

Decision

OFTO Tender Process Changes for Future Tender Rounds implemented for Tender Round 6 onwards

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This document sets out our decisions in relation to changes to the offshore transmission tender process. In particular, it sets out a new approach which includes an increase to the length of the revenue term for offshore transmission licensees, an increase in the number of bidders that will be able to proceed to the invitation to tender (ITT) stage, the possibility of an additional enhanced pre-qualification (EPQ) stage and revisions to the manner in which tenders at the ITT stage will be evaluated. We set out our rationale for these decisions and address stakeholder responses to Ofgem's OFTO Tender Process Consultation for Future Tender Rounds of 8 March 2018.

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1. Introduction

Context and related publications

1.1. In 2009, the Government introduced the regulatory regime for offshore electricity transmission to connect significant amounts of renewable offshore generation to the onshore electricity network (the "**OFTO regime**").

1.2. Offshore Transmission Owners ("**OFTOs**") are appointed through a competitive tender process. OFTOs are granted an offshore transmission licence ("**OFTO Licence**") with a fixed revenue stream for a specified period of time. For the first five tender rounds this revenue stream is fixed for 20 years.

1.3. The OFTO regime has three objectives:

1.3.1. 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;

1.3.2. Provide certainty and best value to consumers through the competitive tender process; and

1.3.3. Attract new entrants to the transmission sector.

1.4. The OFTO regime is flexible, delivers lower costs to consumers – we estimate the OFTO regime has saved between £0.7bn and £1.1bn over the first three tender rounds (independent evaluation by CEPA) – and makes a major contribution to the UK's renewable energy targets. We have licensed 17 OFTOs with a further seven in the pipeline. The first five tender rounds will deliver £5bn in investment and 4.6GW connected renewable generation.¹

1.5. Since the commencement of the OFTO regime, the OFTO market has matured, with larger scale projects and an established bidding market. Whilst we consider that the current tender process generally performs well against the stated objectives for the OFTO regime, there could be scope for improvement in attracting new entrants to the transmission sector and in ensuring that the tender process is efficient. Accordingly, we have reviewed the tender process to ensure it that continues to deliver value and to perform against the objectives.

Our decision making process

1.6. On 8 March 2018, we published a consultation on the tender process for future tender rounds (the "**Consultation**"). In the Consultation, we set out possible drivers for changes to the tender process and two proposed packages for change:

1.6.1. a **moderate change package**; and

¹ [See our latest infographic.](#)

1.6.2. a **significant change package**.

1.7. The **moderate change package** was designed to target and streamline specific elements of the existing tender process and encourage new entrants whilst maintaining high levels of robustness. Options that were proposed as part of the moderate change package included:

1.7.1. **Increasing the number of QBs**

For the Enhanced Pre-Qualification ("EPQ") Stage (the "EPQ Stage"), we set out an option either to retain the current process with three to five qualifying bidders ("QB") that can progress through to the Invitation to Tender ("ITT") Stage (the "ITT Stage") or to increase the maximum number of shortlisted bidders to greater than five QBs.

1.7.2. **Removing the scored robustness sections**

For the ITT Stage, a proposal that the current section 8 (underlying assumptions) of the ITT questionnaire which is scored and weighted as 40% of the overall ITT score, would be converted into non-scored robustness thresholds. This would have the effect that the QB submitting the lowest price, i.e. the lowest tender revenue stream ("TRS"), which also met the required robustness thresholds would be appointed as the preferred bidder ("PB").

1.7.3. **Evaluating only the lowest priced bids**

A proposal to assess only the two lowest TRS bids at the ITT Stage to determine whether they met the robustness thresholds rather than, as currently, evaluating all of the bids submitted at the ITT Stage.

1.8. The **significant change package** proposed:

1.8.1. **Unlimited QBs**

Removing the limit to the number of QBs that can be shortlisted for the ITT Stage.

1.8.2. **No robustness thresholds at ITT Stage**

The QB submitting the lowest TRS would be appointed PB with no requirement to meet any robustness thresholds at the ITT Stage. This 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 the EPQ Stage and/or introducing mechanisms at the PB stage to encourage robust TRS bids at the ITT Stage.

This significant change package would require:

1.8.3. unconditional price only bids to be submitted by bidders;

1.8.4. the ITT Stage to be run later than currently and based on a more complete project data room; and

1.8.5. a short confirmatory PB Stage after the ITT Stage in which, to incentivise the delivery of bids, QBs would be required to post a bid bond which could potentially be supplemented by a pain/gain share mechanism.

1.9. We acknowledged in the Consultation that both of the different packages proposed involve trade-offs between the stated objectives of the OFTO regime, with the significant change package requiring more radical options for managing these trade-offs.

1.10. We invited comments on these packages from any interested parties as well as on any other areas of change that could be considered to improve the tender process. The opportunity to respond to the Consultation closed on 17 May 2018. We received 15 responses. Of these, seven were from potential bidders/OFTOs, six were from offshore developers and two were from other industry participants. We have published all of the non- confidential responses on our website.

1.11. Since the Consultation was published, we have also met with a number of industry participants to further discuss our proposals, including:

1.11.1. Bidders;

1.11.2. OFTOs;

1.11.3. Offshore developers and generators ("**Developers**");

1.11.4. Ofgem's technical advisers for TR6 ("**Technical Advisers**");

1.11.5. Ofgem's financial advisers for TR6 ("**Financial Advisers**"); and

1.11.6. Other interested stakeholders.

1.12. This is in addition to the analysis, consultations and considerations that occurred before and after the development of the proposals set out in the Consultation.

1.13. Following consideration of the responses received to the Consultation, our internal analysis and further discussions with stakeholders, we have decided to implement particular changes to the tender process for future tender rounds commencing with tender round 6 ("**TR6**"), as announced at the TR6 launch event on 9 October 2018 and as set out in this document.

Related Publications

Link to the Consultation: <https://www.ofgem.gov.uk/publications-and-updates/ofto-tender-process-policy-consultation-future-tender-rounds>

Link to non-confidential responses to the Consultation: <https://www.ofgem.gov.uk/publications-and-updates/ofto-tender-process-policy-consultation-future-tender-rounds>

TR6 OFTO Launch Event presentation: <https://www.ofgem.gov.uk/electricity/transmission-networks/offshore-transmission/offshore-transmission-tenders/tender-round-6>

Your feedback

General feedback

1.14. We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this decision document. We would also like to get your answers to these questions:

- 1.14.1. Do you have any comments about the overall quality of this document?
- 1.14.2. Do you have any comments about its tone and content?
- 1.14.3. Was it easy to read and understand? Or could it have been better written?
- 1.14.4. Are its conclusions balanced?
- 1.14.5. Did it make reasoned recommendations?
- 1.14.6. Any further comments?

Please send any general feedback comments to offshorelicensing@ofgem.gov.uk.

2. Policy changes

Key changes

2.1. Following consideration of the responses received to the Consultation, our internal analysis and further discussions with stakeholders, we are implementing three key changes to the tender process commencing with TR6:

2.1.1. Increasing maximum number of QBs and additional EPQ

We are increasing the maximum number of QBs that can be shortlisted for the ITT Stage from five to eight. If all eight QB places are not filled at the EPQ Stage, an additional EPQ Stage may be held in specified circumstances. This change is set out further below at paragraphs 2.2 to 2.10.

2.1.2. Replacing scored robustness with threshold robustness

We are incorporating the existing scored robustness requirements contained in section 8 (underlying assumptions) of the ITT questionnaire (the "**ITT Questionnaire**") into the non-scored robustness thresholds in sections 3 to 6 of the ITT Questionnaire (the "**deliverability robustness thresholds**"). This means that at the ITT Stage, the QB that bids the lowest priced TRS and which also meets the deliverability robustness thresholds will be appointed as the PB. This change is set out further below at paragraphs 2.11 to 2.15.

2.1.3. Increasing OFTO revenue period

We are increasing the OFTO revenue period from 20 years to 25 years. This change is set out further below at paragraphs 2.16 to 2.19.

Increasing maximum number of QBs and additional EPQ

2.2. We are implementing the following changes to the EPQ Stage:

2.2.1. Minimum threshold

We are introducing a minimum threshold to be met for a bidder to pass sections 5 to 8 of the questionnaire in the EPQ document that commences the EPQ Stage (the "**EPQ Questionnaire**").

2.2.2. Increasing maximum number of QBs

We are increasing the maximum number of QBs that can be shortlisted for the ITT Stage to eight.

2.2.3. Additional EPQ

Where the shortlist of QBs has not met the maximum number of eight for a Qualifying Project, we are introducing an additional EPQ Stage to aim to meet that maximum number where there are Eligible and Willing Bidders (as defined at paragraph 2.5 below).

2.3. In order to be shortlisted for the ITT Stage, a bidder will need to achieve a minimum score for each of sections 5 to 8 in addition to passing the threshold sections in section 1 to 4 of the EPQ Questionnaire.

2.4. All shortlisted QBs will be “passport” into the ITT Stage for each Qualifying Project, as in the current process.

2.5. If there are fewer than eight QBs for any Qualifying Project, Ofgem may run an additional EPQ Stage aiming to fill the remaining places on the shortlist for the relevant Qualifying Project(s) provided there are one or more Eligible and Willing Bidders. To be an “**Eligible and Willing Bidder**”, a bidder must:

2.5.1. have expressed its interest in any additional EPQ Stage by returning a correctly completed and signed Confidentiality Agreement and Conflict of Interest (**COI**) declaration prior to the deadline for EPQ submissions (each, an “**EPQ Submission**”);

2.5.2. where it participated in the EPQ for any Qualifying Project, have not been excluded by reason of a failure of one or more of sections 1 to 4 of the EPQ Questionnaire (the “**selection criteria**”) for any Qualifying Project; and

2.5.3. have confirmed its willingness to participate in any additional EPQ Stage when required by Ofgem.

2.6. An additional EPQ Stage will not be held if there are:

2.6.1. no Eligible and Willing Bidders; or

2.6.2. eight QBs already shortlisted for each Qualifying Project in the tender round. This means that Eligible and Willing Bidders not already shortlisted will not have the opportunity to make an EPQ Submission.

2.7. Where a bidder failed to be shortlisted for the ITT Stage of any Qualifying Project on the basis of failing any of the applicable thresholds in sections 5 to 8 of the EPQ Questionnaire (the “**limitation criteria**”), it will have the opportunity to seek confidential feedback from Ofgem before submitting a bid at any additional EPQ Stage in order to utilise that feedback in preparing for the additional EPQ Stage.

2.8. Any feedback provided by Ofgem to a bidder at this stage will be in the same format and at the same level of detail as the feedback that we currently offer to all bidders following the EPQ or ITT Stages. Such feedback can comprise of both general and specific feedback and is intended to highlight particular strengths and comparative weaknesses of a bidder’s response that contributed to that bidder failing the applicable threshold for any of the limitation criteria.

2.9. Where an additional EPQ Stage is to be held, it will open for EPQ Submissions for a shorter duration than the time provided in the EPQ Stage. However, Bidders can express interest in the additional EPQ Stage in accordance with paragraph 2.5.1 above and access relevant information before the additional EPQ Stage is held. Also, the same EPQ Questionnaire and evaluation criteria as contained in the EPQ document will apply to the additional EPQ Stage.

2.10. As there are 3 Qualifying Projects in TR6 with varying first power dates, the ITT Stages for each of those projects will be staggered. Any additional EPQ Stage, if held, is expected to take place around the time that the ITT Stage for the Beatrice project has begun. This means that bidders intending to participate in any additional EPQ Stage, where they meet the requirements above, will only be eligible to bid for Hornsea Project One and East Anglia ONE in that additional EPQ Stage, if held.

2.11. We consider that encouraging new entrants to participate in the OFTO regime will be beneficial and that the following actions will facilitate competition whilst safeguarding the quality and competence of QBs:

2.11.1. Increasing the number of bidders that can be shortlisted at ITT Stage:

Raising the maximum number of QBs that can be shortlisted for the ITT Stage through the EPQ and any additional EPQ should encourage new entrants by improving their chances of being selected as QBs.

In the Consultation, we noted that there could be scope for further improvements in relation to attracting new entrants in line with the OFTO regime objectives. In previous tender rounds we have seen new bidders participating at the EPQ Stage though some have failed to be shortlisted for the ITT Stage.

We noted from discussions with potential new entrants, that bidders new to the market felt there was not sufficient time to prepare their EPQ submissions during the EPQ Stage. The additional EPQ Stage, where held, will give bidders another opportunity to participate in the additional EPQ Stage with more time to prepare their bid, and/or take account of feedback from the earlier EPQ Stage.

2.11.2. Stimulating competition through raising robustness requirements at the EPQ Stage

We consider that introducing an averaged minimum threshold (as set out at paragraphs 2.2.1 and 2.3 above) will help to implement a check and balance to ensure that all bidders, particularly new entrants, have a stronger minimum understanding of, and viability of approach to, asset takeover, operating transmission assets, their expected funding strategy and the management and mitigation of key financial and commercial risks, so that we facilitate a genuinely competitive process at the ITT Stage.

Replacing scored price deliverability robustness with deliverability robustness thresholds

2.12. Currently, bids at the ITT Stage are evaluated on:

- 2.12.1. first, passing 5 deliverability thresholds; and
 - 2.12.2. then, bids are scored on price (with a 60% weighting of the overall score) and price deliverability robustness (with a 40% weighting of the overall score).
- 2.13. We are changing the evaluation to:
- 2.13.1. give the price (TRS) 100% weighting; and
 - 2.13.2. incorporate the price deliverability robustness requirements that were previously scored under the existing section 8 of the ITT Questionnaire into the existing thresholds contained in sections 3 to 6 of the ITT Questionnaire.
- 2.14. All bids compliantly submitted by QBs at the ITT Stage will be evaluated. Those that pass the deliverability robustness thresholds will then have their bid TRS evaluated, with the QB submitting the lowest TRS becoming the PB. Where the TRS is tied or very close together, a best and final offer (**BAFO**) stage may be run to determine the PB.
- 2.15. Our decision to change to 100% weighting on price (TRS) with enhanced deliverability robustness thresholds is reflective of the maturing OFTO regime. We consider that this change will deliver the following benefits:
- 2.15.1. **increase the competitiveness of bids** by encouraging QBs to seek better value pricing solutions that result in a lower TRS whilst continuing to meet deliverability robustness thresholds;
 - 2.15.2. **make evaluating bids more efficient** by removing the need to score price robustness beyond meeting the relevant threshold; and
 - 2.15.3. **maintain robustness and offset the risk of a PB being appointed without the requisite skills and capability to be an OFTO** through raising the robustness thresholds required for all QBs. This signals to all bidders that robustness is a crucial component of each bid and addresses Developers' wishes that we place a higher level of importance on the OFTO's ability to maintain availability and operate the asset to a high standard.
- 2.16. As we are evaluating all bids submitted at the ITT Stage, we can continue to provide confidential feedback to unsuccessful QBs to enable those QBs to improve their bids in any future tender exercises. This feedback can include informing the bidder of the area in which they failed and generally indicating where they priced high against the mean, and therefore where price adjustments can be made in the future.

25 Year OFTO Revenue Period

- 2.17. The OFTO revenue period will be extended from 20 years to 25 years from TR6 onwards.

2.18. The original revenue period was set at 20 years to align with the forecast life of the wind farm and therefore to minimise the risk of stranding the OFTO assets. In 2012-13, Ofgem consulted on, amongst other things, extending the revenue period². At that time, the fixed 20-year period was retained as (i) there was no degree of certainty that the generation assets would be operational significantly beyond 20 years and (ii) the analysis did not indicate that a term longer than 20 years would offer a significant value-for-money benefit. As part of the Consultation, we re-considered whether there is evidence to support increasing the 20-year revenue period for future projects.

2.19. We have decided to increase the revenue period for the following reasons:

2.19.1. **Useful economic life of greater than 20 years**

Responses from Developers and advice received from our Technical Advisers concluded that the maturing of the offshore wind sector together with evolving technologies has resulted in the forecast life of the generation assets being longer than the 20 years originally envisaged in the OFTO regime and transmission assets being built to last for much longer than the 20 years, and that therefore the useful economic life of these assets is in excess of 20 years.

2.19.2. **Increasing use of bond financing**

Our Financial Advisers and Bidders agreed that determining the length of the revenue term should be driven by the available and best value debt sources.

Market conditions, with increasing appetite from institutional capital and the increased value of upcoming tender rounds, suggest that bond solutions will play a greater role in OFTO financing. As projects, such as Hornsea Project One in TR6, grow larger, it is unlikely these can be financed by bank debt alone due to the limited bank debt capacity for assets of this size on competitive terms.

25 years is a preferable term for bond financing so extending the term should encourage more competitive bond pricing for the larger TR6 projects therefore offering value-for-money for consumers. Recent market engagement undertaken by our Financial Advisers signalled a preference for longer tenors where possible. Our Financial Advisers also indicated that the increase in revenue period should not result in a significant change to the availability of bank debt based on current market conditions.

2.20. As a result of the above, we have decided that extending the revenue period to 25 years will strike the right balance between encouraging interest from the bond market, maintaining the viability of bank debt solutions for OFTO financings, and providing value-for-money for consumers.

² A copy can be found on our website:
https://www.ofgem.gov.uk/sites/default/files/docs/2013/07/offshore-electricity-transmission-statement-on-future-generator-build-tenders_0.pdf

Process Improvements

2.21. We are implementing improvements to the tender process, also commencing with TR6, as follows:

2.21.1. **Providing EPQ evaluation criteria**

We will provide the evaluation scoring criteria against which we assess EPQ Submissions to bidders in the EPQ document. This should increase transparency to improve the quality of bids.

2.21.2. **ITT confirmatory questions**

The questions in the ITT Document that require the provision of information which is not necessary to be provided until a bidder has been appointed the PB will become confirmatory. This will include documents such as shareholder agreements, board structures and the CVs of board members. If needed, this information can instead be provided at PB stage to prevent unnecessary information being sourced and provided by unsuccessful bidders.

2.21.3. **Mandatory credit rating**

We will require all bidders proposing to fund the acquisition of the OFTO assets through listed bonds to obtain a preliminary credit rating via a rating agency service. This is currently optional, we consider a mandatory rating requirement will provide greater certainty that a bidder proposing a bond financing solution is robust.

2.21.4. **Facilitating wider range of financial structures**

We will provide a wider range of credit ratings in respect of bond solutions, bond spreads, interest rates and gilt rate tenors in the ITT Document. These changes are required as a result of the increase in revenue period to 25 years and will provide bidders with the choice to adopt a range of financial structures which should support price competitiveness.

2.22. The rationale for implementing these changes, including our consideration of responses to the Consultation, are set out in section 3 of this document.

Aspects to be reviewed

2.23. We are further considering the following aspects of the tender process in response to concerns raised by respondents to the Consultation:

2.23.1. **Reducing conditionality**

We will review the ITT Questionnaire to identify any elements of conditionality in the questions and consider whether such conditionality can be reduced.

2.23.2. **Project specific risks**

Where possible, we will provide more information to bidders in relation to specific project risks identified by the developer that may be covered in their bid at the ITT Stage, such as technical project specific features.

2.23.3. **Due diligence and VDD reports**

We are working with TR6 developers to consider ways in which we could standardise the provision of project-specific due diligence information and documents. We are aiming to make it easier for bidders to identify and locate the information that they require for a comprehensive assessment of the relevant project. We intend that developers will produce a document that will form the starting point for bidders to commence their own due diligence process.

2.23.4. **Data room improvements**

We are working with TR6 developers to ascertain whether improvements can be made to the data room and the process for reviewing data room documents to enable bidders to better understand where information is contained in the data room and how it is organised so that it is easier to find and clearer when new information is uploaded and where.

We are undertaking a review of Ofgem's data room system provider to ensure we have the most appropriate services required for the tender process. Ofgem intends to conclude this review by the end of 2018.

2.23.5. **CfD cross-over**

We will work with our Financial Advisers and Technical Advisers to consider the relevance of any cross-over from the CfD qualification process to the tender entry process, and then to identify any aspects in which tender entry process is unnecessarily duplicative for projects which have already qualified under the CfD process. We can then consider whether it is necessary and/or appropriate for the tender entry requirements to be streamlined for such developers and whether doing so requires amendments to the Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2015³.

2.24. The considerations set out in paragraph 2.22 are detailed in section 3 of this document.

³ SI 2015/1555

Decision - OFTO Tender Process Changes for Future Tender Rounds implemented for Tender Round 6 onwards

3. Summary of Consultation Responses

3.1. We received 15 responses to the Consultation from stakeholders which have helped to inform the decisions set out in this document. The Consultation asked both specific questions and for views on the OFTO process generally. We have summarised and grouped these responses accordingly.

Were the right drivers for possible change to the OFTO process considered and are the objectives of the OFTO regime appropriate?

Summary of Responses

3.2. The majority of respondents agreed that the Consultation considered the right drivers and objectives.

One respondent considered that a driver for change should address developers' concerns with the 18-month generator commissioning clause ("GCC") date.

Another respondent thought that one driver should be the ongoing ability of existing OFTOs to efficiently resolve issues that arise in operation.

3.3. The majority of respondents agreed that the OFTO regime objectives are appropriate, although a few respondents queried the inclusion of the fourth objective that the OFTO regime has an "efficient and streamlined process". Such respondents considered that this objective gave the impression that Ofgem is more concerned with ensuring the tender process is efficient at the cost of ensuring the bid submitted by the PB is robust.

Our View

3.4. The 18-month GCC date is statutory⁴ and therefore any changes to it will require an amendment to legislation. Ofgem is aware of the concerns developers have in relation to the GCC period and intends to commence discussions on it with the Department for Business, Energy and Industrial Strategy (**BEIS**) as part of a wider initiative.

3.5. In the Consultation, we noted that the potential fourth objective would consider the resources (i.e. time and money) needed to participate in and run the tender process, as well as the clarity and simplicity of the process (for example, in the assessment of bids). The fourth objective was not proposed to be a priority over any other of the stated objectives of the OFTO regime and, following consideration, we have concluded that it is not necessary for this to be included as an express aim of the OFTO regime since we would always strive to ensure the tender process is as efficient as it can be.

OFTO financial and operational robustness in the tender process

Summary of Responses

⁴ Section 6G of the Electricity Act 1989.

3.6. Most responses to the Consultation addressed the OFTO financial and operational robustness of the tender process together.

3.7. There were concerns expressed by both Bidders and Developers as to risks associated with the tender process focusing too much on price:

3.7.1. Some Developers felt it was important that Ofgem should not relax its assessment of the bidders' assumptions applied in formulating their bids.

3.7.2. Three Bidders considered that there was a risk if the bidding process focused too closely on price that bidders might not include contingencies for unexpected events in their bid.

To counter these risks, the following suggestions were raised:

3.7.3. One Bidder suggested that the evaluation at the ITT Stage should look beyond the standard O&M budget to consider contingencies for ad-hoc activities that might ultimately protect the integrity of the OFTO and maximise availability.

3.7.4. One Bidder suggested scoring bidders on how they would propose to deal with unforeseen events.

3.7.5. A Developer suggested that additional questions needed to be asked of bidders at the EPQ Stage to ascertain the extent of financial interlinking between projects. There was a concern that if the bidding process focused too much on price, it could leave OFTOs exposed if unexpected events occurred on assets owned by the same entity, for example, the financial distress of one OFTO business could expose the business of another OFTO owned by the same equity partners.

3.7.6. One Bidder suggested that we should provide more guidance about project specific risks to ensure bidders are adopting the same assumptions as each other in formulating their bids for the ITT Stage.

3.8. Two Developers raised suggestions for Ofgem intervention after the transfer of the transmission assets to ensure that if an OFTO asset is divested, the new owner should be subject to the same financial and operational robustness requirements as the original PB and that the risk of financial or technical failure is not heightened.

3.9. The Consultation referenced Carillion, a major construction contractor, becoming insolvent this year amid the failure of multiple construction and operations and maintenance contracts, typically in the PFI/PF2/PPP market. Previously Carillion has acted as a contractor on the construction of two sets of OFTO assets. Generally, respondents felt that the OFTO process was financially robust and would stand up to a Carillion-style scenario.

Our View

3.10. Ofgem recognises the importance of ensuring bidders are financially and operationally robust and does not intend to lessen its assessment of bidders at the EPQ Stage or ITT Stage. Existing protections include:

3.10.1. With regard to unforeseen events, section 4 of the ITT Questionnaire deals with bidders' proposals for mitigating and responding to a major failure event of the assets and requires each bidder to set out how it would ensure that the assets are resumed to normal operations as quickly as possible. In addition, section 8 of the ITT Questionnaire distinguishes between standard ongoing costs and any amount included to cover events such as major failure events. Separately, Qualifying Bidders are required to detail any contingencies included in their bid assumptions.

3.10.2. Pre-licence grant, bidder group changes must be determined by the Authority, amongst other things, on the basis that the change in membership meets the relevant evaluation criteria and, where applicable, the PB matters remain satisfied.

3.10.3. Following licence grant, should any OFTO assets be divested, the new OFTO would be required to comply with the same licence obligations as the incumbent OFTO, including financial ring-fencing conditions that are designed to secure that assets, cash flows and other financial resources of the OFTO are applied to meet the needs of the regulated company, and to provide the transmission services in accordance with the System Operator Transmission Owner Code (**STC**). One Bidder in its response to the Consultation suggested that lenders and rating agencies continue to monitor the financial and operational strength of the OFTO post licence grant.

3.11. As a result of the changes set out in this document, QBs will no longer have their price robustness scored as in previous tender rounds, however, price robustness will still be assessed as part of the deliverability robustness thresholds which introduce a threshold for pricing robustness.

3.12. It is difficult for Ofgem to provide guidance on project risks as Ofgem is not in a position to warrant the quality of the information provided by developers. However, we will strive to provide further clarity around project risks and the particular assumptions to be made by bidders in relation to a Qualifying Project. To assist with ensuring that bidders are submitting operationally and financially robust bids, we will work with TR6 developers and our Technical Advisers to get a greater understanding of each project and the project specific technical requirements and features.

3.13. Ofgem does not consider that it needs to make any changes to specifically mitigate a Carillion-style scenario. We consider that the overall robustness of OFTOs will be further tested and evaluated through new provisions in the ITT Document that take into account different financing arrangements to ensure that they can be appropriately evaluated and scored, such as requiring a preliminary rating assessment for bond solutions (see paragraph 3.48 below).

Moderate change package

Summary of Responses

3.14. Many respondents were opposed to both the moderate and significant change packages as set out in the Consultation, but were supportive of Ofgem's aim to make the tender process more efficient and to encourage competition, provided the process remains robust.

3.15. There was support for some aspects of the moderate change package, however most respondents felt the package, as it was presented, did not adequately address the inherent risks of implementing such a package. Respondents were concerned it represented a move towards Ofgem reducing the robustness of the tender process and suggested that any improvements to the process should focus on better assessing the financial and technical capabilities of bidders. Bidders all agreed that some form of robustness assessment is important.

3.16. Some respondents did support a move to 100% weighting on price, provided that bidders were still required to meet the deliverability robustness thresholds at their current levels or higher. Other respondents were concerned that this could lead to a PB making changes to their offer once appointed. They indicated there was a lack of certainty over TRS changes generally and better clarity and guidance on this should be provided by Ofgem.

3.17. Developers felt there should be greater focus on the operations and maintenance arrangements of the bidder in evaluation at the ITT Stage. They emphasised the importance of retaining appropriate operational and technical thresholds. Six Developers thought these thresholds should be set at a higher level and customised across projects and suggested developers should be involved in setting these threshold requirements for each project, ahead of tender rounds.

3.18. All respondents agreed that the tender process could be made more efficient by reducing repetition and any duplication of questions at the EPQ and ITT Stages. Various approaches to achieving this were suggested by Bidders.

3.19. Developers were concerned about the consolidation of the bidding market and agreed the push to increase competition was important. However, most Developers considered that allowing an unlimited number of bidders was not realistic. In particular, Developers thought it would have a detrimental impact on their ability to respond to clarifications at the ITT Stage.

3.20. All Bidders except one thought industry consolidation should not be viewed negatively. One Bidder thought allowing more than five bidders through to the ITT Stage would be a disincentive to bid, due to the reduced possibility of winning and the cost of submitting a bid. At least two Bidders thought three bidders was an adequate number for a competition. Three Bidders queried whether there was sufficient expertise amongst legal, financial, insurance and technical advisers to support more than five bidders, with the consequence that it might lead to generic pricing.

3.21. Developers supported removing conditionality in bids as much as possible, due to concerns that bidders use adjustments to the TRS as a way to win based on unrealistic prices and then claw back at a later stage. Their view is that allowing TRS changes once the PB has been selected undermines confidence in the bid process and the lack of transparency increases risks to developers, ultimately reducing value-for-money for consumers. To facilitate due diligence and reduce conditionality, one Developer suggested that all developers should make available a prescribed set of information at the commencement of the ITT Stage.

3.22. Bidders considered that it was important to have the opportunity to qualify their bid, as they often do not have all of the necessary information at ITT Stage. Their view is that not allowing any movement in the TRS is impossible when financial markets move and there are elements outside the bidders' control that are difficult to price at the time of bidding. Bidders are dependent on third parties, primarily the developer, for timely and comprehensive information and appropriate mitigation/allocation of risks outside of the OFTO's control.

Our View

3.23. As set out above in paragraphs 2.11 to 2.15, we have decided to change the weighting of the ITT to be 100% on price (TRS). We will remove section 8 of the ITT Questionnaire and incorporate the price robustness requirements currently in section 8 into earlier threshold questions, which will help to streamline the ITT Questionnaire and avoid duplication.

3.24. We will set higher deliverability robustness thresholds in conjunction with our Technical Advisers, Financial Advisers, and the project developers for TR6. In setting the thresholds, Ofgem will consider what is necessary to guarantee robust OFTO performance now and for the duration of the TRS.

3.25. In response to Bidders' concern that increasing the maximum number of bidders at the ITT Stage could be detrimental to encouraging competition and whether there is a large enough pool of advisers to support bids, advice from our Technical Advisers and Financial Advisers is that: (i) an increased pool of bidders should not have a detrimental effect on competition and (ii) the advisory market is large and existing advisers can implement separate teams with sufficient barriers between them within their organisation in order to support multiple bidders whilst preventing commercially sensitive information being shared between staff working on different bids.

3.26. We have set a maximum number of QBs that may be shortlisted for the ITT Stage, alleviating Developer concerns that an unlimited number of bidders is not realistic and could have a detrimental impact on their ability to respond to clarifications at the ITT Stage. We do not consider that increasing the number of QBs would deter potential bidders from participating in the tender process.

3.27. To address the remaining points expressed by respondents:

3.27.1. The evaluation scoring criteria against which we assess each EPQ Submission will be set out in the EPQ document. We already provide the evaluation criteria against which we assess the ITT Submissions in the ITT Document, however Bidders have requested we also provide further guidance on how we assess EPQ Submissions.

3.27.2. It is necessary to set tighter restrictions around the conditionality permitted in bids where such conditionality is unnecessary and causes concern about the overall robustness of the bid as set out in paragraph 3.21. We intend to review the questions and thresholds in the ITT Document to identify any elements of conditionality and consider whether these can be reduced. As set out at paragraph 3.12 above, we will also be working to provide more information to the bidders about what they need to include in their bid, where possible, based on project risks identified by the developer, at the ITT Stage.

Significant change package

Summary of Responses

3.28. Overall, respondents did not support the significant change package. Only one potential Bidder indicated that the significant change package would streamline the tender process and encourage new entrants.

3.29. Generally, respondents deemed the risk that a PB's arrangements to operate and maintain the OFTO would not be sufficiently robust and could lead to a failure of the OFTO once licenced, is too high.

3.30. Developers supported the element which encouraged new entrants into the OFTO market but not at the expense of the OFTO's operation and maintenance expertise. Developers considered that delaying the ITT Stage would not work in practice as staff with project expertise would no longer be retained by the project at that point to answer due diligence clarifications.

3.31. Bidders expressed particular concerns that by not assessing the robustness of the written response, the PB may not have fully considered and priced all of the project risks at the ITT Stage, or secured a fully funded finance solution. Again, Bidders suggested the ITT Stage retains the pass/fail scoring of robustness of each bid against clearly defined threshold limits. Going further, three Bidders suggested that this risk could be mitigated if Ofgem provided more guidance at the ITT Stage to ensure bidders adopt consistent assumptions regarding project risks.

3.32. Some respondents considered that if the significant change package was introduced, the proposed bid bond and pain/gain share mechanism would be necessary to help hold bidders accountable to their bids. However, they did not deem it a necessary change if the significant change package was not implemented. Other respondents did not see either mechanism as a positive amendment to the process.

Our View

3.33. We agree with respondents' views that to implement the significant change package, as presented, would be challenging.

3.34. We consider that introducing certain elements of the moderate change package outlined above, such as increasing the number of QBs that may be shortlisted for the ITT Stage, 100% weighting on price underpinned by stronger robustness thresholds and working to reduce the conditionality of bids will achieve a more efficient, competitive process without sacrificing robustness of bids.

3.35. Accordingly, we have decided that consequential changes proposed to complement the significant change package such as the bid bond or pain/gain share mechanism and starting the ITT later will not be introduced.

Would other packages of change better deliver against the objectives?

Summary of Responses

3.36. Respondents generally supported process changes that would streamline the administrative elements of the tender process. Many of the responses overlapped with points Bidders and Developers already raised in their answers to other questions.

3.37. One Developer considered that with the introduction of the Contracts for Difference regime (**CfD**), we could reduce the tender entry requirements that we require developers to pass in order for their project to qualify for a tender round. This is because the CfD process requires developers to pass rigorous qualification requirements prior to being granted a CfD, many of which are the same as the tender entry process.

Our View

3.38. We will work with our Financial Advisers and Technical Advisers to consider the relevance of the cross-over from the CfD qualification process to the tender entry process, and then to identify any aspects in which tender entry process is unnecessarily duplicative of those requirements for projects which have already been qualified under the CfD process. We can then consider whether it is necessary and appropriate for the tender entry requirements to be streamlined for such developers and whether doing so requires amendments to the Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2015.

Vendor Due Diligence

Summary of Responses

3.39. Some respondents, both Bidders and Developers considered that the vendor due diligence (**VDD**) process proposed added unnecessary expense to the process for developers because bidders typically do not rely on the VDD. Bidders considered that the VDD provided by developers was out of date and lacking crucial information, which necessitated performing their own due diligence.

3.40. However, some Bidders felt that if VDD was provided in a timely fashion, it would help reduce their costs in performing additional due diligence, particularly if a certificate of title was provided.

3.41. Most Developers requested that Ofgem engage more with industry when developing VDD requirements. Four Developers thought VDD would benefit from a more focused approach; one that was clearly defined, standardised and complemented the set of information required for the bidders' own assessments.

Our View

3.42. Ofgem, together with our Technical Advisers, will work with TR6 developers to consider ways in which we could standardise the approach to VDD, the aim of which will be to provide a more comprehensive VDD document which bidders can use to more easily identify the necessary information in relation to a particular project. The document will provide a starting point for the bidder to then commence their own due diligence process.

3.43. Some areas of information which we consider could be included are the following:

- marine aspects of assets - seabed topography and conditions, final depth of cable burial analysis and marine aspects of offshore substation platforms;
- detailed summary of key features - contracts, amount, variations, liability caps, warranties of all construction contracts transferring to OFTO;
- summary of all permits/consents/licences to be transferred to the OFTO and clarity around split of obligations and future environmental liabilities;
- condition of assets and commissioning; and
- certificate of title.

Data Room Improvements

Summary of Responses

3.44. All respondents expressed the need for a better data room system.

3.45. At least three Bidders requested more complete information in a standardised format to be available in the data room at the start of the ITT Stage. One Bidder suggested a key information deliverables schedule agreed with developers could be useful, and another Bidder requested an overarching document that linked the master document index to its location in the data room.

Our View

3.46. We intend to introduce more uniformity and completeness to the data room during the ITT Stage, where possible. We will work with each TR6 developer closely on the provision of timely information, to help facilitate the provision of necessary documentation in the data room at the commencement of the ITT Stage. This should help reduce the number of clarifications from bidders and the conditionality of bids. We will also encourage each developer to engage with the PB as early as possible on issues relating to the transfer agreement.

3.47. We are also undertaking a review of Ofgem's data room system provider to ensure the provider delivers the most appropriate services required for the tender process. We intend to conclude this review by the end of 2018.

Updating financing arrangements

Summary of Responses

3.48. Two Bidders supported reassessing bond pricing methodology and accepting credit spreads for a wider range of credit ratings. Two Bidders requested that no changes be made to the bond spread methodology. One Bidder suggested that if bidders use bond pricing, they should be obliged to acquire a preliminary rating assessment issued from a credit rating agency.

Our View

3.49. We will be requiring all bidders who propose to fund the acquisition of the OFTO assets through listed bonds to obtain a preliminary rating via a rating agency service. This is currently optional, but making it mandatory will provide greater certainty that a bidder proposing a bond financing solution is robust. This is particularly important given the size of assets in TR6 and the increasing use of bond financings.

3.50. We will also be providing a wider range of credit ratings for bonds, bond spreads, interest rates and gilt rate tenors in the ITT Document. These changes are being implemented to take account of responses received by stakeholders and are also required as a result of the increase in the revenue period to 25 years. These changes should provide bidders with the choice to adopt a range of financial structures which, in turn, should support and aid price competitiveness.

Confirmatory approach to questions

Summary of Responses

3.51. Generally, respondents considered that a confirmatory approach to certain questions at the ITT Stage is acceptable provided that (i) such approach did not compromise Ofgem's ability to assess the suitability of each bidder to operate the OFTO assets and (ii) that any declarations were proven at PB stage.

Our View

3.52. Certain information is currently requested from bidders at the ITT Stage that is not necessary to be provided until a bidder has been appointed as the PB. Therefore, the questions in the ITT Document requesting the provision of this information will become confirmatory. For example, bidders will have to confirm that they will have in place arrangements such as shareholder agreements, but will not have to provide drafts of those agreements. This information can instead be provided at PB Stage, thus preventing unnecessary information being sourced and provided by unsuccessful bidders.

Approach by Ofgem to larger, more complex projects

Summary of Responses

3.53. Developers stated that we should be aware of changing technologies such as HVDC. One Developer suggested that we might need to review how we determine 'efficiency', as HVDC technology is likely to result in higher upfront costs, but a more efficient economic outcome in the long term.

3.54. Some Bidders mentioned the only significant change with projects located farther from shore is the length of the offshore cable, which could result in increased risks of cable failures. This would bring a need for increased spares and offshore maintenance would need to be more efficient to ensure faults are prevented and addressed quickly.

3.55. Some Bidders felt that as projects become larger, the more likely it is that debt capital markets will play a more prominent role in funding OFTO assets. If this is the case, the tender process should enable the maximum flexibility in financing arrangements. Further, it was more important that OFTO investors have a greater understanding of OFTO assets, and also end of revenue term obligations and income

adjusting events. Others noted that there may be fewer bidders with the skills and financial backing to take these projects on.

3.56. One Bidder noted as the projects become more complex a one-size-fits-all approach to the technical criteria in the EPQ and ITT Stages, would become less appropriate in the future.

Our View

3.57. We will continue to work with our Technical Advisers and developers to ensure we can adapt our processes to take account of new technologies.

3.58. We will continue to work with our Financial Advisers to ensure the tender process allows for maximum flexibility in financing solutions whilst maintaining robustness. As noted in paragraph 3.49, we will be providing a wider choice of credit ratings in respect of bond solutions, debt and swap tenors in the ITT Document to assist with this.

3.59. We will work with TR6 developers and our Technical Advisers to get a greater understanding of each project and to consider where we can provide further guidance at the ITT Stage as to the project specific technical requirements or features and any particular assumptions for bidders, as set out in paragraph 3.12. For the EPQ Stage, at set out above in paragraph 2.3, we are introducing a minimum threshold to be reached for a bidder to pass sections 5 to 8 of the EPQ Questionnaire thereby requiring a stronger minimum understanding of asset takeover, management and operation of the transmission assets, and mitigation of key commercial risks.

3.60. In respect of providing OFTOs with a better understanding and guidance of income adjusting events, we published an open letter⁵ setting out, for consultation, our views on the OFTO licence's income adjusting event (**IAE**) provisions and OFTO uninsurability. That consultation has closed and the decision has been published on our website today. The approach to the end of revenue arrangements is addressed below.

Revenue Term and End of Revenue Period

Summary of Responses

3.61. Most respondents were in favour of increasing the revenue period to 25 years.

3.62. Whilst some respondents suggested lifespans of OFTO assets vary across projects and the term should be determined on a case-by-case basis, other respondents generally agreed that developers are disclosing an assumed operational life beyond 20 years and OFTO assets can have a technical life of beyond 25 years with limited additional capex requirements.

3.63. Developers agreed that most components used in the construction of OFTO assets are designed to a standard of a 35-40 years. When properly maintained, they should last well beyond 25 years. One Developer thought the revenue period should remain at 20 years with a possibility of extension for a further term. They requested evidence that

⁵ Available on our website at: <https://www.ofgem.gov.uk/publications-and-updates/open-letter-consultation-income-adjusting-event-policy-offshore-transmission-licences>

OFTOs can be financed for longer than 20 years and thought it was important that arrangements were flexible.

3.64. Bidders viewed this as a finance question with most agreeing that the funding markets are well established for 25-year operational periods.⁶ One Bidder questioned whether the banking market could extend terms beyond 20 years, which would remove a source of competitive finance.

3.65. With respect to end of revenue period arrangements, some respondents thought we should be flexible about revenue term extension but the key was to start developing a policy framework as to the approach that may be taken by Ofgem. Both Bidders and Developers considered that the timing of this decision should be driven by developers and the operation of the wind farm.

3.66. Bidders indicated that we need to take account of insurance costs and deductibles, as well as asset replacement and condition assessment. Bidders stated they need to know with certainty how the residual value will be set, and if earlier clarity was given, bidders could implement the best structure possible to allow for efficiencies.

3.67. Developers mentioned that if the life of the OFTO asset is extended, the main revenue requirement would be covering O&M costs and not capital costs as the asset will be fully depreciated. They were keen to understand the legal implications of extending the licence or re tendering the OFTO asset, especially considering that current OFTOs are being paid decommissioning costs as per their TRS- how will over recovery from the consumer be accounted for.

Our View

3.68. As discussed in paragraphs 2.16 to 2.19, the OFTO revenue period will be extended from 20 years to 25 years from TR6 onwards. For the reasons set out at paragraphs 2.18 and 2.19 above, as the useful economic life of the assets is longer than 20 years and the larger size of the projects in TR6, this should provide better value for money for consumers.

3.69. With regard to setting the policy approach for end of revenue period arrangements for the OFTO, including reviewing our decommissioning policy, this is an area of work that we will undertake, and consult as appropriate, in the future.

RPI/CPI

Summary of Responses

3.70. During this Consultation we highlighted that further consultation related to changing the indexation from RPI to CPI/CPIH would follow. We gave stakeholders an opportunity to share their views on this potential change in advance of the indexation consultation. Only one Bidder responded, with the view that moving to CPI inflation for the TRS would cause a mismatch between the indexation of revenues and its costs, which would add additional risk to the OFTO. It could also impact bidding strategies as the swap market is not liquid and lacks transparency, making benchmarking difficult.

⁶ Using availability based PPPs as an example.

Our View

3.71. We will continue using RPI as the measure for indexation in TR6. Although RIIO-2 intends to use CPI going forward, none of the responses favoured a change in indexation. Therefore, CPI/CPIH will be considered in future tender rounds.

4. Conclusions and next steps

- 4.1. We are implementing the relevant changes as set out in section 2 of this document for future tender rounds, commencing with TR6.
- 4.2. The TR6 EPQ document will primarily implement the changes particularly relevant to the EPQ Stage, such as the possibility of an additional EPQ Stage and publication of the evaluation criteria, and is due to be published imminently.
- 4.3. Following that, we will be progressing the activities and implementing the changes to be made to the ITT Stage as set out in section 2 of this document.