SCOTTISHPOWER

Rupert Steele OBE
Director of Regulation

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17 May 2018

Dear James,

OFTO Tender Process – Consultation on Future Tender Rounds

We welcome the opportunity to comment on the issues raised in this Consultation. ScottishPower is a leading offshore windfarm developer with extensive experience of the UK OFTO market. Through our West of Duddon Sands joint venture project with Orsted, we jointly designed, consented and delivered the OFTO assets through generator build and jointly managed the OFTO divestment process. We are currently installing the OFTO assets for the East Anglia ONE (EA1) offshore windfarm through the generator build model and we will manage the divestment of this OFTO asset in the upcoming Tender Round 6 (TR6).

We have recently secured consent for the East Anglia THREE project and, on the assumption that the project secures a Contract for Difference (CfD) in the Spring 2019 CfD auction we intend to build the OFTO assets through the generator build model. We also expect to adopt the same approach for the East Anglia Two and East Anglia One North projects that we have in development.

We welcome Ofgem's review and agree that there are potential areas for improvement. That said, it is not yet clear whether either proposed package of reforms ('moderate change' or 'significant change') will deliver better outcomes than the present arrangements, given the high level nature of the proposals and their inherent optionality.

Our responses to the consultation questions are in the Annex to this letter. We would highlight the following points:

- **Application of changes to TR6 –** Our EA1 development transmission link is currently scheduled for inclusion in TR6, due to start in June 2018. In this context, while we consider a review of the OFTO tender process is important to ensure the regime remains effective, we consider that applying potential changes in time for TR6 could be challenging. Some of the proposals being contemplated in this Consultation could lead to material changes to the tender process and will require development with all stakeholders involved. The EPQ stage for TR6 is due to commence in Q3 of 2018 and the introduction of material reforms to the way this operates is likely to create unnecessary uncertainty in the process for both bidders and developers. We think it is unlikely that Ofgem will be able to develop and consult on such reforms in time for them to be implemented in a robust manner for TR6, whilst also providing enough clarity and stability for all participating parties. We therefore recommend that

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any change proposals should be consulted on further and in more detail, and should not affect TR6 but be targeted at TR7 and subsequent tender rounds.

- **Robustness of OFTO bids** – we agree with Ofgem's general assessment that the industry is sufficiently mature with respect to operational and technical competence and it is important that such standards are maintained and strengthened. Where reforms are targeted to encourage new entrants, the tender process should be constructed so that it ensures that all bidders have robust operation and maintenance arrangements to cover the lifetime of the transmission asset. If Ofgem introduces reforms that reduce or remove the evaluation of bids on operational robustness it is important that the alternative arrangements do not risk reducing operational standards of bids. We would expect that where thresholds are determined in order to confirm that a minimum level of operational standards have been met, developers should be involved in determining such thresholds and have the ability to verify that the thresholds have been met.

- **Ensuring the timeliness of the Preferred Bidder –** As noted in this Consultation a developer adopting the self-build approach is subject to strict liability under the Electricity Act 1989 (the Act) regarding the divestment of the transmission asset. Conversely, OFTOs have no obligations to ensure they do not delay divestment. We welcome the potential proposals by Ofgem to rectify this imbalance.

- **Confirmatory Preferred Bidder stage** – We support the removal of conditionality from bids to the extent practicable, which should alleviate the need for the developer to engage in protracted negotiations with the Preferred Bidder. We agree that cutting conditionality could be accommodated through an enhanced due diligence stage in the ITT phase. This is will, of course, create practical difficulties for tenderers and bidders. In order to facilitate this, Ofgem and the industry will need to work together to develop a mechanism for managing this process in the timescales allowed. For example, a prescribed set of information could be made available during the due diligence stage that is sufficient to enable unconditional bids. This will require some further detailed work between bidders, developers and Ofgem in order to deliver a workable solution.

- **Bid bonds** – in addition to ensuring commitment from bidders, we believe the bid bond could be used to ensure the Preferred Bidder does not unduly delay the process once appointed. For example, the bid bond could be called where it can be shown that the Preferred Bidders is intentionally protracting negotiations to push the developer closer to the commissioning clause deadline. In order to be practicable the circumstances in which the bond could be drawn down would have to be set out in advance to deter the Preferred Bidder from prolonging negotiations unnecessarily.

Whilst we currently disagree with the implementation of these wide reaching reforms for TR6, it would be helpful if Ofgem could issue a timeline showing how each of the potential reforms set out in the Consultation could, if implemented, impact the timeline for TR6 - which is known and which we (and no doubt other developers) are working in line with. This will help industry better understand the practical and commercial impact on their preparations for TR6 and enable further comment in that context.

If you have any questions regarding this response please don't hesitate to contact me.

Yours sincerely,

Rupert Steele

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Director of Regulation

Annex 1

OFTO TENDER PROCESS – CONSULTATION ON FUTURE TENDER ROUNDS– SCOTTISHPOWER RESPONSE

Chapter 2: The objectives and methodology of this review

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?

We agree with the factors listed in paragraph 1.11 as potential drivers for change and the context for this review. We agree with Ofgem's assessment of the industry's maturity with respect to operational and technical competence. In the context of potential reforms aimed at encouraging new entrants it will be important to ensure safeguards are in place so that any new entrants deliver high levels of operational robustness, in line with established industry participants.

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

We agree with the stated objectives for this review.

Chapter 3: Outcomes of our review

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?

We agree with Ofgem's general assessment that there are no obvious areas for change to the existing tender process with regards to improving the verification of financial and operational robustness of OFTO bidders. A Carillion situation is likely to arise where an organisation becomes overstretched financially and operationally. In the context of offshore transmission it is important to ensure licensed OFTO businesses are sufficiently ring-fenced to be insulated from the wider business activities of their owners. In this respect we would suggest reviewing the OFTO ring-fencing licence obligations to determine if they are robust and in line with other classes of network licences, and to ensure they cannot be impacted by a Carillion type situation.

4. With respect to the moderate change package:

a) Do you believe this option would be an improvement over the current tender process?

In this response we have set out some considerations that would need to be taken into account before assuming this option to be an improvement over the current tender process.

Weighting bid assessment to 100% of price, subject to specified operational and technical thresholds, should simplify the bid assessment by Ofgem, saving some resource and time.

In this variant of the moderate change package, it is imperative that developers have confidence regarding the operational and technical thresholds underpinning OFTO bids, and therefore we would recommend the relevant developers are involved in setting the threshold requirements ahead of the tender round. For example, developers are likely to expect the successful bidder to contract with the developer for O&M services or an appropriate alternative. This approach would require the opportunity for relevant developers to evaluate the technical schedules of the bids and to confirm their acceptability including likely transmission asset availability.

Clearly a tender regime where bid assessment is based solely on price potentially risks new or inexperienced parties being tempted to win bids by pricing themselves at what would later prove to be an unsustainable level of revenue, which may compromise the operation of the transmission asset or in the worst case lead to insolvency of the OFTO. In our response to Question 5 we comment on Ofgem's suggestions as to how some of these risks might be mitigated by the requirement for a bid bond.

We would welcome further information from Ofgem on the mechanisms it would propose to avoid these types of scenarios.

b) Do you agree with our assessment of this package against the objectives?

We agree that if parts of the evaluation at the ITT stage are reduced to determining whether threshold criteria have been met, there may be no incentives for bidders to exceed the thresholds, which could deter developers from striving to achieve the best service, and instead always focussing on achieving only the minimum standard to pass the test. We do agree that in order to mitigate this issue, the threshold for operational robustness must be set at a high enough level to ensure an appropriate standard from all bids and we, as a developer, would welcome further detail on how this might be achieved and the chance to comment on such thresholds. We also note later in this response that we have a real concern with setting minimum standards in a generic manner across all projects, as each set of OFTO assets will be unique and there may be differing levels of complexity and size to take into consideration.

This is important because the main way the benefit of lower OFTO costs will feed back into electricity prices will be lower bids in future cfd auctions. If the price/quality trade-off is not optimised from the point of view of the developer, this objective is unlikely to be achieved. Ofgem should therefore be cautious in taking an approach which could be seen as substituting its judgement for that of the developer.

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?

At the 30 April workshop Ofgem suggested it could make available the ITT questions from Tender Round 5 for stakeholders to review and comment on with regards to the questions and evaluation in future tender rounds. Were Ofgem to follow up on this we would be able to compare the ITT questions against the EPQ and provide views on potential overlaps.

d) Are there any amendments to this package that would improve it?

We believe the ability of OFTO bidders to impose conditionality, or the way in which conditionality is managed within their bids, remains a significant constraint on the tender process in terms of assessing bids and the level of negotiation required at the Preferred Bidder stage. Whilst we realise it will be difficult to remove conditionality completely, it is a

positive aim to remove conditionality as far as possible. We note, however, that there are some practical issues with the suggestions set out in this Consultation and would welcome the opportunity to discuss improvements once the proposed amendments are sufficiently developed.

e) What are your views on the most appropriate ways to mitigate the challenges of this package?

We agree with Ofgem that, by setting operational and other performance thresholds sufficiently high in relation to the operation of the transmission asset over its lifetime, OFTOs will be incentivised to deliver the required level of service and value. As noted in our response to Question 4(a) it is important that developers are involved in setting these thresholds and have the opportunity to scrutinise OFTO bidders in relation to these thresholds.

f) Are there other considerations we should have taken into account that present practical or other challenges to implementation?

We believe there is a need to consider the practical implications of developers having to interact with an increased number of bidders. In particular, we may need to factor in additional time and resources, particularly for the management of the TQ phase of the ITT stage. We would welcome confirmation that Ofgem will be considering putting more resource in place to help manage this process, including allowing developers to recover associated increased transaction costs.

We also note that an increased number of bidders during the ITT process is likely to require more time for all eligible bidders to complete the required level of due diligence, thus reducing the amount of time for the Preferred Bidder stage. We would like to understand how Ofgem would intend to manage the practicalities of this, so as not to create an (even more) strained timetable for completion, which would add undue pressure and create a weaker bargaining position for the developer – who is ultimately subject to strict liability under the Act if it fails to divest its transmission assets in the required timescales.

Additionally, as more complex and innovative financing becomes available (which inherently makes the bidders' models more complex), we would seek confirmation from Ofgem regarding the robustness of the financial model in place. In addition, or alternatively, the threshold criteria could include confirmation of certain financial metrics, eg the level of gearing.

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.

In our response to Question 4(d) we outline two general approaches for managing conditionality of bids. In the context of a reform package that seeks to reduce conditionality of bids and mitigate this through enhanced due diligence by OFTO bidders, we believe there should be a prescribed set of information and documentation that developers should be expected to make available to facilitate such due diligence. In developing these prescribed data requirements, Ofgem together with stakeholders should be satisfied that this information will offset the need for bidders to impose conditionality. Furthermore, a delay to the ITT in order to facilitate an enhanced due diligence stage after construction is completed, needs to be balanced against the fact that personnel involved in the construction of the transmission link are likely to have moved on to other projects and are less likely to be available at the due diligence stage to respond to bidder queries. It is therefore important

that bidders are clear on the prescribed documents and their scope and content, that will be made available to them as part of the due diligence stage.

5. With respect to the significant change package:

a) Do you believe this option would be an improvement over the current tender process?

It is difficult to comment on the outline proposals noted in the Consultation without further detail on how they would operate in practice and further time to more thoroughly assess the implications. However, we have set out some initial observations and suggestions below.

In the context of the significant change package, where explicit conditionality of bids is to be restricted, there is of course the risk that bidders could implicitly price this into their bids. We would welcome further clarification from Ofgem as to how it would avoid the risk that bidders increase their bids in this way. It is possible over successive tender rounds with greater learning and experience that prices could fall, and we suggest a more detailed assessment of these dynamics is undertaken to help stakeholders assess this proposed package of reforms.

The proposal to facilitate unconditional bids through an enhanced due diligence stage run at a later time where most or all construction issues are identified could work in principle. The main challenge will be to identify the information and documentation that will enable OFTO bidders to gain the necessary information regarding the transmission assets, on which they can make unconditional bids. As noted above, we would recommend that Ofgem together with the industry identify a prescribed set of documentation developers should make available for the purposes of bidder due diligence which all stakeholders agree should facilitate unconditional bids.

Whilst delaying the ITT stage, and consequently requiring less conditionality in bids, would achieve the welcome goal of greater certainty for developers between ITT and Preferred Bidder stage, it does potentially have a large resource impact on developers as they will have to enable an enhanced due diligence and negotiation of the Transfer Agreement by and between a potentially greater number of OFTO bidders, particularly given the proposal to allow an unlimited number of bidders into the ITT stage. Whilst we don't believe this is an insurmountable problem, we would welcome views from Ofgem as to how this practicality could be managed, eg via greater involvement from Ofgem.

b) Do you agree with our assessment of this package against the objectives?

Similar to our response to Question 4(a), we believe further development and analysis of these initial principles is required to assess the package against the objectives and consider the impact on the tender process. This will depend on when certain stages (eg ITT and Preferred Bidder) of the process take place and the implementation of these changes.

c) Are there any amendments to this package that would improve it?

In our response to Question 5(a) we have set out some additional considerations we think will be required in order to successfully achieve the aim of removing conditionality from bids. In addition we believe the significant change package would have to, as proposed, include the requirement on bidders to post bid bonds to ensure commitment from bidders and adherence to specified thresholds. We would also welcome the suggestion that the bid bond could be used to prevent the Preferred Bidder causing undue delay after the ITT on the lead up to the generator's commissioning deadline. Finally, as set out in response to

Question 5(d), we would expect developers to be involved in determining the operational robustness thresholds and have the ability to verify that they have been met by bidders.

d) What are your views on the most appropriate ways to mitigate the challenges of this package?

Ensuring operational and financial robustness of bids

We agree that the industry is now sufficiently mature, such that the operational and technical competence of potential OFTO bidders is more assured. However, where there are new entrant bids in future tender rounds (as is the driver behind some of these reforms), there will be a need to ensure they are realistic and sustainable.

We believe there would be merit in considering a minimum set of thresholds at the EPQ stage with certain pass/fail questions at the ITT stage, to ensure competence and due diligence is in place. For example, bidders could confirm they have certain documentary evidence/assurance in place that demonstrates operational and technical competence. Failure then to produce such documentation at the Preferred Bidder stage could be grounds to draw down on a bid bond, as rectifying this would inevitably delay the process.

Bid bond

We consider that a bid bond would be required to ensure the veracity and integrity of OFTO bids (see out response to Question 5f below.)

Enhanced due diligence

We believe that, if conditionality in OFTO bids is to be removed or significantly restricted, the onus should be on potential bidders to ensure they have undertaken robust due diligence before bids are submitted at the ITT stage. In this context, we agree that the tender process will need to be reviewed to assess the extent that ITT should be pushed back to enable documentation and technical information regarding the transmission link to be made available by offshore developers to OFTO bidders. It will be important to identify the additional information that can practicably be made available by developers ahead of the ITT. Ultimately it is imperative that extensions to the tender process timescale, which could impact the 18 month timeframe by which the generator must complete the sale, are avoided. This could disadvantage the developer unnecessarily, and has the potential to undermine any benefits of the proposed reforms.

e) Are there other considerations we should have taken into account that present practical or other challenges to implementation?

As noted in our covering letter, we consider applying the significant change package in time for TR6 which starts in summer 2018, would be very challenging. It would be essential for a developer participating in TR6 to have early sight and confirmation of increased information requirements for OFTO bidders, if they are to be able to facilitate enhanced due diligence and robust bids. Depending on the timing of Ofgem's conclusions and implementation of changes, all stakeholders will need to be reassured that changes can be implemented in a timely and robust manner for TR6 and the impact on the assumed timescales will need to be communicated as soon as possible.

As noted above, a practicality, at a project level, of delaying the ITT to enable enhanced due diligence, is the greater likelihood that personnel involved in the asset construction will have moved onto other projects. This will put greater emphasis on the documentation made

available by developers during due diligence stage and reduce the scope for bidders to query anything that falls outside the documentation.

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.

We consider some form of bid bond is essential to ensure resultant bids are realistic and sustainable given the sole focus on Tender Revenue Stream and the restrictions on conditionality. In addition we believe the bid bond should be used to ensure bidders do not cause undue delay to the transaction. This will be particularly relevant where a Preferred Bidder is appointed closer to the end of the 18 month window, as a result of an ITT stage that would, per the proposals, commence later than would currently be the case.

We agree that the bond will have to be sufficiently material to ensure commitment to OFTO bids. Based on our experience of other jurisdictions our initial view is that an appropriate bond value might be 5% of asset value rising to 10-15% at the Preferred Bidder stage. It is important to note, however, that much will depend on the asset value and a thorough assessment of the risk exposure of both parties. We would also welcome prescriptive rules as to the exact circumstances under which Ofgem would propose that the bid bond may be engaged.

We agree that the circumstances under which the bond can be drawn on require clear definition and, in the first instance, this should include any act/omission by the Preferred Bidder chat causes a delay to financial close. At present, during negotiations at the Preferred Bidder stage the developer is held to tight timelines for divestment under the Act. There is little or no incentive for the OFTO to complete the transaction within the same timescales, which leads to an unfair balance of negotiating power between the two parties, such that the developer may be forced to make decisions which are detrimental to it and less efficient in the round than would otherwise be the case.

We believe that the calling of a bid bond where the assets are not divested within the statutory time frame could address this imbalance, at least in part, as it would provide an incentive to the OFTO which does not currently exist. We believe the bond should also be used to guarantee that OFTO bidders have put in place the required minimum operational and technical robustness and competence. If the Preferred Bidder fails to produce the evidence that it had the required thresholds in place, it should be liable to lose some of the bond, as this will inevitably delay financial close whilst the issue is rectified.

With respect to the potential pain/gain share mechanism, we agree this should be very tightly defined and limited to changes in circumstances that emerge after the ITT stage, either in relation to the OFTO bidder or the transmission assets.

We believe that the pain/gain share mechanism for the financing of the OFTO assets should favour the consumer. In particular, if the re-financing of the OFTO assets happens within the first year post divestment, without there being significant macro-economic changes (which can be properly explained), the ratio of the pain/gain share should favour the consumer. Following this, we will be happy to maintain the current ratio for pain/gain share.

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

We have not identified any alternative packages of proposals at this time.

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?

Whilst the provision of a VDD report that can be relied upon by the bidders should, in principle, have the effect of streamlining the process, experience shows that it is likely that most bidders will not be content to rely upon the diligence carried out by the vendor and the findings set out in a broad report. It is unlikely that bidders will be content to base their bid solely on VDD, particularly if bids are to be unconditional. We therefore question whether, in practice, this would address the problem identified and satisfy the objective of streamlining the process. Instead it may put an additional cost and resource burden on developers whilst not circumventing the need for detailed due diligence. We do see some benefit in a more focussed approach ie a Certificate of Title. This is common practice in corporate transactions and experience shows that it can have a benefit to bidders and can speed up the process. Should Ofgem consider this to be appropriate, we would expect the parameters of such a Certificate of Title to be tightly defined from the outset of the Tender Round.

b) Are there 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?

We agree that there is room for improvement in how the data room is organised. Presently the organisational structure results in inefficiencies in the way that advisors of the parties interact with it, introducing extra cost on both the developer and bidder side which ultimately feeds through to the consumer. We would welcome the use of a more standardised approach to eg naming conventions and the use of external “purpose built” data room software to enable a more efficient process.

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?

We are not currently in a position to comment in detail on the current bond spread methodology.

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

Where bidders are left to confirm certain thresholds have been met or documents are in place, we believe this should be linked to the bid bond to ensure that if the Preferred Bidder fails to verify confirmations supplied at the ITT stage, it may lose some of the bond if this delays subsequent financial close.

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?

In practical terms, the engineering on these types of projects will become more innovative and technical and this will likely lead to the requirement for longer windows for bidders to carry out the necessary due diligence. It will also be very important to keep the minimum technical requirements, specified at EPQ stage, under careful review, as the bar that is set will likely change as assets continue to develop. This means that a "one-size fits all" approach to setting the technical criteria will become even less appropriate in the future.

Ofgem will also need to continually review the way they benchmark projects in order to assess the reasonableness of costs. All costs will not necessarily have a linear relationship which will make scaling current costs unreasonable in comparing smaller to larger and more complex projects. However, we would hope that the principles of the tender process are not materially changed.

Chapter 4: Other policy changes

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?

As Ofgem note in the Consultation, the first OFTO, Robin Rigg, will be required to confirm its decommissioning plan with BEIS in three years' time. It is therefore important that Ofgem begins to consider the regulatory arrangements that will apply now, as this issue will become more prevalent as the early OFTOs reach the end of their 20 year terms.

In relation to the options available at the end of the normal 20 year OFTO revenue term, Ofgem considers 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*."

In a scenario where the developer and OFTO are agreed that the life of the transmission asset is to be extended, the main revenue requirement of the OFTO is to cover the extension of operation and maintenance (O&M) costs. There should be no capital cost considerations as the asset will be fully depreciated. The timing of these decisions should be driven by the developer, allowing it maximum optionality regarding extending the life of its wind farm, repowering etc.

If Ofgem were to follow the second option and re-tender the project and appoint a new OFTO, we have identified a potential regulatory issue with this approach that will need to be addressed. If Ofgem want to appoint a replacement OFTO, it would need to consider how it may compel the incumbent OFTO to transfer the OFTO assets to the new OFTO and how it would set the transfer value of the assets and the timeframe for transferring them.

Without this, the risk arising from this is that the incumbent OFTO could hold onto the assets to extract the maximum value. This could result in a 'stand-off' situation arising, which could be damaging for consumers, generators and investor confidence in the OFTO regime.

Whilst the focus of this Consultation is on the end of the 20 year term, we have also identified that this is an issue, should a new OFTO require to be appointed during the 20 term, eg through the OFTO of Last Resort scheme. We can identify no provision which deals with how OFTO assets would be regained from the incumbent OFTO and the value attributable to those assets. Ofgem should also consider the impact of this at the same time, as the two issues are interrelated.

Under Schedule 2A of the the Act, Ofgem has powers to make a property scheme to transfer property from the wind farm developer to the successful bidder following a tender exercise. We would welcome clarity from Ofgem as to whether it considers that its statutory powers to make a property scheme would also apply following a tender for an existing OFTO project to appoint a new OFTO. From our reading, Schedule 2A has not been drafted with this scenario in mind. For example, there is no definition or reference to an 'Incumbent OFTO'. Paragraph 14(3) also does not include the circumstance where compensation is to be paid from the successful bidder to the current OFTO, but we assume the current OFTO will expect to receive a transfer value for the assets.

If Ofgem does not consider that the provisions of the Act would apply in these circumstances, a regulatory gap exists whereby there would be nothing in the legal framework which could compel the incumbent OFTO to transfer the OFTO assets to the new OFTO.

Even if Ofgem's statutory powers extend to these circumstances, the powers are limited to the transitional period. Paragraph 5 provides that "*No application may be made for a property scheme after the end of the transitional period*". The "*transitional period" means the period of 4 years beginning with the day on which section 92 of the Energy Act 2004 (competitive tenders for offshore transmission licences) comes into force*".[1] Section 92 came into force on 20 May 2009. Before the end of the transitional period, on 20 May 2013, the Secretary of State can make an order to extend the transitional period.[2] Under the Electricity (Extension of Transitional Period for Property Schemes) Order 2013, the transitional period was extended to 19 May 2025. The total transitional period cannot exceed 16 years.[3] This means that after 19 May 2025 it will not be possible to make an application to Ofgem to make a property scheme following a tender exercise.

Therefore even if Ofgem's powers do apply in the context of a re-tender exercise, there will be a regulatory gap after 19 May 2025 whereby, if Ofgem re-tenders for a new OFTO at the end of a 20 year revenue term, Ofgem would have no powers to compel the incumbent OFTO to transfer the required assets to the new OFTO. This results in the same regulatory gap.

We consider that this regulatory gap could be detrimental for generators, consumers and investor confidence. If Ofgem has appointed a new OFTO (for example, if the current OFTO's business has failed, it is not performing to standard, or the OFTO has reached the end of its 20 year term), but the incumbent OFTO is either refusing or delaying the transfer of the transmission assets and necessary property rights, the generation assets would become stranded and the generator would be unable to export electricity to the onshore transmission network. This would result in a 'stand-off' situation.

[1] Electricity Act 1989 Schedule 2A paragraph 5(2)
[2] Electricity Act 1989 Schedule 2A paragraph 5(3)
[3] Electricity Act 1989 Schedule 2A paragraph 5(5)

The generator's key concern, if a stand-off arose, would be to ensure that the generation assets could remain connected to the OFTO system to allow them to continue to export and so allow the generator to continue to receive a revenue stream. A stand-off situation could also be very damaging to consumers. It could mean that a large offshore windfarm would be taken off the system for an unplanned and unknown period of time which could lead to an increase in wholesale electricity prices and balancing costs. In some circumstances it could also create a security of supply issue. Additionally, a stand-off could damage the confidence of investors in offshore windfarms and the OFTO regime, especially if it arose as a result of a known gap in the regulatory framework.

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?

It is likely that offshore wind assets will follow trends in onshore wind and other technologies, and that developers will be operating beyond the current 20 years assumed asset lifetimes. That said, it is not clear at this stage of the offshore wind industry development that there is a consensus on what asset life is possible, but it does appear very likely that it will extend beyond 20 years. At this stage, it is perhaps more important that arrangements are flexible to allow developers to operate their assets as long as is commercially viable, whilst addressing the regulatory gap noted above.

ScottishPower
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