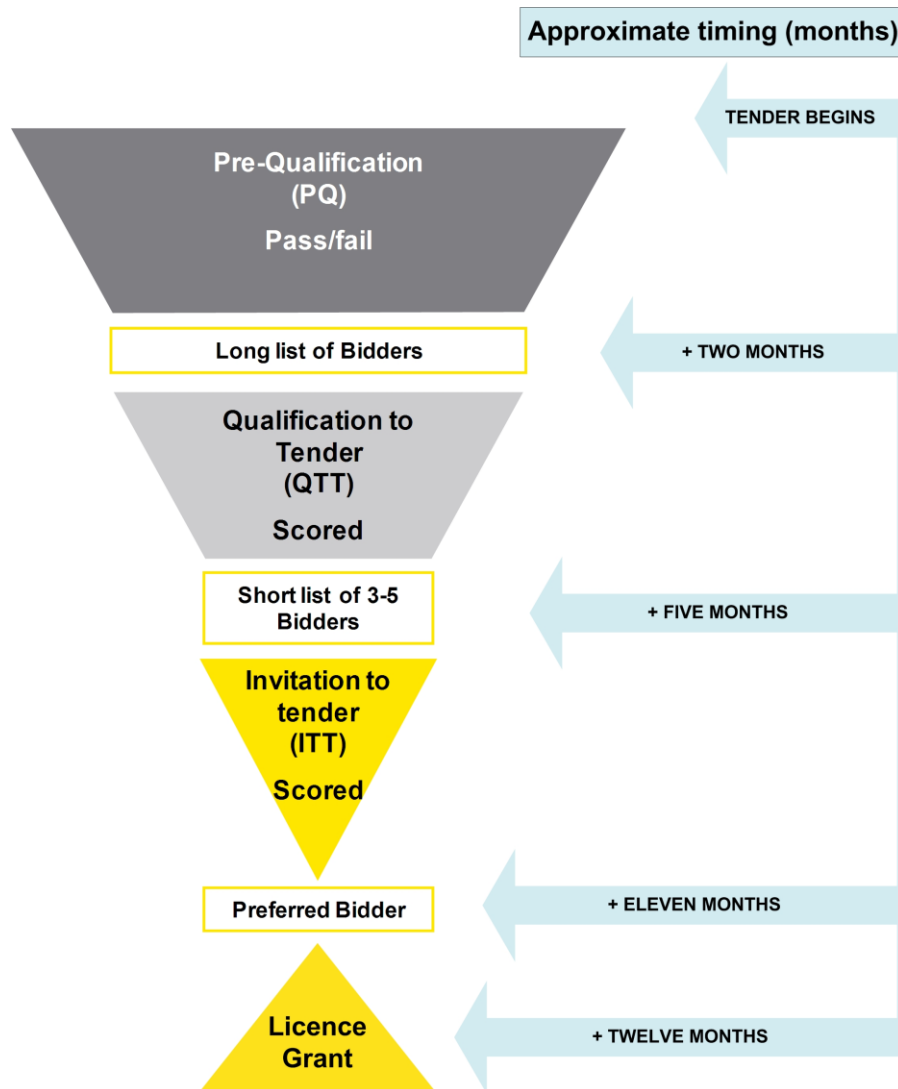
We have consulted over a period of around 18 months on the design of a competitive tender process for the identification of offshore transmission owners (OFTOs) for both for the transitional and enduring regimes. We last consulted on our approach in October 2008. We believe this competitive tender process should:

- Deliver fit for purpose transmission infrastructure to connect offshore generation,
- Provide certainty and best value to consumers through the competitive process, and
- Attract new entrants to the sector.

This document is our final consultation on the tender process and also the associated tender regulations that would provide the legal framework for the process. We intend to publish our final decisions before commencing tenders for the transitional regime this summer.

Enhancements to the Tender Process

We have updated our proposed tender process, introducing greater delineation and clarity in the tender stages, as illustrated in the following diagram (including approximate timing):



This consultation provides further detail on each stage of this process, setting out our proposals for project qualification, bidder assessment and scoring, tender regulations, and arrangements for recovering our administration costs. We have further developed detailed tender documentation that would support the tender process, and updated draft template documents are published alongside this document.

In summary, the key proposals we are consulting on are:

- The separation of the tender pre-conditions into those that identify a qualifying project and those that would need to be satisfied before entering a tender round, for both the transitional and enduring regimes,
- A requirement for developers of projects that would qualify for the transitional regime to populate and agree with Ofgem a model Sale and Purchase Agreement for the transfer of the transmission assets to the OFTO,
- Refinements to the design of the tender process to introduce more robust gateways into the selection process, and
- Updated selection criteria and process for each stage of the tender process.

First Round of Tenders for the Transitional Regime

The first round of tenders in the transitional regime is expected to commence shortly after the Go Active date for the regime, expected to be June 2009. As well as engaging with developers to assess which projects are eligible for this first tender round, we are also going through a process of establishing the estimate of the efficient and economic costs of the transmission assets for these projects. This value would represent the transfer value for the assets.

Based on the most recent information we have, we expect that 8 projects could qualify for the first tender round, with an approximate value of £500 million. High level details of these projects are set out in the table below.

Project information for potential first tender round

Project	Developer	Size (MW)	Expected Completion Date
Barrow	DONG Energy / Centrica	90	2006
Robin Rigg	E.ON	180	July 2009
Gunfleet Sands 1 and 2	DONG Energy	172	2009
Sheringham Shoal	SCIRA	315	June 2010
Ormonde	Eclipse Energy Ltd (Vattenfall)	150	November 2010
Greater Gabbard	Airtricity (SSE) / RWE	504	March 2011
Walney 1	DONG Energy	178	Awaiting date from developer
Thanet	Vattenfall	300	Awaiting date from developer

We welcome feedback from stakeholders on all issues raised in this document and the supporting appendices and annexes.

1. Introduction

Chapter Summary

This chapter provides the policy context for our updated proposals on the competitive tender process for identifying offshore electricity transmission owners (OFTOs). It sets out a brief overview of the history of the development of the regime, as well as our work to date on developing the tender process.

Questions

There are no questions in this chapter.

Introduction

1.1. The Government has decided that licences for offshore electricity transmission owner (OFTOs) shall be granted by means of a competitive tender process. The Government has also decided that Ofgem is the most appropriate organisation to manage this process. This document is the final consultation on the design of the competitive tender process ahead of the first round of tenders commencing, expected this summer.

1.2. This document confirms many of the principles of the competitive tender process that we set out in our Competitive Tender Process consultation document we published in October 2008 (the October 2008 document). This document also provides the opportunity to seek further stakeholder feedback on those issues where we are proposing to update our approach.

1.3. DECC and Ofgem will be publishing shortly be publishing a final consultation document on the regulatory regime for offshore electricity transmission shortly, covering the detailed regulatory design, together with proposed changes to the key regulatory documentation necessary to implement the regime.

Purpose of this document

1.4. This document:

- Provides an overview of the regulatory regime for offshore electricity transmission (Chapter 2),
- Provides an update on those projects that we expect to be subject to a tender in the transitional regime, based on information provided to us by project developers (Chapter 3),

- Updates our position on the key issues that need to be satisfied in advance of commencing a tender exercise (Chapter 4),
- Updates our approach for running competitive tenders for the grant of offshore electricity transmission licences in the transitional regime (Chapter 5),
- Updates our approach to running tenders in the enduring regime, and sets out our views on how the enduring tender process is compatible with a coordinated approach to future network development (Chapter 6),
- Consults on a number of other tender related issues, including our approach to recovering our costs incurred in running the competitive tender process (Chapter 7),
- Consults on the draft regulations that provide the legal framework for running the competitive tender process (Chapter 8), and
- Sets out our next steps in the run up to Go Active for the regime (Chapter 9).

Policy context

1.5. The Gas and Electricity Markets Authority (the Authority) is the regulator for gas and electricity markets in Great Britain and has a principal objective and a number of general duties set out in statute. Ofgem is the office that supports the Authority in performing its duties and functions. In this document, “the Authority” and “Ofgem” are used interchangeably. However, in all cases the Authority is the body that has the legal responsibility for exercising any relevant requirements set out in statute.

1.6. The Authority's principal objective is to protect the interests of gas and electricity consumers in Great Britain, wherever possible by promoting effective competition. Where effective competition is not possible, for example where natural monopoly network infrastructure providers exist, we protect consumers by setting incentive based price controls and revenue streams for those providers. The enactment of the Energy Act 2008 amends Ofgem's general duties by elevating the need to contribute to the achievement of sustainable development to a primary duty.

1.7. Ofgem has been working with Government¹ to design and introduce a new regulatory regime for offshore electricity transmission to connect significant amounts of renewable offshore generation to the onshore electricity network. The regime would help to facilitate connection of the offshore generation to the onshore grid in a timely and cost effective manner whilst maintaining the integrity of the system as a whole and achieving best value for electricity consumers.

¹ The Department of Energy and Climate Change (DECC) and its predecessors, the Department of Business and Regulatory Reform (BERR) and the Department for Trade and Industry (DTI).

1.8. We have regulated existing onshore monopoly networks principally through price controls. This has encouraged those network providers to reduce costs and increase efficiency over time, with the gains shared between the regulated companies and their customers. As networks evolve and the demands placed upon them change we have sought to adapt and vary our regulatory approach to meet the new challenges. Offshore electricity transmission is one such challenge which provides an opportunity for a more market-based approach, and this is one of main reasons for the Government's decision to adopt a competitive tender approach to identify licensees for offshore electricity transmission.

1.9. As a result of the Crown Estate's current competitive tender process to identify zonal development partners for Round 3 sites, and the leasing of new sites in Scottish Territorial waters, it is estimated that around 33GW of new generation could seek to develop in UK waters over the coming years. Whilst the Government has decided that the process of granting licences for offshore transmission is different to the onshore process, it has also decided that the principles behind the regulation of the GB onshore electricity transmission networks should be extended offshore, except where the specific circumstances of offshore generation mean that changes should be made. In practice this means that:

- Transmitting electricity offshore at 132kV and above will be a prohibited activity without a licence,
- The safe and secure transmission of electricity offshore will be achieved through amendments to the existing system of licences, codes and agreements that govern onshore electricity transmission,
- NGET, as GBSO will be responsible for operating and co-ordinating both onshore and offshore grid connections, and
- The costs of building and operating the new offshore transmission assets will be recovered from generators via NGET's charging methodology.

1.10. It is important that the regulation of offshore electricity transmission networks is considered within the context of the Government's overall energy and environmental policy. The Energy Review², Energy White Paper³, and the Renewable Energy Strategy⁴ set out the Government's energy strategy and how it links to its strategy for tackling climate change. In October 2008 the Government pledged to reduce carbon emissions in the UK by 80 per cent (the previous target being 60 per cent) compared to 1990 levels. Increasing renewable electricity generation will be an important element in achieving its aim.

² The Energy Challenge; Energy Review; A Report, July 2006

³ Meeting the Energy Challenge: A White Paper on Energy, May 2007

⁴ UK Renewable Energy Strategy Consultation, June 2008

Development of the Offshore Electricity Transmission Regime

1.11. In March 2007, the Government announced its decision on the approach for licensing offshore electricity transmission. It concluded that an approach whereby licences were granted on a non-exclusive basis with the right to build, own and operate offshore transmission assets was the most appropriate model. In reaching its decision the Government concluded that this approach would deliver better value and timelier grid connections, encourage innovation through competition, enable new entrants to compete in the market and be more focused on generator's requirements than the onshore system.

1.12. In July 2007, Ofgem and BERR published a joint policy statement⁵ that set out, among other things, that:

- An OFTO would receive a regulated revenue stream for meeting its licence obligations over a predetermined regulated period. The OFTO would be incentivised to meet specified performance requirements during this period, and
- There would be transitional arrangements for projects where the generator is already constructing or undertaking steps towards constructing the offshore transmission assets. The transitional arrangements would apply to projects that met certain pre-defined criteria. To assist the transition to the enduring arrangements there would be a two-stage process to enact the new regime. Those two stages would be:
 - a "Go Active" date for the new regime, at which point appropriate modifications to be made to licences and codes, and the first tenders would commence, and
 - a "Go Live" date, that would be 12 months later, from which point unlicensed participation in the transmission of electricity offshore at voltages of 132kV or above would be a prohibited activity
- The Government published a set of further decisions⁶ with regard to the design of the offshore electricity transmission regime in January 2008, in particular that:
 - The Authority would be the body that runs the competitive tender process to determine the appointment of new licensed OFTOs,
 - The Government would seek additional powers in the Energy Act 2008 to enable the Authority to recover its costs of running the tender process, and ensure sufficient commitment to the tender process, from parties

⁵ Offshore Electricity Transmission - A Joint Ofgem/BERR Policy Statement, 189/07, July 2007

⁶ Government Response to Offshore Electricity Transmission - A Joint Ofgem/BERR Policy Statement, URN 08/546, January 2008

participating in the tender (in most cases the generator and potential OFTOs), and

- The Government would also seek time-limited powers in the Energy Act 2008 to enable the Authority, once an OFTO licence has been granted, to make a property transfer scheme in order to ensure that property is transferred from the developer to the successful OFTO in a fair, timely and effective manner. The Authority would only have the power to do so in certain circumstances.

Design of the Competitive Tender Process

1.13. We have been developing the detailed design of how the tender process would work in practice. Particular effort has been focussed on ensuring that the design of the competitive framework is in line with our statutory objective and duties, focussing on delivering benefits for both consumers and offshore generators.

1.14. To help meet these requirements, we have consulted extensively with interested stakeholders both on the design of the competitive tender process, as well as the overarching regulatory framework. Since the Government published its decisions in January 2008, we have sought further views from stakeholders on the design of the process, with each publication setting out in further levels of detail how the process would operate in practice, taking into account the feedback provided.

1.15. In particular, our June 2008 and October 2008 documents consulted on increasing levels of detail about how the tender process would work in practical terms. We also published with the October 2008 document draft template Pre-Qualification and Invitation to Tender documents.

1.16. In designing the competitive tender process, we have sought to take into account best practice from other, similar, competitive processes. Over recent months, we have also sought advice on how this competitive tender process complies with more general EU procurement rules. Given the nature of the competition (i.e. Ofgem is seeking to grant a licence by a competitive process, but is not procuring anything directly), we consider that it would be good practice to abide by the requirements of the Part B Service provision within the Public Contracts Regulations 2006 when running competitive tenders. We have also designed the tender process to comply with the EC Treaty principles, particularly the principles of transparency and equal treatment of economic operators.

Objectives of the Competitive Process

1.17. We believe that vigorous competition should deliver the most appropriate outcomes for all stakeholders (including consumers), both in the transitional and enduring regimes. Based on this, we are structuring a competitive process that is designed to meet the following key objectives:

- Delivering fit for purpose transmission infrastructure to connect offshore generation,
- Providing certainty and best value to consumers through the competitive process, and
- Attracting new entrants to the sector.

Legal Framework

1.18. The offshore electricity transmission regime will largely be implemented through the commencement of a number of sections of the Energy Act 2004. In particular, section 92 of the Energy Act 2004 (which when commenced will insert section 6C into the Electricity Act 1989) enables the Authority to make regulations which are appropriate for facilitating the making of a determination on a competitive basis of the person to whom an offshore transmission licence is to be granted. These regulations would effectively provide the legal framework for running the competitive tender process.

1.19. The powers provided for under the Energy Act 2004 have been supplemented by additional powers granted in the Energy Act 2008. In particular, they introduce:

- a provision enabling the Authority in regulations under section 6C of the Electricity Act 1989 to create new mechanisms to recover its costs in carrying out and administering the tender exercises, and
- 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.

1.20. In addition to these provisions, the Energy Act 2004 also provides:

- for the Secretary of State to make appropriate modifications to the existing standard licence conditions of transmission and distribution companies and amend the industry codes for the purpose of facilitating offshore transmission. This will be implemented by the Government commencing section 90 of the Energy Act 2004,
- for the Government to extend the role of the GBSO offshore by making appropriate licence modifications under section 91 of the Energy Act 2004. Section 90 and section 91 will be commenced at Go-Active, and
- a mechanism to change the classification of 132kV offshore circuits from low voltage to high voltage by commencing section 180 of the Energy Act 2004 (and clause 44(3) of the Energy Act 2008). Section 180 will be commenced at Go-Live.

1.21. Offshore electricity transmission licences will be granted in accordance with section 6 of the Electricity Act 1989.

Other Relevant Legislation

1.22. The legal framework set out above confirms the powers under which the offshore electricity transmission regime has developed and under which decisions would be taken on the grant of OFTO licences. There are however additional pieces of legislation, both national and at a European level, with which OFTOs would be required to abide by in addition to those set out above.

1.23. One such piece of legislation is the Utilities Contracts Regulations 2006. Given that each onshore network licensee is required to enter into works and services contracts in accordance with the requirements of this piece of legislation, we have considered its application to offshore transmission licensees as well. Our analysis suggests that OFTOs would need to act in accordance with this piece of legislation. However, it would be for each OFTO to satisfy itself as to its application and its ongoing compliance.

Programme to Go-Active

1.24. We anticipate the following key high-level milestones and dates for implementing the tender process up to the Go Active date:

March 2009	Final joint statutory consultation on Offshore Transmission Regulatory Regime, including codes and licences.
June 2009	Tender Regulations expected to come into effect. Preliminary cost assessments ⁷ published. Go-Active for the offshore electricity transmission regime, and commencement of sections 90 and 91 of the Energy Act 2004.
Summer 2009	First round of tenders commence for the transitional regime.

⁷ We are currently engaging with developers of projects that expect to meet the pre-conditions for the transitional regime. As part of this process, we are gathering information to assess the economic and efficient costs of the transmission assets, which would establish their transfer value. We expect to publish our preliminary cost assessments in June for those projects that would have qualified for the first round of tenders.

Responding to this Document

1.25. We would welcome comments from respondents on all issues raised in this consultation, although particular issues in which we are seeking feedback are highlighted in the relevant sections.

1.26. Responses should be received no later than **16 April 2009** on the issues raised on the design of the competitive tender process. Detailed responses on the Tender Regulations should be received no later than **2 April 2009**. All responses should be sent to:

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2. Overview of the Regulatory Regime

Chapter Summary

This chapter provides an overview of the regulatory arrangements that would apply to the offshore transmission electricity transmission regime. It highlights our current thinking on the OFTO revenue stream (including predefined adjustments and incentives), and gives an overview of the key regulatory documents including the OFTO licence and industry codes.

These arrangements will be consulted on in detail through the final consultation document for the regime that we intend to publish jointly with DECC shortly.

Questions

There are no questions in this chapter.

Introduction

2.1. The key purpose of this document is to consult on our updated proposals for the competitive tender process for appointing OFTOs, principally in the transitional regime. However, we recognise the importance of setting the design of this process in the context of the regulatory framework against which OFTOs would be appointed. As such, this chapter provides an overview of our proposals for the regulatory regime. It also confirms the key documents that make up the regulatory framework.

2.2. We will be consulting, jointly with DECC, shortly on the detailed design of the regulatory regime. As such, this chapter is for information only and any new issues will be consulted on fully through that joint document.

Overview of Regulatory Regime

2.3. This section sets out an overview of the regulatory regime for offshore electricity transmission. In particular, it sets out our proposed approach for setting the revenue stream and the performance incentives that would apply to OFTOs. In summary:

- An OFTO would be responsible for the design, construction, financing and operational maintenance of the transmission assets needed to connect an offshore generator to the onshore network (known as the enduring regime),
- In order to ensure ongoing projects are not delayed, where generators have started construction of their transmission assets before Go-Live and met our pre-

conditions, an OFTO would be appointed to adopt these assets post construction (known as the transitional regime),

- Generator connection requirements would determine the scope and trigger the selection of an OFTO through a competitive tender process run by Ofgem, with the successful bidder granted an open ended electricity transmission licence,
- This licence would entitle the OFTO to a regulated revenue stream for a period of 20 years. It would also set out the obligations and entitlements of the OFTO,
- The OFTO's annual revenue received from the GB System Operator (GBSO) is based on asset availability not utilisation,
- OFTOs would have performance targets for availability and be liable for penalty payments through a reduction in their regulated revenue stream, and
- To prevent asset stranding, and subject to EU unbundling requirements, an existing Transmission Owner (TO) (be that an onshore or offshore TO) could be appointed as 'OFTO of Last Resort' to take over ownership of transitional assets in the highly unlikely event that the tender process could not identify a competitive and competent bidder. This would apply to the transitional regime only.

2.4. Whilst this will be subject to the final consultation, there are a number of key issues drawn out in the following section that we consider provide stakeholders an overview of the shape of the potential regulatory regime.

The Revenue Stream

Revenue Entitlement

2.5. An OFTO, selected by competitive tender, would receive an initial regulated revenue stream with a real flat profile for 20 years⁸. This revenue would be subject to the OFTO meeting its licence requirements, including performance obligations.

End of the Revenue Stream

2.6. At the end of the 20 year revenue stream, the OFTO assets would be fully depreciated and revenues to the OFTO would cease. The Authority would make its

⁸ In the event that a tender is not sufficiently competitive, a revenue stream would be granted that would be consistent with the 20 year period, but rather than providing a 20 year commitment we recommend that the Authority reserves the right to review the level of that revenue stream at predefined intervals over that period (i.e. adopt traditional price control review approach). If an OFTO was not willing to accept a modified revenue stream, we could refer the case to the Competition Commission.

decision on the ongoing regulation of the transmission assets before 20 years had lapsed, based on the ongoing demand for the asset.

Adjustments to the Revenue Stream

2.7. We do not consider that it is appropriate to provide for pre-defined mechanisms such as event specific re-openers, to adjust the regulated revenue stream (either up or down) for unexpected changes in costs during operation arising from exceptional events. We have taken the view that such risks may be insured or mitigated by licensees and we continue to believe that it is appropriate to address such events, if necessary, on a case by case basis, in a manner consistent with the licence issued and our statutory duties and functions⁹ at the time.

2.8. However, given that OFTOs may not be best placed to manage several known but unpredictable costs that could arise during the period of the revenue stream, we have reallocated these risks. In summary, the revenue stream would be subject to the following pre-defined adjustments for known but unpredictable costs:

- Indexation to inflation – We propose to allow full indexation of the revenue stream to RPI. However, stakeholders should note that the Authority would reserve the right to amend this position at the point of tender, should the market strongly favour an alternative solution which would result in better value for network users and consumers.
- Incremental Capacity Investments – We propose to allow for incremental capacity investments of a value of up to 20 per cent of the project's original capital cost¹⁰. We also note that in some instances it is possible to deliver additional capacity without investing in new assets. Instead, additional capacity may be delivered by changing the way in which the network is operated. Given the significant costs of installing offshore assets, we believe that there is merit in providing incentives to encourage the OFTOs to utilise existing assets before undertaking costly further investments.
- Claw back of refinancing gains – We are aware that OFTOs may realise significant post construction refinancing gains. However, we note that in an efficient market, bidders would be expected to reflect this potential refinancing in their bids. The Authority intends to consider the merits in introducing such a mechanism before the start of each tender exercise, taking account of current market feedback. Any refinancing mechanism (including the level of sharing) would be defined on an ex-ante basis to the specific tender exercise, and would not be applied retrospectively.

⁹ It should be noted however the Authority must, when carrying out its functions, have regard to the need to secure that licence holders are able to finance the activities which are the subject of obligations on them.

¹⁰ For transitional projects this would be the transfer value.

- Decommissioning Costs – The OFTO would be liable for its decommissioning obligations. We note that these obligations are set by Government and, as such, the OFTO would need to form a view on their likely costs of compliance. We consider that it is appropriate that bidders include the expected costs of their current decommissioning liabilities when bidding but that it is appropriate that OFTOs are able to recover their efficient cost of complying with any additional decommissioning obligations (set by Government).
- Codes changes – The Scottish onshore TOs both have a symmetrical adjustment mechanism in their price controls to allow a revenue adjustment where their costs materially change as a result of changes to the STC. We consider that it would be appropriate to provide a similar mechanism for OFTOs.
- Leasing, Licence Fee and Ofgem tender costs – We propose that these costs are pass-through items, as they are unpredictable for the OFTO. This is similar to the arrangements for onshore licensees.

Performance Incentives

2.9. Stakeholders' views have highlighted the divergence in commercial drivers that would exist between the OFTO and the generator without a well designed performance incentive. When considering what exposure should be placed on the OFTO in the event of poor performance, the incentive should recognise both the cost of a loss of connection for the generator but, also too, the relative size of the OFTO relative to the generator. As such, we consider that a 10 per cent annual cap on OFTO revenue exposure should be applied with respect to the OFTO performance incentive.

2.10. Furthermore, we recognise that offshore generators may place different values on availability dependent on their location, technical capabilities and energy contracting strategy. This is reflected in the mixed views of respondents in terms of the need for symmetry in the availability incentive.

2.11. Because of this, we propose that default targets are set for the incentive (as set out in the "straw man" published in November 2008 Policy Update), but also allow some degree of flexibility in the tender process for alternative parameters to be defined by the Authority. Such variation in targets would be informed by generator's preference as to these parameters. However, for transitional projects the Authority would also seek and consider the view of our technical advisors on what level of availability the asset is capable of achieving.

2.12. To ensure the effectiveness of the performance incentive towards the end of the revenue stream, we anticipate that the licensee would be required, through a provision in its Special Licence Conditions, to post a performance bond with a suitable third party. This financial commitment would be at risk in the event that OFTO failed to maintain adequate performance towards the end to the revenue stream period.

Standard Framework

2.13. The regulatory regime is provided for in a number of different standard documents, known as Standard Framework documents. These include the licences granted in accordance with the Electricity Act 1989 and industry codes which provide for governance on specific and technical issues.

2.14. We do not propose to set out in this document the detailed contractual and commercial relationships that form as a result of these documents. However, we do consider that it would be useful to provide an overview of the applicable documentation that, going forward, participants in the competitive tender process would need to familiarise themselves with. Bidders in particular would need to take account of these documents as part of their due diligence during the tender process. Appendix 5 provides an overview of the key contractual relationships between parties, and how these relate to these documents.

Licences

2.15. A licence granted by the Authority is formed of three elements, being:

- The terms (set by the Authority),
- The Standard Conditions (which may be common to all licensees, or certain classes of licensee), and
- Special conditions (which are conditions specific to each individual licensee).

2.16. Each of these elements is explained further below. Examples of standard and special conditions may be found on our Electronic Public Register which may be found on our website¹¹.

Terms

2.17. All licences are issued by the Authority with certain terms. The terms of the licence typically refer to, amongst other things, the geographical area in which the licence applies and its duration. The terms are set by the Authority upon grant of the licence and may not be subsequently altered except as provided for by specific primary legislation.

2.18. In the case of offshore electricity transmission, there is such a provision in primary legislation (Section 91 of the Act) which allows the Secretary of State to

¹¹ <http://epr.ofgem.gov.uk/>

modify NGET's licence for the purposes of extending its authorisation to cover SO activities offshore.

Standard Conditions

2.19. Standard conditions typically define obligations intended to apply to licensees of a particular type. There are five main categories of electricity licensee (Generation, Supply Transmission, Distribution and Interconnector). Within each category there can be more than one type of licensee and reflective of this, standard conditions are often grouped into discrete sections within the licence. Once the proposed offshore transmission regime is implemented, there would be three types of transmission licensee (GBSO, onshore transmission owner and OFTO) and the transmission licence would consist of five sections. The term of each specific transmission licence would define the relevant section(s) of standard conditions that apply to the licensee.

2.20. Except where there are specific legal provisions that provide otherwise (as in the case here of the modification of conditions for purposes connected with offshore transmission under Section 90 the Act), standard conditions may be modified if a certain proportion of relevant licence holders do not object. For transmission SLCs, in practice this means that the transmission licensees and the Authority have to be in favour of the modification before it can be made.

Special Conditions

2.21. A special condition is a condition that applies only to one individual licensee. Typically, such conditions cover matters that are specific to the licensee, such as a restriction on the geographic limit of its authorised area, the manner in which it is remunerated (typically price control conditions), and any specific performance obligations it may have, such as the quality of service it provides. Such conditions may be inserted, withdrawn or amended by bi-lateral agreement between the licensee and the Authority (when the licence is granted and at other time during the duration of that licence).

2.22. In respect of the offshore transmission regime, the key issues to be included in the special conditions would be the provision of the revenue recovery mechanism and the performance incentive framework.

Industry Codes

2.23. The licences define at high level the obligations with which the licensee must comply. These obligations and the processes intended to enable the licensee to comply with its licence obligations are defined in detail in documents referenced by the licence (industry codes and the security and quality of supply standard, GBSQSS). In respect of the development of the offshore transmission regime, these are collectively known as the "standard frameworks documents".

2.24. Changes to these standard framework documents are required to introduce the proposed offshore transmission regime. Ofgem and DECC have been consulting on these since June 2008 and the proposed changes when finalised will be implemented using the powers granted to the Secretary of State under section 90 and 91 of the Energy Act 2004. The final consultation on these change proposals is expected shortly.

2.25. There are provisions contained in the relevant licence conditions which oblige the licence holder to comply or enter into arrangements with these documents. We are proposing that an OFTO should be required by the standard conditions of its transmission licence to comply with the STC and to develop, operate and maintain its offshore transmission system in accordance with the GBSQSS. The STC would require each OFTO to comply with relevant parts of the Grid Code.

2.26. Whilst the consultation document will set out in detail the proposed changes, we believe it would assist stakeholders' understanding of the regime to set out in outline the scope of these documents – see below:

System Operator-Transmission Owner Code (STC)

2.27. This code defines the framework for contractual relationships between transmission owners and the GBSO. The STC defines rights and obligations of both transmission owner and GBSO in respect of the transmission services that are being provided to the GBSOP and of the use that the GBSO can make of transmission services provided by a transmission owner. We have proposed to extend the current STC framework and the majority of obligations, offshore.

Great Britain Security and Quality of Supply Standard (GBSQSS)

2.28. This technical standard defines the minimum security criteria which must be met when planning and operating a transmission system. The standard allows for higher levels of security to be provided if justified by specific cost benefit analysis. We have proposed to define offshore minimum security criteria as new sections to the GBSQSS.

Grid Code

2.29. The Grid Code is primarily a user facing document setting out technical requirements and information exchange obligations to facilitate the development and operation of the GB transmission system. The GBSO is required to have in force and comply with the Grid Code. The STC requires transmission owners to comply with the Grid Code in respect of:

- Standard transmission system operating range parameters, and
- Safety processes and procedures at interface points between the transmission owner's transmission system and user connections.

2.30. We have proposed to extend, as far as possible, the existing Grid Code requirements offshore.

Other Industry Documents

2.31. The BSC¹², CUSC¹³, DCUSA¹⁴ and Distribution Code are user facing documents. We are not proposing that OFTOs would have to comply with any of these documents. As onshore, we have proposed that the GBSO will back off any of its relevant obligations from these documents in the STC.

Risk

2.32. A key determinant of the proposed regulatory regime is how and which risks are allocated between the various stakeholders, i.e. the OFTO, the offshore generator and consumers/network users (via the GBSO). We published a high level overview of risk and responsibilities in our July 2007 document, and followed this up with a more detailed indicative risk allocation matrix for each stage of the tender process in the enduring regime in our January 2008 document. Respondents on both of these broadly agreed that these were useful in understanding further the regime.

2.33. In addition to these, we have provided an overview of the key contractual arrangements and payment flows between the main parties in Appendix 5. This is illustrative only and does not identify risks in the same way. However, whilst bidders would need to make their own risk assessments, we believe that OFTO risks are significantly mitigated due to:

- A clearly defined long term regulatory regime, with pre-defined revenue adjustment mechanisms,
- Energy risk, and generator stranding/failure risk remain with the generator and consumers respectively,
- The regulated GBSO mitigating credit risk, as counterparty to the OFTO revenue stream, and
- Construction risk is assumed by the developer for transitional projects.

¹² Balancing and Settlement Code

¹³ Connection and Use of System Code

¹⁴ Distribution Connection and Use of System Agreement

3. Update on Transitional Projects

Chapter Summary

This chapter provides an update on those projects we expect to be tendered under transitional regime. It builds on the information we published in our October 2008 document, and is based on information provided to us from offshore developers.

Questions

There are no questions in this chapter.

Introduction

3.1. As set out previously, the offshore electricity transmission regime is primarily geared towards granting transmission licences for new offshore electricity generation projects connecting at 132kV or above. These projects would require OFTOs to design, build, finance and maintain transmission assets under the enduring regime.

3.2. There are, however, a number of other offshore transmission projects that are either already built or are expected to be under construction by a developer before the regime reaches the Go Active or Go Live dates. These projects would fall within the remit of the offshore transmission regulatory regime as they are or will be connected at 132kV or above. Assuming that they our pre-conditions, they would fall under the transitional tender regime and are among the projects that were granted leases under The Crown Estate's leasing programme for Rounds 1 and 2. The transitional tender process would select an OFTO to adopt these assets post construction at a transfer value to be determined by us.

3.3. We expect to commence the first of two tender rounds for transitional projects as soon as practicable after the Go Active date, which is currently expected in June 2009.

3.4. For clarity we are not proposing for these transitional arrangements to apply to any Round 1 and 2 projects that do not meet our pre-conditions, or any of the projects in receipt of Crown Estate's Round 3 awards or the 10 exclusivity awards for potential windfarms in Scottish territorial waters announced in February 2009. It is expected that these projects and future projects would fall under the enduring regime.

3.5. In our October 2008 document, we set out those projects we considered would fall within the transitional regime, based on information received from offshore developers at that time. Since then, we have maintained ongoing engagement with developers of projects that we expect to be in the transitional regime. Furthermore, we have developed a cost assessment process that would be used to determine the

economic and efficient costs incurred by the developer in developing and constructing the transmission assets.

3.6. This chapter provides an update on our developer engagement to date and, subsequently, the projects we expect to be tendered as part of the transitional regime. This is based on further information provided by developers to demonstrate compliance with the transitional regime pre-conditions (our updated proposals with respect to the pre-conditions are set out in Chapter 4).

3.7. This chapter also provides an overview of the cost assessment process we are currently undertaking to determine estimates of the economic and efficient costs of the transmission assets, and sets out an overview of our work programme on this over the coming months.

Developer Engagement

3.8. As the Go Active date approaches, we have sought to increase our engagement with developers. Since the publication of our October 2008 document, meetings with offshore developers have focussed on technical issues associated with each project, and obtaining updates on timelines and project status. We are also in the process of determining those projects that would meet the transitional regime pre-conditions, based on information provided.

3.9. In conjunction with these bilateral developer meetings, we have also issued a Developer Information Request (DIR), the responses to which would facilitate our cost assessment exercise. The issue of the DIR is being followed up with further clarification meetings with project developers to ensure that our requirements are clear and to discuss any developer issues or questions in relation to the request.

3.10. The information requested covers a number of technical and financial issues, including:

- System design and equipment life,
- The extent of development and pre-construction works,
- Financial and accounting methodologies, and
- Connection and construction arrangements.

3.11. Over the coming months, we, along with our project advisers, will review documentation submitted by developers in respect of the DIR, to establish our estimate of the economic and efficient costs of each transitional project that is expected to be subject to the first round of transitional tenders. This information would be available to bidders to use in establishing their firm revenue bids at the ITT stage of the tender process. Once assets are constructed, we would undertake a

further cost assessment to establish the final economic and efficient cost that had been incurred by the developer.

3.12. Our engagement with developers to date has been generally productive and we welcome this approach. It should, however, be noted that without an appropriate level of developer engagement, it will be difficult to undertake the necessary cost assessment, marketing and tender processes. With this in mind, we are keen to work proactively with all relevant transitional developers to ensure the smooth and timely running of the tender process. In instances where information is not available, we would determine the economic and efficient value of the transmission assets based on the best information available.

Update on Transitional Projects

First Transitional Tender Round

3.13. On the basis of our recent discussions with, and information submitted by, offshore project developers we have taken a view as to which projects are likely to qualify for the first rounds of the transitional tender process. These projects are set out in table 3.1 below. Qualification is based upon the status of projects in relation to our proposed transitional project pre-conditions and tender entry criteria.

Table 3.1: Projects likely to qualify for first transitional tender round

Project	Developer	Size (MW)	Expected Completion Date ¹⁵
Barrow	DONG Energy / Centrica	90	2006
Robin Rigg	E.ON	180	July 2009
Gunfleet Sands 1 and 2	DONG Energy	172	2009
Sheringham Shoal	SCIRA	315	June 2010
Ormonde	Eclipse Energy Ltd (Vattenfall)	150	November 2010
Greater Gabbard	Airtricity (SSE) / RWE	504	March 2011
Walney 1	DONG Energy	178	Awaiting date from developer
Thanet	Vattenfall	300	Awaiting date from developer

¹⁵ This represents the expected date for practical completion of the transmission assets, and when they would be ready to be transferred to the OFTO.

3.14. We are proposing to separate the pre-conditions into those that identify a qualifying project (known as "qualifying project" pre-conditions) and those that would be needed before a tender is commenced (known as "tender entry" pre-conditions). The detail of our updated proposals on this are set out in Chapter 4. One of the key aspects of our updated proposals is that we are proposing to introduce some flexibility with respect to the qualifying project pre-conditions. However, we are not proposing to extend this to the tender entry pre-conditions. As such, where a project fails to demonstrate the tender entry pre-conditions in advance of the first tender round commencing, it would not be eligible for that round. However, provided that these were met before the commencement of the second round of transitional tenders, the project would be eligible for that round instead.

3.15. Where we believe there is strong evidence that tender entry pre-conditions would not be met, we propose to cease any work connected with the cost assessment for that project. This would also be the case where a developer fails to provide the necessary information to facilitate the cost assessment or evidence that the qualifying project pre-conditions have been met.

3.16. In situations where we cease a cost assessment exercise, we propose that the developer in question would forfeit its payments for the purposes of the assessment process. Furthermore, should a new cost assessment process be required for a future tender process, the assessment would start again, with the developer charged accordingly.

Second Transitional Tender Round

3.17. We have set out previously that there would be two rounds of tenders in the transitional regime, commencing shortly after Go Active and after Go Live. It should be noted that we are mindful of the possibility of unexpected circumstances which may lead to a delay on an individual project within a tender round. Further detail of how we propose to deal with such a circumstance is detailed in Chapter 4.

3.18. For tenders that are to commence shortly after Go Live, we have, based on information submitted by developers, come to a view as to those projects that could be included in this tender round. These are set out in table 3.2 below.

Table 3.2: Projects likely to qualify for second transitional tender round

Project	Developer	Size (MW)
London Array	E.ON and DONG Energy	1000
Lincs	Centrica	250
Docking Shoal	Centrica	500
Race Bank	Centrica	500
Gwynt-Y-Mor	RWE	750
Walney 2	DONG Energy	183

3.19. It should be noted that the information provided in tables 3.1 and 3.2 above is based on information provided to us by project developers. Any changes to this may mean we may need to revise these tables at a later date.

Next steps

3.20. We are actively engaging with developers across all of the above projects to provide ample opportunity for information to be shared and status updated in the lead up to both tender rounds. We will undertake ongoing review of project developments and will form of final view on project status for the purpose of entry into each of the tender rounds closer to Go Active and Go-Live. Our continued engagement with developers will also include discussion and clarification of information provided to us to enable the cost assessment process.

3.21. Going forward, we expect the Authority would take a view on those projects that would qualify for the first round of tenders in the transitional regime, based on information provided by developers, in May 2009. We also expect the Authority to take a preliminary view on the estimate of efficient and economic costs at the same time. We would expect that the Authority would confirm its view on these in July 2009.

4. Pre-Tender Requirements for Projects

Chapter Summary

This chapter sets out our updated proposals on those issues that would need to be undertaken or satisfied ahead of a tender process commencing. This includes the pre-conditions that offshore developers would need to satisfy before they could enter into the tender process (for both the transitional and enduring regimes) and the terms of transfer for the transmission assets (transitional regime only).

Key Questions

We welcome feedback from stakeholders on all of the issues raised in this chapter. In particular, responses are requested on:

- Our proposal to separate the pre-conditions in the transitional regime.
- The scope and level of detail an engineering audit report should contain.
- The scope for an additional pre-condition requiring developers to confirm their expectation that their projects should be completed within a reasonably short period after licence grant.
- Our proposal to separate the pre-conditions in the enduring regime.
- The proposal to develop a model Sale and Purchase Agreement for developers to populate and agree with Ofgem prior to a tender commencing.

Introduction

4.1. It would be important that certain positions are established or issues resolved to our satisfaction before we commence a tender process for a particular project. Taking into account responses received to the October 2008 document, we have considered carefully those issues that need to be resolved in advance of a tender from a practical perspective, and it is on this basis that we now believe that it is necessary to adjust our approach in two key areas:

- the pre-conditions that developers would need to satisfy, where we are now proposing it is more appropriate to firstly identify "qualifying projects" (in both the transitional and enduring regimes), and then separately identify when projects enter a tender process , and
- the terms of transfer for the transmission assets, where we are now proposing to adopt an approach of developing a model sale and purchase agreement (SPA) for each developer to populate and then agree with us in advance of entering into a tender process.

4.2. Our updated proposals on these issues are set out below. These positions are reflected in the draft regulations in Annex 4.

Pre-conditions

Previous Proposals

4.3. We set out in our July 2007 document¹⁶ that an OFTO would be responsible for designing, building, financing and maintaining the offshore transmission network. We also set out that there would be transitional arrangements for projects where the generator is already constructing or undertaking steps towards constructing the offshore transmission assets. The transitional arrangements would apply to projects that met certain pre-conditions by either the Go Active or Go Live dates. We also confirmed in the July 2007 document that we would run two rounds of tenders in the transitional regime, commencing after the Go Active and Go Live dates.

4.4. Before commencing a tender exercise in either the transitional or enduring regimes, we have also confirmed that offshore developers would be required to meet certain pre-conditions. In light of responses received to previous consultations, we have refined our approach in this regard, and our updated proposals are set out below.

Pre-Conditions in the Transitional Regime

4.5. We have set out in previous consultation documents that we consider it necessary for a developer of a transitional project to demonstrate that it had met certain requirements before the Go Active or Go Live dates to be eligible to tender under the transitional regime. The principles of these pre-conditions have remained the same since we initially consulted on them in the July 2007 document, and they have been broadly accepted by stakeholders. The pre-conditions we have consulted on previously for the transitional regime were that a developer had:

- Secured a connection agreement with NGET or a connection offer with a Distribution Network Operator (DNO) for a connection at 132kV or above,
- Obtained all necessary property rights (e.g. consents and leases) and all environmental and planning consents for the offshore transmission assets that are to be constructed and maintained,
- Completed construction of, or entered into, all necessary construction contracts for the construction of the offshore transmission assets,

¹⁶ Offshore Electricity Transmission - A Joint Ofgem/BERR Policy Statement, 189/07, July 2007

- Secured financing to the satisfaction of the Authority to construct the transmission assets¹⁷,
- Provided its financial model for the offshore transmission infrastructure 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 to the satisfaction of the Authority 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 payment to cover the costs of initiating the tender process, and
- Where the transitional project has been constructed ahead of Go Active, provided an independent engineering audit report on functioning and performance to Ofgem.

4.6. We also set out that where a developer does not meet these pre-conditions in advance of Go-Active, it would have two options. It could either wait until Go-Live and be considered under the second round of the transitional regime, provided that it had met the pre-conditions in advance of that date, or it could seek an OFTO under the enduring regime once the Go-Active date has passed.

Updated Proposals

4.7. On the basis of recent discussions with developers and responses to our October 2008 document, a more detailed consideration of the pre-conditions in terms of their practical application has led us to believe it would be appropriate to separate the pre-conditions into:

- Those that identify a "qualifying project" for the transitional regime, and
- Those that pre-conditions that would need to be satisfied before a project enters a tender process (i.e. "tender entry" pre-conditions).

¹⁷ We have confirmed in previous consultation documents that demonstration of this pre-condition would not necessarily need to be financial close, given that in some instances projects would be financed on balance sheet. In such cases, we would be willing to accept other forms of commitment from the developer that sufficient funds would be released (e.g. unconditional parent company guarantee that sufficient funds are provided for). We also set out that we would consider this on a case-by-case basis as appropriate.

4.8. We believe that this offers a key benefit to project developers to be able to demonstrate to Ofgem that they meet the necessary pre-conditions to be considered a transitional project, but separately come forward with the appropriate information to enter into a tender process. This maintains the proposal to identify the total envelope of projects that would be tendered under the transitional regime in advance of Go Live, but would allow, for example, a developer to decide which round of transitional tenders it would want to enter.

4.9. Those projects that do not meet the transitional qualifying project pre-conditions would be tendered in the enduring regime, subject to them meeting the relevant enduring project pre-conditions (see below for further detail). We are not proposing to run tenders for any Round 1 and 2 projects that do not meet our transitional pre-conditions, or for projects that obtain Crown Estate leases under the Round 3 leasing programme or the exclusivity awards announced in February 2009 for potential windfarms in Scottish territorial waters. We expect that only those projects that have, or will, be granted leases under The Crown Estate's Round 1 and 2 leasing programmes would be eligible for the transitional regime, subject to them satisfying the necessary pre-conditions.

4.10. We have set out below how we propose to separate the project pre-conditions and tender entry criteria for the purposes of the transitional tender regime.

Qualifying Project Pre-Conditions

4.11. We have considered carefully those pre-conditions that developers would need to demonstrate for it to be considered as a transitional project (or a qualifying project). We propose that a developer, in respect of its project, must demonstrate it has:

- Secured a connection agreement with NGET or a connection offer with a DNO for a connection at 132kV or above,
- Obtained all necessary property rights (e.g. consents and leases) and all environmental and planning consents for the offshore transmission assets that are to be constructed and maintained,
- Completed construction of, or entered into, all necessary construction contracts for the construction of the offshore transmission assets,
- Secured financing to the satisfaction of the Authority to construct the transmission assets, and
- Provided its financial model for the offshore transmission infrastructure 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;

4.12. A small number of respondents to the October 2008 consultation suggested that Ofgem should adopt a more pragmatic approach towards compliance with the

pre-conditions. On balance, we agree with this as we recognise that adopting a rigid approach to assessing these may actually be detrimental to the timing of a project, particularly where it narrowly fails to meet a single requirement.

4.13. For these reasons, we are proposing to introduce some flexibility to allow project developers that can provide evidence that they have used their reasonable endeavours to meet the qualifying project pre-conditions in advance of the Go-Active or Go-Live dates to be able to qualify for the transitional regime. However, we would only expect to use this flexibility in limited circumstances. For example, we would not expect to exercise any flexibility around the requirement for an offshore developer to have obtained its Section 36¹⁸ consent, its Crown Estate lease or its FEPA¹⁹ licence, when being assessed against the relevant pre-condition.

4.14. As set out in Chapter 3, we are currently engaging with project developers to understand their position with respect to these pre-conditions in advance of the first round of tenders in the transitional regime. We will continue this engagement over the coming months with a view to announcing those projects that have met the qualifying project pre-conditions in advance of the Go Active date.

4.15. We would expect to go through the same exercise a number of months in advance of the Go Live date in order to determine those projects that would qualify for the second transitional tender round, making a similar announcement in advance of the Go Live date.

Tender Entry Pre-Conditions

4.16. In order to run an effective tender process, we continue to believe that it is important for a developer to meet a number of entry criteria in advance of a tender exercise commencing. Such criteria are important to provide all parties with the necessary confidence in both the integrity of the process and commitment of the developer. Based on the proposed separation of pre-conditions, we are proposing a developer would need to satisfy the following tender entry pre-conditions before its project would be eligible for a particular tender round:

- Provided information to our satisfaction to enable us to establish a data room for bidders to be able to bid effectively, and to provide a written warranty that the information provided is, to the best of its knowledge, accurate and complete in all material respects,
- Provided a written undertaking to transfer the offshore transmission assets to the successful bidder under terms agreed during the tender process,

¹⁸ Consent required under Section 36 of the Electricity Act 1989

¹⁹ Consent required under the Food and Environmental Protection Act 1985, awarded by the Secretary of State for Environment, Food and Rural Affairs

- Provided the appropriate payment to Ofgem to cover the costs of initiating the tender process, and
- Where the transitional project has been constructed ahead of Go Active, provided an independent engineering audit report on functioning and performance to Ofgem.

4.17. Since publication of the October 2008 document, we have refined the tender entry pre-conditions to reflect the overall development of the regime as we move closer to the Go Active date. In particular, we have refined the data room pre-condition to reflect that it would be Ofgem that owns and operates the data room facility for each competitive tender process. Chapter 5 sets out further detail on the information we expect to be provided into the data room.

4.18. Whilst we are proposing to retain some flexibility with respect to the qualifying project pre-conditions in the transitional regime, we are not proposing to extend this to the tender entry pre-conditions. We continue to consider that these are essential requirements would need to be demonstrated in full ahead of us commencing a tender.

4.19. We would welcome views on our proposal to separate the pre-conditions in the transitional regime.

Independent Engineering Audit Report

4.20. In situations whereby a transitional project has been constructed in advance of Go Active or Go Live, we have set out previously that the developer would be required to provide an engineering audit report to Ofgem. This is encapsulated in the tender entry pre-conditions. A number of project developers have queried this requirement, such as the form the report should take and what, specifically, it should contain.

4.21. We do not intend to be prescriptive on the form of the report, as this is outside of the area of our expertise. However, we do recognise that it would helpful if we provided guidance to developers who were required to submit such a report. Given that the report would provide a level of comfort to bidders within a tender process on the performance of the assets, we consider it important to seek views on the scope and detail that should be contained in the report. **As such, we would welcome views on the scope and level of detail an engineering audit report should contain.**

Financing Issues

4.22. We recognise that in the current economic climate, raising capital will pose significant challenges to investors. Nevertheless, as a regulated asset class, offshore transmission involves a long-term low risk profile that we consider would be attractive to a significant number of investors, including new entrants.

4.23. We also recognise that the potential for delays to arise between the grant of the OFTO licence for a transitional project and completion of the asset construction. Where a delay occurs that is greater than 12 months, we recognise that this may make a project comparatively less attractive for investment in current market conditions. The main reason for this being that the regulated revenue stream would be delayed until the assets were transferred to the OFTO whereas other projects in the same tender round that had not experienced the same delay would receive their regulated revenue stream earlier. We are also concerned that commencing a tender exercise significantly in advance of the completion of construction may also mean that the successful bidder could face (i) delayed recovery of bidding costs, and (ii) higher commitment fees for holding finance for extended periods, which would likely be passed on to the developer through the required revenue stream.

4.24. In the light of these concerns, we have considered in detail whether it may be appropriate to modify the tender entry pre-conditions. For example, we could seek to introduce a new pre-condition that requires developers to confirm that they expect that construction of the transmission assets would be complete within a reasonably short period after we have granted a licence, for example within 12 months. We consider that the key benefit of this would be the avoidance of additional financing costs that would occur if there were delays as described. We would propose to deal with any projects that are in this situation on a case by case basis.

4.25. We would welcome views on how, if at all, this could be dealt with in the transitional regime. We would particularly welcome feedback from developers on this issue.

Pre-Conditions in the Enduring Regime

4.26. We have set out in previous consultation documents that we consider it necessary for a developer of an enduring project to demonstrate that it has met a number of pre-conditions in advance of its project entering a tender process. In particular, we have consulted on requiring a developer to satisfy the following before we commenced a tender exercise:

- Entered into a CUSC bilateral connection agreement with NGET; and
- Entered into lease arrangements with The Crown Estate.

4.27. A number of respondents to previous consultations requested further clarity on what "lease arrangements" meant and we set out that we would consider this further. On balance, we consider that it would be sufficient for a developer to have demonstrated it has obtained an agreement for a lease from The Crown Estate in order for us, and bidders, to have the necessary confidence that the project was sufficiently committed.

Updated Proposals

4.28. As with the pre-conditions for the transitional regime, we have considered their practical application, particularly in terms of how and when they need to be met in advance of commencing a tender exercise. We now consider that it would be appropriate to introduce a new pre-condition for developers to provide any available and relevant project information that it has undertaken (such as seabed surveys it has undertaken and any other pre-construction development work) into a data room, in advance of a tender exercise commencing. Whilst we recognise that the volume of this information would be significantly less than for projects in the transitional regime, it would be similarly important that this information is available in a secure environment to enable bidders to undertake their due diligence when tendering.

4.29. We also consider that, for the same reasons set out above for the transitional regime, it would be appropriate to have separate qualifying project pre-conditions to determine a qualifying project for the enduring regime and separate tender entry pre-conditions that determine the round in which a project would be tendered. We believe that this would be beneficial to project developers as they would be able to confirm their project status with respect to the enduring regime separately from satisfying the requirements to enter into a tender round.

4.30. On the basis of these refined proposals, we believe it is possible to identify separate qualifying project and tender entry pre-conditions for the enduring regime.

Qualifying Project Pre-Conditions

4.31. We are proposing that a developer would be required to demonstrate the following for it to be considered an enduring project:

- Entered into a CUSC bilateral connection agreement with NGET; and
- Obtained an Agreement for Lease from The Crown Estate.

Tender Entry Pre-Conditions

4.32. We are proposing that the only pre-condition that a developer would be required to meet in advance of us commencing a tender exercise, once it has achieved "qualifying project" status would be for it to provide information to our satisfaction to enable us to establish a data room for bidders to be able to bid effectively, and to provide a written warranty that the information in the data room is to the best of knowledge accurate and complete in all material respects.

4.33. We would welcome views on this refined approach.

Terms of Transfer of the Assets

Previous Proposals

4.34. We set out in the October 2008 document that in order to facilitate the tender process in the transitional regime, we would require each developer to provide its complete terms of transfer for the transmission assets and present these in the data room. This document would be the detailed Sale and Purchase Agreement (SPA) for the transfer of the transmission assets from the developer to the successful OFTO, containing all transfer terms, for example with respect to warranties and performance requirements. We also set out that as part of each bidder's commercial proposal during the ITT stage, they would be required to accept these terms without amendment.

4.35. A number of respondents to the consultation document raised concerns with this proposed approach. For example, one respondent suggested that on occasions the developer may wish to negotiate these terms. Another respondent sought further information whether there were any limits on what the developer is able to specify in these terms.

Updated Proposals

4.36. Since publication of the October 2008 document, we have considered this issue further in light of comments received and additional analysis. On balance, we now believe there is benefit in adopting an approach whereby we issue developers a model SPA, which they would be required to populate, both in respect of certain general provisions, but also detailed project specific schedules in readiness for the commencement of the tender process. We consider that this would help ensure that each project within the tender process has certain common documentation in order to help ensure that parties reach timely commercial agreement. To help initiate this process, we have included our initial view of the key provisions of the SPA in Appendix 6.

4.37. We recognise that this approach raises a number of detailed issues and that a process of firstly developing a model SPA and then secondly agreeing it with many developers is challenging. To this end, we propose to engage with developers on the model SPA and offer a series of workshops for those developers whose projects would likely fall into the transitional regime to obtain feedback and progress the development of such a document. We will issue further information on this in due course.

4.38. We expect that it would be in the relevant parties' interest to reach a commercial agreement as to the terms of transfer and use the model SPA as a basis for negotiation. However, in cases where an agreement is not possible, Schedule 2A of the Act enables the Authority, in certain circumstances, to make a scheme transferring property, rights and liabilities from an asset owner or a developer to the successful bidder. This would ensure that property, rights and liabilities are

transferred in a fair, timely and efficient manner and avoid an asset owner or developer being stranded or the tender being frustrated by stalled negotiations.

4.39. We set out our updated proposals on bidder requirements with respect to the SPA in Chapter 5.

4.40. We would welcome views from respondents on this revised approach.

4.40. In discussions subsequent to the October 2008 document, the question has been raised with us as to the scope for developers to offer O&M services to the potential OFTOs for that project as part of the tender process. We are currently considering this issue, particularly on the basis of any developer backed O&M offer being made available to all bidders in ITT stage for the specific project, with bidders free to choose as to adoption or not of the developer O&M offer and assuming a non-exclusive arrangement. **We would welcome feedback and views from respondents on this issue, particularly in relation to terms and conditions to be applied to any such offer.**

5. Tender Process for the Transitional Regime

Chapter Summary

This chapter provides a detailed explanation of the tender process Ofgem intends to adopt to select OFTOs for the transitional regime. It builds on what we have published previously, taking into account stakeholders' feedback, as well as further analysis.

Key Questions

We welcome feedback from stakeholders on all of the issues raised in this chapter. In particular, responses are requested on:

- Our updated proposals on the pre-qualification stage of the tender process.
- Our proposals for the financial and non-financial criteria we are proposing for the PQ, QTT and ITT stages of the competition (as set out in this chapter and Appendix 7).
- Our proposals on dealing with changes to consortiums within a tender process.
- Our updated proposals for dealing with bidder dialogue and clarifications within a tender process.
- Our updated tender documentation contained in Annexes 1-3.
- Our initial thoughts on further developments for the tender process going forward.

Introduction

5.1. We have consulted over a period of around 18 months on the design of a competitive tender process for the identification of OFTOs for both for the transitional and enduring regimes. We believe this competitive tender process should:

- Deliver fit for purpose transmission infrastructure to connect offshore generation,
- Provide certainty and best value to consumers through the competitive process, and
- Attract new entrants to the sector.

5.2. Our consultation process to date has included public consultation documents, debate in open forums and bilateral meetings with interested stakeholders. Through this process, we have reached firm positions on the overall design of the tender process, and these were set out in our October 2008 document.

5.3. Broadly, we are proposing to maintain these positions. However, there are a small number of issues where we have refined our thinking based on the formal responses received to that document, as well as other engagement with stakeholders since and further analysis including with our project advisers. These are with respect to:

- The structure of the pre-qualification stage of the tender process,
- The process for selecting bidders and evaluating tenders, and
- The transfer of assets from an offshore developer to an OFTO (transitional regime only)

5.4. This chapter re-affirms our key principles for running the competitive tender process in the transitional regime, and seeks views on our updated proposals.

5.5. Stakeholders should refer to our October 2008 document for further detail of the competitive tender process. For completeness, we have set out an overview below of those stages of the process where we are not proposing any changes.

Previous Proposals

5.6. The key features of the competitive tender process that we have previously consulted on are:

- Each tender would follow a number of distinct stages:
 - A pre-qualification stage, which would enable Ofgem to select those parties that it would invite to bid for each project in the tender round based on evidence presented,
 - An invitation to tender (ITT) stage, during which bidders would have the opportunity to put forward their detailed proposals for providing transmission services, including their firm bid revenue stream for the 20-year regulatory period,
 - An optional best and final offer (BAFO) stage, where a small number of bidders would have the opportunity to put forward an improved final bid,
 - The identification of the preferred bidder and reserve bidder (if appropriate), and
 - The licence grant stage, where the Authority would grant the offshore electricity transmission licence to the preferred bidder, subject to it satisfactorily completing any outstanding issues required by the Authority.
- Ofgem would advertise projects in advance, in relevant national and international publications,

- Competitive tenders would commence from a common starting point (or window), determined by the offshore developer demonstrating it had met the necessary transitional pre-conditions. In the transitional regime, this common starting point would be the Go Active and Go Live dates,
- The process would be sufficiently flexible to allow bidders to bid for more than one OFTO licence,
- There would be increasing amounts of information available about the projects at each stage of the tender process,
- Ofgem would publish standardised tender documentation to support the tender process, and
- Participants in the tender process would be required to fund Ofgem's costs incurred in running the competitive tender process.

5.7. Since the October 2008 document, engagement with interested stakeholders on the design of the tender process has, generally, been positive. However, we also recognise that some stakeholders still have reservations about the overall approach proposed for offshore electricity transmission. Other stakeholders have raised detailed clarifications with us on certain aspects of how we would run the tender process.

5.8. The remainder of this chapter confirms the principles of the approach we propose to adopt when running tenders in the transitional regime. Where possible, it also clarifies those outstanding issues raised by respondents. More information on certain detailed issues is set out in relevant appendices. We will be publishing, jointly with DECC, a final consultation on the overall offshore transmission regime shortly. This should address those concerns about the overall approach being adopted for offshore electricity transmission going forward.

Updated Proposals

5.9. One of the key aims of the competitive tender process is to attract effective, credible bidders into the ITT stage of the competition, which we believe would ensure that the most appropriate outcome is secured for all parties. We are proposing a small number of changes to the overall approach we intend to adopt to achieve this. An overview of this updated approach is illustrated in the following diagram, which highlights the key stages in the tender process through to the award of a licence to an OFTO. Further detail is also provided in Appendix 7.



5.10. The detailed description and rationale for the proposed amendments is set out in the following sections, with reference to the previous iteration in the October 2008 document.

Pre-Qualification Stage

5.11. The October 2008 document set out that we would select bidders for each project in a tender round, based on evidence provided in response to a detailed Pre-Qualification Questionnaire. Applicants would be assessed against a number of pre-defined criteria, which would be published as part of our Pre-Qualification Documentation. We proposed that the assessment would be over two parts, with the first identifying compliance of the submission and the second an assessment against the selection criteria. The intended outcome of this stage was a short list of bidders per project in a tender round.

5.12. A small number of respondents to the October 2008 document commented that the process as designed may lead to the early de-selection of potentially low cost bidders, particularly as we were seeking a small number of parties who would be invited to tender. Others commented that a potential way to avoid this happening would be to consider a financial metric to assist the down selection process, potentially based on the on the applicants' expected rate of return. We have considered these comments carefully and recognise there may be ways of improving the design of this stage of the process to take into account these factors.

5.13. We have particularly considered ways in which this stage could be enhanced to provide a more robust process and ensure all participants, including developers, have confidence that the bidders invited to tender would produce the most competitive outcomes. On balance, we consider that a more effective way to achieve this would be to introduce more distinct gateways into the tender process, and to ensure that financial robustness is assessed explicitly before the ITT stage. We believe that this would be best achieved by delineating the pre-qualification stage into two separate stages – a Pre-Qualification Stage (PQ) and a Qualification to Tender Stage (QTT). This would enable us to filter applicants through two distinct processes in advance of inviting them to tender. Our updated proposals for this are set out below. Appendix 7 contains further detail on the evaluation approach and criteria we would apply in these stages.

Two-stage Pre-Qualification

PQ Stage

5.14. The purpose of the PQ stage is to assess an applicant's (i.e. a party that submits a response to the PQ) economic and financial standing, legal standing and management and operational capability, with reference to evidence of the applicant's general track record, against pre-defined minimum thresholds. This assessment would be based on current standing and track record, and where the applicant is a consortium, the standing and track record of consortium members. We are proposing that the evaluation would include assessment against defined metrics of

those project(s) that the applicant would be interested in bidding for if it were qualify and be invited to tender.

5.15. We recognise that it would be important that a base level of information be available to inform applicants in their decision-making at this stage. Much of this would be included in key marketing materials that we would make available in advance of a tender round. The material for the first round of the transitional regime is currently in development, but at this stage we would expect it to contain high level information about each offshore project included in the tender round (such as capacity and location) and our ex-ante cost assessment for each project.

5.16. Assessment of applicants would be on the basis of achieving general prequalification, rather than a per project qualification. The expected outcome of the PQ stage would be a published long list of those applicants that had met the necessary minimum thresholds of the tender round. The list of projects each applicant has indicated an interest in in their PQ submissions would remain confidential to Ofgem, as we are proposing that applicants would have the ability to re-consider which projects they are interested in bidding before entering the QTT stage.

QTT Stage

5.17. The purpose of the QTT would be for Ofgem to select a small number of applicants it would invite to tender for each project within the tender round, known as 'qualifying bidders'. In essence, this is similar to the single stage PQQ we proposed in the October 2008 document. However, the key difference is that at the QTT stage under the updated proposals, we would have already established that the applicant had met the necessary minimum thresholds.

5.18. Applicants would be required to re-confirm the projects they are interested in bidding for at this stage. They would then be required to set out their proposed approach against a number of key financial and non-financial criteria. The proposals and evidence in support of the proposals in relation to these criteria would determine the outcome of the stage, which would be a short list of qualifying bidders per project within the tender round.

5.19. We recognise that it would be important that applicants have sufficient information available at this stage to be able to provide the necessary evidence to set out their approach. Therefore, in addition to the information available at the PQ stage, we would expect to release a detailed Information Memorandum (IM) on a project specific basis to each applicant that is in the QTT stage. We are currently confirming the extent of information that the IM would include at present, but we would expect it to provide:

- a detailed description of the regulatory regime,
- more detailed information about the investment opportunity, such a detailed description of the transmission assets and relevant equipment suppliers, and

- the methodology for calculating the ex-ante cost assessment

5.20. We consider that our updated proposals enable greater opportunity for participants to engage during a tender process. **We would welcome feedback on this approach.**

5.21. In relation to the event that, during the PQQ and QTT stages, we become aware that a project may attract insufficient applicant interest, we are considering options to seek to obtain feedback from the bidders in that round with a view to address and rerun. We are also considering whether the alternative approach may be to bundle such a project on a geographic basis with another in the same tender round. **We welcome feedback on this matter and the options being considered.**

Consortium Changes

5.22. Where an applicant is a consortium, we are proposing that the consortium would be able to adjust its configuration or membership between the PQ and QTT stages, subject to the newly configured consortium meeting the minimum requirements of the PQ stage. In addition, if a consortium applicant wanted to be considered for different projects than those it had initially indicated at the PQ stage, we would require that consortium to demonstrate it could meet the minimum requirements for those different projects.

5.23. Whilst we are proposing this flexibility for the pre-qualification stage, we would expect consortiums to be fully formed at the QTT stage of the process. This would give certainty to all parties, including ourselves when conducting the ITT tender process and assessing final ITT bids. With regard to bidding consortia changes that may unexpectedly arise during the ITT stage, we propose to consider these on a case by case basis, giving due regard to the progress of the ITT at the time, the significance of the change and the continued compliance of the bidder with the PQQ and QTT.

5.24. **We would welcome views from respondents on the proposed approach to enable the proposal to: (i) enable consortiums to adjust between the PQ and QTT stages, (ii) for consortiums to be fully formed at the submission of the QTT stage, and (iii) for us to consider unexpected consortia changes during ITT on a case by case basis.**

5.25. In addition to issues around consortium changes, we have also been considering the matter of the role of supply chain in applicant and bidder consortia. Recognising the nature of the supply chain market and to ensure achievement of the benefits of the competitive regime we propose to preclude the inclusion of supply chain in consortia on an exclusive basis. We are proposing to take a specific power in respect of this in the tender regulations. **We would welcome feedback on this issue.**

Selection Criteria and Process

5.26. In the light of our updated proposals, we have also refined the selection process and evaluation approach and criteria proposed to be used to identify those parties who would be invited to tender. An overview of this is set out in this section, with a detailed description of the selection process for each stage of the tender process provided in Appendix 7.

PQ Stage

5.27. We propose that applicants would be assessed at the PQ stage against minimum threshold requirements for financial and non-financial criteria. However, the first part of the assessment would be to assess completeness and compliance of the response, followed by:

- Financial Criteria
 - i. Economic and Financial Standing – we are considering, in addition to financial solvency, measuring the applicant's total net assets against a requirements to be greater than or equal to 120% of the indicative RAV of the applicants' preferred projects, as well as an assessment of their track record of achieving comparable spend of debt and equity in the proposed financing structure.
- Non-Financial Criteria
 - i. Organisation, Ownership and Governance - where applicants would indicate the ownership structure for the OFTO, specifically identifying any potential conflicts of interest. This would include the provision of evidence of their good standing.
 - ii. Management and Operational Capability – which would include an assessment of the applicant's expertise (or approach to acquiring the necessary expertise) to operate an infrastructure project of the size of assets indicated. This would include evidence to demonstrate an understanding and experience at dealing with health and safety on large scale projects.

5.28. As part of the non-financial criteria, we would require applicants to provide sufficient information to demonstrate that they would meet the minimum legal requirements required of all licensees. These would mirror the requirements set out in the Licence Application Regulations²⁰ for licences granted through sections 6A and 6B of the Electricity Act 1989. Demonstration of these requirements would be important to ensure we are treating applications for all types of licence on an equal basis. Given this, we propose that for each stage of the competition, there would be

²⁰ The Electricity (Applications for Licences, Modifications of an Area and Extensions and Restrictions of Licences) Regulations 2008.

a requirement for the applicant or bidder (as appropriate) to confirm the information provided in response to these questions.

5.29. Assessment would be tested by means of a series of questions, which would all be assessed on a pass/fail basis only. The purpose of this would be to identify those applicants that meet the necessary minimum threshold requirements. We would only seek to de-select applicants at this stage where the evidence presented would not support a pass in all section. To achieve a position on the long list each applicant must pass every section of the PQ.

QTT Stage

5.30. Determination of qualifying bidders at the QTT would be made based on an objective assessment against certain key pre-defined criteria. These would follow the same financial/non-financial criteria split as the PQ stage, but would focus instead on the applicant's proposed approach to specific aspects of the offshore transmission operator roles and responsibilities and project elements, supported where appropriate by evidence supporting the specifics of the approach. An overview of these criteria is set out below:

- Financial Criteria
 - i. Economic and Financial Standing – a pass/fail assessment of the applicant's standing, based on its turnover against confirmed appetite for projects in the tender round.
 - ii. Economic and Financial Robustness - which would include an assessment of the applicants' deliverability of the proposed funding structure, package, an assessment of the desired project internal rate of return (IRR) and an ability to identify and apportion project risk.
- Non-Financial Criteria
 - i. Management Capability - would include an assessment of proposed approach to managing a regulated or public infrastructure asset, approach to delivery of services including roles and responsibilities of consortia members and approach to interface management and transition planning.
 - ii. Legal Capability – which would include an assessment of the applicants' proposed approach to compliance with relevant regulatory requirements (for example the applicable industry codes).
 - iii. Operational Capability – which would include an assessment of the applicant's approach to managing technical and operational issues, including performance and repairs to the transmission infrastructure.

5.31. Assessment at the QTT stage would primarily be a quantitative evaluation with the questions underlying each criterion scored based on the quality of evidence presented. We would also propose to weight each criterion, according to its relative

importance. We believe that this approach would result in a more robust determination of qualifying bidders for each project, based on best practice models of competitive tendering.

5.32. We are seeking feedback from respondents both on the overall approach to selection as described in this section, and also the detailed elements set out in Appendix 7.

5.33. We would specifically welcome respondents' views on the financial tests we are proposing to adopt at the PQ and QTT stages, in terms of the underlying principles and also the scale of the metrics - particularly the proposed use of measures such as total net assets, fundraising track record metrics, turnover, funding structure and IRR. We also welcome views on the non-financial criteria we are proposing to apply at the PQ and QTT stages.

Identifying Qualifying Bidders

5.34. Based on the scores achieved at the QTT stage, all applicants would be ranked with a shortlist of 3-5 qualifying bidders identified to be invited to tender for each project in the tender round. For example, if there were 7 applicants that are interested in Project A, a shortlist would be identified, ranked by weighted scores, with the top 3-5 qualifying bidders invited to tender for that project. Given that we intend to allow the same qualifying bidder to be able to bid for more than one project, if any of these qualifying bidders were also shortlisted for Project B on the basis of their ranking for Project B, they would also be invited to tender for that project.

5.35. A small number of respondents to the October 2008 document requested clarification as to why we proposed to limit the number of parties we would select to bid for a particular project. We set out at the time that this would be important to ensure that each bidder had sufficient confidence that it had a reasonable chance of success in the bidding process. We considered this important to ensure the quality of the tender process, given that the process is likely to cause bidders to incur significant costs, both in terms of its own internal bid costs and also the charges it would be required to pay to Ofgem to participate. We believe that if there were more than a small number of parties invited to tender, the quality of bids could suffer.

5.36. We propose to maintain this principle, but whereas we previously set out that we would limit this at up to four bidders, we propose that it would be optimal to have flexibility to invite 3-5 parties to bid. We consider this additional flexibility would be allow us to take into account the number of applicants at the QTT stage as well as the quality of information provided.

Invitation to Tender Stage

5.37. We set out in the October 2008 document that the main purpose of the Invitation to Tender stage would be to identify the preferred bidder for each offshore project within a tender round, with the option of a best and final offer stage for a smaller number of bidders if deemed necessary. We proposed that we would evaluate bids largely on the basis of the firm revenue stream, as long as the bidder had demonstrated it a suitable ownership structure and a suitable approach for managing the transmission assets over the regulatory period.

5.38. We have considered carefully the responses received to the October 2008 document in respect of this stage, and whilst we recognise some clarification is necessary, we propose that the key features of the ITT stage remain as previously set out. As with the pre-qualification stage however, further work since the publication of this document, has led us to update our proposals in a small number of areas. These are set out below.

Evaluation Criteria and Process

5.39. We set out in the October 2008 document that we would be seeking bidders to provide a firm 20-year revenue stream bid against standard assumptions as part of their response, and that the evaluation process would largely be based on this. We noted however that a number of respondents suggested that there should be a balance between the revenue stream bid and the technical and operational capabilities of bidders.

5.40. We set out that whilst the firm bid revenue stream would be the key factor in the assessment at this stage, bidders would also need to demonstrate through their technical proposal a suitable approach for managing the assets over the regulatory period. We considered that this would provide the overall best value bid, and that this approach would be in the best interests of offshore generators given that the level of the revenue bid would feed directly through to transmission charges.

5.41. We remain of the view that adopting an approach that largely focuses on the proposed revenue stream should lead to the best value outcomes in the transitional regime. We provide further detail on how we intend to assess bidders at the ITT stage in Appendix 7.

Information Available

5.42. As set out in the October 2008 document, we recognise that bidders would need a significant amount of information to enable them to undertake the necessary due diligence in order to submit a bid at the ITT stage for an OFTO licence. We also set out that we would expect that this would predominantly be information provided by the offshore developer, but would also likely include the standard industry documentation, the standard conditions of the offshore electricity transmission licence and relevant information from NGET in its capacity as System Operator.

5.43. We proposed that this information would be made available to bidders by means of a secure electronic data room controlled by Ofgem, and that only those bidders bidding for a particular OFTO licence would be able to access, via this facility, the information specific to the project for which they have been invited to tender. We maintain this proposal and can confirm that we will be employing an e-tendering portal to provide this service. Each bidder would also be required to enter into a Confidentiality Agreement before gaining access to the data room.

5.44. As set out in Chapter 4, we are currently liaising with offshore developers to establish their eligibility to be tendered under the transitional regime. As part of this exercise, we are also undertaking to establish the detailed information underlying each project (for example O&M contracts and warranties). We remain of the view that this should include:

- all contracts, consents, leases, warranties and guarantees relating to the transmission assets,
- the Connection Agreement the developer holds with NGET or an electricity distribution licensee,
- details of all assets and liabilities relating to the transmission project,
- the investment and operation plans for the transmission project,
- relevant seabed surveys,
- evidence of compliance with applicable legislation, regulations and industry governance arrangements, and
- the terms of transfer for the transmission assets.

5.45. In addition to this information, we also would expect that details of any derogations against requirements of the industry codes that the offshore developer had gained or is in the process of seeking with respect to the transmission assets would also be made available.

5.46. We confirm that this information would be provided in the secure data room and would only be accessible by the ITT bidders for each particular project.

Bidder Dialogue and Clarification

Bidder Dialogue

5.47. As set out in Chapter 4, we are now proposing to adopt an approach whereby all transitional project developers would be required to populate – and agree with us – a model SPA in advance of a tender commencing. We envisage that this would include general provisions and project specific schedules. Whilst this is an updated

proposal with respect to the developer interface, we have also considered further the bidder interface with respect to the SPA.

5.48. We set out in the October 2008 document that as part of a bid submission, bidders would be required to accept the terms of transfer provided by the developer without amendment. We received a number of comments from respondents on this issue, including that developers may want to negotiate these terms with bidders. We have reconsidered our proposals in the light of these comments.

5.49. On balance, we now consider that it would be beneficial for bidders to be able to enter into structured dialogue around the SPA during the ITT stage of the tender process. For example, we would expect this process to be a moderated forum used to identify particular commercial issues within the SPA, and for parties to set out their proposed approach to dealing with these.

5.50. Given that the counterparty to the SPA will be the offshore developer, we recognise that it would be important for it also to be involved in this dialogue. We are considering further how such a process should be established. We are particularly mindful that developers could be in consortia that bid for OFTO licences, which introduces issues around protecting confidential and bid information and the need to ensure competition law compliance. Our current thinking on this issue is it would be possible for us to facilitate moderated dialogue between bidders and the developer during the ITT stage. This would enable a developer to understand any issues bidders have with the SPA, and to consider how and if it would be willing to accommodate these through negotiation.

5.51. It is important to reiterate we do not intend to move from a position whereby we take the decisions on the identification of the preferred bidder. However, we recognise that this may be a useful input into that process. **We would welcome views on this issue.**

Bidder Clarification

5.52. In addition to this, we also consider it would be important to establish a robust mechanism through which to deal with the likely clarifications bidders would bring forward during the ITT stage.

5.53. We set out in the October 2008 document that we would act in a hub capacity to manage this process, with bidders' clarifications being forwarded to the developer (and NGET as appropriate) for response, with the responses placed in the data room for all bidders to access. In order to ensure that this engagement is managed in a transparent and consistent way, we propose to ensure that this process is carried out on an anonymous basis, i.e. correspondence issued by Ofgem would not reveal the name of the bidder. We would also expect developers to provide the response to the clarifications sought in within defined timescales.

5.54. In order to provide further confidence to bidders regarding the response returned, we would propose that the developer warrants these responses, in the

same way it would be required to warrant the completeness and accuracy of information in the data room. We consider that facilitating this approach to clarifications before bids are returned should mean a more optimal solution is determined through the submission of the ITT bid.

5.55. We would welcome views on this proposal. We would especially welcome feedback on whether it would be necessary or appropriate for us to establish rules for developer engagement in this way, possibly through the tender regulations.

Tender Documentation

5.56. It will be important for the confidence of the regime that there is a clear framework for decision-making within a pre-determined set of rules and it remains our intention to publish detailed tender documentation to support the process. On the basis of our updated proposals, this documentation would now be:

- A Pre-Qualification Document,
- A Qualification to Tender Document, and
- An Invitation to Tender Document

5.57. We published initial draft templates of the Pre-Qualification and Invitation to Tender Documents with our October 2008 document. Given our updated proposals, attached as Annexes 1 to 3 are draft PQ, QTT and ITT documents respectively. We will continue to update these documents during the consultation period and in the run up to the Go Active date. **We invite respondents to provide feedback on these draft documents, which would assist this process.**

Best and Final Offer Stage

5.58. We set out in the October 2008 document that where we considered it appropriate and necessary, we would seek to ask a limited number of bidders to come forward with a best and final offer (BAFO). We remain of the view however that it is not possible to specify in advance how a BAFO process would work in detail, as this would be dependent on the specific issues raised at the time. However, we can confirm that whilst we would likely be asking each BAFO bidder to provide an updated bid against a limited number of revised issues, the evaluation of these responses would be undertaken against pre-defined criteria. The evaluation process would be set out at the time in the relevant BAFO documentation.

5.59. We also remain of the view that it may not always be necessary to proceed with the BAFO stage. For example, if the bids received at the ITT stage clearly identify a strong bid that Ofgem considers appropriate to identify as the preferred bidder for a particular project, we may decide that there is little benefit in seeking a BAFO. This approach was broadly supported by those respondents that responded

on this issue. For these reasons, we intend to reserve the right to extend the process on a tender-by-tender basis.

Preferred Bidder and Licence Grant

5.60. We set out in the October 2008 document that we would:

- Identify the Preferred Bidder from the pool of bidders that provided the initial bid, or from the subset of bidders that is requested to provide a best and final offer,
- Retain the ability to identify a reserve bidder, who would be appointed as preferred bidder if the original preferred bidder falls away,
- Required the Preferred Bidder to demonstrate it had met those issues identified by Ofgem as outstanding at that time, for example including:
- Entering into an agreement with the developer to transfer the transmission assets, and
- Demonstrating its funding proposition is in place, for example in terms of its Senior Lender Facility Agreements and Shareholder Agreements

5.61. We maintain this proposed approach at this stage of the process. However, as set out above, we would intend to supplement this by requiring the Preferred Bidder to confirm it still met the minimum legal requirements of all licensees before the licence is granted.

Timing for Tenders in the Transitional Regime

5.62. Given the proposed refinements to the design of the tender process set out in this chapter, we have updated our expected timeline for running tenders in the transitional regime. We have included this in the diagram in Appendix 7.

Further Development of the Tender Process

5.63. We set out in the introduction to this section that we have a number of key objectives for the competitive tender process. It will be important for the ongoing success of the approach to consider the extent to which these are met over time. As such, we propose to gather evidence over the course of the first round of tenders in the transitional regime against these objectives. We will be particularly considering the extent to which new entrants are encouraged to participate in - and have success in - the process, as we believe that over time this should lead to benefits for both consumers and offshore developers, for example through pricing and supply chain innovation.

5.64. We also believe that encouraging new entrants into the sector during the tender process for the transitional regime would have benefits for tenders in the enduring regime, as new players would acquire relevant expertise in key supply chain areas. **We would welcome views from respondents at this stage if there is anything explicit we should consider to ensure that new entrants are encouraged over time, and how we might introduce this into the process.**

5.65. A further issue we are considering for our tender design for future tender rounds is whether it would be possible to introduce auction stages into the competitive tender process for OFTOs, potentially leading to greater visibility on pricing. Our view is that this would probably be most effective once the competition was based solely on price, which we believe could happen at the BAFO stage, when we would expect that the relative strengths of bidders on all issues other than price should be clear and understood.

5.66. Potential benefits from introducing auction stages could, in theory, feed through in the form of more competitive and effective pricing, which should in turn deliver benefits to consumers now and in the future. However, our current view is that we should recognise that the first transitional tender process needs to address the practical issues and complexities arising from individual project characteristics, as well as the new regulatory regime, and that we should explore the auction option for future tender rounds. **Nevertheless, we would welcome feedback from stakeholders on whether principles from auction processes could be applicable to the offshore electricity transmission tender process.**

6. Tender Process for the Enduring Regime

Chapter Summary

We propose to apply the broad principles for running tenders in the transitional regime to the tender process for the enduring regime. However, we recognise that there would need to be some differences in the process, given that the OFTO would be required to design, finance and construct the transmission assets in addition to their ongoing maintenance. This chapter reflects these differences, and also sets out our view on how we consider our approach is compatible with a coordinated approach to future network development.

Key Questions

We would welcome feedback on our overall proposed approach to competitive tenders as set out in this chapter.

Introduction

6.1. We set out in our July 2007 document²¹ that an OFTO would be responsible for designing, building, financing and maintaining the offshore transmission network. We also set out that there would be transitional arrangements for projects where the generator is already constructing or undertaking steps towards constructing the offshore transmission assets. The transitional arrangements would apply to projects that met certain pre-conditions by either the Go Active or Go Live dates. We explained our updated proposals with respect to these in Chapter 4.

6.2. Based on the information we have received from project developers to date, we do not expect to be running tenders for any projects in the enduring regime from the Go Active date. We do however expect to be running tenders for those projects that demonstrate that they have met the necessary transitional pre-conditions from the Go Active date. We set out our current view on those projects that we expect to be in this first tender round in Chapter 3. For these reasons, this document is primarily focussed on the design of the competitive tender process for the transitional regime.

6.3. Nevertheless, we recognise that offshore generation projects that would need to seek an OFTO under the enduring regime are continuing to develop. This includes all projects that are granted leases by The Crown Estate under its Round 3 or other leasing programmes (such as the exclusivity awards recently announced for offshore generation in Scottish territorial waters), and who would seek to connect at 132kV or

²¹ Offshore Electricity Transmission - A Joint Ofgem/BERR Policy Statement, 189/07, July 2007

above. Given this, this chapter sets out further information on the process for identifying an OFTO in the enduring regime.

6.4. We shall be refining the design of the tender process for the enduring regime over the coming months. In part, we expect that this would be informed by the experience of the first round of tenders in the transitional regime.

Tender Process for the Enduring Regime

6.5. We confirmed in our October 2008 document that we would apply the same broad principles for running tenders in the transitional regime to the enduring regime as well. We also confirmed that we would make the necessary adjustments to the process to reflect that OFTOs would be required to design and construct the transmission infrastructure as well as maintain it in accordance with licence obligations. Whilst we are consulting on a small number of refinements to the process for the transitional regime, we can confirm that our overriding principle is retained - that we would adopt the same approach to running tenders in both the transitional and enduring regimes.

6.6. Given we are consulting on our updated proposals through Chapter 5, this chapter sets out the key features of the competitive tender process for the enduring regime only. Stakeholders should refer back to our previous consultations for further detail.

6.7. However, we do set out further detail on how we expect that this process would deliver the necessary future transmission investment needed to connect up the expected significant amounts of offshore generation over the coming years.

Key Features of the Tender Process for the Enduring Regime

6.8. This section identifies the key features of the tender process in the enduring regime. Where appropriate, these are updated to reflect the updated proposals set out in Chapter 5.

- Each tender would follow a number of distinct stages:
 - A two-stage pre-qualification process. The first stage (Pre-Qualification) would enable us to identify a long list of potential bidders on a generic basis, based on the applicant demonstrating it has met certain pre-defined minimum thresholds. The second stage (Qualification to Tender) would enable us to select a short-list of applicants on a project-specific basis to invite to tender. This project specific short-list (of 3-5) would be determined based on the evidence provided by each applicant in response to questions on their proposed approach in a number of pre-defined areas. In the enduring regime, this would include approach for design and construction of the necessary transmission infrastructure.

- An invitation to tender stage, during which bidders would have the opportunity to put forward their detailed proposals for providing transmission services, including their firm bid revenue stream for the 20-year regulatory period.

In the enduring regime, we would be seeking detailed financial and technical proposals from bidders that would include the design, construction and maintenance of the transmission assets. As we set out in our November 2008 document, we would expect the technical proposal for the design of the offshore network, including in respect of energy losses. This would be a key issue in our selection criteria at this stage.

In order to ensure that design proposals may be efficiently completed, we would propose to allow sufficient time at this stage in the process for bidders and their suppliers to prepare their firm technical proposal.

- An optional best and final offer stage, where a small number of bidders would have the opportunity to put forward an improved final bid,
- The identification of the preferred bidder. A key difference in the enduring regime would be that the preferred bidder would be required to enter into a contractual relationship with NGET for the construction of the offshore transmission assets, via a Transmission Owner Construction Agreement (TOCA). Entering into a TOCA in this way would enable NGET to issue an agreement to vary the Connection Agreement it holds with the offshore developer, to take into account the offshore works²².

We would also expect the preferred bidder to demonstrate to us that it had met a number of requirements, including that the financing and technical proposals set out in its bid are in place. At this stage, we would expect this to include, but not be limited to:

- Project Agreement Contracts,
 - Design and Build Contracts (such as the EPC contract),
 - Operation and Maintenance Contracts,
 - Senior Lender Facility Agreements, and
 - Shareholder Agreements
- The licence grant stage, where subject to the offshore developer agreeing to the variation to its Connection Agreement, the Authority would grant the offshore electricity transmission licence to the preferred bidder once it had satisfactorily met the outstanding requirements identified.

²² We proposed in the June 2008 and October 2008 documents that the preferred bidder in the enduring regime would be able to accede to the STC to enable it to enter into a TOCA with NGET. Proposals to amend the STC to allow for this are being consulted on separately.

- We would advertise projects in advance, in relevant national and international publications,
- Tenders would be run in annual rounds and commence from a common starting point (or "tender window"), which would be announced each year in accordance with the tender regulations. A project would be eligible for a particular tender round based on the developer demonstrating that it had met the necessary enduring pre-conditions by a specified date (which would also be announced in accordance with the tender regulations),
- The process would be sufficiently flexible to allow bidders to submit variant bids, for example to connect more than one project that is being tendered in the same tender round,
- The process would be sufficiently flexible to allow bidders to bid for more than one OFTO licence,
- Each tender would be based on the developer's specific requirements. Where a developer has undertaken pre-construction development work (for example in obtaining relevant consents and leases or undertaking a seabed survey), these could be included in the developer specification. Where appropriate, the efficient costs of these would be remunerated by the successful OFTO and recovered through its regulated revenue stream,
- There would be increasing amounts of information available about the projects at each stage of the tender process. Whilst the developer would provide its requirements at the outset, much of this information would be provided by NGET prior to and during a tender process. We proposed in the October 2008 document that NGET's role within the tender process would be set out in a new licence condition in its licence. This new licence condition is being progressed through the consultation process on amendments to the standard framework documentation, with the next consultation due to be published shortly,
- We would publish standardised tender documentation for each stage of the process. This would include, but not be limited to, rules of the tender process and the selection criteria and process we would follow at each stage, and
- Participants in the tender process would be required to fund our costs incurred in running the competitive tender process.

Coordinated Network Development

6.9. We note that respondents to previous consultations - both the October 2008 document and the joint Ofgem/DECC Regulatory Policy Update published in

November 2008²³ - have expressed some concern that that the proposed approach for the enduring regime would fail to deliver anything beyond the "point to point" connections that are currently envisaged for the majority of individual Round 1 and 2 projects. We also note that a number of respondents have called for more extensive transmission systems to connect more than one offshore generation projects under Round 3.

6.10. In respect of the overall design of the offshore electricity transmission regime, we note that the Government has previously announced that the extension of the regulated price control approach for the provision of new offshore transmission infrastructure would best meet its energy policy objectives. We also note that in reaching that decision the Government concluded that this should also ensure a coordinated approach to the development of that offshore infrastructure. Other related decisions that the Government has taken support this view, including to extend the principles behind the regulation of the onshore grid offshore, and to extend the role of the GBSO offshore.

6.11. For a number of reasons, we consider that the overall approach being adopted would facilitate a coordinated approach to network development in the enduring regime. These are set out below.

The Crown Estate's Leasing Programme for Round 3

6.12. Under The Crown Estate's programme for leases under Round 3, potential partners (known as zonal development partners) are being invited to bid for Development Zones (Zones) on a competitive tender basis. As proposed, these Zones cover larger areas of the seabed than in Rounds 1 and 2, and there may be the potential to develop more than one offshore generation site per Zone. The Crown Estate has published a number of indicative maps to assist potential partners in identifying opportunities for these. The Crown Estate has also offered to make a joint investment alongside the partners to fund up to 50 per cent of total investment for the development of sites.

6.13. It is proposed that successful bidders in The Crown Estate's tender process (i.e. the zonal developer partners) would acquire exclusive rights to develop offshore generation opportunities in these Zones. It is expected that this would enable a more strategic approach to the expansion of offshore generation under Round 3, by increasing the developers' flexibility to choose the best sites, to minimise impacts, explore strategic mitigation measures and enable strategic planning (such as electricity grid infrastructure investment).

²³ Offshore Electricity Transmission - A Joint Ofgem/DECC Regulatory Policy Update, November 2008

6.14. As such, we would expect that the zonal development partner would be able to consider what kind of electricity transmission infrastructure would be the most economic and efficient for its long term plans, and signal its requirements on these. It is on this basis that we would expect to run competitive tenders to identify OFTOs in the enduring regime, i.e. on the basis of the long term commitments provided by the zonal development partner. However, it would also be possible for a zonal development partner to initiate a tender process for a single connection as well if required.

6.15. Given this, we consider that the Crown Estate's approach provides a strong commercial incentive for developers to work collectively, which should, where possible, help to assist the coordinated development of the offshore grid

Role of NGET

6.16. We consider that there are key roles for NGET in overseeing the development of offshore generation. In particular, we note that the Energy Act 2004 powers that enable the Secretary of State to extend NGET's role as GBSO to include offshore waters, which we expect would be commenced at Go Active.

6.17. As GBSO, NGET has an obligation under the Electricity Act 1989 "to develop and maintain an efficient, co-ordinated and economical system of electricity transmission". In the light of this, we would expect NGET to be proactive in its approach to offshore network development, being responsive to the requirements of developers and OFTOs. A key aspect of this would be NGET enhancing its annual planning statement (known as the Seven Year Statement), to assist developers and OFTOs in planning for future development.

6.18. Under our proposed approach for the enduring regime, developers would approach NGET for a connection offer. Whilst the detailed requirements of its response is a matter for NGET to manage in accordance with its licence and the CUSC, we would expect NGET to be able to offer offshore connections in a number of ways, including:

- A connection designed for a single project between the onshore grid and the offshore connection point,
- A connection designed for a single project on a phased development basis – i.e. a phased increase in cables over a defined period,
- A connection designed for a group of separate projects. This connection could be phased as well.

6.19. Our understanding is that in Round 3, the zonal development partner would be able to work with the GBSO to establish its high-level connection requirements, which, if approved by the GBSO, would be set out in a bilateral connection agreement. We are proposing that tenders would then be run on the basis of these requirements, which could be a more coordinated network development where that

is specifically sought by developers. Where this is sought, our tender process would be geared towards meeting these requirements.

Tender Windows

6.20. We have set out consistently in previous consultation documents that we would commence competitive tenders from a common annual starting point, or tender window. To reiterate, all those projects that have satisfied the enduring pre-conditions by a pre-defined date - and have asked us to seek an OFTO - would be included in that tender round.

6.21. We note that some respondents have previously questioned the effectiveness of the tender windows approach. We revisited this in the June 2008 and October 2008 documents and we confirmed that we would retain flexibility to commence tenders at a different point where necessary, for example when we are aware from market information (such as from NGET) that there would only be one tender required in any round.

6.22. Whilst we would adopt some flexibility in this regard, we strongly believe that by maintaining this approach of annual tender windows, where there are more than one project in a tender round potential bidders would be able to take a view on the opportunity to connect these via the same connection design. We maintain the proposal that in these instances, a bidder would submit a variant bid alongside a compliant bid for each project separately. We also maintain the proposal to seek NGET's input with respect to any variant bids received, for example to understand implications for the onshore network design and cost. We are consulting separately on changes to NGET's licence to provide for this technical assistance²⁴.

Remunerating Efficient Pre-Construction Costs

6.23. We recognise that developers may wish to undertake offshore transmission pre-construction work (e.g. conducting sea-bed surveys and obtaining the necessary planning consents) in advance of making a connection application to NGET or asking us to commence a tender process.

6.24. We set out in the October 2008 document that efficient pre-construction costs may be recovered from the successful bidder, through its regulated revenue stream. We note that this was strongly supported by respondents and propose to maintain this approach. We consider that a key benefit this approach would support a timely and coordinated approach to network development as it would enable a developer (or another party) to progress certain pre-construction work in advance of a tender.

²⁴ We will be publishing our final proposals for all changes to the licence conditions necessary for offshore electricity transmission shortly.

This could then be made available to bidders in the tender process. Equally however, where a developer does not progress pre-construction work, we would seek to tender on that basis as well.

7. Other Tender Process Issues

Chapter Summary

This chapter covers other tender design issues not captured in the previous chapters. We are seeking feedback on these issues, including the disqualification of bidders, cancellation of tenders, how we intend to recover our tender costs and the approach to advertising tenders.

Key Questions

We welcome feedback from stakeholders on all of the issues raised in this chapter. In particular, responses are requested on:

- Our proposals on disqualifying bidders.
- Our proposals for the instances where we would cancel a tender process.
- Our proposed cost recovery methodology and indicative charges.

Introduction

7.1. The previous two chapters set out our updated proposals for the process we intend to follow for running the competitive tender process in the transitional and enduring regimes. There are however a small number of other issues which we have identified as being necessary to run an effective tender process, and on which we are seeking feedback in advance of the process taking effect later this year. These are:

- Instances where we would disqualify applicants or bidders from a tender process,
- Instances where we would seek to cancel a tender exercise, and
- Proposals for recovering our costs incurred in running the competitive tender process.

7.2. Proposals for these follow, and in the accompanying draft tender regulations.

Disqualification of Bidders

7.3. Whilst the competitive tender process provides a number of gateways for the de-selection of bidders, we recognise that there may be instances where we would also need to disqualify a bidder for other reasons, for example based on its conduct during a tender exercise. We have considered other similar competitions, where such conduct rules commonly appear.

7.4. We would propose that these issues are contained in the tender regulations. As such, the draft regulations in Annex 4 to this document contain our proposed reasons for disqualifying bidders. **We would welcome respondents' views on these proposals, in particular whether we should be taking into account other reasons for disqualifying a bidder during a competitive tender.**

Cancellation of Tenders

7.5. In certain exceptional circumstances, there may be a need for us to cancel a tender exercise, for example where no responses are received to a project's pre-qualification stage or where a developer withdraws its project during a tender. Whilst these powers would on be used on rare occasions, we believe it is prudent to consider and make provision for those potential circumstances.

7.6. Similarly to disqualifying bidders, our proposals for the reasons when we would cancel a tender exercise are set out in the draft tender regulations in Annex 4. **We welcome respondents' views on these proposals, particularly on whether other reasons for disqualifying a bidder during a competitive tender should be taken into account.**

Advertising Tenders in OJEU

7.7. In designing the tender process and in drafting the regulations, we have paid due regard to EC and UK law on public procurement procedures. We recognise that the tender and grant of the offshore transmission licences presents significant opportunities for businesses in the Internal Market. We also recognise that an open and competitive award method would help attract a broader range of potential bidders for such contracts, create gain from better value offers and ensure proven safeguarding against corruption and favouritism through transparent award practices. In accordance with such consideration, we have concluded that the granting of the offshore transmission licences is relevant to the Internal Market and should therefore be awarded in conformity with the basic Community law standards.

7.8. For these reasons we propose that the tender process commencement will be advertised in the OJEU at the same time that advertisements are placed in UK/GB national and trade journals.

Standstill Period

7.9. 1.2. In designing the tender process and in drafting the regulations, we have paid due regard to EU law relating to the question of judicial protection, and the importance of the possibility to review the impartiality of procedures followed in a tender process. As a result, we consider that it is necessary to provide for a minimum standstill period during which the conclusion of the contract in question is suspended, irrespective of whether conclusion occurs at the time of signature of the contract or not.

7.10. In accordance with best practice and upholding the principles set out in EU law, we intend to include a 10-day standstill period in the OFTO tender process. This would commence from the time of publication of notice of the proposed successful bidder for any particular offshore transmission licence grant. This provision is contained in the draft regulations.

Appeals

7.11. We note that respondents to our previous consultations have suggested that we could build in an appeals mechanism into the tender process. We are considering this further, and would propose to set out any approach on this in our final decision document.

Recovering our Tender Costs

7.12. One of the key decisions that the Government took in January 2008 was that it would seek powers in the Energy Bill to enable the Authority to recover its costs of running the tender process from participants. Since that time, the Energy Bill has passed into the statute, becoming the Energy Act 2008, confirming the powers sought through the Energy Bill in this respect.

7.13. This section summarises the Energy Act powers and sets out our proposed approach for recovering these costs from participants. Appendix 8 provides further detail on our methodology for calculating costs and their recovery.

Energy Act 2008 powers

7.14. The Government has taken powers through the Energy Act 2008 to enable us to fully recover our costs incurred with running the competitive tender process. In summary, the powers set out in the Energy Act 2008 enable the Authority to:

- secure a financial commitment from the offshore developer to secure the Authority's potential liability for running a tender process,
- secure payments from participants in the process (i.e. the offshore developer and bidders) to cover the Authority's costs of running each tender process, and
- in respect of projects being tendered in the transitional regime, secure amounts from the owner of the regulated asset to cover costs incurred in relation to undertaking asset valuations.

Cost Recovery Methodology

7.15. We set out in the October 2008 document that we would seek to develop a detailed cost recovery principles document to set out how we would use the Energy

Act 2008 powers in practice. Respondents generally welcomed this proposal, with a small number seeking further detail.

7.16. In the light of the powers in the Energy Act 2008, we have developed this detailed methodology, setting out how we would recover our costs of running tenders from participants in an equitable way. We have also added a requirement into the draft tender regulations for us to publish this cost recovery methodology in advance of a tender round, so as to provide certainty to participants as to the charges they would face, and at what stage of the process. The draft cost recovery methodology is provided in Appendix 8.

7.17. We would welcome comments from participants on the draft cost recovery methodology.

Costs and Indicative Charges

7.18. Our current estimate of the costs we expect to incur in running each tender is in the first round of the transitional regime is £560k (including the costs of undertaking the cost assessment exercise). This is broadly consistent with the estimate provided in the Government's Impact Assessment for the regime, published in June 2008²⁵. This cost estimate includes:

- our set up costs for the tender process, which would include staff costs, external advisers and IT requirements,
- ongoing tender related costs, which would include our direct costs of running each tender (such as advertising and external advisers) and indirect costs (such as overheads), and
- costs associated with cost assessments.

7.19. Based on our draft cost recovery methodology, we have developed indicative charges that we propose to apply during the first round of the tender process in the transitional regime. Our current estimate of charges for participants in the first round of tenders is set out in table 7.1 below.

²⁵ The Impact Assessment is available to download at www.berr.gov.uk/files/file43553.pdf. The estimate in that document was based on an earlier Go Active date. As such, our current estimate is higher, primarily as a result of us incurring additional set up costs.

Table 7.1: Indicative Charges for Participants

Process Stage	Participant		
	Developer	Bidder	Successful Bidder
Application	£100,000 ²⁶	N/A	N/A
PQ Stage	N/A	£5,000 ²⁷	N/A
QTT Stage	N/A	N/A	N/A
ITT Stage	N/A	£35,000 ²⁸	N/A
Preferred Bidder	N/A	£150,000	N/A
Licence Grant	N/A	N/A	£250,000 ²⁹

7.20. In addition to these charges, we would be seeking financial commitment from the developer to fully underwrite the costs of the process.

7.21. The indicative charges set out in table 7.1 are reflective of the costs we expect to incur at each stage of running tenders. We are proposing that, with the exception of the charges levied at the PQ and ITT stages, these charges would be rolled up and included in the cost assessment process. This means that a developer would be able to include the Ofgem charge as a cost item in its ex-post cost assessment and recover it through the transfer value paid to it by the successful bidder. Equally, it means that the successful bidder would be able to include the charge levied at the licence grant stage in its cost base for determining the ongoing revenue stream.

7.22. Based on the proposed approach, this means that the only element of our costs that are at the bidders' risk are the charges we would levy at the PQ and ITT stages. **We would welcome feedback on the level of proposed charges, as well as the underlying principles as set out in our draft cost recovery methodology.**

Bidder's Own Bid Costs

7.23. We do not propose that the process provides for the recovery of bidder's internal costs of bidding.

²⁶ This charge would be able to be recoverable by the developer as part of its transfer value.

²⁷ This is a flat charge and is not dependent on the number of projects the applicant signals its interest in.

²⁸ This is a charge per project bid for.

²⁹ This charge would be included within the base value for determining the ongoing revenue.

8. Tender Regulations

Chapter Summary

This chapter provides the legal framework for the tender regulations. It provides an overview of those issues raised in response to our previous consultation on the draft regulations (July 2008) and identifies the key areas in which the draft regulations have developed since that time.

The draft regulations are provided in Annex 4. We are seeking feedback on these draft regulations by 2 April 2009, which is two weeks prior to the close of the main consultation. We are seeking earlier feedback earlier to enable sufficient time to make any changes to these in advance of them being made by the Authority.

Key Questions

We welcome feedback from stakeholders on the draft tender regulations contained in Annex 4, specifically on the translation of our proposed approach to running competitive tenders into the relevant legal instrument.

Introduction

8.1. This is the final consultation on the draft regulations that would provide the legal framework for the competitive tender process as described in previous chapters of this document. The draft regulations set out the Authority's proposed approach to carrying out a competitive tender process to identify the person to whom it would grant an offshore transmission licence.

8.2. The draft regulations have been substantially updated since we published our consultation letter for draft tender regulations³⁰ in July 2008 ("the July consultation"), with this version incorporating our updated policy positions.

8.3. The draft regulations are available at Annex 4. This should be read in conjunction with Appendix 9, which sets out the purpose and intent of the draft regulations by explaining the general effect of each of the regulations.

8.4. This chapter of the document explains:

³⁰<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=22&refer=Networks/offtrans/pdc/cdr/cons2008>

- our response to the comments we received to the July consultation,
- the legal framework for making the draft regulations, and
- the key changes to the July 2008 draft tender regulations.

Our Response to the July Consultation

8.5. We received 9 responses from interested parties to the July consultation. The key issues raised by respondents related to:

- specific drafting suggestions,
- further detail on a number of issues,
- the dates and timings for tender exercises, and
- the purpose and intent of the regulations.

8.6. There were a number of specific drafting suggestions from stakeholders. Some of these are directly reflected in the updated draft of the tender regulations. Other points have either been addressed more widely by our updated policy positions or because of the policy decisions we have taken, are not appropriate to reflect in the regulations. For more detail on how some of these in-depth issues have been considered please see Appendix 9.

8.7. A general theme that emerged from the responses was a request for further detail on the design of the tender process we are intending to adopt. The October 2008 document responded to some of the issues raised, with our updated proposals contained in this document responding to others.

8.8. In some instances, we do not consider that the regulations are best places to reflect the level of detail requested. For example, there were a number of stakeholders who requested more detail in relation to the payments that would be required from participants in the tender process. As set out in Chapter 7, we are proposing to set these out in a detailed cost recovery principles document, and we are consulting on this accordingly.

8.9. Similarly, a number of respondents requested more clarity in the regulations regarding dates and timing of tender exercises. The draft regulations set out the framework for the process but we are proposing that the specific timing and dates for each step would be set out in separate supporting documentation issued both in advance of the commencement of each tender exercise and at various stages during the tender process.

8.10. Some stakeholders requested greater clarity in relation to the purpose and intent of the regulations. One requested a principles addendum. In order to address

this issue, we have set out the purpose and general effect of each of the regulations at Appendix 9.

Legal Framework for the Regulations

8.11. Once commenced, Section 92 of the Energy Act 2004 and section 44 of the Energy Act 2008 will insert sections 6C and 6D into the Act. Section 6C empowers the Authority to make regulations which would enable it to decide on a competitive basis the person to whom an offshore transmission licence is to be granted. It also enables the Authority to dispense with or supplement provisions made in relation to applications for transmission licences by or under sections 6A or 6B of the Act. Section 6D permits the Authority to recover its associated costs in undertaking the competitive tender process in accordance with the regulations.

8.12. The making of these regulations is not subject to a specific parliamentary procedure. However the approval of the Secretary of State is required under section 6C in order to bring the draft regulations into effect. The offshore electricity transmission licence itself would be granted in accordance with section 6(1)(b) of the Act, which provides the Authority with the legal scope to grant specified types of licence.

Key Amendments to the Draft Regulations

8.13. We have made a number of key changes to the July 2008 consultation. The points below are a high level summary of the main changes, which include:

- The removal of some detailed information which has been put into schedules,
- The order of the regulations to better reflect the sequence of each stage of the tender process,
- the removal of a number of definitions, where these have already been defined in primary legislation,
- The separation of requirements relating to the qualifying project stage from the entry conditions,
- The introduction of reasonable endeavours provision for transitional projects to become qualifying projects,
- The introduction of a review process for developers,
- The amendment of the pre-qualification stage and insertion of a qualification to tender stage,
- The insertion of an expanded section on cancellation of a qualifying project from a tender exercise,

- The insertion of a new section on disqualification,
- The introduction of a standstill period for unsuccessful bidders,
- The requirement for the Authority to publish a cost recovery methodology,
- The insertion of a new regulation on bidder groups, and
- The expansion of the regulation relating to the relationship with sections 6A/6B of the Act. We have retained the Authority's power to modify the terms of a transmission licence in case of abandonment of the asset by an OFTO after licence grant.

8.14. We are seeking feedback on all aspect of the draft tender regulations. We would particularly welcome feedback from stakeholders on the translation of the updated policy proposals into the draft regulations.

8.15. Stakeholders should be aware that a small number of regulations are still under internal review. We have used square brackets to indicate these in the draft regulations. However, we would welcome stakeholders' comments on these sections as drafted nevertheless.

9. Next Steps

Chapter Summary

This chapter provides an overview of how Ofgem would implement the tender process in advance of Go-Active.

Questions

There are no questions in this chapter

Implementing the Tender Process

9.1. Over the coming months, we will be finalising the design of the competitive tender process, in advance of running tenders for those projects that meet the transitional pre-conditions as soon as practicable after Go Active. In doing so, we will take into account feedback to the updated proposals set out in this document.

9.2. Particular focus will be on finalising the tender regulations, which would provide the legal framework for the tender process. We expect these to come into effect in June. We will also be focussing on finalising the detailed tender documentation that would support the tender process, drafts of which are provided in the annexes to this document. These documents would be key to the efficient running of the tender process as they would provide the detailed rules and requirements on participants. Given this, we are seeking feedback on our updated drafts.

9.3. We will also be publishing a joint document with DECC shortly. This will be the final consultation on the design of the regulatory regime and also on the detailed modifications to industry codes and licences necessary to implement the offshore electricity regime. As part of this joint document, we will set out a detailed timetable for the implementation of the regime, including with respect to the tender process. The key high-level milestones and dates are set out below:

March 2009	Final joint statutory consultation on Offshore Transmission Regulatory Regime, including codes and licences.
June 2009	Tender Regulations expected to come into effect. Preliminary cost assessments published. Go-Active for the offshore electricity transmission regime, and commencement of sections 90 and 91 of the Energy Act 2004.
Summer 2009	First round of tenders commence for the transitional regime.

Index of Appendices

Appendix	Name of Appendix	Page Number
1	Consultation Response and Questions	69
2	The Authority's Powers and Duties	73
3	Glossary	74
4	Feedback Questionnaire	78
5	Overview Contractual Framework for Transitional Projects	See separate document
6	Key Provisions in the Sale and Purchase Agreement	See separate document
7	PQ, QTT and ITT Selection Process	See separate document
8	Draft Cost Recovery Methodology	See separate document
9	Key Features of the Draft Tender Regulations	See separate document

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 becoming an OFTO as well as developers of offshore generators that are likely to fall under the transitional regime.

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 16 April 2009. Responses on the draft tender regulations should be received by 2 April 2009. All responses should be sent to:

Richard Clay
Senior manager, Offshore Transmission
Ofgem
9 Millbank, London
SW1P 3GE

Tel: 020 7901 7264

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

Questions - Chapter 1:

There are no questions in this chapter.

Questions - Chapter 2:

There are no questions in this chapter.

Questions - Chapter 3:

There are no questions in this chapter.

Questions - Chapter 4:

We welcome feedback from stakeholders on all of the issues raised in this chapter. In particular, responses are requested on:

- Our proposal to separate the pre-conditions in the transitional regime.
- The scope and level of detail an engineering audit report should contain.
- The scope for an additional pre-condition requiring developers to confirm their expectation that their projects should be completed within a reasonably short period after licence grant.
- Our proposal to separate the pre-conditions in the enduring regime.
- The proposal to develop a model Sale and Purchase Agreement for developers to populate and agree with Ofgem prior to a tender commencing.

Questions - Chapter 5:

We welcome feedback from stakeholders on all of the issues raised in this chapter. In particular, responses are requested on:

- Our updated proposals on the pre-qualification stage of the tender process.
- Our proposals for the financial and non-financial criteria we are proposing for the PQ, QTT and ITT stages of the competition (as set out in this chapter and Appendix 8).
- Our proposals on dealing with changes to consortiums within a tender process.
- Our updated proposals for dealing with bidder dialogue and clarifications within a tender process.
- Our updated tender documentation contained in Annexes 1-3.
- Our initial thoughts on further developments for the tender process going forward.

Questions - Chapter 6:

We would welcome feedback on our overall proposed approach to competitive tenders as set out in this chapter.

Questions - Chapter 7:

We welcome feedback from stakeholders on all of the issues raised in this chapter. In particular, responses are requested on:

- Our proposals on disqualifying bidders.
- Our proposals for the instances where we would cancel a tender process.
- Our proposed cost recovery methodology.
- Our indicative charges for participants in the tender process.

Questions - Chapter 8:

We welcome feedback from stakeholders on the draft tender regulations contained in Annex 4, specifically on the translation of our proposed approach to running competitive tenders into the relevant legal instrument.

Questions - Chapter 9:

There are no questions in this chapter

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 for 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.³¹

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 accordingly³².

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 existing and future consumers, 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 them³³;
- the need to contribute to the achievement of sustainable development; and
- the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.³⁴

³¹ entitled “Gas Supply” and “Electricity Supply” respectively.

³² 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.

³³ 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.

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:

- promote efficiency and economy on the part of those licensed³⁵ 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; 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 about its contribution towards the attainment of any on social or environmental policies issued by the Secretary of State.

1.8. 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 Regulation³⁶ 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 The Authority may have regard to other descriptions of consumers.

³⁵ or persons authorised by exemptions to carry on any activity.

³⁶ Council Regulation (EC) 1/2003

Appendix 3 - Glossary

A

Authority

Gas and Electricity Markets Authority

B

BaFO

Best and Final Offer

BERR

Department for Business Enterprise and Regulatory Reform

BSC

Balancing and Settlement Code

C

CE

Crown Estate

CUSC

Connection and Use of System Code

D

DCUSA

Distribution Connection and Use of System Agreement

DECC

Department of Energy and Climate Change

DIR

Developer Information Request

DNO

Distribution Network Operator

E[EA2004](#)

Energy Act 2004

G[GBSO](#)

Great Britain System Operator

[GBSQSS](#)

Great Britain Security and Quality of Supply Standard

[GW](#)

Gigawatt

I[IRR](#)

Internal Rate of Return

[ITT](#)

Invitation to Tender

K[kV](#)

Kilo Volt

M[MW](#)

Megawatt

N[NGET](#)

National Grid Electricity Transmission plc

O[Ofgem](#)

Office of Gas and Electricity Markets

[OFTO](#)

Offshore Transmission Owner

P

[PFI](#)

Private Finance Initiative

[PPP](#)

Public Private Partnership

[PQ](#)

Pre Qualification

Q

[QTT](#)

Qualification to Tender

R

[RAV](#)

Regulatory Asset Value

[RPI](#)

Retail Price Index

S

[SLC](#)

Standard Licence Condition

[SO](#)

System Operator

[SQSS](#)

Security and Quality of Supply Standard

Offshore Electricity Transmission: Updated
Proposals for the Competitive Tender Process

March 2009

SSE

Scottish and Southern Energy

STC

System Operator - Transmission Owner Code

T

TO

Transmission Owner

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, 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