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James Norman

New Transmission Investments

Ofgem 9 Millbank, Westminster, London SW1P 3GE

12 October 2017

Re. Hinkley-Seabank – Consultation on the project's Final Needs Case and potential delivery models.

Dear Mr. Norman,

Thank you for sharing your views on the Hinkley-Seabank Final Needs Case and its potential delivery models for consulatation.

InfraRed Capital Partners is a leading global investment manager focused on infrastructure and energy. We create real value for our investors, project partners, communities and end consumers through long term partnerhship. Our track record in Infrastructure dates back around 20 years. The company's investment capabilities extend across the spectrum from financing and building new 'greenfield' infrastructure to buying and managing ''brownfield' operational infrastructure assets. InfraRed currently manages investments in over 175 social, transportation and energy infrastructure projects, operating in a comprehensively regulated environment. To date, we have launched 8 infrastructure funds, three of which are currently actively deploying capital; two companies listed on the London Stock Exchange which invest on a long term hold basis, HICL Infrastructure Company Limited and The Renewables Infrastructure Group; and a closed ended fund ("Fund V") with target commitments of USD 1 billion (currently USD 674 million admitted) and which has a mandate covering energy and infrastructure.

Either HICL or Fund V would be suitable candidates for participating in a competitive procurement of the Hinkley-Seabank project, depending on the final risk allocations and scope for sponsor involvement in shaping the contracting arrangements. We have not received sufficient detail for an assessment of risk, and therefore type of capital targeted, at this stage. It appears from the consultation document that NGET may play a substantial role in negotiating the construction and O&M contractor arrangements on behalf of the SPV. Since NGET operates as a corporate and may therefore not be as familiar with project finance as potential financiers of the SPV, we encourage Ofgem to mitigate the risks to financial efficiency and deliverability through careful design of process. We consider that the SPV model can adopt a a variety of approaches with respect to asset delivery risk:

WACC	Model	Description / comment
Lowest	Operational SPV	NGET to fund and deliver the asset, being reimbursed upon a sale at or after the commencement of operations when construction risk is no longer relevant. No delivery risk previum required. As demonstrated by the OFTO processes, competitive long term income investors will be interested to participate.
Mid - low	EPC contracted SPV	Competition to fund an SPV in which the construction risks have been substantially contracted away from the SPV, usually through a single EPC contract, or if more contracts, where interface risk between those contracts is limited and within control of the SPV.

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		The contained risk will enable participation of the most competitive of long term income investors. Contractors will seek a premium to cover risks to which they wouldn't be exposed in a multi-contract strategy, however the premium will be small where the risk is well understood.
Mid - low	Regulation protected SPV	Competition to fund an SPV where the SPV is substantively protected by regulation (or through the terms of the delivery agreement) against construction risks it faces (comparable to the approach on Thames Tideway). As for the EPC contracted SPV, the model can attact the lowest return investors, but is not exposed to the contractor premium associated with risks covered by the regulation.
Higher	Multi-contracted SPV	Competition to fund an SPV where construction risk related to contract interface remains with the SPV. This appears to be consistent with the counterfactual construction programme presented within the consultation document. The additional risk is potentially a challenge for lenders and long term equity financiers, resulting in a higher cost of finance.

Assuming that the Delivery Agreement, technical specifications and accompanying studies are sufficiently advanced, it will be possible to tender the SPV as a whole, leaving it to the market to determine the most efficient balance of construction risk and financing cost. In our experience this should be comfortably achievable ahead of the second quarter of 2019. In order to ensure that the SPV competition is deliverable we would encourage you to ensure the preparations for tender are advancing as quickly as possible, including elements which NGET's construction programme indicate would have been contracted after the proposed financial close date.

We also agree with you that a Competition Proxy model may also deliver better value for consumers than RIIO-T1. However, to legitimise the WACC, not only will the project will need to be structured comparably to the benchmarks on which it is based, but adjustments to reflect the differences in risk profile ought also to be made. Given these challenges the SPV model will provide a fairer result and we believe one which will be better value for consumers.

A successful tender process is likely foster increased investor interest supporting the government's objective of using competition to secure greater benefits for GB consumers. We therefore welcome the opportunity to participate in this process and encourage Ofgem to work with the incumbent Transmission Owners so that it may incorporate the delivery of further projects through competition.

Appended to this letter, we have responded to the consultation questions where we believe our input could be useful to you.

We look forward to your considerations expected to be published in December 2017.

Yours sincerly,

Sébastien Pochon

Director, Infrastructure
InfraRed Capital Partners Limited

COMPETION ASSESSMENT

Chapter 1 - Regulatory Framework

Question 1: Do you agree with our initial views on the appropriateness of the new, separable and high value criteria for the SPV and Competition Proxy models?

We agree that your views are appropriate. As a general comment, from an investor perspective we do not see the need for the assets to be new: operational history can inform a view of risk to the benefit of pricing and re-packaging may result in more complex project interfaces. However we acknowledge that new investors may not be as capable as incumbents at pricing risk associated with ageing and hidden network infrastructure.

Question 2: Do you think the criteria for identifying projects suitable for delivery through models intended to secure the benefits of competition should be the same, irrespective of which delivery model is used?

We agree.

Chapter 2 – SWW Final Needs Case Assessment

Due to the technical nature of the questions InfraRed has not given detailed consideration to the project's design decisions and needs assessment.

Chapter 3 - Assessment of suitability for competition and potential delivery models

Question 6: Do you agree with our assessment of HSB against the criteria for competition, including our view on potentially re-packaging the project so that it meets all the criteria?

We agree with the assessment of HSB against the criteria for competition. Please note that whilst the re-packaging of the project addresses the "newness" criteria, the project would be investible absent a re-packaging and, subject to detailed consideration, we would not expect the inclusion of the identified assets to significantly adversely impact value for the consumer.

Question 7: Do you agree that the SPV model or Competition Proxy model would deliver a more favourable outcome for consumers relative to the existing status quo SWW delivery arrangements under RIIO?

We agree.

Question 8: What are your thoughts on the SPV model, including:

(a) The structure of the model and length of revenue term?

In our experience the optimum investment horizon for project finance debt investors is in the region of 20 to 25 years. Factoring in the senior debt terms which we anticipate the project will attract, we advise that a 25 to 30 year revenue stream with no terminal value will result in an optimal balance between competitive cost of equity and duration of investment, minimising the financial burden on consumers. We therefore agree with the proposed 25 year revenue stream.

We understand that the asset is expected to continue to operate comfortably beyond 30 years and advise that valuing revenues outside of a contract period is challenging for investors. We therefore advise that, subject to appropriate risk transfer, the contract should enable a high degree of visibility over revenues up until the point of transfer of the assets and operations to NGET as determined by the contract.

(b) Should construction funding start during construction, or once it has completed?

Given the length of the investment delivery timeline, we believe that a completion condition will present challenges for a number of the most competitive providers of equity. Additionally the funding requirement for compounding interest and liquidity reserving required to support completion funding introduce inefficiency. We would therefore strongly advocate a structure which provides at least partial revenues during the construction period, expecting that acceptable incentives can be structured which would be equally as effective as a completion condition.

(c) The contractual and regulatory arrangements?
As noted there is insufficient detail to comment on risk allocation, but as a general principal, exposure of the SPV to risks which are beyond its control and uninsurable may be inefficient. It may therefore be better value to leave these with consumers.

Subject to appropriate risk allocation, the proposed contractual and regulatory arrangements in respect of the revenues are attractive to InfraRed's investors. It is important that the structuring, approach and allocation of risk is sufficiently robust and is made clear to the private sector in advance or during early stages of the competition process, enabling optimal partnering interaction and joint venture structuring. From discussions it is our understanding that previous CATO material will be built upon to inform this process and therefore it is unlikely that there will be material deviation in risk allocations, which is welcome.

The consultation raises the possibility of NGET holding an investment in the SPV in order to create the right incentives for successful implementation. We are in agreement that this could create the right incentives, but counsel that the governance ought to reflect a market position with respect to relative equity contributions and satisfactorily address potential conflicts of NGET with the SPV. Traditional contractual incentives may also be able to deliver appropriate incentivisation.

(d) The identified benefits?
We agree with Ofgem's assessment of the cost of capital benefits by comparison to the RIIO-T1 regime, as evidenced by the success of OFTO tendering. We also expect that competition can introduce benefits to procurement, noting that it may be expedient to address deliverability risk by novating contracts which have been procured by NGET as proposed for the Mendips underground cable.

(e) Any potential downsides or implementation risks?
Clearly the consequences of failing to deliver HSB within the required timescale are potentially severe for the Hinkley Point investment and security of supply generally. However, the timescales proposed in the consultation document are aligned with other competitive tenders recently carried out by InfraRed and other projects we have seen in the energy and infrastructure sectors.

(f) Any other considerations?
None.

Question 9: What are your thoughts on the Competition Proxy model

In order to achieve best value, the Competition Proxy model requires that arrangements are put in place to efficiently allocate risk consistently with the benchmarks used for reference pricing. There is no reason why terms should differ from the SPV model.

We agree with the principle of comparison with large infrastructure projects with a similar risk profile, however finding appropriate market comparators is not easy and any determination will be open to the challenge of differentiation of technical, regulatory or structural risk as well as market conditions.