



To all with an interest in renewable energy and offshore electricity transmission.

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Date: 6 May 2009

Dear Colleague,

Offshore Electricity Transmission: Consultation on Draft Model Sale and Purchase Agreement and Draft Data Room Guidelines for Transitional Tenders

Introduction

We published updated proposals for the design of the competitive tender process on 5 March 2009 (the March document). This document included updated proposals in respect of the conditions that would need to be satisfied by developers of offshore projects in advance of a tender commencing and the tender process stages that we would follow in order to identify a successful bidder for each project. We also consulted for the final time on draft tender regulations, which will provide the legal framework for the tender process.

A new proposal in the March document was that we would develop and issue a model Sale and Purchase Agreement (SPA), which the developer and successful bidder could use to define the terms for the transfer of the transmission assets and associated rights and liabilities to the newly licensed offshore transmission owner (OFTO). We are aware that such a transfer would be necessary for each project tendered under the transitional regime to comply with the legislative framework to be implemented by the Government for offshore electricity transmission. We consider that the use of a model SPA should facilitate successful commercial negotiations and minimise the need for parties to seek to use the statutory transfer powers provided for in the Energy Act 2008. Overall, we consider that this will produce more efficient outcomes for all parties concerned. Generally, respondents to the March document welcomed this approach, and we have since developed a draft model SPA.

We also re-confirmed in the March document our previous proposal that developers would be required to provide information to our satisfaction about the transmission assets to enable the population of a data room, which bidders could use to undertake their necessary due diligence ahead of submitting their bids. In order to assist developers in this regard, we have developed draft guidelines on a proposed data room structure and what we would expect it to include.

This consultation letter builds on the March document and seeks feedback from interested parties on our draft model SPA, both in terms of the generic provisions as well as the project specific schedules. The draft model SPA is included at Annex 1. We are also seeking feedback on our draft data room guidelines, included at Annex 3.

On both issues, we are particularly seeking feedback from developers of transitional offshore projects and potential parties that are interested in becoming OFTOs. This consultation closes on 3 June 2009.

Background and Overview

The Government has decided that offshore transmission licences should be granted by means of competitive tenders, and that Ofgem is the appropriate organisation to run this process. In the light of these decisions and others on the overall policy framework for offshore transmission, we have published a number of consultation documents both on the proposals for the overall regulatory regime for offshore transmission, as well as the detailed design of the competitive tender process we are proposing to adopt. Final consultations were published in March 2009¹.

The legislative basis for the offshore transmission regime is mainly provided for in the Energy Act 2004. Among other things, this Act provides powers for the Authority to make regulations (i.e. secondary legislation in the form of a Statutory Instrument) to determine to whom to grant an offshore transmission licence on the basis of a competitive tender. We consulted for the final time on draft regulations as part of the March document. We have taken into account responses to that consultation in updating the draft regulations, and we currently expect these to come into effect in June 2009.

The Government took further powers with respect to the offshore electricity transmission regime in the Energy Act 2008. Among other things, these additional powers enable the Authority to make a scheme to transfer property rights and liabilities from a developer to the successful bidder identified through the competitive tender process in the transitional regime. The rationale behind these additional powers was to ensure that property rights and liabilities are transferred in a fair, timely and efficient manner and avoid a developer being stranded or the tender being frustrated by stalled negotiations. However, we have set out previously that we would only expect to use these powers as a last resort as we consider that a commercial solution would lead to the most equitable outcome for all parties. We maintain this view.

Sale and Purchase Agreement

Given this, we have developed a model SPA which parties could use as the basis for an agreement to transfer the specific transmission assets and associated rights and liabilities. We proposed in the March document that we considered a commercial transfer would be best provided for through adopting a structured approach within the tender process, with each party having an opportunity to tailor the SPA to align the specific requirements of each offshore development before the transfer agreement is entered into. Our proposed approach is that at the outset of the competitive process, developers would be required to populate the project specific schedules of the SPA and that dialogue with bidders around these terms would be permissible during the Invitation to Tender (ITT) stage of the process. Further detail on how we envisage this working in practice is set out below.

As part of the overall design of the offshore transmission regime, we have previously set out that it would be important that developers demonstrate that they have sufficiently progressed their projects in order to enter a tender process, and that this would be evidenced through the provision of information in respect of certain pre-conditions. The March document confirmed our updated proposals with respect to these pre-conditions. One of the key pre-conditions is that a developer would be required to provide a written undertaking to transfer the offshore transmission assets to the successful bidder under the terms agreed during the tender process. So as to provide effect to our policy approach with respect to the SPA, we propose to build upon this pre-condition and require developers

¹ (i) Offshore Electricity Transmission: Updated Proposals for the Competitive Tender Process, March 2009, (Ofgem Ref 21/09) and (ii) Government Response to Offshore Electricity Transmission – A Further Joint Ofgem/DECC Regulatory Policy Update, March 2009, (DECC Ref URN 09/681)

to populate a model SPA as part of the same pre-condition. We consider that this is a logical extension of the intent behind the existing drafting of the pre-condition, and enables a practical way forward to facilitate the transfer of assets on a commercial basis.

Draft Sale and Purchase Agreement

In the light of the proposals in the March document, we have been working with our legal advisers, Herbert Smith, to develop a draft model SPA which includes both generic provisions and provisions which will require tailoring to the project specific circumstances. The draft SPA is included at Annex 1. A separate commentary describing our approach to the preparation of the draft SPA is provided at Annex 2. We are keen to receive feedback from developers of offshore projects and potential parties that are interested in becoming OFTOs on these documents. We consider that this engagement is a good opportunity for all parties to contribute to the preparation and agreement of the model SPA before it is finalised after the consultation period has closed. We welcome comments on all proposed clauses, but would draw attention to the following in particular:

- Clause 3.3 and 17 – Initial and deferred payment
- Clause 10 – Conduct of vendor activities before completion,
- Clause 11 – Transition Plan, and
- Clause 16 - Warranties

All clauses are summarised in detail in the accompanying commentary.

Developer Engagement

Some respondents to the March document requested further information and clarity on how we intend to engage with developers with respect to the SPA. Whilst we would expect to engage with developers at different stages of the tender process in the transitional regime, we expect that engagement on the SPA would have two distinct stages.

Firstly, following any revisions to the model SPA as a result of this consultation exercise, we would invite developers to populate the project specific provisions to produce complete and bespoke SPAs for each project that has qualified for the first round of tenders in the transitional regime². This would include detailed descriptions of the transmission assets and the supporting contractual and commercial information (such as warranties and guarantees) that would also be transferred. We would expect to hold bilateral meetings with developers to facilitate this process. Once the model has been populated, the second stage of engagement would be during the ITT stage of the tender process³, where developers would have the opportunity to consider any revisions to the SPA in light of feedback from bidders. Further detail on how we envisage this process working is set out below.

Bidder Dialogue and Clarifications

We set out in the March document that we saw benefit in enabling bidders and developers to enter into structured dialogue with respect to the SPA during the ITT stage of the tender process. We consider that this would lead to the most efficient and equitable outcomes, and enable developers and the preferred bidder to ultimately transfer the transmission assets on a commercially agreed basis without recourse to the statutory transfer scheme provided for in the Energy Act 2008. However, we are aware that such negotiations are a key element of the tender process and as such, need to be effectively managed in order to strike a balance between the ability for bidders to clarify issues and propose changes to the

² Projects that do not qualify for the first round of tenders in the transitional regime but qualify for the second round of tenders in the transitional regime would be required to populate the model SPA as part of the process for the second round of transitional tenders.

³ The SPA would be first available to bidders during the ITT stage of the tender process.

terms set out in the SPA offered by the developer, to enable the developer to consider these, and for this to be achieved in a timely manner.

We set out above that we are proposing that developers would be required to populate the model SPA at the outset of the tender process, and that this document would be released to bidders at the ITT stage of the process. In order for a commercial arrangement to be reached with respect to the transfer, we recognise the importance of negotiation around the terms of the agreement. As such, we propose that bidders would have the opportunity, prior to submitting their bids at ITT, to propose changes to the model SPA, based on their clarification requests on the SPA and the information available in the data room within a short period of time (for example 4 weeks). We consider that it would be beneficial for bidders to indicate the revenue implications of these changes at that time (i.e. price mark) as we recognise that pricing a fixed document may constrain bidders' ability to provide a competitive response.

As part of the structured process, we propose that the developer would have an opportunity to consider their commercial response to the proposed changes, and consider any revisions to the SPA in the light of these. Again, we would allow a short period of time for this. We consider that this process enables both bidders and developers the opportunity to negotiate the SPA in a controlled and timely way. Within this process, we propose that Ofgem would retain the ability to facilitate direct dialogue between the parties as appropriate, based on the circumstances of each tender. Based on any revisions to the SPA, we propose that we would re-issue the revised SPA to bidders and seek final ITT bids based on that document, with no further amendments permitted.

Whilst we recognise that this would be a fast-tracked process, we consider it would provide the necessary engagement on the terms of transfer between the developer and the bidders at the ITT stage of the process, and in a fair and transparent way. We would welcome views on this proposed approach.

Draft Data Room Guidelines

We set out in the March document and previous consultations that developers would be required to populate a data room that would be available to bidders at the ITT stage of the tender process. This is one of the key tender entry conditions that a developer would need to satisfy by a date determined by us in order for its project to be tendered in a particular tender round.

Based on responses to the March document, we have considered further how best to facilitate the population of the data room in keeping with the above. To this end, we consider it would be beneficial to develop and issue guidelines for the data room. Our current working draft of these guidelines is included at Annex 3. We recognise that each project is different, but consider that adopting a model guide in this way would assist both developers and bidders in the tender process. We would welcome feedback on our draft guidance document.

Next Steps

Following this consultation exercise, we will finalise the draft model SPA and data room guidelines, taking into account comments received and our own further analysis, incorporating our external advice. The next stage after this will be for those developers that meet the qualification criteria to be tendered this summer to populate the model SPA and populate the data room in accordance with the tender entry pre-conditions. Going forward, we will consider the appropriate mechanisms that we would need to put in place to treat similar issues arising in the enduring regime.

Responding to this Consultation

Responses are due no later than 3 June 2009. All responses should be sent to:

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Please direct all queries in the first instance to Richard Clay (Senior Manager, Offshore Transmission) or, for legal matters, to David Perry (Senior Legal Adviser, Offshore Transmission) – richard.clay@ofgem.gov.uk or david.perry@ofgem.gov.uk.

Yours faithfully,

Robert Hull
Director, Regulatory Services