

## **Appendix A: Review of Decision Criteria Used to Select Transmitters for Major Network Investments**

This appendix outlines the decision criteria and overall framework employed in Texas and the United Kingdom (UK) for selecting transmitters that would make major transmission system investments. Texas is pursuing the development of Competitive Renewable Energy Zones to unlock the significant wind generation development potential offered in remote areas that require significant transmission investment to deliver this generation to major load centers. The UK is aggressively pursuing the development of offshore wind resources which require significant transmission investment to deliver this generation to the backbone transmission network. The decision criteria and frameworks employed to select the transmitters that will build, own and operate these facilities is reviewed below.

### **Texas' Approach: Competitive Renewable Energy Zones**

In 2005 the Texas legislature enacted Senate Bill 20 to establish long-term transmission planning to develop the state's significant wind resource potential. This bill directed the Public Utility Commission of Texas (PUCT) to implement a proposal for Competitive Renewable Energy Zones (CREZs) under which it would select the transmission service providers (TSPs) who would build the high voltage transmission facilities that would interconnect those areas with significant wind resources to major load centers. The overall process used to identify the CREZ Transmission Plan's (CTP) facilities and the TSPs that will build or upgrade them is reviewed first and then the criteria for designating TSPs to build these CTP facilities is reviewed.

### **Overview of the Process**

In December 2006 the Electricity Reliability Council of Texas (ERCOT), the independent system operator for the Texas market area, submitted a study to the PUCT that identified possible CREZ alternatives by reviewing the estimated resource potential of CREZ alternatives and the corresponding transmission system investments required to deliver this energy to customers. The PUCT issued an order in October 2007 designating eight areas which were combined into five zones as CREZs and directed ERCOT to evaluate further the resulting transmission options and corresponding resource potential. In April 2008 ERCOT filed with the PUCT a transmission optimization study that identified four alternative transmission plans that would connect different amounts of wind generation. In July 2008 the PUCT selected a CREZ proposal which will enable the interconnection of 18,456 MW of wind power from West Texas and the

Panhandle and the transmission of this power to the major metropolitan areas in eastern Texas at an estimated cost of \$4.9 billion. This CREZ proposal identified the specific transmission facilities that needed to be built or upgraded. The PUCT also conducted a proceeding to identify the criteria that would be used to select the TSPs for these facilities. These criteria and corresponding rules were adopted by the PUCT in May 2008.<sup>1</sup> In July 2008 TSPs interested in constructing CTP projects filed expressions of interest with the PUCT. In July 2009, the PUCT issued a final order on rehearing that designated the TSPs that would build the various CTP facilities.

### **Criteria for Selecting TSPs**

The rules for selecting these TSPs specify that they will be selected based on:

“the current and expected capabilities of the Interested TSP to finance, license, construct, operate, and maintain the CTP Facility or Facilities in the most beneficial and cost effective manner and the expertise of the Interested TSP’s staff, the Interested TSP’s projected capital costs and operating and maintenance costs for each CTP Facility, the Interested TSP’s proposed schedule for development and completion of each CTP Facility, the Interested TSP’s financial resources, the Interested TSP’s expected use of historically underutilized businesses unless the Interested TSP is an electric cooperative or municipally owned utility, and the Interested TSP’s understanding of the specific requirements to implement the CTP Facilities in its CTP Proposal and, if applicable, the Interested TSP’s previous transmission experience and the Interested TSP’s historical operating and maintenance costs for its existing transmission facilities.”<sup>2</sup>

The rules also require that the prospective TSPs provide:

“a description of the interested TSP’s CCN [Certificate of Convenience and Necessity] process; a general description of the proposed structure, conductor types, and right-of-way; the projected in-service date; the type of resources contemplated for licensing, design, engineering, material and equipment procurement, right-of-way and land acquisition, construction, and project management; the type of resources contemplated for operating and maintaining each CTP facility; the capability and experience of the TSP to comply with all on-going scheduling,

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<sup>1</sup> <http://www.puc.state.tx.us/rules/subrules/electric/25.216/34560adt.pdf>

<sup>2</sup> <http://www.puc.state.tx.us/rules/subrules/electric/25.216/25.216.pdf>

operating, and maintenance activities required; resumes for key management personnel; a demonstration that the TSP's business practices are consistent with good utility practices for proper licensing, designing, right-of-way acquisition, constructing, operating, and maintaining CTP facilities; a summary of law violations found or current investigations; the estimated direct costs to construct representative structures; a detailed estimate of the anticipated average annual operating and maintenance cost; the actual average direct operating and maintenance cost if the TSP is an incumbent utility; the overhead rate for managing third-parties and the willingness to maintain the overhead rate; the TSP's preexisting procedures and historical practices, or a detailed description of the plans for acquiring right-of-way and land and managing right-of-way and land acquisition for transmission facilities; the TSP's preexisting procedures and historical practices, or a detailed description of its plan for mitigating the impact of transmission facilities on affected landowners and for addressing public concerns regarding transmission facilities; a proposed financial plan that confirms the TSP has adequate capital resources and no significant negative impact on the creditworthiness or financial condition will occur as a result of the construction, operation, and maintenance of the CTP facilities; an affidavit by an officer stating that the information in the application is true and that the TSP will comply with the rules and PURA[Public Utility Regulatory Act]; other evidence the TSP provides supporting its selection; and, unless the TSP is an electric cooperative or municipally owned utility, a description of the use of historically underutilized businesses."<sup>3</sup>

The PUCT also requested utilities to indicate the cost of financing \$100 million (municipal utilities) and \$500 million (privately held) of debt given their credit rating for 1, 3, 5, 10 and 30 year terms. Interestingly, the privately held TSPs were also required to indicate their proposed return on equity if they were selected. The rules also specify additional financial criteria and general requirements including how investment grade status is established and requiring a summary of any history of bankruptcy, dissolution, merger or acquisition of the TSP.

The PUCT summarized the financial factors considered as:

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<sup>3</sup> <http://www.puc.state.tx.us/rules/subrules/electric/25.216/34560adt.pdf>, p. 4 as cited in <http://www.lcra.org/library/media/public/docs/energy/crez/PUCFinalOrder.pdf>, p. 4

“the current and expected capabilities of each interested TSP to finance, license, construct, operate, and maintain CTP facilities in the most beneficial and cost-effective manner; each interested TSP's projected costs for financing, construction, and operation and maintenance; an interested TSP's average direct operating and maintenance costs-per-mile of same-voltage transmission lines during the last five calendar years (when applicable); an interested TSP's estimated overhead rate for managing third parties (when applicable); and each interested TSP's current and projected financial resources.”<sup>4</sup>

The PUCT also noted that

“regarding each TSP's current and projected financial resources, of particular concern are each TSP's demonstration of available, adequate resources to finance requested CTP facilities; a TSP's current credit rating by a nationally recognized credit agency (when applicable); and whether each TSP's creditworthiness or financial condition would suffer a significant negative impact as a result of its being assigned varying sizes of CTP facilities.”<sup>5</sup>

### **Other Criteria for Specific Types of CTP Projects**

While considerable weight was given to the financial capability of the prospective TSP and its demonstrated ability to secure appropriate financing, consideration was also given to balancing financial requirements with available resources and the selection of multiple TSPs for the projects and the proximity of facilities to each other and resulting economies. The order issued by the PUCT doesn't provide any indication regarding the relative weight that is applied to these different considerations which are further discussed below.

For existing transmission facilities which required upgrades or modifications the PUCT indicated that it would select the owner of that facility to be responsible for that project, “unless the owner requests an alternate TSP or there is good cause to select a different TSP.”<sup>6</sup> These are referred to as default TSPs. In addition, the PUCT found that there were priority projects that were critical to relieve current congestion that is limiting the delivery of existing wind generation. These priority projects were given precedence in the permitting and review process and

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<sup>4</sup> <http://www.lcra.org/library/media/public/docs/energy/crez/PUCFinalOrder.pdf>, p. 8.

<sup>5</sup> <http://www.lcra.org/library/media/public/docs/energy/crez/PUCFinalOrder.pdf>, p. 8.

<sup>6</sup> <http://www.lcra.org/library/media/public/docs/energy/crez/PUCFinalOrder.pdf>, p. 4

responsibility for these projects was assigned to incumbent TSPs given that they currently hold a CCN.

Given the magnitude of required investment and current financial market conditions, the PUCT recognized “the importance of striking the proper balance between selecting a large pool of TSPs to participate in the CTP in order to spread financial risk, introduce novel technologies, and diversify sources of skills and materials against selecting a small number of TSPs in order to avoid unnecessary complexity and coordination difficulties”.<sup>7</sup>

The PUCT also noted that “given the current economic climate and the strong qualifications of many of the interested entities in this docket, the proper balance will be struck through the selection of several incumbent TSPs as well as the strongest new entrants.”<sup>8</sup>

The PUCT also sought to assign geographically proximate projects to the same TSP when possible. The PUCT noted that

“Ensuring that each selected TSP's projects are close together (or in the case of incumbent TSPs, are at least close to their pre-existing service areas) provides several advantages. Economies of scale can be better employed. For example, multiple facilities can be addressed by a single service center. Additionally, the difficulties of coordinating with multiple TSPs during the planning, certification, construction, and operation and maintenance stages will be reduced. Furthermore, the TSPs will not be required to familiarize themselves with multiple regions of the state.”<sup>9</sup>

The PUCT also considered the size and resources of the TSP relative to the facilities to be assigned. The PUCT noted that its

“allocations of CTP facilities should reflect each TSP's demonstration of significant experience with large-scale energy projects, the capacity to finance a large CREZ assignment without a significant negative impact on creditworthiness or financial condition, the importance of experience working with landowners and other members of the public to reach mutually beneficial arrangements, and the capability to expand their operations to include CTP facilities promptly and effectively. While the size of an interested TSP's current service area was considered when

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<sup>7</sup> <http://www.lcra.org/library/media/public/docs/energy/crez/PUCFinalOrder.pdf>, p. 9.

<sup>8</sup> <http://www.lcra.org/library/media/public/docs/energy/crez/PUCFinalOrder.pdf>, p. 9.

<sup>9</sup> <http://www.lcra.org/library/media/public/docs/energy/crez/PUCFinalOrder.pdf>, p. 10.

applicable, this was not the sole determining factor used by the Commission when determining the appropriate total amount of each TSP's assignment."<sup>10</sup>

## **United Kingdom: Transmission Facility Ownership to Interconnect Offshore Wind**

In the UK the Office of Gas and Electricity Markets (Ofgem), the electricity and gas regulator, is conducting a process to select transmission companies to own and operate the high voltage offshore transmission facilities that are required to integrate the expected generation from offshore wind facilities. These offshore transmission facilities will be built by or on behalf of the offshore wind project developer and transferred to the Successful Bidder of this process. Facilities are transferred after commissioning so that construction risks remain with the developer. As part of this process, Ofgem will conduct an "assessment of the economic and efficient costs of developing the assets to be transferred for each project."<sup>11</sup> The overall process used, starting with an open call and ending with a Preferred Bidder, is described first. Specific criteria used to generate the short list of bidders are then reviewed.

### **Overview of the Process**

Ofgem uses a three- or four-stage winnowing process to arrive at the final Preferred Bidder. The stages (as listed by Ofgem<sup>12</sup>) are

- Pre-Qualification (PQ),
- Qualification to Tender (QTT),
- Invitation to Tender (ITT),
- Best and Final Offer (BAFO) (optional),
- Preferred Bidder, and
- Successful Bidder to whom a licence would be granted

The number of participants is reduced at each of these stages. Pre-Qualification is open to all and will produce a long list of bidders; selection is pass-fail against the criteria. Qualification to Tender results in a scored selection against criteria

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<sup>10</sup> <http://www.lcra.org/library/media/public/docs/energy/crez/PUCFinalOrder.pdf>, p. 10-11.

<sup>11</sup> Ofgem, "Offshore Transitional Tenders First Round Transitional Projects Tender Guidance Note on Process to Asset Transfer", pg. 6.

<sup>12</sup> Ofgem, "Offshore Electricity Transmission: Final Statement on the Competitive Tender Process", pg. 5. (Cited as Final Statement)

specified in the QTT documents to arrive at a short list of up to five bidders. The Invitation to Tender is then issued to the short list. The bids are scored against criteria specified in the bid documents. Ofgem may, after evaluating the bids, ask for a Best and Final Offer, or it may directly choose a Preferred Bidder. It may also designate a reserve bidder who would be approached if Ofgem is unable to come to an agreement with the Preferred Bidder.

The structure of this process is set forth in a regulation.<sup>13</sup> The regulation describes the stages of the process and the application of the criteria at each stage. The regulation implies which evaluations will be scored and which will be pass-fail. It does not list any criteria, but says that the criteria against which bids will be measured will be set out in the bidding documents.

Ofgem has initiated one round of competitive tenders, which has reached the QTT stage. The stage descriptions therefore draw on and cite the tender documents as issued by Ofgem.

### **Expected Schedule**

The Final Statement had a proposed timetable for the first process. It expected the Pre-Qualification stage to start in July 2009, followed by QTT in Sept. 2009. The short list would be announced in December 2009 and the ITT stage would start in January 2010. Preferred Bidders would be selected by Spring 2010.

The process has adhered to this timetable up to December 2009. The Ofgem website does not indicate that the short list has yet been chosen or that the ITT stage has begun.

### **Stage Descriptions**

#### ***Pre-Qualification***

In Pre-Qualification, potential bidders demonstrate their track record against criteria on a non-project specific basis. At this point in the process, Ofgem has not identified particular projects for which the bidders will compete, but it does provide more generic information on the kind of projects which may become available. The selection is based on the applicant's economic and financial standing, legal standing, and management and operational capability on a generic basis.<sup>14</sup>

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<sup>13</sup>Statutory Instruments 2009 No. 1430 "The Electricity (Competitive Tenders for Offshore Transmission Licenses) Regulations 2009". Made 1 June 2009.

<sup>14</sup> Ibid., pg. 12.

The evaluation process section from the Pre-Qualification stage of the current process, including the criteria, is copied below.<sup>15</sup>

### ***Evaluation Process***

#### **(A) Evaluation Criteria**

The purpose of the Pre-Qualification Stage is to determine those Applicants that meet the criteria to be Qualifying Applicants by assessing whether an Applicant has sufficient economic and financial standing, management and operational capability and legal standing, based on the Applicant's current standing and track record, to satisfy Ofgem that the Applicant is capable of (i) taking over ownership of the Qualifying Project(s) for which it wishes to be invited to tender and (ii) assuming the responsibilities and duties associated within being an OFTO [offshore transmission owner]. Where the Applicant is a consortium, this assessment will be based on the current standing and track record of the consortium taken as a whole.

Applicants are required to demonstrate through their responses to certain questions that they meet the criteria on a pass/fail basis. The criteria relevant to each section of the Pre-Qualification Questionnaire are set out below:

#### ***Section 2 – Organisational structure***

An Applicant must provide details and evidence of its ownership and organisational structure.

#### ***Section 3 – Economic and financial standing***

An Applicant must demonstrate that it has the necessary financial strength to be considered viable to support the proposed expenditure level (on the basis of the aggregate of Ofgem's estimated transfer values for the Qualifying Project(s) for which the Applicant wishes to be invited to tender). Where the Applicant proposes a combination of Corporate Finance and external financing, it should provide answers to the relevant questions in this section.

#### ***Section 4 – Management and operational capability***

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<sup>15</sup> Ofgem "Pre-Qualification Document 2009 Transitional Tenders", issued 22 July 2009, pp. 10-11. Material cited is copyright by the Crown.

An Applicant must demonstrate that it has the necessary expertise to manage and operate an essential services asset or regulated infrastructure asset of similar size and complexity to the Qualifying Project(s) for which the Applicant wishes to be invited to tender.

*Section 5 – Legal standing, pending litigation and potential conflict issues*

An Applicant must demonstrate that it satisfies the minimum legal requirements in order to be granted an Offshore Transmission Licence, that it is not involved in any relevant material litigation and that it does not have any potential conflicts of interest which materially detract from its ability to tender for, manage and operate the nominated Qualifying Project(s).

At this stage of the Tender Process, Applicants are required to provide a methodology statement for managing conflicts of interest, for information purposes only. However, Ofgem reserves the right to evaluate this information as part of future stages if the Applicant is taken forward.

*Section 6 – Certificate*

A duly authorised officer of the Applicant is required to confirm the statements in section 6. An Applicant who does not satisfy the criteria in section 6 will have its Pre-Qualification Submission rejected and such Pre-Qualification Submission will not be considered further. In relation to statement (C) in this section, an Applicant will not be required to initial and sign where it can demonstrate that any relevant bankruptcy or other insolvency related claim is vexatious or not material in the context. In evaluating an Applicant's response to statement (C), Ofgem will consider whether an Applicant's explanation raises or fails to answer concerns over its ability to service the anticipated finance liabilities of an OFTO.

(B) Applicants are also required to provide information in response to certain questions in the Pre-Qualification Questionnaire which may be used by Ofgem to contextualise a wider evaluation.

Some of the questions contained within the Pre-Qualification Questionnaire are included in order to allow the Applicant to demonstrate that it meets the minimum legal requirements required of all licensees<sup>16</sup>.

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<sup>16</sup> Ibid., pp. 10-11.

The Pre-Qualification document also says that the submissions will first be checked for compliance with all requirements. Then they will be evaluated against the criteria on a pass/fail basis, and all submissions which pass all of the criteria will be invited to the next (Qualification to Tender) stage.

The criteria in this stage relate to the general capability of the firm both organizationally and legally. They include questions relating to the legal status of the bidder and its potential conflicts of interest in addition to asking for demonstrations of technical competence.

### ***Qualification to Tender***

This stage becomes more specific to the tasks at hand, both by focusing more on the bidders' capability and by asking them to identify which projects they are interested in. This stage also begins to ask for costing and financing information.

During the Qualification to Tender, bidders are given information on specific projects and are asked to identify those for which they wish to compete. The assessment of the submissions is against several key criteria, including the financial offer, the financing strategy, managerial and legal capability, and the provisional operating plan. Each project will be assessed separately; that is, if a bidder has proposed for more than one project, its bid will be scored separately with respect to each project for which it has proposed.

The evaluation criteria part of the Qualification to Tender document has eleven sections, of which seven contain scored criteria. Weights are indicated for each section. The relevant sections are quoted below. Details are retained only for the scored sections.<sup>17</sup>

#### ***QTT Evaluation Criteria***

Ofgem will evaluate and score the Qualifying Applicant's QTT Submissions, on a per Qualifying Project basis. The criteria relevant to each section of the QTT questionnaire and the weighting for each section are set out below.

*Section 1 – Confirmation of PQ Submission*

*Section 2 – Relevant Qualifying Project*

*Section 3 - Project IRR and Tender Revenue Stream (25% Weighting)*

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<sup>17</sup> Ofgem, "Qualification to Tender Document 2009 Transitional Tenders", issued 24 Sept 2009. Criteria and weighting are on pp 12-13. Material is Crown copyright.

The Qualifying Applicant must provide an indicative annual Tender Revenue Stream for the relevant Qualifying Project incorporating its proposed Project IRR and other relevant assumptions.<sup>18</sup> Qualifying Applicants will be evaluated on the basis of their Project IRR together with their approach to deriving the Tender Revenue Stream.

*Section 4 - Financing strategy (25% Weighting)*

The Qualifying Applicant must provide its proposed financing strategy. Qualifying Applicants will be evaluated on the basis of the coherence, deliverability and viability of the proposed financing strategy in support of their Project IRR and Tender Revenue Stream. The response should include evidence of support including, where appropriate, indicative terms.

*Section 5 – Financial and commercial risk management (10% Weighting)*

The Qualifying Applicant must demonstrate an understanding of the key risks that could have a financial and/or commercial implication for the relevant Qualifying Project. Qualifying Applicants will be evaluated on the basis of their understanding and proposed approach to managing and mitigating these.

*Section 6 - Shareholding/consortium structure (5% Weighting)*

The Qualifying Applicant will be evaluated on the basis of the robustness and clarity of its proposed shareholding/consortium organisational and contractual structure.

*Section 7 - Management capability statement (20% Weighting)*

The Qualifying Applicant must demonstrate its capabilities through experience-based management approaches to key aspects of the role to be undertaken by an OFTO and the specifics of operating within the offshore transmission regime.

Qualifying Applicants will be evaluated on the basis of their understanding of the requirements and the coherence and viability of their proposals in relation to the relevant Qualifying Project.

*Section 8 - Take over and operational plan (10% Weighting)*

The Qualifying Applicant must demonstrate, with regard to its management approach, its understanding and approach to acquiring a business or assets from a third party and developing and evolving an operations plan for newly acquired assets.

Qualifying Applicants will be evaluated on the basis of the coherence and deliverability of their approach in relation to the relevant Qualifying Project.

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<sup>18</sup> These other relevant assumptions are not specifically identified.

*Section 9 – Sale & Purchase Agreement (5% Weighting)*

The Qualifying Applicant must demonstrate its understanding of the scope and considerations associated with the Model SPA [Model Sale and Purchase Agreement] in the context of the project specific information provided through the tender process to date. The Qualifying Applicant will be evaluated based on their clear and considered identification of key commercial issues associated with the Qualifying Project and its transfer via an SPA. A legal mark up of the Model SPA is not required.

*Section 10 - Certificate*

*Section 11 - Confidentiality*

**Invitation to Tender**

ITT tender documents are not available.

After identification of the bidders on the short list, the ITT phase begins with establishment of a data room to which the short listed bidders will have access.

The description of the ITT stage given here is taken from the Final Statement.

The Invitation to Tender Stage (ITT) is designed to enable the short-listed qualifying bidders to submit their detailed proposals against a number of criteria, including their required revenue stream for the project. The key attributes of this stage are:

- Qualifying bidders will be provided with access to a fully populated data room for the specific project(s) for which they have been shortlisted,
- Qualifying bidders will be invited to submit a detailed bid for each project for which they have been shortlisted,
- Assessment will be based on the qualifying bidders' responses against a number of detailed criteria, including their required revenue stream and their managerial, operation and legal capability,
- Assessment will be on a scored basis against the criteria,
- Where a qualifying bidder has been shortlisted for more than one project, they will be required to submit an ITT bid for each project individually but may also submit a variant bid for a combination of projects. However, any variant bid submitted must, at a minimum, identify the required revenue stream on a per project basis, and
- Where a qualifying bidder wishes to change its consortium, it must notify Ofgem, who will use its discretion to permit the change having regard to

whether the change would be fair and equitable to all other qualifying bidders for that project.

The outcome of the ITT Stage will be the identification of the Preferred Bidder for each project. Where we consider it appropriate, we will run a Best and Final Offer Stage to identify the Preferred Bidder.

As planned in the Final Statement, the entire competitive process would require about 9 months, from July 2009 to Spring 2010.