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Please find below Infracapital's response to the " Extending Competition in Electricity Transmission: Tender Models and Market Offering" consultation.

CHAPTER: One

Question 1: How well aligned do you think the proposals in this document are with our objectives for onshore competition?

Overall we believe that the proposals are well aligned to that of your objectives for onshore competition. In particular we agree that a competitively tendered revenue stream over 25 years will drive value for money for the consumer through creation of a strong competitive field. However, key to the success of the regime will be establishing a robust pipeline of opportunities, and providing clarity on the evaluation of tenders and risk allocation. In consideration of the cost to tender, bidders are only likely to invest in the opportunity if they can see clarity and confidence of the proposition.

Question 2: What do you think are the implications of our overall proposed policy around the tender process, CATO incentives and obligations on CATO cost of capital and levels of competition for a CATO licence?

As noted above, we consider that the proposals including the further detail on the tender process, CATO incentives and obligations, should overall deliver value for money for the consumer through high competition and a competitive cost of capital.

The tender process should achieve the right balance of maintaining competition and minimising aborted costs, though in developing the detail of the Outline Proposal Stage, Ofgem need to consider how bidder costs are minimised. We believe that the ITT phase should include no more than 3 bidders.

The CATO incentives are reasonable and the core availability incentive is well understood by the investment and funding community. The other incentives are closely aligned with the

responsibilities/obligations of the CATO and should incentivise the intended behaviour, subsequently they should not have an adverse impact on the cost of capital assuming that appropriate caps on loss of revenues are in place (in a similar manner to the OFTO regime).

We concur that it is necessary to develop a CATO specific regulatory model and that generic licence conditions will be required along with specific conditions for individual projects. Whilst it is important to achieve this flexibility we would expect that “standard licences” can be developed for each project type where a common behaviour is required. The principal of the CATO’s obligations being defined under industry codes, licence and other agreements is similar to the OFTO regime and therefore we see no negative impact on the cost of capital or competition.

CHAPTER: Two

Question 1: What do you think about our proposed approach to tender evaluation? Are any elements missing that we ought to look at?

Overall we concur with the concept of weighting between deliverability and cost, and that the number of bidders at the ITT phase needs to be minimised to reduce waste bid costs. We concur that there should be no need for bidders to undertake design activities at the Outline Tender stage. Specific comments on the evaluation and the proposals include;

- For overhead line projects in particular, access and management of stakeholders will be key and we expect the bidders approach to be an important topic for consideration in the evaluation. This topic has not been explicitly mentioned in the proposals; and
- It may be necessary to have separate construction and O&M sections in the ITT tender.

Question 2: What are the main detailed aspects/criteria of our evaluation that you would like further clarity on as a priority over the next few months in order to inform your decision on whether or how to bid?

With an increased focus on robustness in comparison to OFTOs, it is critical for the transparency of the tender evaluation, to provide clarity on the approach of scoring robustness/deliverability. In particular differentiating between evaluation of robustness with respect to quality of proposals and price certainty, which we have seen has become increasingly important in the OFTO regime. Further clarity is required specifically in how the design is to be assessed and what are the criteria of evaluation.

Question 3: What do you think about our proposals for variant bids? Which areas are likely to lead to the largest benefits for consumers?

For the late CATO projects we consider the opportunities for innovation to be largely associated with procurement and construction management. Innovative approaches to procurement and construction management within the boundaries of the specification/consent should be achievable. In consideration of this, along with the complexity of the tender evaluation process and minimisation of bid costs, we consider that only compliant bids should be assessed.

Question 4: How could Ofgem best value the relative merits in variant bids of enhanced consumer outcomes, potential savings and likelihood of delivery where these do not align?

See above.

Question 5: Do you consider that our proposed tender process stages and timings provide sufficient time for interaction with the supply chain and bidders to undertake required design work in order to put forward robust, fixed price bids at the ITT stage?

The length of the ITT period needs to consider the complexity of the project, but an overall IT phase with 8/9 months for bid development is considered appropriate for most projects. From the experience of OFTOs as well as other PPP industries, a preferred bidder phase of greater than 6 months should be expected.

Question 6: Which contracts from preliminary works would you expect to be novated to the CATO on appointment?

We would expect contracts novated to the CATO to include the following; ground investigation; geotechnical consultancy services; LIDAR, photographic and other route mapping services; preliminary design services for the development of the design for consenting purposes; land access arrangements; and any other applicable supply contracts which may have been entered into.

Question 7: What are your views on the potential value, and practical implications, of a share sale model for tendered RIIO-T2 projects?

We would be happy to consider both an asset sale and a share sale model for tendered RIIO-T2 projects. For complex projects with many contracts and assets, a share sale model may be considered more appropriate, though consideration would need to be made to the treatment of employees through vendor warranties and indemnities to ensure no employees are transferred (where applicable).

Question 8: Based on your understanding of the HVDC supply market, what are the priority areas we should be looking to consider over the next few months in order to ensure HVDC projects can be tendered efficiently under late CATO build?

No comment.

CHAPTER: Three

Question 1: What do you think about our proposed package of CATO incentives? Do you think we are missing anything?

We consider the lists of CATO incentives to be reasonable.

Please see comments on “payment on completion” below.

Question 2. What do you think about our proposals for the CATO availability incentive?

We concur that an availability incentive is the most appropriate form of incentive for a CATO. We also agree that specific optimum behaviour will vary in considering the specific nature of individual CATOs and that the availability incentive scheme needs to be tailored for each project using “bolt-on weightings” e.g. radial connections to new generators which would benefit from a specific seasonal availability and a higher availability target. The core incentive may also need to reflect higher/lower availability targets on specific assets.

The objective of maintaining flexibility and incentivising specific behaviour needs to be balanced with maintaining simplicity.

Question 3: What do you think about our proposals for CATOs to participate in a Network Access Policy (NAP)? How do you think the NAP could best be managed to accommodate CATOs?

We concur that CATOs should engage in NAP to enable effective outage planning across the TOs and SOs. We do not have any specific comments on how the NPA should accommodate CATOs.

Question 4. What do you think about our proposed incentives for CATO asset management? Do you have any views on how we could best appraise asset health?

In consideration of the uncertainty of revenues post year 25, it is important to have clarity on the asset condition requirement at the end of the 25 year revenue stream to ensure that all CATOs are tendered on an equal basis. In recognition of this we agree a prescriptive asset condition and asset management incentive is required over and beyond the availability incentive mechanism. It is important that the

requirements are explicit and well defined, to ensure ambiguity and should be considered in the tender assessment. We concur with Option 2 as the preferred mechanism to minimise the risk of any financial penalty for the CATO at the end of the 25 year period. We also agree that a performance bond security, in a similar structure to that used of OFTOs, would be appropriate.

Question 5: What do you think about our proposed obligation for CATOs to fund new asset investment during the revenue term?

We concur that additional investment below a certain threshold during the 25 year period should be the responsibility of the CATO. We believe that a threshold of £100m should apply for each occurrence in line with CATO definition and are ambivalent to whether a cap should be applied over the 25 year tender revenue period. If a new investment is required the licence needs to reflect that the CATO may need to refinance and/or bring in additional equity investors, and any investment should be on the same basis of the original CATO. A framework for how costs should be assessed needs to be clear.

Question 6. What are the main considerations to ensure CATOs are financially robust, particularly during the construction period?

The primary considerations to ensure CATOs are financially robust can be divided into two aspects; tender evaluation and ongoing obligations. The tender evaluation process will play a key role in determining the robustness of the tendering CATOs, which will include in particular:

- financial deliverability;
- robustness and experience of CATO shareholders and contractors;
- contractual arrangements and securities; and
- tender assumptions and certainty.

The ongoing obligations need to be designed in consideration of the tender assessment and licence conditions (appropriate allocation of risk, reporting etc.). We therefore see no need to have an obligation to maintain a baseline financial structure and/or equity spend profile, as the funders' due diligence and requirements will maintain this and any prescriptive requirement may reduce innovative funding solutions.

Question 7. What do you think about our proposal that CATOs should provide a construction security and have a credit rating during construction? How might this affect costs to consumers?

We do not think CATOs should be required to have a credit rating. The credit rating process adds additional costs and complexity to the bid process without being necessary or adding value for the

investors/funders. The PFI industry has shown that it is possible to raise construction finance without a rating, and that appropriate allocation of risk commensurate to an investment grade occurs through the project finance process.

Similarly, a provision of a construction security adds additional costs to the consumer and complexity with potential inter-creditor issues. An alternative approach would be for the CATO to provide evidence, as part of the bid process, of the security packages the CATO has with the constructor(s). It may also be possible for step in rights to be provided.

Question 8. Do you have any views on our proposed CATO of last resort policy?

No comment

Question 9: What do you think of the scope of proposed changes to industry codes and standards for CATOs that we set out in Appendix 4. What do you think would be the best mechanism for us to facilitate bidder market understanding of industry codes and standards (bearing in mind that Ofgem resourcing is limited and that there will always be a requirement for bidder due diligence)?

Facilitation of bidder after understanding could be supported by industry workshops, but as referred to in the question, bidders and funders will be supported by legal and technical due diligence which will ensure that the industry codes and standards are fully understood by the industry participants.

CHAPTER: Four

Question 1: What do you think about our proposal to start CATO revenue on completion? Do you have any views on whether there would be benefit in allowing some revenue before completion for certain types of project, and if so, what should this be tied to?

Broadly we consider the principal of starting revenues on completion to be appropriate, providing a strong incentive for the CATO to finish construction. This incentive will typically outweigh the additional cost to the consumer of the capitalised interest over this period. However, for the larger projects with long construction timeframes it may be necessary to consider a form of interim payment at completion milestones to reduce the level of capitalised interest.

Question 2: What do you think about our proposal to align the depreciation period with the CATO revenue term?

We recognise the benefits of the simplicity of a fully depreciated asset base over the CATO revenue term. Whilst we would have anticipated that a longer depreciation period and residual asset value at the

end of the CATO revenue term would have had some financing benefits, we note from your analysis that a fully depreciated approach provides best value to the consumer. On this basis we therefore concur with your approach.

Question 3: Do you have any views on our proposals for arrangements at the end of the revenue term?

Whilst we have a preference to hold the assets in perpetuity, it is important that clarity or guidance is provided to the bidders on future revenue stream to ensure that there are comparable and consistent tenders. We concur that a price control mechanism would be an appropriate form of regulatory price control, in consideration that the revenues have not been competitively tendered.

Question 4: Do you have any views on our proposed debt refinancing sharing arrangements?

We concur that it is reasonable to have debt refinancing sharing arrangements. The details of the arrangements need to achieve the right balance of incentivising the CATO whilst optimising value to the consumer. In consideration of this we feel that a 90% sharing of any interest margin gain is too high to incentivise the CATO.

Whilst we are considering various financing solutions, for projects with long construction periods we are anticipating that short term construction bridge facilities will offer value for the consumer. However, the terms of the long term facility may not be known at FC presenting a refinancing risk to the CATO. Therefore any refinancing gain share provisions need to ensure that there is an appropriate risk/reward allocation so that CATOs are incentivised to consider the optimum financing solutions for the consumer.

Question 5: What do you think about our proposal to include a mechanism to capture some of the benefit of a CATO equity sale? What impact do you think it would have on the cost of capital bid during the tender?

We believe that a mechanism to capture benefits of an equity sale will discriminate certain types of investors, be complex to define (it is unclear how you would differentiate sources of capital e.g. capital funds, directs, balance sheet etc) and ultimately not deliver value for money for the consumer. We understand there is an objective to target long term investors, but this can be achieved in other ways. For example, in the French PPP industry there is a "stability clause" which requires the original SPV owners/investors to hold their ownership for a number of years post completion of construction.

Question 6: What do you think about our proposed risk allocation for CATOs? How do you think we can best mitigate and/or allocate risks associated with preliminary works?



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We recognise and broadly agree with the principals adopted in the allocation of risk for CATOs, and that sharing factors are not likely to be efficient. However more detail needs to be provided on the treatment of risks related to the treatment of new information post tender and unexpected external factors, which the CATO cannot contract to its supply chain e.g. Unexpected ground conditions, extreme weather conditions. A form of licence protection may offer consumers best value, rather than a full pass through of risk which the risk allocation matrix seems to be indicating.

Another topic requiring clarity and perhaps further consideration is land access which can often be the largest risk of delay on an overhead line project. It is unclear at this stage what work will be undertaken by the preliminary works provider and what will be required by the CATO. Either way land access could be a challenging issue on projects where the project is held to ransom by individual landowners, through no fault of the preliminary works provider or the CATO. More clarity on how what activities are expected to be undertaken by the preliminary works provider and how this risk is to be treated is required.

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