Ofgem Consultation.

Accelerating onshore electricity transmission investment

Laing O'Rourke response

Q3: Do you agree that it is in the consumer interest to consider exempting projects from competition?

Pipeline Information

We believe a key element to providing value for clients and consumers is being able to offer certainty in delivery. Delivering certainty requires an aligned supply chain, early engagement with clients and the ability for all involved to plan strategically for projects.

Suppliers rely upon accurate pipeline information to inform their overarching business strategies, market focus, resource allocation and research and development. Where suppliers can rely upon pipeline information and inform their wider business strategy to respond to future demands, customers such as Government/Ofgem could expect value to be returned through an innovative supplier landscape that drives to secure the available work.

Ensuring certainty on the TO's delivering the 26 strategic ET projects would be a positive step towards providing transparency on the planned pipeline and allows suppliers to plan and invest with confidence to deliver with greater economies of scale and increased productivity.

If there is uncertainty on which TO's will be delivering certain ET projects (i.e. CATO legislation), the supply chain will not be willing to invest in these schemes until such certainty is given – therefore the CATO process will likely lengthen the existing timeline for appointment of a TO's supply chain and consequentially may delay or prevent early delivery of new onshore ET projects as the time taken to run the competition is time taken away from being able to engage with the supply chain early and customers will ultimately not be able to benefit from an innovative and productive supplier landscape.

Accurate pipeline information that can be relied upon is characterised by the following:

- Certainty that opportunities will come to market and clarity on timing
- Clarity on who will deliver the project/programme of projects
- Clarity of opportunity value, anticipated programme, and form of contract
- Clarity on procurement route

Q5: Do you agree that without upfront certainty that they will be delivering enough of the investment needed for 2030, TOs will face significant difficulties mobilising the supply chain to deliver the works on time?

Capacity in the supply chain:

A risk that we foresee impacting the sector over the next 5-10 years (and beyond) is associated with the availability of skilled labour to meet present and growing demand. The introduction of new sectors, such as green infrastructure will place additional pressure on an already constrained and limited resource pool. If ignored, we believe this will have a detrimental effect on the ability for the supply chain to service the needs of the sector and eventually create an unsustainable level of competition for labour.

Laing O'Rourke believes its vertically integrated model/direct delivery and manufacturing-led approach positions it well to navigate these challenges. We acknowledge and highlight however that the wider supply chain will play a key role in how these challenges are managed.

Supply chain will focus on sectors/markets which can offer clarity on future pipeline and offer long-term contracting through portfolio of projects. This approach will enable supply chain to confidently invest in their own resource allocation, research and development and business strategies.

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Ofgem and TO's must provide accurate pipeline information and batch projects (i.e. TO's procuring strategic ET schemes is allocated as a portfolio of works) for the UK ET network, otherwise supply chains will prioritise focus elsewhere in the world/UK construction market. This will ultimately lead to delays to delivery in UK Net Zero investment.

Q7: Which of our options for streamlining our regulatory processes do you favour?

Proposals for early acceptance of project need and early approval of costs will no doubt assist TO's in commencing procurement of their supply chains and engaging them to carry out early contractor involvement and pre-construction services.

Programmatic Delivery Models:

Portfolio and longer term contracting is one of the key requirements mentioned in the Government's Construction Playbook.

If there is un-certainty on which projects will be subject to competition, existing TO's will be restricted to engage with supply chain. If all 26 strategic ET projects can be exempted from competition, this will enable the existing TO's to use a programmatic deliver model (batching their projects, rather than procuring individual projects). Batching projects (i.e. procuring all 26 strategic ET schemes as a portfolio of works) will leverage productivity gains associated with increased volumes of projects with standardised elements through offsite manufacturing to generate greater value for clients / departments across the portfolio of works.

Key benefits of a programmatic delivery model/portfolio approach include:

- Long term partnering and contracting – allows for strategic relationships to be made throughout the supply chain.
- Portfolio approach to delivery allows supply chain to standardise design for large programme of works through early engagement, resulting in standard components being utilised across the entire programme of works – this will allow for efficient delivery across the entire programme of projects.
- Accelerated delivery
- Long term partnering and contracting allows for replication and learning (over and over), to shorten delivery and bring down costs.
- Supply chains are able to invest in their own resource allocation, R&D and skill set to support clients' needs if they are engaged on a programme of works, rather than project-by-project basis - as they have visibility of an accurate portfolio of work to inform their overarching business strategies and market focus.
- Having an accurate pipeline of portfolios of works, allows the supply chain to build up capability and capacity – the current ET supply chain market is not set up to deliver the extent of scope required for 2030 targets.

Early Engagement & Approach

Early supply chain involvement is a key principle of The Construction Playbook. Enacting a standardised procurement process across the electricity transmission network that focuses on bringing projects to market at a quicker rate and batching projects into programmes of work will be a positive means of creating opportunities for early engagement and collaboration with suppliers.

This will offer suppliers the ability to act upon pipeline information in collaboration with Government/Ofgem to influence design and development of ET projects to maximise value for Government. This will result from the ability to develop the 26 strategic ET projects with a modern methods of construction solution at the forefront which will generate productivity improvement, value gains through economies of scale and certainty in delivery.

The savings that could be realised through early supply chain involvement (standardised components, bulk procurement, input into DCO/land take etc.) will outweigh any likely savings derived through competition on the strategic ET projects.

If competition is needed for strategic ET projects, the CATO's will not be able to engage supply chain until the legislation is finalised which could lead to delays. Existing TO's are in a position where they can start engaging with the supply chain and progress pre-construction and construction works before the supporting legislation and regulatory arrangements are in place. This early engagement with supply chain is **critical** if the UK need to achieve 2030 net zero targets.

When will benefits of Early Contractor Involvement be "banked"

We believe most benefits in tender phases can be realised through carrying suppliers involved early through to delivery (subject to good performance). The key benefit here is that a developed relationship between suppliers and customers will exist where key values of respective departments and the nuances of project are aligned. Additional benefits will be the ability for shorter periods to completion from concept that will stem from a removed requirement for extended tender periods and the associated savings in cost of extensive tenders.

ECI input into management of the budget, programme and client KPIs (key performance indicators) from day one. Efficiencies can be seen throughout the statutory process, by streamlining this process, reduce land take needed etc.

From experience on major infrastructure projects, we have seen that major change is typically driven by interfaces. Early integration of these interfaces through ECI would allow for supply chain to get involved early in design process and start managing interface interactions early in the project. This would enable key interfaces mapped out from the start and managed responsible to buy away a lot the "change".

Other benefits that can be "banked" include:

- Standardisation of components (cheaper/ efficient products)
- Accelerated delivery
- Buildability input
- Reduce the amount of major changes throughout the project/programme.

Q10: What are you views on introducing a package of regulatory measures which Ofgem may apply to protect consumers?

Please see our response to Q11 below

Q11: What are you views on the design of each of regulatory measure? (Please clearly reference which measure(s) your comments relate to e.g. Accelerated delivery Output Delivery Incentive, Ex post efficiency review, etc)

Key learning on commercial/incentivisation models from >£8bn of major project delivery.

Laing O'Rourke have been involved in major infrastructure projects and programmes across the UK.

1. **Major projects start with:**

In our experience some major projects/programmes have started with a model with severe downside on the contractor, such as:

- 50:50 target cost
- No programme alignment
- No incentivisation to align employer/contractor on wider objectives or project stakeholder requirements

2. **Reset during delivery:**

Major programmes/projects are subject to major changes during delivery (due to the nature of the works). When these major changes occurred, the model above resulted in protective, non-value add behaviours between employer and contractor, rather than productive behaviours working together to solve the issues. This led to a Reset during delivery, involving the following:

- Cost reimbursable model with adjusting fee (based upon performance) is introduced
- Programme financial incentivisation is introduced to reward good progress/deliver. On long programme of work, these incentives may be set annually to ensure they remain relevant.
- Inclusion of delay damages zero exposure period. This encourages focus of recoverin any delay incurred rather than pursuit of extension of time entitlement.
- Further joint incentives introduced with the interfacing / dependant stakeholder or other contractors to create aligned objectives and delivery.
- A drive to consolidate the Employer/Contractor teams into a one-team collaborative approach is introduced.

3. **Leading to better outcomes:**

The above Re-set leads to a major shift in behaviours, and the project team is focused on right outcomes. Benefits of re-set include:

- ✓ Focus of the project wide team on delivery of the project, not securing/defending historic entitlements to cost and time
- ✓ Cost reduction as less resource is allocated to cost and programme entitlement matters.
- ✓ Combined Employer / Contractor delivery teams reduce head count duplication and increase performance as people best qualified and experienced in certain activities lead these works
- ✓ Ultimately, increased certainty of project delivery as teams are focussed on the matters which make a difference to project outcome

Getting the right commercial/incentivisation model from the start, lessons learnt:

Laing O'Rourke are equal partner in the East West Rail (EWR) Alliance, delivering £1.2bn of scope for Network Rail. This major project had a positive commercial/incentivisation model in place from the outset, which has therefore not needed a reset during delivery. The project has multi-disciplinary parties involved who are aligned on shared positive incentives to drive innovation. One example of this was the Bletchley Flyover, where the client recognised the "Box structure flyover saved £70m and 6 months for EWR" – this is demonstrable value for money. Network Rail's CEO (Andrew Haines) publicly praised the alliancing commercial structure in a construction news article on 07/02/22, voicing benefits such as:

- ✓ Different companies commit to working together to share risk and avoid blame on contracts
- ✓ Convincing evidence that alliancing creates the right contract structures that delivers better VfM and more sustainable solutions.
- ✓ Alliancing stops Network Rail being too heavy-handed as a client – this previously added cost and a lot of risk aversion without necessarily adding the commensurate value.

East West Rail project has been in delivery for 7 years and continues to deliver on time and on budget. This demonstrates the benefits of getting the right commercial model and positive incentivisation mechanism on a project from the start. There is a further 2 years until project competition.

As a potential response to the cost, material, and resource challenges facing the market, we have noted an increasing tendency for clients to demand 'fixed price' contracts where unreasonable levels of risk are placed upon suppliers. Whilst we understand the need to manage the risks described, we believe these behaviours will instead result in a highly unstable environment with insufficient risk protection for suppliers and customers alike. The approach we believe best is where suppliers and customers work collaboratively to jointly-manage any risks faced, specifically through non-fixed contracting models. Risk should sit with the "best athlete", who will be the organisation who can influence the risk the most.

Due to the nature of major infrastructure projects or programmes of works (such as 50GW by 2030 challenge), they will always be subject to major changes over the course of the project/programme. Therefore, it is best for customers to focus on outcomes, rather than lowest input costs/programme.

When a major change occurs during delivery of the 26 strategic ET schemes, Ofgem will need a model to account for these changes in a positive and productive manner. This model should include the following aspects:

1. **Should cost model**:
    a. The Construction Playbook emphasises the need for "should cost models" to be developed for major capital delivery programmes. This involves measuring a project/programme 'should' cost over its whole life i.e. measuring outcomes rather than the inputs for cost/programme.
    b. Do not value cheapest input costs, this promotes the wrong protective behaviours, the project is mis-aligned from the outset and the output will ultimately end up higher.
2. **Incentivisation mechanism:** Major change will happen. Therefore, we'd encourage Ofgem and TO's supply chain contracts to use a model that encourages the right positive and proactive behaviours when these major changes happen.
    a. Positive incentivisation and early engagement, allows a scheme to be developed to hit target cost and programme with appropriate levels of contingency.
    b. Want to avoid claims and LD's, as these promote the wrong protective, non-value add behaviours between employer/contractor. Instead, jointly incentivise against client's KPI's:
        i. e.g. Joint incentives for statutory process - positively incentivise for limited objections on environmental grounds or reduced time to close out objections.
        ii. KPI's can be a cash benefit or lead to future project allocation – this is a positive way to incentivise delivery team rather than using LD's.
    c. VfM is not just linked to cost, there are other aspects important to the client and project. It is appropriate to put KPI's against these important aspects to align and incentivise project delivery teams. Allocation of future work could be based on alignment to cost, programme and KPI's.
3. **Form of contract:** The form of contract plays an ever-present role in the success of projects whereby the model adopted is able to either fairly, or unfairly allocate risks to the parties. The latter has the potential of resulting in issues which can create instability and challenge beyond just the project itself, for both the supplier and customer.
    An example within the current inflationary environment is where suppliers are required to take an unreasonable level of cost risk on a fixed price contract. This not only creates uncertainty in the ability for a supplier to deliver the project, but it would also potentially results in the supplier's lender increasing

the risk profile associated with the business. The impact here is that access to funding may be limited and solvency issues may arise.
We therefore would like to encourage Government to consider different contracting models – in particular those which seek to fairly allocate risk between the parties. Our operation in markets like Australia has allowed us to see positive alternate contracting models (commonly in the form of alliances) which we feel would be equally effective in the UK, such as an Enterprise model/Project 13 approach. These models include:

a. Collaborative model – target cost or incentivised cost reimbursable, with reasonable fee level (to cover overhead plus a reasonable profit). Supply chain should not be exposed to damages/risks out of their control.
b. Positive incentives below "should cost model"
c. Best athlete for the risk – risk needs to sit with the best organisation who can influence and bear it.

Infrastructure market norms for delay LD's:

- Delay damages: capped at no more than 0.5% of contract value at peak.
- Overall cap of delay damages: capped at no more than 10% of contract value
- Total liability: cap at no more than 30% of contract value any LD's to be within the total overall cap)