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All with an interest in offshore
transmission

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Date: 30 April 2015

Dear colleagues,

Summary of feedback on updated policy proposals on OFTO build: providing additional flexibility through an extended framework

Overview

The purpose of this letter is to provide a summary of the key themes from feedback on our updated policy proposals on 'OFTO build: providing additional flexibility through an extended framework' ("our updated policy proposals"), to respond to key questions raised by stakeholders and to set out our next steps on Offshore Transmission Owner (OFTO) build.¹

OFTO build is where the OFTO is responsible for constructing offshore transmission assets as well as owning and operating them. The extended framework for OFTO build is one of several ways we are looking to increase competition in the financing, construction and operation of electricity transmission assets, such as extending the use of competitive tendering onshore.

Our updated policy proposals were published on 12 December 2014 and we requested any feedback by 31 January 2015. We received six non-confidential written responses: from the System Operator (SO), two offshore transmission owners (OFTOs), a generator and two potential OFTO bidders. We have also met with a number of stakeholders including generators and potential OFTOs.

Our updated policy proposals set out our extended framework for OFTO build, allowing generators more flexibility. We set out basic principles and features of any OFTO build tender and some illustrative options for tenders under OFTO build.

¹ Our policy update and non-confidential responses are available on our website:
<https://www.ofgem.gov.uk/publications-and-updates/ofto-build-providing-additional-flexibility-through-extended-framework>

Themes arising from stakeholder engagement

Written feedback on our updated policy proposals can be found on our website.² The key themes across both written feedback and from our meetings with stakeholders are:

- Support for the introduction of greater flexibility to OFTO build through the framework and a view that the proposed options are comprehensive.
- Agreement with our stated benefits of OFTO build for generators, consumers and OFTOs, and our principles for OFTO build tenders.
- Questions about the timing of the tender process, including the interaction of the tender process with the allocation process for Contracts for Difference (CfDs) by DECC and the preparation of construction contracts.
- Questions about responsibilities during construction, including the allocation of risks, specifically around abandonment or delay by either party and agreement that risks should be borne by the party best placed to manage them. Potential bidders noted that appropriate and clear allocation of risks in a generator "EPC" contract would be necessary to raise finance with a competitive cost of capital.
- A desire from both generators and potential bidders to understand which parties are interested in OFTO build, which options are favoured by generators, and what the potential pipeline for tenders might be.
- A general preference from generators for the Generator "EPC" option. Potential bidders also expressed interest in this option, while noting that they could bring significant value to projects by having more influence during the construction stage, such as through the OFTO procurement and "EPC" option.

Responses to requests for clarification and questions

We received a number of questions and requests for clarification, some of which we address here. We encourage stakeholders to contact us if there is anything that remains unclear or that they would like to discuss further.

Interaction of the tender process and CfD allocation process

In our updated policy proposals, we suggested that we might want to align the beginning of the Invitation to Tender (ITT) stage of the OFTO build tender process to coincide with CfD award, so that bidders had certainty that the project was going ahead before incurring significant costs. An indicative timeline is provided in Figure 1 of the annex. We received feedback from some generators that, for certain projects, the generator may prefer that the OFTO build tender process is run earlier relative to CfD award. We consider that there could be flexibility in when the OFTO build tender process is run and have set out a potential alternative indicative timeline in Figure 2 of the annex. We have set out in the annex the implications associated with applying different tender timings relative to the CfD process. We do not consider that there is a single 'right answer' to this and are happy to discuss tender timings with generators on a project-by-project basis.

Risk of delay or abandonment

In our updated policy proposals we outlined the mechanisms in place to mitigate the risk of delay or abandonment by either the generator or OFTO. In response to additional questions around the risk of tender cancellation raised through feedback to our updated policy proposals we consider that:

- Our current consultation on draft tender regulations³ to implement the extended framework for OFTO build tenders outlines events that can lead to the cancellation of a tender exercise. This may occur where, for example, a generator terminates its

² <https://www.ofgem.gov.uk/publications-and-updates/ofto-build-providing-additional-flexibility-through-extended-framework>

³ <https://www.ofgem.gov.uk/publications-and-updates/draft-electricity-competitive-tenders-offshore-transmission-licences-regulations-2015-consultation-0>

bilateral connection agreement with the SO, withdraws its qualifying project from a tender exercise or informs us that it wishes to change its build option to Generator build. In these circumstances the generator will be liable for the costs we have incurred up to the point of cancellation in running the tender. We also have the option to specify in the cost recovery methodology that we will publish before the tender commences, whether we will reimburse bid costs (up to a maximum amount specified by Ofgem) of a qualifying bidder, preferred bidder or successful bidder if the tender exercise is cancelled. The costs of reimbursing the bidders would be borne by the generator.

- If a preferred bidder withdrew from the tender exercise, we could revert to the reserve bidder (if one had been appointed), or re-run all or part of the tender exercise either as OFTO build or generator build.

Interest in OFTO build

We note the desire from both potential bidders and generators to understand more about the market and pipeline for OFTO build. We would therefore welcome public expressions of interest from potential bidders.

Any engagement between potential bidders and generators before a tender commences should be fair and transparent, so as not to prejudice the competitive arrangements during any subsequent tender exercise. During a tender exercise, the interactions between the generator and bidders are governed by the tender regulations.

As this is a new market, we recognise the benefits of interested generators and potential bidders engaging with each other. We would encourage interested parties to engage in a fair and transparent manner about what OFTO build options might be possible and attractive to different parties, particularly in the context of specific projects.

Pipeline of offshore transmission projects

OFTO build

We are currently in discussions with generators about potential OFTO build projects that may apply for CfDs in the 2015/16 or 2016/17 allocation rounds. The earliest that an OFTO build tender exercise might commence is autumn 2015 and we will keep stakeholders informed of any developments in this area.

Generator build

There are a number of generator build projects in the pipeline for the coming years, with at least one tender exercise expected next year.

Next steps

We are currently consulting on draft tender regulations which will implement the extended framework for OFTO build tenders. The consultation will close on 12 May 2015.

As set out in our updated policy proposals, we are continuing to work on the principles for any "EPC" contracts offered as part of a Generator "EPC" OFTO build tender. We intend to hold an industry workshop on "EPC" contract principles in the coming months and will send out details in due course. Following this we intend to publish guidance on "EPC" principles later this year. We would expect any "EPC" contracts provided by generators as part of an OFTO build tender to adhere to these key principles to ensure an appropriate balance of risks and to ensure that our objectives for the offshore transmission regime are met.

Other than the above, we do not intend to undertake any further policy development in relation to OFTO build, as we consider that all necessary arrangements are in place to

facilitate a tender. We therefore encourage any generators who would like to pursue OFTO build to contact us to discuss the practicalities of running a tender.

Yours faithfully,

Steve Beel
Associate Partner, Electricity Transmission

Annex – indicative timetables for tender process and CfD allocation and associated implications

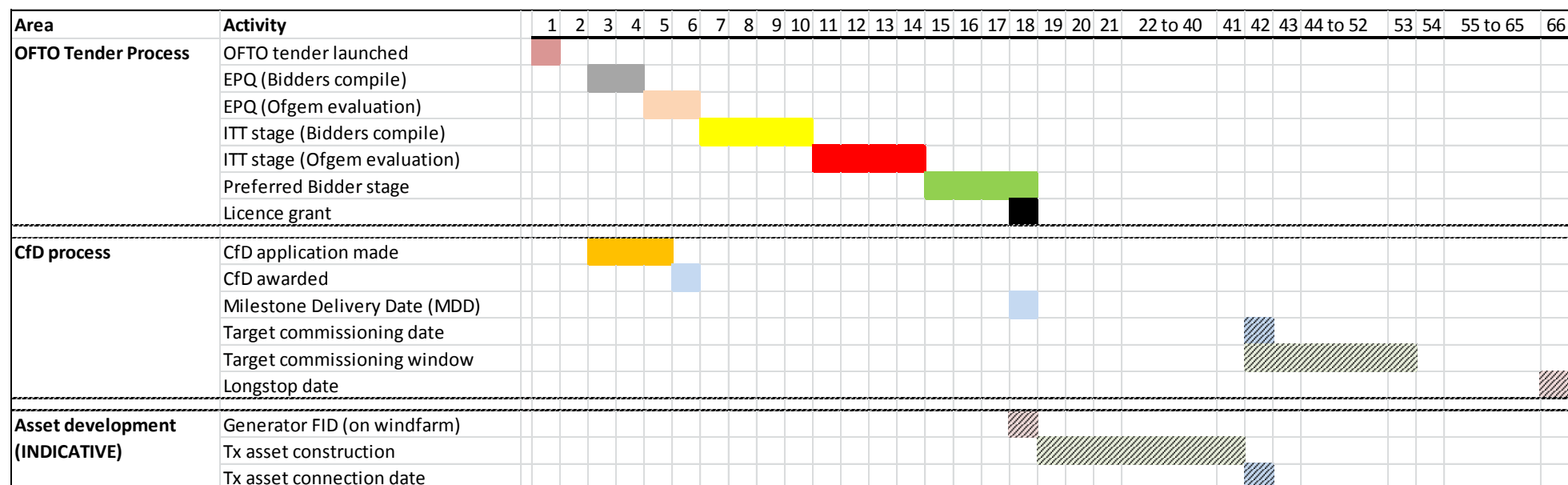


Figure 1: Indicative timetable where CfD award takes place before the ITT stage commences

Key implications of CfD award being before the ITT stage:

- Generator costs at risk: if the project failed to secure a CfD and the tender was cancelled as a result, the generator would be liable for the costs incurred by Ofgem up to the point of cancellation. Up until the ITT stage, Ofgem’s costs are relatively low. We do not anticipate that the generator would be liable for bidder costs.
- Bidder interest: we would not anticipate that bidders would incur significant costs until the ITT stage so may be willing to participate in the EPQ stage and take the risk that a project may not go ahead.
- Timing: most of the tender process would take place after CfD award, which could have timing considerations for generators, although we consider that the timeline above is deliverable.

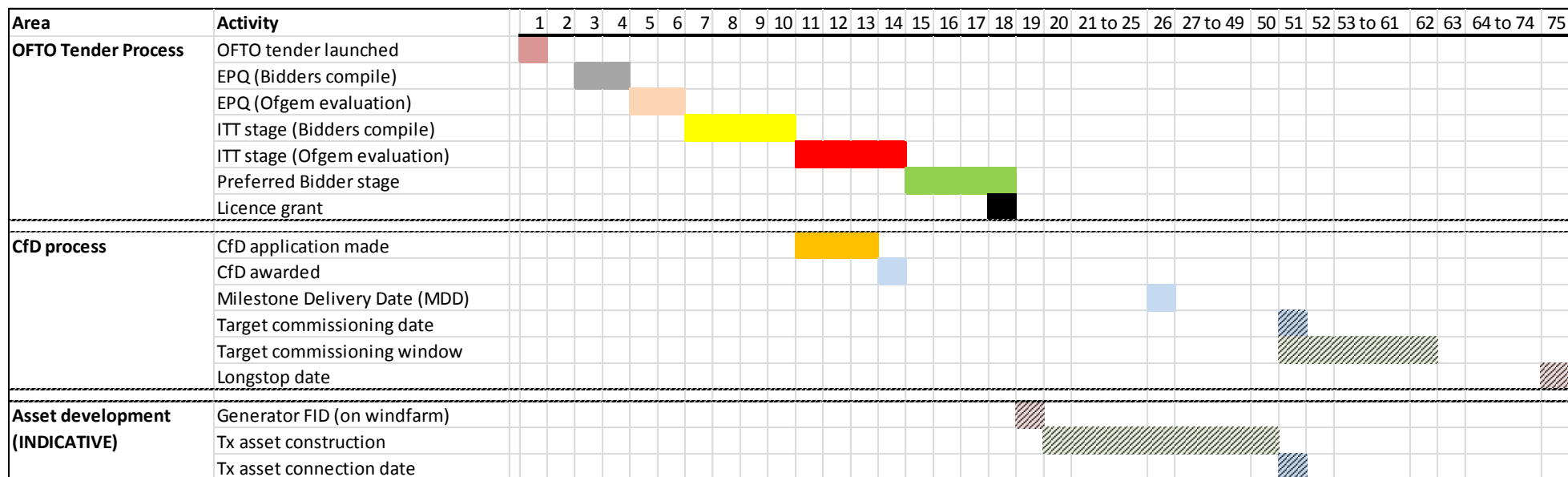


Figure 2: Indicative timetable where CfD award takes place during the ITT stage*

Key implications of evaluating ITT submissions before the project has been awarded a CfD:

- **Costs at risk:** if the project failed to secure a CfD and the tender was cancelled as a result, the generator would be liable for the costs incurred by Ofgem up to the point of cancellation and may also be liable for some of the costs incurred by bidders in developing their ITT submissions. Ofgem incurs significant costs during the ITT stage, as do bidders when preparing their ITT submissions. We could provide details of indicative costs upon request; but are not including these here as costs are dependent on a range of factors.
- **Bidder interest:** bidders may not be willing to invest time and money in developing ITT submissions when they are not certain that the project is going ahead, unless they would be compensated in the case of a failed tender.
- **Timing:** most of the tender process would take place before CfD award, which could be beneficial for generators; however there may be less certainty at the start of the ITT stage on the details of any construction contracts or underlying supply chain contracts provided by the generator (under the generator 'EPC' option).

* It may be possible to run the tender process even earlier relative to CfD award but we consider that it may be difficult to progress significantly with the preferred bidder stage without having a CfD in place. For example, the bidder may not be able to conduct detailed final financial due diligence with lenders until it had certainty on the project.