

Offshore Electricity Transmission: Process to Asset Transfer and Licence Grant for the Second Transitional Tender Round (Tranche B Tender Exercise)

Guidance

Issue date: 14 December 2012

Contact: Marcia King, Senior Manager, Tenders and Transactions

Team: Offshore Tenders and Transactions

Tel: 020 7901 1888

Email: tendercoordinator@ofgem.gov.uk

Overview:

The regulatory regime for offshore electricity transmission enables the Authority to grant offshore transmission licences on the basis of a competitive tender process. Ofgem E-Serve is responsible for managing this process.

This document provides guidance to bidders, offshore developers and other interested stakeholders on the process from the determination of a preferred bidder to the transfer of transmission assets from the offshore developer to the offshore transmission owner (OFTO) identified through the competitive tender process. It also provides an overview of the process to licence grant. This guidance applies to the tender being run in the second tranche (Tranche B) of the second transitional tender round.

Ofgem E-Serve may update this guidance document over time taking into account further experience gained in the granting of licences to OFTOs.

Document version history

Version number	Date	List of changes
1	December 2012	New document to apply to the Tranche B tender exercise

Context

Electricity generated from offshore renewable sources is expected to make an important contribution towards the United Kingdom achieving its renewable energy targets by 2020. As part of the regulatory regime introduced by the government in June 2009 to ensure cost effective development of offshore transmission infrastructure, licences for offshore electricity transmission are granted to a person who is identified by means of a competitive tender process run by Ofgem¹ in accordance with the Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2010 (the Tender Regulations). This means that offshore generating assets (offshore wind farms) will be owned and operated by the generator, whilst the offshore transmission system, which connects the offshore wind farms to the onshore transmission system, will be owned and operated by the offshore transmission owner (OFTO). Both of these activities are licensable in accordance with the provisions of the Electricity Act 1989.

The regulatory regime for offshore transmission encompasses both a transitional and an enduring regime. Under the transitional regime, developers are able to construct transmission assets which are then transferred, on completion, to an OFTO. Ofgem expects this transfer to be effected by a transfer agreement which will be commercially agreed between these parties.

The developer will transfer the transmission assets at a transfer value determined by Ofgem E-Serve in accordance with the Tender Regulations following an assessment of the economic and efficient costs of developing and constructing them. OFTOs will then operate and maintain the assets in accordance with the requirements of the licence and the wider regulatory framework.

The offshore regime has been commenced by the government for specific purposes connected with transitional projects. The mechanics of commencement have been developed by the Department of Energy and Climate Change (DECC) with support from Ofgem to account for the time required to transfer transmission assets to the successful bidder and to ensure that there is no adverse impact on offshore renewable generation.

¹ 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. Whilst the terms "Ofgem", "Ofgem E-Serve" and "the Authority" are used interchangeably in this document, it is the Authority which is responsible for exercising the relevant statutory powers.

Associated documents

- The Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2010
<http://www.legislation.gov.uk/uksi/2010/1903/contents/made>
- Offshore Electricity Transmission: Tender Rules (v1.2 – 14/12/11)
http://www.ofgem.gov.uk/Networks/offtrans/rott/Documents1/Tender-Rules-for-TR1_v.1.2_141211.pdf
- Guidance on Licence Derogation Requests (19/01/09)
<http://www.ofgem.gov.uk/Networks/Tech/TechStandds/Derogtns/Document s1/090119DerogationsGuidance.pdf>
- Offshore Electricity Transmission: Cost Recovery Methodology for the Second Transitional Tender Round (v1.1 – 14/12/11)
http://www.ofgem.gov.uk/Networks/offtrans/rttt/Documents1/Cost%20Recovery%20Methodology%20for%20TR2_v-1.1.pdf

Example documents

- Notice under Section 8A(3) of the Electricity Act 1989 (Walney 2)
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=5&refer=Networks/offtrans/rott/w2>
- Offshore Transmission: Cost Assessment for the Walney 2 transmission assets
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=14&refer=Networks/offtrans/rott/w2>

Contents

Contents	4
1. Executive Summary	5
Introduction	5
Summary	5
Timing of Licence Grant and Asset Transfer	6
1. Preferred Bidder to Successful Bidder	7
The PB Notice and the PB Matters	7
Ofgem's role	9
Derogations and "Minded to" statements	10
Finalising the Licence and section 8A consultation	10
Tender Revenue Stream	10
Market Rate Revenue Adjustment	11
Section 8A Consultation	12
The Transfer Value	13
2. Successful Bidder to Licence Grant	15

1. Executive Summary

Introduction

The purpose of this document is to provide guidance to qualifying bidders and other interested parties in relation to the process to asset transfer and financial close, including finalisation of the tender revenue stream and grant of the OFTO licence (the Licence).

This guidance document is intended to apply specifically to the second tranche of the second transitional tender round (Tranche B). It incorporates relevant aspects of:

- a) the Guidance Note on Process to Asset Transfer (published in respect of the first transitional tender round) dated October 2009;
 - b) Addendum to the Guidance Note dated February 2010; and
 - c) Guidance on the Process to Asset Transfer and Licence Grant for the Second Transitional Tender Round (Tranche A Tender Exercises),
- and is further informed by our experience on the process to asset transfer undertaken for projects in the first transitional tender round.

We anticipate that this guidance document may be updated or amended over time to reflect any further experience and feedback gained from ongoing tender processes.

Summary

The process to asset transfer runs from appointment of the preferred bidder through to achieving transfer of the transmission assets and granting a Licence in relation to the qualifying project in the second transitional tender round (Tranche B).

The process to asset transfer will include the following key steps:

- a) appointment of the preferred bidder;
- b) the preferred bidder performing confirmatory due diligence and working to resolve the "PB Matters" set by the Authority (see section 2);
- c) finalisation of the tender revenue stream (the TRS) in parallel with resolution of the "PB Matters" (see section 2);
- d) the section 8A consultation in respect of the Licence, which is a consultation under section 8A of the Electricity Act 1989 to propose an amendment to the standard conditions of the Licence in order to incorporate the OFTO specific provisions (see section 2);
- e) standstill period and appointment of the successful bidder (see section 3); and
- f) Licence grant, financial close and asset transfer (see section 3).

An indicative high level diagram setting out the generic process to asset transfer is set out at figure 1. This diagram is provided for information purposes only and is based on the anticipated process to asset transfer as at the date of publication of this guidance document. The timeline for the qualifying project will be published in the invitation to tender (ITT) document and on Ofgem's website².

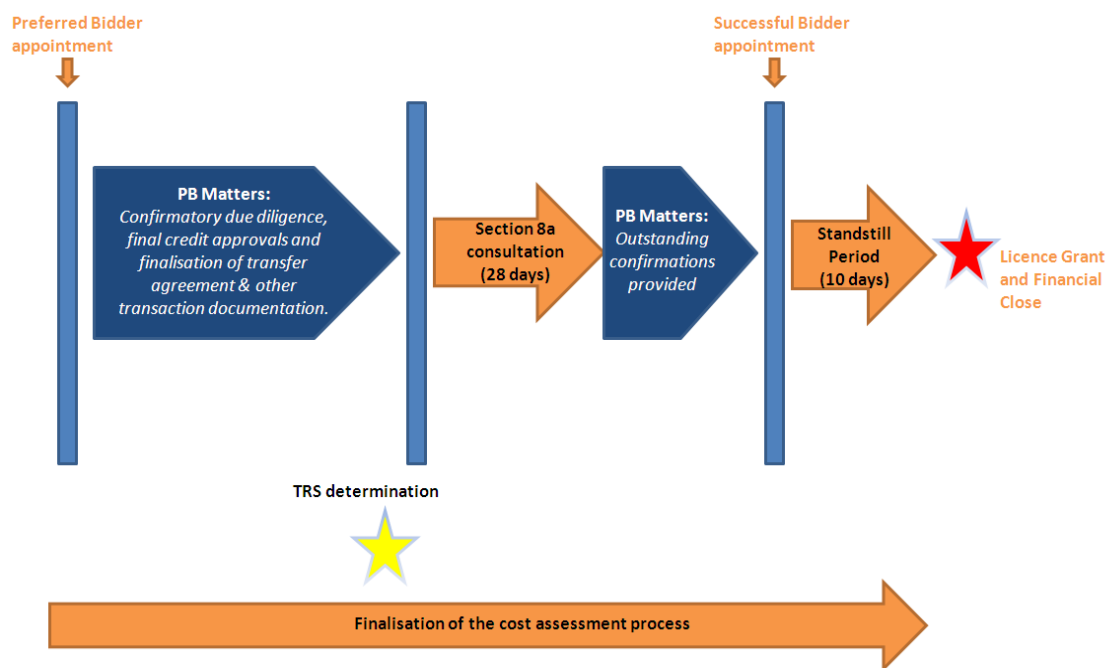


Figure 1

Timing of Licence Grant and Asset Transfer

The timing of licence grant and asset transfer will depend on the underlying construction programme and the readiness of the transmission assets to be transferred. Based on our experience to date of the first transitional tender round, we are aware that the point of asset transfer may not necessarily be the point of completion of construction of the transmission assets. For example, there may be a need for the preferred bidder and developer to finalise certain aspects of technical due diligence following completion of construction of the transmission assets, before the PB Matters are resolved and Ofgem is able to start the licence grant process.

For the purposes of this guidance document, we assume that it will take up to six months from the time of the appointment of a preferred bidder to the grant of a Licence for a particular qualifying project.

² <http://www.ofgem.gov.uk/Pages/OfgemHome.aspx>

1. Preferred Bidder to Successful Bidder

The PB Notice and the PB Matters

- 1.1. The preferred bidder stage is the penultimate step in the tender process and follows the pre-qualification, qualification to tender, ITT and (if applicable) the best and final offer stages. The preferred bidder stage will commence once a preferred bidder (and possibly a reserve bidder) is identified in respect of the qualifying project. The purpose of the preferred bidder stage is to resolve certain matters to the Authority's satisfaction before the preferred bidder becomes the successful bidder.
- 1.2. Following selection of a preferred bidder in respect of the qualifying project, Ofgem will issue a notice to the preferred bidder (the PB Notice) setting out the matters (the PB Matters) which must be resolved by the preferred bidder to the Authority's satisfaction, as required under the Tender Regulations. The preferred bidder must satisfy the PB Matters within certain timeframes before becoming the successful bidder. Such PB Matters are likely to include:
 - (a) confirmations that:
 - (i) contractual and other arrangements which are required for the transmission assets to be transferred are agreed (including the transfer agreement, interface agreement, disclosure letter, Crown Estate lease, any crossing agreements, deeds of assignment and/or novation or security documents);
 - (ii) relevant property, rights, consents, licences and permits required by the preferred bidder for operational purposes are in place or are agreed;
 - (iii) contractual and financial arrangements required by the preferred bidder are agreed (including all necessary financing, operation and maintenance, and management service agreements);
 - (iv) operational arrangements are in place (including the takeover and transition plans, operation and maintenance, and health and safety policies);
 - (v) the proposed terms and conditions of the Licence have been accepted following the section 8A consultation;
 - (vi) a proposed market rate revenue adjustment methodology is in place in relation to any proposed market rate revenue adjustment term in the Licence;
 - (vii) a financial close protocol, setting out the processes and timescales which are to be followed by the preferred bidder to

achieve financial close, together with the accompanying financial model optimisation protocol are in place; and

(viii) all necessary contractual and financial arrangements are in place.

b) confirmation that the bilateral agreement between the proposed OFTO and the National Electricity Transmission System Operator is in place;

c) confirmation that the proposed OFTO has acceded to the System Operator-Transmission Owner Code (STC); and

d) any other matters which Ofgem determines necessary in relation to the qualifying project.

- 1.3. Ofgem anticipates that the PB Notice for the qualifying project may include the PB Matters listed at paragraph 2.2 above, however the PB Notice and the PB Matters will be tailored to the particular project characteristics and circumstances of the preferred bidder as at the time of issue. The Authority will also publish a notice of appointment of preferred bidder in respect of the qualifying project on the Ofgem website, setting out an overview of the PB Matters in general terms.
- 1.4. Once the Authority has issued the PB Notice, Ofgem expects the preferred bidder to move promptly to satisfy the PB Matters within the relevant timeframes set out in the PB Notice by liaising directly with the developer and other relevant third parties.
- 1.5. Where there is a significant period of time between a preferred bidder being appointed and construction of the transmission assets for the qualifying project being completed, Ofgem may apply an "on hold" period with reference to the estimated date for completion of construction of the transmission assets. The preferred bidder will not be required to undertake any activity to progress resolution of the PB Matters (though it may choose to do so) during the "on hold" period but will be expected to move promptly to resolve the PB Matters in the normal course once the "on hold" period has ended. The preferred bidder will therefore be taken off hold with consideration given to the construction timetable and the process for completing due diligence and the preferred bidder will be requested to confirm its ITT tender revenue stream submission. There is currently no expectation of applying an "on hold" period for the Qualifying Project in Tranche B of Tender Round 2.
- 1.6. After appointment and before the preferred bidder commences substantive work to complete the PB Matters, it will be required to make a payment to Ofgem. The PB Notice will set out details of the preferred bidder payment, including the amount, when and how this payment should be made, in accordance with regulation 18(5) of the Tender Regulations. The preferred bidder payment and all other payments described in this guidance document will be recoverable by the OFTO as allowed pass-through items

via a revenue adjustment condition in the Licence. Further details on payments can be found in the cost recovery methodology³.

Ofgem's role

- 1.7. In managing the tender process, including the process to asset transfer, Ofgem will have regard to its statutory duties and functions.
- 1.8. The various roles of Ofgem during the competitive tender process generally are set out in the Tender Rules for the Second Transitional Tender Round⁴. In relation to the process to asset transfer and Licence grant, Ofgem's role during this period may include:
 - a) establishing the matters to be resolved by the preferred bidder in light of the project characteristics, circumstances of the preferred bidder and any other relevant factors;
 - b) determining whether the preferred bidder has resolved the PB Matters to the Authority's satisfaction;
 - c) calculating an assessment of costs which will be used by Ofgem to determine the value of the transmission assets to be transferred to the successful bidder for the project (see paragraph 2.32 below);
 - d) granting derogations and/or consents (see paragraph 2.12 below);
 - e) specifying the TRS and running the section 8A consultation (see paragraph 2.25 below); and
 - f) granting the Licence to the successful bidder, including determining the final TRS.
- 1.9. A key PB Matter to be resolved by the preferred bidder will be finalisation of documentation to effect asset transfer and financial close including the transfer agreement, funding documentation, the operation and maintenance, and the interface arrangements. Ofgem does not propose to review or participate in the development of documents to which it is not a party, or to act as an arbiter of disputes between the parties.
- 1.10. Ofgem expects that where issues arise in the process to asset transfer, most will be for resolution on a commercial basis between the preferred bidder, the developer and any other relevant parties.
- 1.11. During the process to asset transfer, Ofgem will host bilateral meetings between Ofgem and each of the preferred bidder, developer and other third parties as necessary to monitor progress towards resolution of the PB Matters. In limited circumstances, Ofgem may also attend meetings between the preferred bidder and the developer where this serves to aid in any aspect of Ofgem's overall role.

³ Offshore Electricity Transmission: Cost Recovery Methodology for the Second Transitional Tender Round (v1.1 – 14/12/11)

⁴<http://www.ofgem.gov.uk/Networks/offtrans/rttt/Documents1/Tender%20Rules%20for%20the%20Second%20Transitional%20Tender%20Round.pdf>

Derogations and "Minded to" statements

- 1.12. If the qualifying project does not meet an applicable requirement of a particular technical code or standard, for example the STC, the preferred bidder may request that the Authority grant a derogation from the Licence requirement to comply with that particular technical code or standard. A derogation is a direction from the Authority relieving the licensee from its obligation to comply with a technical standard or code in its licence in specified circumstances and to a specified extent. The preferred bidder is expected to identify and approach the Authority promptly with any such derogation requests. We refer you to the Guidance on Licence Derogation Requests for further information.
- 1.13. Where the preferred bidder has submitted a request for a derogation to the Authority prior to Licence grant, the Authority will consider each request, indicating in advance of Licence grant whether it is minded to consent to or approve of such arrangements following Licence grant.
- 1.14. Where the licensee has submitted a request for a derogation to the Authority on or after Licence grant, the derogation will apply from the date on which the direction is issued by the Authority.
- 1.15. Each derogation will be entered onto Ofgem's public register after it has been granted.
- 1.16. Similarly, the Authority has discretion to derogate or provide consent to alternative arrangements in relation to certain matters set out in the Licence, for example with respect to credit rating or business separation arrangements. The preferred bidder may identify and approach the Authority in advance of Licence grant to request any relevant consent or approval in respect of such alternative arrangements.

Finalising the Licence and section 8A consultation

Tender Revenue Stream

- 1.17. At the appointment of a preferred bidder we require the TRS Bid⁵ to be firm, fully reflective of the final transfer agreement for the qualifying project made available by the developer during the ITT stage, and subject only to the conditions precedent set out in the ITT document.
- 1.18. There may be certain circumstances under which the Authority may consider changes to the TRS Bid once the preferred bidder has been appointed. The following may lead to a permissible change:
 - a) changes to underlying market rates (excluding any applicable credit spreads and margins) up to the point of financial close (the market rate revenue adjustment – see paragraph 2.23);

⁵ i.e. the TRS Bid upon which the preferred bidder was selected

- b) changes to the indicative or final transfer value notified to the preferred bidder by Ofgem prior to Licence grant (see paragraph 2.32);
 - c) updates to the final transfer agreement, only where these result in a reduction to the TRS Bid;
 - d) material changes in respect of the transmission assets since the date of the ITT/BAFO submission;
 - e) any other circumstances expressly notified by the Authority to the preferred bidder as potentially leading to a permissible change to the TRS Bid.
- 1.19. During the process to asset transfer, the preferred bidder is requested to notify Ofgem of any proposed permissible changes (whether an increase or reduction) to the TRS as soon as reasonably practicable after such change is identified.
- 1.20. Ofgem expects the preferred bidder to work on a transparent basis to identify to Ofgem matters which may lead to a reduction in the TRS as a result of any improvements to the position set out in the ITT/BAFO submission, including, but not limited to, potential savings identified in the ITT/BAFO submissions. These reductions may lead to permissible changes.
- 1.21. Finalisation of the TRS for the purpose of publication in the section 8A consultation (the section 8A TRS) will occur in parallel to the activities to be carried out by the preferred bidder in advance of the section 8A consultation. The preferred bidder will be provided with further details of the process for notifying the Authority of proposed permissible changes to the TRS Bid and finalising the TRS for the purpose of both the section 8A consultation and the Licence grant following their appointment.
- 1.22. In requesting any TRS changes, Ofgem expects the preferred bidder to factor in sufficient time for Ofgem to undertake a thorough review and a modelling audit before finalisation of the TRS.

Market Rate Revenue Adjustment

- 1.23. The Licence allows for an adjustment on a project specific basis to the revenue stream to reflect the difference between market rates assumed in the section 8A TRS and the market rates determined on the day of financial close. This is referred to as the market rate revenue adjustment (MRA) term in the Licence. It ensures that the OFTO is not affected by underlying movements in market rates, where this was the basis of its ITT/BAFO submission.
- 1.24. As part of the PB Matters, the preferred bidder is required to prepare a statement outlining the proposed methodology to calculate this adjustment. This statement must meet the criteria outlined in the Licence and be approved by the Authority. The Authority will subsequently determine the value of the MRA, in accordance with this methodology, and direct the MRA term in accordance with the terms of the Licence on the day of financial close.

Section 8A Consultation

- 1.25. Once Ofgem has received the relevant confirmations from the preferred bidder as required under the PB Matters and Ofgem has determined the final TRS for the qualifying project, Ofgem intends to commence a section 8A consultation for the qualifying project.
- 1.26. The Licence granted by Ofgem will, by default, include only standard conditions and the terms. As such, we will need to modify the Licence at Licence grant to incorporate the OFTO specific provisions (such as the revenue stream, incentives, business separation requirements etc). We intend to make use of our powers under section 8A of the Electricity Act 1989 to propose such a modification to the standard conditions of the Licence in order to incorporate the OFTO-specific provisions at the time of Licence grant. This will require a statutory consultation of at least 28 days to be run prior to such a modification taking place.
- 1.27. Ofgem will issue a public notice setting out its intention to commence the section 8A consultation process. Any circumstances occurring during the section 8A consultation which give rise to the need to change the proposed Licence conditions may require the section 8A consultation to be re-run. For example any change to the TRS (set for the purpose of the section 8A consultation) arising from further discussions between the parties during the consultation period would have this effect. It is therefore important that all parties confirm that an effective “commercial close” has been reached before the section 8A consultation commences.
- 1.28. It should be noted that neither commencement of the section 8A consultation, nor the resolution of commercial issues and transaction documents prior to commencement of the section 8A consultation, places the preferred bidder under any contractual obligation in relation to the transmission assets nor does it require the Authority to grant a Licence.
- 1.29. Following expiry of the section 8A consultation period, Ofgem will consider any responses received before issuing a final version of the Licence for consideration by the proposed OFTO.
- 1.30. Where Ofgem is not satisfied that the preferred bidder has resolved the PB Matters, the preferred bidder has failed to make the preferred bidder payment specified in paragraph 2.6, or the preferred bidder withdraws or is disqualified from the tender exercise, Ofgem may discontinue the tender exercise with the preferred bidder and may treat the reserve bidder (if it has selected one) as if it were the preferred bidder for that project.
- 1.31. A reserve bidder is the second choice qualifying bidder to which Ofgem would consider granting the Licence should Ofgem determine not to grant the Licence to the preferred bidder. Where a reserve bidder is so appointed, Ofgem will notify the preferred bidder and reserve bidder accordingly.

The Transfer Value

- 1.32. Pursuant to regulation 4 of the Tender Regulations, the Authority will assess the economic and efficient costs which ought to have been incurred in connection with the development and construction of the transmission assets of the qualifying project. The assessment of costs will be used by the Authority to determine the value of the transmission assets to be transferred to the successful bidder for the project.
- 1.33. Ofgem will calculate its estimate of the economic and efficient costs in respect of the qualifying project and provide this as the indicative transfer value for use in relation to the TRS Bids submitted by qualifying bidders at ITT stage. The final transfer value will be calculated once the transmission assets are available for use for the transmission of electricity.
- 1.34. Based on our experience from previous tender rounds and on our interaction with bidders on the second transitional tender round, we reviewed our approach to deferred consideration for the purposes of an ITT submission for qualifying projects in Tranche A of the second transitional tender round. Ofgem considered that removing the assumption that deferred consideration will be payable following asset transfer allowed for greater certainty and deliverability for both the developer and potential OFTOs regarding the amount, timing and funding of the final transfer value. Ofgem considers that this approach is still appropriate and will continue to apply for the qualifying project in Tranche B.
- 1.35. It is intended that Ofgem will finalise the assessment of costs prior to commencement of the section 8A consultation with the section 8A TRS accounting for 100 per cent of the final transfer value. Where the assessment of costs is to be finalised after commencement of the section 8A consultation, the section 8A TRS would continue to reflect the indicative transfer value. Where the Authority completes the assessment of costs after the section 8A consultation and sufficiently in advance of Licence grant, we would look to utilise the post tender revenue adjustment term (contained in amended standard condition E12-A3 of the Generic OFTO Licence) at Licence grant in order to enable a transfer of assets for 100 per cent of the final transfer value payable at asset transfer. If, under exceptional circumstances, this is not possible then Ofgem may determine that deferred consideration would be paid by the OFTO to the developer on conclusion of our cost assessment and we would utilise a post tender revenue adjustment term after Licence grant to reflect the final transfer value. A provision to use the PTRAs term post-licence grant would be included in the amended standard conditions to enable this to happen.
- 1.36. During the process to asset transfer, Ofgem will liaise with the developer in order to finalise the assessment of costs and notify the preferred bidder of any updates in relation to the cost assessment process and the transfer value where relevant (for example an update of the indicative transfer value or determination of the final transfer value). Any change to the transfer value prior to commencement of the section 8A consultation will be notified to the preferred bidder and considered as a permissible change to the TRS Bid.

- 1.37. A sample cost assessment report for Robin Rigg provides an example of the key principles that were applied in the cost assessment process for the first transitional tender round to determine the value of the transmission assets. This report is provided for information purposes only and Ofgem is not bound to follow the format or contents of such report for the purposes of the second transitional tender round.

2. Successful Bidder to Licence Grant

- 2.1. The successful bidder stage is the final step of the tender process and immediately follows the preferred bidder stage. The purpose of the successful bidder stage is for the Authority to grant a Licence to the successful bidder so that it becomes the OFTO for the relevant qualifying project.
- 2.2. Following the section 8A consultation process and once Ofgem is satisfied that the preferred bidder has resolved all the PB Matters to the Authority's satisfaction including provision of any confirmations required from the preferred bidder arising out of the consultation process, the preferred bidder shall become the successful bidder for the qualifying project. Ofgem will notify the successful bidder accordingly. The notice will confirm the amount of, and include request for, the successful bidder payment in accordance with regulation 23(4) of the Tender Regulations. This is referred to as the successful bidder payment.
- 2.3. At the same time as notifying the successful bidder, Ofgem will notify each unsuccessful bidder in relation to the qualifying project of its determination to grant a Licence to the successful bidder. A standstill period of 10 working days will then be observed as set out in regulation 24 of the Tender Regulations.
- 2.4. As soon as reasonably practicable after the end of the standstill period, Ofgem will confirm its determination whether or not to grant a Licence to the successful bidder in respect of the qualifying project and shall publish a notice to that effect.
- 2.5. Following completion of the tender exercise in respect of the qualifying project Ofgem will confirm the amount of, and include a request for, the cost assessment payment from the successful bidder in accordance with regulation 5(2) of the Tender Regulations. This payment is to cover Ofgem's costs in carrying out the assessment of the costs which ought to have been incurred in connection with the development and construction of the transmission assets for the qualifying project.
- 2.6. Ofgem will liaise with the preferred bidder in the period leading up to Licence grant to discuss the detailed mechanics of the Licence grant process, which may vary depending on the particular characteristics of the proposed OFTO, its funding structure and the qualifying project.
- 2.7. Licence grant will be coordinated alongside financial close, the process by which the OFTO secures the funding to enable it to make payment for the purchase of the transmission assets from the windfarm developer as well as to put in place the funding for its own activities. This process will culminate in the transfer of the transmission assets to the new OFTO. The OFTO is then a regulated entity subject to the regulatory regime administered by Ofgem.