

Offshore Electricity Transmission: Competitive Tender Process

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Target audience: All with an interest in renewable energy and offshore electricity transmission.

Overview:

Ofgem and DECC are working together to implement a new regulatory regime for offshore electricity transmission. As part of this, offshore electricity transmission licences will be granted on the basis of a competitive tender process managed by Ofgem.

This document sets out Ofgem's proposed approach to managing the tender process for those offshore transmission assets that have been or will be constructed by offshore developers, known as the transitional regime. It also proposes that the broad principles of the approach for the transitional regime would be applied on an enduring basis, where the new offshore electricity transmission licensee would construct the transmission assets.

The regime will be implemented by the commencement of certain provisions of the Energy Act 2004.

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Context

Offshore renewables are expected to make an important contribution to the achievement of the UK's share, when agreed, of the EU target of generating 20 per cent of energy from renewable sources by 2020. It is therefore important that 'fit for purpose' offshore transmission assets are developed efficiently to ensure consumers and generators do not face unnecessarily high charges and that connections are provided at the lowest possible cost through technical innovation. Ofgem and Department for Energy and Climate Change (DECC) are working together to implement a new regulatory regime for offshore electricity transmission, and this document forms part of the ongoing consultation process.

The Government has taken a number of decisions with respect to the development of the offshore electricity regime, including that offshore electricity transmission licences will be granted by way of a competitive tender process, and that the Authority would be the body that runs these tenders. As such, this document specifically sets out Ofgem's proposed approach to managing the tender process for those offshore transmission assets that have been or will be constructed by offshore developers, known as the transitional regime. It also proposes that the broad principles of the approach for the transitional regime would be applied on an enduring basis, where the new offshore electricity transmission licensee would construct the transmission assets. It seeks views on additional issues which may need to be taken into account in tenders in the enduring regime.

Associated Documents

- [Offshore Electricity Transmission - Consultation Letter for Draft Tender Regulations, July 2008](#)
- [Offshore Electricity Transmission - A Joint Ofgem/BERR Regulatory Policy Update, June 2008, Ofgem ref: 84/08](#)
- [Offshore Electricity Transmission - Regulatory Policy Update, January 2008, Ofgem ref: 4/08](#)
- [Regulation of Offshore Electricity Transmission: Government Response to Offshore Electricity Transmission - A Joint Ofgem/BERR Policy Statement, January 2008, BERR ref: URN 08/546](#)
- [Offshore Electricity Transmission - A Joint Ofgem/BERR Policy Statement, July 2007, Ofgem ref: 189/07](#)
- [Offshore Electricity Transmission - Second Scoping Document, March 2007, Ofgem ref: 58/07](#)
- [Regulation of Offshore Electricity Transmission: Government Response to the Joint DTI/Ofgem Consultation on Licensing Offshore Electricity Transmission, March 2007, BERR ref: URN 07/634](#)

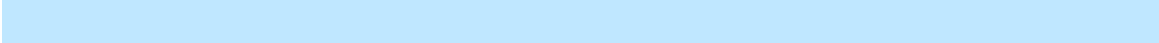
- [Licensing Offshore Electricity Transmission - A Joint Ofgem/DTI Consultation, November 2006, Ofgem ref: 199/06](#)
 - [Offshore Electricity Transmission - Scoping Document, April 2006, Ofgem ref: 60/06](#)
 - [Regulation of Offshore Electricity Transmission - A Joint Consultation by DTI/Ofgem, July 2005, Ofgem ref: 178/05](#)
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Executive Summary

We are working with Government to design and introduce a new regulatory regime for offshore electricity transmission to connect significant amounts of renewable offshore generation to the onshore electricity network. The regime will ensure connection to the onshore grid in a timely and cost effective manner whilst maintaining the integrity of the system as a whole and achieving best value for electricity consumers.

The design of the regime has been consulted on since 2005 and, over that time, the Government has taken a number of decisions that have shaped its direction. This has included that offshore electricity transmission licences will be granted by way of a competitive tender process, and that the Authority would be the body that runs these tenders.

Ofgem has been working on the design of the tender process in the light of the Government's decisions to date and this document sets out in detail how we intend to run the competitive tender process where the transmission assets have been, or will be, constructed by the offshore developer (known as the transitional regime). In particular, we set out how we propose to select bidders from those parties that express interest in becoming an offshore electricity transmission licensee and how we propose to identify the licensee from those parties that submit detailed tenders. The document also considers those issues that we expect we would need to take into account when running competitive tenders for offshore electricity transmission licensees who will be required to construct the offshore electricity transmission assets (known as the enduring regime).

The Government has taken powers in the Energy Act 2004 that enable the Authority to make regulations which are appropriate for identifying the person to whom to grant an offshore electricity transmission licence. Ofgem consulted on the preliminary draft of these regulations in July, and responses received have been taken into account in the design of the tender process as set out in this document. Whilst the regulations would set out the legal framework for the tender process, over recent months we have also been developing detailed tender documentation that would support the process. Our draft template Pre-Qualification and Invitation to Tender documents are published as annexes to this document.

We welcome feedback from stakeholders on all of the issues raised in this document.

1. Introduction

Chapter Summary

This chapter provides the policy context for this document and outlines its purpose and structure.

Questions

There are no questions in this chapter.

Policy Context

1.1. The Gas and Electricity Markets Authority (the Authority) is the regulator for gas and electricity markets in Great Britain and has a principal objective and a number of general duties set out in statute. Ofgem is the office that supports the Authority in performing its duties and functions. The Authority's principal objective is to protect the interests of gas and electricity consumers in Great Britain and wherever possible by promoting effective competition. Where effective competition is not possible, for example where natural monopoly network infrastructure providers exist, we protect consumers by setting incentive based price controls and revenue streams for those providers. We also have a number of other general duties, including a duty to ensure sustainable development and to ensure that the companies' regulated activities take due regard of environmental issues. In this document, "the Authority" and "Ofgem" are used interchangeably. However, in all cases the Authority is the body that has the legal responsibility for exercising any relevant requirements set out in statute.

1.2. We are working with Government to design and introduce a new regulatory regime for offshore electricity transmission to connect significant amounts of renewable offshore generation to the onshore electricity network. The regime will ensure connection to the onshore grid in a timely and cost effective manner whilst maintaining the integrity of the system as a whole and achieving best value for electricity consumers. We have principally regulated existing onshore monopoly networks through a price control method known as "RPI-X" which has encouraged those network providers to increase their efficiency, with the gains shared between the companies and their customers over time. As networks evolve and the demands placed upon them change we have sought to adapt and vary our regulatory process and approach to meet the new challenges. Offshore electricity transmission is one such challenge which provides an opportunity for a different approach.

1.3. It is important that the regulation of offshore electricity transmission networks is considered within the context of the Government's overall energy and environmental policy. The Energy Review¹, and Energy White Paper², and the recent Renewable Energy Strategy³ set out the Government's energy strategy and how it links to its strategy for tackling climate change. It has an aim of reducing carbon emissions in the UK by 60 per cent by 2050, and views the development of renewable electricity generation as an important element in achieving its aim.

1.4. Following The Crown Estate's launch of its leasing process for Round 3 in June 2008, there is now an estimated potential for up to 33GW of offshore generation in UK waters. To enable these new generation projects to connect to the GB onshore grid, the Government has already decided that the principles behind the regulation of the GB onshore electricity transmission network should be extended offshore, except where the specific circumstances of offshore generation mean that changes should be made. In practice this means that:

- Transmitting electricity offshore at 132kV and above will be a prohibited activity without a licence;
- The safe and secure transmission of electricity offshore will be achieved through amendments to the existing system of licences, codes and agreements that govern onshore electricity transmission;
- National Grid Electricity Transmission (NGET), as Great Britain System Operator (GBSO) will be responsible for operating and co-ordinating both onshore and offshore grid connections; and
- The costs of building and operating the new offshore transmission assets will be recovered from generators via NGET's charging methodology⁴.

1.5. In addition to the Government's targets for increasing the share of electricity generated from renewable sources, the Government's policy for the UK energy market is to introduce competition where possible and only regulate where necessary. Since this will be a new licensing regime offshore, with the opportunity for new market players to enter the market, the Government has also concluded that there should be competitive tenders to select the licensed offshore electricity transmission owners (OFTOs) for specific offshore transmission assets.

¹ The Energy Challenge; Energy Review; A Report, July 2006

² Meeting the Energy Challenge: A White Paper on Energy, May 2007

³ UK Renewable Energy Strategy Consultation, June 2008

⁴ NGET is responsible for the charging arrangements for transmission in Great Britain. Following on from previous discussions with industry and a formal consultation, it has committed to completing a full and comprehensive consultation on the offshore charging regime over the coming months, and to provide the Authority with its recommendations in November.

Competitive Tenders for Offshore Electricity Transmission

1.6. In March 2007, the Government announced its decision on the approach for licensing offshore electricity transmission. It concluded that an approach whereby licences were granted on a non-exclusive basis with the right to build, own and operate offshore transmission assets was the most appropriate model. In reaching its decision the Government concluded that this approach would deliver cheaper and timelier grid connections, encourage innovation through competition and enable new entrants to compete in the market, and be more focused on generator's requirements than the onshore system.

1.7. In July 2007, Ofgem and BERR jointly published a policy statement⁵ that set out, among other things, that:

- An OFTO would be responsible for designing, building, financing and maintaining the offshore transmission network. The OFTO would be selected by competitive tender and granted a transmission licence. It would receive a regulated revenue stream for meeting its licence obligations over a predetermined regulated period. The OFTO would be incentivised to meet specified performance requirements during this period; and
- There would be transitional arrangements for projects where the generator is already constructing or undertaking steps towards constructing the offshore transmission assets. The transitional arrangements would apply to projects that met certain pre-defined criteria. To assist the transition to the enduring arrangements there would be a two-stage process to enactment of the new regime. Those two stages would be (i) a 'Go-Active' date for the new regime to enable appropriate modifications to be made to licences, codes and agreements so that tenders can be held, and (ii) a 'Go-Live' date, that would be 12 months later, from which point unlicensed participation in the transmission of electricity offshore at voltages of 132kV and above would be a prohibited activity.

1.8. Following on from this, the Government published a set of further decisions⁶ with regard to the design of the offshore electricity transmission regime in January 2008, in particular that:

- The Authority would be the body that runs the competitive tender process to determine who will be appointed as new licensed OFTOs;
- The Government would seek additional powers in the Energy Bill to enable the Authority to recover its costs of running the tender process, and ensure sufficient

⁵ Offshore Electricity Transmission - A Joint Ofgem/BERR Policy Statement, 189/07, July 2007

⁶ Government Response to Offshore Electricity Transmission - A Joint Ofgem/BERR Policy Statement, URN 08/546, January 2008

commitment to the tender process, from parties participating in the tender (in most cases the generator and potential OFTOs); and

- The Government would also seek time-limited powers in the Energy Bill to enable the Authority, once an OFTO licence has been granted, to make a property transfer scheme in order to ensure that property is transferred from the developer to the successful OFTO in a fair, timely and effective manner. The Authority would only have the power to do so in certain circumstances (which it is envisaged would arise when commercial negotiations fail) and upon application.

1.9. Further consultations have been published since these decisions were taken, setting out further detail on the design of the regulatory regime and the tender process Ofgem would adopt to identify OFTOs. In particular, in July 2008 Ofgem published its preliminary draft of the regulations that would set out the framework for running the competitive tender process. These regulations will be made by the Authority in accordance with section 92 of the Energy Act 2004 (which will insert section 6C of the Electricity Act 1989 when commenced), and enable the Authority to identify, on a competitive basis, the person to whom an offshore transmission licence is to be granted. The offshore electricity transmission licence itself will be granted in accordance with section 6(1)(b) of the Electricity Act 1989, which provides the Authority with the legal scope to grant specified types of licence.

1.10. We received a number of comments from interested parties to this preliminary draft regulations. In particular, a general theme from these was that further detail was needed on the design of the tender process we are intending to adopt. This document provides a further level of detail than has previously been published and we intend to publish a further draft of the regulations later this year which reflects the responses received to the preliminary draft, as well as to this document.

Purpose of this Document

1.11. The main purpose of this document is to set out our proposals for the framework for running competitive tenders in the transitional regime. This includes further detail on the stages in the process, our proposed selection and evaluation strategy as well as the key activities that will be required ahead of a tender round commencing. We are focussing on this part of the overall regime at this time given that we expect to be running tenders on this basis from the Go Active date.⁷ We intend to apply the principles set out in this document to running tenders in the enduring regime. However, we also recognise that there are key differences between the two regimes, and so a chapter is included which sets out, at a high level, our further thoughts on these issues. This chapter also tackles some of the

⁷ We will consider on a case-by-case basis offshore projects that come forward after the Go Active date has passed seeking an OFTO under the enduring regime.

key issues raised by respondents to the joint Ofgem/BERR policy update document⁸, published in June (the June document).

1.12. We are keen to ensure that the tender process we adopt, for both the transitional and enduring regimes, results in fit for purpose transmission investment to connect the anticipated offshore generation that is likely to be seeking transmission connections over the coming years. In designing the regime, we are mindful that in order to ensure the most appropriate outcome for consumers, the process should be designed to be as accessible to as many potential competitors as possible - both current market players and new entrants. We believe that a vibrant and competitive process should ensure that consumers are most appropriately protected through the competitions revealing the most efficient pricing as well as innovation in the market, including the wider supply chain. **To this end, we would welcome views from all interested parties on issues raised in this document and in the ongoing design of the tender process.**

1.13. We have been developing the tender process for the offshore electricity regime with our advisers, including Herbert Smith and Ernst & Young.

1.14. For the avoidance of doubt, this document and its appendices are not intended to form part of any specific tender process that Ofgem will follow for the offshore electricity transmission regime. It merely sets out our proposed framework and current thinking about how we will select and grant licences, and invites comments on this basis. We will consider the responses received and take account of these, as appropriate, in developing and optimising the tender process. Further documents will be issued in due course, providing increased levels of detail in advance of the new regime going active.

1.15. We are developing the tender process for offshore electricity transmission with advice from Herbert Smith and Ernst & Young.

Structure of this Document

1.16. This document has 8 chapters:

- Chapter 2 provides an overview of those offshore generation projects that have indicated that they should meet the necessary pre-conditions to be tendered in the transitional regime;

⁸ Offshore Electricity Transmission - A Joint Ofgem/BERR Regulatory Policy Update, 84/08, June 2008

- Chapter 3 provides an update on Ofgem's current thinking on some of the key issues on the design of the regulatory regime, specifically the revenue stream and incentive framework;
- Chapter 4 sets out the proposed approach for the tender process for the transitional regime;
- Chapter 5 sets out our proposed approach to dealing with those issues that would need to be undertaken ahead of a tender round commencing in the transitional regime;
- Chapter 6 provides an overview of those issues we consider need to be dealt with differently in the enduring regime;
- Chapter 7 summarises the cost recovery powers in the Energy Bill; and
- Chapter 8 provides an overview of the implementation of the tender process and next steps.

Responding to this Document

1.17. This document sets out Ofgem's detailed proposals for the tender process in the transitional regime. We would welcome comments from respondents on all issues raised, although particular issues in which we are seeking feedback are highlighted in the relevant section.

1.18. Responses should be received no later than 14 November 2008. All responses should be sent to:

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2. Transitional Projects

Chapter Summary

This chapter provides an overview of those offshore generation projects that have indicated that they should meet the pre-conditions for tender in the transitional regime.

Questions

There are no specific questions in this chapter.

Introduction

2.1. The offshore electricity transmission regime is primarily geared towards granting new transmission licences for all offshore electricity generation projects connecting at 132kV or above. The majority of these projects will require OFTOs to design, build, finance and maintain transmission assets under the enduring regime. However, there are a number of projects that are either already built, are expected to be under construction or achieve financial close before the regime reaches the 'Go Active' or 'Go Live' dates. We refer to such offshore projects as falling under the transitional regime. We expect to commence tenders in the transitional regime as soon as practicable after the Go Active date. In the June document, we set out that the target date for Go Active was April 2009, followed by Go Live a year later.

2.2. For those projects that fall within these transitional arrangements, the offshore transmission assets will be constructed by the respective offshore developer. The provisions of the Energy Act 2004 will still apply to these projects however, which means that their participation in the transmission of electricity will need to be separately licensed. In keeping with policy decisions to date, there will be a competitive process to identify the licensee, but with a key difference that bidders will only bid to finance and maintain the constructed assets. This means that OFTOs in the transitional regime will not face any construction risk. This differs significantly to the enduring regime whereby the successful OFTO will have responsibility for construction.

2.3. Ahead of Go Active, there are a number of activities that need to take place so that the first tender round can commence as soon as practicable after that date. These include Ofgem establishing ex-ante Regulatory Asset Values (RAVs) for the offshore transmission assets and developers meeting the necessary pre-conditions for the tender round. In our June document, we requested those offshore developers who believed that they would meet the pre-conditions for the transitional regime to provide initial information about their projects. This included:

- Technical Information on the offshore development, including:
 - Capacity,

- Expected onshore connection date,
 - Detail on the extent of pre-construction works,
 - The expected construction start date, and
 - When the developer expects to begin commissioning
- Financial information specifically on when developers expect to reach full financial close or have in place equivalent financial commitment; and
 - The extent to which the developer has obtained or is in the process of obtaining the necessary consents and leases.

2.4. Whilst this was a high level information request, it provided the first opportunity for offshore developers to signal to us the stage they were at in their project development cycle. We consider this a useful starting point to firstly identify the numbers of those projects that are likely to come forward in the transitional regime and secondly to initiate the information gathering needed to establish the ex-ante RAV of the assets. This is discussed in further detail in Chapter 5.

Offshore Project Summaries

2.5. Developers have provided the following high level information about the offshore projects that they expect to be subject to the tender arrangements for the transitional regime. To this end, table 2.1 below lists the projects that may fall within either the first or second transitional tender round, based on the information received from offshore developers.

Table 2.1: Overview of offshore projects likely to be tendered in the transitional regime

<i>Project may qualify for First Transitional Tender</i>		
Project	Developer	Size (MW)
Barrow	DONG Energy/Centrica	90
Robin Rigg	E.On	180
Gunfleet Sands 1 & 2	DONG Energy	172 (in total)
Thanet	Thanet Offshore Wind Ltd	300
Greater Gabbard	Airtricity (SSE)	504
Ormonde	Eclipse Energy Ltd (Vattenfall)	150
Walney Phase 1 and Phase 2	DONG Energy	380 (in total)
London Array	E.On/DONG Energy	1000

Sheringham Shoal	SCIRA	315
<i>Project may to qualify for Second Transitional Tender</i>		
Lincs	Centrica	250
Gwynt-Y-Mor	RWE Npower	750
Docking Shoal	Centrica	500
Race Bank	Centrica	500

2.6. Given that this information has been provided by the relevant project developers, Ofgem cannot verify at this stage that these projects will meet the transitional regime pre-conditions and will be subject to tender under these arrangements. We will be continuing to work with developers over the coming months to understand more about their projects.

3. Overview of Regulatory Regime

Chapter Summary

This chapter provides an overview of the regulatory regime that would apply to the offshore electricity transmission regime. Where appropriate, it sets out our current thinking on issues that we believe would be beneficial for stakeholders to take into account when considering the tender process, such as the licence term, the revenue stream (including adjustments) and performance incentives.

The issues outlined in this chapter will be consulted on in more detail through a document we intend to publish jointly with DECC shortly.

Questions

There are no questions in this chapter.

Introduction

3.1. The key purpose of this document is to consult on our proposed tender process, principally for the transitional regime. However, we recognise the importance of providing stakeholders with a short background on the key commercial proposals that would apply to OFTOs. As such, this chapter sets out a brief summary of our current thinking on relevant aspects of the design of the regulatory framework for offshore electricity transmission, updating where relevant the proposals put forward in the Joint Ofgem/BERR Regulatory Policy Update published in June.

3.2. While the issues set out in this chapter are ones for the Authority to decide upon when granting licences to successful bidders, in order to ensure that as clear a picture as possible of the overall regime is provided, we will be consulting in detail on the design of this regime in a joint document (the joint document) with DECC shortly. The joint document will also cover updated proposals on changes to codes and licences to implement the new regime. Stakeholders will be consulted on the fully described policy positions that are summarised in this chapter through the joint document. As such, this chapter is for information only as any new proposals set out here will be consulted upon in the joint document.

Summary of Key Proposals

3.3. In summary, the key proposals for the regulatory regime for offshore electricity transmission are:

- The Authority would grant a transmission licence that would remain in force until revoked, through a competitive tender process;

- OFTOs would bid and be awarded a revenue stream for an initial period of 20 years, with limited regulatory intervention. However, the Authority would reserve the right to award a revenue stream of a shorter duration where a competitive tender process has not been fully effective;
- At the end of the initial 20 year period, the Authority would consider, on a case by case basis and taking into account generator wishes and consumers' interests, setting a revenue stream for a further period either by undertaking a regulatory review or undertaking a further tender exercise;
- OFTOs would face an asymmetric incentive for operational performance for failing to deliver against the target level of performance;
- OFTOs would be allowed, at the discretion of the Authority to accommodate incremental investments in offshore assets of a value of up to 20 per cent of initial capital cost, without a retendering process;
- There would be regulatory reporting requirements in place; and
- The regulatory regime would be subject to any relevant requirements of EU legislation.

3.4. The key commercial issues are elaborated on further below. We believe that these will be of particular interest to stakeholders at this time when considering the proposed tender process as they would be dealt with in certain special conditions of the offshore electricity transmission licence, which may to be the subject of some potential negotiation with bidders during the tender process. This is discussed further in Chapter 4.

The Revenue Stream

Period of revenue stream

3.5. Our position remains that an OFTO, selected by competitive tender, would bid and receive a regulated revenue stream for 20 years subject to the OFTO meeting its licence obligations, including performance obligations. This was proposed in the June document.

3.6. In the event that a tender is not sufficiently competitive, a revenue stream would be granted that would be consistent with the 20 year period, but rather than providing a 20 year commitment the Authority reserves the right to review the level of that revenue stream at predefined intervals over that period (i.e. adopt a traditional price control review approach). This will allow us to analyse and evaluate the costs and revenues of the OFTO and reflect these in an updated revenue stream. If an OFTO was not willing to accept the modified revenue stream, Ofgem could refer the case to the Competition Commission.

Licence grant and the revenue stream

3.7. In both the transitional and enduring regimes, we are proposing that the offshore electricity transmission licence would be granted once the preferred bidder has satisfied a number of issues to the Authority's satisfaction. However, we would only intend that the revenue stream would be activated once the transmission assets have been constructed and been confirmed as fit for purpose. Further detail on this is set out on this issue in Chapter 4.

End of regulated revenue stream

3.8. Where there is a demonstrable ongoing need for the assets beyond the 20 year revenue stream, we remain of the view that the Authority should determine the most sensible course of action (extension or retender) taking into account its statutory duties at that as well as the needs of the generator.

3.9. A mechanism for ensuring that the transmission of electricity can continue beyond the end of the initial revenue stream is being determined through the regulatory regime consultation process. This will be included in the joint document.

Adjustments to the Revenue Stream

3.10. We outlined in the June document that we were considering whether adjustments were needed to the revenue stream to take account of unknown costs or savings that may arise in the future. These were broadly defined as;

- 'unknown unknowns' i.e. unpredictable and uncertain costs and savings that may emerge over the licence period; and
- 'known unknowns' i.e. predictable but uncertain costs and savings that may emerge over the licence period.

'Unknown Unknowns'

3.11. Our position remains that as stated in the January 2008 and June 2008 consultation documents. We will not provide pre-defined mechanisms (e.g. event specific re-openers) to adjust the regulated revenue stream, either up or down, for unexpected changes in costs during operation arising from exceptional events. Possible adjustments to the revenue stream for exceptional events will be made on a case by case basis, in line with the Authority's statutory objective and general duties at that time.

'Known Unknowns'

3.12. Following stakeholder responses to the June document our thinking on some of the possible adjustments for 'Known Unknowns' has developed further. We recognise that the proposed 20 year revenue stream provides strong incentives to manage costs efficiently, but also increases the exposure of licensees to regulatory and macro-economic risk. We consider that OFTOs may not be best placed to manage such risks and therefore we need to consider further how risks might be reallocated. This will be set out in the joint document for further consultation.

Indexation

3.13. We suggested in the June consultation that we saw some merit in arguments put forward on the indexation of the revenue stream to the inflation rate. We are minded to index the revenue stream to RPI to allow for cost inflation over the period of the revenue stream. However, we have not concluded whether to fully or partially index the revenue stream. Our current thinking is that this should be the only indexation mechanism. We will consult on this in the joint document.

Refinancing

3.14. In the June document we noted that an adjustment mechanism for refinancing may be beneficial. Our current thinking is that there may be a case for including an automatic adjustment mechanism for refinancing costs/savings and will be consulting further on this issue through the joint document.

Incremental capacity increases

3.15. We set out our view on the treatment of incremental capacity increases in both our January and June documents. Our proposal remains that an appointed OFTO be allowed to alter investment up to a value of 20 per cent of the initial capital cost over the life of the offshore transmission systems without being subject to a further tender exercise. However, in practical terms, it will be for Ofgem to make the decision on whether or not the investment falls within this threshold. A revenue adjustment would be put in place to take account of the efficient costs (including profit margin) of constructing and operating the additional capacity. Further details on this issue will be set out in the joint document.

Other volatile and unpredictable costs

3.16. We expect to allow business rates and licence fees to be cost pass through items. We do not consider that there are any other items that should be considered for pre-defined adjustments at this stage, although we will be consulting on this further through the joint document.

Performance obligations

3.17. Several OFTO performance incentive schemes have been considered in previous consultation documents on the offshore electricity transmission regime. Our current thinking for incentive schemes is outlined below.

Capacity delivery incentives

3.18. In the June document, we proposed a capacity delivery incentive would be appropriate to ensure that transmission assets are constructed on time. Our thinking has changed on this issue, and we are now of the opinion that a capacity delivery incentive will not be necessary in the enduring regime. We consider that the commercial incentive on OFTOs should be sufficiently strong given that the revenue stream will not commence until the assets are constructed. We also do not consider that this is a necessary incentive for the transitional regime. Further details will be set out in the joint document.

Operational incentives

3.19. We remain of the view that we have set out in both our January and June documents that an operational performance incentive would be highly beneficial to encourage suitable availability of the offshore transmission assets. Our current thinking in this area is that the default availability target should be 98 per cent, and that an OFTO should have up to 10 per cent of annual revenue exposed to this incentive. We will be consulting on this in further detail through the joint document.

Late delivery of onshore transmission assets

3.20. One further risk faced by a potential OFTO is that the onshore TO will not complete their assets in time for the OFTO assets to be commissioned at the date originally proposed. We are currently considering whether it would be appropriate for the onshore TO to make late delivery payments to the OFTO and how such a mechanism would work in practice. Without such a mechanism, this risk would be borne by the OFTO. With a mechanism such as this, the risk would be passed to the onshore TO. It would not be appropriate for the onshore TO to then pass these costs onto consumers. We will consult on these possibilities as part of the joint document.

4. Tender Process in the Transitional Regime

Chapter Summary

This chapter provides a detailed explanation of the tender process Ofgem intends to adopt to select OFTOs for the transitional regime. It builds on what we have published previously, taking into account stakeholders' feedback, as well as further analysis

The chapter refers to our draft template Pre-Qualification and Invitation to Tender documents. These are located in Annexes 1 and 2 to this document.

Questions

We welcome feedback from stakeholders on all of the issues raised in this chapter. In particular, responses are requested on:

- the extent of information that should be requested at the Pre-Qualification and Invitation to Tender stages;
- the extent of information we propose should be available to bidders;
- our proposed approach to selecting bidders;
- our proposed approach to identifying the preferred bidder;
- our proposed approach to dealing with bids for multiple offshore projects;
- our draft template Pre-Qualification Document, particularly whether any further or alternative questions need to be considered in the Pre-Qualification Questionnaire; and
- our draft template Invitation to Tender document

We would also be interested to receive stakeholders' views on the practical application of this proposed approach.

Introduction

4.1. We have consulted on the design of the tender process for the offshore electricity transmission regime for over a year, and the process has been refined significantly over that time. Furthermore, the Government confirmed in January 2008 that Ofgem was the most appropriate organisation to manage the tender process to identify the parties to be granted offshore electricity transmission licences. Since then, Ofgem has:

- Continued to develop a robust and transparent tender process, with draft template tender documentation, taking into account stakeholder feedback; and
- Developed and published a preliminary draft of the tender regulations, which will provide the legislative framework for the tender process. These will be made in accordance with section 92 of the Energy Act 2004, once that section is commenced.

4.2. This chapter sets out in detail how Ofgem proposes to manage the tender process for granting offshore electricity transmission licences. We are focusing on the transitional regime in this document given that as soon as practicable after the Go Active date, we intend to commence tenders for transmission assets that have been or will be constructed by the offshore developer. A proposed timeline for the process is provided in Appendix 2.

4.3. We intend that the key features of the tender process as described should also broadly apply in the enduring regime. However, certain details of the process will differ given that in the enduring regime, OFTOs would be required to construct the transmission assets as well as operate and maintain them over the regulatory period. Chapter 6 sets out some of the key issues we consider need to be taken into account in the enduring regime.

Design of Process

4.4. Ofgem's proposed tender process for the offshore transmission regime has been developed in accordance with our Better Regulation duties which include principles of transparency and consistency⁹, and also best practice from other similar processes. For example, we have considered in detail the experience of the Private Finance Initiative (PFI) approach the Government has used to involve the private sector in the provision of key public sector services. We have also considered and reviewed the experience of Ofcom in its spectrum auctions process and the Department for Transport's rail franchising model.

4.5. We consider that the process described in this chapter should lead to the identification of OFTOs for transitional projects in a timely and efficient way. It is important to note however that whilst we have considered best practice from a number of similar processes in coming to our current view, we are designing a process that is unique to the electricity industry, in particular the way in which the Authority issues licences. As such, the process described is unlikely to be identical to other processes stakeholders have participated in. In the light of this, we recognise that the process described in this document will need refining over the coming months, and we would encourage continued stakeholder engagement.

⁹ Section 3A(5A) of the Electricity Act 1989

Transitional Tender Process Overview

4.6. In summary, the tender process to identify an offshore electricity transmission licensee is proposed to follow a number of distinct stages:

- A pre-qualification stage, which would enable Ofgem to select those parties (including consortiums) that it would invite to bid for each project in the tender round based on detailed responses to the Pre-Qualification Questionnaire (PQQ);
- An invitation to tender stage, during which bidders would have the opportunity to put forward their detailed proposals for providing transmission services, including their firm bid revenue stream for the 20-year regulatory period;
- An optional best and final offer stage, where a small number of bidders would have the opportunity to put forward an improved final bid;
- The identification of the preferred bidder¹⁰ and reserve bidder;
- The licence grant stage, where the Authority would grant the offshore electricity transmission licence to the preferred bidder, subject to it satisfactorily completing any outstanding issues required by the Authority.

4.7. In addition to these stages, there will be a need for a number of activities to take place ahead of any tender round, including establishing the ex-ante RAV for the transmission assets, and for the developers to meet the necessary pre-conditions. These additional issues are covered further Chapter 5.

Pre-Qualification Stage

4.8. The main purpose of the pre-qualification stage is to enable all interested parties to express interest in becoming an OFTO for particular projects, through the completion of the PQQ and the returning of other relevant documentation. Ofgem's role will be to assess the responses received, and identify in a robust and transparent way those applicants it considers appropriate to invite to tender. This shortlist of bidders will be those parties that Ofgem considers could be offshore electricity transmission licensees, based on the information provided at that time.

4.9. This section sets out our proposed approach to pre-qualifying those parties that express interest in the offshore generation projects (offshore projects) in the transitional regime. Annex 1 to this document also provides our draft template Pre-Qualification Document (PQD). This includes:

¹⁰ The preferred bidder may be identified either after the invitation to tender stage or the best and final offer stage

- The PQQ; and
- Detailed instructions on the requirements of response.

Advertising projects

4.10. Our proposals for the pre-qualification stage are designed to identify those applicants who would be invited to tender for each offshore project. In order to attract sufficient interest in the projects, as soon as practicable after the Go Active date, we intend to formally advertise all those offshore projects that have met the pre-conditions in advance of Go Active, and that have applied to Ofgem to identify an OFTO in that round. We would expect to advertise in relevant national and international publications, as well as on our website.

4.11. It will be important that Ofgem selects bidders on the basis of robust and detailed information, and we have designed a PQQ to identify the most appropriate applicants to take forward to the next stage of the competition on this basis. This PQQ would be available on Ofgem's website from the date the advertisement is issued, as part of the PQD. We intend that there is one common PQD issued per tender round in the transitional regime, covering all of the offshore projects that are subject to tender at that time.

Information available

4.12. At the pre-qualification stage of the competition, we recognise that applicants will need enough information so as to provide sufficiently detailed responses to the PQQ. We would expect that this would include:

- High level information about each offshore project that is included in the tender round (such as capacity and location);
- Ofgem's ex-ante RAV assessment, which will form the guide price to the competition;
- The prevailing industry legislation and governance requirements, including codes, technical standards and transmission licences (i.e. the Standard Industry Framework); and
- The selection and licence grant process in place for that tender round.

4.13. We would expect this to be predominantly available in the Pre-Qualification Document. However, information relating to industry codes and standards would be available from each code owner, as is the case currently.

Requirements of response

4.14. We propose that responses should be submitted within a reasonably short period of time after the advertisement is issued, for example within 2 months. We

consider that this should allow applicants sufficient time to develop detailed responses to the questions set out in the PQQ, whilst at the same time ensuring that the process is not unnecessarily drawn out.

4.15. In addition to returning the completed PQQ within this timeframe, a key element of the response would also be that applicants acknowledge a willingness to accept the project requirements, should they be invited to tender. This would include:

- Compliance with the standard conditions of the offshore electricity transmission licence;
- Compliance with project operation and performance requirements (which would be included with the high level information about the offshore project);
- Compliance with relevant decommissioning requirements;
- Compliance with the industry codes and technical standards; and
- Acceptance of tender rules

Applications for more than one project

4.16. We expect that there will be a number of offshore projects that will meet the pre-conditions for the transitional regime in advance of the Go Active date. Ofgem has set out in previous consultation documents and in public forums that we see no reason why an OFTO should not be able to operate and maintain the transmission assets for more than one offshore project. Indeed, we recognise that there may be significant benefits to this, for example in terms of the economies of scale that might be achieved in maintaining the asset infrastructure for multiple projects or obtaining insurance for these. We therefore propose that applicants would be able to identify, in their responses to the PQQ, each project for which they are interested in becoming an OFTO. Ofgem would select the bidders for each project based on their responses to the PQQ and where an applicant is successful for more than one project, they would be invited to tender for each. If an OFTO was successful in winning more than one tender in a round, we would expect to issue that party a separate licence for each transmission system.

Selection criteria and process

4.17. Ofgem's key principle for the pre-qualification stage is to assess whether the applicant meets the minimum criteria required to bid. The tender process has been structured to enable both existing market participants and potential new entrants to be able to express interest (and bid if successful at this stage). We consider that facilitating the widest possible competition will be in the best interests of consumers, both now and in the future.

4.18. Against this background, our proposed selection process for the pre-qualification stage is set out below. We are committed to ensuring a transparent process, taking decisions based upon the evidence submitted by applicants in their documented responses. In instances where other information is available or comes to light during the selection (or indeed the grant process), Ofgem reserves the right to take this into account in its decision making processes. At all times, the Authority's decisions will be taken in accordance with its principal objective and general duties as set out in the Electricity Act 1989.

4.19. We propose that the PQQ selection process is conducted over two parts.

Part 1

4.20. In order to pass Part 1 of the selection process, applicants would be required to meet certain minimum standards and to have fulfilled the requirements of the response. We propose that these are that the applicant:

- a. Has submitted a complete and compliant response to the PQQ; and
- b. Meets minimum compliance and legal eligibility criteria (including confirmation that the applicant is not prohibited from participating further in the competition).

4.21. If these minimum standards and requirements of response are not met, Ofgem proposes that it would not undertake the detailed assessment (i.e. Part 2). However, in order to avoid a situation where a minor omission or administrative deficiency in a submission invalidates an otherwise acceptable response, we intend to check responses soon after the response deadline. We propose that a response checklist is then returned to each applicant with an opportunity, if needed, to remedy any deficiencies within a short period of time, for example within 48 hours. We do not propose to exercise any judgement at this stage as to the quality of the submission in relation to the selection criteria.

Part 2

4.22. All applicants that pass Part 1 of the selection process would then be assessed against clear and objective criteria by Ofgem's Tender Panel¹¹. At this stage, we propose that, for the transitional regime, these are:

¹¹ Ofgem proposes to establish a Tender Panel to make key recommendations to the Authority on the grant of OFTO licences. This includes making recommendations at the selection and grant stages of the tender process. The remit of the Tender Panel would be set out clearly in the tender documentation.

- a. The extent of evidence of a suitable ownership structure for the OFTO, demonstrating that there is an efficient and legally robust decision-making process for the management of the proposed organisation, specifically identifying any potential conflicts of interest;
- b. The extent of evidence of a suitable approach for financing the OFTO, demonstrating adequate financial standing and an understanding of the investment economics;
- c. The extent of evidence of suitable management capability for operating the OFTO, demonstrating infrastructure management experience, stakeholder management experience and delivery assurance; and
- d. The extent of evidence of relevant technical and specialist capability for OFTO operation, including but not limited to:
 - o Evidence of an understanding of the key Health & Safety requirements (including policies and experience); and
 - o Evidence of an understanding of key environmental requirements.

4.23. We have developed these criteria and a robust process of assessment so as to give confidence to applicants that they are entering a fair and transparent process. The draft PQQ has been developed so as to enable all applicants to provide sufficiently detailed responses and evidence to demonstrate these requirements.

4.24. We propose that Ofgem's Tender Panel selects bidders for each project based on responses to questions in these areas. In instances where there are a large number of applicants that pass the Part 1 threshold, it will be important to ensure that the number selected to bid for each project are limited to an efficient number. This needs to give sufficient confidence to bidders that it is worth their while to incur the costs of preparing a bid for an offshore electricity transmission licence. It will also be important to ensure that the process is manageable and leads to Ofgem being able to make timely decisions in an efficient manner.

4.25. We envisage that bidders would incur significant costs at the ITT stage, including undertaking detailed due diligence on their proposed investment. In order to ensure an efficient tender process for all parties, we propose that the Tender Panel ranks the submissions received based on the evidence submitted by the applicants. At this stage, we propose to limit the number invited to tender for each project at up to four. Depending on the quality of responses received, we would potentially re-run this stage of the process, or seek further information from applicants.

4.26. Those applicants that are selected to bid for a project through this process would be notified of their success by Ofgem, and provided details of the next stage of the competition. Those applicants that are unsuccessful would also be notified, and offered feedback on their response.

4.27. We would welcome views from stakeholders, especially potential bidders, on this approach.

Invitation to Tender Stage

4.28. The main purpose of the Invitation to Tender stage is for Ofgem to identify the preferred bidder for each offshore project in that tender round. Where this is not possible from the initial tenders received, Ofgem may request that a small number of bidders submit a best and final offer so that a preferred bidder can be identified.

4.29. This section sets out our proposed approach to running the bid stage of the tender process in the transitional regime. It includes further detail on the information that we would expect to be available to bidders, the requirements of response and our proposed approach to evaluating bids (including where a best and final offer is sought). Annex 2 to this document also provides our draft template ITT documentation. This includes:

- An overview of the generation project¹²;
- Rules of the competition going forward;
- An overview of the regulatory and contractual framework relevant to electricity transmission;
- An outline of the OFTO's key technical and commercial obligations (including in respect of the standard industry framework documents);
- Detailed instructions on the requirements of response; and
- Guidance on the data room contents and access arrangements.

4.30. We propose to issue an ITT document for each project to those bidders that were successful at the PQQ stage for that project, inviting them to provide their detailed bids. For example, if Applicant A was successful at the PQQ stage for Project X, it would be invited to tender for this project. If it were also successful at the PQQ stage for project Y, it would be invited to tender for that project as well, via a separate ITT document.

¹² Note that this section can only be fully populated once Ofgem has further information from offshore developers.

Information available

4.31. We recognise that bidders will need a significant amount of information about the project and the relevant transmission assets if they are to provide a sufficiently detailed bid. We expect that this will predominantly be information provided by the offshore developer, but will also likely include the standard industry documentation, the standard conditions of the offshore electricity transmission licence and relevant information from NGET in its capacity as System Operator.

Information from the developer

4.32. We consider that the information provided by the developer should be sufficient to enable the bidders to undertake a full due diligence exercise, and so at this stage we consider that at a minimum this should include:

- all contracts, consents, leases, warranties and guarantees relating to the transmission assets (including the Connection Agreement the developer holds with NGET or an electricity distribution licensee);
- details of all assets and liabilities relating to the transmission project;
- the investment and operation plans for the transmission project;
- relevant seabed surveys; and
- evidence of compliance with applicable legislation, regulations and industry governance arrangements.

4.33. One of the pre-conditions for entry into a tender process is that the offshore developer has agreed to populate a data room to Ofgem's satisfaction. In addition to providing information about the assets, we would also expect that the developer provides its complete terms of transfer for the transmission assets and associated contractual information, and make this available in the data room. We consider that this is necessary so that bidders can bid effectively, and in the full knowledge of the risk profile of the arrangements. For the same reasons, it will also be important that these terms are fully understood so that we can undertake the RAV assessments.

4.34. It is important that bidders have confidence that the information provided is full and complete. As such, we also propose that developers are required to provide a written warranty to the bidders in respect of the suite of information in the data room, and confirm that they have held discussions with counterparties to the guarantees and warranties for the assignment of these upon transfer.

4.35. As the bid stage of the competition unfolds, we expect bidders will be seeking points of clarification about the information provided by a developer, as well as other queries about the project. It will be important for the transparency of the competition that questions and responses are managed in a structured way and Ofgem intends to be the hub for these. This would mean that all points of

clarification are requested through Ofgem, with responses made available to all bidders via the data room, subject to any commercially confidential issues.

Standard framework documentation

4.36. The regulated electricity industry has developed over many years and operates under a structured framework. This means that Ofgem would largely be taking decisions on the determination of the identity of a preferred bidder within existing industry rules. Given a large part of the framework is pre-defined and non-negotiable, bidders would need to understand and then accept the requirements of the key relevant documents in formulating bids. It is important therefore that bidders are aware of these documents. They include:

- The standard conditions of the Electricity Transmission Licence;
- The Grid Code;
- The System Operator- Transmission Owner Code (STC);
- The Connection and Use of System Code (CUSC);
- The Balancing and Settlement Code (BSC);
- The Distribution Code;
- The Distribution and Use of System Code (DCUSA); and
- The Great Britain Security and Quality of Supply Standard (GBSQSS)

4.37. As part of the bidder's commercial proposal, they would be required to confirm their acceptance of the relevant requirements of these standard documents¹³. Bidders would also be required to accept the developer's terms of transfer, without amendment, for the project as part of their commercial proposal.

¹³ The Government took powers in the Energy Act 2004 that enables the Secretary of State to direct changes to industry codes and the standard conditions of the electricity transmission licence that he considers appropriate for purposes connected with offshore electricity transmission. To this end, Ofgem and DECC have (and will continue to) jointly consult on the necessary modifications to these documents. We expect that these modifications will be directed once section 90 of the Energy Act 2004 has been commenced, which will be in advance of the Go Active date. The initial consultation on amendments to the standard framework took place in June 2008 (and closed in August 2008) and a further consultation is expected shortly.

Other information

4.38. In the transitional regime, we do not consider that there will be a need for significant information to be provided by NGET at the outset of the process. However, we do expect that bidders will seek clarification on issues as the process unfolds, such as the programme of construction works (if the assets are not constructed at the time of the tender) and on those parts of the standard industry framework that are owned by NGET. Similarly to the process set out above in respect of interactions with the developer, we propose that Ofgem acts in a hub capacity, managing questions and responses in a structured way so as to ensure that all bidders have access to the same information. This is discussed in more detail in Chapter 6.

Data room

4.39. Ofgem proposes that all relevant information will be available to bidders for each project in a secure electronic data room. Only those bidders that have been selected to bid for a particular project will have access to the data room, and access arrangements will only be provided once the bidder has entered into a Confidentiality Agreement with Ofgem.

4.40. At this stage, we propose to require bidders to enter into one overarching Confidentiality Agreement that covers all members of the bid group, including subcontractors and consortium members (where appropriate). This should result in a lesser administrative burden for all parties, but afford the same protection, as the situation where all members enter into individual agreements with Ofgem. **We would welcome views on this.**

4.41. We would welcome feedback on the package of information that we expect to be available for bidders during the bid stage of the competition. In particular, we would welcome feedback on whether, and how, site visits could be accommodated within the proposed tender process.

Requirements of response

4.42. We propose that bidders would be given a reasonable amount of time to respond to the ITT, which at this stage we expect to be up to four months. This would allow bidders to develop detailed proposals, including the firm bid revenue stream that we would require. The draft template ITT document sets out in detail what we expect bidders to submit in terms of a compliant response, but in summary it would need to include the following sections:

- a. Executive Summary;
- b. Technical proposal (including its approach to operating and maintaining the assets over the regulatory period);

-
- c. Financial proposal (including its complete bankable¹⁴ financial model, populated input sheets for Ofgem's reference financial model, insurance proposals and most importantly its firm bid 20-year revenue stream); and
 - d. Commercial proposal.

Evaluation strategy and process

4.43. The main aim of the ITT stage is to identify the most economically advantageous bid for each offshore electricity transmission licence. In the transitional regime, we consider that satisfaction of this will largely be based on the firm 20-year revenue stream that bidders' bid in their detailed responses. However, it will also be based on our assessment of bidders' ability to manage and deliver the required electricity transmission services. This section sets out Ofgem's proposed approach to evaluating bids in the transitional regime.

4.44. Similarly to the PQQ stage, we propose that the assessment of the bid shall be conducted over two parts.

Part 1

4.45. In order to proceed to the detailed evaluation, bidders would need to demonstrate that they have met certain minimum standards and fulfilled the requirements of response. At this stage of the competition, we propose that this part would be demonstrated by the bidder:

- a. Submitting a complete and compliant response to the ITT;
- b. Providing a declaration that it accepts the generator's performance requirements; and
- c. Providing a firm and binding commitment to undertake the investment (with evidence of the appropriate corporate approvals).

4.46. If these minimum standards and requirements of response are not met by a bid, Ofgem proposes that it would not undertake the detailed assessment (i.e. Part 2) of that bid. However, in order to avoid a situation where a minor omission or administrative deficiency in a submission invalidates an otherwise acceptable response, we intend to check responses soon after the response deadline. We propose that a response checklist is then returned to each applicant with an opportunity, if needed, to remedy any deficiencies within a short period of time (e.g.

¹⁴ Bidders will be required to submit the financial model which has been used by the bidder's financiers to assess the viability of the project and by which the bidder has secured its finance.

within 48 hours). We do not propose to exercise any judgement at this stage as to the quality of the submission in relation to the evaluation criteria.

Part 2

4.47. All bidders that have provided a compliant bid would be assessed to establish the most economically advantageous bid. At this stage we consider that, for the transitional regime, the key factor in our evaluation strategy should be the firm 20-revenue stream bids received as part of the financial proposal. As long as the bidder has demonstrated through its technical proposal a suitable approach for operating and maintaining the assets over the regulatory period, can demonstrate it has put in place a suitable ownership structure and confirms its approach to dealing with corporate issues such as Health & Safety requirements, we believe that identifying the preferred bidder on the basis of the 20-year revenue stream is in the best interests of consumers. We also believe that this would be in the best interests of the offshore generators, as ultimately the regulated revenue stream would feed through into its transmission charges.

4.48. In order to support the firm 20-year revenue bid, we would require bidders to provide their detailed bankable financial model. Whilst we are still developing our detailed thinking in this area, we expect that as a minimum, bidders' models would be required to set out projected and historic information including:

- Profit and Loss Statement or Income Statement;
- Cash Flow Statement;
- Balance Sheet; and
- Key Accounting Ratios¹⁵

4.49. The draft template ITT document appended to this document contains more information on the proposed requirements of bidders' models. Where bidders are entering bids for more than one project, they would be required to provide one model per project.

4.50. In addition to the bidder's own model, we also intend that bidders complete input sheets for Ofgem's reference financial model. This model would be used as a benchmarking tool to assist in the evaluation of bids. Ofgem published draft input sheets with its January 2008 consultation document. Whilst these are currently being updated, we expect they would request information in a number of key areas, including:

¹⁵ Including but not limited to gearing, interest cover and Return on Capital Employed.

- General finance data;
- Capital expenditure data;
- Financing data; and
- Revenue data

4.51. Similarly to the bidder's model, the draft ITT template document contains more information and guidance for the completion of the input sheets.

4.52. We would welcome views from stakeholders, especially potential bidders, on this approach.

Bids for more than one project

4.53. We confirmed above that bidders would be able to submit bids for more than one project, where the bidder has pre-qualified for multiple projects. It will be important however that bids are provided on a single project basis so that Ofgem can compare these on a robust and transparent basis. This would mean that detailed responses, including separate financial models, must be submitted for each project the bidder is bidding to become an OFTO for.

4.54. We propose that bidders would also be able to submit a variant bid for any combination of projects for which it has pre-qualified. We would expect that this additional bid would allow bidders to demonstrate any potential savings that would become apparent through any economies of scale that might be achieved, for example in the operation and maintenance of more than one transmission system or obtaining enhanced financing terms for multiple projects. However, we also propose that any additional bid must identify the 20-year revenue stream for each project within that bid, so that we can compare bids against our key criterion in a robust way. We consider that this is a fundamental feature of allowing additional bids, because it would allow us to identify the most economically advantageous bid for each project.

4.55. By way of example, if Bidder A has pre-qualified for Projects X, Y and Z, a compliant response would be one where it submits a bid for each project separately. It would also be open however for Bidder A to submit an additional bid that sets out adjusted revenue stream bids that take account of any economies of scale it might achieve if it were to be granted more than one licence. So, if Bidder A bids for a combination of projects X and Y, it would need to submit a bid identifying a firm revenue stream for both Project X and Y, taking into account the savings it can achieve if it were to get both licences. Given our proposed evaluation strategy for the transitional regime, we would then evaluate these on the basis of the firm bid revenue streams for this combination bid. If it provided the most economically advantageous for each project relative to the other bids received for these projects, Bidder A would be identified as the preferred bidder for both Projects X and Y. This

principle would be extended to any combination of projects for which a bidder has pre-qualified.

Bid clarification and negotiation

Bid clarification

4.56. As set out earlier in this chapter, much of the regulatory framework is provided for in standard documents, such as the industry codes and standard licence conditions of the offshore electricity transmission licence. We have also set out that bidders must accept the developer's terms of transfer in its bid proposal. In the light of this, there is little scope for bidders to request changes to these documents. Furthermore, generator requirements and the OFTO/GBSO relationship (including onshore connection arrangements) are also pre-defined. As such, we expect bidders' responses in this area to focus on issues of clarification.

Negotiation

4.57. The only area of potential bid negotiation that we might expect from bidders is with respect to the special conditions of the offshore electricity transmission licence being bid for, which specifically cover the revenue allowances and performance incentives, and which may be adjusted by Ofgem for each tender. However, even in this area, we anticipate limited negotiation given the extent of our existing consultations which seek to identify default positions for revenue adjustments and performance obligations (see Chapter 3 for further information).

4.58. In the light of this, we recognise that in the post-bid receipt period it may be necessary for Ofgem to enter into a period of structured discussions with bidders to explore potential benefits that could be obtained through any alternative solutions that are offered in this area. This would be an important process to explore whether a potential solution would be in the best interests of consumers and relevant generators, as well as to ensure that all bids are as closely matched as possible to enable Ofgem to evaluate in a robust way.

4.59. Whilst to a large extent these discussions would be dependent on the issues raised in the bids received for a particular project, we consider it important to set out how Ofgem would intend to facilitate these. Overall, we propose to allow all bidders up to 3 structured meetings with Ofgem in the post bid period. These discussions would be structured around the bids submitted and would provide an opportunity for both the bidder and Ofgem to explore whether there may be some improvements to the bids in certain areas, for example in respect of the risk-sharing arrangements set out in the draft special licence conditions for a particular project. They would also enable Ofgem to understand any differences in the bids submitted and how these might be taken account of to ensure that all bids are assessed on a like-for-like basis.

Best and final offer

4.60. Where Ofgem considers it appropriate and necessary, we propose to ask a limited number of bidders to come forward with a best and final offer (BAFO), which may be based on the issues discussed in the negotiation meetings referred to above. Ofgem does not consider it is possible to specify how a BAFO process would work in detail, as this would be dependent on the specific issues raised at the time. However, we can confirm that whilst we would likely be asking each BAFO bidder to provide an updated bid against a limited number of revised issues, the evaluation of these responses would be undertaken against pre-defined criteria, which is expected to be the same as at the ITT stage. The evaluation process would be set out at the time in the relevant BAFO documentation.

4.61. It is important to note that a BAFO stage would not always be necessary. For example, if the bids received at the ITT stage clearly identify a strong bid that Ofgem considers appropriate to identify as the preferred bidder for a particular project, we may decide that there is little benefit in seeking a BAFO. We intend to reserve the right to extend the process on a tender-by-tender basis.

Preferred Bidder and Licence Grant

Preferred bidder

4.62. Ofgem proposes to select the preferred bidder from the pool of bidders that provide a initial bid, or from the subset of bidders that is requested to provide a best and final offer. We also consider it would be important to identify a reserve bidder wherever possible, who would be appointed as preferred bidder if the original preferred bidder falls away.

4.63. We expect that the preferred bidder identified for each project in the transitional regime would be required to satisfy a limited number of issues ahead of it being granted an offshore transmission licence. One of the key issues will be for it to enter into an agreement with the developer to transfer the assets. Given that it will be a requirement that bidders accept the developer's terms as part of their bid, we would expect any final commercial negotiations to be in respect of a limited number of issues. We consider it will also be important for the preferred bidder to demonstrate to Ofgem that the financing proposals set out in its bid are in place. At this stage, we expect this to include:

- Senior lender facility agreements; and
- Shareholder agreements

4.64. We consider that it will be important for the preferred bidder to demonstrate that it has secured these arrangements so that we have confidence that upon licence grant, the preferred bidder has the means to meet its licence obligations. Having said this, we do not consider that the period of time allowed for preferred bidders to

confirm these arrangements should be longer than one month. This should ensure that all stakeholders are focused on resolving the outstanding issues and ensure that the end of the process can be completed in a timely manner. However, we recognise that there is likely to be a need to be more flexible at this time to allow for issues to be resolved.

4.65. Dependent on the individual circumstances of each tender, there may be other issues that we consider a preferred bidder should satisfy, for example in terms of the contractual arrangements it proposes to put in place. In the light of this, we would expect to set these out on a case-by-case basis.

Statutory transfer scheme

4.66. The Government is seeking powers in the Energy Bill which will enable Ofgem to put in place a statutory transfer scheme to ensure that property rights and liabilities are transferred from the developer to the successful OFTO. Ofgem will only have powers to use the scheme in certain circumstances and upon application, which it is envisaged will arise when commercial negotiations to transfer the assets fail.

4.67. We expect this to be a scheme of last resort and the parties should exhaust all possibilities to negotiate a commercial arrangement before applying. However, we acknowledge that provision needs to be put in place in case these commercial negotiations break down resulting in unnecessary disruption or delay.

4.68. The process for the scheme is set out in some detail in the Energy Bill, which is currently going through the Parliamentary process. The outcome of the any statutory transfer scheme will be binding on both parties, although the decision is appealable to the Competition Appeal Tribunal.

Licence grant

4.69. The Authority has powers under section 6 of the Electricity Act 1989 to grant licences, and it will be recommended to it to do so once the issues identified have been resolved by the preferred bidder to its satisfaction, as set out above. This should be a streamlined process given the detailed information that has built up during the tender process. Once the licence is granted, the OFTO will be under the same obligation to meet the requirements of the licence as other licence holders.

4.70. Where the assets have not been constructed at the time of licence grant, we would expect to grant the licence containing the standard conditions and at the same time initiate the procedure under section 11 of the Electricity Act 1989 to modify the licence to insert the special conditions, which would contain provisions relating to the revenue stream and the performance incentives. We would expect that these conditions would only come into effect once the licensee has satisfied certain provisions to the satisfaction of the Authority. At this stage, we would expect that this would include that the assets have been constructed and have been signed off by an independent engineering audit as fit for purpose.

5. Pre-Tender Requirements

Chapter Summary

This chapter sets out those requirements we expect would need to be undertaken ahead of the tender process starting in the transitional regime, in particular in respect of RAV assessments, the pre-conditions that offshore developers would need to satisfy and the information we would expect to make available to the market ahead of tenders commencing.

Questions

We welcome feedback from stakeholders on all of the issues raised in this chapter. In particular, responses are requested on:

- our proposed approach to RAV assessments and agreeing to commence a tender; and
- the scope of information we should make available to market ahead of tenders commencing.

Introduction

5.1. Ahead of the Go Active date, there are additional activities that need to take place so that the first tender round can commence as soon as practicable after that date. These include Ofgem establishing ex-ante RAVs for the offshore transmission assets that will be tendered under the transitional regime and developers meeting the necessary pre-conditions for the round.

5.2. These are important issues that need to be resolved over the coming months, and our current thinking on these issues is set out below.

Ex-Ante RAV Assessments

5.3. Ofgem has set out in each of its documents since July 2007 that it will undertake a RAV assessment for each offshore project to establish the initial regulatory value of the relevant transmission assets, before commencing a tender in the transitional regime. Given that the majority of offshore projects are not yet constructed, these assessments will be based on the best information available at the time (such as the result of construction contract competitions). This initial ex-ante value is an important piece of the information that bidders in the competition will need to understand in order to bid effectively, and as such it will essentially form the 'guide price' to the competition in the transitional regime.

5.4. Ofgem has confirmed previously that it will provide comfort on funding to those projects not yet constructed to the extent that offshore developers will be guaranteed to receive the greater of either 75 per cent of Ofgem's ex-ante RAV estimate or 100 per cent of the efficient economic cost incurred on an ex-post basis¹⁶. This approach is designed to achieve an appropriate balance of incentives and risk - the key incentive for the developer being that all efficiently incurred costs will be remunerated and the key risk that any inefficient expenditure (only in excess of our 75 per cent ex-ante estimate) is not guaranteed to be remunerated.

5.5. Establishing the efficient and economic ex-ante RAV will require a significant amount of information from the offshore developers. It is therefore important that this process is started sufficiently early to allow the necessary analytical assessments to take place. The information collected from offshore developers to date, and summarised in Chapter 2, is the start of the process of information gathering. Over the course of the next few months, Ofgem will be seeking further data on a more formal basis so that it can begin the process of assessing the asset values of the transmission infrastructure that will be tendered under the transitional regime in a robust way. We are still considering how this will be best achieved, although we intend to use the approach we adopt for network price controls. As such, we expect to be seeking detailed information from developers using a detailed Business Plan Questionnaire (BPQ).

Pre-Conditions in the Transitional Regime

5.6. Ofgem has published on a number of occasions the pre-conditions that an offshore developer will need to meet if its project is to be tendered under the transitional regime. To re-cap, these are that:

- a. The offshore developer has entered into a Connection Agreement with NGET or an electricity distribution licensee;
- b. The offshore developer has obtained all necessary property rights and environmental and planning consents for the offshore project and regulated assets;
- c. The offshore developer has either completed construction of or entered into all necessary construction contracts for the construction of the regulated assets;

¹⁶ We have set out previously that a further assessment will be carried out once the assets have been constructed (i.e. on an ex-post basis) to determine the efficient regulatory value of the assets.

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- d. The offshore developer has secured financing to the satisfaction of the Authority to construct the regulated assets¹⁷;
 - e. The offshore developer has agreed to populate a data room to the satisfaction of the Authority;
 - f. The offshore developer has committed to transfer the regulated assets to the successful bidder on completion of the tender exercise; and
 - g. The offshore developer has complied with such other conditions in connection with the tender exercise as the Authority may publish in a notice.

5.7. It will be important that these pre-conditions are satisfied in sufficient time ahead of the Go Active date to allow Ofgem to prepare for the subsequent tender round. Whilst some of these will be reasonably straightforward for a developer to confirm, such as demonstrating that there is a Connection Agreement in place, others will be more time consuming. For example, Ofgem will need to allocate sufficient time to undertake the necessary checks to understand the construction contracts the offshore developer has entered into and the financial commitment the developer has in place when considering (c) and (d) respectively.

5.8. For these reasons, we propose to require offshore developers to demonstrate that they have met the pre-conditions well in advance of tenders commencing in the transitional regime. This would be necessary to allow Ofgem the necessary time to confirm that the pre-conditions have been met and to enable the preparation of the documentation.

5.9. We would stress that the onus is on the offshore developer to provide evidence to Ofgem once it believes the necessary pre-conditions have been met. This would be the catalyst for Ofgem considering whether that project qualifies for the next tender round. We believe that this is best initiated by the developer applying in writing to Ofgem requesting that they are included in the next tender round.

5.10. We confirmed in the June document that where an offshore project does not meet these pre-conditions in advance of Go Active, the developer will have two options. The developer can either wait for the Go Live date to apply to be considered under the second tender round in the transitional regime, which will begin as soon as practicable after that date (provided that they meet the pre-conditions in advance of

¹⁷ We confirmed in January 2008 (see Ofgem document 'Offshore Electricity Transmission – Regulatory Policy Update' (4/08)) that satisfaction of this pre-condition would not necessarily need to be full financial close, given that in some instances projects will be financed on balance sheet. In such cases, we would be willing to accept an unconditional parent company guarantee that sufficient funds will be available to finance the project. Ofgem will consider the financing arrangements for each offshore project on a case-by-case basis.

that date), or they can choose to seek an OFTO under the enduring regime once the Go Active date has passed. We remain of this view.

Market Information

5.11. We recognise that one of the ways of making the competition as successful as possible will be to ensure that it is well marketed, particularly to key sectors such as the financial and investment communities. It will also be important that as much information about the projects being tendered, the design of the regulatory regime and the process to granting offshore electricity transmission licences is set out in sufficient detail in advance. To this end, Ofgem intends to ensure that information is made available to the market as far ahead as possible before commencing the first round of tenders in the transitional regime.

5.12. Whilst the form of this and how we present this information is still to be confirmed, Ofgem expects it will contain:

- information about the projects being tendered, including but not limited to:
 - location,
 - initial value (as determined by the ex-ante RAV assessment), and
 - the onshore connection point
- an overview of the proposed regulatory regime including the draft offshore transmission licence;
- the selection and licence grant process; and
- any wider policy issues that interested parties should be aware of (such as the Renewable Energy Strategy or Strategic Environmental Assessment on future rounds of offshore wind).

5.13. Ofgem expects that information will be provided to the market over a period of time, and well in advance of Go Active, to enable parties interested in entering the market to establish their positions.

6. Tender Process in the Enduring Regime

Chapter Summary

We consider that the broad principles for running tenders in the transitional regime should apply to the enduring regime as well. However, we recognise that there would need to be some differences, given that the OFTO would be required to construct the transmission assets.

This chapter provides overview of those additional issues that we consider need to be taken into account in identifying OFTOs in the enduring regime.

Questions

We welcome feedback from stakeholders on all of the issues raised in this chapter. In particular, responses are requested on:

- how we would ensure that information provided by the offshore developer (such as seabed surveys) would be transferred to the successful OFTO;
- whether we should establish parameters for variant bids, to ensure that the evaluation process remains transparent;
- the proposal to introduce a new licence condition for NGET covering information provision and assistance in the enduring regime.

We would also be interested to understand stakeholders' views on the practical application of the proposal to broadly apply the principles of the transitional regime tender process on an enduring basis.

Introduction

6.1. The majority of this document has set out the processes we propose to follow for the transitional regime, i.e. for assets that have been or will be constructed by the developer. We are focusing on that part of the overall transmission regime at this time given that we expect to be running tenders on this basis from the Go Active date¹⁸. However, we recognise that stakeholders are looking for a clearer steer on how we will manage the tender process in the enduring regime.

¹⁸ We will consider on a case-by-case basis offshore projects that come forward after the Go Active date has passed seeking an OFTO under the enduring regime.

6.2. We can confirm that the principles of the approach set out above will be adopted, where possible, in the enduring regime. At this stage, we do not see any reason why the approaches should differ significantly. However, we recognise that there will need to be some differences given that the product that we will be tendering for is different, i.e. the successful bidder will be required to construct a tranche of new assets as well as manage them on an ongoing basis (which will include new offshore projects that come forward following The Crown Estate Round 3 leasing process)¹⁹. This section sets out our proposed approach to dealing with the main differences between the regimes. It also tackles the key issues raised by respondents to the joint Ofgem/BERR policy update document, published in June.

Pre-Conditions in the Enduring Regime

6.3. We set out in the June document that an offshore developer would need to satisfy a number of pre-conditions ahead of a tender exercise being run to give a greater degree of certainty to the process. We also set out that we considered pre-conditions were necessary for both the transitional and enduring regimes. The June document was the first time we raised the issue of pre-conditions in the enduring regime, and we received a number of comments on this approach. To re-cap, the proposed pre-conditions were:

- a. The developer has entered into a CUSC bilateral connection agreement with NGET; and
- b. The developer has entered into lease arrangements with The Crown Estate.

6.4. Broadly, respondents were positive about the need to put in place a set of minimum pre-conditions that needed to be satisfied ahead of a tender process starting, and agreed that these were appropriate. However, a number also sought clarity on what was meant by the requirement for developers to have entered into lease arrangements with The Crown Estate.

6.5. We have considered these responses in detail, and on balance we continue to believe that the pre-conditions set out in June remain valid. We believe they are necessary to provide confidence to participants in a tender process that the developer is committed to going ahead. We do note however the clarity sought in respect of the requirement to have entered into lease arrangements with The Crown

¹⁹ The approach that The Crown Estate is taking to the development of Round 3, through Zonal Development with one Partner Company per Development Zone, should assist in the coordinated development of connection applications and offshore electricity transmission infrastructure. We will continue to work closely with The Crown Estate to ensure that the two processes complement each other and ensure the delivery the most economic and efficient grid connections for Round 3 projects, in addition to those already planned for Rounds 1 and 2.

Estate. We also note that a number of respondents responded to the draft tender regulations setting out that an explicit link that required developers to have exercised the option on a Crown Estate lease was too onerous a requirement. We are considering the position further on this issue, although we are minded to agree that linkage at the early stage in The Crown Estate leasing process may be more appropriate.

6.6. Similarly for the transitional regime, it will be important that these pre-conditions are satisfied in sufficient time ahead of the start of a tender round to allow Ofgem to confirm that the requirements have been met.

6.7. We stress that the onus is on the offshore developer to contact Ofgem once it believes the necessary pre-conditions have been met. This would be the catalyst for Ofgem considering whether that project qualifies for the next tender round. We believe that this is best initiated by the developer applying in writing to Ofgem that they are included in the next tender round.

Interaction with the connection determination process

6.8. The June consultation document set out our initial view that where an offshore developer has received a CUSC connection offer from NGET but had referred this to the Authority for determination, that project should be eligible to be considered in a particular tender round under certain circumstances, being that:

- The offshore developer underwrites the costs of the tender process until it enters into a CUSC bilateral connection agreement; and
- The issue that has been referred for determination would not have a material impact on the design of the changes required to the onshore transmission system (e.g. the assumed landing point for the offshore transmission system is not disputed) that informed the works defined in the offer made by NGET.

6.9. We continue to believe that keeping this flexibility in the regime should mean that connection offers that are subject to determination are still able to be considered in a tender round, if the offshore developer decides that that is the most appropriate approach to pursue. However, it is important to reiterate that Ofgem will consider this on a case-by-case basis given that there are many issues which may be referred to for determination.

Tender Process Overview

6.10. As we have set out in previous consultation documents, we consider that the stages for the tender process should be the same for both the transitional and enduring regimes. As such, we propose that the enduring regime adopts the following stages:

-
- A pre-qualification stage, which will enable Ofgem to select those parties that it will invite to bid for each project in the tender round based on detailed responses to the PQQ;
 - An invitation to tender stage, during which bidders will have the opportunity to put forward their detailed proposals for providing transmission services, including their firm bid revenue stream for the 20-year regulatory period;
 - An optional best and final offer stage, where a small number of bidders will have the opportunity to put forward their final bid;
 - The identification of the preferred bidder;
 - The licence grant stage, where the Authority will grant the offshore electricity transmission licence to the preferred bidder, subject to it satisfactorily completing any outstanding issues required by the Authority.

6.11. As set out earlier in this document, we expect to follow the processes we have set out for the transitional regime. However, we do expect there to be some key differences, which are set out below.

Pre-qualification stage

6.12. Ofgem considers that the PQQ for the enduring regime would need to cover wider issues than in the transitional regime, including detailed questions on applicants' ability to construct and deliver the specific transmission assets. We consider that these would be needed to enable us to be able select bidders in a robust way for offshore projects where the construction of the transmission assets would be undertaken by the OFTO. In particular, we may seek to introduce a Request for Proposals stage to assist this selection process.

Invitation to tender stage

6.13. Ofgem considers that while the process will be similar for at the ITT stage, the requirements of response will differ significantly given the construction requirements in the enduring regime. As such, we consider bidders will be required to submit detailed financial and technical proposals for the design, construction, operation and maintenance for the required transmission assets, including a detailed draft construction contract.

6.14. We are keen to encourage innovation in the enduring regime and anticipate that bidders will want to consider, for example, whether there may be any potential synergies from combining offshore projects via a single link to the onshore network, rather than relying on a link for each project, or perhaps consider an alternative technical solution. We recognise that such solutions may lead to lower overall costs and therefore it would seem to be in the best interests of consumers to allow these variant bids to come forward.

6.15. We are still considering our approach to variant bids in the enduring regime, such that a number of variant offshore solutions provided by bidders could be considered and evaluated in a consistent and transparent way. We would want to ensure a consistent and transparent approach to evaluation while exploiting potential gains from variant bids. One way of addressing this could be to set out at the outset the parameters for variant bids, which is something we are considering further. **We would particularly welcome feedback from stakeholders on this issue.**

Preferred bidder stage

6.16. The preferred bidder in the enduring regime will be expected to fulfil a number of requirements to the satisfaction of the Authority ahead of licence grant. We set out in the June consultation document that the preferred bidder will need to enter into contractual relations with NGET for the construction works offshore, via a Transmission Owner Construction Agreement (TOCA). This is necessary to enable NGET to issue an agreement to vary the offshore developer's connection agreement to take into account the offshore proposals. We confirmed in June that we considered that the most appropriate vehicle for this was via the STC, and those respondents that commented recognised that this was the most appropriate approach. A modification to this effect is currently being consulted on.

6.17. The preferred bidder will also be required to demonstrate to the Authority that the financing arrangements and technical proposals it set out in its bid are finalised. At this stage, we expect this to include, but not be limited to the:

- Project Agreement Contracts (such as the TOCA relevant performance bonds);
- Design and Build Contracts (such as the EPC contract);
- Operation and Maintenance Contracts;
- Senior Lender Facility Agreements; and
- Shareholder Agreements

Licence grant stage

6.18. We consider that the requirements at this stage will be similar to the transitional regime, in that the licence will only be granted when the requirements of the preferred bidder have been demonstrated to the Authority's satisfaction. Similarly to the transitional regime, we propose to issue the full offshore electricity transmission licence to the preferred bidder, but only switch on the special conditions when the assets have been constructed and signed off by an independent engineering audit.

Role of stakeholders

6.19. In addition to the differences outlined above, a further area where we consider that the tender process will differ in the enduring regime is with respect to the role of stakeholders during a tender process. This is primarily due to the fact that in the enduring regime, OFTOs will be responsible for constructing the transmission infrastructure as well as maintaining it in accordance with the offshore electricity transmission licence.

6.20. As in the transitional regime, we expect that the offshore developer will be required to provide a significant amount of information to bidders, including a functional specification for the offshore generation assets. We would also expect that the developer provides information on the consents and leases it has obtained at that time, as well as any relevant seabed surveys. This is discussed later in this chapter.

6.21. We also expect NGET to take on new obligations to provide information and technical assessment to Ofgem in the enduring regime, as set out further below.

Prior to a tender round commencing

6.22. On an ongoing basis, we would expect NGET to provide Ofgem with details of connection agreements it has entered into with offshore developers. Whilst the onus will be on developers to confirm to Ofgem that they have met the necessary pre-conditions for the enduring regime, this will enable Ofgem to gauge an understanding of the likely number of tenders it will need to consider in forthcoming tender rounds.

6.23. As set out earlier in this document, bidders will need significant amount of information in order to compile effective bids. As such, we are proposing that NGET provides to Ofgem information about the projects that will be tendered within a particular round. At this stage, we expect this to include, but not be limited to:

- information from the connection agreement in place with the developer;
- the onshore connection options considered and rejected in the process of determining the most economic and efficient connection point on the onshore network; and
- the assumptions NGET have made about the offshore network in compiling its initial connection offer.

During the tender process

6.24. Both in the transitional and enduring regimes, we expect that bidders will seek clarification and further information from NGET (and the offshore developers) on a number of issues. It will be important for the transparency of the competition that questions and responses are managed in a structured way and Ofgem intends to be the hub for these, with responses made available to all bidders through the data

room, subject to any commercially confidential issues. So as to maintain transparency, we also consider it will also be important for NGET to notify Ofgem if any bidders approach it directly, which will be outside of the rules of the competition.

6.25. In addition to this information exchange role, we also consider that there is a key role for NGET to assist in the assessment of the technical proposals provided by bidders as part of their tenders, from an operational perspective and in line with its current role under the STC. This would be for compliant bids and any variant bids (i.e. where the proposed network designs differ from the assumptions set out in the developer's initial connection agreement). We consider that this will be important to advise Ofgem on the operability of technical proposals put forward.

6.26. We recognise that it will be important however that NGET's role in this regard is managed in a consistent and transparent way across tenders and across bidders. We believe that this is best achieved by Ofgem providing the proposed technical solutions to NGET on an anonymous basis, requesting its advice within a defined timescale.

Engagement with preferred bidder

6.27. When a preferred bidder has been identified, it will be necessary for it to enter into contractual relations with NGET, so that NGET is able to vary the connection agreement it has with the offshore developer.

New licence condition

6.28. We have discussed the above issues with NGET over recent months, and we are considering how they will be most appropriately provided for in the regulatory framework. To this end, we have consulted with the Offshore Transmission Standard Conditions Working Group²⁰ on a new draft licence condition for NGET to provide certain information and assistance to Ofgem in the tender process. It was generally considered that the licence itself was not the most appropriate place to set out the full details of NGET's role, given that this would be a new role and that the process for amending licence conditions is relatively inflexible. However, it was that NGET's role could be more appropriately documented in a subsidiary document to the licence, similar to Regulatory Instructions and Guidance that are used in respect of other standard licence conditions and for other classes of licensee, such as the Distribution Network Operator. We will be considering this further in the next consultation on modifications to the standard licence conditions. **Nevertheless, we would also welcome feedback from stakeholders in this area.**

²⁰ Terms of Reference for this working group are available on Ofgem's website

Tender Windows

6.29. We have set out consistently in previous consultation documents that we would intend to start tenders for all those offshore projects that have met the necessary pre-conditions by a certain date at the same time. We believe that this would facilitate an orderly process and provide the potential for coordination benefits for those projects that fall within the same round (or window). We propose to notify stakeholders of the start of the tender round via a notice to the market issued in accordance with the tender regulations.

6.30. However, as confirmed in the June consultation document, we propose to retain sufficient flexibility in the tender process to commence tenders at a different point where necessary. We consider that this flexibility is important in instances where, for example, market information (such as from NGET) indicates that there would only be one tender exercise required in any round. We would propose that any deviations such as this would be communicated to the market in advance.

Consents, Leases and Seabed Surveys

Consents and leases

6.31. We have set out in previous consultation documents that we would expect developers to continue to obtain the necessary consents and leases for the offshore transmission assets in the enduring regime. We have also set out our expectation that these would then be transferred to the successful OFTO when identified, with the developer being remunerated for their necessary and efficiently incurred expenditure. Of those respondents that commented on this issue, all but one agreed with this approach. We do not intend to amend this position. We do consider however that it will be important that appropriate arrangements are put in place to ensure that any work undertaken by the offshore developer in advance is fully transferred to the successful OFTO. **We would particularly welcome stakeholders' views on this issue.**

6.32. Going forward, we note the proposals under the current Planning Bill²¹ to introduce a single body, known as the Infrastructure Planning Commission, that will be responsible for issuing the relevant consents for all infrastructure projects that are deemed to be of national significance, which we expect would include offshore projects. We will continue to monitor developments with this Bill as it goes through

²¹ We also note that the draft Marine Bill is seeking to introduce a similar body that is responsible for issuing consents to offshore projects below 100MW, known as the Marine Management Organisation. We will similarly follow developments of this Bill and its interactions with the offshore electricity transmission regime.

the Parliamentary process, to understand interactions with the offshore electricity transmission regime.

Seabed surveys

6.33. We set out in the June consultation document that we were minded not to take a prescriptive approach with regard to seabed surveys in the enduring regime, but allow the survey to be undertaken by the offshore developer or by bidders in the tender process. A large number of respondents suggested that this should always be the responsibility of the offshore developer, with some expressing concern if it was left to the tender process, it could lead to delays. Whilst we have considered this further, we remain of the opinion that leaving flexibility in the regime for either the developer or bidders (either jointly or singularly) to undertake seabed surveys is important, not least because it will be bidders that will be using the information to formulate their bids.

6.34. We would expect that the efficient costs of undertaking seabed surveys to be borne by the successful bidder and be a part of its cost base, whether the survey was procured from the offshore developer or commissioned during the tender process. However, in instances where a bidder undertakes additional surveys, we would expect these to be at the bidders own cost. Similar to above, where the offshore developer undertakes the seabed survey, it will be important that appropriate arrangements are put in place to ensure that these are fully transferred to the successful OFTO.

7. Cost Recovery

Chapter Summary

This chapter provides an overview of the powers the Government is seeking through the Energy Bill with respect to the Authority recovering its costs of running the tender process.

Questions

There are no questions in this chapter.

Introduction

7.1. One of the key decisions that the Government took in January 2008 was that it would seek powers in the Energy Bill to enable the Authority to recover its costs of running the tender process, and ensure sufficient commitment to the tender process, from parties participating. This chapter summarises the powers in the Energy Bill, as well setting out how we intend to recover costs in accordance with these. It has been updated since we covered this issue in our January document²², to reflect the content of the Energy Bill as laid before Parliament and further thinking in this area.

Relevant Provisions in the Energy Bill

7.2. The Energy Bill is still subject to the Parliamentary process and therefore the powers proposed may be subject to change. However, this summary represents our understanding of the current position.

7.3. The proposed provisions of the Energy Bill will:

- a. insert in the Electricity Act 1989 a provision enabling the Authority in regulations under section 6C of the Electricity Act 1989²³ to create new mechanisms to recover its costs in carrying out and administering the tender exercises (the Regulations); and
- b. insert in the Electricity Act 1989 a new Schedule (Schedule 2A) which grants the Authority the power, upon application by an eligible party, to make a scheme to

²² Offshore Electricity Transmission - Regulatory Policy Update, 04/08, January 2008.

²³ Section 6C gives the Authority the powers to make regulations to enable it to run a competitive tender process to identify

transfer property, rights and liabilities from an existing owner of offshore transmission assets to the successful bidder.

Proposed Powers

7.4. The new powers will enable the Authority to seek payments from the participants in a tender exercise to cover its tender costs. Offshore developers²⁴ will also be required to pay a deposit or provide such other security (e.g. a letter of credit) as approved by Ofgem to underwrite Ofgem's costs. We may also accept such security or deposit from an approved third party (e.g. a parent company). The powers are limited so that the aggregate of the payments received cannot exceed the total costs incurred in carrying out the tender exercise.

7.5. In addition, the new powers extend into other specific areas. They will enable us to charge for costs arising as a result of any assessment of the costs which have been, or ought to have been, incurred in connection with the asset (i.e. RAV assessments). This power is intended to enable us to recover the costs associated undertaking RAV assessments from the asset owner.

7.6. The proposed powers provide for the Regulations to include timing of payments and mechanisms to allow the Authority to refund or withhold relevant payments, deposits or security required from participants in the tender exercise. The powers also enable the Authority to include provision in the Regulations to address the consequences for a participant's failure to make payments.

Cost recovery methodology

7.7. It will be important that the Tender Regulations set out clearly how Ofgem will recover its tender costs from participants, in accordance with the Energy Bill powers. However, we consider that this would be usefully supplemented by Ofgem making available a more detailed methodology, setting out how we would use these powers in practice. To this end, we intend to publish in the coming months our methodology for cost recovery and make this available to all participants in a tender round. We would also expect that it provides for the methodology for calculating the costs of undertaking RAV assessments.

7.8. It is difficult to set out precisely at this stage what the expected costs of each tender process would likely be, given that we are still in the development phase of the design of the regime. However, our costs will likely comprise a number of different elements, such as direct costs, indirect costs and staff costs. We expect

²⁴The Energy Bill refers to "the person who made the connection request for the purposes of which the tender exercise has been, is being or is to be, held", which we have interpreted for the purpose of this document as being the offshore developer.

direct costs would include consultancy and advertising expenditure and indirect costs would include our overheads. Staff costs would be the direct costs of the Ofgem employed staff who are working on the tender process.

7.9. We recognise that potential participants in this regime would take comfort from further understanding around the likely magnitude of the costs they might face. We would expect to provide further detail on these with the cost recovery methodology.

8. Implementing the Tender Process and Next Steps

Chapter Summary

This chapter provides an overview of how Ofgem will implement the tender process in advance of Go Active.

Questions

There are no questions in this chapter.

Implementing the Tender Process

8.1. The offshore electricity transmission regime will largely be implemented through the commencement of a number of sections of the Energy Act 2004. In particular, section 92 of the Energy Act 2004, which will insert section 6C into the Electricity Act 1989 when commenced, enables the Authority to make regulations which are appropriate for facilitating the making of a determination on a competitive basis of the person to whom an offshore transmission licence is to be granted. These regulations will effectively provide the legal framework for running the competitive tender process. These powers will be supplemented by the powers the Government is seeking in respect of the regime through the Energy Bill.

8.2. In July 2008, Ofgem published its preliminary draft of these regulations. We received 12 responses to the draft regulations, and have considered these carefully both in terms of how the legal drafting could be amended, as well as in developing our thinking in respect of the tender process more generally. Over the coming months, Ofgem will continue develop these regulations and will publish further drafts ahead of the Authority making the regulations in advance of the Go Active date.

8.3. Whilst the regulations provide the legal framework for the tender process, each tender would also be supplemented by detailed tender documentation (i.e. a Pre-Qualification Document and an Invitation to Tender document). We have published draft template tender documentation for the first time alongside this document. These documents provide stakeholders with further information about how Ofgem proposes to select and identify those parties it considers would be the appropriate OFTO for each offshore project. Whilst these documents would be issued as part of each competition, we consider that it is appropriate that stakeholders have early sight of these so that they can effectively contribute to their development.

Next Steps

8.4. This document primarily sets out our proposals for the framework for running competitive tenders in the transitional regime. It also proposes that the key principles of this approach would be applied to tenders in the enduring regime, although it recognises that there will need to be differences of approach given the

different characteristics of tenders when the OFTO would be constructing the transmission assets.

8.5. Alongside the publication of this document, we are continuing to develop these processes detail, including the selection and evaluation process, the scope and content of the tender documentation and the tender regulations. We welcome continued engagement and feedback from stakeholders in each of these areas, and also the other issues discussed, to assist the development of a robust process that would identify fit for purpose transmission investment solutions.

8.6. We will be publishing a joint document with DECC in the coming weeks which will consult in further detail on the design of the regulatory regime and also on the detailed modifications to industry codes and licences necessary to implement the offshore electricity regime. As part of this joint document, we will set out a detailed timetable for the implementation of the regime, including with respect to the tender process.

Appendices

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Appendix 1 - Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document. In particular, we would like to hear from parties interested in becoming an OFTO as well as developers of offshore generators that are likely to fall under the transitional regime.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

1.3. Responses should be received by 14 November 2008 and should be sent to:

Richard Clay
Senior manager, Offshore Transmission
Ofgem
9 Millbank, London
SW1P 3GE

Tel: 020 7901 7264

Email: offshoretransmission@ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. Any questions on this document should, in the first instance, be directed to Richard Clay.

CHAPTER 1

There were no questions in relation to this chapter.

CHAPTER 2

There were no questions in relation to this chapter.

CHAPTER 3

There were no questions in relation to this chapter.

CHAPTER 4

We welcome feedback on:

- the extent of information that should be requested at the Pre-Qualification and Invitation to Tender stages;
- the extent of information we propose should be available to bidders;
- our proposed approach to selecting bidders;
- our proposed approach to identifying the preferred bidder;
- our proposed approach to dealing with bids for multiple offshore projects;
- our draft template Pre-Qualification Document, particularly whether any further questions need to be considered in the Pre-Qualification Questionnaire; and
- our draft template Invitation to Tender document

We would also be interested to receive stakeholders' views on the practical application of this proposed approach.

CHAPTER 5

We welcome feedback on:

- our proposed approach to RAV assessments and agreeing to commence a tender; and
- the scope of information we should make available to market ahead of tenders commencing.

CHAPTER 6

We welcome feedback on:

- how we would ensure that information provided by the offshore developer (such as seabed surveys) would be transferred to the successful OFTO;
- whether we should establish parameters for variant bids, to ensure that the evaluation process remains transparent;
- the proposal to introduce a new licence condition for NGET covering information provision and assistance in the enduring regime.

We would also be interested to understand stakeholders' views on the practical application of the proposal to broadly apply the principles of the transitional regime tender process on an enduring basis.

CHAPTER 7

There were no questions in relation to this chapter.

CHAPTER 8

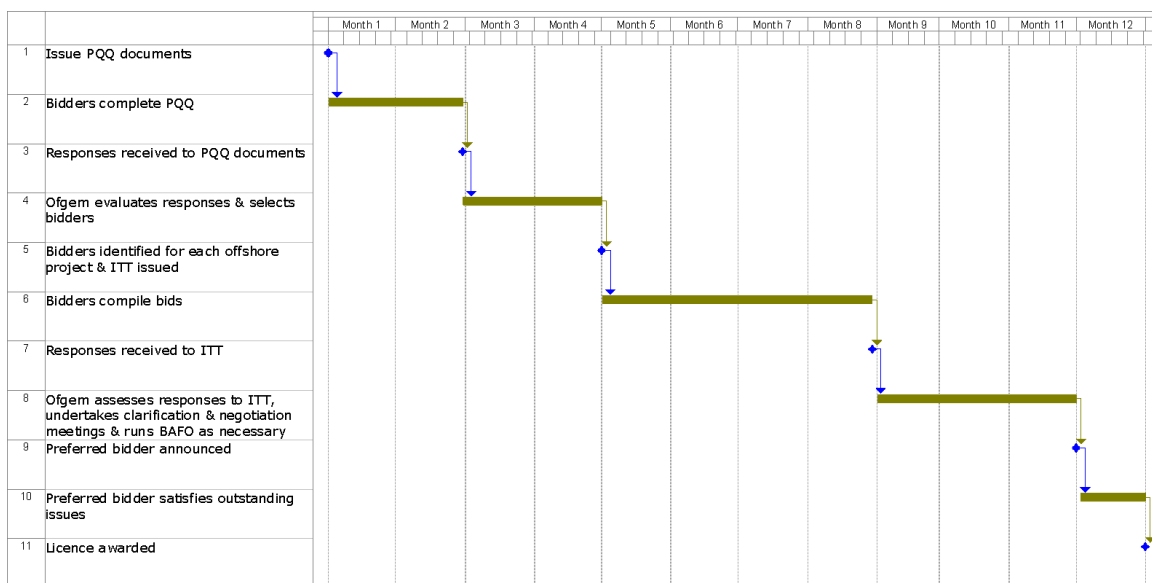
There were no questions in relation to this chapter.

Appendix 2: Proposed Timeline for Tenders in the Transitional Regime

1.1. This Appendix provides our proposed timeline for undertaking tenders in the transitional regime.

1.2. We propose:

- 2 months for applicants to compile responses to the Pre-Qualification Document;
- 2 months for Ofgem to select bidders based on responses received, and issue the ITT documents;
- 4 months for bidders to compile their detailed tenders;
- 3 months for Ofgem to assess the bids and identify a preferred bidder; and
- 1 month for the preferred bidder to satisfy the requirements required by Ofgem in advance of licence grant



Appendix 3 – The Authority’s Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority (“the Authority”), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Act 2004, as well as arising from directly effective European Community legislation. The Authority also has powers and duties in respect of the environment, as set out in various other Acts²⁵. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.²⁶

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly²⁷.

1.4. The Authority’s principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of consumers, present and future, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

1.5. The Authority must when carrying out those functions have regard to:

- The need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- The need to secure that all reasonable demands for electricity are met;
- The need to secure that licence holders are able to finance the activities which are the subject of obligations on them²⁸; and

²⁵ For example, the Environment Act 1995 and the Countryside and Rights of Way Act 2000

²⁶ Entitled “Gas Supply” and “Electricity Supply” respectively.

²⁷ However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

- The interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.²⁹

1.6. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

- Promote efficiency and economy on the part of those licensed³⁰ under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- Protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity;
- Contribute to the achievement of sustainable development; and
- Secure a diverse and viable long-term energy supply.

1.7. In carrying out the functions referred to, the Authority must also have regard, to:

- The effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- The principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- Certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.8. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation³¹ and therefore part of the European Competition Network. The Authority also has

²⁸ Under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.

²⁹ The Authority may have regard to other descriptions of consumers.

³⁰ Or persons authorised by exemptions to carry on any activity.

³¹ Council Regulation (EC) 1/2003

concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

1.9. The Authority has regard to all of its duties when carrying out its functions.

Appendix 4 - Glossary

A

Authority

Gas and Electricity Markets Authority

B

BaFO

Best and Final Offer

BERR

Department for Business Enterprise and Regulatory Reform

BPQ

Business Plan Questionnaire

BSC

Balancing and Settlement Code

C

CAT

Competition Appeals Tribunal

CUSC

Connection and Use of System Code

D

DCUSA

Distribution Connection and Use of System Agreement

DECC

Department of Energy and Climate Change

E

EPC

Engineering, Procurement and Construction

G

[GBSO](#)

Great Britain System Operator

[GBSQSS](#)

Great Britain Security and Quality of Supply Standard

[GW](#)

Gigawatt

I

[ITT](#)

Invitation to Tender

K

[kV](#)

Kilo Volt

M

[MW](#)

Megawatt

N

[NGET](#)

National Grid Electricity Transmission plc

O

[Ofgem](#)

Office of Gas and Electricity Markets

[OFTO](#)

Offshore Transmission Owner

P[PFI](#)

Private Finance Initiative

[PQD](#)

Pre Qualification Document

[PQD](#)

Pre Qualification Questionnaire

R[RAV](#)

Regulatory Asset Value

[RPI](#)

Retail Price Index

S[SQSS](#)

Security and Quality of Supply Standard

[STC](#)

System Operator - Transmission Owner Code

T[TO](#)

Transmission Owner

[TOCA](#)

Transmission Owner Construction Agreement

Appendix 5 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

Andrew MacFaul
Consultation Co-ordinator
Ofgem
9 Millbank
London
SW1P 3GE
andrew.macfaul@ofgem.gov.uk