

All interested parties

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Dear Colleague

**Draft Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2012 for consultation**

In this letter we set out for consultation draft Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2012 (the "Regulations") that will provide the framework for future offshore transmission tender exercises expected to deliver billions of pounds of investment over the next decade.

Offshore transmission plays an integral part in attaining the Government's target to provide 15% of the United Kingdom's energy needs from renewable sources by 2020. Efficient delivery of transmission assets for offshore wind energy projects forms a core part of the strategy for reaching this objective in the most cost effective manner.

The Department of Energy and Climate Change (DECC) together with the Gas and Electricity Markets Authority (the "Authority") have developed a regulatory regime for the construction and operation of offshore transmission assets to facilitate this objective.<sup>1</sup> Under the regime, Ofgem runs a competitive tender process to select and license Offshore Transmission Owners (OFTOs).<sup>2</sup> Since establishing the legal framework in June 2009, we have already licensed five OFTOs for assets worth over £350 million in total and qualified a further eight projects.

We consulted on the enduring regime in December 2011 and May 2012. Through these consultations we established our minded-to policy positions to ensure the regime meets the needs of future projects.<sup>3</sup> This letter and Annex 4 confirm our final policy positions that specifically require implementation through the Regulations. We are consulting on the resulting changes we propose to the 2010 Regulations in the form of the draft Regulations.<sup>4</sup>

**We are seeking feedback from stakeholders on all aspects of the draft Regulations, including whether you consider them to give proper effect to the final policy positions set out in this letter and in Annex 4. Comments should be received by 5 November 2012 and should be sent to Emily Sam, [offshore.enduring@ofgem.gov.uk](mailto:offshore.enduring@ofgem.gov.uk). Unless marked confidential, responses will be published by placing them in Ofgem's library and on its website.**

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<sup>1</sup> The Office of the Gas and Electricity Markets Authority is the regulator of gas and electricity markets in Great Britain. Ofgem is the Office of Gas and Electricity Markets, which supports the Authority in performing its statutory duties and functions. For ease of reference, Ofgem is used to refer to Ofgem and the Gas and Electricity Markets Authority (The Authority) in this document.

<sup>2</sup> This process is run by Ofgem under the Electricity Act 1989 (the "Act") and regulations made under the Act which underpin the regime. The current regulations in force are the Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2010, ("the 2010 Regulations").

<sup>3</sup> *Consultation on tender exercises under the enduring regime*, December 2011 and *Updated proposals for the enduring regime*, May 2012.

<sup>4</sup> See Annex 1 for the draft Regulations and Annex 2 for a copy showing tracked changes to the 2010 Regulations.

## **The 2012 Regulations: regulatory and policy context**

The offshore transmission regime is being delivered in two parts: a transitional and an enduring regime. The transitional regime applies to assets constructed, or currently under construction by generator developers. Transfer of ownership to an OFTO takes place after the generator has completed construction. The OFTO will operate, maintain and decommission the transmission assets. This is known as Generator Build.

Any project which meets the qualifying requirements after 31 March 2012 is considered to be part of the enduring regime. This timeframe was stipulated in the 2010 Regulations. Under the enduring regime, developers may choose either the Generator build option or the OFTO build option. Under the OFTO build option, the generator will obtain the connection agreement and undertake high level design and pre-construction activities. The OFTO will undertake the detailed design work and procurement and deliver the build programme, as well as being responsible for the operation, maintenance and decommissioning of the assets. The draft Regulations set out provisions for the running of tender exercises under either build option following consultation in 2011 and earlier this year.

For the purposes of this letter we use the terms “generator build” and “OFTO build” as per our May 2012 consultation. However, please note that as under the 2010 Regulations, these terms do not appear in the draft Regulations. The Regulations instead refer to a ‘transitional tender exercise’<sup>5</sup> when referring to generator build (where the developer has constructed the assets) and ‘any other case’ when referring to OFTO build. This is because the term ‘transitional tender exercise’ as currently defined in the Regulations is equally applicable to the Generator build model. The term ‘transitional tender exercise’ does not indicate that the related qualifying projects are part of the transitional regime.

In December 2011, we published the ‘Consultation on tender exercises under the enduring regime’ which set out updated proposals for the enduring regime. We then published a series of minded-to positions in our May 2012 publication which addressed responses raised to the December 2011 consultation. This letter and Annex 4 to this letter confirm our final policy positions that specifically require implementation through the regulations and consults on the changes we are proposing to the 2010 Regulations to implement those final policy positions. We have provided a summary of the responses received to the May 2012 consultation which are particularly relevant to our final policy positions that require implementation through the Regulations in Annex 4.<sup>6</sup>

## **Legal framework for the Regulations**

Section 6C of the Act 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 electricity transmission licence is to be granted. The making of these regulations is not subject to a specific parliamentary procedure but the approval of the Secretary of State is required to make them. The first set of the regulations came into force in June 2009, after consultation with stakeholders in July 2008 and March 2009. Following further stakeholder consultation in 2009, the 2010 Regulations were introduced and are the regulations currently in force.

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<sup>5</sup> A ‘transitional tender exercise’ is one in which (a) a tender exercise is held in relation to an offshore transmission licence, (b) any transmission assets have been transferred to the successful bidder or, for operational purposes, it is necessary for any transmission assets to be so transferred, and (c) those assets were not constructed or installed by the successful bidder.

<sup>6</sup> We will publish a summary of the responses to all the questions in the May 2012 publication later this year.

## Associated regulatory framework

Our final policy positions in relation to minded-to policy positions set out in our May 2012 consultation which do not require implementation through regulations are not within the scope of this letter. We intend to communicate further detail on any changes that may be required to the regulatory framework underpinning these positions as follows:

- **the licence** to be granted to an OFTO following either a Generator build or OFTO build tender exercise. We intend to publish further details on the proposals for the licence for the enduring regime in late 2012, building on the licence currently used for transitional projects. This will include our proposals in relation to refinancing, length of the revenue term and indexation of the revenue stream;
- **the relevant industry codes and standards** that apply to construction and operation of offshore transmission assets. Ofgem, in liaison with National Grid, is currently considering whether further changes will be required to the industry codes and standards to support implementation of Generator build and OFTO build tender exercises and our work on coordination. Should any necessary changes be identified, these will be set out for further consideration in due course;
- **other tender documentation.** The draft Regulations refer to various tender documents to be published for a tender exercise. These include the cost recovery methodology, the tender rules and stage-specific documentation (eg the pre qualification questionnaire). The relevant documents will be published in due course and ahead of Generator build and OFTO build tender exercises, as applicable. (We currently anticipate the first enduring tender exercises to commence in summer 2013.)

## Arrangements for projects qualified under the 2010 Regulations

The draft Regulations set out the arrangements for projects which qualified under the 2010 Regulations, but whose tender exercises were incomplete prior to the 2012 Regulations coming into force. Subject to this consultation, we expect the new Regulations to come into force by early 2013. The arrangements apply regardless of whether a project qualified within the transitional regime or the enduring regime.

At the point at which the 2012 Regulations come into force:

- where a project has qualified under the 2010 Regulations and we have issued the notice to all qualifying bidders of the payment they need to make to the Authority in relation to the ITT stage, the tender exercise for that project will continue to be held under the 2010 Regulations; and
- where a project has qualified under the 2010 Regulations but we have yet to issue the notice to all qualifying bidders of the payment they need to make in relation to the ITT stage, the remainder of the tender exercise for that project will be held under the 2012 Regulations.

This is because we consider that where the ITT stage has commenced for a particular qualifying project, it has progressed sufficiently far through the tender process for participants to need certainty on which regulations apply.

## Overview of our final policy positions and key changes from the 2010 Regulations

We have set out below a high level summary of our final policy positions that require implementation through the regulations and, to that end, the key changes we intend to

introduce in the Regulations. The draft Regulations also include a number of administrative changes from the 2010 Regulations. Annex 1 provides a copy of the draft Regulations. Annex 2 provides a copy of the draft 2012 Regulations with all the proposed changes marked up against the 2010 Regulations to assist stakeholders. Annex 3 provides an explanatory note detailing the provisions of each regulation.

- **Definition of 'developer'** – under the 2010 Regulations, a developer is defined as “any person within section 6D(2)(a) of the 1989 Act”. We have reviewed this definition following stakeholder feedback that it may be too restrictive for some future project arrangements. The Regulations propose amendments to that definition and a related new definition of “developer group”.
- **Definition of 'transfer agreement'** – the definition has been revised following feedback on potential arrangements a developer may wish to use to transfer ownership of the relevant assets or shares in those assets to the OFTO. The Regulations propose amendments to that definition. An equivalent definition has been added to the Regulations of a **'preliminary works transfer agreement'** in respect of OFTO build.
- **Qualifying project requirements** – the qualifying project requirements vary depending on the developer's choice of build option and are set out in Schedule 1 to the Regulations.
  - The qualifying requirements for a Generator build tender exercise are set out in paragraph 2 of Schedule 1 and are consistent with those under the 2010 Regulations, other than an amendment to those qualifying requirements for which developer is permitted to use its reasonable endeavours to satisfy within a particular timeframe.
  - The Regulations introduce additional qualifying requirements for OFTO build in paragraph 1 of Schedule 1. This follows consultation on the requirements in May (see Annex 4 for further discussion).
  - The draft Regulations also set out that the developer will be required to notify us at the point of requesting a tender exercise of whether their project is intended to meet the qualifying project requirements for either a Generator build or an OFTO build tender exercise.
- **Entry conditions** – the entry conditions applicable to the developer are set out in Schedule 2 to the Regulations. We are proposing changes following consultation in the December 2011 and May 2012 documents (see Annex 4 for further discussion).
- **Treatment of preliminary works for OFTO build** – the Regulations build in provisions for the treatment of preliminary works by the developer for an OFTO build tender exercise in line with the position set out in May 2012. The Regulations include arrangements for the cost assessment of the preliminary works and provisions allowing the Authority to recover its costs for undertaking such an assessment. The Regulations also provide a definition of the term 'preliminary works'. **(Please note that in previous publications we have referred to these as 'pre-construction works'.** We have amended the term because we believe 'preliminary' more accurately describes the nature of the works. It is not intended to change those works which we would expect a developer to undertake as part of an OFTO build, such as acquiring consents.)
- **Stages of a tender exercise** – we have decided that under a Generator build tender exercise, the Authority may determine not to hold a Qualification to Tender (QTT) stage. For OFTO build, we consider that a relatively detailed QTT stage will be required for each project. The draft Regulations also set out that we will provide in the ITT documentation the criteria to be applied when we determine whether to hold a best and final offer stage.

- **Bidder group changes** – we have decided that bidder groups should notify the Authority of proposed changes to their membership and set out the tests the Authority will apply to determine whether to permit the change. The Regulations build in new arrangements to implement this.
- **Cost recovery of ITT bid costs for an OFTO build tender exercise** – we have decided to implement an optional provision for a reimbursement of the costs or a proportion of the costs incurred by a qualifying bidder in the preparation of an OFTO build tender submitted at the ITT stage. We would determine whether such a provision should be applied depending on the project's particular circumstances and we would calculate the amount to be reimbursed in accordance with the Cost Recovery Methodology published ahead of the relevant tender exercise. The Regulations build in new arrangements to implement this. This reflects our minded-to-position in the May 2012 publication (see Annex 4 for further discussion).
- **Preferred Bidder (PB) stage** – we have decided to include particular obligations on the developer effective from the PB stage to facilitate the timely conclusion of a tender exercise, relating to enabling the PB to meet the PB Matters where these are dependent on the actions of the developer and enabling the transfer of the assets or preliminary works, as the case may be. The Regulations build these in.
- **Re-Run** – the Regulations clarify the position regarding re-run of tender exercises as opposed to events of cancellation.

## Wider developments affecting offshore transmission

We recognise that there are likely to be further regulation changes required in subsequent years in response to ongoing developments affecting offshore transmission. The Regulations subject to this consultation do not seek to pre-judge the outcomes of this ongoing development. In particular, we anticipate future regulation changes may be required to accommodate positions reached on anticipatory investment and the generator commissioning solution. For further discussion on these areas, please see our *Open Letter: Offshore Transmission – update on Coordination policy developments*, published in July 2012.<sup>7</sup>

## Next Steps

As indicated above, we invite feedback on the draft Regulations by 5 November 2012. We will then review the Regulations in light of responses received. Subject to this consultation, we expect the new Regulations to be published and subsequently come into force by early 2013. For further information on offshore transmission, please visit our website<sup>8</sup> or contact [offshore.enduring@ofgem.gov.uk](mailto:offshore.enduring@ofgem.gov.uk).

Yours faithfully

**Martin Crouch**

**Director, Offshore Transmission**

<sup>7</sup>[http://www.ofgem.gov.uk/Networks/offtrans/pdc/cdr/2012/Documents1/201207\\_Coordination%20open%20letter%20Final.pdf](http://www.ofgem.gov.uk/Networks/offtrans/pdc/cdr/2012/Documents1/201207_Coordination%20open%20letter%20Final.pdf)

<sup>8</sup><http://www.ofgem.gov.uk/NETWORKS/OFFTRANS/Pages/Offshoretransmission.aspx>

## **Annexes**

**(All annexes are provided as separate pdfs.)**

- 1** The Draft Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2012
- 2** The Draft Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2012 showing tracked changes to the Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2010
- 3** The Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2012 – Key Features of the Draft Regulations
- 4** Annex 4: Summary of responses to questions in 'Offshore Electricity Transmission: Updated proposals for the enduring regime', May 2012 - Final policy positions as they affect the draft Regulations