

# OFTO Tender Process – Consultation For Future Tender Rounds

## Consultation

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### Overview:

This consultation sets out the outcome of a recent review of our tender processes for appointing Offshore Transmission Owners (OFTOs) and includes proposals for potential amendments to those processes for future OFTO tender rounds. Following this consultation, we expect to make a decision on the tender process for Tender Round 6 in mid-2018.

This document covers three main areas. Firstly, possible drivers for change to the current OFTO tender process and the outcome of our review of the current tender process. Secondly, our proposed packages of possible change to address those drivers. Thirdly, our initial views on other policy areas related to OFTOs we are currently considering.

## Context

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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 and operation 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)<sup>1</sup> together with Ofgem<sup>2</sup> 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).<sup>3</sup> Since establishing the legal framework in June 2009, there are fifteen operational OFTOs in place worth £3.1 billion in total. We expect that there will continue to be more offshore transmission assets coming forward for tender in the future.

In all of the OFTOs to date, the offshore windfarm developer has designed and built the offshore transmission assets before they are transferred to an OFTO, which will operate, maintain and decommission the transmission assets. We refer to this as the ‘generator build’ model.

Our process for appointing OFTOs under the generator build model has remained broadly similar across all the tender rounds we have undertaken to-date. We are now considering whether to make changes to that process, with details set out in this consultation.

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<sup>1</sup> Now the Department for Business, Energy and Industrial Strategy (BEIS).

<sup>2</sup> 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.

<sup>3</sup> This process is run by Ofgem under the Electricity Act 1989 (the “Act”) and regulations made under the Act which underpin the regime.

## Associated documents

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Open letter – consultation on Income Adjusting Event policy in Offshore Transmission Licences, February 2018:

<https://www.ofgem.gov.uk/publications-and-updates/open-letter-consultation-income-adjusting-event-policy-offshore-transmission-licences-0>

Review of the methodology for the calculation of the Interest During Construction for offshore transmission and future interconnectors granted the cap and floor regime, January 2018:

[https://www.ofgem.gov.uk/system/files/docs/2018/01/ofto\\_ic\\_condoc.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/01/ofto_ic_condoc.pdf)

Tender Process Guidance Document TR5, October 2016:

<https://www.ofgem.gov.uk/publications-and-updates/tender-process-guidance-document-tr5>

The Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2015, July 2015:

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

The Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2013, February 2013:

<https://www.ofgem.gov.uk/ofgem-publications/51634/letter-electricity-competitive-tenders-offshore-transmission-licences-regulations-2013-pdf>

Offshore Electricity Transmission: Further consultation on the Enduring Regulatory Regime, August 2010:

[https://www.ofgem.gov.uk/sites/default/files/docs/2010/08/26082010---enduring-consultation\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2010/08/26082010---enduring-consultation_0.pdf)

Offshore Electricity Transmission: Final Statement on the Competitive Tender Process, June 2009:

<https://www.ofgem.gov.uk/ofgem-publications/51252/offshore-electricity-transmission-final-statement-competitive-tender-process.pdf>

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## Executive Summary

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In June 2009 we established, together with the Department of Energy and Climate Change (DECC), the competitive regulatory regime for offshore electricity transmission. Under the regime we run a competitive tender process to select and licence Offshore Transmission Owners (OFTOs). To date we have licenced 15 OFTOs across three tender rounds, and a wide range of parties now operate in the OFTO market. Independent reports have shown significant savings for consumers from the competition for licences under the OFTO regime.

The OFTO market is now mature, projects are becoming larger and more complex, and there are more infrastructure tenders from which to learn lessons. We are also mindful of recent procurement and industry party solvency issues, notably Carillion. In advance of starting our next Tender Round (TR6), we have therefore reviewed our tender process to ensure that it continues to deliver value and continues to deliver against our objectives for the OFTO regime.

This document:

- summarises the background to the current tender process we apply to determine and appoint OFTOs;
- explains reasons for this review, our objectives, and our methodology for the review;
- sets out the outcome of our review and an assessment of potential changes we could make to the OFTO tender process; and
- summarises potential changes we are considering to other areas of OFTO policy.

### **Our objectives for the OFTO regime**

We have assessed the current tender process and potential changes to that process against our overarching objectives (as expressed since 2009) of competitive tenders for offshore transmission licences. These are to:

- (i) Deliver transmission infrastructure to connect offshore generation, on a timely basis, and ensure that OFTOs are robust and can deliver transmission services successfully over the licence period;
- (ii) Provide certainty and best value to consumers through the competitive process; and
- (iii) Attract new entrants to the transmission sector.

To reflect the maturity of the OFTO regime we have also assessed the current tender process and potential changes to that process against another objective, which is to:

- (iv) Undertake streamlined and efficient tender processes.

## The outcome of our review and possible packages for change

We consider that the current tender process performs well in general against the objectives above. For example we consider that our tender process will continue to identify suitably robust bidders as licenced OFTOs and will continue to deliver value to consumers. In particular, we do not consider that we need to make any significant changes to mitigate a Carillion-type situation at this time. We will however continue to monitor the outcomes of any reports or reviews into the Carillion case, and update our tender processes accordingly.

We note that there could be scope for further improvements in relation to attracting new entrants, and streamlining and efficiency. For example, we have set out in this document possible changes around the project data room, developers providing Vendor Due Diligence and Certificate of Titles, the bond financing methodology, and changing some elements of assessment to confirmatory answers.

We therefore also considered two possible packages of options for change to the tender process that could provide benefits to consumers:

- **A moderate change package, where:**
  - we either retain the current arrangements at the EPQ stage, or move to an approach where we no longer shortlist a maximum number of bidders before the Invitation to Tender (ITT) stage. Under the latter approach all bidders that met the threshold at the Enhanced Pre-Qualification (EPQ) stage would be invited to progress to ITT;
  - at the ITT stage the bidder submitting the lowest price (ie Tender Revenue Stream, TRS) would be appointed Preferred Bidder (PB), so long as its bid met a threshold of robustness requirements.
  
- **A 'significant change' package, where:**
  - we no longer shortlist a maximum number of bidders before the ITT stage, ie all bidders that met the threshold at EPQ stage would be invited to progress to ITT;
  - the ITT stage would be run later than currently, based on a more complete project data room, followed by a short confirmatory PB stage;
  - at the ITT stage bidders would be required to submit their proposed price (TRS) only, with the bidder submitting the lowest price being appointed PB; and
  - at the PB stage, to incentivise delivery of bids, bidders would be required to post a bid bond, potentially also supplemented by a pain/gain share mechanism.

We note that the different packages involve trade-offs between the objectives, and the significant change package would require more radical options for managing these trade offs. At this stage, we do not set out a preference towards the current process or either of the other packages.

## **Potential changes we are considering to other areas of OFTO policy**

We have also set out three other areas of OFTO policy that we are prepared to consider changing for future tender rounds where such policy change may be beneficial. These are:

- whether to use CPI or RPI revenue indexation;
- whether there is evidence to support increasing the standard 20 year duration of the revenue term for future projects; and
- the factors we should take into account when making decisions on end of revenue term arrangements for OFTOs, as well as the most appropriate process and timeline for making those decisions.

## **Next Steps**

We invite stakeholders to respond to this consultation, which closes on 17<sup>th</sup> May 2018. Following consideration of responses, we will provide further details on our proposed approach during summer 2018. We expect to run workshops with interested stakeholders ahead of our policy decision. We will notify stakeholders of dates and arrangements for those workshops nearer the time.

We currently expect to commence TR6 in the autumn and so will have built in the outcomes from this consultation by then. We currently plan for TR6 to consist of three projects – Hornsea 1, Beatrice and East Anglia.

# 1. Background to the OFTO tender process and reasons to review

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## Background

1.1. The Department of Energy and Climate Change (DECC), together with Ofgem, established the competitive regulatory regime for offshore electricity transmission in June 2009. Under the regime we run a competitive tender process to select and licence Offshore Transmission Owners (OFTOs). The offshore transmission regime has sought to encourage innovation and to attract new sources of technical expertise and finance, whilst ensuring that connections are delivered and operated efficiently and effectively.

1.2. We have to-date successfully licenced 15 OFTOs, representing £3.1bn of investment in the sector. As demonstrated across the tender rounds, there are now many established strong and experienced bidding groups, with a diverse set of financial institutions and supply chain players becoming involved.

1.3. Our OFTO tenders have also led to significant savings for consumers. Independent reports commissioned by Ofgem show that the consumer savings from Tender Round 1 (TR1) are estimated to be between £200-400m,<sup>4</sup> and the additional savings of Tender Round 2 (TR2) and Tender Round 3 (TR3) lead to an estimated saving of between £680-1,100m across all three tender rounds.<sup>5</sup> We anticipate commissioning similar savings analysis following completion of the currently ongoing tender rounds, Tender Round 4 (TR4) and Tender Round 5 (TR5).

1.4. We have seen a strong track record of the availability of OFTOs to transmit power from the windfarms to shore, with 99.36% annual availability across all OFTOs in 2016/17.<sup>6</sup>

1.5. We consider that the combination of savings and high availability demonstrate the robustness of the tender process, and the capability of industry to successfully own and operate these assets.

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[https://www.ofgem.gov.uk/sites/default/files/docs/2014/05/140508\\_covering\\_letter\\_to\\_cepa\\_report\\_final\\_for\\_publication.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2014/05/140508_covering_letter_to_cepa_report_final_for_publication.pdf)

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[https://www.ofgem.gov.uk/system/files/docs/2016/03/ofgem\\_tr2\\_tr3\\_evaluation\\_final\\_report.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/03/ofgem_tr2_tr3_evaluation_final_report.pdf)

<sup>6</sup> Page 41 of National Grid's Electricity System Performance Report 2016/17:

<https://www.nationalgrid.com/sites/default/files/documents/National%20Electricity%20Transmission%20System%20Performance%20Report%202016-2017.pdf>



## Summary of evolution of the OFTO tender process

1.6. We began running OFTO tenders in 2009 under a 'transitional regime'. Under the transitional regime the offshore windfarm developer designed and built the offshore transmission assets before they were transferred to an OFTO. The OFTO is then responsible for operating, maintaining, and eventually decommissioning the transmission assets. The tender process comprised four tender stages: Pre-Qualification (PQ); Qualification to Tender (QTT); Invitation to Tender (ITT); and Preferred Bidder (PB). This process was used successfully for 13 projects across TR1 and TR2.

1.7. Under the 'enduring regime' for later tender rounds, we offered generator developers the choice of 'OFTO build' (where the OFTO would be responsible for building, operating, maintaining and decommissioning the transmission assets) and 'generator build' (where the generator developer constructs the transmission assets and the OFTO is then responsible for operating, maintaining and decommissioning the transmission assets). All tenders to date under the enduring regime have been 'generator build' – **this document therefore focuses only on the tender process for generator build.**

1.8. For TR3, the first of the enduring regime tender rounds, we made changes to the structure of the tender process. We replaced the PQ and QTT stages with a single Enhanced Pre-Qualification (EPQ) stage. Alongside this structural change, we introduced additional elements such as biddable indexation of the TRS.<sup>7</sup>

1.9. For TR4 and TR5, we made some further amendments to the tender process. For example, we amended our scoring criteria, published more detailed evaluation guidelines, introduced arrangements for bidders to use public-listed bonds, and removed EPQ/ITT bidder payments.

## The context and reasons for this review

### This review

1.10. We consider that it is good practice to review our processes to ensure that consumers continue to achieve good value. This includes ensuring that our processes are robust, levels of competition for OFTO assets are high, and that the market remains open to new entrants, driving value for consumers.

1.11. We have identified that for this review, there are some wider industry and procurement contexts that we should look to consider. In particular, we have identified several reasons to consider changes, including:

- 1) **A more mature bidding market** – we have now completed 15 tenders, and have seen that a wide and increasing variety of investors consider OFTOs to be a robust and investable asset class. We want to continue to ensure that our processes appropriately reflect the maturity

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<sup>7</sup> Bidders may now choose how much of their TRS is indexed to inflation.

of the market while avoiding over-consolidation of the parties appointed to be OFTO licensees, ie that our arrangements are appropriately targeted and ensure a healthy, accessible, and competitive market.

- 2) **Projects are becoming larger** – recent offshore wind projects that have been successful in gaining a Contract for Difference (CfD) have been much larger and further out from shore than previous projects. Therefore, we expect that future OFTOs will be larger, more complex, and more expensive than historical projects. This may also lead to alternative sources and ways of funding, as well as potential changes to the way OFTOs carry out operations and maintenance.
- 3) **More infrastructure tenders from which to learn lessons** – since the initial inception of the regime, a wider and more diverse range of assets have been subject to tenders across both the UK and globally. There may be applicable learning from these.
- 4) **Recent contractor solvency issues** – we have recently seen the instance of Carillion becoming insolvent amid the failure of multiple construction, operations, and maintenance contracts, typically in the PFI/PF2/PPP market. Carillion has acted as a contractor on the construction of two OFTOs, however the company does not currently own or participate in any active OFTOs.<sup>8</sup> Nonetheless, we consider that our review should also cover whether our arrangements for appointing and regulating OFTOs appropriately identify and consider contractor financial health.

### Further policy areas considered in this consultation

1.12. We are also considering some aspects of our wider OFTO policy. In Chapter 4 of this consultation, we set out our views on a number of areas we could consider changing for future tender rounds, such as duration of the initial revenue term, and switching from RPI to CPI indexation.

### Out of scope of this consultation

1.13. This consultation does not propose any changes to the arrangements for ongoing monitoring of licenced OFTOs, and does not consult on changes to arrangements such as licence protections. It also does not cover specific changes to the Tender Entry Conditions.

1.14. We recently published an open letter<sup>9</sup> setting out, for consultation, our views on the OFTO licence's income adjusting event (IAE) provisions and OFTO uninsurability. That consultation has now closed and we are currently considering responses.

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<sup>8</sup> Either as an equity partner or main O&M contractor.

<sup>9</sup> Available on our website at: <https://www.ofgem.gov.uk/publications-and-updates/open-letter-consultation-income-adjusting-event-policy-offshore-transmission-licences-0>

## Structure of this document

1.15. This document contains the following:

- Chapter 2 sets out our objectives for reviewing the OFTO tender process, and our methodology for undertaking the review.
- Chapter 3 sets out the outcome of our review of the current tender process, and possible potential changes to our tender processes that we could make.
- Chapter 4 summarises other OFTO-related policy points some of which we are considering, potentially for Tender Round 6 (TR6).
- Chapter 5 sets out the next steps for our tender process review.

## 2. The objectives and methodology of this review

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### Chapter Summary

This chapter sets out the parameters for our review of the OFTO tender process, i.e. objectives and methodology for the review and initial feedback from stakeholders.

### Question box

**Question 1:** Have we identified (in Chapter 1) the right drivers for possible change to the OFTO tender process? Are there other drivers for change we should consider?

**Question 2:** Are the objectives of our review appropriate? Are there any other objectives that we should consider?

### Our review of the tender process

#### Objectives of reviewing the tender process

2.1. In undertaking our review of the OFTO tender process against the drivers for possible change set out in Chapter 1, we have considered the specific objectives against which we can review the efficacy of the existing tender process, and the possible changes to the tender process we have identified.

2.2. Our overarching objectives (as expressed since 2009) of competitive tenders for offshore transmission licences are to:

- (i) Deliver transmission infrastructure to connect offshore generation, on a timely basis, and ensure that OFTOs are robust and can deliver transmission services successfully over the licence period;<sup>10</sup>
- (ii) Provide certainty and best value to consumers through the competitive process; and
- (iii) Attract new entrants to the transmission sector.

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<sup>10</sup> This first objective has been changed slightly since its expression in 2009, to better reflect the role of OFTOs under a generator build model. The original wording of the objective was “the delivery of fit for purpose transmission infrastructure to connect offshore generation”.

To reflect the maturity of the OFTO regime since 2009 we have also included the following additional objective for this review:

(iv) Undertake streamlined and efficient tender processes.

2.3. Under objective (iv) we have considered the resources (ie time and money) needed to participate in and run the tender process, as well as the clarity and simplicity of the process (eg in the assessment of bids).

2.4. We have used these four objectives as the basis on which to assess our potential changes and have reflected where we consider there are trade-offs between these objectives.

## Methodology

2.5. Our review has been based on the following methodology:

- **We identified objectives for the review.** We have listed these in the preceding section from paragraph 2.2.
- **We engaged with bidders for their feedback** on the current process. We have included a description of the key points from bidder feedback in the following section of this Chapter.
- **We reviewed the current tender process against the objectives, scope and bidder feedback.** The outcome of this review is set out in Chapter 3.
- **We identified a wide range of possible changes to the current tender process,** developing a list of potential options for tender process change - these options are not listed comprehensively in this consultation, but where relevant we refer to them in Chapter 3.
- **We developed potential tender process changes through development of two broad options for change,** and assessed the benefits and challenges of each against the objectives. These potential 'packages of change' are set out in Chapter 3.

2.6. Our review has also considered potential changes or clarifications to other areas of OFTO-related policy. We have set those areas out in Chapter 4 and have asked a number of consultation questions.

## **Initial feedback from the market**

2.7. Through late-2017 we took the opportunity to engage with former and current bidders to understand their experiences with the current tender process.<sup>11</sup> This engagement occurred prior to the issues with Carillion described in Chapter 1. We have set out below key points raised by stakeholders by themes. We would like to get feedback from other stakeholders including developers through this consultation, and we intend to hold workshops to facilitate this (see next steps).

### *Tender process*

2.8. A majority of stakeholders considered that the tender process could be streamlined and that the resource burden on bidders should be reduced.

2.9. Some bidders who have not won an OFTO expressed a view that the EPQ and ITT questionnaires should contain fewer 'essay' type questions where long answers are required. They considered that these favour bidders who had bid in and won previous tenders, as they have a prepared and tested model answer. Bidders also noted some areas of repetition of questions and answers between EPQ and ITT. One bidder suggested that the ITT stage should only ask questions related to the specifics of a particular project rather than the more general questions. Another bidder suggested formatting changes to the EPQ and ITT questionnaires to make them less sensitive to formatting errors.

2.10. Several bidders noted that they considered the tender process to be expensive to participate in, and potentially a barrier to their involvement. However, another bidder noted that their tender costs were typically below those they have seen from tender processes for similar assets.

2.11. Some bidders suggested that generator developers should be required to adhere to a standard data room structure, to make it quicker and easier to undertake diligence on the information they provide.

### *Bidder-Developer Interactions*

2.12. Bidders noted that the Bidder-Developer meetings during the ITT stage were often not as helpful as expected. They suggested a pre-agreed formal structure to the meetings, ensuring the right expertise and information was available. Bidders were also unclear whether and why their suggestions on the Transfer Agreement were accepted or rejected.

2.13. Bidders also suggested that the existing OFTOs and current and future developers should explore the learning from the OFTOs' operations phases, for example through an industry forum.

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<sup>11</sup> We are happy to engage with stakeholders during and after this consultation period. More information on engagement with stakeholders is set out in Chapter 5.

*Bidder-Ofgem Interactions*

2.14. Bidders suggested increasing the amount of information given by Ofgem on the evaluation guidelines, to enable them to provide more focussed answers.<sup>12</sup> In addition, some bidders wanted more and better targeted feedback than currently given.

*OFTO policy points*

2.15. Bidders raised other policy points for consideration, for example:

- Developers providing a 'Certificate of Title' document into the data room;
- Ofgem reviewing the bond price methodology, and making consequential amendments to the ITT for bond bids to take into account future projects getting bigger, and reviewing whether the sample of projects used in the methodology needs to be re-assessed; and
- Further clarity on the regulatory arrangements that will apply at the end of the initial 20-year revenue period.

2.16. Many of these and other policy points are considered in Chapters 3 and 4. Where we do not consider specific points raised above in this consultation, we will take them into account before commencing TR6.

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<sup>12</sup> Since these feedback sessions, we have now published additional information on the evaluation guidelines at ITT.

## 3. Outcomes of our review

### Chapter Summary

This chapter describes the outcome of our review of the current tender process, and our two potential packages of tender process change – the ‘moderate’ or ‘significant’ change packages.

### Question box

**Question 3:** With respect to the existing tender process arrangements:

- (a) Are any different or additional arrangements needed to mitigate the risk of OFTOs not being financially or operationally robust?
- (b) In particular, do you consider that our tender process would be robust to a Carillion-type scenario? Are there additional questions we should ask at EPQ or ITT?
- (c) Do you have any other specific feedback on the existing tender process?

**Question 4:** With respect to the moderate change package:

- (a) Do you believe this option would be an improvement over the current tender process?
- (b) Do you agree with our assessment of this package against the objectives?
- (c) Do you consider that there are questions that could be removed from the ITT questionnaire (for example, where there is overlap with the EPQ, or where the approach is mandated elsewhere)? For what reason and benefit could they be removed?
- (d) Are there any amendments to this package that would improve it?
- (e) What are your views on the most appropriate ways to mitigate the challenges of this package?
- (f) Are there other considerations we should have taken into account that present practical or other challenges to implementation?
- (g) Where we were to allow conditionality only on particular elements of a bid, how should we take into account conditionality in bids which cumulatively raises concern about the overall robustness of the bid?

Where possible, please quantify or describe qualitatively any benefits or burdens from this package of change.

**Question 5:** With respect to the significant change package:

- (a) Do you believe this option would be an improvement over the current tender process?
- (b) Do you agree with our assessment of this package against the objectives?
- (c) Are there any amendments to this package that would improve it?
- (d) What are your views on the most appropriate ways to mitigate the challenges of this package?
- (e) Are there other considerations we should have taken into account that present practical or other challenges to implementation?
- (f) What do you think of potential bid bond arrangements, pain/gain share mechanism and consequential changes to allow efficient unconditional bids?

Where possible, please quantify or describe qualitatively any benefits or burdens from this package of change.



**Question 6:** Are there other packages of change that we should consider that would better deliver against the objectives?

**Question 7:** With respect to the other tender process changes considered that could apply to either the current tender process or any of the potential packages for change:

- (a) Does Vendor Due Diligence (VDD) in practice reduce the total cost of a tender process? Are there any benefits in broad VDD? Are there benefits in a more focussed approach to VDD (for example a Certificate of Title)? Under what conditions and to what extent would bidders base their bid on VDD?
- (b) Are there other cost-effective ways in which the bidder data room could be improved to the benefit of all parties? Are there specific ways to further standardise the structure?
- (c) What changes, if any, should we consider to our current bond spread methodology? Would an appropriate pain/gain share mechanism for bond-financed bids allow us to fairly assess bond and bank-financed bids on the same committed finance basis?
- (d) Do you consider that we could adequately rely on a more confirmatory approach to questions? Are there particular documents or questions we could consider not requiring the bidder to produce, but instead confirm? Are there particular documents/requirements that are better left to the PB stage?

Where possible, please quantify or describe qualitatively any benefits or burdens from this package of change.

**Question 8:** Do you think the approach of Ofgem, developers, and bidders to the tender process will need to change as projects become larger, further from shore and more expensive? What do you see as challenges from this change?

## Our review of the current tender process

3.1. We have reviewed the existing tender process against the drivers for change described in Chapter 1 and the objectives described in Chapter 2. TR5 is the most recent tender process we have underway. In Table 1 we have set out a short description of the process used for TR5. A more detailed description of the process is set out in Appendix 1, along with a detailed description of how the current tender process assesses robustness.

Table 1

<b>Tender stage</b>	<b>Description</b>	<b>Approximate length</b>
Project Qualification and Tender Entry <sup>13</sup>	Developers bring forward their projects to qualify for the tender round, for which the project must meet a set of requirements in order to be tendered.	Dependent on Developer
Enhanced Pre-Qualification (EPQ)	The first bidder stage of the tender. Bidders are required to complete an EPQ questionnaire, which is designed to enable us to evaluate each Bidder’s suitability, economic and financial standing, and technical and professional ability to take over and manage the qualifying project(s). Ofgem selects three to five bidders to proceed to ITT. The EPQ may cover more than one qualifying project. <sup>14</sup>	4-5 months
Invitation to Tender (ITT)	Bidders selected to proceed beyond EPQ are invited to complete an ITT questionnaire, which is designed to enable Ofgem to evaluate each Bidder’s proposals for financing, operating, and managing a specific OFTO project. A Bidder’s final score is a 60%/40% weighting of their proposed tender revenue stream (TRS) and underlying assumptions scores respectively.	6 months
Preferred Bidder (PB)	This stage allows the Preferred Bidder to resolve certain matters to the Authority’s satisfaction before that Preferred Bidder becomes the Successful Bidder. We expect that any issues raised during this stage will be resolved on a commercial basis between the Preferred Bidder, the Developer, and any other relevant third party. We will at this stage determine the final TRS to be set in the OFTO licence.	Varies, with a target of 6 months.

<sup>13</sup> As per Chapter 1, this tender stage is not within the scope of this review.

<sup>14</sup> In TR5 the first EPQ covered three projects: Dudgeon, Rampion, and Race Bank. The second covered two projects: Galloper and Walney Extension.

## Evaluation against objectives

3.2. Table 2 summarises our review of the existing tender process against the objectives set out in Chapter 2.

Table 2

Objective	Assessment
<p>Deliver transmission infrastructure to connect offshore generation, on a timely basis, and ensuring that OFTOs are robust and can deliver transmission services successfully over the licence period</p>	<p>The existing tender process uses various checks to consider financial and operational OFTO robustness. Bidders must pass various thresholds at EPQ and ITT. In addition the Preferred Bidder is determined based on a combined 60/40 weighted score of TRS and robustness of underlying assumptions at ITT.</p> <p>We also have some protections in place in the event of certain adverse events once we have granted a licence such as Income Adjusting Event (IAE) and Exceptional Event (EE).</p> <p>OFTOs have a strong track record of availability of their assets (recent figures show over 99% availability across all OFTOs).</p> <p>Some ongoing issues of cable failure, but there are various protective measures in place such as reserves and managed re-openers via IAEs, and EEs. Current consultation on IAEs sets out further proposals in this regard.</p> <p>The Generator Commissioning Clause was introduced in 2014 to help ensure timely appointment of OFTOs.<sup>15</sup></p> <p>Further details on how the current tender process delivers against this objective are set out in Appendix 1.</p>
<p>Provide certainty and best value to consumers through the competitive process</p>	<p>Independent reports commissioned show the consumer savings from TR1 are estimated between £200-400m, and the additional savings of Tender Round 2 (TR2) and Tender Round 3 (TR3) lead to an estimated saving of between £680-1,100m across all three tender rounds.</p>
<p>Attract new entrants to the transmission sector</p>	<p>A wide pool of competitive parties in the OFTO market has developed.<sup>16</sup> We have seen new entrants participating tender rounds, and recently new players participated at the EPQ and ITT stages.</p>

<sup>15</sup> The Generator Commissioning Clause (GCC) permits electricity transmission by developers for the purposes of commissioning transmission assets during a defined 'commissioning period'. The GCC provides that transmission over an offshore transmission system can take place during a commissioning period if it takes place before the completion notice is issued, or during a period of 18 months from the date on which the completion notice is issued

<sup>16</sup> A full list of previous tenders, including documentation relating to licenced OFTOs, is available on our website: <https://www.ofgem.gov.uk/electricity/transmission-networks/offshore-transmission/offshore-transmission-tenders>

Streamlined and efficient tender process	Regime is reasonably resource intensive with detailed bids needed and subsequent extensive evaluation at both EPQ and ITT stages. Significant due diligence needed on extensive developer-populated data room. Bidding costs are perceived as high by some, however not necessarily out of line with other infrastructure tenders. PB stage can take some time where issues occur and/or are identified with transmission assets.
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3.3. In summary, we consider that the current tender process performs well against the objectives; however, there could be scope for further improvements in relation to attracting new entrants and streamlining and efficiency.

## Possible changes to the Tender Process

### Our approach to tender changes

3.4. As described in our methodology in Chapter 2, we have considered a wide range of changes across the tender process that could provide beneficial changes, particularly relation to attracting new entrants and streamlining and efficiency.

3.5. During our review we considered a broad spectrum of options and have proposed two possible packages of options for change. These are:

- A moderate change package; and
- A significant change package.

3.6. These packages have been developed as examples to allow us to demonstrate how some of the options for change could be implemented. The packages are indicative only, as they represent broad groupings of changes to the tender process that we could consider. At this stage, we consider it more appropriate to consult on broad packages of potential change rather than specific detailed changes, as various combinations of changes could deliver comparable outcomes.

3.7. In this consultation we are not expressing a preference for the current tender process or either of the change packages described in this section. Each of the packages (including the current process) involves some element of trade-offs between the objectives, and we note that the significant change package would require more extreme options for managing this trade off. The following sections describe each of the possible packages of change, consider how these might work, and the extent to which they meet our objectives.

3.8. In addition to these two packages of change, we have considered other incremental changes to the tender processes that could be implemented independently of the packages of tender process change.

3.9. We invite stakeholders to consider the possible changes, our assessment of those changes against the objectives set out in Chapter 2, and whether there are other changes that we could additionally consider.

3.10. We understand that the Crown Commercial Services will issue in the near future revised standard government tender documentation. We expect to review our EPQ and ITT documents and to appropriately reflect the relevant changes made by the Crown Commercial Services.

3.11. Additionally, in light of the Carillion situation, we will continue to consider any changes to our processes to better insulate the tender process from the risk of Carillion-type scenarios. We have undertaken an initial review of our arrangements, and consider that the robustness arrangements summarised in Appendix 1 are appropriate. We therefore do not consider that we need to make any significant changes to mitigate a Carillion-type situation at this time. However, we will continue to monitor the outcomes of any reports or reviews into the Carillion case and update our tender processes accordingly. We welcome views on the robustness of our tender process in light of the Carillion situation through this consultation.

## Moderate Change

### Overview

3.12. The 'moderate change' package is designed to maintain high levels of robustness but target specific parts of the current tender process for streamlining and to encourage new entrants, thus delivering value to consumers.

3.13. Under this package the determination of the PB would be based on price only, so long as the relevant robustness requirements were met at ITT.

### Detailed description

#### *Possible changes to the EPQ stage*

3.14. We have considered whether the EPQ stage could continue as currently under the current tender process or whether it could be changed as proposed later under the significant change package. We consider either is possible.

3.15. The key difference would be that retaining the current EPQ arrangements would result in 3 to 5 bidders being invited to ITT, whereas using the significant change package arrangements at EPQ (ie no limit on the number of bidders proceeding to ITT should they pass the threshold) could result in more than 5 bidders being invited to ITT. We would therefore need to consider the trade-off between increased competition at ITT stage (and increased opportunity for new entrants to participate at ITT) with increased resourcing and costs, for Ofgem and to an increased number of bidders, from submitting and assessing more bids. It is also possible that some bidders may not want to participate in a fairly resource intensive ITT with more than 5 bidders.

3.16. We are interested in stakeholders' views on how to best manage those trade-offs. Our approach will also be informed to some extent by the level of change we make at the ITT stage relative to the current tender process.

*Possible changes to the ITT Stage*

3.17. At ITT, the structure of the stage and requirements in the questionnaire could stay broadly similar to the current tender process. However, we are considering two relatively more significant changes:

- **Make current section 8 (underlying assumptions) a threshold rather than 40% of the final score.** Once a bidder had met all thresholds (including current section 8), final determination of PB would be based on TRS only. This would simplify the assessment process by focusing ultimate determination on price only, whilst ensuring there is full checking that OFTOs are robust. One of the original reasons for section 8 being scored at 40% was because OFTOs were a new asset class under an untested new regime, and we sought comfort that the OFTOs would be robust. Now that the OFTO regime is successfully established, a more general threshold level of comfort on section 8 may be sufficient and appropriate without the need for 40% weighting towards overall score.

Under this approach we would need to consider whether the threshold for current section 8 would be the same as the threshold for other ITT sections, or whether it should be higher. We would also need to consider whether the threshold would apply to all sub-sections or achievement in the section overall. In particular, we would need to further consider how to treat the commitment scoring of bank and bond-financed bids where the scoring is on a threshold basis. Later in this chapter, we set out our initial thinking on potential updates to the bond financing methodology that could take account of this.

- As a variant to the above, we could also consider an option **where we only assess the two lowest price bids at ITT to determine whether they meet the thresholds.** Under this variant approach all bidders would still submit information against each section of the ITT, but Ofgem would focus on assessing all elements of only the two lowest price bids. If the lowest price bid did not meet any of the thresholds it would not be considered further. The second lowest price bid would then be similarly assessed, and so on, on an iterative basis until a PB (and potentially also a Reserve Bidder) was identified. We recognise that the main benefit of this variant approach would be to streamline Ofgem’s assessment process as the requirements on bidders would be the same as under the bullet above.

3.18. We are also considering a relatively less substantial change through the removal of specific questions/sections, which could apply in addition to the more significant changes described above. We could seek to remove specific questions, for example, where we consider that points are no longer necessary as the market is more familiar with OFTO processes, such as explanation on how VAT registration would work. Other reasons for removing content could be because they are already asked in the EPQ, or where bidders are likely to be expected to undertake the analysis as part of their funding Due Diligence.

*Possible changes to the PB stage*

3.19. Our current view is that under this package there would not need to be any significant changes to the current tender process arrangements at the PB stage. However, by focusing ultimately on price, it is possible that the changes under

this package may influence bidder behaviour in ways that slightly reduce the quality of ITT bids relative to the current tender process arrangements by discouraging bidders from going above and beyond the minimum threshold as this would not be rewarded. We are therefore interested in stakeholders’ views on whether this causes any significant concerns, and if so, how they could be addressed.

*Consequential changes*

3.20. It may also be appropriate to consider whether to set out some tighter restrictions around conditionality permitted in bids. This would be to mitigate against the inclusion of a number of conditional aspects, that do not of themselves take a bidder’s score below the threshold, but cumulatively raise concerns about the overall robustness of the bid. We are interested in stakeholders’ views on whether this is an area we should consider further, and if so, the most appropriate approaches for considering conditionality in bids.

**Assessment against objectives**

3.21. We have set out in Table 3 our assessment of the moderate change package against the objectives of this review.

Table 3

<b>Objective</b>	<b>Assessment of impact</b>	<b>Impact against current tender process</b> (range from <b>xxx</b> to <b>✓✓✓</b> )
Deliver transmission infrastructure to connect offshore generation, on a timely basis, and ensuring that OFTOs are robust and can deliver transmission services successfully over the licence period	<p>Robustness no longer carries 40% weighting at ITT, although robustness still assessed as a threshold. This may discourage bidders from going above and beyond the minimum threshold as this would not be rewarded, which may also reduce innovation. In practice this could be partially mitigated by setting the threshold higher in some sections and competition on price (potentially among more bidders at ITT) may in general drive sufficient innovation.</p> <p>Slight reduction in levels of information bidders need to provide at ITT may lead to slightly lower robustness overall, albeit only in lower risk areas or to remove duplication with areas covered at EPQ.</p>	<b>x</b>
Provide certainty and best value to consumers through the competitive process	100% weighting on price could be a driver for keeping TRS as low as possible.	<b>✓</b>

<p>Attract new entrants to the transmission sector</p>	<p>Should we relax limits on numbers of bidders moving to ITT, this may allow more new entrants to progress (assuming they meet the EPQ requirements).</p> <p>100% weighting on price at ITT could make a difference to new entrants.</p>	<p>✓</p>
<p>Streamlined and efficient tender process</p>	<p>Changes at ITT stage likely to make little material difference to bidders – some benefits to bidders of slightly less detail to provide in submissions, but may be offset by increased number of bidders at ITT. Some efficiency benefits to Ofgem of not assessing all bids (if Ofgem applies that variant).</p> <p>Final determination of PB based on price only at ITT may provide simpler assessment process.</p>	<p>-<sup>17</sup> or ✓</p>

## Significant Change

### Overview

3.22. The 'significant change' package is designed to maximise the level of competition at ITT stage amongst the widest possible range of competent bidders, in order to deliver value to consumers.

3.23. This package seeks to significantly streamline the process and improve the chances of capable new entrants being competitive by focusing the ITT submission (and assessment) only on proposed TRS. We consider that the focus on TRS only at ITT stage would need to be accompanied by additional mechanisms for ensuring robustness at other stages of the process, for example raising the requirements for progressing from EPQ and/or introducing mechanisms at the PB stage to encourage robust TRS bids at ITT.

3.24. One of the key challenges of this package is that there would be no explicit testing of operational or financial robustness at the ITT stage and there would be no assessment of a bidder's ability to identify, manage and price-in project specific requirements or features. This may increase the risk that the PB's arrangements to operate and maintain the OFTO are not sufficiently robust, leading to either a failure of the tender process (if the PB pulls out nearer financial close and/or the PB does not meet the PB matters set by Ofgem) or a failure of the OFTO to fulfil its duties once licenced.

3.25. Additionally, without the requirement for bidders to disclose worked up financing solutions we would need to consider how this might impact and

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<sup>17</sup> i.e. stays the same



influence bidders' bidding strategy so they consider not only price but are able to deliver on the funding proposed at ITT.

3.26. We note that the OFTO regime is now well established and the nature of the assets and the regime is well understood by the market. This should provide some confidence that the combination of this level of market understanding, with an appropriate threshold at EPQ stage, would result in robust OFTO bids and bidders. However, we consider that additional arrangements, set out in the rest of this section, would also help address/mitigate the above challenges. We would like stakeholders' views on whether we have identified all the key challenges and whether the potential mitigations would be effective.

### **Detailed description**

#### *Possible changes to the EPQ stage*

3.27. The EPQ could change to be assessed entirely on a minimum threshold basis, **with no limit on the number of bidders proceeding to ITT should they pass the threshold**. The threshold could be set in one of three ways: i) no grading (i.e. pass/fail only) with the bidder required to meet all requirements for every question; ii) bidder responses would be graded and need as a minimum to meet a predefined threshold grade; or iii) a combination of i) and ii).

3.28. We consider that placing no limit on the number of bidders proceeding to ITT (so long as they pass the threshold) would maximise competition at ITT stage. Potentially more bidders would be incurring costs at ITT stage than under the current tender process, with less chance of winning, but the arrangements proposed at ITT stage for reducing the requirements set by Ofgem are designed to mitigate this.

#### *Possible changes to the ITT stage*

3.29. Bidders would be invited to bid only a TRS (along with associated financial model). The bidder with the lowest TRS<sup>18</sup> would be selected as Preferred Bidder. We expect that there would still be a set of minimum, initial questions which bidders would need to answer at ITT (e.g. confirmation of EPQ submission and details on proposed OFTO shareholding structure). These questions would be assessed as pass/fail, with any fail score preventing the bid from being considered further. However, all current sections 3-8 (other than section 7, TRS) would probably be removed.

3.30. We consider that under this approach the ITT stage would **probably require unconditional, price-only bids** in order to promote comparability of assessment of bids. A potential benefit of such an approach would be that the length/complexity of the preferred bidder stage may be significantly reduced. However, requiring unconditional bids may also lead to consequential changes to the process which would likely add costs to bidders (and potentially also developers) at ITT – we consider these later on in this section.

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<sup>18</sup> We expect this would continue to be assessed on a net present value basis.

*Possible changes to the PB stage*

3.31. We consider that one of the benefits of this package would be that parties could financially close on the project significantly quicker than currently, with no conditions or changes to be made to their bid. However, we may need to design additional safeguards to ensure there are incentives for Bidders to submit only robust and achievable bids at ITT. Below are potential safeguards we've considered – we consider that, at a minimum, a bid bond would likely be required, potentially also supplemented by a pain/gain share mechanism:

- **Bid Bond** – The PB provides a bid bond when appointed PB, which is cancelled if the project reaches Financial Close (FC) successfully. If FC is not achieved or is delayed then all or some of the bid bond is called. This would incentivise Bidders to bid only realistic and investable bids, and not seek to reopen their bid or even exit during the PB stage. We would need to consider the cost of Bidders providing a bid bond, which could end up being priced in the TRS. We would also need to consider the size of the bond, which if too small would not affect behaviour. Another point to resolve would be the terms on which the bond could be called, for example where fault may lie with a party other than the PB.
- **Pain/gain share mechanism** – A predefined percentage of changes in TRS during PB stage could be shared by the PB and consumers. This may incentivise the PB to limit changes against their bid and ensure what is bid at ITT can be delivered. We would need to consider the type of events/changes that the pain/gain share mechanism should apply to, and whether that ensured an appropriate allocation of risk. Our initial view is that a pain/gain share mechanism would need to be tightly specified to certain events in order to avoid protracted discussions at PB stage and minimise potential gaming. The pain/gain share mechanism could for example apply where bidders are not be able to commit to an unconditional price, for example if their chosen commercial solution uses uncommitted financing such as public bonds.

*Consequential changes*

3.32. In order to facilitate the significant change package, we consider that there would probably need to be several additional changes to how the tender process is structured in order to allow efficient bids. The key changes are likely to include:

- **Starting the ITT stage later** – Changing the standard timetable such that the ITT is undertaken only when project information and commercial positions are more certain. This could have an impact on the Generator Commissioning Clause, although the later ITT stage start would be mitigated by a planned shorter PB stage.

- **Concluding commercial discussions earlier** – The Transfer Agreement<sup>19</sup> and other contracts (e.g. warranties) would need to be finalised quicker and earlier (probably before bids are submitted at ITT).
- **Increased bidder due diligence completed during ITT** – some bidders may wish to do much of the full technical, commercial, legal, and financial due diligence that they do at the PB stage during the ITT stage in order to commit to competitive unconditional bids at ITT.

**Assessment against objectives**

3.33. We have set out in Table 4 our assessment of the significant change package against the objectives of this review.

Table 4

<b>Objective</b>	<b>Assessment of Impact</b>	<b>Impact against current tender process</b> (range from <b>x x x</b> to <b>✓✓✓</b> )
Deliver transmission infrastructure to connect offshore generation, on a timely basis, and ensuring that OFTOs are robust and can deliver transmission services successfully over the licence period	<p>Main challenge under this package is to ensure robustness for the winning bidder, including being comfortable that the OFTO appropriately considers and prices the project so it is robust to project specific events and project characteristics.</p> <p>Robustness checking at EPQ stage partially mitigates this. New arrangements at PB stage (eg bid bonds) and consequential changes (eg concluding commercial discussions earlier) may also mitigate this.</p>	<p><b>x</b> or <b>x x</b></p>

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<sup>19</sup> The commercial agreement between the developer and the Preferred Bidder which governs the transfer of the transmission assets to the new OFTO.

<p>Provide certainty and best value to consumers through the competitive process</p>	<p>100% weighting on price allows bidders to compete on price, which could be a driver for keeping TRS as low as possible. New/more bidders at ITT may also help reduce TRS.</p> <p>However, additional costs associated with providing a bid bond and potentially also increased due diligence at ITT stage. Pain/gain share mechanism may have neutral overall impact on overall value.</p> <p>Levels of certainty dependent on whether arrangements could be put in place to efficiently support unconditional bids.</p>	<p>-</p>
<p>Attract new entrants to the transmission sector</p>	<p>Removing limits on those moving to ITT may allow more new entrants to progress (assuming they meet the EPQ requirements).</p> <p>New entrants may have a better chance of winning at ITT due to absence of detailed current ITT requirements, so previous experience of participation at ITT stage of OFTO tenders would be less significant.</p>	<p>✓ or ✓✓</p>
<p>Streamlined and efficient tender process</p>	<p>The ITT stage would be significantly streamlined and simplified in terms of requirements set by Ofgem. However, this may be offset to some degree by additional requirements for bidders in relation to consequential changes.</p> <p>May be some efficiency benefits at PB stage, although pain/gain share mechanism would need to be clearly and tightly defined to realise these. The expectation is the bidder would be ready to proceed quickly to financial close but this relies on documentation being in an agreed form.</p>	<p>✓ or ✓✓</p>

### Other incremental tender process changes

3.34. Through our review, and taking into account bidder feedback, we identified several other changes that we consider could improve the current process. We expect that these changes could be implemented for either the current tender process, or any of the potential process change packages described above.

- Vendor Due Diligence/Certificate of Title** – The Developer selling the transmission assets could provide an in-depth report on the technical and value status of the assets to bidders. Where this report is prepared for the developer by an advisor, this is called vendor due diligence (VDD). The advisor would provide comfort to both the Developer and the Bidders with an independent view of the assets, encompassing their current status, performance and prospects. VDD can address the concerns and issues of all bidders and hence reduce the amount of bidder due diligence which is

required. However, we consider that to give most comfort to bidders, the Preferred Bidder should be allowed to have legal reliance on the VDD.

A particular type of VDD is a 'Certificate of Title' prepared by the developer's solicitors and on which the Preferred Bidder can place legal reliance. A Certificate of Title is a report on the property aspects of the transaction including freehold and leasehold interests. The Certificate of Title will identify the owner or owners of real property, along with the parties which have an interest in the property (e.g. rights of access), and the nature of their interest. The Certificate of Title is a statement of opinion on the status of the title, based on a thorough examination of specified public records. Some stakeholders raised the usefulness of Certificate of Titles with us in our stakeholder meetings. As with other VDD, a certificate of title can reduce the due diligence required by bidders, and therefore reduce both cost and resource burden.

- **Data room improvements** – A number of OFTO bidders have indicated to us that better organisation of the project data rooms by project Developers would streamline collaboration, accelerate due diligence, and improve co-ordination among diligence teams from Bidders' advisors. Although all OFTO transactions involve the same high level data structure, at present there is not a standard more detailed level structure for the virtual data room. In practice, the detailed structure of each data room is flexed to respond to the specifics of that particular project.

A more standardised approach to the provision of data, for example in file naming conventions, could accelerate and reduce the cost of bidder due diligence and hence encourage competition and new entrants. We recognise there will be project specific reasons for lower level data structures, but we generally favour a more standardised approach to the data room.

Finally, another data room improvement could be to use more sophisticated and expensive data room software with additional features such as easier bulk document up-load capability, document control functionality and automatic document indexing.

- **Update to Financing** – With the size of future projects getting bigger, we are considering updating the methodology we use to come up with the spread bidders should use in bids which use public listed bonds as a source of finance. For example assessing whether we need to provide assumptions for different rated bonds other than the two we currently do, and also potentially revisiting the sample companies we use to form the basis of our stipulated assumptions.

When assessing different financing solutions, e.g. bank versus bond financing, there is a need to allow for the greater ability of banks, as compared to a bond underwriter, to hold their margin<sup>20</sup> for a number of

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<sup>20</sup> The interest margin is added by a lender to a benchmark interest rate in order to cover the lender's costs, including capital charges and the costs of originating and monitoring a loan, and to provide compensation for the risk taken.

months. For bank debt, the banks will normally fix their interest margin for a period, while for a public bond, the interest margin is determined by demand for the bond in the financial markets on the day of issue and may be expensive to hedge. In the current tender process, the additional certainty for the TRS as a result of fixing the interest margins on bank debt is taken into account when comparing bank versus bond financed solutions.

We are considering the use of pain/gain sharing mechanisms applied to interest margins to allow us to potentially compare bank and bond-financed bids on a similar committed basis, and to incentivise bidders to fix their interest margin and take steps to avoid margin increases and to even reduce margins if possible. If such a mechanism was calibrated to provide appropriate incentives, the interests of consumers and bidders may be more aligned and the tender assessment could take this into consideration.

- **Changing specific questions to confirmatory answers** – the questionnaire could ask bidders to confirm that certain documents are in place, without the need to provide the supporting information. For example rather than asking for shareholder information such as articles of association or loan note documentation, we could ask the bidder to provide appropriate third party certification that it has these in place (e.g. via a signed declaration). We could even consider removing the requirement and request these arrangements are put in place at the PB stage which would have the benefit of not requiring all bidders to provide the information – although it would add to the requirements at PB stage.

## 4. Other policy changes

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### Chapter Summary

This chapter summarises potential changes we are considering to other areas of OFTO policy, including CPI/RPI indexation, and our policies around the end of revenue term period.

### Question box

**Question 9:** With respect to end of revenue term arrangements, where there continues to be a need for the OFTO, what factors should be taken into account when making decisions on OFTO revenue at the end of the normal 20 year term? When should we begin to make these decisions?

**Question 10:** Is there demonstrable evidence that we should consider changing the default revenue period away from 20 years for future projects? If so, what would be the most appropriate revenue period?

4.1. We are also considering some aspects of our wider OFTO policy. In this chapter we set out our views on areas where policy change may be beneficial and we are considering changes for future tender rounds. In some areas OFTO policy will be linked to policy development in other parts of Ofgem, and in other areas any changes will depend upon further evidence justifying the change.

### CPI or RPI indexation of revenue

4.2. We recently published our consultation on the price control framework for RIIO-2.<sup>21</sup> In that consultation, we set out our proposals to move away from RPI to the Government's preferred measure of inflation, the Consumer Price Index (CPI/CPIH).<sup>22</sup>

4.3. We will consult in due course on whether a similar approach should be taken for future OFTOs. For the avoidance of doubt, any change to indexation would not apply to existing OFTOs.

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<sup>21</sup>

[https://www.ofgem.gov.uk/system/files/docs/2018/03/riio2\\_march\\_consultation\\_document\\_final\\_v1.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/03/riio2_march_consultation_document_final_v1.pdf)

<sup>22</sup> This could be either CPI or CPIH, as set out on page 99 of the RIIO-2 framework consultation.

## Revenue term end arrangements

4.4. The first OFTO, Robin Rigg, was granted a licence in March 2011. It is some way through its revenue period and in three years' time will be required to confirm its decommissioning plan with BEIS.

4.5. Where the offshore wind farm that the OFTO connects to the network is likely to continue beyond the OFTO's revenue period, we consider that there are two broad options which could apply at the end of the normal 20 year OFTO revenue term:

- Extend the revenue term of the OFTO with a new TRS based on the costs relating to operating the OFTO assets beyond year 20; or
- Re-tender the OFTO for an additional revenue term.

4.6. We would expect to make a separate decision for each OFTO, based on the particular project circumstances at the time, as to how they will be regulated following the end of their 20-year revenue term. However, we are seeking views from industry now on the factors that we should take into account when making these decisions and the most appropriate process and timeline for making those decisions. For example, we welcome views on when would be the best time to undertake the assessment (eg in year 17 or 18?) and what process Ofgem should follow to determine the route, eg consideration of any additional capital expenditure, and what factors should influence the duration of the additional revenue term.

4.7. For the avoidance of doubt, where the wind farm is likely to cease generation, we expect all OFTOs to execute their decommissioning plans as agreed with the relevant Authorities, including BEIS.

### **Duration of initial revenue period for future OFTOs**

4.8. The default 20 year OFTO revenue period was originally designed to match the expected life of the connected offshore wind farm and hence of the useful economic life of the OFTO assets. We understand that a number of wind farm developers are now seeking to prolong the life of new windfarms beyond 20 years, which may mean that the transmission assets would be required for more than 20 years.

4.9. We would welcome responses from stakeholders that help us to undertake analysis of the optimal revenue period for future OFTOs. We would appreciate views with supporting arguments (which should include both technical and economic considerations) on whether 20 years is the right revenue period and if not why an alternative is superior. Taking account of such evidence, we will undertake analysis of the merits of an OFTO revenue period of longer than 20 years going forward. In undertaking any such analysis we will take account of not just the technical and economic life of the transmission assets but also the period for securing financing, and for pricing operations and maintenance.



## 5. Next Steps

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5.1. This consultation will close on 17<sup>th</sup> May 2018. We invite stakeholders to respond to this consultation using [offshorelicensing@ofgem.gov.uk](mailto:offshorelicensing@ofgem.gov.uk). We are happy to meet with stakeholders during the consultation period to discuss the proposals in this document.

5.2. We expect to run workshops with interested stakeholders ahead of our policy decision. We will notify stakeholders of dates and arrangements for those workshops nearer the time.

5.3. We will assess stakeholder responses after the close of this consultation before publishing further details on our proposed approach during summer 2018. If we decide to make changes to the OFTO tender process we will consider whether these should apply before TR6 or for subsequent tender rounds. Depending on the extent of any changes we will also need to consider whether to first consult on those changes before making a decision.

5.4. We expect to commence a Tender Round 6 EPQ in the autumn, and we will have considered the outcomes from this consultation by then. We currently plan for TR6 to consist of three Projects – Hornsea Project One, Beatrice, and East Anglia One. We also plan to stagger the ITT processes so we are not running any concurrently.

# Appendices

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# Appendix 1 – Current Tender Process and robustness

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## Outline of the current tender process

### *Project Qualification*

Developers bring forward their projects to qualify for the tender round, for which the project must meet a minimum set of requirements in order to be tendered. The requirements for project qualification and tender entry are set out in our Tender Regulations and associated documentation.

### *Enhanced Pre-Qualification*

The first bidder stage of the process is the Enhanced Pre-Qualification (EPQ) stage. Bidders are required to complete an EPQ questionnaire, which is designed to enable us to evaluate each Bidder's suitability, economic and financial standing, and technical and professional ability to take over and manage the qualifying projects.

The EPQ questionnaire is divided into 11 sections. Sections 1-4 are selection criteria questions, for which Bidders must satisfy all criteria, assessed on a pass/fail basis. Sections 5-8 are limitation criteria questions, which Ofgem scores on a scale of A-D against a prescribed set of evaluation criteria. Ofgem can use the criteria scores to reduce the number of bidders to a minimum of three bidders, with the highest limitation criteria scores being invited to the ITT stage.

### *Invitation to Tender Stage*

Those bidders passing the EPQ stage will be invited to participate in the Invitation to Tender (ITT) stage. Bidders are required to complete an ITT questionnaire, which is designed to enable Ofgem to evaluate each bidder's proposals for financing, operating, and managing a specific OFTO project.

The ITT questionnaire is structured into 11 sections. Section 1 asks Bidders to confirm or update information in their EPQ submission where relevant. Sections 2-6 cover non-financial and financial deliverability questions, and are evaluated on a pass/fail basis where each question within each section of a Bidder's submission must pass. Section 7 evaluates a Bidder's proposed tender revenue stream (TRS), producing a score using a prescribed formula that provides a comparison between bids. Section 8 covers the underlying assumptions of the bid TRS, producing a score based on our evaluation guidance and pre-determined question weightings.

A Bidder's final score is a 60%/40% weighting of their Section 7 and Section 8 scores respectively.

Ofgem may run a Best and Final Offer (BAFO) stage in the event that it considers further value can be obtained from the tender process and in such circumstances selected Qualifying Bidders may be invited to submit a BAFO.

Bidders have the opportunity to ask clarifications of the project's developer. This process is strictly managed through Ofgem, with all questions and answers anonymised and published for all bidders to see. Bidders may not interact directly with the developer.

#### *Preferred Bidder (PB)*

During the Preferred Bidder stage of the current tender process, Ofgem, the developer and the Preferred Bidder work to arrive at a final TRS. This comprises the Bidder's bid TRS at ITT and any changes assessed and approved by Ofgem. For example, the TRS could change to reflect Ofgem's Final Transfer Value (FTV), or additional information that may come to light since the ITT stage.

The Preferred Bidder stage is indicatively 6 months long, however some projects have taken longer. For example, Ofgem must, amongst other activities, finalise the TRS, facilitate Preferred Bidder-Developer discussions, and assess any proposed TRS changes.

### **Review of OFTO robustness in the current tender process**

The current tender process considers OFTO robustness in two aspects: financial, and operational. Both of these aspects are tested for at EPQ and ITT. We also have arrangements in place to support OFTO robustness once we have granted them a licence.

#### *Assessment of financial robustness during the tender*

Financial robustness is driven by the enduring financial health of the OFTO itself, the health of its parent companies, and the health of any supporting third parties (e.g. contractors). In the EPQ, Sections 3 (Economic and Financial Standing), 7 (Funding Solution), and 8 (Financial and Commercial Risk Management) cover these points. For example, in Section 3, bidders must provide various relevant financial documents, and we may search news information sources and credit ratings to highlight any issues with bidders.

At ITT, Section 6 (Financial Deliverability) and Section 8 (Underlying Assumptions) cover financial robustness. In particular, Section 8 covers the underlying assumptions robustness of the bidder's submitted base case TRS. For example, bidders must set out their assumptions for a wide range of financial areas, such as O&M costs, insurance, taxation, and SPV management costs, and must also demonstrate sensitivity analyses on their financial ratios and funder covenants.

#### *Assessment of operational robustness during the tender*

The current tender process also tests the operational robustness of a bidder's submission. In the EPQ stage, Sections 4 (Experience of Asset Takeover,

Management and Operations, and Innovation), 6 (Approach to Management and Operations), and 8 (Financial and Commercial Risk Management) cover operational robustness. For example, in Section 6, bidders must describe their approach to maintaining and operating the OFTO assets for the full 20 year revenue term.

At ITT, Section 3 (Asset Takeover) and Section 4 (Ongoing Operations and Statutory and Regulatory Compliance) and certain other parts of the ITT cover operational robustness. For example, in Section 4, bidders must provide details of their expected O&M arrangements, how and from providers they intend to source these, and how they would respond to major failure events. Bidders must exceed a minimum score on both of these Sections to be considered as the Preferred Bidder. Section 8 (Underlying Assumptions) also looks at how a bidder's O&M cost assumptions feed into its base case TRS.

#### *Ongoing robustness during the OFTO revenue term*

Once we have granted them a licence, OFTOs may become financially distressed where there are events that lead to additional unplanned expenditure on the OFTO assets, for example a failure of the transmission assets. The OFTO licence provides protection to the OFTO in the event of certain adverse events. For example, the licence contains protections such as the Incoming Adjusting Event (IAE) and Exceptional Event (EE) licence conditions. The general purpose of the IAE Condition is to provide protection to OFTO licensees for identified unexpected costs arising from certain low probability but high impact events. The EE mechanism allows OFTOs to apply for relief of penalty under the availability mechanism for exceptional type events.

The OFTO licence contains requirements to establish strict financial ring-fencing arrangements from its parent companies. This provides a significant level of protections from financial trouble within those parent companies, caused either by issues localised to that company, or wider economic conditions. These protections ensure that an OFTO is able to function as a standalone entity. In addition, we are aware that the OFTO's debt providers will take steps to ensure that the OFTO they are lending to continues to be financially robust and will apply stress tests to confirm this.

Where an OFTO gets into financial distress, we have the option of undertaking an OFTO of Last Resort process, where we can direct an existing transmission licensee to take on the OFTO assets before running a tender to determine a new OFTO. To-date, we have not had to make use of this last resort process.

OFTO licensees are also potentially subject to the Special Administration Regime within the Energy Act 2004. The objective of an energy administration is to secure that the transmission licensee's system is and continues to be maintained and developed as an efficient and economical system. Where an OFTO is at risk of any type of insolvency and it or its creditors applies to the court to wind the company up, they must first notify the relevant Secretary of State (SoS) and GEMA. Within 14 days of receipt of that notice, either the SoS or GEMA with SoS approval may apply to the court to place the OFTO into special administration. The court may, amongst other available measures, appoint an administrator to keep the company as a going concern.

## Appendix 2 – Feedback on this consultation

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We want to hear from anyone interested in this document. Send your response to the person or team named at the top of the front page.

We've asked for your feedback in each of the questions throughout it. Please respond to each one as fully as you can.

Unless you mark your response confidential, we'll publish it on our website, [www.ofgem.gov.uk](http://www.ofgem.gov.uk), and put it in our library. You can ask us to keep your response confidential, and we'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004. If you want us to keep your response confidential, you should clearly mark your response to that effect and include reasons.

If the information you give in your response contains personal data under the Data Protection Act 1998, the Gas and Electricity Markets Authority will be the data controller. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. If you are including any confidential material in your response, please put it in the appendices.

### **General feedback**

We believe that consultation is at the heart of good policy development. We are keen to hear your comments about how we've conducted this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Any further comments?

Please send your comments to [stakeholders@ofgem.gov.uk](mailto:stakeholders@ofgem.gov.uk)