

# Consultation

## Offshore Transmission Owner (OFTO) Regime Tender Process – Consultation concerning developments to the tender process within the current OFTO regime

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Following extensive informal interaction with a variety of stakeholders, we are now formally consulting on a number of outcomes from a review that we have undertaken of the Offshore Transmission Owners (OFTOs) tender process. This considers whether additional changes should be made to help ensure that efficient, fit for purpose competitions are still run within the existing regime. This consultation does not address issues around offshore transmission coordination. We are continuing to consider stakeholder feedback on a number of other items, many of which will require further thought and discussion to help shape longer term policies. We would like to use this document as an opportunity to provide an update on where we are on such items and how we plan to further progress our review (including when further consultation may be sought).

This document outlines the scope, purpose and questions of the consultation and how you can get involved. Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations. We will publish the non-confidential responses we receive alongside a decision on next steps on our website at [Ofgem.gov.uk/consultations](https://www.ofgem.gov.uk/consultations). If you want your response – completely or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

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## Foreword

Great Britain currently has around 10GW of offshore wind generation connected to the electricity system. In March 2019, the government announced its ambition for 30GW of offshore wind by 2030 as part of the Offshore Wind Sector Deal, and in October 2020 this ambition was raised to 40GW by 2030. The Committee on Climate Change (**CCC**) has also indicated that to become a net zero economy could require 75GW by 2050.<sup>1</sup> Efficient delivery and operation of transmission assets for offshore wind energy projects forms a core part of the strategy for reaching this objective in the most cost effective manner.

The Department of Energy and Climate Change (**DECC**)<sup>2</sup> together with Ofgem<sup>3</sup> developed a regulatory regime to facilitate the construction and operation of offshore transmission assets when it was an emerging sector. Under the regime, Ofgem runs a competitive tender process to select and license Offshore Transmission Owners (**OFTOs**).<sup>4</sup> Since establishing the legal framework in June 2009, there are twenty operational OFTOs in place worth circa £4.6 billion in total. It has been highly effective in driving competition and continues to provide excellent value for money for consumers. We expect that there will continue to be more offshore transmission assets coming forward for tender in the future.

For all of the OFTOs to date, the offshore wind farm developer has designed and built the offshore transmission assets before they were transferred to the relevant OFTO, which will operate, maintain and decommission the transmission assets. We refer to this as the 'generator build' model.

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

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<sup>1</sup> <https://www.theccc.org.uk/wp-content/uploads/2019/05/Net-Zero-The-UKs-contribution-to-stopping-global-warming.pdf>

<sup>2</sup> Now the Department for Business, Energy and Industrial Strategy (**BEIS**).

<sup>3</sup> The Office of the Gas and Electricity Markets Authority (the **Authority**) is the regulator of gas and electricity markets in Great Britain. Ofgem is the Office of Gas and Electricity Markets, which supports the Authority in performing its statutory duties and functions. For ease of reference, Ofgem is used to refer to Ofgem and the Gas and Electricity Markets Authority (The Authority) in this document.

<sup>4</sup> This process is run by Ofgem under the Electricity Act 1989 (the **Act**) and regulations made under the Act which underpin the regime.

The scope of this consultation is separate to our work in the Offshore Transmission Network Review (**OTNR**) that was launched by the Department of Business, Energy and Industrial Strategy (**BEIS**) in July this year. As part of that review, we are looking at whether and how offshore wind connections could be better coordinated in order to deliver the government’s ambition whilst minimising social and environmental impacts. We recently published an open letter with BEIS inviting stakeholders to contact us if they wished to develop coordinated offshore energy infrastructure in the near to medium term and felt unable to do so as a result of the existing legislative or regulatory frameworks. This is part of a programme of work where we are considering what changes would be necessary and appropriate to make to the existing frameworks to facilitate greater coordination in the interests of consumers. We do not consider that any of the proposals set out in this consultation would negatively impact upon our parallel work to develop coordinated infrastructure. However, if respondents disagree they should make this clear in their responses.

## Executive summary

### Background to this consultation

The OFTO regime has been in existence for over 10 years, during which time it has played a key part in the successful development of a mature market. To date we have licensed 20 OFTOs across five tender rounds, with the sixth tender round in an advanced stage, financed with a highly competitive cost of capital and a wide range of parties now operating in the OFTO market. Independent reports have shown significant savings for consumers from the competition for licences under the OFTO regime.

However, projects are becoming larger and more complex, with developers using newer technology on projects or contemplating how they will use this in the medium to longer term future. The infrastructure sector more widely can provide lessons from which Ofgem can learn to improve the effectiveness of how we run OFTO competitions.

In advance of starting our next Tender Round (**TR7**), we have been reviewing the OFTO tender process, both to ensure that it continues to meet our objectives for the OFTO regime and deliver best value to consumers.

The purpose of this document is to:

- Set out proposals for targeted tender process changes, explain the reasons behind them, note the stakeholder engagement we have already undertaken and how we consider our proposals could improve the OFTO regime;
- Ask respondents' views on how Ofgem can deal with specific macroeconomic, monetary policy and market changes that affect the OFTO bidding process; and
- Summarise certain longer term issues that will shape future OFTO regime policy and how you can participate in contributing to the development of that policy.

### Scope of this consultation

Our key objectives of the OFTO regime in running competitive tenders for offshore transmission licences are still to:

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;

2. Provide certainty and best value to consumers through the competitive process;
3. Attract new entrants to the transmission sector; and
4. Undertake streamlined and efficient tender processes.

Part A of this consultation looks at a number of items relating to the OFTO tender process which we propose implementing in upcoming tender rounds to address some of the lessons learned from past tenders. In some ways this document is a follow-up to our consultation of March 2018<sup>5</sup>, which was run prior to Tender Round 6 (**TR6**) taking place. We are currently running the third invitation to tender (**ITT**) process of TR6 and have therefore had some time to reflect on the effectiveness of many of the reforms we made. Given that the ITT for the first TR7 project is due to commence in Q2 of 2021, it seems unlikely that the majority of the proposals in this consultation are capable of being given the necessary scrutiny to implement for TR7, in particular because we envisage further stakeholder engagement will be required. However, where improvements can be practically made for TR7 projects, we shall look do so, engaging where necessary with the relevant stakeholders.

Among the items in Part A are proposals that we consider will benefit both incumbents (developers and bidders), but will also attract new entrants to the sector to continue to ensure strong competition and drive consumer benefits. These include:

- Proposals we consider can facilitate a shorter tendering and transaction process, as well as potential alterations to the way we evaluate bids. Such proposals include commencing ITTs once the cost assessment process is more advanced and having transaction documents in a more advanced state before the submission of ITT bids.
- Proposals that consider whether we continue with the evaluation approach adopted for TR6 or adopt an approach that qualitatively assesses all aspects of bidders' bids, where the bid score is a composite of scores from all evaluated sections.
- A proposal to explore deferring the raising of debt finance until the preferred bidder (**PB**) stage and whether Ofgem should set stricter timetables in the PB stage for PBs to follow, and whether it should appoint the reserve bidder where timetable milestones are not met.

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<sup>5</sup> <https://www.ofgem.gov.uk/publications-and-updates/ofto-tender-process-policy-consultation-future-tender-rounds>

- A request for views on how Ofgem should treat insurance proposals in ITT bids.
- Finally, we are asking for views on how best to introduce the requirements of the Sterling Overnight Index Average (**SONIA**) to replace the London Inter-Bank Offered Rate (**LIBOR**), as well as consulting on whether the Consumer Prices Index (**CPI**) should replace the Retail Price Index (**RPI**) as a measurement of index revenue within the OFTO tender process.

In part B, we set out at a high level the work we are doing in relation to certain issues that have been raised with us during our stakeholder engagement and that are part of wider, longer-term issues faced by the offshore wind sector. There is still a great deal of work to be done in the development of policy in these areas and this document signals how you can engage with us.

### **Next Steps**

We invite stakeholders to respond to this consultation, which closes on **8 January 2021**. Following consideration of responses, we will provide further details on our proposed approach during Q1 of 2021.

We also intend to run further consultations in the near future concerning some of the topics mentioned in this document. Further details will be published in due course.



## 1. Introduction

### What are we consulting on?

#### Part A: Targeted Changes

##### Section 2: Tender process changes

- 1.1 We consider that it is good practice to review our processes to ensure that we maintain strong competition, delivering value to consumers whilst driving the right behaviours from the bidding community and eventual licensees. As part of our continuous review in attempting to improve the OFTO tender process and encourage its appeal as widely as possible, we are consulting on a number of proposed process changes which could offer many benefits, including attracting new entrants and sources of finance to the transmission sector.
- 1.2 In order to facilitate a shorter tender process, we are looking at making a change with regards to the cost assessment process and the development of the key transaction documents into which the preferred bidder (**PB**) will eventually enter. Further, we are looking at our evaluation methods, looking for respondents' views on deferring the raising of debt finance until the PB stage and Ofgem's approach to setting milestones for PBs.

##### Section 3: Reference interest rates – switch from LIBOR to SONIA

- 1.3 Guidance from the Bank of England and Financial Conduct Authority (**FCA**) advises that LIBOR is no longer an effective interest rate for many financial products. Instead it is recommended that SONIA be used as their preferred alternative. We are consulting on when would be the best time to implement SONIA into the OFTO regime.

##### Section 4: CPI or RPI indexation of revenue

- 1.4 We are consulting on whether RPI is the most appropriate revenue indexation for inflation measurement for future OFTO tender rounds, or if CPI should be used instead. We are also keen to understand, in the event that Ofgem opts to move to CPI for the OFTO regime, the measures we should put in place to ensure success and when this should happen.

## Section 5: Insurance requirements for OFTO bids

- 1.5 We are consulting on how we should treat insurance coverage requirements set out in the OFTO tender documentation and whether we should be more or less prescriptive on what insurance cover we expect bidders to have at the ITT stage.

## Part B: Wider regime development

- 1.6 Many of the key opportunities and challenges to the OFTO regime relate to longer term sector changes faced by the whole offshore renewables industry. In particular, with the scale of roll out of offshore wind and as technology advances the need for greater coordination becomes more prominent. As noted earlier, there is a separate area of work supporting BEIS in the Offshore Transmission Network Review and therefore some of the longer term challenges around developing a regime that enables a coordinated offshore network development are being addressed through that workstream. However, there are some specific areas that have been identified to us through our informal engagements with stakeholders that need to be considered and progressed in the shorter term and we are interested to engage with stakeholders on those areas to assist progress.

## Related publications

Increasing the level of coordination in offshore electricity infrastructure: BEIS and Ofgem open letter to developers of offshore wind generation, electricity transmission licensees, and other interested parties (24 August 2020)

<https://www.ofgem.gov.uk/publications-and-updates/increasing-level-coordination-offshore-electricity-infrastructure-beis-and-ofgem-open-letter-developers-offshore-wind-generation-electricity-transmission-licensees-and-other-interested-parties>

Ofgem's Decarbonisation Action Plan (February 2020)

[https://www.ofgem.gov.uk/system/files/docs/2020/02/ofg1190\\_decarbonisation\\_action\\_plan\\_revised.pdf](https://www.ofgem.gov.uk/system/files/docs/2020/02/ofg1190_decarbonisation_action_plan_revised.pdf)

Offshore wind sector deal, Transmission review Short-term solutions paper, Offshore Wind Industry Council (November 2019)

<https://www.owic.org.uk/documents>

Offshore wind sector Deal (7 March 2019)

<https://www.gov.uk/government/publications/offshore-wind-sector-deal>

Open letter – consultation on Income Adjusting Event policy in Offshore Transmission Licences (November 2018)

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

OFTO tender process policy consultation for future tender rounds (March 2018)

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

Indexation for future OFTO and interconnector licences (October 2015)

[https://www.ofgem.gov.uk/system/files/docs/2016/03/open\\_letter\\_indices\\_14oct\\_finalv2\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/03/open_letter_indices_14oct_finalv2_0.pdf)

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

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

## Consultation stages

- 1.7 Following responses to this paper, we will consider respondents' views in line with our objectives and in our decision provide further details of our intended approach. Where possible and practical, we will endeavour to implement any changes as soon as possible. Some will require further development and may require additional stakeholder engagement to fully inform our proposals. We will continue to update stakeholders where appropriate on these changes, for the upcoming tender rounds.

## How to respond

- 1.8 We want to hear from anyone interested in this consultation. Please send your response to the person or team named on this document's front page.
- 1.9 We have asked for your feedback in each of the questions throughout. Please respond to each one as fully as you can.

1.10 We will publish non-confidential responses at [www.ofgem.gov.uk/consultations](http://www.ofgem.gov.uk/consultations).

## Your response, data and confidentiality

1.11 You can ask us to keep your response, or parts of your response, confidential. We will respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.

1.12 If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we will get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.

1.13 If the information you give in your response contains personal data under the General Data Protection Regulation 2016/379 (**GDPR**) and domestic legislation on data protection, the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 4.

1.14 If you wish to respond confidentially, we will keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We will not link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

## General feedback

1.15 We believe that consultation is at the heart of good policy development. We welcome any comments about how we have run this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?

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

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

### How to track the progress of the consultation

- 1.16 You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website. [Ofgem.gov.uk/consultations](https://www.ofgem.gov.uk/consultations).


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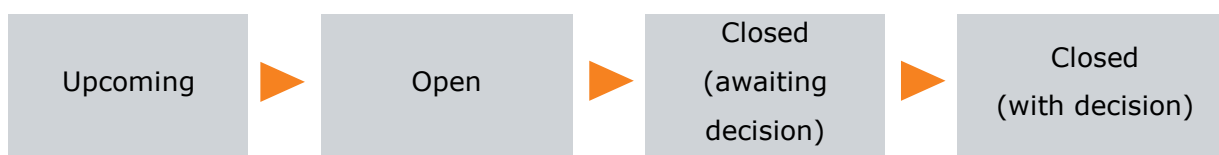
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- 1.17 Once subscribed to the notifications for a particular consultation, you will receive an email to notify you when it has changed status. Our consultation stages are:



## Part A: Targeted Changes

### 2. Tender Process Changes

#### Section summary

This section sets out proposals to (1) facilitate a shorter tendering process and (2) alter the approach we take to the evaluation of ITTs.

#### Background

- 2.1 The OFTO regime has been highly effective in driving competition and continues to provide excellent value for money for consumers.
- 2.2 We consider the TR6 tender process to have driven robust bids, supported by extremely low cost of capital, which we are confident will drive excellent value for consumers. Notwithstanding this, we consider that it is good practice to review our processes to ensure that we maintain strong competition, in order to continue delivering value to consumers whilst driving the right behaviours from bidders and eventual licensees.
- 2.3 We have sought informal views from multiple stakeholders across the industry to understand what their perceptions and concerns are of the regime. We have additionally considered analysis and recommendations as provided by our economic and financial advisors on whether there are any structural changes that could be made, which would help drive improvements in the current OFTO process.
- 2.4 Our stakeholder engagement sessions highlighted that whilst the TR6 process has been in some respects an improvement on past processes, some stakeholders consider that the current tender approach may be undervaluing certain elements of long-term asset management strategies, and that there could potentially be more done to drive the right behaviours in terms of net zero-focused considerations.
- 2.5 An additional notable point raised by multiple stakeholders is the length of time from ITT to eventual asset transfer, which is seen by developers and bidders as being unduly long. Beyond the specific questions posed below in respect of certain policy

proposals intended to address the length of time from ITT to asset transfer, we are interested in respondents’ views on how this might be addressed.

### Potential changes to facilitate a shorter process

2.6 Ofgem has in the recent past aimed to commence each ITT on or around the date at which developers achieve first power (i.e. the issuance of the completion notice from National Grid ESO). Achieving first power starts the 18-month generator commissioning period during which developers must divest themselves of the transmission assets. Figure 1 below describes the typical timeline that the tender process follows. In particular, the ITT and Preferred Bidder (**PB**) timelines present challenges for certain parties, whether that is in supporting bids or expeditiously closing the transaction. We have identified below some changes that we propose to address the issue and facilitate a shorter process.

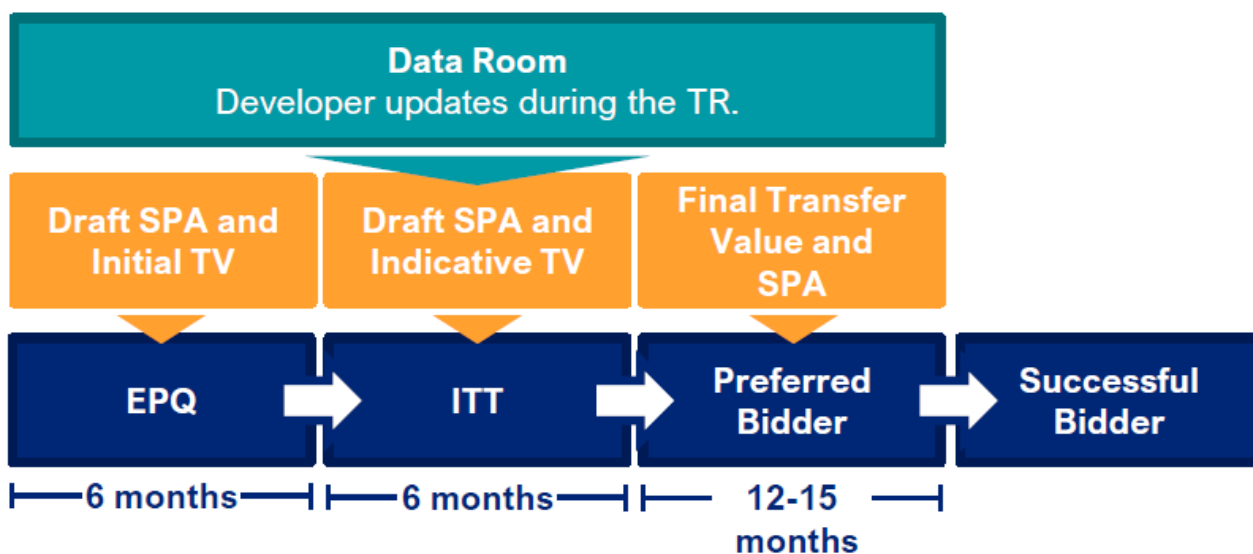


Fig.1 Current tender process

### Bid Information: Data Room and Site Visits

2.7 Our stakeholder engagement flagged issues regarding the existing data room structure and functionality. Additionally, stakeholders highlighted concerns over the quality of the contents in the data room and the need for developers to fully populate the data room at the start of the ITT process to enable full due diligence to be undertaken.

2.8 We have already taken steps to address this during TR6 by procuring the new Ansarada data room and requiring a signposting document, in which developers must

flag to bidders the location of key documents. Further, we require bidders to submit a data room contents overview questionnaire to indicate any issues with the documents provided by the developer which could impact on the preparation of their ITT submissions. The questionnaire is to highlight, in particular, any omissions of key documents/information and invites comment on the quality of documents uploaded and/or the structure of the data room.

- 2.9 However, as our practice is to launch an ITT as close to the completion notice issuance as possible, this means developers may not be in possession of all as-built documentation, and key issues, such as the developer's capital allowance position, may not have been settled. Thus, this may compromise the quality of the due diligence that can be undertaken at the ITT stage in terms of cost and agreements, which could potentially impact the firmness of the commercial terms in the bid and/or lead to issues during the PB stage.
- 2.10 To address this issue we propose either: a) to permit bidders to access the data room earlier to facilitate a longer time to enable greater due diligence; or (b) to delay the start of the ITT until the data room is more complete/contains the necessary finalised documentation. We would welcome respondents' views on:
- 2.10.1 Would allowing earlier access assist bidders? If not, why not?
  - 2.10.2 What would indicate that the data room is more complete/contains the necessary finalised documentation to enable the ITT stage to commence and what would assist/improve pre-tender submission due diligence?
- 2.11 We are further aware that it is essential that site visits are conducted to observe certain matters that documentation alone would not adequately demonstrate or describe. Would it be viable or practical for site visits to both offshore and onshore substations to be conducted as part of the tendering process and would this assist due diligence to reduce uncertainties and improve the firmness of bid pricing? In the event that this is not viable or practical, what could be done in advance of bidders submitting their tenders to deal with this in a pragmatic way?

## **Cost Assessment**

- 2.12 Our cost assessment process itself has gone through multiple iterations since the regime's inception and generally our stakeholder engagement has indicated that the



process is robust. Therefore, we do not propose to make any significant changes to how we engage with developers and the process of analysis undertaken at present.

- 2.13 Whilst we are not proposing any changes to the cost assessment process itself, we note there could be scope to revise timelines, as several stakeholders have noted that they consider that the time it takes to conclude cost assessment processes has delayed the divestment process.
- 2.14 Presently, Ofgem conducts an estimate (in accordance with the Tender Regulations) of the economic and efficient costs which ought to have been incurred in constructing the transmission assets: the Indicative Transfer Value (**ITV**). The ITV is provided to bidders at ITT. Ofgem then, as soon as reasonably practicable and once it has all relevant costs information, conducts its assessment of the economic and efficient costs which ought to have been incurred in constructing the transmission assets: the Final Transfer Value (**FTV**). Following the conclusion of this assessment and the provision of the cost assessment report to the PB, the PB is able to conclude its confirmatory due diligence process. In order that PBs can conclude confirmatory due diligence and provide lenders with their technical advisers' reports sooner after being appointed the PB, Ofgem would need to finalise the FTV earlier during the PB stage and adopt a process basing its estimate on more detailed cost information.
- 2.15 In order to finalise the FTV earlier, we consider that the ITV would need to be undertaken based on more detailed costs information. We could conduct the process so that at the time of setting the ITV, Ofgem has had the opportunity to estimate costs with greater confidence. In practice we consider that this would mean that all costs (bar settlement of claims and/or future costs yet to be incurred at the time of making the estimate) would need to be settled as part of the ITV so that the only costs that remain to be determined at the FTV stage are less material.
- 2.16 In our view, although this will likely have the effect of commencing the ITT bidding phase after the completion notice has been issued (as costs could not be estimated with greater confidence until this point), it could potentially allow for a firmer price to be bid and accelerate the PB to asset transfer process. On the other hand, such an approach would condense the cost assessment period and would remove the opportunity to consider further information to substantiate costs at the FTV stage. We would welcome respondents' thoughts on this, including views on risks and how these might be mitigated.

## Transfer and Interface Agreements

- 2.17 Despite bidders being able to provide comments on both the transfer and interface agreements (the **transaction agreements**) prior to submitting their bids, the conclusion of these agreements tends to take many months. This can have a material impact on concluding the PB stage expeditiously.
- 2.18 In order for bidders to price risk as fully as possible, these agreements need to be in near final form and represent what both parties consider to be a clearly defined apportionment of risk. We are therefore considering how to amend the current process to result in near-final transaction agreements prior to ITT submission which take fuller account of bidders' comments provided on the EPQ and ITT versions of the transaction agreements. One way to achieve this could be to delay the date of submission of ITTs until the transaction agreements are considerably more advanced, with only minor and immaterial changes to be required. This would involve Ofgem encouraging developers to take fuller account of bidders' comments and bidders to be clearer in their comments on areas that have greater pricing implications, with further iterations of the process if necessary. We consider that this would expedite the conclusion of confirmatory due diligence and therefore conclusion of the transaction. We would therefore welcome views on:
- 2.18.1 Whether respondents would welcome Ofgem delaying the submissions of ITTs until such time as the transaction documents are considerably more advanced.
  - 2.18.2 If so, what could Ofgem do to ensure that the process of further developing the transaction agreements is effectively managed without needing much extra time in the phase prior to bids being submitted?
  - 2.18.3 If not, what could be done in the alternative in order to provide bidders with the necessary certainty from a pricing perspective, without doing so to the consumer detriment, and also expedite the conclusion of finalising the necessary transaction agreements?

## **Potential ITT Changes**

### **Evaluation approach**

2.19 As noted above, we consider that the evaluation approach for TR6<sup>6</sup> has delivered robust, extremely competitively priced bids. Notwithstanding this, we would like to hear respondents' views on whether different evaluation approaches would address the concerns about the primacy of a low Tender Revenue Stream (**TRS**) potentially undervaluing certain elements of long term asset management strategies which would look to ensure better, long-term consumer value. Prior to TR6, Ofgem evaluated the bids on the basis that bidders' proposals were evaluated on a threshold basis and then the evaluation scores were a mix of price (60%) and price robustness (40%). In TR6, bids are evaluated on a threshold basis where price robustness is factored into this threshold, but with the bid score being 100% weighted on price. An alternative approach we are considering is to assess qualitatively each constituent element to bidders' bids (financial and operational resilience; financial deliverability; tender revenue stream), providing a score for each section, which would then be weighted and added together to provide an overall bid score (see Fig. 2 below). We would like to understand respondents' views on:

- 2.19.1 Whether respondents would support in principle a qualitative assessment of all elements of a bidder's bid (asset takeover, decommissioning, financial deliverability, etc.), with each section forming part of the overall evaluation score, and why.
- 2.19.2 Would doing so lead to bidders proposing engineering solutions that come at high consumer cost for marginal (if any) consumer benefit when compared to robust, yet less costly alternatives?
- 2.19.3 Could such an approach deliver more environmentally conscientious approaches to operations and maintenance?

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<sup>6</sup> The process evaluates bidders' technical, financial, insurance and asset management proposals on a threshold basis, then the lowest TRS of compliant bids is determined the PB.

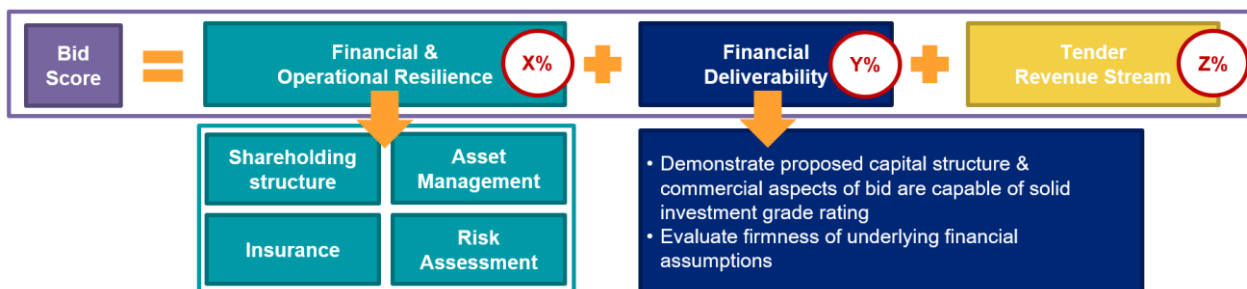


Fig. 2 Potential evaluation approach

## Funding

- 2.20 Under the current model, there has been historically a lengthy period from submission of the ITT bid to financial close. We acknowledge that this can cause difficulties for many debt providers in holding terms long enough to support bidders in the first place and, as such, creates barriers to entry for a range of debt providers. We are conscious that, in turn, this could cause barriers to entry for potential new equity investors.
- 2.21 As a way to try to address this, we would like to understand respondents' views on an approach where the debt finance competition is deferred until the PB stage.
- 2.22 We envisage that for this to work, bidders would submit ITT responses outlining their proposed approaches to and pricing for asset management, insurance and risk management, as well as the capital structure and sources of finance with committed equity returns. In order to demonstrate the financial deliverability of bidders' proposals, we consider that bidders would need to show the capital structure and commercial aspects of the bid are capable of a solid investment grade rating with a shadow rating (as a mandatory requirement). Bidders would also be evaluated on their plan for a debt funding competition.
- 2.23 Bidders would submit a TRS using standard debt finance terms common to all bidders. Once a PB is appointed, there would be a second stage where a debt funding competition would be run to secure the tightest pricing available from the market and determine the final TRS.
- 2.24 We welcome any general observations on the above, but would like to specifically hear respondents' views on:

- 2.24.1 Whether respondents consider that deferring debt finance to the PB stage could open up the market to more sources of finance and drive better value for consumers. By way of example, would such an approach be more amenable to Green Finance and, if so, what benefits would that bring to consumers?
- 2.24.2 Would deferring debt funding competitions until the PB is appointed reduce the costs of bid preparation and be attractive to new equity investors?
- 2.24.3 Would securing funding later in the process have an impact – positive, negative or none – on the overall time to conduct the tender and transaction process? We note that in order to make this effective, it would likely have to be combined with some/all of the process changes referred to in paragraphs 2.6 to 2.16, inclusive.

## **Reserve Bidder**

- 2.25 To date, Ofgem has almost always appointed a reserve bidder to stand by and be appointed PB in the event that the PB is incapable of progressing (or unwilling to progress) with the transaction. During stakeholder engagement, some stakeholders expressed views that PBs do not progress transactions in a timely fashion and attempt to leverage an asymmetrical bargaining position against the developer where the generator commissioning period is expiring. The views of certain stakeholders is that to ensure correct behaviours continue as the transaction progresses, Ofgem should be more ready to replace the PB with the reserve bidder.
- 2.26 We would like to understand respondents' views on whether Ofgem should be more prescriptive in setting matters to be concluded to its satisfaction by PBs (the PB matters) and expected timings by which they are to be concluded, and where they are not met, appointing the reserve bidder in its place.
- 2.27 For example, should Ofgem set a deadline by which all confirmatory due diligence and/or final approvals from funders must take place? In this example, how could we ensure that it is not the developer that is delaying matters returning iterations of key agreements or providing necessary technical documents/data? Further, what considerations would be needed to maintain the ability of the reserve bidder to mobilise quickly?

## Questions

### *Data Room*

- 2.28 Would allowing earlier access to the developer's data room assist bidders?
- 2.29 What would indicate that the data room is more complete/contains the necessary finalised documentation to enable the ITT stage to commence and what would assist/improve pre-tender submission due diligence?

### *Site Visits*

- 2.30 Would it be viable or practical for site visits to both offshore and onshore substations to be conducted as part of the tendering process and would this assist due diligence to reduce uncertainties and improve the firmness of bid pricing? In the event that this is not viable or practical, what could be done in advance of bidders submitting their tenders to deal with this issue in a pragmatic way?

### *Cost Assessment*

- 2.31 Would there be a benefit to moving the timing of the cost assessment process so that the ITT bid phase is delayed until all costs (bar settlement of claims and/or future costs yet incurred) are settled? What are the risks of doing so and how might these be mitigated?

### *Transfer & Interface Agreements*

- 2.32 Would respondents support Ofgem's proposals to delay the submission of ITT bids until the transfer and interface agreements are substantially concluded, with Ofgem delaying the submissions of ITTs until such time as they are considerably more advanced?
- 2.33 If so, what could Ofgem do to ensure that it is effectively managed without needing much extra time in this phase?
- 2.34 If not, what could be done in the alternative in order to provide bidders with the necessary certainty from a pricing perspective, without doing so to the consumer detriment, and also expedite the conclusion of finalising the necessary transaction agreements?

### *Evaluation Approach*

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- 2.35 Would respondents support in principle a qualitative assessment of all elements of a bidder's bid with each section forming part of the overall evaluation score, and why?
- 2.36 Would doing so lead to bidders proposing engineering solutions that come at high consumer cost for marginal (if any) consumer benefit when compared to robust, yet less costly alternatives?
- 2.37 Could such an approach deliver more environmentally conscientious approaches to operations and maintenance?

#### *Funding*

- 2.38 Do respondents consider that deferring debt finance to the PB stage could open up the market to more sources of finance and drive better value for consumers, including Green Finance and, if so, what benefits would that bring to consumers?
- 2.39 Would deferring debt funding competitions until the PB is appointed reduce the costs of bid preparation and be attractive to new equity investors?
- 2.40 Would securing funding later in the process have an impact – positive, negative or none – on the overall time to conduct the tender and transaction process?

#### *Reserve Bidder*

- 2.41 Should Ofgem exercise its powers to withdraw the appointment of the PB where deadlines are not met?
- 2.42 Should Ofgem set a deadline by which all confirmatory due diligence and/or final approvals from funders must take place?
- 2.43 How could we ensure that it is not the developer that is behind delays leading to deadlines being missed?
- 2.44 What considerations would be needed to maintain the ability of the reserve bidder to mobilise quickly?

### 3. Reference interest rates – switch from LIBOR to SONIA

#### Section summary

Guidance from the Bank of England and Financial Conduct Authority (**FCA**) advises that the London Inter-Bank Offered Rate (**LIBOR**) is no longer an effective interest rate for many financial products. Instead it is recommended that the Sterling Overnight Index Average (**SONIA**) be used as their preferred alternative. This section provides the background behind this change and seeks views on how it would be appropriate to implement this for the OFTO tender process.

#### Background

- 3.1 OFTO bidders consider a variety of capital structures, financing sources and hedging strategies when developing their Preferred and Alternative Funding Solutions (**PFS** and **AFS**); these include term loans from commercial banks or other financial institutions, private placements, and public bonds. Some of these solutions, e.g. term loans, require the payment of a floating interest rate, which is determined with reference to a particular benchmark, with the resulting interest rate risk generally hedged through interest rate swaps (**IRS**). Historically, and in previous tender rounds, the interest rate benchmark underpinning both term loans and IRS was LIBOR.

#### Discussion

- 3.2 The list of reference rates provided by Ofgem at the start of the tendering process for each project currently includes 3-month and 6-month LIBOR swap rates for a range of tenors. Bidders are required to apply any relevant spreads and charges on the top of these reference rates.



- 3.3 The FCA<sup>7</sup> has recently reiterated that lenders should be in a position to offer non-LIBOR linked products by the end of Q3 2020 and that LIBOR will cease to exist after the end of 2021.
- 3.4 Therefore, we envisage that, by the time we come to issue ITTs for TR7 projects, loans and derivatives will reference SONIA rather than LIBOR and consequently we expect to provide SONIA-based, rather than LIBOR-based, benchmark rates for loans and derivatives.
- 3.5 We would like to invite interested parties to provide their views regarding the benchmarking of interest rates for future OFTO tender rounds, focusing in particular on any potential challenges arising from a switch from LIBOR to SONIA.

## Questions

- 3.6 Is your expectation that SONIA-based products will be used for TR7?
- 3.7 What do you consider would be the most appropriate information screens to be used by Ofgem to inform ITT assumptions and benchmarking? Please provide examples/evidence to back up any preferences.
- 3.8 How do you expect bid margins and charges to SONIA to differ to those bid to LIBOR?

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<sup>7</sup> [Financial Conduct Authority, Further statement from the RFRWG on the impact of Coronavirus on the timeline for firms' LIBOR transition plan](#)

## 4. CPI or RPI indexation of revenue

### Section summary

This section provides an overview of the use of RPI revenue indexation within the OFTO tender process and asks for views from respondents as to whether (and when) it would be appropriate to move over to CPI as a more effective measure.

### Background

- 4.1 Currently, OFTO bidders can choose to index any proportion of the TRS to RPI and hedge their exposure to inflation risk through a combination of index-linked debt and/or inflation swaps.
- 4.2 At the start of the tendering process for each project, Ofgem provides bidders with a list of reference rates to use in the financial modelling undertaken by each bidder to determine their required TRS. This list currently includes an RPI swap rate as well as index-linked gilt rates for a range of tenors. Bidders are required to apply any relevant spreads and charges on the top of these reference rates.

### Discussion

- 4.3 In October 2015, Ofgem issued an open letter seeking views on moving from RPI to CPI as the index applicable to future OFTO and interconnector licences<sup>8</sup>. A number of responses highlighted concerns regarding the lack of a liquid CPI-linked debt and swap market, which could lead to difficulties in benchmarking. In addition, Ofgem noted that, at the time, CPIH<sup>9</sup> was undergoing review, it had not yet been re-accredited as a National Statistic, and the UK Statistic Authority (**UKSA**) had stated that further work was required to establish the credibility of CPIH. As a result, in

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<sup>8</sup> [Ofgem, \*Indexation for future OFTO and interconnector licences\*, 14 October 2015](#)

<sup>9</sup> Consumer price inflation including owner-occupiers' housing costs

March 2016, Ofgem decided to retain use of RPI for Tender Round 4 (TR4), but stated its intention to continue keeping the issue under review<sup>10</sup>.

4.4 Since then, the following developments have occurred:

4.4.1 CPIH has been re-accredited as a National Statistic and is currently the lead measure of inflation for household costs.

4.4.2 Most economic regulators in the UK have switched away from RPI for the purpose of indexing price controls, moving to either CPI (Ofcom in 2014, WICS in 2015, ORR in 2018) or CPIH (Ofwat in 2017)<sup>11</sup>.

4.4.3 For the RIIO-2 price controls, starting in April 2021 (transmission, gas distribution) and April 2023 (electricity distribution), Ofgem proposed<sup>12</sup> a switch from RPI to CPIH for the purpose of calculating Regulatory Asset Value (**RAV**) indexation and allowed returns<sup>13</sup>.

4.4.4 In February 2019, the National Statistician recommended that the publication of RPI should cease and, in the interim, the shortcomings of RPI should be addressed by aligning its methodology and data sources with those used for CPIH.

4.4.5 In March 2020, UKSA and HM Treasury published a joint consultation on reforming the methodology used to calculate RPI, seeking views on the potential impact on the gilt market of changing this methodology<sup>14</sup>. Following this consultation, which closed in August 2020, it is possible that, at some point between 2025 and 2030, index-linked gilts will start reflecting a measure of inflation that is different from RPI in its current form, for example CPI or CPIH.

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<sup>10</sup> [Ofgem, Decision regarding the indexation of future OFTO and interconnector licences, 31 March 2016](#)

<sup>11</sup> [Ofwat, Final Methodology for PR19, December 2017](#)

<sup>12</sup> [Ofgem, RIIO-2 Sector Specific Methodology Decision – Finance, 24 May 2019](#)

[Ofgem, RIIO-2 Draft Determinations Consultation – Finance Annex, 9 July 2020](#)

[Ofgem, RIIO-ED2 Sector Specific Methodology Consultation - Finance Annex, 30 July 2020](#)

<sup>13</sup> Ofgem also acknowledged that what is appropriate for a large scale corporate with significant equity headroom is not necessarily appropriate for a project-financed and highly geared individual project (such as an OFTO). Therefore, switching the relevant inflation index in one regulatory regime does not necessarily imply that the same change should be implemented in other regimes.

<sup>14</sup> [HMT and UKSA, Consultation on the Reform to the Retail Price Index Methodology, 11 March 2020](#)

- 4.4.6 There have been an increasing number of public and private CPI-linked transactions; examples include the Walney Extension and Thames Tideway Tunnel projects and transactions involving Ørsted and Cambridge University.
- 4.5 In light of these developments, we would like to invite interested parties to provide their views regarding revenue indexation for future OFTO tender rounds, focusing in particular on any potential obstacles to a) switching away from RPI to either CPI or CPIH, or b) adding either CPI or CPIH as an alternative bidding option (in addition to nominal and RPI-linked).

## Questions

- 4.6 For OFTO projects, would a switch to CPI/CPIH or the addition of CPI/CPIH as an alternative option impact on your strategy for revenue indexation and, if so, what would the impacts be?
- 4.7 In your view, would CPI/CPIH-linked indexation result in a net benefit or cost to consumers?
- 4.8 What challenges could you foresee that a change of index or the addition of an alternative indexation option could bring? How would you suggest that any challenges are overcome and/or mitigated?

## 5. Approach to Insurance Requirements

### Section summary

This section discusses the Authority’s approach to insurance requirements in the ITT stage evaluation.

### Background

- 5.1 Following a number of offshore cable failures in 2016-17, several OFTOs lost their LEG3<sup>15</sup> insurance cover. In response, the Authority announced in spring 2018 that it proposed to clarify the position under the OFTO licence, to make it clear that the income adjusting event (**IAE**) provisions could apply where a latent defect meant that OFTO assets became effectively uninsurable, ie that LEG3 insurance cover was not available at economic rates in the worldwide insurance market. At the same time, the Authority introduced a requirement for bidders to include LEG3 cover as part of their ITT insurance proposals, or to provide an equivalent package of protections, in order to satisfy the relevant award criteria.
- 5.2 The Authority’s position on uninsurability is settled and it does not envisage altering this in the near future.

### Discussion

- 5.3 Stakeholders have noted that whilst LEG3 insurance is still available in the market, the price of premiums has risen notably and that fewer insurers are offering LEG3 cover for certain elements of offshore transmission assets.
- 5.4 Notwithstanding that the Authority is not proposing to change its policy regarding IAEs and that it expects licensees to obtain LEG3 insurance, we are interested in stakeholders’ views on the approach that should be taken in the ITT evaluation.

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<sup>15</sup> “LEG 3/06” refers to the the London Engineering Group Unique Market Reference for the Model “Improvement” Defects Wording.

- 5.5 First, would there be any benefit in being less prescriptive with regards to insurance requirements, allowing bidders to choose whether to bid on the basis of less comprehensive insurance cover at their own risk? We can foresee the benefits to bidders being that it would allow bidders to decide on the level of risks that they regard as acceptable, potentially lowering premiums and deductibles, and reduce the cost to consumers. Conversely, reduced insurance cover could diminish the resilience of the eventual licensee and prove a cause for concern to investors and debt providers, potentially increasing the cost of capital and leading to increased costs to consumers.
- 5.6 Alternatively, would there be any benefit in the ITT requirements being more prescriptive on other elements of the insurance package, such as whether to take out business interruption cover, or whether perhaps to set fixed levels for estimated maximum loss or the deductible? We consider that while this could potentially reduce some elements of risk and allow us to evaluate bids on a more comparable basis, it could also lessen the ability of bidders to set their own risk profiles, reducing competition and increasing costs to consumers.

## Questions

- 5.7 What are your views on the ITT evaluation continuing to require bidders to take out LEG3 or an equivalent package of cover in ITT bids, or do you consider it would be preferable to allow bidders to decide on the risks that they regard as acceptable?
- 5.8 Should the ITT requirements be more prescriptive about some elements of the insurance cover – and if so, which aspects and what benefits would this bring?

## Part B: Wider Regime Development

### Section summary

This section identifies areas that stakeholders have raised with us, e.g. innovation, co-location, anticipatory investment, information sharing and end of tender revenue stream policy. A number of these areas are being considered as part of our longer term work on offshore coordination as part of BEIS' Offshore Transmission Network Review. However, this section sets out details for further engagement with us on these topics.

## Background

- 6.1 Feedback from our informal stakeholder engagement earlier this year identified certain topics to be addressed through wider regime development. These included how innovative technologies are affected by our cost assessment process, whether the regulatory framework could enable co-location of technologies (e.g. storage) and considerations around anticipatory investment. As noted earlier, Ofgem is currently engaged in looking at longer term issues regarding the development of offshore transmission, as part of the OTNR, to meet the government's offshore wind and net zero targets. This section seeks to set out how to engage with us further on these topics.
- 6.2 Associated with wider regime development is our end of TRS policy. As the tender round 1 OFTO projects are now nearing the mid-point in their regulated revenue period, Ofgem has commenced work on what policy approach it will adopt at the end of the regulated revenue term. As part of this, we are looking at stakeholder concerns about a lack of information on existing assets that relevant developers have, which could assist and inform investment decisions and how developers deal with extant assets.

## Discussion

### Cost Assessment – Treatment of Innovative Design Proposals

- 6.3 Stakeholder feedback through our recent informal consultation process expressed concerns that innovative technological advancements would be prejudicially viewed,

when benchmarked against previous projects during the cost assessment process. We agree with stakeholder feedback that the OFTO regime must not impede innovation that benefits consumers as technology progresses.

- 6.4 We set out in para 3.15 of our cost assessment guidance that: *“We use benchmarking analysis to guide our decisions on what cost areas it may be appropriate to investigate further, rather than as an absolute determinant of allowable costs. Where specific costs are highlighted as a concern, we conduct further analysis to determine whether such costs would be or were incurred economically and efficiently. Developers are given the opportunity to explain why their costs may differ from those on similar projects. In the absence of appropriate evidence to justify these differences, we may use the benchmarking data to inform our view of whether or not the relevant costs can be considered economic and efficient. Our investigation and analysis are not solely based on the results of our benchmarking work. We may also investigate areas where project costs are benchmarking well.”* We consider that this approach allows developers the appropriate opportunity to recover the costs of innovative technological advancements, where they can justify the benefits of doing so. We encourage stakeholders to engage early in the cost assessment process to discuss any project specifics in that context. Should you wish to discuss anything specific relating to a particular project, please contact: [offshore.costassessment@ofgem.gov.uk](mailto:offshore.costassessment@ofgem.gov.uk)

## **Offshore Coordination**

- 6.5 To date, all offshore wind farms in the UK have been connected to the onshore system by individual point-to-point, or radial, links. We acknowledge that this type of link may not be the best outcome for consumers in the future as generating capacity increases, thereby increasing pressure on coastal connection points. As noted previously, we are working closely with BEIS in their OTNR in order to address this.
- 6.6 As part of the OTNR, we issued a joint open letter with BEIS in August.<sup>16</sup> We would like to understand what has stopped the development of coordinated transmission assets to date with the aim of understanding how barriers may be overcome. Through the joint open letter we have invited views and pathfinder projects from stakeholders who are

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<sup>16</sup> <https://www.ofgem.gov.uk/publications-and-updates/increasing-level-coordination-offshore-electricity-infrastructure-beis-and-ofgem-open-letter-developers-offshore-wind-generation-electricity-transmission-licensees-and-other-interested-parties>



either already pursuing some level of coordination or have identified an opportunity to do so. For example, considering anticipatory investment, combining wind and interconnector assets or the co-locating of technologies.

- 6.7 Co-location of technologies, e.g. storage and offshore wind, is an issue that developers also flagged to us during our recent stakeholder engagement exercise. Our engagement has resulted in lessons learned and we acknowledge that in cases presented to us, the regulatory framework has not proven straightforward to support the development of such projects.
- 6.8 Offshore coordination in its widest sense is an area that will require further development to ensure future technologies and projects can be facilitated under the regulatory frameworks for which we are responsible. We are considering what changes could be made to the existing OFTO regime to facilitate these projects in the near term whilst also working with BEIS and others on what an enduring regime could look like to fully realise the benefits of offshore coordination. We will continue to build on the constructive engagement we have had with developers to date.
- 6.9 Should you wish to discuss any of the detail of these developments, please contact [Offshore.Coordination@ofgem.gov.uk](mailto:Offshore.Coordination@ofgem.gov.uk).

### **O&M/Asset Health/ Information sharing**

- 6.10 Stakeholders flagged concerns over the amount of information received from OFTOs on the health of transmission assets, which is important to determine whether an existing wind farm should be repowered.
- 6.11 Within Ofgem, we are currently reviewing what assets should be included in any information sharing exercise, including which data and analysis should be recovered in respect of individual assets. We are additionally considering how this would be best monitored and within what timescales. This work forms part of the 'End of TRS' discussion as discussed below.

### **End of TRS Policy**

- 6.12 Ofgem would like to highlight to interested parties that a work programme to develop the required policy and guidance to manage the end of TRS process has started. This

work programme is in response to a number of recent queries to Ofgem from stakeholders who were seeking further clarity as to the process at the end of the TRS.

- 6.13 To date initial views have been collected from a number of key stakeholders on a bilateral basis who will be directly impacted first as their projects were the first to be granted OFTO licences.
- 6.14 It is the expectation that in early 2021 an open consultation on the current thinking around the end of TRS will be carried out. During this informal consultation, initial Ofgem and stakeholder views will be presented and the wider industry views sought. This will be the beginning of a series of events to gain the views, opinions and feedback of the offshore industry on what should happen at the end of the TRS period. Ofgem will then aim to finalise the policy, and subject to final consultation amendments, publish it in late 2021.
- 6.15 In the meantime if you wish to express early views or indicate your organisation's interest in being involved in the development of the end of tender review stream work programme please contact George Cobb ([George.Cobb@ofgem.gov.uk](mailto:George.Cobb@ofgem.gov.uk)) independently of the current consultation.

## Appendices

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## Appendix 1 – Privacy notice on consultations

### Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name, address and anything that could be used to identify you personally) not the content of your response to the consultation.

### 1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, “Ofgem”). The Data Protection Officer can be contacted at [dpo@ofgem.gov.uk](mailto:dpo@ofgem.gov.uk)

### 2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

### 3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. I.e. a consultation.

### 3. With whom we will be sharing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. I.e. a consultation.

### 4. For how long we will keep your personal data, or criteria used to determine the retention period

Your personal data will be held for up to one year after the project is closed.

### 5. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete

- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data
- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3<sup>rd</sup> parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at <https://ico.org.uk/>, or telephone 0303 123 1113.

**6. Your personal data will not be sent overseas.**

**7. Your personal data will not be used for any automated decision making.**

**8. Your personal data will be stored in a secure government IT system.**

**9. More information** For more information on how Ofgem processes your data, click on the link to our "[Ofgem privacy promise](#)".