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Date: 7 March 2014

Dear colleague

The generic offshore transmission owner (OFTO) licence for Tender Round 3

Overview

On 7 October 2013 we published a consultation on the generic OFTO licence for Tender Round 3 (**TR3**) (the **October consultation**[1]). The consultation set out the proposed licence drafting for TR3 including the proposed drafting to implement key decisions from our statement on generator build tenders (the **July statement**[2]) such as the introduction of a refinancing gain share and biddable indexation. We also consulted on how to evaluate biddable indexation bids.

The consultation closed on 2 December 2013 and we have considered the consultation responses. This letter summarises those responses and sets out our decisions in respect of the licence drafting and the biddable indexation evaluation process. It is structured as follows:

1. Indexation of revenue.
2. Refinancing gain share.
3. Availability incentive - capacity weighting mechanism.
4. Financial security.
5. Sulphur hexafluoride (SF_6) emissions reporting.
6. Other licence drafting changes.

An updated TR3 licence is published alongside this letter.

1. Indexation of revenue

Evaluation of bids

The July statement included a decision to adopt a policy of biddable indexation for TR3. This will allow bidders to bid a proportion of the revenue stream they would like to have indexed to the retail prices index (**RPI**) which will allow bidders to more closely align their revenue and cost profiles.

In the October consultation we set out that bids based on biddable indexation will consist of two key numbers:

[1] Consultation on the generic Offshore Transmission Owner (OFTO) licence for Tender Round 3 (October 2013)
[2] Offshore Electricity Transmission: Statement on future generator build tenders (July 2013)

1. A first year tender revenue stream (**TRS**) requirement.
2. A percentage representing the proportion of that TRS that will increase with RPI over the length of the revenue term. The proportion of TRS not indexed to RPI will remain constant in nominal terms. We also proposed that the bidder should provide a percentage representing the proportion of the market rate revenue adjustment (**MRA**) and post tender revenue adjustment (**PTRA**) (where applicable) that will increase with RPI over the course of the revenue term.

To compare bids on equal terms it is necessary to convert them to a net present value. In the October consultation we proposed to use an inflation assumption to project the actual cash flows for the default 20 year revenue period based on the proposed proportion of TRS indexed and then discount those cash flows to present values. The cash flows can then be added together to produce a total present value of revenues.

To calculate a net present value we need a real discount rate and to make an assumption about inflation over the 20 year revenue period. In the October consultation our minded-to positions were that:

- we will use the social time preference rate (**STPR**) as the real discount rate

- we will use a market implied inflation figure for the inflation assumption. We proposed that the breakeven inflation implied by zero coupon 10-year index linked gilts (**ILGs**) would be a suitable inflation assumption.[3]

One respondent suggested that the developer should be able to set the proportion of OFTO revenue to be indexed and the inflation series to which it should be indexed because this would remove the need to evaluate bids with different proportions of revenue indexed. All other respondents to the October consultation agreed with our proposed approach to evaluation and our minded-to positions. We have decided not to allow the developer to set the inflation series or proportion of revenue to be indexed because the intention of the biddable indexation policy is to allow bidders flexibility in their approach to indexation in order to reduce costs, for example by reducing costs of entering into RPI swaps, and to attract different sources of finance. These objectives would not be achieved if the developer set the inflation series and proportion of revenue to be indexed.

We have decided to adopt the evaluation approach set out in the October consultation and to use the STPR and a market implied inflation figure as, respectively, the real discount rate and inflation assumption when evaluating biddable indexation bids. We will use the breakeven inflation implied by zero coupon 10-year ILGs as the market implied inflation figure. In advance of each stage of TR3 we will announce the value of the inflation figure to be used for the purposes of evaluation.

Licence drafting

To implement biddable indexation, we proposed in the October consultation to amend the calculation of base transmission revenue ($\mathbf{BR_t}$). The proposed drafting introduced two new constants:

- BI_{TRS} which is a constant between 0 and 1 representing the proportion of the TRS indexed to RPI.
- BI_{RA} which is a constant between 0 and 1 representing the proportion of the MRA and PTRA indexed to RPI.

[3] Series Name: Yield from British Government Securities, 10 year Inflation Zero Coupon, Series Code: IUDMIZC (Bank of England)

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Most respondents had no comments on the licence drafting but one respondent suggested allowing bidders to bid a variable indexation proportion over the 20 years rather than a fixed amount. The same respondent suggested that bidders may not wish to index the same proportion of MRA and PTRA and suggested that these two revenue terms should therefore be subject to separate indexation constants.

We have decided not to introduce a variable indexation profile. We believe fixing the proportion of income indexed to RPI will significantly reduce the cost of RPI swaps. Allowing bidders to bid a variable indexation profile as opposed to a fixed one would result in marginal, if any, additional cost savings for consumers, but would greatly increase the complexity of the licence and would make it more difficult to evaluate bids on level terms. Therefore the proportion of revenue indexed to RPI will remain fixed over the revenue term.

We have amended the licence drafting to allow bidders to index different proportions of MRA and PTRA should they wish. The amendment is to the calculation of BR_t in amended standard condition E12-J2. In summary, the constant BI_{RA} is replaced by two constants BI_{MRA} and BI_{PTRA} which represent, respectively, the proportion of the MRA and PTRA indexed to RPI. Bidders will provide these constants as part of their invitation to tender (**ITT**) bid, along with the value of BI_{TRS}. This is a relatively simple change to implement and provides bidders with greater flexibility.

Implementation of biddable indexation

Further information on how bidders should submit bids with biddable indexation will be provided at the Enhanced Pre-Qualification (**EPQ**) and ITT stages of the TR3 tender process.

One respondent requested clarification as to how biddable indexation will affect a generator's transmission network use of system (**TNUoS**) payment. TNUoS charges should reflect the cost of installing, operating and maintaining the transmission system and we have invited National Grid to consider the impact of biddable indexation and to make any changes required to ensure the TNUoS methodology continues to meet its objectives.

2. Refinancing gain share

Parameters

The July statement detailed our decision to introduce a refinancing gain share of OFTO senior debt. In the October consultation we consulted on the parameters of the gain share and the proposed licence drafting. Our minded-to views were that:

1. The OFTO in question will calculate the refinancing gain in accordance with the principles set out in the licence drafting and Ofgem will subsequently review the calculation, with the option to make changes where the original calculation has not been made in accordance with the licence, prior to issuing a direction to specify the amount of the revenue adjustment.

2. Refinancing gains will be shared either through an annual adjustment to revenues over the remaining life of the default 20 year revenue period[4] or as a lump sum. We would decide this on a case by case basis, with the expectation that the profile of the gain share would mirror the profile of the gain.

3. The blended equity internal rate of return (**IRR**) from the relevant OFTO's financial model used at financial close will be used as the discount rate to calculate the present value of the refinancing gain.

[4] This adjustment would be constant in real terms.

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4. Refinancing gains will be shared 50:50.

Respondents were generally supportive of our proposals. One generator suggested that refinancing evidence submitted by OFTOs is reviewed by an independent third party advisor as well as Ofgem but we believe that this is unnecessary because we are independent and are capable of reviewing the evidence submitted by OFTOs. Where we consider that an external opinion would add value we will consult financial advisors. Another generator felt that the 50:50 gain share ratio may over compensate OFTOs but other respondents felt that the proposed sharing mechanism was reasonable.

One OFTO requested confirmation that the profile of the gain share would mirror the profile of gain except where the repayment profile would lead to a refinancing gain share pass through that increased overall OFTO revenue in some years. We cannot confirm that this would be the only situation in which the profile of the gain share would not match the profile of the gain but we expect that in the vast majority of cases it will be reasonable to match the gain share and gain profiles.

We have decided to adopt our minded-to positions as set out above.

Licence Drafting

There were few comments on the licence drafting proposed in the October consultation. One respondent questioned whether the licence drafting, in particular the definition of 'external debt' to which the refinancing applies, was appropriate for an OFTO build project. The drafting consulted on in the October consultation was for projects in TR3 only, all of which are generator build. We will consult separately on the licence content and drafting for an OFTO build project.

Another respondent also suggested that the three month notice period required by the licence in advance of an 'exempt refinancing' is unrealistic. We have amended the licence drafting to require the OFTO to provide written notice of an exempt refinancing and to use best endeavours to provide three months notice, but it is no longer an absolute requirement to meet this timeframe.

The same respondent recommended that we revise the definition of 'exempt refinancing' to align with the definition used in the latest HM Treasury guidance on Private Finance Initiative (**PFI**) contracts[5] in order to prevent the OFTO having to inform the Authority when it makes minor changes to its financing documents. We have reviewed the definition and do not believe any changes are required. The OFTO only has to notify us of a 'qualifying refinancing', which is a refinancing that results in a financial gain to the OFTO. Therefore administrative changes to finance documents which lead to no refinancing gain already fall outside of the refinancing gain share.

However the intention of the refinancing gain share is to ensure consumers share the benefit of any refinancing of external debt undertaken by OFTOs, not to be an excessive administrative burden. Therefore, we have amended the process by which OFTOs notify us of a 'qualifying refinancing' through the licence. Under the drafting set out in the October consultation an OFTO had to provide notification of a proposed refinancing along with an updated financial model and calculation of the refinancing gain and gain share. Under the revised licence drafting the OFTO must only provide written notification of a proposed refinancing along with the terms of the refinancing. The Authority can then request additional information from the OFTO where it considers it to be cost effective to subject the refinancing to the gain share. This will avoid the OFTO having to incur significant administrative costs for a qualifying refinancing which leads to a minimal gain.

One respondent asked for confirmation that raising additional capital to pay for incremental capacity works required under the licence would not be subject to a refinancing gain share.

[5] HMT: Private Finance 2

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We can confirm that this is not the intention of the refinancing gain share. However if an OFTO used the raising of additional capital as an opportunity to refinance its debt more generally then this wider gain would be captured by the refinancing gain share.

The licence drafting proposed in the October consultation set out that the refinancing gain would be calculated using the project blended internal rate of return to shareholders of the licensee and its affiliates over the project lifetime (the **Equity IRR**). One respondent thought that the OFTO should be able to adjust this value at the point of the refinancing if Equity IRR expectations have changed since financial close. We do not feel that this would be appropriate as it could allow the OFTO to unfairly increase the proportion of the gain it receives.

One respondent felt that if an OFTO is performing below the equity return levels projected in its financial model at financial close that it should be allowed to use a portion of any refinancing gain to restore returns to the level assumed at financial close and then share any remaining gain. We do not feel that such a provision would be suitable or in the best interests of consumers as any failure to meet the original equity return projections may be due to OFTO management or performance, both of which are risks that lie with the OFTO. In addition, such a provision would undermine the purpose of the availability incentive.

A generator asked for confirmation of how any refinancing gain share would feed through into TNUoS charges. TNUoS charges should reflect the cost of installing, operating and maintaining the transmission system and we have invited National Grid to consider the impact of the refinancing gain share, along with the impact of biddable indexation mentioned earlier, and to make any changes required to ensure the TNUoS methodology continues to meet its objectives.

3. Availability incentive - capacity weighting mechanism

In the July statement we set out our decision to introduce a capacity weighting mechanism to the availability incentive. In the October consultation we consulted on the licence drafting to implement this mechanism and the proposed values of the capacity weightings.

The capacity weighting mechanism will weight outages based on the proportion of transmission capacity available during a particular outage, with higher capacity outages penalised more heavily. This will encourage the OFTO to take smaller capacity outages where this is possible and cost effective.

Respondents were generally supportive of the introduction of the capacity weighting mechanism and the rationale behind weighting the incentive using two constants, *a* and *b*. One respondent suggested that the penalties should be linked to whether an outage actually resulted in generation losses to encourage OFTOs to align their outages with periods of low or no output. A similar option was considered in our May 2012 consultation[6] but was not adopted because we did not feel that there is a sufficiently robust method of calculating the level of lost generation.[7] The current availability incentive already includes a seasonal weighting which encourages the OFTO to plan outages in months where generation is typically lower.

In the October consultation we proposed to use the values of *a=1* and *b=1.3* as the default values for both projects in TR3. Some respondents were happy with the proposed values whilst others suggested amendments.

One respondent suggested that the value of *b* should be increased to *b=2* to accentuate the difference in penalties between low and high capacity outages, whilst other respondents were happy with the value of *b=1.3* but felt that the value of *a* should be increased above 1 in line with the number of export cables in a transmission system.

[6] Offshore Electricity Transmission: Updated proposals under the enduring regime (May 2012)
[7] Offshore Electricity Transmission: Consultation on licence policy for future tenders (November 2012)

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Several respondents noted the importance of keeping the values of *a* and *b* under review whilst one suggested that the generator should be allowed to suggest the values of *a* and *b*, provided this was supported with evidence.

We have decided to retain the default values of *a=1* and *b=1.3* for TR3 although we will approach the developers of the TR3 projects with the opportunity to present their own suggestions for *a* and *b*. The final values for each of the TR3 projects will be published ahead of the ITT stage. We will review the default values ahead of each tender round.

4. Financial security

Availability incentive penalties are paid in the year after they are accrued, with the potential to roll over for up to five years for a large outage (50 per cent of base transmission revenue is the maximum penalty paid out over up to 5 years). The licence requires the OFTO to procure financial security no later than 16 years after financial close (assuming a 20 year revenue term). The security may be called upon to cover financial liabilities incurred through amended standard condition E12 – J4 (Part A: Transmission System Availability Incentive) which are not paid through the normal revenue adjustment method.

The licence requires the financial security to be held in an independent financial institution. We proposed in the October consultation that the TR3 licence guidance should advise that the financial institution has a credit rating requirement equivalent to at least an "A-" with a credit rating agency recognised by Ofgem (currently Standard & Poor's, Moody's, Fitch and DBRS) residing in a country with a credit rating of at least "A" unless otherwise agreed with Ofgem.

Most respondents agreed with the proposed credit rating requirements and one respondent suggested that the credit rating requirement should be included in the licence rather than guidance to the licence to minimise the likelihood of change. **In light of these responses we have decided to adopt the proposed credit rating requirements and have amended the wording of amended standard condition E12-J4 to include the credit rating requirement in the licence.**

5. Sulphur hexafluoride (SF_6) emissions reporting

In the October consultation we proposed to introduce a simple monitoring and reporting requirement on OFTOs similar to the SF_6 data requirement in distribution licences.[8] This information will enable us to assess the extent to which offshore transmission assets contribute to SF_6 emissions. The information we proposed to collect was:

- SF_6 bank: This is the total kilograms of sulphur hexafluoride (in kg) held by the OFTO at the start of each financial year, both for assets installed on the network and those held in inventory. Each OFTO's SF_6 bank should be calculated according to the methods set out in the Energy Networks Association's (**ENA**) Engineering Recommendation S38.[9]
- SF_6 emitted: This is the total kilograms of sulphur hexafluoride emitted during asset installation (only if gassed by the OFTO), service life and decommissioning. Service life emissions include those due to leakage (measured through top-ups), those measured during service activity requiring gassing and degassing, and those due to equipment failure resulting in the loss of all gas contained by the asset. The SF_6 emitted value should account for gas recovered. Each OFTO's SF_6 emissions should

[8] For more details see the DCPR5 Regulatory Instructions and Guidance (Cost and Revenue Reporting and Glossary of Terms)
[9] ENA Engineering Recommendation S38: Reporting of SF_6 Banks, Emissions and Recoveries

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be calculated according to the methods set out in ENA's Engineering Recommendation S38.

Most respondents supported our proposed reporting requirement although one respondent felt that it should be extended to include a financial incentive. As set out in the October consultation, we do not feel that it would be appropriate to introduce a financial incentive to encourage the replacement of equipment with high SF_6 emissions as the equipment on OFTO systems has been installed recently and is unlikely to require replacement over the 20 year revenue period. **Therefore we have decided to implement the reporting requirement set out in the October consultation. The licence drafting has not been altered since the October consultation.**

One respondent suggested that OFTO emissions should be published as a five year rolling average to even out annual variations and to identify where good or poor maintenance is being carried out in the OFTO sector. We have decided not to publish the data immediately following TR3 due to the small amount of data that will be initially available. However we will keep the decision on whether to publish emissions data under review as a larger quantity of data becomes available.

6. Other licence drafting changes

One respondent suggested minor changes to paragraph 4 and the definition of 'networks rates' which we have made to the revised licence published alongside this decision letter. We have also updated amended standard condition E12-C2, which sets out the requirements for separation and independence of the transmission business, to show that allowing the system operator to have access to an OFTO's premises, facilities, data recording equipment and staff is only prohibited when the system operator is an associated business of the OFTO. The previous version of the licence stated that allowing the system operator access to any of the items mentioned above was always prohibited without Authority consent. The revised wording is in line with our approach to existing OFTOs and reflects policy intent.

As well as these changes and those detailed earlier in this decision letter we have made a small number of minor housekeeping changes and clarifications. These are summarised at the front of the licence published alongside this letter and highlighted in the 'redline' version of the licence.

If you have queries on this letter, please contact Hannah Evans (offshore.enduring@ofgem.gov.uk , Tel: 020 7901 7358).

Yours faithfully,

Min Zhu and Steve Beel
Associate Directors, Offshore Transmission

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Appendix 1: Summary of responses to 'Consultation on the generic Offshore Transmission Owner (OFTO) licence for Tender Round 3'
Appendix 2: Glossary

Published as separate documents:

Appendix 3: Generic OFTO Licence for Tender Round 3, Version 2 (TR3_V2)
Appendix 4: Generic OFTO Licence for Tender Round 3, Version 2 (TR3_V2) (Redline from Version 1 (TR3_V1))

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Appendix 1: Summary of responses to 'Consultation on the generic Offshore Transmission Owner (OFTO) licence for Tender Round 3'

Introduction

The 'Consultation on the generic Offshore Transmission Owner (OFTO) licence for Tender Round 3'[10] set out the proposed licence drafting for TR3 including the proposed drafting to implement key decisions from our July 2013 statement on generator build tenders.[11] The response period ran from 7 October 2013 to 2 December 2013.

This appendix provides an overview of the key themes from the responses. Copies of all responses are available alongside the consultation on our website. Seven responses were received.

Chapter 1: Indexation of Revenue

Question 1.1*: Are there any other options or implications you think we should consider in determining the parameters to use for implementing biddable indexation?*

One generator suggested that the generator should be able to specify in the data room the proportion of bidders' TRS bids that should be indexed and the inflation series (the RPI or the consumer prices index (**CPI**)) that the TRS should be indexed to.

Another generator raised concerns about how biddable indexation would affect the TNUoS paid by generators. They stated that it has the potential to result in more variable real terms cash flow requirements for the generator.

An OFTO respondent stated that the use of a fixed biddable indexation proportion over the entire 20 year revenue period will generate mismatches because the cost (and reserve) profile varies over time. They suggested that bidders should be allowed to submit bids where the proportion of revenue indexed varies over time in order to perfectly match the debt service.

Question 1.2*: Do you agree with the rationale we set out for adopting the parameters identified in paragraph 1.6 as minded-to positions?*

Respondents agreed with our minded-to positions to use the STPR as the real discount rate and a market implied inflation figure for the inflation assumption. One OFTO suggested including a separate calculation in the financial input sheet (used in the ITT bid) so that bidders can clearly separate their own inflation assumptions from those used by Ofgem to evaluate the bids.

Question 1.3 *Do you agree that using the breakeven inflation, calculated in accordance with the method described in paragraph 1.15, is a suitable market implied inflation figure to use in evaluating biddable indexation bids?*

Respondents agreed with our proposed approach. One OFTO agreed with our proposal to publish the breakeven inflation we will use for evaluation at the ITT stage. They also suggested publishing a template evaluation spreadsheet to allow bidders to see how factors such as MRA and PTRA assumptions will be assessed.

Question 1.4 *Are there any other options we should consider when selecting a market implied inflation figure?*

No other options were suggested by respondents.

[10] Consultation on the generic Offshore Transmission Owner (OFTO) licence for Tender Round 3 (October 2013)
[11] Offshore Electricity Transmission: Statement on future generator build tenders (July 2013)

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Question 1.5: *Do you agree with the proposed amendment to the calculation of Base Transmission Revenue (BR_t) to implement biddable indexation?*

Respondents generally agreed with the proposed amendment. One OFTO suggested introducing separate biddable indexation constants for the MRA and PTRA as there may be circumstances under which bidders would not wish them to be indexed to the same extent.

Chapter 2: Refinancing of external debt

Question 2.1: *Are there any other options or implications you think we should consider in determining the parameters to use for implementing a refinancing gain share?*

Respondents were generally supportive of our approach to introducing a refinancing gain share, although one OFTO reiterated their concerns that refinancing gain share arrangements will reduce incentives to recycle capital and therefore they felt that it may not be in the best interests of future efficiency in the OFTO sector.

One generator felt that a 50:50 split of refinancing gains between OFTOs and generators/consumers may over compensated the OFTO. Another generator requested clarity from National Grid or Ofgem on how a generator's TNUoS payments would be affected by a refinancing gain share.

Question 2.2: *Do you agree with the rationale we set out for adopting the parameters identified in paragraph 2.3 as minded-to positions?*

A generator agreed with our proposal that the methodologies for calculating and assessing the refinancing gain should be set out transparently and should be applied robustly and consistently in all cases. The respondent also suggested that the information provided by OFTOs carrying out a refinancing gain share should be audited by an independent capital and energy market expert.

Another generator stated that the refinancing gain, which was proposed to be shared 50:50, may over compensate the OFTO to the detriment of the consumer.

An OFTO suggested that, under certain circumstances, the blended equity IRR used to calculate the refinancing gain should be altered at the request of the OFTO rather than always using the equity IRR indicated by the financial model submitted with the bid. They also requested confirmation of whether there are any other circumstances under which the profile of the gain share would not match the profile of the debt service repayments, other than the example set out in the consultation (where the repayment profile would cause an increase in OFTO revenue payments in some years).

Question 2.3: *Do you think the scope of the refinancing gain share, and in particular the definition of the debt to which it will apply, is appropriate?*

One generator raised concerns about the difference between OFTO build and generator build refinancing gain shares.

An OFTO agreed with the definition of 'external debt'. They also suggested that if a project is performing below the levels projected in the original financial close base case financial model, then the investors should be entitled to apply the benefits of a refinancing to restore this base case projected performance, with gain-sharing only applying to gains above this level. The same OFTO also believed that the definition of 'Exemptions to the Refinancing Gain Share' needs further revision to align more with market-accepted 'exempt refinancing' positions used in PFI contracts. They also stated that if a refinancing has resulted from the OFTO complying with a request from the system operator to provide additional capacity, then this refinancing should be exempt.

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Question 2.4: *Do you have any views on the proposed licence drafting for the refinancing gain share set out in amended standard condition E12-J3 (Restriction of Transmission Revenue: Allowed Pass–through items) of the Licence (Appendices 5 and 6)?*

A generator suggested that the drafting should oblige the OFTO to provide certified documentary evidence in support of its refinancing gain calculation. An OFTO believed that the 3-month notice period should be waived when the OFTO is in financial distress. They also suggested including our proposal that the refinancing gain share will normally mirror the profile of the gain in the licence drafting.

Chapter 3: Availability incentive – capacity weighting mechanism

Question 3.1*: Do you have any views on the drafting of the capacity weighting mechanism in the generic OFTO licence?*

Generators were generally supportive of the capacity weighting mechanism but raised concerns that the level of weighting resulted in a reduction in penalty payments overall. One generator suggested that the licence drafting should incorporate provisions to ensure that the OFTO is obliged to liaise closely with the offshore generator to coordinate outages.

Another respondent felt that the capacity weighting mechanism is an improvement to the existing incentive but that it should be further revised to link the incentive to the actual output of the wind farm and encourage outages at times of low generation.

Question 3.2*: Do you agree with our rationale for setting the proposed values of a and b at a=1 and b=1.3?*

Responses from generators generally agreed with the rationale behind setting the values of *a* and *b*, however one generator felt that the value of *a* should be increased in line with the number of export cables to reflect the fact that the OFTO will have a greater ability to avoid large capacity outages. Another generator agreed with the default values of *a* and *b* but suggested that these be reviewed regularly.

An OFTO did not consider that the introduction of the capacity weighting mechanism will either create consumer savings (through more competitive bids) or change the OFTO behaviour in taking outages unless the value of *b* is increased to 2.

Question 3.3: *Do you agree with our approach to use the same values of a and b for all projects in TR3?*

Two respondents thought that it was reasonable to use the same values of *a* and *b* in all projects in TR3 although one noted that the values should be reviewed for future tender rounds. Other respondents felt that the values of *a* and *b* should be bespoke and take into account the design of the system, in particular the number of export cables. One generator stated that Ofgem should allow generators an opportunity to suggest their preferred values of *a* and *b* where the generator can provide evidence as justification for moving away from the currently established values.

Chapter 4: Financial security

Question 4.1*: Do you agree with our proposed requirements for the credit rating of the financial institution holding the financial security?*

Most respondents agree with the proposed credit rating requirements although one noted that the credit rating requirements for users of the National Electricity Transmission System under Appendix 1 of the CUSC are more stringent. One OFTO felt that the credit rating of the institution would be influenced by the country in which it is situated; therefore it was unnecessary to include both in our credit rating requirements.

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Question 4.2*: Do you agree with our proposal to increase the value of the financial security in line with base transmission revenue?*

Most respondents agreed with our proposal. One OFTO suggested that the financial security should be sculpted to reflect the part of the availability incentive not recoverable through the normal licence mechanisms rather than being fixed at 50 per cent of base revenue in all years.

Question 4.3*: Do you have any views on the licence drafting proposed in Part B of amended standard condition E12-J4 (Restriction of Transmission Revenue: Annual Revenue Adjustment)?*

An OFTO suggested setting out the credit rating requirements in the licence, rather than the licence guidance to reduce the risk of change at a later date. A generator felt that the impact of the financial security obligations on an OFTO of Last Resort appointed in the final five years of the revenue term should be considered.

Chapter 5: Sulphur Hexafluoride (SF_6) emissions reporting

Question 5.1: *Do you agree with our decision to introduce a reporting requirement on SF_6 emissions?*

Most respondents supported our decision to introduce a reporting requirement although one respondent felt that the requirement should be extended to include a financial incentive. One OFTO stated that the requirement may add to OFTO costs, while another OFTO questioned the rationale for introducing a reporting requirement.

Question 5.2: *Do you have any views on the licence drafting of amended standard condition E12-J12 (Sulphur Hexafluoride Reporting Requirements)?*

One respondent thought that the reporting requirement should be extended to include a financial incentive. Another respondent felt that it would be preferable if reporting requirements were fixed in the licence drafting rather than being set out in the Regulatory Instructions and Guidance which may be periodically changed.

Question 5.3: *Do you have any views on the proposed approach to reporting emissions?*

One generator stated that they agreed that measurements, calculations and reporting should be in line with ENA standard S38. Another respondent suggested that OFTO emissions should be published as a five year rolling average to account for the fact that annual emissions may be misleading as equipment may not require SF_6 refills every year. They considered that publication of the data would help to identify where good or poor maintenance practice is being employed in the OFTO sector.

Chapter 6: Other licence drafting changes

Question 6.1*: Do you have any views on the licence drafting changes made to the generic OFTO licence for TR3?*

One respondent suggested minor changes to the wording in paragraph 4 and some of the defined terms set out in amended standard condition E12-A1.

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Appendix 2: Glossary

B

Base Revenue (BR_t)

The transmission revenue of the OFTO before adjustments. It is calculated in accordance with the formula set out in amended standard condition E12-J2 (Restriction of Transmission Revenue: Revenue from Transmission Owner Services) of the Offshore Transmission Licence.

Biddable Indexation

A feature of the enduring regulatory regime allowing bidders in a Tender Exercise to specify the amount of their revenue they wish to be indexed to inflation.

C

Consumer Prices Index (CPI)

The Consumer Prices Index is a measure of inflation that measures the change in consumer prices over time. It differs from the RPI (Retail Prices Index) in that it does not measure changes in housing costs and mortgage repayments. They are calculated using different formulae and have a number of other more subtle differences.

D

Developer

The Tender Regulations define a 'developer' as 'any person within section 6D(2)(a) of the 1989 Act or within a developer group'. Section 6D(2)(a) of the Electricity Act 1989 defines such person as 'the person who made the connection request for the purposes of which the tender exercise has been, is being or is to be, held'. In practice, such person is also the entity responsible for the construction of the generation assets and, under Generator Build, the transmission assets.

Discount Rate

The annual rate at which the present value of a future pound, or other unit of account, is assumed to fall away through time.

E

ENA

The Energy Networks Association.

Enhanced PQ (EPQ) Stage

An extended version of the PQ stage of a Tender Exercise that can be used for Generator Build Tender Exercises where the Authority decides not to run a QTT Stage. At the end of this 'enhanced' PQ stage, the Authority will determine which Bidders become Qualifying Bidders and will be invited to participate in the ITT Stage of the Tender Exercise.

F

Financial Close

The process by which ownership of the offshore transmission assets is transferred. Often used to refer to a particular day or set of procedures.

G

Generator Build

A model for the construction of offshore transmission assets. Under the generator build option, the Developer carries out the preliminary works, procurement and construction of the transmission assets. The OFTO operates, maintains and decommissions the transmission assets.

The Office of Gas and Electricity Markets
9 Millbank London SW1P 3GE **Tel** 020 7901 7000 **Fax** 020 7901 7066 **www.ofgem.gov.uk**

Generic OFTO Licence

The non-specific version of the transmission licence which is modified with conditions specific to the particular circumstances of the project when it is granted to the Offshore Transmission Owner.

I

Internal Rate of Return (IRR)

The discount rate that generates a zero net present value for a series of future cash flows.

Invitation to Tender (ITT) Stage

The stage of a Tender Exercise during which the Authority may determine which qualifying bidder becomes the preferred bidder or whether to hold a Best and Final Offer (BAFO) stage. This stage starts from the distribution of the ITT Document to qualifying bidders by Ofgem, and includes the preparation, submission and evaluation of ITT submissions.

J

The July statement

Ofgem publication: 'Offshore Electricity Transmission: Statement on future generator build tenders' (Published 18 July 2013).

M

Market Rate Revenue Adjustment (MRA)

An adjustment to the base revenue under amended standard condition E12-A2 of the Offshore Transmission Licence to account for any difference between the market rates assumed in the TRS and the market rates on the date that the Offshore Transmission Licence comes into force.

N

National Electricity Transmission System (NETS)

The system consisting (wholly or mainly) of high voltage electric lines owned or operated by transmission licensees in Great Britain, in the territorial sea adjacent to Great Britain and in any Renewable Energy Zone and used for the transmission of electricity from one generating station to a sub-station or to another generating station or between sub-stations or to or from any interconnector and includes any electrical plant or meters owned or operated by any transmission licensee in Great Britain, in the territorial sea adjacent to Great Britain and in any Renewable Energy Zone in connection with the transmission of electricity.

Net present value

The discounted sum of future cash flows, whether positive or negative, minus any initial investment.

O

The October consultation

Ofgem Publication: 'Consultation on the generic Offshore Transmission Owner (OFTO) Licence for Tender Round 3 (Published 7 October 2013).

Offshore Transmission Licence (OFTO Licence)

The licence awarded under section 6(1)(b) of the Electricity Act 1989 following a Tender Exercise authorising an OFTO to participate in the transmission of electricity in respect of the relevant Offshore Transmission System. The licence sets out an OFTO's rights and obligations as the offshore transmission asset owner and operator.

Offshore Transmission Owner (OFTO)

The holder of an Offshore Transmission Licence.

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OFTO Build

A model for the construction of offshore assets. Under the OFTO build option, the Developer obtains the connection offer and undertakes high level design and preliminary works. The OFTO constructs, operates, maintains and decommissions the transmission assets.

OFTO of Last Resort

An OFTO appointed outside of a Tender Exercise from existing transmission licensees to provide transmission services in respect of particular offshore transmission assets in accordance with standard conditions B18 and E21 of the Transmission Licence where there is a significant likelihood that the Developer whose generating station that is, or is to be, connected to those transmission assets would be unreasonably delayed or stranded.

P

Post Tender Revenue Adjustment (PTRA)

An adjustment to the base revenue under amended standard condition E12-A3 of the offshore transmission licence to account for any difference between the indicative transfer value and the final transfer value of the transmission assets.

R

Retail Prices Index (RPI)

Is a measure of inflation that measures the aggregate change in consumer prices over time. It differs from the Consumer Prices Index (CPI) in that it measures changes in housing costs and mortgage interest repayments, whereas CPI does not. They are calculated using different formulae and have a number of other more subtle differences.

S

Senior Debt

A class of debt which ranks preferentially to other classes of debt for payout in the event of default.

Social Time Preference Rate (STPR)

The rate at which social costs and benefits are reduced annually to reflect the time preferences of society. The standard real discount rate used by HM Treasury, is currently set at 3.5%.

Sulphur Hexafluoride (SF_6)

A colourless, odourless, nontoxic and non-flammable greenhouse gas with a lifetime of 3200 years. It is used in the electricity industry for insulation and current interruption (predominantly in switchgears).

T

Tender Exercise

The competitive process run by Ofgem in accordance with the tender regulations to identify a successful bidder to whom a particular Offshore Transmission Licence is to be granted.

Tender Revenue Stream (TRS)

The revenue established through the tender process, which is the value set out in paragraph 4 of amended standard condition E12–J2 (Restriction of Transmission Revenue: Revenue from Transmission Owner Services) of the OFTO Licence.

Tender Round

One or more Tender Exercises being held or to be held by Ofgem, with a view to determining the successful bidders to whom Offshore Transmission Licences are to be granted for each qualifying project subject to such Tender Exercises, commencing on the date specified in a notice given in accordance with the tender regulations.

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Tender Round 3 (TR3)

The first competitive Tender Round for the grant of Offshore Transmission Licences for generator build projects under the enduring regime.

Transmission Licence

The licence awarded under section 6(1)(b) of the Electricity Act 1989 authorising the National Electricity Transmission System Operator (NETSO) or a transmission owner to participate in the transmission of electricity including an Offshore Transmission Licence. The licence sets out a TO's rights and obligations as a transmission asset owner and operator.

Transmission Network Use of System (TNUoS) charges

Charges made by the National Electricity Transmission System Operator (NETSO) to users of the National Electricity Transmission System for the provision of transmission network services. Charges are set according to the TNUoS charging methodology in the CUSC.

TRS Bid

The revenue entitlement of the OFTO as bid by the OFTO through the tender process.

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