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Our Reference: Ofgem151019

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Dear James

Consultation on extending competition in electricity transmission: arrangements to introduce onshore tenders
Amey response

Amey welcomes the opportunity to continue to participate in the ongoing consultation process in submitting our response to your email of 19th October 2015 regarding a competitive tender process to deliver new, separable and high value onshore electricity transmission assets.

As a major service based organisation, active in the design and construction of new transmission projects and with broad based experience in financing, building, owning and operating major infrastructure assets in the UK, we recognise the opportunity to deliver value to the consumer through consideration of such an approach for onshore transmission assets and are keen to contribute to the consultation process.

We thus respond to your questions as follows:

CHAPTER: Two

Question 1: What are your views on the proposed detailed interpretations of new, separable and high value (the 'criteria')?

In general, we are comfortable with the proposed detailed interpretations for new, separable and high value and welcome the additional clarity on these following the last consultation. We are content with establishing a £100m threshold in capital value terms as projects being of at least this scale will justify upfront investment by bidders, enable competitive funding to be raised, and meet expectations in respect of delivering value for the consumer.

We further suggest it may be worthwhile considering implications of projects being beyond a higher limit. Once a project is of a certain size it may limit competition through exclusion of potential bidders or reduce liquidity of funding options for the project, potentially limiting delivery of value for money.

The principles around new and separable would appear clear, fair and workable, although clearly there is detail to be resolved in this respect on a scheme by scheme basis moving forward. A transparent risk allocation for separability in terms of future availability and potential deductions is essential as discussed later on.

Question 2: Under what circumstances do you think asset transfer from an existing asset owner to a CATO would be required, recognising the principle that projects identified for tendering should be new?

As Ofgem has identified, asset transfer requirements will be driven by system needs in respect of the nature of the project and how the scheme will deliver its functional requirements. This will define the most suitable interface points with the existing infrastructure to support effective management and operation of new CATOs.

When a New project involves the full replacement of an existing asset, it may be cleanest to transfer the existing asset first before replacement works are carried out. How this is priced needs careful consideration as the valuation of an asset will differ between the existing owner and the new CATO.

Also, on a case by case basis, there may be value in transferring other assets in addition to those being replaced in order to ensure a clear boundary and separability of projects.

If any transfer of assets is required, a clear and unambiguous approach to valuation should be agreed in advance of the tender process commencing, along with sufficient due diligence to assess the condition of existing assets and the correct risk transfer between public and private sectors. Risks that cannot be assessed or are outside the control of bidders (e.g. contamination) is often best kept with the public sector in order to achieve value for money.

Question 3: What are your views on our proposal that electrical separability should not be required at each interface, but that the SO can propose it to us if it thinks there is a cost-benefit justification based on system operability?

We would concur with Ofgem position on this, where electrical separability requirements will be driven by network requirements defined by the SO, or a CATO itself deriving some operational benefit. This needs to be supported by a clear process for identifying responsibility for unavailability between CATO/SO/TO etc. In the event of faults/unavailability and deductions for unavailability, these need to be restricted to only events that are in the control of the CATO.

Question 4: What are your views on the suggested process and roles for identifying projects for tendering?

- **We have proposed specific roles for the SO – do you think there are any additional roles the SO could take on to support competition?**

We concur that the SO is well placed to undertake the suggested roles in identifying potential projects for tendering. As addressed elsewhere, comfort will be required from a conflict of interest point of view in respect of any roles following the identification/prelim works period. We expect that Ofgem will define and monitor the processes in a way that eliminates any conflict of interest or advantage should a TO bid for the identified project

We have no further suggested roles for the SO.

- **What's the most appropriate way to ensure that the network options assessment (NOA) considers the widest range of network options, including those that would be tendered?**

The proposals for the NOA process would appear robust in providing a platform for identification of future tendering opportunities, and effective engagement with stakeholders, whilst maintaining the integrity of the network. An annual process with a ten year look forward as proposed would appear appropriate on the basis that this would include sufficient challenge with respect opportunities from future technology solutions and likely network needs.

Question 5: What incentives and obligations should the SO and TOs have for undertaking preliminary works for tendered projects, and is there any value in considering a success fee incentive?

We agree that there is a clear driver and imperative for the SO to undertake the preliminary works for tendered projects, and would anticipate that, notwithstanding the ultimate delivery model, the SO would undertake these works efficiently and with due skill and care.

The process/structure for managing this is not defined, however, clear definition of scope and reporting/management requirements will support effective delivery and scrutinising of associated costs to ensure that only reasonable costs are incurred in a similar vein to that used for the OFTO procurements.

In addition, the scope of preliminary works should be such that they do not restrict potential solutions that tenderers may propose during the tender phase. To encourage innovation within tenders, preliminary works such as consents and assessments should be flexible enough to allow this.

Success fees and similar incentives are generally used during competitive processes to encourage competiveness and reward upfront investment and resources spent at risk. Given the lack of competition in the development of the prelim works under the Late model, if these costs are recoverable by the SO, the costs are not ‘at risk’. Thus a success fees may be hard to justify when assessing value for money to the consumer. However, an appropriate mark up for their work may be reasonable and provide an incentive for the works to be carried out.

A further consideration arises if the TO bids for the project. The potential of one entity achieving double success fees compared to other bidders may adversely impact competitiveness.

Question 6: Should CATOs pay for the preliminary works at the point of transfer?

We have a number of successful projects where development costs are funded through the first drawdown, so this is a possibility. This would be dependent on the value of these payments, and will need clear identification of cost build up and the value it provides to the project.

Controls imposed by Ofgem should ensure the party carrying out the prelim works only incur reasonable costs to avoid any contention on the justification of the spend. As mentioned in our response to question 5, we believe it is reasonable to expect recovery of costs associated with preliminary works in a similar way to the retrospective review carried out with the OFTO opportunities.

Any knock on impacts upstream (that may require further consents/consultations etc.) should be excluded from these costs that are funded by the CATO.

CHAPTER: Three

Question 1: What are your views on our proposed late CATO build tender model? Including:
- **the basis of bids;**
- **the use of cost sharing factors; and**
- **what risks, if any, it would not be efficient for a CATO to manage during construction.**

We consider that the late model, particularly with respect to the early projects, will provide an open market enabling more participants, and this model is likely to be a more efficient process and, if managed correctly, likely to result in better value for money. An early model whilst the market is still taking shape would be more expensive and result in more cost at risk for potential bidders.

We would anticipate that, under likely scheme scope and performance requirements, a fixed price for construction and operation is appropriate. Cost sharing or target cost approaches can provide a suitable mechanism to risk share, and we do not necessarily concur with Ofgem view that this approach may lead to artificially low costs and a claims based contract approach, as this model has been successfully utilised across the construction industry to reward innovation and efficient working. However in a large, well defined project, a fixed price approach is simple and effective and provides greater certainty of cost. Where the project is very large, and some risks hard to be assessed/controlled by the CATO, cost sharing may be a beneficial approach to take.

As seen in other publically procured contracts of this nature, there are certain risks that are not typically taken by the private contractor. These include, inter alia, archaeological findings, contamination, un-insurability, future planning requirements, ground conditions and Change in Law. Having a standard form of documentation for all projects will help provide clarity to tenderers and ensure a market standard position is adopted across projects.

Under the Late model there is an overlap between some of the consent activities and the tender process. We see this as acceptable but would note that, if significant applications or decisions are still outstanding, tenderers may be reluctant to commit too much time and resource until these are complete or sufficient comfort can be given. In addition, if Ofgem are expecting committed funding during the tender stages, having as little outstanding as possible will naturally help with the terms that can be achieved and would expect Ofgem to retain any outstanding planning/permit risk at this point.

Question 2: What are your views on our proposed early CATO build tender model? Including:
- **what tender specification would best facilitate innovative but deliverable bids; and**
- **how we can best manage cost uncertainty after the tender.**

The Early CATO build model may provide scope for a wider range of solutions, and models akin to the proposed Early model have been successfully used in other markets. Once the CATO market has matured and initial projects successfully procured, the Early model may be beneficial for future schemes. However, for the initial wave of projects, we believe it's best to use the late model in order to control costs and encourage competition.

We would reasonably expect the Early build model to be at a higher relative cost than the late model due to the larger levels of uncertainty and risk when bidders are developing their solutions. More focus would be required at the PQQ stage to ensure the bidders taken forward have the capabilities to bid an Early model, and that competition remains throughout the procurement. If up front design costs for a project are particularly high, one option seen elsewhere is to reimburse an element of these costs even for unsuccessful bidders. This helps sustain competitiveness throughout the process, and hence still delivering value for money and has been utilised in a number of bids in the health sector.

Question 3: Do you have any views on the best way to tender projects using high voltage direct current (HVDC) technology?

Whilst we recognise the constraints in respect of the HVDC technology solutions and market place, and the associated risk in respect of achieving consent and programme, we would reflect that the proposal to separately procure this technology package via the SO may impact on a scheme, reducing its attractiveness to bidding organisations and adding additional interfaces, thus reducing competition and impacting on value for money.

Clearly the HVDC technology provider is a key part of an HVDC scheme, and as such teaming arrangements will reflect this aspect, and commercial arrangements between parties reflect the relative scope. Introducing uncertainty in respect of scope and technology arrangements will complicate such arrangements, particularly if there is a possibility of the HVDC technology solution being separated out from the scope, along with the added complication of any integration/novation issues.

We would concur with the view that the competitive tendering process will open up the supply chain to new participants and welcome the opportunity that provides, and we consider that this will substantially mitigate some of the perceived supply chain constraint issues.

We would reflect that projects should be assessed on a project specific basis, with a full and proper consultation before decisions are made. We do consider that, with an understanding of likely constraints appropriate approach can be developed, be this an early stage CATO's, or a "worst case" approach to planning consent.

Question 4: Do you have any views on our proposal to prioritise late CATO build? Do you have any views on specific circumstances where early CATO build might lead to better outcomes than late CATO build?

Prioritising late CATO build would appear appropriate in the context of achieving the earliest possible introduction of the competitive tendering process and, whilst the Early model may provide opportunity for consideration of a wider range of solutions, we envisage the Late Model, initially at least, resulting in greater competition.

As mentioned in questions 1 and 2 above, we believe the initial wave of projects should be procured under the Late build model but after this, it may not be necessary to 'prioritise' the late model and the Early build model may prove beneficial, subject to the considerations above.

Question 5: Do you have any views on how we could mitigate the risk of a CATO not being in place?

We consider that this would vary depending on what point the CATO in unavailable. At some points, the CATO of last resort will be the TO, whilst in other situations, replacement contractor provisions and re-tendering will provide best Value for money.

In terms of mitigation we consider as follows:

During tender stage:

- Having a large focus on the qualitative aspects of bids and assessing bidders track record and ability to deliver rather than overly focusing on price

- Having standardised documentation in place to help tenders to be procured efficiently and assessed fairly whilst keeping to original timescales. This will also help with the raising of finance as funders will become familiar with the commercial positions to expect from CATO procurements
- Keeping a reserved bidder during the Preferred Bidder stage can provide a good contingency should anything prevent the final appointment of the Preferred Bidder

During construction/ops:

- We suggest an approach typical of a PFI style contract is taken whereby clauses are included within the project documents that allow a re-tendering process to appoint a replacement contractor should the original contract be terminated. In appointing the original CATO, the security packages should be sized to enable continued operation during this period of appointing a replacement

Question 6: What are your views on our proposed revenue package for CATOs? Including:
- **the proposed duration of the revenue term, including how it links to the asset cost recovery period and whether operations and maintenance costs can be fixed over this period; and**
- **our proposed approach to indexation, refinancing and enabling new asset investment.**

We concur with the Ofgem view in respect of a 25 year revenue term although we would also support a slightly longer term if preferred by Ofgem. Going beyond 25 years will limit the availability of traditional bank debt, but will become more attractive to institutional investors. Given these investors also prefer larger ticket sizes, it may prove best value for money to match larger projects with longer terms (greater than 30 years) and smaller projects with shorter terms (20-25 years).

With regard residual values at the end of the term, this is not a typical approach when using project finance as funding. By the end of the contract, all financing costs have been repaid and there are minimal remaining costs that a residual payment can be used for. To ensure maximum life is still achieved from the assets, we would suggest a form of handback requirement at the end of the concession. At the end of the concession, the assets are assessed against a pre-agreed series of tests to check the remaining life of the assets. In addition, having a well-defined asset management programme throughout the concession provides comfort in the condition of the asset at the end of the term.

We would agree with the approach to indexation in proposing a partially indexed revenue stream. It is generally regarded as better value for money for inflation risk not to be taken by the private sector.

With regards refinancing, we generally support a gain share type approach but would naturally seek further clarity on percentage shares and intended approaches to refinancing. The approach of 50:50 taken on the OFTO projects is seen as sufficient to encourage the private sector to explore refinancing opportunities. We suggest Ofgem take accounting advice to ensure the percentages and rights to call for refinancing do no jeopardise their preferred balance sheet treatment.

Question 7: What are your views on our proposed package of financial incentives for CATOs? Including:

- **how we could structure an availability-based incentive to ensure CATOs operate their assets with a 'whole network' view;**
- **the proportion of a CATO's annual revenue that should be at risk; and**
- **whether there are circumstances under which 'payment on completion' would not be appropriate to incentivise timely asset delivery.**

The proposed package of financial incentives would seem appropriate and we would concur with the proposed mirroring of the 10% cap of revenues at risk model as used for the OFTO projects.

In general, we agree that commencing payments at completion with no interim milestone payments seems the sensible approach for these projects. For larger projects, if it is decided that an interim payment will be made, it may be preferred as an initial step up to availability payments rather than as a one off milestone payment. In general, either approach can work.

Question 8: Are there other types of incentives not covered in this chapter that you think should apply to CATOs

None

CHAPTER: Four
Question 1: Are there any risks or conflicts of interest arising from the SO's role that we haven't identified?
Question 2: Are there any risks or conflicts of interest arising from the participation of incumbent onshore TOs that we haven't identified?
Question 3: Are there any additional conflicts of interest that we haven't identified?
Question 4: What measures do you think would be appropriate to mitigate the risks and conflicts of interest? What additional conflict mitigation measures would be needed if the SO takes on a broader role in supporting competition?

Given the varying roles that may be carried out by the SO, we would require Ofgem to provide the required comfort that any potential conflicts of interest are addressed in advance of the commencement of any tender process.

We trust these responses are of use and should there be any comments in this letter that Ofgem would look to discuss further, we would welcome the opportunity. We look forward to monitoring the development of these opportunities, continuing to participate in consultation process, and ultimately the competitive tender process when they come to market.

Yours sincerely

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