Consultation

Consultation on initial proposals for an OFTO Build model to deliver non-radial offshore transmission assets

Publication date:	17/04/2024
Response deadline:	29/05/2024
Contact:	Ho Man Lo / Richard Johnson / Agustin Mengoni
Team:	OFTO Build Tender Development
Telephone:	020 7901 3073 / 020 3263 9830
Email:	oftobuild@ofgem.gov.uk

In March 2023 we issued our final decision on the delivery models available for non-radial offshore transmission assets for in-scope projects. This decision provided developers with the choice of either a very late competition generator build model, or a late competition offshore transmission owner (**OFTO**) build model for the delivery of non-radial offshore transmission assets.

We are now developing an OFTO build model for the delivery of non-radial offshore transmission assets. This consultation requests feedback on specific areas for the development and implementation of this model.

We invite views from parties with an interest in offshore transmission, transmission, offshore generation, and interconnection, particularly those who are exploring options for coordination of projects now or in the future. We would also welcome responses from other stakeholders and the public.

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 Consultations | Ofgem. If you want your response - in whole 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.

Any enquiries related to the text of this publication should be sent to Ofgem at:

10 South Colonnade, Canary Wharf, London, E14 4PU.

This publication is available at www.ofgem.gov.uk. Any enquiries regarding the use and re-use of this information resource should be sent to: psi@nationalarchives.gsi.gov.uk

Contents

Executive Summary

In March 2023 we issued our final decision on the delivery models for non-radial offshore transmission assets for in-scope projects (the **March 2023 Decision**).[1] By in-scope projects, we refer to non-radial assets included within the Holistic Network Design (**HND**) and Holistic Network Design Follow Up Exercise (**HNDFUE**) (including the floating wind projects in the Celtic Sea).

Our March 2023 Decision provided developers the choice of either a very late competition generator build model, or a late competition offshore transmission owner (**OFTO**) build model. Within this decision, we committed to developing an OFTO build delivery model for the delivery of non-radial offshore transmission assets over the next year.

We have since conducted further stakeholder engagement on proposed arrangements for an OFTO build delivery model and gathered feedback from a range of OFTOs, generators and financial institutions.

This consultation considers both the feedback received through that stakeholder engagement exercise as well as responses to our previous consultations.

We are now seeking feedback on specific areas regarding the development and implementation of this model.

The areas we are seeking feedback on from stakeholders include which party should have responsibility for procurement, whether any changes are required to the existing OFTO tender process to facilitate the model, how best to ensure the timely delivery of offshore transmission assets, how cost increases during the construction phase should be treated, and how refinancing gains can be approached.

This consultation sets out our initial proposals on these key areas and invites views from stakeholders with the aim of ensuring that these are taken into account and inform the ongoing development of the OFTO build model.

[1] Decision on Pathway to 2030 | Ofgem

1. Introduction

Section summary

In this section we set out the relevant background on the OFTO build model for non-radial offshore transmission assets. We also outline our initial views on the key areas of the OFTO build model on which we are inviting feedback.

Background

1.1 The Offshore Transmission Network Review (**OTNR**)[2], launched in July 2020, sought to take a more strategic approach to windfarm development. It captured the United Kingdom's increased ambition for offshore wind to achieve net zero while balancing environmental, social, and economic costs.

1.2 The government's Ten Point Plan for a Green Industrial Revolution in November 2020[3] set an ambitious offshore wind target of 40GW by 2030. In April 2022, the British Energy Security Strategy[4] built on previous offshore wind targets to set an ambition of 50GW of offshore wind by 2030.

1.3 Under the current regulatory framework, offshore wind farms are connected to the onshore network via radial point-to-point connections which are owned and operated by an OFTO. As the ambition for offshore wind is scaled up, point-to-point connections may not be appropriate due to impacts on marine ecosystems, the local communities that host the connections and the incurring of additional cost to consumers.

1.4 Among the four workstreams of the OTNR, Pathway to 2030 was the medium-term workstream, covering largely the projects delivered through the Crown Estate (**TCE**) Leasing Round 4 and Crown Estate Scotland's ScotWind leasing round which will make a significant contribution to the government's 50GW ambition for offshore wind by 2030.

1.5 In July 2022 the National Grid Electricity System Operator (**NGESO**) published its HND.[5] The HND sets out the network requirements to facilitate the connection of

[2] Offshore transmission network review - GOV.UK (www.gov.uk)
[3] The ten point plan for a green industrial revolution - GOV.UK (www.gov.uk)
[4] British energy security strategy - GOV.UK (www.gov.uk)
[5] A Holistic Network Design for Offshore Wind | ESO (nationalgrideso.com)

23GW of projects, recommends potential locations of infrastructure, including offshore cable route corridors and new substations, and points to potential technology choices for the network.

1.6 The HNDFUE includes ScotWind leaseholders which were not included in the HND, who comprise 20.7GW of generation, as well as 4.5GW of generation expected to receive seabed leases through TCE Celtic Sea floating offshore wind leasing round. The HNDFUE therefore comes to a combined potential generation capacity of 25.2GW.

Relevant decisions to date

1.7 Our March 2023 Decision confirmed our revised minded-to position to give developers the choice of either a very late competition generator build model or a late competition OFTO build model for the delivery of non-radial offshore transmission assets. This decision was preceded by a consultation, in which 21 out of 22 stakeholder responses agreed with our decision to include these two options for non-radial offshore transmission assets.

1.8 Our March 2023 Decision also confirmed our minded-to decision, to extend our Anticipatory Investment policy to projects within scope of the HND and HNDFUE.

1.9 As part of the March 2023 Decision, we published a final impact assessment which brought together the analysis and results of our coordinated non-radial delivery model policy development process.

Stakeholder Engagement

1.10 Throughout Q2 and Q3 of 2023 we ran a series of stakeholder engagement sessions gathering initial feedback from OFTOs, generators and financial institutions. The feedback received during these stakeholder engagement sessions has informed the proposals and questions presented in this consultation. We have summarised the key concerns and common themes below.

1.11 On procurement, stakeholders highlighted that supply chain constraints and long lead times on equipment pose a significant risk of delay. The procurement of HVDC assets is of particular concern to stakeholders.

1.12 This point feeds into the question of which party should be responsible for procurement. Some stakeholders noted that generators may be able to mitigate

the risk of delay, as generators can overlap their procurement with the consenting process. Others however noted that a whole life approach including OFTO responsibility for procurement, construction and operation may see benefits.

1.13 Some stakeholders preferred the certainty of commencing the OFTO tender only after consenting is complete. Most stakeholders also agreed that the broad structure of the existing OFTO tender process remains suitable for the non-radial OFTO build delivery model.

1.14 Stakeholders also provided views on how to incentivise timely delivery, ranging from milestone payments to project delay charges. Some stakeholders also raised concerns about lengthy negotiations with regards to liquidated damages, further adding to delay risk.

1.15 In broad terms, stakeholders outlined that project financeability rests in large part upon a well-balanced risk and reward framework.

Supply chain constraints and high costs of capital

1.16 A common theme identified through stakeholder engagement was how current market conditions have changed the dynamics in the market and, in-turn, parties' (ie, generators, OFTOs, suppliers and investors) risk profiles.

1.17 As countries plan to reach their 2050 carbon targets and decarbonise their grids, there is a sustained demand for generation and transmission assets. In turn, this has led to constraints in supply chains.

1.18 Geopolitical events, the Covid-19 pandemic and increasing inflation rates have also contributed to the changing market conditions. These conditions have led to investors seeking greater levels of protection for taking risk. In the current climate, OFTOs and developers may also find it more difficult to share their risks with financial counterparts, such as insurance companies.

1.19 Market conditions are unlikely to change in the short-term. Our proposals seek to take these considerations into account where possible.

What are we consulting on?

1.20 This consultation applies to non-radial in-scope projects. By in-scope projects, we refer to non-radial assets included within the scope of the HND and HNDFUE (including the floating wind projects in the Celtic Sea).

1.21 Our March 2023 Decision committed to developing arrangements for a late competition OFTO build model. This document sets out our initial proposals for the development of an OFTO build model.

1.22 The feedback received in response to this consultation will inform the further development of detailed proposals for the OFTO build model for non-radial offshore assets.

1.23 The remainder of this document is structured in sections covering our initial proposals and questions concerning a late competition OFTO build model for non-radial offshore transmission assets around six key themes:

- **Procurement** – we set out our proposals on the suitable approach for procurement.
- **Tender process** – we set out two proposals on the timing of the competitive tender. We are seeking feedback from stakeholders on whether overlapping the generator's consenting process with the tender process is feasible, which may help to mitigate the risk of delayed delivery and ensure an efficient overall project delivery timeline.
- **Timely delivery** – we set out our thinking on two initial proposals to incentivise the timely delivery of offshore transmission assets and enable generators and OFTO to manage the risk of delay.
- **Cost increase during construction** – we set out our initial proposals for how cost increase during the construction phase may be treated.
- **Refinancing Gain Share** – this section explores whether we should expand the existing refinancing gain share mechanism to cover the conversion of equity to debt or the sale of equity.
- **OFTO failure during construction** – we set out our initial view on how the failure of an OFTO business during the construction phase could be addressed. We are

seeking input from stakeholders on how a failure scenario during construction could be approached.

Recent Publications

Decision on the Early-Stage Assessment for Anticipatory investment (December 2023)

Decision on the Early-Stage Assessment for Anticipatory Investment | Ofgem

Consultation on the Early-Stage Assessment for Anticipatory investment (May 2023)

Consultation on the Early-Stage Assessment for Anticipatory Investment | Ofgem

Decision on Pathway to 2030 (March 2023) – Decision on Pathway to 2030 | Ofgem

Revised Minded-to decision and further consultation on Pathway to 2030 (December 2022) – Revised Minded-to Decision and further consultation on Pathway to 2030 | Ofgem

Minded-to Decision and Further Consultation on Pathway to 2030 (May 2022) – Minded-to Decision and further consultation on Pathway to 2030 | Ofgem

Decision on asset classification for assets included in the NGESO Holistic Network Design (October 2022) – Offshore Transmission Network Review: Decision on asset classification | Ofgem

The Pathway to 2030 Holistic Network Design (July 2022) – The Pathway to 2030 Holistic Network Design | ESO (nationalgrideso.com)

Consultation on our Minded-to Decision on Anticipatory Investment and Implementation of Policy Changes (April 2022) – Offshore Coordination – Early Opportunities: Consultation on our Minded-to Decision on Anticipatory Investment and Implementation of Policy Changes | Ofgem

Decision on Anticipatory Investment and Implementation of Policy Changes (October 2022) – Decision on Anticipatory Investment and Implementation of Policy Changes | Ofgem

Next steps

Figure 1. Consultation Steps

Consultation	Further Consultation	Decision	Implementation phase
Consultation open for 6 weeks	Further detailed proposals/Minded-to	Decision	Implementation of policy decision/statements
April 2024	Autumn/Winter 2024	Winter 2024/2025	2025

How to respond

1.24 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.

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

1.26 We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations.

Your response, data, and confidentiality

1.27 You can ask us to keep your response, or parts of your response, confidential. We'll 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.

1.28 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'll 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.

1.29 If the information you give in your response contains personal data under the General Data Protection Regulation (Regulation (EU) 2016/679) as retained in domestic law following the UK's withdrawal from the European Union in the UK GDPR, 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**.

1.30 If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't 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

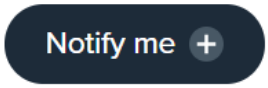
1.31 We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

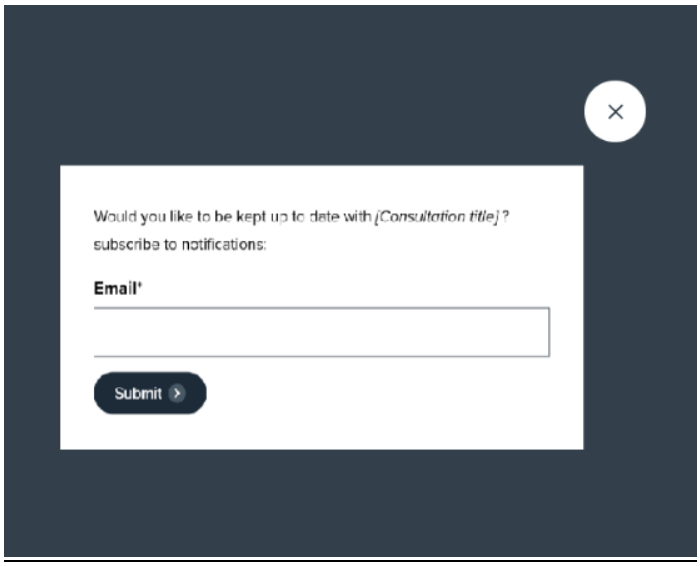
- Do you have any comments about the overall process of this consultation?
- Do you have any comments about its tone and content?
- Was it easy to read and understand? Or could it have been better written?
- Were its conclusions balanced?
- Did it make reasoned recommendations for improvement?
- Any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

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

How to track the progress of the consultation

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





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:

Upcoming > **Open** > **Closed** (awaiting decision) > **Closed** (with decision)

2. Procurement under a late competition OFTO Build

Section Summary

In this section we outline two options for the allocation of responsibility for procurement under a late competition OFTO build model. These two options are either generator led or OFTO led procurement.

Questions

Q1. Which party should be responsible for procurement in the late competition OFTO build model and why?

Background

2.1 Within our March 2023 Decision we provided a summary of the feedback we received from stakeholders on how an OFTO build model should be designed. We also outlined that we would further consider the appropriate allocation of roles and responsibilities within the model.

2.2 Our stakeholder engagement to date indicates that the party responsible for procurement is of particular importance, given the associated risk of delay and the currently constrained nature of the supply chain, particularly for HVDC assets.

Allocation of responsibilities

2.3 Under a late competition OFTO build model, different parties will have responsibility for the engineering, procurement, and construction stages of the project development process. In the following paragraphs, we set out further detail on the allocation of responsibilities.

2.4 Under a late competition OFTO build model:

- the OFTO is responsible for construction and for financing construction under the terms of its licence, which includes ensuring its transmission system is compliant with industry codes and standards; and
- the generator has responsibility over engineering and detailed design, which will be based on the high-level design provided by the NGESO in the HND and HNDFUE.

2.5 While the generator is responsible for engineering, and the OFTO is responsible for construction, responsibility for procurement remains an open question.

2.6 Regardless of which party is responsible for procurement, contracting arrangements will likely utilise a multi-vendor/multi-contract model. Contracting arrangements are ultimately a commercial matter, and can be split, combined, or tailored in different ways to suit the specific project requirements of relevant parties.

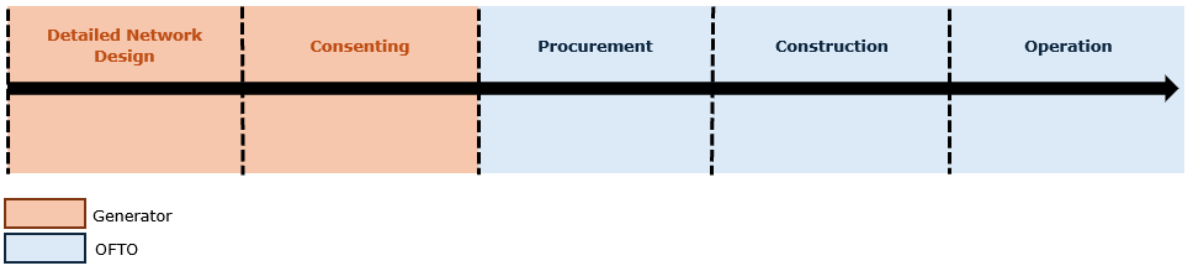
2.7 These contracts usually cover an export cables contract plus onshore and offshore substation works via an electrical works agreement, as well as an inter-array cables contract, vessel procurement, and a foundations contract, which can be wrapped into a single balance of plant contract.

2.8 We have outlined below two options on which parties could undertake the procurement role, together with our initial views as to which party we consider is, on balance, best placed to do so.

Option 1 – The OFTO undertakes procurement

2.9 Under this option, the generator obtains the connection offer and consents, undertakes detailed design, and conducts other preliminary works for the transmission assets. The OFTO would be responsible for procurement prior to construction and, thereafter, for the construction of the transmission assets. The OFTO would subsequently own, operate and maintain these assets.

Figure 2: Overview of OFTO procurement



2.10 This option provides a meaningful alternative to the current very late competition generator build model by presenting a new option for procurement. As OFTOs are responsible for maintaining and operating the asset, OFTOs may prefer to control the procurement process to ensure a holistic approach.

2.11 Under the existing generator build model for radial projects, everything up until the completion of the transmission assets is the responsibility of a generator. This means that the generator can approach all activities in what they deem to be the most efficient manner for the completion of the project.

2.12 However, should procurement be the responsibility of the OFTO under the OFTO build model, there is a risk that the delivery timeframe becomes drawn out given that the OFTO will be unable to complete procurement prior to licence grant at culmination of the tender (**the OFTO tender process**).[6] This is of particular concern given the current supply chain constraints.

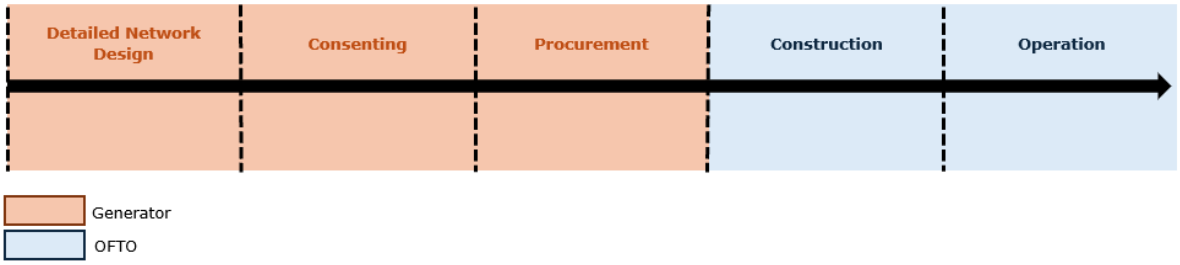
2.13 In chapter 3 we consider two different options for when to commence the OFTO tender process and the potential impact of these may have on project development timeframes.

Option 2 – The generator undertakes procurement

2.14 An alternative option is for a generator to be responsible for procurement. Under this option, the generator obtains the connection offer and consents, undertakes detailed design, and conducts other preliminary works for the transmission assets. The generator carries out the procurement for the contracts to construct the transmission assets. After completion of the OFTO tender process and the grant of the OFTO licence, the generator will transfer the construction contracts to the OFTO. The OFTO is then responsible for managing the construction of the transmission assets.

2.15 This option could help to address long lead times. As is the case in the current generator build model for radial offshore transmission assets, generators can overlap procurement activities with the consenting process and begin procurement at a relatively early stage.

Figure 3: Overview of generator procurement



2.16 We recognise that this option could risk increasing the complexity of the interfaces and dependencies between the generator and the OFTO. Compared with the OFTO undertaking the procurement, the OFTO would be taking over the management of

[6] See **Appendix 1** for an outline of the OFTO tender stages and process.

contracts procured by the generator. OFTOs may view this as raising unique risks and challenges.

2.17 From a generator perspective, they will rely upon OFTOs to undertake construction of the transmission assets in a timely manner so they can begin to export power and generate revenues. Giving generators the ability to select contractors and choose equipment provides them with some influence over the delivery of the assets, and therefore a greater degree of comfort in transferring control over the construction phase to a competitively appointed OFTO.

2.18 The current generator build model for radial offshore transmission assets has resulted in high levels of transmission availability. Regardless of who is responsible for procurement, both OFTOs and generators have strong commercial motivations for delivering high quality and reliable assets that are compliant with industry codes and standards. We would also expect warranties and insurance to be procured along with the contracts where possible, providing additional security to the OFTO.

Our initial view

2.19 We consider that generator procurement presents the most feasible option to facilitate project delivery in the short to medium term, due to the current constrained condition of the supply chain.

2.20 Generators have extensive previous experience of procuring the construction of offshore transmission assets under the existing OFTO regime and can engage in procurement activities at a relatively early stage of development compared to prospective OFTOs.

2.21 This is because under the generator procurement option, procurement activities can be overlapped with the consenting process and be completed earlier, which we consider would partly mitigate the risk of procurement related delays. Generator procurement would therefore seem to facilitate the continued development of offshore wind at pace.

2.22 We recognise that generator procurement may present risks and challenges for OFTOs for example concerning the high degree of project maturity that the OFTO will inherit as well as pre-appointed construction contractors. We would like to hear views on what those risks and challenges may be, and we will then consider how they might be addressed.

2.23 While this is our initial view for offshore transmission assets in scope of the HND and HNDFUE, we consider there may be some merit in revisiting an OFTO procurement option in the future.

2.24 We consider that OFTO procurement could be an appropriate option in the longer-term as supply chain constraints improve and as prospective bidders acquire experience with greater involvement in delivery of offshore transmission assets. We also note that the further development of accepted industry standards and specifications may also help address concerns about the quality and reliability of assets procured such that the question of which party undertakes procurement becomes of less material consequence.

2.25 We are seeking views on whether stakeholders agree with our initial proposals on responsibility for procurement.

3. Tender process

Section Summary

In this section, we set out two proposals on the timing of launching the competitive OFTO tender under the OFTO build model. We are seeking feedback from stakeholders on whether it is feasible to overlap the generator's consenting process with the OFTO tender process, to mitigate against the risk of delayed delivery.

Questions

Q2. At what point should the OFTO tender process commence? Does option 1 or option 2 present the best approach?

Q3. Do you agree with the view that, providing stakeholder engagement is properly conducted ahead of consent submission, generators should have a reasonably clear view, at the time of consent submission, as to whether the consent is likely to be granted in the form requested, and that an OFTO would be comfortable to submit tender bids on this basis?

Background

3.1 As stipulated by the Electricity Act 1989[7] (**the Act**), Ofgem awards OFTO licences via the OFTO tender process. In each tender round, we assess bids and ultimately grant OFTO licences to bidders for specific transmission assets connected to offshore wind farms around Great Britain.

3.2 The OFTO competitive tender regulations[8] (**the Tender Regulations**) set out the framework for the OFTO tender process, and Ofgem publishes tender process guidance[9] and stage specific guidance for the Pre-Qualification (**PQ**)/Enhanced Pre-Qualification (**EPQ**) and Invitation to Tender (**ITT**) stages.

3.3 A detailed summary of the existing OFTO tender process under the current generator build model is provided in **Appendix 1** for reference.

[7] Electricity Act 1989 (legislation.gov.uk)
[8] The Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2015 (legislation.gov.uk)
[9] Ofgem publishes the most up to date Tender Process Guidance Document to be utilised for each tender round. The latest version of the guidance was published in February 2024 Offshore Transmission: Tender Process Guidance Document for TR11 | Ofgem

Triggering the OFTO tender process

3.4 An OFTO tender exercise is triggered with a notice published by Ofgem confirming its intention to commence a tender exercise.[10] The Tender Regulations require that a developer who wishes Ofgem to publish such a notice and commence a tender exercise, must make a request to that effect to Ofgem. The OFTO tender process may be triggered before the construction of transmission asset is completed.

3.5 Under the late competition OFTO build model, construction can only take place after the OFTO tender process is triggered and completed. This means that the construction phase will commence later than under a generator build framework. Hence the point at which the OFTO tender process is triggered will have an impact on when the OFTO completes construction.

3.6 In this section, we outline two options on how the OFTO tender process could interact with the consenting process. We are considering how best to mitigate the risk of delay, where roles and responsibilities prior to operation of the assets are shared between the OFTO and generator.

Option 1 – Tender commences at consent grant

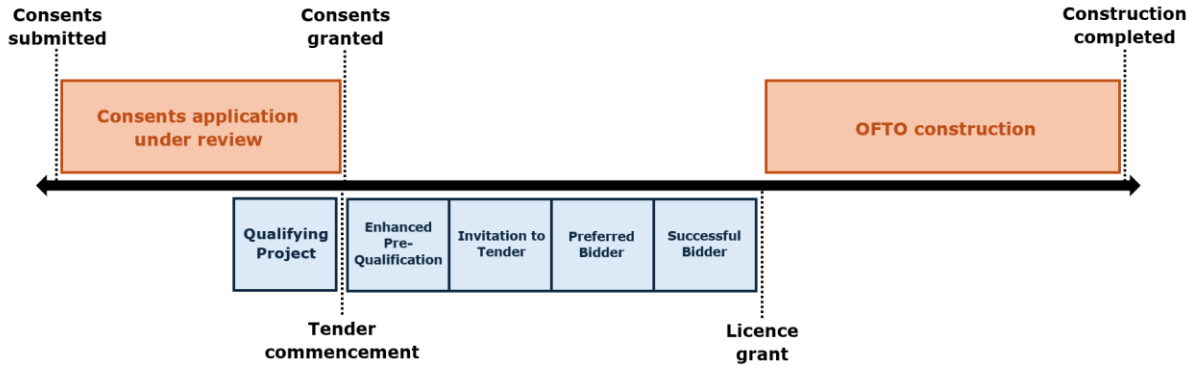
3.7 Our first proposal is to commence the OFTO tender process once the consent pertaining to the offshore transmission assets has been issued, and once any period where the decision is open for legal challenge has also been concluded. Under this option, the grant of either a Development Consent Order (**DCO**) under the Planning Act 2008[11] or consent under Section 36[12] of the Act (**Section 36**) could serve as a milestone at which sufficient certainty is obtained for potential OFTOs bidders to participate in a tender exercise.

3.8 Depending on the location of the project within Great Britain, the granting of a DCO or Section 36 (for projects in Scotland) consent could act as the point at which the first tender stage commences (see **Figure 4**). We anticipate that engagement to

[10] in accordance with regulation 12(1) of the Tender Regulations.
[11] The Planning Act 2008 (legislation.gov.uk)
[12] Section 36 of the Electricity Act 1989 (legislation.gov.uk) applies to proposals for the construction, extension or operation of electricity generating stations. It applies to all offshore generating stations whose capacity exceeds 1MW in the case of wind, wave or tidal power located up to the seaward limits of the territorial sea or in a Renewable Energy Zone.

establish whether the Qualifying Project (**QP**) criteria[13] have been met, could occur prior to consent grant.

Figure 4: Tender commences at consent grant



3.9 Under this option, we would expect generators to make a request for Ofgem to publish a tender notice[14] ahead of the consent decision. Generators should have an indication of when they can expect their consent decision from the authority assessing their application (ie, the Planning Inspectorate or Marine Directorate at the Scottish Government). This would allow us to engage with the generator to establish whether the QP criteria have been met, ready to commence the first stage of the tender (EPQ Stage) when the DCO or Section 36 decision has been granted.

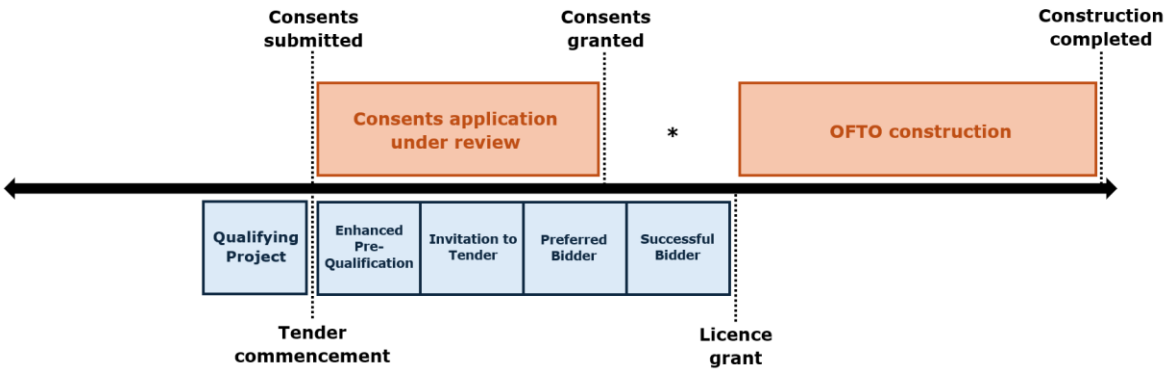
Option 2 – Tender commences at consent submission

3.10 Our second proposal is to allow developers to begin the OFTO tender process applications once the submission of either the DCO or Section 36 application for the project is with the relevant authorities for review (see **Figure 5**).

3.11 The merit of this option is to achieve a significant saving of time, which may be more than 12 months[15], by overlapping the OFTO tender and consent process.

[13] The Qualifying Project Criteria for an OFTO build tender, are outlined in paragraph 1 of Schedule 2 of The Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2015.
[14] In accordance with regulation 12(1) of the Tender Regulations.
[15] This is a rough estimation for indicative purposes. It is based on the time required for obtaining consent under DCO which is more than 12 months.

Figure 5: Tender commences at consent submission



***** Consent granted prior to the conclusion of the PB stage. The point at which it is granted will vary depending on the type of consent.

3.12 Given that the consent application has been submitted, the generator should have sufficient project information to commence the tender. For example, the generator should have the information needed to prepare project-specific transfer agreements required at the EPQ stage and to populate the data room at the ITT stage, among other items.

3.13 The Section 36 application and decision-making process is designed to take 9 months.[16] Under the DCO process the expected timeline from formal acceptance of an application to releasing a decision is 16 months.[17] We note that consents will need to be in place for the transaction phase negotiations to conclude. In principle, there should be sufficient time for this to happen.

3.14 An OFTO tender process under the generator build framework is designed to take 18 months. We expect that timelines may differ slightly under the OFTO build model as the transmission assets are yet to be constructed. Furthermore, after the licence grant, there may be an additional period before the construction can begin as contractors prepare to commence activities.

3.15 We acknowledge the risks associated with this approach. This option could lead to a delayed or abandoned tender process should the generator's consent application be rejected or significantly delayed. Under this option, consent would be granted while the tender is ongoing raising the risk that the relevant authorities could impose consent conditions at this stage. Should such conditions materially change

[16] Offshore wind, wave and tidal energy applications: consenting and licensing manual - gov.scot (www.gov.scot)
[17] The process | National Infrastructure Planning (planninginspectorate.gov.uk)

the project, running a smooth and competitive tender process could prove complex. As such, we also anticipate that it could be challenging to attract sufficient interest from potential OFTOs.

Our initial views

3.16 Our initial view is that option 1 (ie tender commences at consent grant) is preferrable because the potential risks associated with option 2 may be too high. We consider that the OFTO may not want to face the uncertainty surrounding the project to be tendered prior to consents being granted.

3.17 However, we note a potential argument that the uncertainty and the potential risk of option 2 may be manageable. This is because the generators should, if effective stakeholder engagement has been conducted before consent submission, be reasonably clear about whether the consent is likely to be granted in the form requested.

3.18 Whilst our preference at this time is option 1, we note the potential significant time saving afforded by option 2 and would like to ascertain whether option 2 is practicable. As such, we would like to obtain feedback on the following –

- The extent to which generators, based on experience in obtaining consents, have sufficient confidence in securing planning consents in the form requested, and triggering the tender process at the time of consent submission.
- The extent to which OFTOs would have an appetite to submit a tender in circumstances where a consent request has been formally submitted and pending approval, including at which point of the process would they feel comfortable in submitting a tender.

4. Timely delivery

Section Summary

In this section, we set out our initial proposals to incentivise the timely delivery of offshore transmission assets, and to enable both generators and OFTOs to manage the risk of delays during construction under a late competition OFTO build model.

Questions

Q4. As compared with commercial liquidated damages, how effective are options 1 and 2 in incentivising timely delivery and managing the risk of delay? Could these options make OFTO build a meaningful option for the generators?

Q5. How can the OFTO delay charge and consumer underwriting in option 1, as well as the TRS reduction in option 2, be appropriately set and executed?

Background

4.1 Delivering offshore transmission assets is complicated given the lengthy construction process, the complex technical requirements and the number of parties involved, etc. While the generators, OFTOs and contractors are incentivised to complete projects on time, delays may still arise for a range of reasons.

4.2 To date, the OFTO build model has not been chosen for the delivery of radial assets. One of the potential reasons for this is that generators would lack control over a project's development and construction activities. They therefore face the risk of third-party late delivery and the losses that would follow from that. As a mitigation, generators may need a mechanism that allocates at least part of the delay risk to the third-party.

4.3 We consider it important to ensure that a late competition OFTO build model for non-radial assets includes suitable measures to incentivise the timely delivery of the transmission assets and enable both generators and OFTOs to manage the impact of delays.

OFTOs' ability to mitigate delay risk

4.4 OFTOs will be taking on construction risk under a late OFTO build model. The financing options available to the OFTO will likely reflect the risks associated with construction. Should the risk of delay be too onerous on the OFTO this could severely impact the OFTO's ability to secure suitable finance.

4.5 Adopting a conventional method to mitigate the risk of late delivery could mean requiring an OFTO to pay liquidated damages (**LDs**) to generators, thereby incentivising the OFTO to complete construction on time and partially compensating generators' losses.

4.6 LDs are commercially negotiated. We recognise that generators may face some uncertainty about the value of the LDs that they could receive from OFTOs at the time they make the choice between generator build or OFTO build delivery models. This is because the choice of delivery model needs to be made before the OFTO is selected and the negotiations commence. Given this uncertainty, commercially negotiated LDs between generators and OFTO may not be sufficient for the generators to manage the risk of delay.

4.7 From the OFTOs' perspective, negotiating with multiple generators about LDs are more complex and lengthier under a non-radial setting than with a single generator under a radial setting.

4.8 Additionally, the cumulative total of potential LDs sought by generators may be too large for the OFTO to construct a financeable bid. As outlined below, OFTOs have limited ability to deal with the risk of delay through contractor's LDs, insurance, equity, and risk-bearing capital. This presents a case for exploring alternative solutions.

4.9 The current constrained supply chain market gives suppliers potential advantages in the negotiations with the procuring party. An OFTO may find it difficult to pass on a large portion of the delay risk to its suppliers. Besides, in a multi-contractor setting, delays by one subcontractor could have a wider impact upon the whole project. If one subcontractor is at fault, the LDs recovered by the OFTO from that contract may be inadequate to compensate the generators.

4.10 Insurance cover to mitigate against delay risk may be an option for an OFTO, however coverage may be limited. We also note that where an OFTO can secure comprehensive insurance coverage, the associated insurance premiums to be paid by the OFTO for that cover may be expensive. OFTOs would price this insurance cost into their Tender Revenue Stream (**TRS**) bids, resulting in higher costs for consumers.

4.11 OFTOs may elect to provide some risk-bearing capital to meet potential delay payments. However, there may also be limits on the amount of capital the OFTO can set aside because this would incur additional costs.

4.12 The more capital an OFTO has to set aside, the more the OFTO will seek to recover these costs by pricing it into the TRS bids. Again, this would mean higher costs to consumers than would otherwise be the case, even though the risk of delay may not actually materialise.

4.13 Where the delay charge exceeds the amount that is recoverable through LDs, insurance, and risk bearing capital, OFTO investors would be expected to inject equity to pay the remainder of delay charge. However, we note that this will diminish equity returns, and hence there will be a limit to what equity investors are willing to contribute towards the delay charge.

Adopting a standardised regulatory approach

4.14 We consider it to be preferable to adopt an approach that provides clear and standardised treatment, and that does not depend on the outcome of commercial negotiation. This allows respective parties to know what they are able recover, or need to absorb, at the point of choice of delivery model. This would also help ensure that the approach can be applied consistently to all in-scope projects.

4.15 This approach should help provide certainty to generators as they can better assess risks at the point of choice of delivery model. This will also help OFTOs to make considered financial arrangements upfront and improve their capability to deal with the delay risk. If responsibilities over risks are clear at the beginning, there should be less uncertainty and less risk premium that OFTOs consider necessary to price into TRS bids. Hence this approach should also benefit the consumer.

4.16 We outline below two initial proposals for feedback from stakeholders. One of the proposals focuses on partial compensation for the generator. The other proposal instead focuses on strengthening incentives for the OFTO to deliver on time.

4.17 We consider it important to retain the existing incentive aimed at ensuring timely delivery, ie an OFTO only receives its TRS upon completion of the transmission asset. Accordingly, we propose that this incentive would continue to apply to both options that we consider below.

4.18 Our initial two options for timely delivery are:

- **Option 1 –** which seeks to partially compensate the generators by imposing a standardised delay charge on the OFTO. The delay charge on the OFTO would only be payable to the generator upon completion of the transmission assets, to avoid adverse effect on OFTO's cash flow during construction.

- **Option 2 –** which seeks to strengthen the existing incentive mentioned above with an additional incentive that exposes the OFTO to a progressive reduction of TRS in the event of a delay. Unlike option 1, the generators will not receive compensation for the loss in revenue due to delay.

Option 1 –Standardised compensation

4.19 Under option 1, generators would receive a delay charge from the OFTO to partially compensate their loss of revenue. The delay charge would be standardised and set by Ofgem upfront on a non-project specific basis. The delay charge would be set according to parameters[18] that apply to every in-scope project, without dependence on any negotiation between the OFTO and the generators. This ensures that when generators choose the delivery model, it is clear how much they would be partially compensated in case of late delivery by the OFTO.

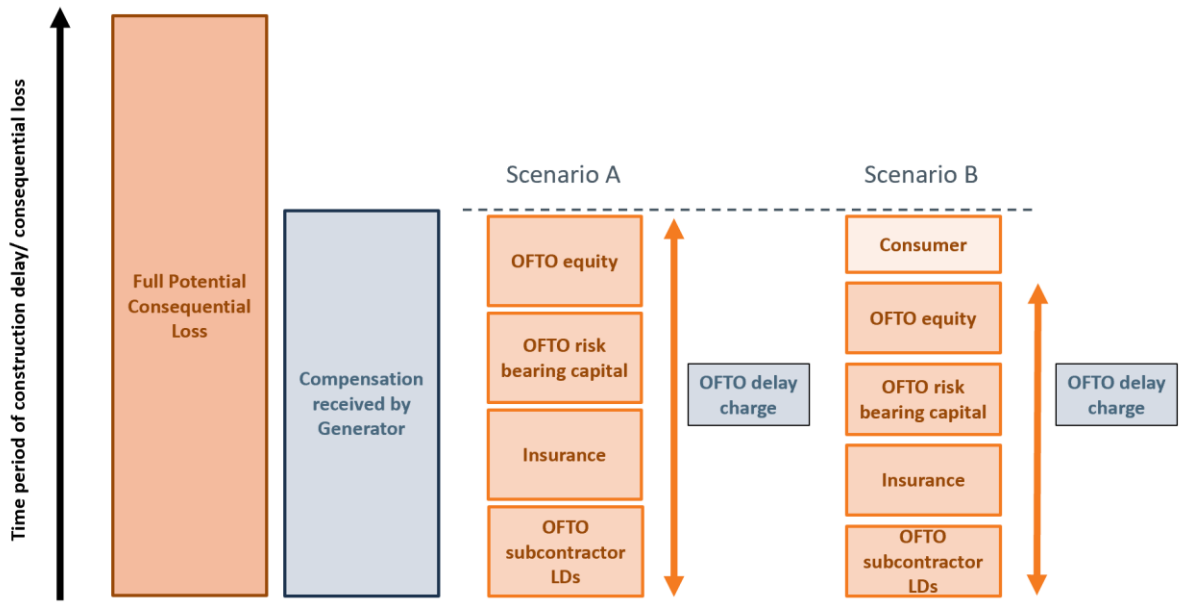
4.20 The delay charge parameters may be linked with generators' revenue loss or another appropriate measurement. However, we note that there may be limitations on how much delay charge OFTOs can absorb without placing undue upward pressure on the TRS and impacting the OFTOs' financeability. We consider that there may be a need for a cap to the delay charge. This may mean that generators can only be partially compensated and possibly undermine their willingness to opt for the OFTO build model.

4.21 We have explored how to supplement the OFTOs delay charge such that the OFTO build model remains a meaningful alternative option for generators. One possibility may be to supplement the delay charge by including a guarantee of availability which draws on consumer underwriting in case of delay.

4.22 Like the delay charge, the guarantee of availability would be capped and would be based on parameters linked to the generators' revenue loss, or another appropriate measurement. Combined, the OFTO delay charge and the guarantee of availability constitute scenario B in **Figure 6** below.

[18] To be further developed and will be pre-determined by Ofgem ahead of model implementation.

Figure 6: Diagram of partial compensation scenarios



4.23 The diagram above displays two compensation scenarios. In scenario A, the OFTO may meet the level of compensation through a combination of LDs, insurance, risk bearing capital and an equity injection from investors. In scenario B, the OFTO makes up a portion of the compensation to the generator, with the consumer also making up a portion. We do not intend to ask the OFTO and consumer to fully compensate generators' loss which might include loss beyond lost revenue due to delay. The generators will have to absorb part of the loss.

4.24 The guarantee of availability is intended to lower the OFTOs' exposure to delay related costs while keeping the compensation received by generators at a level they would find more acceptable.

4.25 Whilst the guarantee of availability would expose consumers to some delay risk, we would manage the consumer exposure by putting a cap on the guarantee of availability value and requiring consumer contribution only when a delay occurred. Also, we intend to first utilise the whole OFTO delay charge to compensate the generators and make use of the consumer contribution only when the OFTO delay charge has been paid in full.

4.26 The guarantee of availability should reduce the risk on OFTOs during the construction phase, and we would expect this reduced risk profile to be reflected in TRS bids which ultimately benefit consumers. Consumers would also benefit from longer term savings achieved by the delivery of non-radial transmission assets.

4.27 We are seeking feedback on whether option 1 can sufficiently incentivise timely delivery and enable generators and OFTOs to manage the risk of delay. We would also like feedback on the following questions:

- Do you think scenario A or scenario B is a better formulation of option 1?
- Would you prefer a delay charge set by Ofgem according to non-project specific parameters to commercially negotiated liquidated damages?
- If generators can be partially compensated for delay, would generators consider OFTO build a meaningful option to generator build?
- How can the delay charge and consumer underwriting be appropriately set and executed?

Option 2 – Phased progressive TRS reduction

4.28 We take the view that, given the choice, generators would much rather have the transmission assets constructed and ready on time than receive compensation from the OFTO for delays. As such, option 2 aims to place an additional incentive on OFTOs to deliver on time and does not involve pre-determined compensation arrangements for generators.

4.29 Under this option, Ofgem would seek to strengthen the existing incentive[19] by introducing a phased, progressive reduction in the TRS, relative to the length of the delay, and subject to an annual cap.

4.30 As a hypothetical example for illustrative purposes, in the event of a 6-month delay, the TRS payable in the first year of operational phase could reduce by 0.5%. In the event of a 12-month delay, the reduction would be 1% of the TRS in the first year of operation.

4.31 This option broadly mirrors the approach in the current availability incentive[20], which sees a phased reduction in the TRS received by the OFTO in the operational phase should availability levels drop below specified thresholds.

4.32 The OFTO availability incentive is well established and has proven to be an effective means on incentivising OFTO availability. We also note that OFTOs are familiar with this approach.

[19] Whereby the OFTO only starts receiving their TRS on project completion.
[20] See standard condition E12-J4 Part A of the Generic OFTO licence: Offshore Transmission: Generic Licence and Guidance for TR10 | Ofgem

4.33 We are seeking feedback on whether option 2 can sufficiently incentivise timely delivery and manage the risk of delay. We are also seeking views on the most appropriate way to set the reduction of TRS under this option.

5. Cost increases during construction

Section Summary

In this section, we invite feedback to our initial proposals for how cost increases during the construction phase should be treated. Our initial view is that a degree of flexibility to the TRS or sharing a portion of the increased cost with other parties may be required to ensure that the model presents a viable option for OFTOs.

Questions

Q6. Which of the four proposals offers the most suitable option for the treatment of cost increases during construction?

Q7. What, in your view, is an appropriate calibration for the pain-gain share mechanism outlined in options 3 and 4?

Background

5.1. Under the generator build delivery framework, potential OFTOs bid for a TRS having regard to the Final Transfer Value (**FTV**) of the constructed transmission asset. The FTV is determined following an assessment of project costs by Ofgem toward the conclusion of construction of the transmission assets by the generator. Only costs deemed to have been economically and efficiently incurred are approved as part of the cost assessment process.

5.2. After the tender process, the TRS (as bid by the OFTO during the OFTO tender process) is fixed for a set period[21] during the operational phase. The TRS may only be adjusted under a limited set of circumstances. Such adjustment mechanisms include:

- **the Market Rate Revenue Adjustment**, which permits an OFTO's TRS to be adjusted to account for the difference between market rates which support the TRS published as part of the Section 8A[22] consultation and the actual market rates that apply on the day of financial close; and
- **the Post Tender Revenue Adjustment**, for projects where Ofgem has been unable to complete our final assessment of costs sufficiently ahead of

[21] Usually between 20 and 25 years

[22] The section 8A consultation in respect of the Licence, which is a consultation under section 8A of the Electricity Act 1989 to propose a modification to the standard conditions of the Licence to incorporate the OFTO specific provisions.

the Section 8A consultation[23] meaning the TRS has been based upon the Indicative Transfer Value (**ITV**). The Post Tender Revenue Adjustment is calculated once the FTV has been determined and accounts for the difference between the ITV and the FTV.

OFTOs' risk exposure

5.3. Under the late competition OFTO build delivery model, the OFTO tender will take place before construction of the transmission assets. An OFTO will need to submit a proposed revenue in its TRS bid based on cost estimates. However, the actual construction costs may go beyond the estimates.

5.4. Current market conditions may not be favourable for an OFTO to manage the risk of escalating construction costs. In recent years, the offshore wind industry has felt the impact of inflation on materials and labour, coupled with the increased cost of borrowing to finance offshore wind projects. We expect that developers will encounter supply chains reluctant to offer fixed price contracts given the prevailing market conditions.

5.5. If the TRS is fixed upon the award of the OFTO, the relevant OFTO will be exposed to the entire risk of cost increase during construction. This could increase the risk that the OFTO is unable to progress the transmission assets to completion if actual costs go beyond estimated costs.

5.6. In addition, if the TRS is fixed, to the extent the proposition is bankable, an OFTO will likely price this risk into its TRS bids. The TRS is in eventually borne by consumers.[24] How cost increases during construction will be managed is therefore crucial in developing a model that is financially viable and in the consumer interest.

Flexibility in TRS

5.7. Our initial view is that some flexibility in the TRS or sharing a portion of the extra costs with other parties may be needed to deliver an investable proposition. In developing our proposals, we are considering this together with the need to ensure OFTOs are incentivised to manage the project cost efficiently.

[23] Notice under Section 8A (3) of the Electricity Act 1989 – before making any modifications under subsection (2) to modify any of the standard licence conditions in granting a licence of any type, the Authority must give notice under Section 8A (3).
[24] The TRS paid to the OFTO is funnelled through the ESO, which collects the TRS to be paid to the OFTO via Transmission Network Use of System (TNUoS) charges.

5.8. The options presented have given due consideration to the legislative landscape in which the OFTO regime operates. TRS variations are permissible within the existing regulatory framework and we consider this to be compliant with the Public Contracts Regulations 2015[25], provided that TRS variations:

- are based on unequivocal review clauses that are transparent and defined ex-ante,
- do not materially change the nature of the contract,
- are not material from a financial perspective.

5.9. Under all the options outlined below, the OFTO will be required to bid a TRS based on a target cost envelope. Given our initial view that generators will be responsible for the procurement (outlined in Chapter 2) and have a leading role in developing and finalising the detailed design, we expect that generators will be able to propose a forecast of the project costs which will form the basis of the target cost envelope.

5.10. Once the generator submits these costs, Ofgem would undertake a cost benchmarking exercise to determine whether these costs are economic and efficient. Once the target cost envelope has been assured by Ofgem, it will be submitted to the ITT stage data room.

5.11. This target cost envelope would form the basis of OFTO bids. OFTOs will bid based on an ex-ante TRS while noting that the TRS may change after construction if the actual construction costs exceed the cost estimation.

5.12. Our four options aimed at dealing with a cost increase scenario during construction of the project are as follows.

Option 1 – Post construction cost assessment

5.13. Our first option utilises specific re-opener mechanisms in a post-construction cost assessment to seek approval for TRS variations post tender.

5.14. To obtain Ofgem's approval, the OFTO will need to justify to Ofgem that any cost increase against the target cost envelope for the project are economic and efficient. This ensures consumers are not exposed to construction risk that is within the OFTO's reasonable control.

[25] The Public Contract Regulations 2015 (legislation.gov.uk) – we note that the Procurement Act 2023 provisions will need to be considered in due course.

Option 2 – Post construction cost assessment with materiality threshold

5.15. Our second option is a modified version of option 1. The difference from the first option is that the post-construction cost assessment will be triggered only when the construction cost increases and exceeds a threshold that is set by Ofgem, eg 10% of the target cost envelope.

5.16. Once the cost review is triggered, the relevant OFTO will need to justify, with relevant supporting evidence as required, that costs incurred beyond the threshold were economically and efficiently incurred. Adjustments to the TRS will be made in line with the outcomes of Ofgem's post-construction review. Cost increases within the threshold will be borne by the OFTO.

5.17. This option provides a degree of consumer protection by requiring an Ofgem cost assessment for TRS variations. Additionally, given option 2 will require OFTOs to bear the risk of cost overruns within the materiality threshold, it offers an extra incentive for OFTOs to minimise cost overruns as far as reasonably possible.

Option 3 - Uncapped 'pain-gain' share mechanism

5.18. Our third option is a 'pain-gain' share mechanism in which the OFTO shares outturn cost variations with generators.

5.19. Under this option, a non-project specific pain-gain share mechanism will be set out in the OFTO licence, whereby outturn cost variations against the target cost for the project are shared between the OFTO and the generators.

5.20. The sharing mechanism will be designed to ensure the OFTO is incentivised to complete the project as close to the target cost as possible, whilst also managing the risk that the OFTO is unable to proceed due to cost overruns during construction.

5.21. We welcome stakeholder feedback on what the calibration of such a pain-gain share mechanism should be. We expect any share allocated to the generator would be smaller, given they are not responsible for construction. However, we acknowledge that should generators conduct procurement, the pain-gain share mechanism could act to incentivise procurement with a successful and cost-efficient construction phase in mind.

Option 4 - Capped 'pain-gain' share mechanism

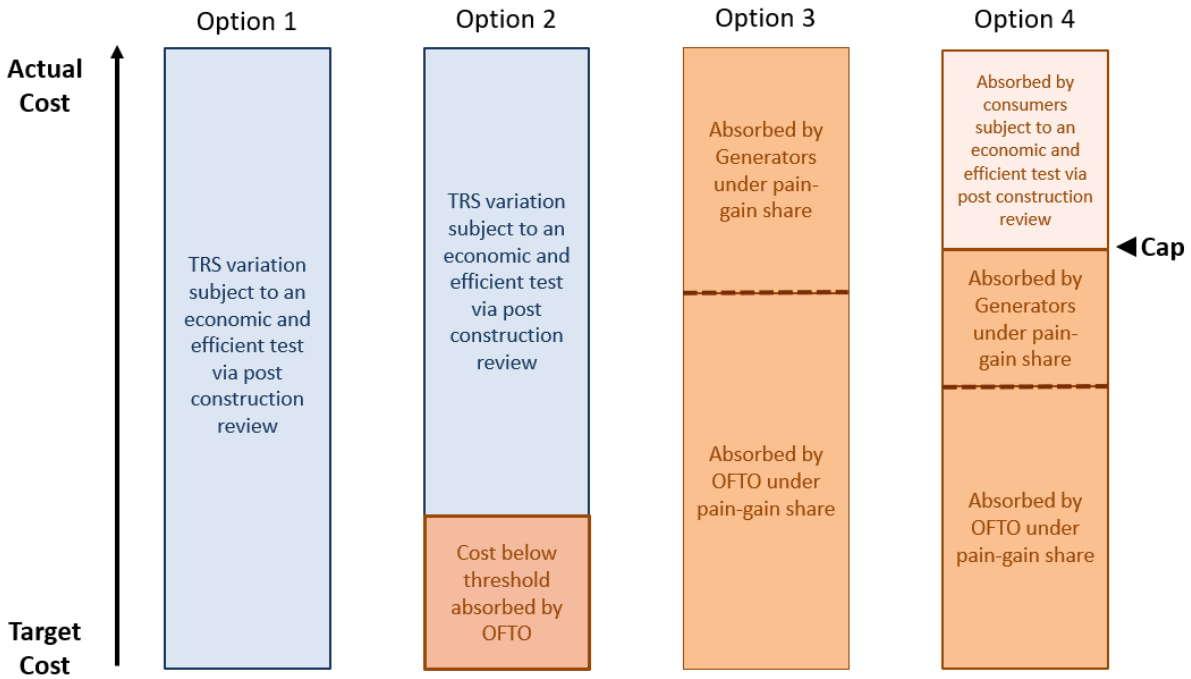
5.22. Under this option, the pain-gain share mechanism would apply as outlined above up to a non-project specific cap, with cost variations beyond the cap allocated to consumers. The cost variations borne by consumers would need to go through a cost assessment process and prove to be economic and efficient to be approved by Ofgem.

5.23. The cap aims to ensure that the OFTO can proceed in the event of cost increase above a set cap, with the consumer acting as a last resort source of funding to progress the project to completion.

5.24. We welcome stakeholder feedback on a reasonable and balanced non-project specific cap for the pain-gain share mechanism under option 4.

5.25. Our four options proposed to address cost changing during construction are summarised in **Figure 7** below.

Figure 7: Allocation of costs under the four options proposed



Construction phase delays caused by events or circumstances beyond an OFTO's reasonable control

5.26. We recognise that sometimes delays during the construction phase may be caused by specific external factors that are beyond the reasonable control of the OFTO. We also note that such an event or circumstances of force majeure, during the construction phase, may have an additional cost implication and prolong the construction period for the project.

5.27. We recognise that any additional costs arising from delays caused by an event or circumstance of force majeure during the construction phase may need to be treated differently to reflect that the reasons for the cost overruns occurring were due to reasons beyond the control of the OFTO. In any case, we would expect the OFTO to clearly demonstrate, with supporting evidence, what actions it took appropriately mitigate and manage the event or circumstances of force majeure.

5.28. A related issue is whether an OFTO would have to pay the delay charge where the delay has been caused by circumstances or events beyond their control. We are currently minded to explore what additional arrangements may be required to differentiate between delays caused by a force majeure event beyond the reasonable control of the OFTO and delays caused by events or circumstances that are within the OFTO's reasonable control.

5.29. We invite views from stakeholders about what, if any, additional arrangements may need to be put in place to address force majeure related cost overruns or delays during the construction phase.

6. Refinancing Gain Share

Section summary

This section explores whether we should expand the existing refinancing gain share mechanism to cover the conversion of equity to debt or the sale of equity.

Questions

Q8. Should we expand the refinancing gain share mechanism to cover the conversion of equity to debt or the sale of equity? How could the mechanism work in principle?

Background

6.1 A refinancing gain share mechanism is stipulated in the current OFTO licence.[26] Under this mechanism, if the OFTO realises any gain from refinancing of its external debt, ie debt provided directly or indirectly by a party who is not a shareholder of the OFTO, the OFTO is required to share 50% of any such gain with consumers.

6.2 This mechanism has not been used by an OFTO in any project to date. This may be due to fact that the risks for operating the asset under the current model have remained stable, and interest rates have remained low over the past decade, leaving little room for the OFTO to refinance at a lower cost.

6.3 Under a late competition OFTO build model, an OFTO's risk profile is likely to change given that the OFTO will be responsible for managing the construction. The risk and financing costs before and after construction will be different than under the current generator build approach. Once construction of the transmission asset is complete, risks associated with construction fall away. We would expect borrowing costs to reduce making it more likely that an OFTO could make a refinancing gain.

Sharing gains from equity

6.4 Whilst we intend to keep the current mechanism that provides for any gains made by the OFTO from refinancing debt to be shared with consumers, we expect OFTOs may gain from equity sale under the OFTO build model. This gives rise to the question of whether gains from equity should be shared with consumers.

[26] See amended standard condition E12–J3 in Generic Offshore Transmission Owner (OFTO) licence for Tender Round 10

6.5 We expect OFTOs to be more highly capitalised, given that they will need additional capital to address the increased level of risk associated with timely delivery and cost increases during construction as explained in previous chapters. Once the OFTO assets are operational, we consider there may be room for investors to increase their leverage by converting their equity into debt.

6.6 Besides, given that the value of equity should have risen with a reduction in risk post construction, investors could realise the capital gain by selling the equity to other investors.

6.7 We see potential benefits for consumers in expanding the current mechanism, specified in the OFTO licence, such that the conversion of equity to debt and the selling of equity are covered by the mechanism.

Potential issues

6.8 We recognise that investors in OFTOs may consider it appropriate to keep any equity gain because they have legitimately earned it by taking the risks associated with construction of the assets.

6.9 As explained in Chapter 4, the OFTO will likely have to arrange insurance, equity, and risk-bearing capital to deal with the risk of delay during construction. The cost of such arrangements will be priced in the TRS bid and borne by consumers. Consumers would also be taking some of the risks inherent in the delivery of the assets, but there is no current mechanism for consumers to benefit, say from a reduced TRS, if the risks for which OFTO has structured the above mitigation measures do not materialise.

6.10 Applying an equity gain share mechanism will encourage investors to hold on to their equity and keep the investment throughout the entire lifecycle.[27] This investment approach might not align with the preference of some investors, particularly those who are more specialised and interested in developing rather than operating infrastructure projects. Expanding the existing refinancing gain mechanism to include equity gain may also discourage some types of investors from participating in OFTO build projects.

6.11 A mechanism for sharing the refinancing gain from equity with consumers is rare in the market, particularly for projects where the public sector has not taken a

[27] ESO has elaborated on this point in the context of onshore transmission network found on page 43 in the Early Competition Implementation – Update published in February 2024.

stake. We are also conscious that there could be practical issues with introducing such a mechanism.

Feedback sought

6.12 We invite stakeholder feedback on whether Ofgem should consider expanding the current refinancing gain share to ensure both the conversion of equity to debt and the sale of equity between investors are covered, and how such a mechanism could work in principle.

7. OFTO build failure during construction

Section summary

In this section, we set out our initial thinking on how the failure of an OFTO business during the construction phase could be addressed. We are seeking views on how a failure scenario during construction could be addressed. Who would be best placed to continue the build? How should the partially completed assets be valued and dealt with?

Questions

Q9. What do you think is the best way to deal with a failure scenario during construction?

Q10. In the event that the appointed OFTO cannot continue with the project, which party is best placed to take the build to completion? How should the transfer value for a partially completed project be set?

OFTO business failure after successful tender exercise

7.1 With the OFTO taking on responsibility for construction following an OFTO build tender exercise, there is the risk of an OFTO business failure or abandonment scenario during construction. Should an OFTO encounter difficulties, this could result in a connection delay to the onshore electricity network for the generator or, in the extreme, asset stranding.

7.2 The 2014 Guidance on the OFTO of Last Resort (**OLR**) Mechanism (**OLR Guidance**)[28] outlines that, in such circumstances, it may be necessary to appoint an OLR after revoking an OFTO licence.[29]

7.3 The appointment of an OLR would only occur should proactive steps by Ofgem to prevent the need for further action and attempts to appoint an OFTO using other regulatory and statutory options fail. This could include enforcement, open market sale/transfer of the assets by the OFTO, Energy Administration or a re-tender exercise.

7.4 Should these initial steps fail or prove to be inappropriate, the structure and duration of an OLR process would depend on when the triggering event occurs.

[28] Guidance on the Offshore Transmission Owner (OFTO) of Last Resort mechanism | Ofgem, paragraph 4.1.

[29] Revocation of an OFTO licence can occur prior to the completion of the construction of the transmission assets in an OFTO build scenario.

While the assets are still under construction the requirements and nature of the process to address an OFTO failure will differ from scenarios where asset construction has been completed.

7.5 After valuation of any assets and commercial contracts under the management of the failing OFTO, a transfer value will need to be determined for the OLR. The appointed OLR would then take responsibility for constructing, owning, and operating the asset.

Unsuccessful OFTO build tender exercise

7.6 In line with the OLR Guidance, where an OFTO build tender exercise fails to appoint an OFTO the generator should be free to construct the transmission assets and take the project through a generator build tender exercise.[30]

Which party is best placed to complete the build in a failure scenario?

7.7 As the OFTO build market in the UK is undeveloped, it may be that in the event of failure another OFTO may not be able to take the build to completion. There may therefore be a case for supplementing the OLR regime, at least until the OFTO build market matures.

7.8 In the event that another OFTO cannot take the build to completion, which party is best placed to complete the build in a failure scenario?

Setting the Transfer Value

7.9 Regardless of which party will be responsible for completing the build following an OFTO build failure scenario, where the originally appointed OFTO is failing, a transfer value for the project would have to be set. This may include the valuation of partially completed assets and contracts yet to be delivered on.

7.10 Before an OLR under the OLR mechanism could be appointed, we would expect to determine an assumed transfer value, reflective of net asset value after regulatory depreciation, with input from the distressed OFTO prior to inviting proposals from

[30] Guidance on the Offshore Transmission Owner (OFTO) of Last Resort mechanism | Ofgem, page 6.

transmission licensees for a transfer. This assumed transfer value may then be revisited after the proposals have been received and before the OLR is appointed.[31]

7.11 Should a party that is not a transmission licensee be responsible for taking the project to completion, we expect that the transfer value would be determined in the same way as it is in the OLR process.

Feedback sought

7.12 We are seeking feedback on the best way to deal with failure scenarios prior to the completion of construction under the OFTO build model. Including:

- Which party is best placed to take a project to completion in a failure scenario?
- How should we approach determination of the transfer value?

[31] The last resort process would commence pursuant to Standard Condition B18 and E21 of the Electricity Transmission Standard Licence Conditions 19 10 2021 (ofgem.gov.uk). These standard conditions are incorporated into the OFTO licences by reference.

Appendices

Appendix 1 – Stages of Tender Process

Stage	Description
Tender Commencement	Under the existing OFTO tender process, Ofgem assesses whether a project meets all the QP requirements and requests information required to satisfy that the Tender Entry Conditions are met. Once Ofgem is satisfied that all conditions are met, a Tender Round can commence.
Enhanced Pre-Qualification (EPQ)	The EPQ stage is the first stage of the Tender Round following tender commencement. Potential Bidders must submit a questionnaire for any Qualifying Project(s) they wish to bid for. The outcome of the EPQ stage is a shortlist of Bidders to proceed to the ITT stage, following application of the evaluation criteria and process set out in the EPQ document.
Invitation to Tender (ITT)	At the ITT stage, the Bidders shortlisted at EPQ stage are granted access to the Data Room relating to the QP for which they have been invited to tender. Bidders make ITT submissions to be assessed by Ofgem and its advisers. The output of the ITT stage is for Ofgem to identify a PB and possibly a Reserve Bidder.
Preferred Bidder (PB)	In the PB stage of the Tender Process, the PB and Developer resolve certain matters to Ofgem's satisfaction for the Preferred Bidder to become the SB. At the start of the PB stage, Ofgem will publish a notice containing, in general terms, the matters to be resolved by the PB.
Successful Bidder (SB)	Following the conclusion of the Section 8A Consultation, and once Ofgem is satisfied that the PB has resolved all the required matters, the PB will become the Successful Bidder for the QP. Following a stand still period, an OFTO Licence is granted and the transfer of assets to the new OFTO takes place.

Appendix 2 – Consultation Questions

Procurement under a late competition OFTO Build

Question 1. Which party should be responsible for procurement in the late competition OFTO build model and why?

Tender process

Question 2. At what point should the OFTO tender process commence? Does option 1 or option 2 present the best approach?

Question 3. Do you agree with the view that, providing stakeholder engagement is properly conducted ahead of consent submission, generators should have a reasonably clear view, at the time of consent submission, as to whether the consent is likely to be granted in the form requested, and that an OFTO would be comfortable to submit tender bids on this basis?

Timely Delivery

Question 4. As compared with commercial liquidated damages, how effective are options 1 and 2 in incentivising timely delivery and managing the risk of delay? Could these options make OFTO build a meaningful option for the generators?

Question 5. How can the OFTO delay charge and consumer underwriting in option 1, as well as the TRS loss in option 2 be appropriately set and executed?

Cost increases during construction

Question 6. Which of the four proposals offers the most suitable option for the treatment of cost increases during construction?

Question 7. What, in your view, is an appropriate calibration for the pain-gain share mechanism outlined in options 3 and 4?

Refinancing Gain Share

Question 8. Should we expand the refinancing gain share mechanism to cover the conversion of equity to debt or the sale of equity? How could the mechanism work in principle?

OFTO of Last Resort

Question 9. What do you think is the best way to deal with a failure scenario during construction?

Question 10. In the event that the appointed OFTO cannot continue with the project, which party is best placed to take the build to completion? How should the transfer value for a partially completed project be set?

Appendix 3 - Glossary

D

DCO

Development consent order

E

EPQ

Enhanced project qualification stage

F

FTV

Final Transfer Value

H

HND

Holistic Network Design

HNDFUE

Holistic Network Design Follow-up Exercise

I

ITT

Invitation To Tender

ITV

Indicative Transfer Value

L

LDs

Liquidated Damages

N

NGESO

National Grid Electricity System Operator

O

OFTOs

Offshore Transmission Owners

OLR

OFTO of Last Resort

OTNR

Offshore Transmission Network Review

P

PB

Preferred Bidder

PQ

Pre-qualification

Q

QP

Qualifying Project

T

TCE

The Crown Estate

TRS

Tender Revenue Stream

Appendix 4 – 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

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, ie a consultation.

4. With whom we will be sharing your personal data

We may share consultation responses with the Department for Energy Security and Net Zero. If you do not wish us to do so, please clearly let us know in your response. Please note that the responses not marked as confidential will be published on our website. Please be mindful of this when including personal details.

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

Your personal data will be held for six months after the project is closed, including subsequent projects or legal proceedings regarding a decision based on this consultation, is closed.

6. 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 3rd 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.

7. Your personal data will not be sent overseas

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

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

10. More information For more information on how Ofgem processes your data, click on the link to our "Ofgem privacy promise".