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All interested parties

Direct Dial: 020 7901 1849
Email: offshore.enduring@ofgem.gov.uk

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Dear Colleague

Draft Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2015 for consultation

In this letter we set out for consultation draft Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2015 (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.

We are seeking feedback from stakeholders on all aspects of the draft Regulations. This consultation will close on 12 May 2015. Please send responses to Elizabeth Cooper, offshore.enduring@ofgem.gov.uk. Unless marked confidential, responses will be published by placing them in Ofgem's library and on its website.

Context

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 Ofgem¹ developed a regulatory regime for the construction and operation of offshore transmission assets to facilitate this objective. Under the regime, Ofgem runs a competitive tender process to select and license Offshore Transmission Owners (OFTOs).² Since establishing the legal framework in June 2009, we have licensed twelve OFTOs for assets worth over £2.2 billion in total. A further three projects worth approximately £700m are currently being tendered.³

¹ The Office of the Gas and Electricity Markets Authority (the "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.

² This process is run by Ofgem under the Electricity Act 1989 (the "Act") and regulations made under the Act which underpin the regime.

³ The current regulations in force are the Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2013, ("the 2013 Regulations").

The offshore transmission regime is delivered in two parts: a transitional and an enduring regime. The transitional regime applied to offshore transmission projects constructed by offshore generator developers (“developers”) which met the qualifying requirements under the Regulations before 31 March 2012⁴. The final transitional tender exercise, for the offshore transmission assets for West of Duddon Sands, is currently at the Preferred Bidder stage.

Any projects meeting the qualifying requirements under the Regulations after 31 March 2012 are considered to be part of the enduring regime. Under the enduring regime, developers may choose either the generator build option or the OFTO build option.

Under the generator build option, the developer will design and construct the offshore transmission assets before they are transferred to an OFTO, which will operate, maintain and decommission the transmission assets.

Under the OFTO build option, the developer will obtain the connection agreement and undertake high level design and preliminary works associated with the offshore transmission assets before transferring these to an OFTO, which will be responsible for the construction and ongoing operation of the offshore transmission assets.

Legal framework for the Regulations

Section 6C of the Electricity Act 1989 (‘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. The current 2013 Regulations came into force in February 2013, following consultation in 2012.

The draft 2015 Regulations: regulatory and policy context

In December 2014 we published ‘OFTO build: Providing additional flexibility through an extended framework’⁵ (the “December 2014 publication”) which introduced an extended OFTO build framework to provide flexibility to respond to both the current and future requirements of offshore developers.

The December 2014 publication introduced a range of potential tender options for OFTO build in relation to the roles of the offshore developer and OFTO. This range of tender options provides flexibility to allow developers and OFTOs to have greater or lesser degrees of control over procurement and construction management of the offshore transmission assets, depending on the OFTO build option chosen by the developer. Under all options however the OFTO will be ultimately responsible for construction. We identified that changes to the 2013 Regulations will be required to implement the arrangements set out in the December 2014 publication.

In the December 2014 publication we invited stakeholders to provide feedback on the proposals where they wished to do so, and we have received a number of written responses and held discussions with a number of stakeholders. Non-confidential responses are

⁴ This timeframe was stipulated in the 2010 Regulations.

⁵ OFTO Build: Providing additional flexibility through an extended framework (December 2014)

<https://www.ofgem.gov.uk/publications-and-updates/ofto-build-providing-additional-flexibility-through-extended-framework>

Non-confidential stakeholder responses to this document are also available on this webpage.

available on our website.⁵ We received generally positive feedback on our proposals and there was general agreement from stakeholders with our stated benefits of the extended OFTO build framework. Although stakeholders' views on the attractiveness of some of the possible tender options varied, no significant issues were raised. We therefore intend to take forward the proposals set out in the December 2014 publication that require implementation via the Regulations and have set out the relevant amendments to the Regulations in this consultation.

We have also considered aspects of the tender process in relation to generator build tender exercises, where minor amendments may help to achieve greater clarity for participants, enable greater efficiencies and ensure the Regulations continue to meet the objectives of the regime.⁶

As set out above, we are consulting on the resulting changes we propose to the 2013 Regulations in the form of draft Regulations. We are seeking feedback from stakeholders on all aspects of the draft Regulations,⁷ including whether you consider them to give proper effect to the final policy positions set out in the December 2014 publication.⁸

Arrangements for projects qualified under the 2013 Regulations

The draft Regulations set out the arrangements for projects which qualified under the 2013 Regulations, but whose tender exercises have not yet concluded. Subject to this consultation, we expect the new Regulations to come into force in summer 2015.

At the point at which the 2015 Regulations come into force:

- a) where a project has qualified under the 2013 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 2013 Regulations; or
- b) where a project has qualified under the 2013 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 2015 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.

All three ongoing tender exercises (for the offshore transmission assets for West of Duddon Sands, Westernmost Rough and Humber Gateway) will therefore continue to be held under the 2013 regulations as they have all passed the point described in (a) above.

⁶ The objectives of competitive tenders for offshore transmission licences are: the delivery of transmission infrastructure to connect offshore generation, provision of certainty and best value to consumers through the competitive process, and attracting new entrants to the sector.

⁷ We have determined that a 6 week consultation period (with additional days added to account for bank holidays) is appropriate for the draft Regulations. The draft Regulations seek to implement the policy positions for OFTO build developed over a long period of time and certain minor amendments to improve the tender process. These modifications to the existing regulations are necessary to be able to run an OFTO build tender as set out in December 2014 publication and enable us to respond to a request to qualify a project for a tender exercise if a developer submits this request.

⁸ In this instance we do not consider that an Impact Assessment is necessary or appropriate. We have considered section 5A Utilities Act 2000 and our own Impact Assessment Guidance. The draft Regulations do not involve a major change in the activities of the Authority. The modifications to the existing Regulations facilitate tendering of the new models of OFTO build described in the December 2014 publication. This publication concluded extensive investigation and stakeholder engagement relating to OFTO build.

Overview of key changes from the 2013 Regulations

We have set out below a high level summary of our policy positions and administrative changes that require implementation through the Regulations and, to that end, the key changes we intend to introduce. Annex 1 provides a copy of the draft Regulations. Annex 2 provides a copy of the draft 2015 Regulations with all the proposed changes marked up against the 2013 Regulations to assist stakeholders in reviewing these changes. The explanatory notes at the end of the draft Regulations set out the overall content of the Regulations and how they fit together.

Changes relating to OFTO build tenders only

- **Definition of 'OFTO build qualifying project'** - this is a new definition, which is included to improve clarity and respond to stakeholders' feedback regarding the ease of reading of the Regulations, particularly in relation to the distinctions between generator build and OFTO build tender exercises.
- **Definition of 'notified preliminary works'** - this is a new definition included to identify the preliminary works which the developer has obtained or intends to obtain prior to transfer to an OFTO and which must be notified to Ofgem when a developer submits a request to commence an OFTO build tender exercise.
- **Definition of 'construction phase contract'** - this is a new term included to describe a contract which may be offered by the developer for the construction of the transmission assets for an OFTO build tender exercise. This definition is intended to cover any scenario under OFTO build where a developer offers as part of the tender process a contract relating to the construction period for the offshore transmission assets, ranging from the offer of an 'EPC' style construction contract to the offer of one or more underlying supply chain contracts.
- **Calculation and payment of costs incurred in connection with preliminary works and construction phase contracts** - to enable the extended OFTO build framework to be implemented the draft Regulations include a number of changes to regulation 6, which sets out how we will assess that the costs incurred, or to be incurred, during the development and construction of the transmission assets, are economic and efficient. This aligns with the policy intent, as described in the December 2014 publication, for Ofgem to assess the economic and efficient value of any construction phase contracts provided by the developer.
 - The draft Regulations include updated provisions to enable Ofgem to undertake a cost assessment to determine the economic and efficient costs associated with the notified preliminary works and with the development and finalisation of any construction phase contracts provided by the developer. This cost assessment will be used to determine the initial, indicative and final value of these during the tender. These values will be payable by the OFTO to the developer at Financial Close and Licence Grant. This has resulted in changes to a number of paragraphs in regulation 6 and paragraphs 1 and 3 of regulation 7.
 - The draft Regulations introduce a provision to enable the Authority to determine the economic and efficient costs that ought to be incurred by an OFTO once appointed in relation to any payments relating to construction phase contracts provided by the developer. These calculations will be used to determine the initial, indicative and final value of the construction phase contracts during the tender. We will use these values to determine the price for the construction phase contracts that bidders should use in their bid

submissions. This has resulted in changes to a number of paragraphs in regulation 6 and paragraphs 1 and 3 of regulation 7.

- **Qualifying project requirements** – to enable the extended OFTO build framework to be implemented, the qualifying project requirements for OFTO build have been updated as follows:
 - The draft Regulations set out in regulation 8(6)(b) that a developer submitting a request to commence a tender and qualify an OFTO build project must give notice to the Authority of: the preliminary works the developer has (or intends to) obtain; whether or not any construction phase contracts are to be provided; and the intended scope of these construction phase contracts. This is intended to ensure the details of the tender option are confirmed and can be clearly communicated to the market before the OFTO tender process commences.
 - A new qualifying requirement has been introduced in paragraph 1(d) of Schedule 1 for OFTO build projects where construction phase contracts will be provided. Developers will be required to satisfy the Authority that the terms of the construction phase contracts will be conducive to the development of an economic and efficient system of electricity transmission. This will enable us to ensure that the construction phase contracts do not expose OFTOs and consumers to undue risk, and that the contracts will allow the appointed OFTO be able to meet their duties as a transmission licensee under section 9 of the Act. The wording of the new qualifying requirement in paragraph 1(d) of Schedule 1 reflects these duties under the Act.
 - The draft Regulations extend the existing provision in paragraph 3 of Schedule 1, which previously related only to generator build tenders. This will allow us to qualify an OFTO build project where the developer has met most of the relevant qualifying requirements and the Authority is satisfied that they have appropriate arrangements in place to meet certain outstanding requirements within a reasonable timeframe. This change is intended to provide additional flexibility in meeting certain requirements that may take longer to finalise before commencement of a tender exercise. This change also covers the scenarios addressed under an existing provision in regulation 8(4) of the 2013 Regulations, so that provision has been removed.
- **Developer payment** – the Authority will incur costs in undertaking both the initial estimate of the economic and efficient costs in relation to any construction phase contracts offered by the developer and the review of any such construction phase contracts terms at the project qualification stage. The draft Regulations introduce a developer payment, in regulations 8(4) and 8A, to enable the Authority to recover the tender costs incurred in relation to the above. As soon as reasonably practicable after the Authority either makes a determination of whether or not that project qualifies, or the developer withdraws its request, the Authority will return any of the payment that it has not used in assessing the economic and efficient costs of any construction phase contracts and reviewing the terms of those contracts.
- **Tender entry conditions** - the entry conditions applicable to the developer for an OFTO build tender exercise are set out in paragraph 1 of Schedule 2 to the Regulations.
 - The draft Regulations introduce a new requirement in paragraph 1(g) of Schedule 2 for the developer to provide any draft construction phase contracts, which should be developed in as much detail as possible. This will ensure the most complete version of any construction phase contracts will be provided to the bidder data room as part of the tender.

- The draft Regulations have also removed paragraph 1(j) of Schedule 2 in the 2013 Regulations, a tender entry condition relating to providing planned submission dates for outstanding consents, as we consider that this is covered by an existing OFTO build project qualifying requirement.
- **Stages of a tender exercise** – in the 2013 Regulations we introduced the provision under a generator build tender exercise where the Authority may determine not to hold a Qualification to Tender (QTT) stage. In the draft Regulations we have decided to extend this provision in regulation 12(2) to an OFTO build tender exercise, as a QTT stage is unlikely to be necessary for all OFTO build tenders (particularly those where the developer provides construction phase contracts and/or where a shorter tender timeline may also be of benefit).

Changes implemented to improve the overall efficacy of the tender process

- **Reimbursement of ITT bid costs for a generator build tender exercise** – In the 2013 Regulations we introduced 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 propose to extend this optional provision to generator build tender exercises to help support a continued diverse competitive market. We anticipate only using this provision in exceptional circumstances and we would determine whether to do so depending on the particular circumstances at the time. If we determined to apply this provision, we would notify potential bidders of the amount to be reimbursed ahead of the commencement of a tender round. This change has been made by amending the definition of 'bid costs' and making changes to regulations 17(2), 25 (4) and (5) and 29(2).
- **Preferred Bidder (PB) stage** – we propose that the Authority may require the PB to run a funding competition under certain circumstances as part of the PB matters. In Tender Round 3, at the ITT stage we introduced a right for Ofgem to request the PB to review its preferred funding solution in certain circumstances and asked bidders to give details of the steps that they would take to ensure that sufficient funds would be available at financial close and that funding terms remained competitive. The new provision in regulation 20(5) of the draft Regulations would allow the Authority to determine that the PB must run a funding competition of a kind specified by the Authority. This is an optional provision, and we are proposing to use it only in cases where we consider there may be merit in having certain terms of the funding solution competed closer to the point of financial close. We will set out further information on the detail of the circumstances in which we might request a funding competition at the PB stage of a particular tender exercise before the commencement of that tender exercise.
- **Events of Cancellation** – the events of cancellation, listed in Schedule 8 to the Regulations, have been amended to include three events where the Authority may decide to cancel a tender exercise:
 - if a developer notifies the Authority that it intends to re-specify whether the project is a generator build qualifying project or an OFTO build qualifying project;
 - if the developer intends to notify a construction phase contract which was not previously notified; and
 - if the developer changes a construction phase contract in such a way that the Authority is no longer satisfied that it meets the qualifying project requirements.

These additional events have been included to provide protection from the incurring of unnecessary and inefficient costs during the tender exercise in the unlikely scenario of one or more of the events occurring and the Authority determining that the competitive tender process would be undermined. This has resulted in changes to paragraph 1(i) and (j) of Schedule 8.

Additionally, in order to clarify the position in relation to when a breach of an undertaking provided to the Authority by a developer may be an event of cancellation, as opposed to an event of disqualification, paragraph 1(d) of Schedule 8 and paragraph 2(c) of Schedule 9 have been updated.

Minor amendments implemented

The draft Regulations implement a number of smaller changes. These changes do not signify changes to our policies, but are intended to ensure the Regulations align with changes made to other pieces of legislation and remain fit for purpose. These are discussed below

- **Recovery of Ofgem's costs** – in order to provide tender participants with more clarity the draft Regulations set out revised details about our approach to cost recovery through the inclusion of a new Schedule 10. We will continue to publish, before the start of a tender round, administrative details relating to methods of payment and details of costs associated with each particular tender round. To reflect how costs are treated under the new structure of the draft Regulations, amendments have been made to regulations 5(1) and (2), 7(1) and (3), 9(a) and (b), 10(4) – now deleted, 15(2), 17(1), 20(6), 22(5), 25(2), (3), (4) and (5), 26(2) and (3), 27(4), 28(7), 29(1), (2), (3), (5), (6) and (8), 31(2), 32(6), Schedule 3(1)(e) and Schedule 10. We have also modified the provision in regulation 29 relating to the aggregation exercise undertaken to allow Ofgem to recover any outstanding costs at the end of a tender round. This is intended to clarify the position that the Authority's total tender costs are recoverable, in the unlikely scenario where we have under-recovered our costs during the course of a tender round. Paragraphs 7, 8 and 9 of regulation 29 have been updated to reflect this change.
- **Agreement for lease of the seabed** - following publication of the draft Scotland Clauses⁹ by the Scotland Office in January 2015, which proposes devolving ownership of the seabed to local authorities in Scotland, we have amended the qualifying project requirements in Schedule 1 paragraphs 1(b) and 2(b) to ensure that the requirement is relevant across the whole of GB and avoid the need for changes to Regulations if the relevant body changes through the devolution process.

The draft Regulations also implement a number of changes intended to improve the quality of the drafting and make the regulations easier to use. These appear throughout the draft Regulations so we have not listed them here.

⁹ "Clause 23 of the draft Scotland Clauses provides for the management and revenue of Crown Estate assets in Scotland to be transferred to the Scottish Parliament, for management responsibility to be further devolved within Scotland, and a MoU between the Scottish and UK Governments to protect strategic UK-wide critical national infrastructure (such as defence & security and oil & gas and energy) to be achieved."
Scotland in the United Kingdom: An enduring settlement (January 2015)

<https://www.gov.uk/government/publications/scotland-in-the-united-kingdom-an-enduring-settlement>

Next Steps

As indicated above, we invite feedback on the draft Regulations by 12 May 2015. We will then review the Regulations in light of responses received. Subject to the outcomes of this consultation, we expect the new Regulations to be published and subsequently come into force by summer 2015.

Our positions in relation to areas set out in our December 2014 publication on OFTO build which do not require implementation through the 2015 Regulations are not within the scope of this consultation. 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 an OFTO build tender exercise. We would expect to publish further details on the proposals for the licence for OFTO build well in advance of the first OFTO build tender exercise commencing;
- **Tender documentation.** The draft Regulations refer to various stage-specific tender documents to be published for a tender exercise (e.g. the pre-qualification questionnaire). In addition to these documents we will also publish guidance and necessary administrative details relating to the tender process and other relevant documents. These documents will be published in due course and ahead of future OFTO build tender exercises;
- **The relevant industry codes and standards** that apply to construction and operation of offshore transmission assets. As set out in our December 2014 publication, we do not consider that any changes are required to the industry codes and standards to support future OFTO build tenders. In the event that stakeholders consider that any changes may better facilitate tenders, it would be for industry to bring forward these changes.

As set out earlier, we only anticipate making minor amendments to the arrangements for future generator build tender exercises via the 2015 Regulations. We will communicate any relevant changes to tender documentation and the OFTO licence for generator build in advance of the next generator build tender exercise(s). For the avoidance of doubt, we do not consider that any changes are required to the industry codes and standards to support future generator build tenders.

For further information on offshore transmission, please visit our website¹⁰ or contact offshore.enduring@ofgem.gov.uk.

Yours sincerely

Steve Beel

Associate Partner, Electricity Transmission,

Annexes

(All annexes are provided as separate pdfs.)

- 1** The Draft Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2015
- 2** The Draft Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2015 showing tracked changes to the Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2013

¹⁰ <http://www.ofgem.gov.uk/NETWORKS/OFFTRANS/Pages/Offshoretransmission.aspx>