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Our Reference: Ofgem150710

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Dear Peter

Criteria for onshore transmission competitive tendering
Consultation response

Amey welcomes the opportunity to participate in the above consultation process in submitting our response to your letter of 29th May 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 seven questions as follows:

1. **What are your views on the analysis and conclusions in Jacobs' report?**

We consider that Jacobs report is comprehensive in considering the specific issues requested, and is particularly useful in including not only Jacobs' views, based on their considerable experience in the field, but also views of relevant stakeholders. Thus, their report and conclusions has examined the key elements of extending competition in transmission, whether raised by Ofgem, Jacobs or the stakeholders.

We understand that Jacobs were commissioned to provide technical assistance to Ofgem, and to make recommendations regarding three criteria, namely "High Value", "New" and "Separable". These criteria are considered in some detail in this report, and clearly, assessment of these criteria form the basis of the conclusions and recommendations. The inclusion of these three criteria was pre-determined, so we recognise that it is only their application which is discussed. We comment on Jacobs' treatment of this in our answer to Question 3.

2. **What are your views on using £100m as the high value threshold? Should this be whole life or capex?**

We are more than comfortable raising capital for projects around the £100m mark, and have significant experience raising funds ranging from less than £50m to more than £400m. This is through the vast experience we have acquired through the years, across a variety of different high value projects, raising funds via a number of different methods including; commercial bank debt, wrapped and unwrapped project bonds, mezzanine debt, EIB funding, and equity investments. A threshold of £100m should attract sufficient funding interest to obtain competitive terms. However if the limit was higher than £100m and closer to £150m-£200m and above, there would be heightened interest from the capital markets, whilst still maintaining the funders interested at sub £100m. Therefore by allowing a maximum of greater than £100m, more funding options are likely to be available, providing more choice, flexibility and competition from a funding perspective. In terms of operational activities, we do not see a limit of greater than £100m being an issue. Ofgem may also find that for projects of larger potential value, more companies may be interested in acquiring the project, potentially resulting in better possible terms and value from the heightened competition.

Amey would recommend taking a whole life approach to the valuing of projects, as it is more reflective of the actual cost of a project. Although a limitation of whole life costs is that it can be difficult to estimate individual costs, it has been done effectively before. We also realise that implementing whole life can be 5-20% more than capex, and agree the high value threshold should be revised as a result.

3. What are your views on defining new and separable? Are our principles clear? In your view, do they appropriately capture projects where using competitive tendering would bring value to consumers? If not please explain and suggest how we can improve them.

"New" and "Separable" are both defined clearly, and we agree with Ofgem that they should be considered together. Also, we agree with Ofgem's summary of potential approaches for applying the criteria, which considers these together.

Regarding "New", it is clear that practically speaking, in any project to be delivered through such a vehicle as the CATO, it is highly improbable that all assets involved will be new. The effective integration of such infrastructure to an existing network would sensibly require a level of adoption of existing assets. Thus, given that "New" is already pre-determined, and setting the figure of a minimum of 75% new assets seems reasonable. However, given the likely nature and value of the projects, we would anticipate that in the majority of cases it is likely to be a substantially higher % of new assets, or not least the existing assets incorporated into scope will be small number, high value. Notwithstanding this, it is recognised that all parties (Ofgem, Jacobs and Stakeholders) seem to agree on this minimum figure and we agree that assets may need to be transferred (those which are not new), in order to ensure that the CATO has a separable project scope.

We note that the stakeholder workshop also recognised that interaction with existing assets will be influenced by the "project purpose and dependencies", and that this perhaps should be included as a further high level criterion. Certainly, the purpose of the defined project on the network, particularly in regard of its criticality to safe and reliable operation, will have a significant influence on the definition of suitable interface point, and consequently existing assets that are sensibly included as part of the scope.

Regarding "Separable", it is clear within Ofgem's original definition that the projects can largely be identified as discrete construction projects with limited interfaces with the existing network. "Electrical Separability" should be treated separately, as this is not a pre-requisite for a separable project. Thus, we agree with Jacobs' conclusion that Electrical Separability is not a fundamental requirement, but may be beneficial.

We agree with Jacobs that electrical separability may assist system operation, allowing more effective isolation of owned infrastructure but clearly, creating such electrical separability may incur costs, and it seems reasonable to set a limit on that cost.

4. **What are your views on the importance of electrical separability and electrical contiguity, including on the alternative approaches for considering electrical separability?**

It is clear from the report, and we agree, that electrical contiguity is basically a pre-requisite within a project, as otherwise the number of interfaces required increases risk and impacts on competiveness.

We also agree that there seems to be no reason why constituent assets of a project have to be connected (contiguous). Parts can be non-contiguous whilst retaining overall separability. It is clear, however, that this should be determined at the project definition stage.

Jacobs recommend that any additional cost required to make a project electrically separable should not exceed 5% of total asset cost. We tend to agree with Ofgem, however, that any requirement for electrical separability may be incorporated by the tenderer. It seems to us reasonable to enable a CATO to propose any such required electrical equipment as part of its tendering process.

5. **In thinking about how to apply the criteria, what should be taken into account when establishing different packages of works to address a given need?**

Regarding the different approaches outlined for applying the criteria, it would seem that approach 1 may be preferable for projects which are toward the higher end of the High-Value spectrum, e.g. above £100M. We feel that many such projects would not require compromise on "New" and "Separable", and that they are likely to largely meet those criteria anyway.

Thus, further to this, we believe that approach 1 may not necessarily be favourable for projects which are at the low end of this spectrum, e.g. below £100M. We feel that such projects are less easy to define in terms of "New" and "Separable", and thus more compromise may be required. In these cases, approaches 2 (carving out) & 3 (transferring) should be considered.

Please also see our response to question 6.

6. **What are your views on the three approaches we suggest for applying the criteria? Are there other options for applying the criteria that we should consider?**

From our perspective we already have vast experience of working within similar approaches and scenarios in some of our current projects. In regards to carrying out projects that are structured as each potential approach, there are differing impacts they would have in the delivery of the project.

Of the three approaches, approach 1 naturally seems the simplest compared to the other approaches, due to less risk during the construction process from potential complications and interfaces trying to manage and work with existing assets. Through this decreased level of risk it will also mean that the pricing of the project can be more thorough with lower risk allocations needing to be priced in. We view Approach 1 as the ideal approach for all parties and should be implemented wherever possible. However we appreciate this approach can't always be implemented due to potential existing assets already being in use and not offering value for money to replace with new assets.

The other two approaches do not have the same level of simplicity due to the involvement of existing assets. We regard approach 2 in particular to have the most operational risks due to the link up with existing assets, and required interfaces between different operators. This may cause problems when trying to rectify any problems that could arise, at the boundary of the new and existing assets.

Approach 3 is familiar to us in that one party would not only build the new assets but also manage and maintain the existing ones. This would reduce the operational interface risks and complications that can arise within approach 2 and, whilst it may initially appear more complex to structure, we have seen the approach work well in other markets, such as highways and rail. There will exist the latent risk of the existing assets failing and needing replacement and repair however, if one party is managing both the new and existing asset, problems can be resolved more efficiently than would be the case in approach 2. When using approach 3, Amey recommends Ofgem carefully consider the process for the asset transfer well in advance and how to execute the transfer from both a legal and technical due diligence point of view. In addition, Ofgem should consider whether to leave incumbent and incoming asset owners to negotiate the transfer or if Ofgem act as the intermediary. From past experience we recommend that Ofgem lead on the asset purchase (preferably before the commencement of the bidding process) as this ensures a fairer and more balanced bidding process, ensuring one bidder cannot claim an unfair advantage. If ever a choice between 2 and 3, we regard approach 3 to be better and whilst it may involve more work initially, the project will benefit in the long run.

7. **Are there any additional considerations that should be taken into account in relation to the new, separable and high value criteria?**

In respect of the new and separable criteria, there may benefit from further clarity on the individual project's purpose and scope before deciding. Rather than a one size fits all approach it may be worth considering sub criteria depending on characteristics of the project i.e. criteria to being designated 'new' or 'separable' could vary slightly depending on the type of project. This process could also be applied to the criteria of approach 2 and 3.

In terms of the high value criteria, we note the comments in respect of the simplicity of capex versus the complexity of totex assessment but do not consider taking a totex approach to be significantly harder to implement. We believe the opportunity for driving innovation and competitiveness would be enhanced with a whole life cost assessment, and would encourage its use in line in line with our response to question 2.

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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