John laing
making infrastructure happen

Gordon Hutcheson
OFGEM
Transmission Competition Policy Team
9 Millbank
London
SW1P 3GE

TransmissionCompetitio@ofgem.co.uk

Mark Westbrook
John Laing
1 Kingsway
London
WC2B 6AN

29th[th] Sept 2016

Dear Gordon

RE: Re: Consultation document "Extending competition in electricity transmission: Tender Models and Market Offering", dated 4th Aug 2016

Thank you for the opportunity to respond to the Ofgem consultation document regarding Tender Models and Market Offering dated 4th Aug '2016.

John Laing is a leading international developer, investor and manager of infrastructure projects and is active in the energy, transport and social infrastructure markets.

Appendix 1 of our response should be treated as confidential.

We are happy for the rest of our response to be treated as non-confidential.

We request further dialogue regarding our response as we believe this would be useful in explaining our views on a number of points.

Your sincerely

Mark Westbrook

[attachment 1: John Laing response to the Consultation document…, Oct '15]

Attachment 1: John Laing Response to the Consultation document "Extending competition in electricity transmission: Tender Models and Market Offering", dated 4th August 2016

CHAPTER: 1

Introduction

QUESTION	JOHN LAING RESPONSE
Question 1: How well aligned do you think the proposals in this document are with our objectives for onshore competition?	Generally we believe Ofgem's proposals are well aligned with achieving the objectives. We have a number of concerns which are elaborated on in our response and we believe important improvements can be made to achieve a better outcome.
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?	We believe some of the proposals will limit competition and artificially constrain bidder's ability to offer the best value solution.

CHAPTER: 2

Late CATO build tender model

QUESTION	JOHN LAING RESPONSE
Question 1: What do you think about our proposed approach to tender evaluation? Are any elements missing that we ought to look at?	We agree with the general criteria. We note that when scoring the TRS Ofgem should consider how it scores different construction programmes because a simple NPV would tend to favour slower delivery unless some adjustment is made to reward early completion. Various approaches are used to "neutralise" the impact of different construction programmes and if early delivery provides additional consumer benefits then this should be rewarded in the NPV evaluation.
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?	We would expect evaluation criteria to be provided prior to bid with relative weightings.
Question 3: What do you think about our proposals for variant bids? Which areas are likely to lead to the largest benefits for consumers?	We are supportive of the principle of allowing variant bids. As well as the areas noted we often see innovative approaches to construction which can give rise to improved programme.
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?	One approach is for Ofgem to prescribe key project risks for which it would like the bidders to provide innovative solutions with a clear evaluation framework for these so that bidders can undertake the cost/benefit trade-off as part of their tender. This is a model used by Rijkswaterstaat (the Dutch procuring authority for roads and waterworks). This process commences during the shortlisting phase when bidders are required to prepare a risk management plan addressing a set of prescribed risks by offering risk mitigation measures on top of the scope under the concession agreement. Rijkswaterstaat explicitly identifies in the evaluation criteria how performance levels against each of their risks will be evaluated. At final tender stage a more extended version of the risk management plan forms part of the final submission and can make up approx. 40% of the overall bid evaluation.
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?	In relation to the Financial Deliverability, Ofgem should consider the extent to which it will require committed senior financing. While many lenders will provide multiple trees, there are also many institutional lenders with limited capacity and certainly could not support 3 to 4 bidders. Depending on the size of the project (and whether 3 or 4 bidders are being taken through) Ofgem may need to prescribe a certain level of firm commitments (rather than 100% commitment). This approach will then impact the timing for the PB stage.

Question 6: Which contracts from preliminary works would you expect to be novated to the CATO on appointment?	We would expect all surveys and site investigations which we would rely on in preparing our tender to be novated. We would expect any reports on land access rights and any reports/surveys used to obtain consents, to be transferred. All consents obtained also need to be transferred.
Question 7: What are your views on the potential value, and practical implications, of a share sale model for tendered RIIO-T2 projects?	Ultimately investors and lenders will want to create a new CATO entity to deliver the project and the benefit of the preliminary works needs to be assigned to this entity. We think the asset sale model would more easily achieve this although it's possible that the share sale model could also work.
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?	We would be reluctant to tender an HVDC project if bidding in competition with the key HVDC equipment/cable suppliers because we would be concerned about our ability to compete fairly.

CHAPTER: 3

CATO obligations and incentives

QUESTION	JOHN LAING RESPONSE
Question 1: What do you think about our proposed package of CATO incentives? Do you think we are missing anything?	We think these are appropriate
Question 2: What do you think about our proposals for the CATO availability incentive?	We agree with the underlying principles of rewarding reliability. We suggest "well managed" outages (which will therefore minimise disruption) should not be discouraged by being captured in an availability deduction. The mechanics of how this is achieved is not entirely clear to us from the consultation but this may be a level of detail beyond the description provided.
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 agree with your proposal that the CATO should be involved in the NAP process on similar terms to the current TO arrangements. We don't envisage that this should be a separate exercise though: we propose that CATO input is included in the TO's NAP; the industry codes governing the current NAP process should be amended to reflect this obligation on TO's side; CATO licence should include provisions reflecting this obligation on the CATO's side.
Question 4: What do you think about our proposed incentives for CATO asset management? Do you have any view on how we could best appraise asset health?	We agree that a periodic inspection/assessment is reasonable and 5 yearly frequency seems appropriate. The proposed end of term bond seems inefficient. We suggest any financial security be sized based on the expected cost to rectify any agreed deficiency in the asset condition and progressively released as the rectification is achieved. Failure to provide the agreed financial security should allow retention of revenue capped at a % of total revenue. This is a typical structure used on other projects where there is a condition based handback obligation and is more efficient because most bidders will plan their asset management so that they will never get in the position where financial security is required to be posted and therefore will not need to allow a cost against this risk.
Question 5: What do you think about our proposed obligation for CATOs to fund new asset investment during the revenue term?	We agree that the CATO's should be obliged to seek to fund additional asset investment. If on a particular project it is considered very likely that during the construction phase an additional investment may be required, then it may be beneficial if bidders are required to build this "option" into their initial funding for the project although this would attract commitment fees which would need to be justified by the certainty of funding at a fixed cost.

	For future investments where it is not justified to have committed facilities, funders (equity and debt) will need to understand the consequences in the unlikely (market disruption) situation where despite using its best endeavours it is unable to raise additional finance. The cost of raising the additional debt finance will depend on the project status at the time and financial markets and a test based on what an efficient CATO would be able to achieve at the same time in similar circumstances would be reasonable. In terms of caps on the level of additional investment we agree that option 4 is preferred.
Question 6: What are the main considerations to ensure CATOs are financially robust, particularly during the construction period?	The absolute obligation to post security (3.51) would need to be pricing during the tenders. In other projects with an asset handback obligation it is common for the security to be posted only against the determined value of the cost to rectify any shortfall in asset condition. This allows bidders to take a view on whether it is appropriate to allow for security given their asset management proposals and therefore would like be better value.
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?	Ofgem should evaluate financial robustness of proposals however we don't think prescribing aspects of financial structure, security or a formal rating is appropriate or provides value to consumers. A project financed based solution will likely require a fixed time and price EPC contract to be in place at financial close with an appropriate security package provided from the EPC contractor to the Project Company (with lenders having direct recourse). The security package is designed to ensure that ultimately the Project Company would have sufficient financial resource to be able to replace the EPC contractor in extreme scenarios and continue to deliver the project prior to any long stop date. Providing additional security to Ofgem would be additional to this amount that lenders/equity investors have required based on detailed due diligence of the possible costs to replace. Requiring further security is in our view overly conservative and poor value for consumers. Greenfield construction projects are normally funded with deferred equity. Under these arrangements equity is committed (and secured to lenders) at day one but not invested (or earning any return) until the project is delivered. If there were "financial distress" lenders have the ability to automatically draw down the equity at the point of distress. This means the equity is always fully available to the project. Mandating pro-rata injection of equity with debt offers poor value to consumers.

	Bidders will develop optimal financing structures during their tenders which will vary depending on the particular characteristics of their approach. Most senior debt providers (banks and institutions) undertake their own credit evaluation based on the due diligence they undertake during the bid. They commit to lend without a need for a formal rating because they have their own views on financial robustness. A formal rating process is expensive and if mandated would ultimately be factored into bidder recoveries and paid by consumers. From a bidder perspective it also increases at risk costs and strengthens our view that a bidder stipend should be considered particular if 4 bidders are proposed to be taken through to full tender.
Question 8: Do you have any views on our proposed CATO of last resort policy?	Generally, we agree with the proposed approach. We noted that a direct agreement between the Authority and key contractors (to the initial CATO) is possible, allowing on replacement of the initial CATO for the key contract(s) to be assigned to a replacement "CATO of last resort". In reality however it is in our view unlikely such direct agreements would ever be used because if the initial CATO has failed to deliver or operate the project, and lenders have failed to replace the initial CATO and rescue the project, it would have to be a fundamental failure of the contractor and therefore unlikely that a replacement CATO would be contracting with this contractor to complete the build or operate the project.
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)?	We agree with the scope of the changes. Detailed discussion/consultation with industry over the coming months is the best way to achieve bidder market understanding.

CHAPTER: 4

CATO regulated revenue

QUESTION	JOHN LAING RESPONSE
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?	Our experience as an investor in greenfield projects with relatively long construction periods is that up to 5 years does not create any additional constraint on the availability of senior debt for projects. Commitment fees and interest (to senior lenders) do accrue during the construction period but there is no particular reason why this become uneconomic after year 3 (i.e. no step up in construction margins) and therefore we don't see the logic of commencing debt payments from year 3. Our experience is that most investors in greenfield construction projects are also comfortable without any return during the construction period. Equity investors commit their equity from day 1 without any return (earned or accrued) during the construction period and only start to earn a return once projects are operational. Where projects have a staged completion we do see revenues being available on completion of each stage and lenders will allow these revenues to offset the funding requirement if backed by LaDs from the EPC contractor – therefore making the project cheaper to fund. We do think it is sensible therefore to allow for staged revenues where there is a sensible concept of staged completion and entry into operation.
Question 2: What do you think about out proposal to align the depreciation period with the CATO revenue term?	This seems sensible
Question 3: Do you have any views on our proposals for arrangements at the end of the revenue term?	We agree that the proposed approach seems reasonable. If the assets have residual life we agree that following the initial revenue term, the CATO should continue to operate the assets under price control based on the regulatory principles at the time. We agree that the obligation to decommission assets is a project specific issue. We think different asset management approaches would be appropriate depending on the life of the asset and it will be important to have a "base" assumption during the bid phase with a transparent process to deal with a material change.
Question 4: Do you have any views on our proposed debt refinancing sharing arrangements?	We suggest that refinancings assumed in the bidder's base case financial model should be exempt from the gain share mechanics. If bidders are only taking downside risk on these assumed refinancings, they will need to be more conservative (than if there is a neutral

	risk position, the normal approach in PPP projects where assumed refinancings are exempt). We would be supportive of either refinancing gain share approach although we note that the PPP/PF2 model also gives rights to the Authority to require the private sector entity to evaluate potential refinancings in a transparent process with the Authority. This requires the Authority to actively manage this process and without this full package of rights and obligations, the incentives on the private sector to actively pursue a refinancing are quite limited.
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 to you think it would have on the cost of capital bid during the tender?	Refer Appendix 1
Question 6: What do you think about our proposed risk allocation for CATOs? How do you think we can best mitigate and/or allocated risks associated with preliminary works?	1. Delay or Cancellation (through changes to the project need or planning). This is noted as a Consumer risk however bidders will be exposed in relation to their sunk tender costs. Ofgem should consider a bidder stipend in circumstances where this uncertainty is significant. This is a common feature of other PPP markets (e.g. NL) 2. The strength of the warranties/reliance which the CATO/lenders can place on preliminary works is worth discussing further to ensure an appropriate level of risk is taken by the providers of the preliminary works. For example, we suggest legal analysis of land access rights (and related due diligence) would include an appropriate legal opinion that would be transferred to the successful CATO and on which lenders can place reliance. 3. Unforeseeable Changes in law/standards during the delivery phase would normally give rise to relief (cost and time). Discriminatory changes in law which impact all CATOs or the specific CATO/Project should also give rise to compensation.