

TRANSMISSION CAPITAL PARTNERS

James Norman
New Transmission Investment
9 Millbank
London
SW1P 3GE

9th October 2017

Dear James,

Hinkley Seabank (“HSB”) - Consultation on Final Needs Case and potential delivery models

Transmission Capital Partners (“TCP”) – a joint venture formed of Amber Infrastructure Group (“Amber”) and Transmission Investment LLP (“TI”) with in-depth knowledge of financial, technical and regulatory issues associated with electricity transmission in the UK – is pleased to provide you with a response regarding the *“Hinkley – Seabank - Consultation on Final Needs Case and potential delivery models”*. TCP manages one of the largest offshore electricity transmission portfolios in terms of the capacity of offshore wind connected. Our managed portfolio of Offshore Transmission Owner (OFTO) assets includes the connections to the Robin Rigg, Gunfleet Sands, Barrow, Ormonde, Lincs and Westernmost Rough offshore wind farms - a portfolio of over 1000MW (circa £800m in capital employed).

In addition, Amber and TI have a strong and proven track record in the procurement of large scale infrastructure projects through their respective involvement in the Tideway Tunnel (“Tideway”) and the France-Alderney-Britain (“FAB”) interconnector.

International Public Partnerships (“INPP”) a FTSE-250 listed investment company managed by Amber is a primary investor in over 125 infrastructure projects, including all OFTOs managed by TCP, Tideway and in Cadent (formerly known as National Grid Gas). Amber and TCP have therefore direct and recent experience in the successful procurement of Tideway. We believe HSB and Tideway share many similarities notably a new, high value and separable infrastructure project procured by a utility company all in the context of a stable regulatory framework.

TI is developing and procuring the circa 220km 1400MW FAB interconnector project in partnership with French national grid company, RTE. This large infrastructure project, regulated in the UK under Ofgem’s cap & floor regime, is expected to be one of the first electricity transmission projects structured for project finance, to be constructed in the UK. TI is therefore at the leading edge in specifying, contracting for and structuring electricity projects to be constructed using project finance.

We remain strong advocates of introducing competition into the delivery of onshore transmission and TCP continues to support the development of the required arrangements *inter alia* through industry groups, responding to consultations such as these and, when called upon, providing evidence to parliament. We welcome the HSB consultation and Ofgem’s innovative approach on HSB in the absence of parliamentary time to enact the primary legislation necessary for the full CATO model.

TCP believes that the SPV model has the highest probability of attracting an appropriate level of competition therefore achieving best value for money to the UK consumer. The ingredients

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of a successful procurement are numerous and we believe precise timescales, clearly defined areas of responsibilities and balanced risks and incentives allocations amongst the various stakeholders will be key to the success of the HSB delivery.

Our response to your specific questions is attached as Annex 1.

Yours sincerely,



Chris Veal

Director

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Annex 1 – Responses to specific questions

Question	Response																
Chapter 1 - Regulatory framework for Hinkley-Seabank and other similar projects																	
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?	<p>We have evaluated the criteria for competition for three models which we have termed:</p> <ol style="list-style-type: none">SPV Very Late: A model similar to the Tideway procurement where the incumbent regulated monopoly (Thames Water in that case, NGET in the case of HSB) establishes the SPV and procures all necessary construction contracts on the SPV’s behalf. As was the case with Ofwat and Tideway, it would be expected that the competition for the construction contracts is also overseen by Ofgem, not least to ensure that the terms of the competition and final position are able to produce the most efficient financing solution.SPV Late: Under this model the competition overseen by Ofgem would comprise competing proposals which include differing construction contracts as well as the activities in the “SPV Very Late” model – this would be similar to the late CATO model (the main differences being that NGET would run the competitive process and be the licensee whereas in the CATO model Ofgem would run the competitive process and the CATO would be the licensee).Competition Proxy: As described in the consultation document. <p>Our high level assessment of the relevance of the new, separable and high value criteria differs between these three models as shown in the table below:</p> <table><tr><th></th><th>SPV Very Late</th><th>SPV Late</th><th>Competition Proxy</th></tr><tr><td>NEW - The risk of a [CATO] taking over assets that have been operational for some time</td><td>Relevant (same as CATO)</td><td>Relevant (same as CATO)</td><td>Not relevant</td></tr><tr><td>SEPARABLE - the costs and risks of managing interfaces between a [CATO] and other parties</td><td>Relevant (same as CATO)</td><td>Relevant (same as CATO)</td><td>Not relevant</td></tr><tr><td>HIGH VALUE - the costs of administering a tender</td><td>Relevant (but a lower threshold could be used than the SPV Late/CATO model as the administration/bidding costs could be lower)</td><td>Relevant (same as CATO)</td><td>Relevant (but a lower threshold could be used than even the SPV Very Late model)</td></tr></table>		SPV Very Late	SPV Late	Competition Proxy	NEW - The risk of a [CATO] taking over assets that have been operational for some time	Relevant (same as CATO)	Relevant (same as CATO)	Not relevant	SEPARABLE - the costs and risks of managing interfaces between a [CATO] and other parties	Relevant (same as CATO)	Relevant (same as CATO)	Not relevant	HIGH VALUE - the costs of administering a tender	Relevant (but a lower threshold could be used than the SPV Late/CATO model as the administration/bidding costs could be lower)	Relevant (same as CATO)	Relevant (but a lower threshold could be used than even the SPV Very Late model)
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	<p>In general we agree with the assessment set out by Ofgem in Appendix 3 of the consultation document. Our main difference would be on the high value criteria where we think there is a strong argument for different thresholds for different models:</p> <ul style="list-style-type: none"> i) The SPV Very Late model could have a lower threshold than the CATO (or SPV Late) model as the scope of competition, and therefore the administration cost, is lower; and ii) Whilst the cost benchmarks for equity/debt may be different for a £50m (say) rather than a £100m project there could still be consumer value in the Competition Proxy model at this level.
<p>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?</p>	<p>See our response to question 1, we think differences are justified based on the varying levels of administrative costs (depending on the delivery model used), and whether the potential project deliverer is the same as the incumbent monopoly or not.</p> <p>In particular we would expect that the Competition Proxy model should have relatively low administrative costs and therefore could be beneficially applied to much smaller projects than say the SPV Late or CATO models. We consider that the SPV Very Late model sits between these two in the complexity and cost of administering a competitive process.</p>
<p>Chapter 2 - SWW Final Needs Case assessment</p>	
<p>Question 3: Do you agree that there is a technical need for the HSB project and that the proposed connection is compliant with SQSS requirements? If not, please give evidence.</p>	<p>It appears that there is a technical need for the HSB project. We have not assessed the proposed connection against the SQSS.</p>
<p>Question 4: Do you agree with our initial conclusions?</p>	<p>We do not have the information to challenge the costs and CBA performance of connection options shown in Table 1 of the consultation document and therefore we have not assessed whether it is the preferred project to meet the technical need.</p> <p>We have also not assessed the justification for the costs of mitigating impact on the local landscape (undergrounding and use of T-pylons).</p> <p>However, we would argue that a process by which a TO seeks consent for a project assuming additional costs to mitigate impact on the local landscape, and only after consent has been granted learns whether it can recover these costs, does not seem efficient. We are not aware whether the TO had the opportunity to</p>

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	have these costs approved in principle ahead of consents application, but if these costs are not allowed, the TO in future may be incentivised to take greater consenting risk than is in the consumer's interest, in order to avoid further disallowed costs.
Question 5: Are there any additional factors that we should consider as part of our SWW Final Needs Case assessment?	No response.
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?	<p>We agree that the HSB project meets the new, separable and high value criteria and is therefore suitable for opening competition.</p> <p>With respect to the repackaging, our understanding is that in general what has been done is to exclude a 275kV line that is being upgraded to 400kV and we would agree that this is a reasonable exclusion. We note that the repackaging still includes the DNO works that are presumably expected to be undertaken by the DNO but paid for by the SPV (under the SPV model) and therefore would benefit from the competitively procured financing. We agree that this should be in the interests of consumers.</p>
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?	<p>We believe that the SPV model would provide a more favourable outcome for UK consumers relative to the existing status quo SWW arrangements. Furthermore, we believe that the SPV model would generate greater savings for the UK consumer than the Competition Proxy model.</p> <p>In TCP's experience the SPV model will not only provide the benefits of competition in the elements that are competed, but will also provide evidence of what benefits can be derived through competition and will be less open to challenge than the Competition Proxy as to the results it produces. Genuine competition also allows for innovation in the approach to project development and delivery.</p> <p>The successful procurement of the Tideway project and competitive financing package obtained by introducing competition for the financing and delivery of Tideway (a high value, new and separable project) demonstrates the extent of the benefits that competition can bring to the UK consumers. For Tideway, the extent of consumer savings between status quo and the introduction of competition are clearly measurable (regulatory WACC <2.5% for Tideway vs 3.60% for other regulated water companies).</p>
Question 8: What are your thoughts on the SPV model, including:	<p>TCP believes the ingredients of a successful competitive procurement for a project like HSB to include:</p> <ul style="list-style-type: none"> - Clearly define scope of responsibilities / risk allocation between stakeholders (Ofgem, NGET, SPV,

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	<p>Contractors and financiers) with the aim to create a level playing field amongst potential bidders for either or both the construction contract procurement and financing and delivery of HSB ; and</p> <ul style="list-style-type: none"> - A realistic procurement timetable and independence in governance around the procurement process (there would be a preference for Ofgem to run the tender process to ensure a fair process) <p>In our response to Question 1 above, we briefly described two alternative SPV models and we would welcome further discussions with Ofgem on the merits of these two models and the appropriate risk allocation for each.</p>
<p>(a) The structure of the model and length of revenue term?</p>	<p>Our positive experience on the Tideway procurement and the consumer savings achieved means that we are very supportive of the SPV model. The structure and steps outlined in Appendix 1 of the consultation document appears adequate for HSB.</p> <p>For such a large scale and long construction period infrastructure project with multiple interfaces (DNO, TO, Ofgem), we believe that a bespoke incentive regime driving positive behaviours of all stakeholders will be in the best interests of the consumer.</p> <p>Given the first-of-a-kind nature of HSB, the relatively short time period to construction commencement, the length of construction and the overall project size, we see benefit in what we describe as the SPV Very Late model above whereby NGET/Ofgem would also manage the procurement of the construction contracts. Key to achieving economic equity and debt pricing will be the nature of the construction contracts and construction counterparties. There are few contractors of sufficient credit standing able to undertake, on a full risk transfer basis, construction of this duration, complexity and value. To the extent it is not turn-key, fixed price construction backed by strong credit-worthy counterparties, in order to attract low cost of capital investment, there would need to be adequate protections built into the model such that the risk of construction cost overrun and delay risk is mitigated in some way.</p> <p>We believe that typical utility construction contracts such as the NEC 3 model can be beneficial as the contractor does not carry a large contingency within his construction total price. Such a model (as was used on Tideway) does, however, require significant protections for the project company SPV to be financeable.</p> <p>The terms of the Delivery Agreement and the adequate risk allocation between stakeholders will be key to the successful delivery of HSB. The Delivery Agreement needs to provide for certainty of revenues and provide for ring-fenced regulated revenues (see our response below to the issues raised in Appendix 1 to the consultation).</p> <p>In general, we believe that the revenue term should match the life expectancy of the asset and as such the proposed 25 years appears adequate. Long term certainty of revenues will result in greater consumer</p>

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	benefit. Adjustments to the revenue during that term should also be permitted for events that are outside of the control of the SPV.
(b) Should construction funding start during construction, or once it has completed?	<p>Depending on the construction contractual arrangements put in place (and the party responsible for this) we believe it may be worthwhile considering staging revenue commencement before construction completion or introducing a RAV build up model similar to that used on Tideway.</p> <p>We believe the long construction period and lack of equity yield during the construction period will significantly reduce the level of competition for provision of equity finance. Additionally, the absence of revenue during construction is also likely to negatively impact any ratings outcome and cost of debt that could otherwise be achieved if revenue were to be received during the construction period.</p> <p>On Tideway the licensee receives revenue during construction, a positive feature contributing to the level of competition for providing finance and consumer savings achieved on the cost of funds.</p> <p>Whilst our recommendation would be to increase the competition and reduce the required WACC by creating revenue during construction, if that were not the case, we have identified four work packages in the HSB project which once completed could lead to commencement of revenue:</p> <ul style="list-style-type: none"> i) Overhead lines; ii) Underground cables; iii) Substations; and iv) DNO works. <p>If all revenue commences at the completion of all packages, then the SPV (assuming it is project financed) will either require:</p> <ul style="list-style-type: none"> i) An EPC wrap from a creditworthy contractor (of which there are relatively few with the skills and experience to deliver the HSB project on a turn-key basis), or from a contractor who would be able to put in place bonding arrangements (which would be challenging for such a large project covering a significant construction duration); or ii) Under a multi-contract construction contract strategy would require delay liquidated damages from each contractor at a rate which compensates for the complete project delay (which would be challenging given the individual package sizes). <p>An alternative would be to allow the revenue for each package to commence on completion of that package – this would then allow a multi-contract construction contract strategy with delay LD requirements proportional to package size. We understand that in terms of revenue commencement (or accrual thereof) this is not dissimilar to the risk allocation currently under RIIO-T1 where construction expenditures are</p>

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	<p>accrued into the RAV as and when incurred.</p> <p>The terms of the Delivery Agreement should allow for adequate financial incentives to deliver the complete project by a given deadline, the increased construction competition, and reduced risk and therefore cost, would lead to a better outcome for the consumer.</p>
(c) The contractual and regulatory arrangements?	<p>Under the SPV model, we understand (per Step 5 in Appendix 1) that the SPV would indirectly benefit from a license granted to NGET with the direct revenue entitlement defined under the terms of the Delivery Agreement. The competitiveness of the finance package for HSB will be driven by the level of protections received under the Delivery Agreement and capacity of the SPV to sustain its obligations under various scenarios (including insolvency of NGET and ability of the SPV to recover its revenue entitlement). The extent of the legal steps allowing the SPV to directly claim its revenue will be heavily scrutinised by financiers and will directly impact the competitiveness of the finance package.</p> <p>In the event of NGET insolvency, last resort arrangements (see our response below to issues raised in Appendix 1 of the consultation) similar to those applicable to an OFTO and ability of the SPV to continue to recover revenue will be key to the success of attracting competitive finance.</p> <p>The Delivery Agreement would need to provide for some regulatory protections in a way that is back to back with NGET's licence / regime – investors take a great deal of comfort from the following features of a regulated deal that go beyond a PPP/PFI contracted model:</p> <ul style="list-style-type: none"> • Length of the price control and with a separate ring-fenced allowance for NGET for the SPV; • Financeability duty of the regulator; • Price re-openers (e.g. under recovery from consumer billing / Incoming Adjusting Event and Exceptional Event equivalents). <p>Indexation of revenues, or the ability to compete for the level of indexation, is of strong importance.</p>
(d) The identified benefits?	<p>In TCP's opinion and if adequately structured, the SPV model is likely to generate extensive value for money for the UK consumer notably through:</p> <ul style="list-style-type: none"> • A lower cost of debt than the RIIO T1 allowance (which is determined using the 10-year average of A and BBB 10 year + IBoxx) reflecting the current low interest rate environment; • Lower cost of equity through introduction of competition • Innovation in procurement and contracting strategies • Innovation/cost competition in O&M and asset management

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	<ul style="list-style-type: none"> Focussed and strongly incentivised construction and asset management
(e) Any potential downsides or implementation risks?	Ofgem has previously set out an indicative 18-24 month process from the start of the tender to the end of the preferred bidder stage for the CATO process ¹ . In respect of HSB, the indicative timeline (figure 2 of the consultation) allows for 15 months from 1 Jan 2018 for SPV activities including construction contracts, equity and debt competitions, and financial close (essentially the end of the preferred bidder stage) by 31 March 2019. This is a tight timescale, particularly as this is the first-of-a-kind tender process, and there must be some risk that the commencement of construction is delayed. This risk would be mitigated to some extent in the SPV Very Late model.
(f) Any other considerations?	None
Question 9: What are your thoughts on the Competition Proxy model, including: (a) The structure of the model and length of revenue term? (b) Should construction funding start during construction, or once it has completed? (c) How we identify comparable benchmarks? (d) The identified benefits? (e) Any potential downsides or implementation risks? (f) Any other considerations?	<p>In general whilst we understand that the Competition Proxy model is a useful model for Ofgem to have at its disposal (particularly for smaller projects where the administration costs may not justify a separate and independent competitive process to be run), we consider that it is subject to the specific downside of disagreement between Ofgem and the TO as to what the appropriate benchmarks should be. In the extreme this could lead to a reduction in investor confidence in the RIIO framework if it was considered that the revenue stream was insufficient to deliver the project. This is clearly avoided under the SPV model where third parties enter a competitive process.</p> <p>Competition is more likely to drive value than a subjective view of what could have been.</p>
Other questions from Appendix 1 – Outline of SPV model and associated arrangements	
Our initial preference is that the SPV	In response to Question 1, we identify the SPV Late and SPV Very Late models. Whilst on the face of it we

¹ Para 2.12 of Extending Competition in Electricity Transmission: Tender Models and Market Offering, Ofgem, 4th August 2016

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<p>competition covers the widest possible scope, ie that the competition invites bidders to procure all the contractors/sub-contractors for construction and operation of HSB, and all the associated financing (debt and equity) and submit their proposals in relation to all these areas at the ITT stage. This will support efficiencies through holistic delivery of construction, operations and financing, and ensure that competitive pressure is brought to bear on all these areas.</p>	<p>do not have a preference for either of these models, for the purpose of the HSB project, given it would be first-of-a-kind, has a relatively short time period to construction commencement, the length of construction and the overall project size, we favour an SPV Very Late model for the delivery and financing of HSB.</p> <p>Under the SPV Very Late model NGET would retain responsibilities for procuring various elements of the construction contracts, managing through the procurement process interface risks between the construction packages and ensuring adequate provision for risk contingencies. These would be signed off by Ofgem and tested by an experienced financial adviser as being capable of raising efficient debt and equity finance. Under the SPV Very Late mode, an <i>Independent Technical Assessor</i> (similar to that on Tideway) would annually certify the level of Capex incurred capitalising onto the RAV and earning a regulated return. Such degree of independence effectively provides NGET and Ofgem with the assurance that costs are being efficiently incurred.</p> <p>For such a large project, we are of the view that the level of risk contingencies that a contractor will add to his base price in order to provide a <i>bankable</i> EPC wrap (adequate level of guarantees supported by creditworthy entities) is unlikely to be economic. Hence, we are of the view that risk contingencies would be best placed in the hands of the SPV/Project Manager. Under this scenario, contingencies are only released to construction contractors if certain risks materialise as opposed to <i>baked in</i> to the contractor base price. As such the consumer is only paying for costs efficiently incurred. If a lump sum wrap approach is adopted, then the WACC costs will be significantly influenced by the views of debt and equity on the creditworthiness of the construction counterparties over what could be substantial periods of construction.</p> <p>Under this model, the SPV is responsible for the delivery and financing of the Project (with certain back stop protections) and the transmission assets are then leased for the 25 years to NGET.</p>
<p>We are open to considering alternative approaches to the scope of the SPV tender, where these deliver consumer benefit. For example, we referred in Chapter 3 to the contract for the Mendips underground cable potentially being procured by NGET before the SPV tender and that contract then being novated to the SPV. This would slightly reduce the scope of the SPV competition (and therefore potentially reduce savings), but may assist with timely deliverability of HSB. Where</p>	<p>We agree that in general reducing the scope of the SPV will reduce the scope of competition but we do not agree that this will necessarily increase the savings achieved. Whilst by definition a wider scope will enable competition across more activities, a wider scope may also restrict the number of qualified bidders. It is important that the optimal balance is struck between competing those activities which will attract a significant number of qualified bidders, and extending the scope of competition to activities for which there may be fewer qualified bidders.</p> <p>For example there are circumstances where it may be beneficial for the procurement of construction contracts (and in this case the underground cable) to be separated from the procurement of the financing, O&M and delivery of the project. Such circumstances in TCP's opinion include:</p> <ul style="list-style-type: none"> - First-of-a-kind projects - Significant time constraints to start construction

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<p>NGET proposes any variations to the scope of the SPV competition, we would expect them to justify the consumer benefit before we decide to allow them.</p>	<ul style="list-style-type: none"> - Large scale projects with long construction periods and multiple interfaces; and - A limited number of construction contractors able / willing to offer EPC wrap with adequate credit support. <p>In particular we believe that there may be a level of capex above which the pool of construction contractors able to provide turnkey contracts with adequate credit support may decrease. Projects with a capital cost above this value may be more suitable for the SPV Very Late model, and we consider that HSB fits into this bracket. This could also be applicable for future SWW projects with a high capital requirement and long construction periods but we would suggest that these are looked at on a case-by-case basis as the pool of contractors, and their ability to provide credit support, will vary significantly with the type of project.</p> <p>If it is necessary for NGET to commence the cable procurement in advance of bidder selection in order to meet timescales then that would have to be done, but it is unlikely to result in a single EPC turnkey wrap and so will have consequences for (in particular for delay) risk allocation.</p>
<p>We have no fixed view at this point as to whether the specific terms of the debt would need to be bid at the ITT stage, or whether the Preferred Bidder could bid its approach to securing debt at the ITT stage and then run a debt funding competition at the Preferred Bidder stage.</p>	<p>Given the long construction period and the scale of the HSB project TCP believes it may not be necessary to raise 100% of the long-term senior debt at ITT, Preferred Bidder or even at financial close provided that the bidder demonstrates certainty of financing solution. The length and duration of the construction period and the extent of any protections available to the SPV will all impact the credit rating and appetite of senior debt providers during construction. As such, it may be necessary to bridge finance into the longer-term lower cost senior debt. Exposure to refinancing risk without regulatory protection would limit the appetite of and increase return expectations of equity investors so it is worth considering how that risk might be mitigated.</p> <p>On Tideway the regulatory regime provides protections to the licensee for future variation in the cost of debt. In practice the licensee receives direct compensation (through an increase in revenue allowance) in the event of an increase in the cost of debt benchmark (BBB IBoxx 10year +). Such protection provides flexibility and allows the licensee to access the debt capital markets at the most opportune time. It differs from the typical RIIO regime, as the revenue adjustments are made on an annual basis rather than requiring the licence holder to wait for the next regulatory period. On Tideway this mechanism equally provides upside to the UK consumer (through a reduction in the revenue allowance) in the event of a decrease in the cost of debt benchmark. The reduction in the IBoxx benchmark since Tideway Financial Close has meant that the UK consumer will directly benefit from the low interest rate environment through a reduction in the Tideway revenue allowance. Such mechanism appears particularly suitable for large infrastructure assets with a long construction period.</p>
<p>Whether the SPV is a subsidiary (as</p>	<p>This raises the question, also noted elsewhere in the consultation document, as to whether NGET should</p>

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<p>defined in the Companies Act 2006) or not of NGET after SPV financial close may depend on the percentage of equity held by NGET and/or on the form of any control NGET has over the SPV as set out in the Delivery Agreement. Our initial expectation is that the SPV will not ultimately be a subsidiary of NGET.</p>	<p>be a (minority) shareholder in the SPV on an on-going basis. We do not consider that this is appropriate for several reasons:</p> <ul style="list-style-type: none"> i) Additional complexity – the need for the successful bidder to agree a shareholders’ agreement with NGET; ii) The requirement for NGET to accept a bid equity return on its investment (with no knowledge or control of what that might ultimately be); iii) Possible restrictions on how the successful bidder, through the SPV, delivers on its obligations under the Delivery Agreement; iv) Conflict of interest introduced by having NGET on both sides of the Delivery Agreement.
<p>P44 Delivery Agreement. We welcome responses from stakeholders on which high impact risks it might be sensible for NGET or consumers to retain</p>	<p>The Delivery Agreement should allocate risks to the party best able to manage it. In order to drive consumer savings, we expect the SPV will be substantially leveraged and as such high impact low probability risks will not be able to be adequately managed if they materialise.</p> <p>Consequently, we believe Force Majeure protections similar to that received under the OFTO regime (Exceptional Event, Income Adjusting Event, Change in law) will be necessary to achieve substantial consumer savings.</p> <p>Other risks which may be better covered elsewhere than by SPV include weather risk, ground risk, programme interface delay risk. An approach similar to PPP/PFI standards would appeal to investors.</p>
<p>P45 Other areas</p> <p>As we consider the SPV model further over the coming months, we will also set out our initial views on various other areas not covered here, for example:</p>	
<ul style="list-style-type: none"> • any minimum requirements we would set for conflict mitigation and whether and how any subsidiary of the incumbent TO could participate 	<p>We do not consider appropriate that any NG entity should be allowed to participate in such a tender due to the extensive conflicts of interest that would arise. We note the parallel from the PR19² regulatory regime in the water sector being proposed by Ofwat in respect of direct procurement for customers (DPC) in which they state that:</p>

² Delivering Water 2020: Consulting on our methodology for the 2019 price review, Ofwat, July 2017

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in the SPV tender	<p><i>“In general, existing appointees and associated companies should not be able to bid into their own tender process. We consider that there are significant real and perceived conflicts of interest that may distort the competitive process if we allowed this. In order to maximise potential competition and therefore benefits to customers in terms of innovation, financing and other costs, it will be vital that potential bidders perceive that competition is open to all. While, in theory, the potential and actual conflicts of interests could be managed by strict governance arrangements and “Chinese walls” between appointee and DPC bidder, these arrangements introduce additional complexity and may reduce or confuse the accountability of the procurer and/or provider of services. We want to ensure that the appointee plays a complete role as the buyer of services as this will help ensure best value for customers.”</i></p> <p>We echo these views and believe they are equally true in respect of the electricity transmission and distribution sectors.</p>
<ul style="list-style-type: none"> credit rating and counterparty risk 	<p>In line with the OFTO, we expect that the combination of (i) the solid financial standing of NGET (namely strong credit rating of A3/A-/A from Moody's/S&P/ Fitch); (ii) appropriately apportioned risks between creditworthy construction counterparties, consumer and shareholder; and (iii) a strong last resort mechanism would be adequate and likely attract competitive pricing for financing HSB. The last resort mechanism, underpinning regulatory arrangements and back stop provisions (similar to the Income Adjusting Event and Exceptional Event provisions under the OFTO arrangements) of HSB will constitute the corner stone of the SPV financial standing.</p>
<ul style="list-style-type: none"> extent to which the revenue stream is completely fixed, or whether for example there may be review points for operational expenditure 	<p>Fixed revenue entitlement appears suitable given the expected relatively low operational leverage and stable maintenance expenditure profile. The Delivery Agreement (and regulatory underpin between NGET and Ofgem) should cater for possible reopeners (Force Majeure events, Income Adjusting Event). The incentive regime of the OFTO has proven efficient in driving high levels of availability and savings for the UK consumer, we believe that incentives regime similar to that of the OFTO will similarly attract competitive capital for the delivery of the HSB project.</p>
<ul style="list-style-type: none"> arrangements for additional investment and new connections during the revenue term; and 	<p>Undoubtedly catering for additional unknown investments and new connections adds a degree of complexity to the finance arrangements, but the OFTO regime has shown that certain mechanisms are able to be incorporated in the initial financing documentation.</p>
<ul style="list-style-type: none"> last resort arrangements (for example special administration, methods of payment that might 	<p>The last resort arrangements and special administration regime, TO termination and step-in-rights will be heavily scrutinised by financiers and have a direct impact on cost of capital/consumer savings achieved for the delivery of HSB.</p>

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bypass the licensee, TO termination and step-in rights).

For instance the direct access of the SPV to the consumer for revenue collection in the event of NGET insolvency will be key to limit any premium lenders might otherwise require for counterparty risk.

{End}