

Consultation

Extending competition in electricity transmission: commercial and regulatory framework for the SPV Model

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We are consulting on the commercial and regulatory framework for the Special Purpose Vehicle (SPV) model of competition in onshore electricity transmission. We would like views from people with an interest in our policy development and its future application to onshore electricity transmission projects in RIIO-T1. We would also welcome responses from other stakeholders and the public.

This document outlines the scope, purpose and questions of the consultation and how you can get involved. Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations. We will publish the non-confidential responses we receive alongside a decision on next steps on our website at Ofgem.gov.uk/consultations. If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

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Contents

Executive summary	4
Background to competition.....	4
Next level of detailed design of the SPV model	4
Today's other publications.....	6
Next steps	6
1. Introduction	8
Purpose and scope of this document.....	8
Benefits of the SPV model	8
Ofwat and 'Direct Procurement for Customers' (DPC)	9
How to respond	9
Your response, data and confidentiality.....	9
General feedback.....	10
How to track the progress of the consultation	10
2. Overview of the SPV commercial and regulatory framework ...	12
Section summary	12
Overview of the SPV Model.....	12
Overview of the commercial framework and DA	16
Overview of the regulatory framework.....	19
3. Commercial Framework.....	22
Section summary	22
Introduction	22
Roles and responsibilities	24
Additional detail on the commercial framework	26
4. Regulatory Framework	32
Section summary	32
Introduction	32
TO Obligations during the Pre-tender stage	34
TO Obligations during the SPV Tender stage.....	36
TO Obligations during the construction period.....	38
TO Obligations during the operational period	39
TO allowances for SPV payments and implementation	40
Integration with the TO's regulatory obligations and incentives.....	43
Arrangements for the period after the end of the SPV's revenue term.....	44
Conflict mitigation - TO or related entity bidding in 'own area' SPV tender.....	44
5. Procurement principles.....	51
Section summary	51
Introduction and our role	51
Appendices	56
Appendix 1 – Draft illustrative licence conditions.....	57
Description of the proposed licence conditions	57
Proposed new licence condition.....	60
Appendix 2 – Privacy notice on consultations.....	70

Executive summary

Background to competition

In our Final Proposals for RIIO-T1, we indicated that Strategic Wider Works (SWW) projects to be constructed during the price control period could be subject to competition. Following further policy development under our Integrated Transmission Planning and Regulation (ITPR) and Extending Competition in Transmission (ECIT) projects, we committed to introducing competitive tendering for new, separable and high value (expected capital value of £100m or more) onshore electricity transmission assets.

In June 2017 we published an update on our plans to introduce competition to onshore electricity transmission, stating that we are deferring further development of the Competitively Appointed Transmission Owner (CATO) regime until the timing of the necessary legislation is more certain. In this context, through 2017 we considered alternative ways in which we could protect the interests of existing and future consumers by implementing competition in onshore electricity transmission, or seeking to replicate its effects.

In August 2017 we published our Hinkley-Seabank (HSB) consultation¹ which set out, amongst other things, our views on two alternative delivery models that would benefit consumers and that we considered could be implemented for HSB and future projects. These are the **Special Purpose Vehicle (SPV) model** and the **Competition Proxy model (CPM)**.

Our January 2018 "Update on competition in onshore electricity transmission"² set out our updated position on the overarching form and core features of the SPV model and the CPM, taking into account the stakeholder responses received in relation to our August 2017 consultation. We also set out that **we intend to consider the CPM and SPV model for all future SWW projects that are subject to a Needs Case assessment during RIIO-T1.**

Next level of detailed design of the SPV model

We consider that the core features previously set out in January 2018 remain appropriate for the SPV model. In summary, those features are:

- The incumbent TO would run a competition for the construction, financing, and operation of a new, separable and high value project through a project-specific Special Purpose Vehicle (SPV). In general, we consider that a 25-year operational period would be appropriate.
- The SPV competition would determine an annual revenue stream for the project, reflecting the underlying capital and operational costs and weighted average cost of capital (WACC), which would be paid to the SPV

¹ <https://www.ofgem.gov.uk/publications-and-updates/hinkley-seabank-consultation-final-needs-case-and-potential-delivery-models>

² <https://www.ofgem.gov.uk/publications-and-updates/update-competition-onshore-electricity-transmission>

by the TO on behalf of consumers. The TO would recover these costs from users of the system (and ultimately from consumers) through its transmission licence.

- The SPV would deliver the project under the terms of a contractual arrangement (the "Delivery Agreement" (DA)) with the TO.
- The TO would retain regulatory responsibility (under the terms of its transmission licence) for, and operational control of, the project.
- The capital invested by the SPV in the project would be fully recovered over the revenue period, ie the equivalent of the "regulatory asset value" would be zero at the end of the revenue term.

In this document we have provided further information on three core areas of the SPV model:

- **The commercial framework and DA that govern the relationship between the TO and the SPV.** We appointed consultants, Agilia, to support our work on developing the commercial terms of the DA between the TO and the SPV. We have published a report by Agilia alongside this consultation, and this report forms the basis of the proposed commercial framework for the SPV model. We have provided further context and information on particular elements of the commercial framework, for example further detail on our views of the scope of price adjustment mechanisms and revenue during construction.
- **The regulatory framework for the TO and licence conditions, ie the regulatory arrangements that we will apply to the TO.** The SPV model will be underpinned by licence conditions in the TOs' transmission licences, including a project-specific ring-fenced revenue stream where an SPV is appointed. The licence conditions will set out obligations on the TO before the appointment of the SPV, including the design and implementation of the SPV competition. The licence conditions will reflect the provisions within the DA as appropriate, so that for certain obligations and mechanisms there is a link between the commercial and regulatory treatment. This is to provide clarity to all parties as to how our regulatory treatment of the TO will relate to the contractual arrangements within the DA between SPV and TO. We have set out in this consultation our views on the regulatory framework for the TO, including pre-tender and tender obligations, how the TO would recover the SPV's revenue stream from consumers, and conflict mitigation for TO participation in an SPV tender. In Appendix 1 of this consultation we have published, for consultation, our proposed illustrative licence conditions³ to implement the regulatory framework.
- **The procurement framework for the SPV tender, ie the key considerations the TO must take into account when running a competition to appoint an SPV.** Under the SPV model, the TO would be responsible for designing the tender processes and documentation for the SPV tender. We intend to develop and publish Procurement Guidance (PG) setting out the procurement principles that the TO must take into

³ We set out our view that the regulatory framework should be based on: a new TO licence condition 6M/J and supporting guidance.

account when developing its SPV tender documentation and running the competitive tender to appoint the SPV. We would consider the TO's proposed tender processes and documentation against this guidance to determine whether to approve the tender documentation and allow the tender to take place. We consider that the PG is likely to include a combination of strict requirements and broader guidance around potential options for tender design to ensure that each tender will produce beneficial outcomes for consumers, and be reasonably similar and reproducible across tenders for the benefit of SPV market participants.

Today's other publications

Alongside this consultation, we have today published three other documents:

- 1) **Update on Extending Competition in Transmission⁴** – this letter updates stakeholders on our arrangements to extend competition in onshore electricity transmission. It sets out the background to competition in electricity transmission, our approach to the future application of the CPM and SPV model, and an overview of our future programme and its links to our RIIO-2 work.
- 2) **Update on the Competition Proxy delivery model⁵** – an update on how we will consider applying the CPM for future projects.
- 3) **Impact Assessment on applying the Special Purpose Vehicle and Competition Proxy competition models to future new, separable and high value projects⁶** – an Impact Assessment setting out our analysis of the benefits and costs to consumers and other industry parties of applying the CPM and SPV model to future projects that meet the criteria for competition, against a counterfactual of delivery through the prevailing price control by the relevant incumbent TO.

Next steps

We invite stakeholders to respond to this consultation by 9th November 2018. Following the conclusion of this consultation, we will assess stakeholder responses and provide our updated views on the arrangements proposed in this consultation. We expect that this will include decisions in some key areas such as the commercial and regulatory frameworks, and further consultation in other areas such as the licence conditions to implement the model.

We intend to progress the SPV-related licence conditions over the course of the Autumn, including holding licence drafting workshops with interested participants,

⁴ <https://www.ofgem.gov.uk/publications-and-updates/update-extending-competition-transmission-and-impact-assessment>

⁵ <https://www.ofgem.gov.uk/publications-and-updates/update-competition-proxy-delivery-model>

⁶ <https://www.ofgem.gov.uk/publications-and-updates/update-competition-proxy-delivery-model>

with a view to a statutory consultation on the proposed licence changes in early 2019.

1. Introduction

Purpose and scope of this document

1.1. This consultation document sets out our views on the next level of detailed design of the Special Purpose Vehicle (SPV) model for extending competition into onshore electricity transmission, building on our previous documents published in August 2017 and January 2018. This document also sets out for stakeholders how our work on the SPV model fits into our wider programme of competition in electricity transmission networks.

1.2. The policies and arrangements set out in this document and the accompanying Agilia report are for consultation, and we invite stakeholders to respond using the contact details set out on the front of this document. We have provided questions for stakeholders on particular areas at the start of each chapter, but stakeholders should not feel constrained by those questions in their response.

Scope of this document

1.3. This consultation contains our views and information on several areas of the SPV model and competition related policy, including:

- Our proposed commercial proposition for the SPV model, supported by a report produced by our external consultants, Agilia;
- Our proposals for the regulatory framework to support and implement the SPV model within the TO licence, including illustrative licence conditions for consultation; and
- Our view of the procurement principles that a TO should follow when running a tender to determine and appoint an SPV.

Benefits of the SPV model

1.4. We continue to consider that the SPV model, where implemented in line with the arrangements proposed within this document, can provide benefits to consumers over the SWW status quo approach under the RIIO price control to fund the delivery of new, separable and high value projects. As a part of our January 2018 minded-to consultation on the Hinkley-Seabank project, we undertook analysis to demonstrate the benefits of the SPV model and the CPM over the SWW approach. Our analysis showed that there are significant financing benefits associated with the SPV model and the CPM, and that for the SPV model there were potential additional savings in capital and operational costs available. This is because the competitive nature of the model can drive further innovation in contractual arrangements and operating approaches across a wider pool of potential contractors.

1.5. Alongside this consultation we have published an Impact Assessment (IA) in relation to both the SPV model and the CPM, considering the models'

application in general to new, separable and high value projects rather than in the context of a specific project. The IA shows that there are significant potential benefits to consumers from applying the CPM or SPV model under a range of different scenarios.

1.6. We are inviting stakeholders to provide comments on the IA as it pertains to the SPV model, and those who wish to respond should use the details given on the front of that document.

Ofwat and 'Direct Procurement for Customers' (DPC)

1.7. The England and Wales Water Regulator, Ofwat, is undertaking work to establish a similar model of competition to the SPV model for application in the next water company price controls, PR19.

1.8. Ofwat's Direct Procurement for Customers (DPC) are arrangements where an incumbent water company competitively tenders for a third party (a Competitively Appointed Provider (CAP)) to design, build, finance, operate and maintain infrastructure that would otherwise have been delivered by that incumbent water company. The water companies will be the purchaser and run the CAP procurement process. The companies will enter into a long-term contract with the CAP for a revenue stream to be paid to the CAP for the provision of the infrastructure. Ofwat will amend companies' licences to allow them to recover the CAP's revenue from their customers.

1.9. Ofwat expects water companies to consider DPC for discrete, large-scale enhancement projects expected to cost over £100 million, based on whole-life total expenditure.

1.10. We will continue to monitor developments in DPC for potential learning to apply to the SPV model, given there are some similarities between the two models. In particular, both models involve the incumbent infrastructure operator tendering out the construction, operations, and financing to a third party provider, and the regulatory arrangements are established through the geographical incumbent's licence, rather than awarding a new licence.

How to respond

1.11. We want to hear from anyone interested in this consultation. Please send your response to the person or team named on this document's front page.

1.12. We've asked for your feedback in each of the questions throughout. Please respond to each one as fully as you can.

1.13. We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations.

Your response, data and confidentiality

- 1.14. You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.
- 1.15. If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.
- 1.16. If the information you give in your response contains personal data under the General Data Protection Regulation 2016/379 (GDPR) and domestic legislation on data protection, the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 4.
- 1.17. If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

General feedback


- 1.18. We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:
 1. Do you have any comments about the overall process of this consultation?
 2. Do you have any comments about its tone and content?
 3. Was it easy to read and understand? Or could it have been better written?
 4. Were its conclusions balanced?
 5. Did it make reasoned recommendations for improvement?
 6. Any further comments?

Please send any general feedback comments to stakeholders@ofgem.gov.uk

How to track the progress of the consultation

You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website. [Ofgem.gov.uk/consultations](https://www.ofgem.gov.uk/consultations).


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2. Overview of the SPV commercial and regulatory framework

Section summary

This chapter provides an overview of the SPV commercial and regulatory framework. Further detail of each area is set out in Chapter 3 and 4 respectively.

Overview of the SPV Model

2.1. In January 2018, we set out that the core structures of the SPV model are:

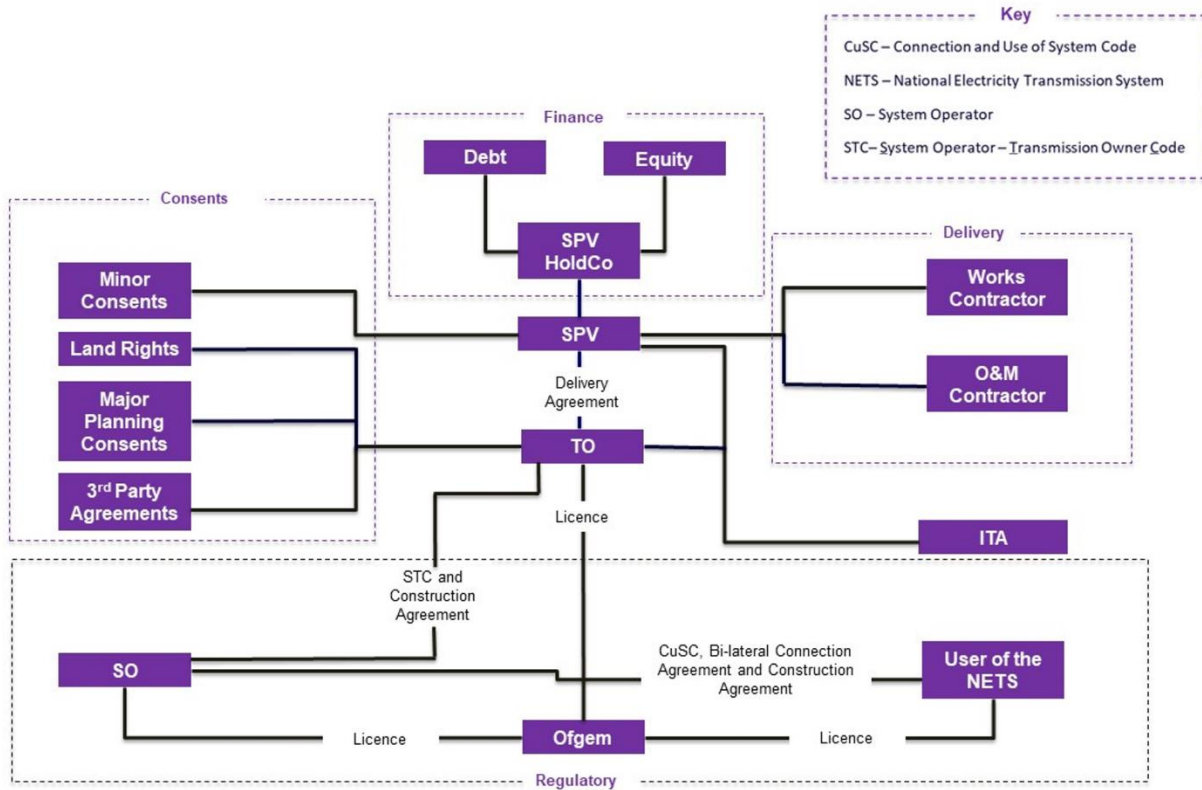
- The incumbent TO would run a competition for the construction, financing, and operation of the project, for a 25 year operational period, through a project-specific SPV.
- The SPV competition would determine an annual revenue stream for the project, reflecting the underlying capital and operational costs and weighted average cost of capital (WACC), which would be paid to the SPV by the TO on behalf of consumers. The TO would recover these costs from users of the system (and ultimately from consumers) through its transmission licence.
- The SPV would deliver the project under the terms of a contractual arrangement (the "Delivery Agreement" (DA)) with the TO.
- The TO would retain regulatory responsibility (under the terms of its transmission licence) for, and operational control of, the project.
- The capital invested by the SPV in the project would be fully recovered over the revenue period, ie the equivalent of the "regulatory asset value" would be zero at the end of the revenue term.

2.2. With regards to the process to determine and appoint the SPV, we set out in January 2018 that while the TO would run the process, we expect the competitive tender would be approved by Ofgem and run with Ofgem oversight. This tender would determine the terms of the contractual arrangements through the DA between the SPV and the TO.

2.3. In this Chapter we have set out an overview of the commercial and regulatory frameworks we propose to underpin the SPV model and the roles and responsibilities of parties (including Ofgem). More detail on all these areas are available in the subsequent chapters of this document.

2.4. In Figure 1, we have reproduced the potential outline structure of the SPV set out in the Agilia report. This includes the key relationships between us, the TO, and the SPV.

Figure 1 – Overview of the potential structure of the SPV model



2.5. We have set out in Table 1 a summary of the key roles and responsibilities for the three main parties within the SPV model. The details of these roles are explored in more detail in Chapters 3 and 4, and the Agilia report published alongside this consultation.

Table 1: Key roles and responsibilities at each stage of the SPV model.

Stage	TO	Bidders/Appointed SPV	Ofgem
Project Identification	<ul style="list-style-type: none"> • Provide input to the SO's NOA process. • Submit needs case in line with TO licence and SWW guidance documentation. 	<ul style="list-style-type: none"> • Not Applicable 	<ul style="list-style-type: none"> • Decide on the need for the project - depending on when the needs case is submitted, and on any conditions for needs case approval, this may also happen during the pre-tender or even during the tender stages, so this is also shown in those stages. • Decide on the applicable delivery model for the project.
Pre-tender	<ul style="list-style-type: none"> • Continue to undertake relevant pre-construction activities. • Develop the project's output specification. • Develop DA and Tender Documentation in line with the DA guidance and Procurement guidance documents. 	<ul style="list-style-type: none"> • Engage in any early market engagement/testing 	<ul style="list-style-type: none"> • Review, provide comment on, and where satisfied, approve the TO's DA and Tender Documentation. • Decide on the needs case for the project.
Tender	<ul style="list-style-type: none"> • Continue to undertake relevant pre-construction activities. • Commence and conclude an SPV tender in accordance with the documentation approved by Ofgem. • Seek approval from Ofgem for material changes to the DA or Tender Documentation. 	<ul style="list-style-type: none"> • Where requested to, provide comment on the TO's proposed DA. • Participate in the SPV tender. 	<ul style="list-style-type: none"> • Review, provide comment on, and where satisfied, approve material changes to the TO's DA or Tender Documentation. • Approve the appointment of the Preferred Bidder. • Approve the award of the DA to the Preferred Bidder.

			<ul style="list-style-type: none"> • Confirm that any conditions for needs case approval have been met – if applicable
Post-Tender	<ul style="list-style-type: none"> • Overall regulatory responsibility and operational control of the transmission assets. • Monitor the activities and reporting of the SPV. • Report to Ofgem on certain items. • Review, and where appropriate, approve changes to the SPV's TRS or costs. • Apply to Ofgem for revenue stream or cost adjustments under the relevant licence mechanism, as appropriate. 	<ul style="list-style-type: none"> • Construct, operate and maintain the transmission assets as required under the DA. • Report to the TO as required. • Where allowed, apply to the TO for TRS or cost adjustments. 	<ul style="list-style-type: none"> • Review reporting by the TO on the SPV. • Review, and where satisfied, approve, changes to the TO's SPV-related cost allowances.

Overview of the commercial framework and Delivery Agreement

2.6. We consider that in order to ensure a successful outcome from an SPV tender, the commercial principles that underpin the DA must represent an appropriate allocation of risks and responsibilities between the SPV, the TO (as licensee), and consumers.

2.7. In this section, we have set out an overview of our proposed SPV commercial offering principles and risk allocation. This builds on the SPV model set out in our January 2018 Update. Further detail of the proposed SPV commercial framework is available in Chapter 3 and in the accompanying Agilia report.

Commercial structure

2.8. A core feature of the SPV model is that a project would be delivered by an appointed SPV on the basis of an SPV DA. The DA would set out the contractual terms under which the SPV would deliver the project on behalf of the TO. Supported by Agilia, we have developed the underpinning commercial framework that the TO must adhere to when developing a detailed DA for any particular project.

2.9. In high level terms, the DA covers the basis under which the SPV and TO will work together to deliver the project. As such it is an extension of the sort of arrangements a TO would have with any sub-contractor delivering for them, albeit under the SPV model the scope of works is clearly significantly wider.

2.10. We have set out in Table 2 below an overview of the key underlying commercial principles and risk allocation for the DA. Table 2 is a simplified and abbreviated version of the key commercial principles and risk allocation set out in the Agilia report – for the avoidance of doubt we are consulting on the more detailed and comprehensive framework set out in the Agilia report as the basis for the SPV model.

2.11. It should be noted that the arrangements relate to use of the SPV model for 'late model' competition, ie where the SPV is responsible for detailed design, construction, financing and operation, but where the TO undertakes preconstruction works, including securing major planning consents.⁷

Table 2

Delivery Agreement Area	Summary
Consents	To help manage risk and schedule, the TO will obtain the Development Consent Order (DCO)/Section 37 ⁸ consent and other specified key consents. The SPV will be obliged to comply

⁷ We consider that the SPV model could be adapted for earlier models of competition, ie where competition is introduced earlier in the project development process. Potential arrangements for this are outside of the scope of this document. We expect to consider early models as part of our work on the RII0-2 competition arrangements.

⁸ Scottish Energy Consents.

	with those consents and will be responsible for obtaining any other consents required to deliver the project.
Land	The TO will identify the parcels of land required to construct and operate the transmission assets, by reference to the preliminary design and will acquire the necessary land for the project (however it is recognised that there may some flexibility required here depending on overall timing).
Design	The TO will carry out preliminary design, which the SPV will adopt with no recourse to the TO (but potentially with warranties from the designer, subject to insurance and liability). The TO will also prepare the project's output specification. The SPV will be responsible for carrying out detailed design and then implementing that design to meet the output specification.
Construction Risks	<p>The SPV will carry out the construction and operation for a fixed price (in general) which will be modelled within the profiled project-specific revenue stream. The actual construction and operations costs are accordingly an SPV risk. The SPV will be responsible for managing all aspects of the construction and will report regularly to the TO on the status of the works.</p> <p>In some circumstances, for particular types of construction or operational period risk and/or longer or more complex construction periods, an alternative to a fixed price model may be suitable where pricing may be on a capped or target cost basis. This is likely to be applicable where elements of construction or operational period risks would not be value for money under fixed cost pricing, and where cost-reopeners are in themselves too uncertain. In such circumstances the alignment options and certain cost/risk elements would need to be tailored to ensure the SPV remains incentivised to preserve affordability and value for money for consumers.</p>
Payments	<p>The SPV's full revenue entitlement commences on completion of asset commissioning and continues to expiry of the term of the DA. The revenue will be paid in full subject only to payment deductions and incentives as set out within the terms of the DA. Delays to commissioning may result in a shorter revenue period, as the operational period does not extend with a later start.</p> <p>The SPV will be subject to an appropriately sized availability-type incentive. Additional project specific incentives may apply.</p> <p>In limited circumstances, eg long and/or complex construction periods, a limited quantum of revenue may be paid during the construction period, likely tied to delivery of key milestones. Similarly, depending on the nature of the construction and commissioning of the transmission asset(s), it may be beneficial to consider staged revenue (eg where the assets are commissioned in multiple stages over time).</p>
Refinancing	Benefits of refinancing senior debt will be shared between the SPV and consumers.

<p>Price Adjustments (covering change in law, compensation events etc.)</p>	<p>The general principle of the price model is that the SPV should take all, or defined, risks associated with the financing, construction and maintenance of the transmission asset and should price the assumption of these risks accordingly.</p> <p>There are four sets of events which are proposed as exceptions to the above principle:</p> <ol style="list-style-type: none"> 1. specified cost and output adjusting events (uncontrollable events, which are not the fault of the SPV, that are not foreseeable and are low probability but high impact); 2. events that are treated as pass through costs (e.g. changes in business rates will be passed through fully, without deduction); 3. certain changes in law (e.g. (i) increases in costs which apply specifically to the project or to the contractor or to electricity transmission construction or maintenance; and (ii) operational period general changes in law requiring capital expenditure); and 4. certain breaches of the DA by the TO. <p>Other events may be considered where a clear cost benefit can be demonstrated.</p>
<p>Handback</p>	<p>The DA will clearly set out the handback condition for the transmission assets and will provide for a robust process and criteria with a high degree of certainty for determining compliance with the handback conditions. This provides clarity to the SPV concerning its obligations and to ensure the TO is able to carry on operations for the remainder of the transmission asset's life (and to price them in advance).</p>
<p>Termination</p>	<p>Termination rights will be developed on similar principles to Private Finance 2 (PF2), so that the SPV and financiers have certainty as to the precise nature of the termination events, with appropriate opportunities to engage with the TO to resolve issues to prevent termination.</p>
<p>Compensation on Termination</p>	<p>This will broadly follow PF2 principles, being that:</p> <ul style="list-style-type: none"> • On SPV default (including insolvency), a re-tendering (to a liquid market⁹) will establish the value of the DA, with the valuation paid by the successful bidder to the SPV; and • On no-fault termination (e.g. Force Majeure) the debt and breakage costs, plus equity investment (absent future returns) will be paid. <p>One key difference to PF2, is that it is envisaged that TO payment default issues will be addressed via: (i) the credit standing requirement in the TO licence, and (ii) the enforcement of the requirement to comply with the DA (set out in the TO</p>

⁹ I.e. there are a sufficient number of contractors in the market to ensure that the price that any new bidding party will offer for the DA is reasonably likely to represent a fair value

	<p>licence). In cases of TO insolvency, energy administration (involving transfer to a new TO) is the likely outcome and the DA would therefore continue.</p>
<p>Independent Technical Advisor (ITA)</p>	<p>The TO and the SPV would jointly appoint an 'Independent Technical Advisor' (ITA) to provide various functions under the DA for a particular project. The ITA would need to be suitably skilled to provide those functions, and the appointment should take into account the particular nature of the assets delivered under the DA. The full range of functions of the ITA would be similar between projects, but with some differences allowed to reflect the nature of particular projects.</p>

2.12. In Chapter 3 we invite stakeholders to comment on the commercial framework.

Overview of the regulatory framework

2.13. The SPV model will be underpinned by licence conditions in the TO licences. The TOs will be required to implement the model, including running the competitive tender to determine and appoint the SPV. This is different to the approach proposed for the CATO regime where Ofgem would run the competitive tender and award a new transmission licence to the successful entity identified through the competition. The effect of this difference is that the regulatory framework, and the associated conditions under the TO's licence, would cover project identification, pre-tender, tender and post-tender (construction and operational) periods for any project delivered under the SPV model.

2.14. In this section, we have set out a summary of the regulatory framework we are proposing to introduce for the SPV model. More detail on the regulatory framework is available in Chapter 4.

TO Licence conditions / obligations

2.15. Our intention is to implement the SPV model by developing and putting into place clear obligations in the transmission licence of the incumbent TO procuring the SPV to deliver the project. These will include the need for clear and robust arrangements that ensure a fair and transparent procurement process.

2.16. The licence conditions will set out obligations on the TO before the appointment of the SPV, including in relation to project identification, design and implementation of the SPV competition.

2.17. Once the SPV is appointed, the licence conditions will establish a ring-fenced project-specific revenue stream. The licence conditions will require the TO to comply with the DA

agreed with the SPV at the conclusion of the SPV tender. At the point that an SPV is appointed, the licence conditions will reflect the provisions within the DA as appropriate, so that for certain obligations and mechanisms there is a link between the commercial and regulatory treatment. For example, where particular events occur that are covered within the DA and that lead to cost changes, there will be provisions in the TO's licence to allow the TO to seek to reflect those costs within its allowed revenue.

Regulatory framework structure

2.18. We want to ensure that the SPV model regime is built on a strong foundation of clear licence conditions. To support those licence conditions, we propose to place further detail of the regime into appropriately scoped and developed guidance documents. This is similar to the approach taken in other regimes such as SWW and Ofwat's DPC.¹⁰

2.19. We propose to base the SPV model on:

- 1) **A new TO licence condition covering implementation of the SPV model** – this proposed new licence condition (6M/J)¹¹ would set out the obligations on the TO across the full lifecycle of a project delivered under the SPV model, i.e. from the pre-tender phase of a project, through the tender, and to the ongoing operational reporting and management of the SPV for the duration of the revenue term. This would also include obligations to mitigate conflicts of interest and TO incentives.
- 2) **Supporting guidance** – we propose to introduce a set of guidance documents to provide more detail on implementation of the SPV model than we consider would be appropriate to include in the TO's licence conditions. Indicatively, this would cover at least three core areas:
 - a. **Licence Guidance (LG)** – detailed guidance on the obligations contained within the proposed new licence condition 6M/J.
 - b. **DA Guidance (DAG)** – setting out the commercial principles described in Chapter 3. This would broadly be built on the Agilia report published alongside this consultation.
 - c. **Procurement Guidance (PG)** – this would set out procurement principles that the TO must take into account when developing its SPV tender documentation and running the competitive tender to appoint the SPV.

2.20. Table 3 sets out a summary of how the different conditions and documents described above correspond with the stages of development of a project taken forward under the SPV model.

¹⁰ Further information on the structure of Ofwat's DPC model is available in Chapter 7 of Ofwat's final methodology for PR19: <https://www.ofwat.gov.uk/wp-content/uploads/2017/12/Final-methodology-1.pdf>

¹¹ This would be 6M in the existing NGET licence, and 6J in the SPT and SHET licence, reflecting their differing existing licence conditions.

Table 3 – Summary of project stage and corresponding licence conditions and guidance documents

		Project Stage				
		Project Identification	Pre-Tender	Tender	Construction Period	Operational Period
Proposed Implementation	Licence conditions	6I and C27 (SO)	6M/J	6M/J	6M/J	6M/J
	Ofgem guidance	SWW Guidance	LG, DAG, PG	LG, DAG, PG	LG	LG

Implementation

2.21. We have included in Appendix 1 our proposed illustrative licence conditions to implement the regulatory framework for the SPV model into the TO licences. We intend to continue to develop and refine the proposed licence conditions, ahead of a future statutory consultation to implement them into the transmission licences. The draft conditions provided now contain sufficient detail to enable stakeholders to have a greater understanding of how the model is intended to work.

2.22. In Chapter 4 we have set out more detail on the regulatory framework and our proposals to implement the SPV model.

3. Commercial Framework

Section summary

This chapter provides a summary of our proposed commercial framework for the SPV model, i.e. the basis for the DA between the TO and the appointed SPV.

Questions

Question 1: What are your views on the commercial framework as set out in the accompanying Agilia report?

Question 2: Do you agree with the scope of our role in the SPV model?

Question 3: Do you agree with the scope of the Independent Technical Advisor? Do you have examples you can share of Independent Technical Advisors working well or not so well, and any examples of lessons learned from this approach?

Question 4: What are your views on operational period incentives for the SPV?

Question 5: What are your views on where there may be consumer value in a target cost rather than fixed price model?

Question 6: What are your views on possible TO and SPV enhanced alignment options?

Question 7: Are there any other points we should consider within the commercial framework?

Introduction

3.1. We set out in our January 2018 Update and in chapter 2 the outline SPV commercial and regulatory framework. In this chapter, we have set out further information on the conclusions of our work, supported by our appointed consultants – Agilia, to further develop the detailed commercial framework for the SPV model.

3.2. We propose that the TO would be required to use this commercial framework as the basis for developing the SPV DA for any particular project to be delivered under the SPV model. Therefore the detail contained in the Agilia report and supporting information in this Chapter will form the main part of the SPV model's commercial offering to the market and will drive the model's benefits to consumers.

Consultancy support

3.3. We appointed Agilia to support our work on the development of the SPV model. Agilia were contracted to develop the details of an SPV commercial framework that would represent an appropriate allocation of risks to drive benefits for consumers.

Guiding principles

3.4. Agilia's guiding principles while developing the detailed commercial framework were to:

- Achieve an efficient allocation of risk between the Transmission Owners, the SPV, and consumers.
- Build on the commercial framework provided in our January 2018 Update and use principles established in existing electricity industry regimes – including RIIO and the OFTO regimes (and wider supporting documentation published in respect of OFTO Build and the CATO regimes, noting that these have not been implemented to date).
- Use well tested and understood, financeable and value for money risk allocation positions from other models such as PFI/PF2, Thames Tideway Tunnel and other Public-Private Partnership (PPP) models.

Market engagement sessions

3.5. In March 2018 Agilia undertook a market sounding exercise on their draft SPV model commercial framework. Agilia met with 19 parties, representing a range of potential participants in the SPV model including TOs, banks, pension funds, contractors, and other equity providers.

3.6. Potential market participants were broadly supportive of the introduction of the SPV model, in light of the pause to the development of the CATO regime. In particular, participants were generally supportive of an approach that sought to use established principles from other similar regimes such as Thames Tideway Tunnel, Ofwat's DPC, and PF2. Some participants expressed a preference that the forms of contract should be broadly similar for each project to assist with reproducibility.

3.7. Participants were generally supportive of a 25 year operational revenue stream, noting that this was a balance between the preferences of different finance providers. A few participants noted the potential for conflict with the relevant TO on handback of assets at the end of the revenue period, and that this area may require specialist support from an independent party, perhaps the ITA. TOs similarly expressed concerns about handback, and the regulatory treatment after the SPV's revenue period.

3.8. Participants stressed the need to secure planning consent for a project in such a way that they could innovate in the detailed design and sufficiently differentiate their bids. However, the TOs noted their concerns around innovation impacting the standards of the network. A majority of finance participants preferred a fixed price approach, while contractor views were more mixed, with some in favour of a target price approach (in particular for works involving an offshore element).

3.9. TO participants expressed a range of concerns with the introduction of the SPV model, including issues around standards, the efficiency of appointing a third party to deliver the projects, and their exposure to a range of risks.

3.10. Agilia considered the above feedback in pulling together their proposed commercial framework. Alongside this document we have published the detailed report produced by Agilia on their recommended commercial framework.¹² Stakeholders should read that report to ensure a complete picture of the commercial framework detail being proposed and in order to respond fully to the consultation questions we have included in this document.

3.11. The remainder of this chapter sets out further information to support the Agilia report. The further information we set out below builds on Agilia's proposals in some areas in order to provide additional clarity on our policy rationale. More specifically, we cover our roles and responsibilities and those of the ITA, as well as more detail on contract and revenue duration, and arrangements during design and construction and operational periods.

Roles and responsibilities

Our role

3.12. Our role in the commercial framework involves:

- Enabling implementation of the commercial framework through both TO licence conditions and supporting guidance (the DAG)
- Ensuring the DA developed by a TO is appropriate before and during an SPV tender, up to the point of SPV appointment
- Once the SPV is appointed, making changes to the TO's licence to reflect when particular events occur that are covered within the DA.

DA Guidance (DAG)

3.13. As set out in Chapter 2, we intend to develop and publish a DAG document. This will build on the commercial framework set out in this Chapter and the Agilia report, and take into account stakeholder responses to this consultation.

3.14. We expect that the DAG would contain the final version of the DA commercial framework. We expect that the contents of the DAG will continue to develop over time as learning from future SPV tenders is incorporated. Our intention is to begin formalising the DAG following this consultation.

DA

3.15. We intend to ensure that the DA can ensure economic and efficient outcomes for consumers from delivery of a project via the SPV model. We will do this by requiring the TO

¹² <https://www.ofgem.gov.uk/publications-and-updates/extending-competition-electricity-transmission-commercial-and-regulatory-framework-spv-model>

to adhere to the DAG and retaining approval rights over the draft DA used in the tender and the final DA entered into by the TO and SPV. However, we do not intend to have any formal role in the DA once it is signed following appointment of the SPV. The TO is the licenced entity in the SPV model, and therefore our direct statutory relationship is only with the TO.

3.16. Once an SPV has been appointed, we would, where appropriate, approve any changes to the TO's allowed revenue recovery through its licence where requested by the TO in response to a relevant provision in the DA. For example, we will need to approve the initial commencement of revenue and any subsequent adjustments to the TO's revenue for a project.

3.17. While they are clearly linked, our approval of any cost adjustment or revenue change in the TO's licence is necessarily a separate decision to the adjustment to the SPV's costs (by the TO) under the terms of the DA. We therefore cannot guarantee that any decision to adjust SPV costs under the terms of the DA will automatically be mirrored by a decision by us to amend the TO's revenue accordingly under its licence. This is because, in deciding whether to adjust the revenue, we have a principle objective to protect the interests of consumers. We cannot fetter our discretion and we are required to take account of all of the circumstances and reasonableness of costs incurred.

3.18. We intend to adopt a timely process for considering any changes to the revenue allowance within the TO's licence, to ensure that our processes do not negatively impact on delivery of the project. As part of our processes, we would expect to take into account the recommendation of the ITA in its independent role under the DA for the relevant project. However, we note that the ITA's recommendation would not be binding on us when making our decisions whether to adjust costs within the TO's licence.

3.19. For the avoidance of doubt, we do not consider that our role in the above arrangements should delay or prevent the SPV being paid by the TO where required under the DA.

Role of the ITA

3.20. We propose that the TO and the SPV jointly appoint an ITA to provide various functions under the DA for a particular project. We consider that the ITA would benefit the implementation of the SPV model by providing an independent view on the TO's management of the SPV and the SPV's delivery of its obligations. The ITA would need to be suitably skilled to provide those functions, and the appointment should take into account the particular nature of the assets delivered under the DA, as well as any conflicts of interest.

3.21. We would need to consider, on a case by case basis, the full range of parties to which the ITA would have a duty, and any conflicts that may arise from this. For example, in addition to the SPV and the TO, there may be an advantage in the ITA providing functions to other interested parties such as ourselves and the SPV's financiers.

List of proposed roles

3.22. The following is a non-exhaustive list of the roles that the ITA could have within the SPV model for a particular project, as described in the Agilia report:

- agreeing between the TO and the SPV the procedure and quantum of any permitted SPV revenue changes as a result of a price adjustment mechanism in

the DA, and supporting Ofgem in its process for considering any equivalent changes in the TO Licence;

- advising the TO and SPV on any changes to the design of the project;
- confirming that the construction completion tests have been passed for the purposes of the DA, and supporting Ofgem on the equivalent in the TO Licence;
- confirming satisfaction of construction milestones (if revenue is paid during construction, or more generally if there is a duty of care to financiers);
- acting as the arbiter in disputes between the SPV and the TO;
- confirming satisfaction of milestones for purposes of any Alliance Agreement¹³ (if used); and
- assessing the annual performance of the SPV during the operational period to establish any availability payments and performance incentives payments / deductions.

3.23. We recognise there may be other roles the ITA could fulfil under the SPV model, and we expect the TO to identify where doing so would generate further consumer value on a project-by-project basis.

Funding of the ITA

3.24. We propose that the ITA is funded by the SPV through the DA. This cost would be a pass-through addition to the SPV's bid Tender Revenue Stream (TRS), and would be recovered by the TO from consumers.

Additional detail on the commercial framework

3.25. In this section we have provided more detail and contextual information for certain points within Agilia's commercial framework where we consider it helpful for a fuller understanding by stakeholders. We have presented these in the same order as the Agilia report.

Design and construction

Fixed and target pricing models

3.26. As described in Table 2 in Chapter 2, we propose a default fixed price model for the SPV. We believe this approach ensures that the certainty on price driven by the competition can lead to the most economic and efficient outcomes for consumers. We consider that a fixed price model is likely to be efficient for most projects likely to come forward under the

¹³ Further detail on this approach is available in the accompanying Agilia report and Chapter 4 of this consultation.

SPV model, given the relatively short construction periods (2 to 4 years) and the scope of the arrangements for price adjustments, as set out in the Agilia report.

3.27. However, we recognise that there may be situations, by exception, where the nature of the works make a fixed priced approach less efficient than an alternative target cost model.¹⁴ For example this might be where elements of construction risks do not lend themselves to value for money fixed cost pricing and where cost-reopeners are in themselves too uncertain. We expect the TO to consider the most efficient approach for a particular project during the development of the DA. The TO will then be able to propose to us, as part of the draft DA, any elements that would more efficiently be delivered under a target cost approach. We would expect any such proposal to provide clear reasoning for the consumer benefit of moving away from a fixed price approach. This should include both quantitative and qualitative considerations. It should also set out proposals for ensuring the SPV remains incentivised to preserve value for money for consumers.

Price adjustments

3.28. Along with a default fixed price, we recognise the need for reopener mechanisms under which the SPV could make a claim for certain qualifying events. We consider that the cost impact of claims by the SPV in the event of an allowed price adjustment event would fall into two categories:

1. **Claims that produce a one-off payment** (whether paid in a single year or over multiple contiguous (but limited) financial years). For example, this could occur where there is a single qualifying event producing a specific cost, or for compensation in the event of delays beyond the reasonable control of the SPV.
2. **Claims that could require a change to the base TRS in the operational phase.** Typically, we expect that this could include qualifying events such as changes in law, or where an unforeseen event leads to an enduring uplift in costs.

3.29. We would expect the SPV to apply to the TO for a suitable remedy after any qualifying price adjustment event. We propose that the ITA would initially determine whether the event qualified for a price adjustment. Where the event qualified, the ITA would assess the SPV's proposed costs and determine the appropriate compensation, for review and approval by the TO.

3.30. For the avoidance of doubt, and as described in paragraph 3.17, the approval of the SPV's claim by the TO does not automatically permit the TO to recover those costs from consumers through its licence. We would necessarily retain the approval of those costs in the TO licence in line with our statutory duties.

3.31. Nonetheless, the TO should not withhold the agreed compensation from the SPV where required to pay for a qualifying event under the DA, even in the scenario where we do not approve matching compensation in the TO's licence. In particular, this may be the case where the qualifying event and compensation arose out of the detrimental actions of the TO or a breach of the DA by the TO.

¹⁴ A target cost model is one where, for example, the contractor and procuring authority share in any under- or over-spend on the project.

Construction completion

3.32. We are proposing in the commercial framework that the operational period, and therefore the full SPV revenue, would only commence at the point of construction completion.

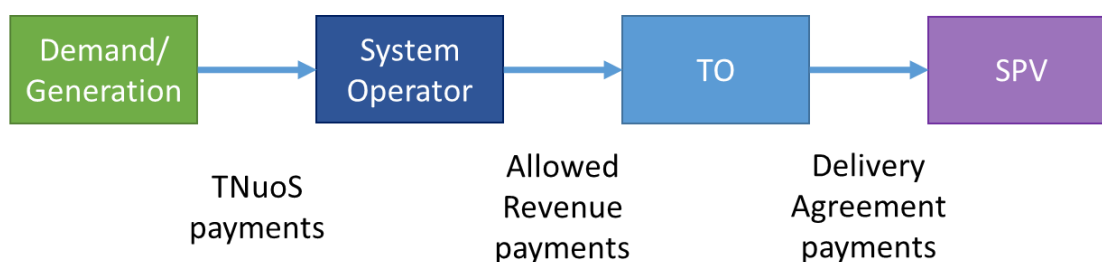
3.33. We consider that the definition of construction completion may vary between projects based on the scope and particular type of transmission assets being built. For example, this may be where the assets are constructed in multiple stages, over time. We would expect the TO to take account of the specifics of the project when defining the completion criteria. We expect that bidders would also have the opportunity to provide their views on the completion criteria during the tender process and we would also provide a view when reviewing the DA.

Payment and financing

Payment flows between the TO and the SPV

3.34. We expect that the flow of payments from consumers and users of the system to the SPV will be as shown in Figure 2.

Figure 2



3.35. We propose that the SPV should be paid on a monthly basis, as is the case in the OFTO regime. This also reflects typical contracting precedents such as PF2.

3.36. In the SPV model, the TO is the counterparty to the SPV rather than the SO under licence-award based models such as the CATO and OFTO regimes. The TO recovers its money monthly from the SO under the terms of its licence and (usually) adjusts its recovery on an annual basis. We do not consider there to be any material counterparty risk arising from this arrangement, as the TO is also a regulated entity with appropriate statutory backstops, such as the Energy Administration provisions in the Electricity Act 1989.

Revenue during construction

3.37. We consider that revenue during construction will only be allowed on an exceptional basis where the TO can demonstrate a clear consumer benefit from doing so. For example, this could occur where the construction period is particularly lengthy (eg above 4 years) or where the risk profile is such that investors may require a return during the construction period in order to bid efficient financing costs.

3.38. In such cases the revenue allowed during the construction period would need to be appropriately sized and tied to appropriate outputs (eg delivery of key milestones), such that it does not erode the overall delivery incentive on the SPV. We would also need to assess the

overall consumer benefit case, for example by considering the balance between lower cost of capital from reducing risk during the construction period, and the impact on the profile of costs for consumers on a Net Present Value (NPV) basis. In general, we would expect any revenue during construction provisions to be agreed in the pre-tender phase, based on the consumer benefit case and any supporting evidence from the relevant market sounding exercises.

Target completion date

3.39. We propose that the TO should set a target delivery date in the DA, by which the SPV could reasonably be expected to have completed the assets and met the construction completion criteria. We would assess this date as part of our assessment of the DA prior to the commencement of the SPV tender. This date would then be the date by which the operational period could start at the earliest, and the date by which delays to service would be measured.

Operational Period

Availability incentive

3.40. We propose that the SPV incentives during the operational period should be structured around an availability-type incentive. Availability incentives are an established mechanism for incentivising operational performance on stand-alone projects and are used in other sectors as well as for OFTOs and for our proposed CATO regime. As described in the Agilia report, the details of any availability incentive would necessarily have to reflect the particular nature of the assets under consideration.

3.41. We would expect the TO to apply a similar approach to that we apply to OFTOs and have previously considered for CATOs, namely an up- and downside incentive, with appropriately scoped limits on under- and over-performance. Our indicative view is that 98% is a reasonable generic starting point for target availability, but that this figure could be different based on the particulars of any project, for example its criticality to the network or the technology of the assets (eg HVDC or HVAC).

SF₆ incentive

3.42. We consider that there may also be a benefit in appropriately incentivising an SPV on its leakage of SF₆, a detrimental greenhouse gas. This would be optional based on relevant assets being utilised in the project. We would expect the financial element of any incentive to be appropriately sized.

Other incentive areas

3.43. Under the proposed CATO regime, we have previously considered a range of other incentives that could apply to any particular project. For example, this could include areas such as safety, transmission losses, and asset condition. We would expect to work with the TO on a case-by-case basis to develop a DA that covered an appropriately scoped and suitably sized set of incentives.

Contract and revenue duration

3.44. In our January 2018 Update, we set out that the operational period of the SPV should by default be 25 years. As set out in our previous work on the CATO regime, and in our decision to apply the CPM to Hinkley-Seabank, we consider that this period is currently likely to deliver the best value for consumers within the debt and equity markets, whilst ensuring consumers do not pay too much for the assets on a total NPV or year on year basis.¹⁵

3.45. We consider that the TO would be able to propose an alternative length of operational period where it can demonstrate that an alternative approach would provide benefits to consumers. For example, this could occur where the technology would lend itself to shorter or longer timescales of SPV operation and maintenance, or based on the prevailing market conditions.

3.46. As set out in Table 2 in Chapter 2, where there is a delay to the completion of construction of the SPV's assets, the operational period will reduce as the final date of the DA stays the same in all cases. As set out in paragraph 3.28, where this was not the fault of the SPV, it would receive suitable compensation for this reduction.

TO and SPV enhanced alignment options

3.47. We have previously set out in our August 2017 HSB consultation that we were considering two main options for further incentivising the TO to run a successful SPV model, beyond the obligations contained in the licence. Those options were:

- Allowing or obliging the TO to retain a specified equity stake in the SPV; or
- Allowing the TO to retain a proportion of the overall consumer saving derived from its role in successfully implementing the SPV model.

3.48. Several respondents to the August 2017 HSB consultation identified that the TO holding an equity stake in any SPV should incentivise efficient behaviour, though some of the responses also warned that any conflicts of interests that emerge as a result of such an arrangement will need to be carefully considered. One respondent argued that rather than an equity stake, the TO should receive a percentage of any consumer savings.

3.49. We consider that allowing the TO to retain a proportion of the benefit of the savings derived from the SPV model would not be an efficient way of incentivising the TO. We considered options such as providing the share based on estimates of savings at financial close of the SPV, or an arrangement where the benefit was spread out over a number of years. To implement these arrangements would be unnecessarily complex, and potentially not achieve the desired level of incentivisation across both the construction and operational periods.

3.50. Instead, and in line with the Agilia report, we are now additionally considering an 'Alliance Agreement' type approach, where the TO and the SPV have the potential to share

15

https://www.ofgem.gov.uk/sites/default/files/docs/2015/10/ecit_consultation_v6_final_for_publication_0.pdf (from para 1.139)

additional revenue (up to a certain limit), subject to certain conditions being met, such as project progress and timely problem resolution.

3.51. We have set out further analysis on the 'Alliance agreement' and TO equity stake approaches below. For the avoidance of doubt, we retain the option of relying on the obligations proposed for the TO licence only, with no further TO incentives.

TO Equity stake in the SPV

3.52. Under this incentivisation approach, the TO would have an equity stake in the SPV. We could oblige the TO to take this stake, or allow the TO to choose whether to take the stake on a project-by-project basis. We consider that the TO would need in all cases to retain the stake for the full revenue term, to ensure the incentive remains for that whole term.

3.53. The cost of that equity stake would need to be determined through the SPV tender, i.e. the TO would be a price taker and provided with a market-tested return. We would need to undertake analysis for any particular project on the size of the equity stake. The stake should be sufficiently large to incentivise the TO, without distorting the financial incentives of bidders into the SPV tender.

3.54. We would need to consider the governance arrangements for the equity stake. Our preference would be for the TO's stake to be significantly restricted in function and essentially 'silent', i.e. that it cannot seek to influence the decision making of the SPV.

Alliance Agreement

3.55. The Agilia report sets out a summary of how this approach could work between the TO and the SPV.

3.56. We would need to consider further how the value of the Alliance Agreement would be calculated and awarded. For example, the incentive could be based on an assessment of the consumer benefit of the SPV model at the point of SPV appointment. In all cases, we would need to ensure that the incentive does not adversely impact on other structural incentives, such as full revenue only starting on completion of construction of the assets.

3.57. We consider that this approach has benefits over the equity stake option by removing the need to consider SPV governance and conflict arrangements. However, in comparison to the equity stake option, not all methods of calculating and awarding payments under the Alliance Agreement necessarily incentivise success over the full revenue term.

3.58. In summary, we do not consider that any enhanced alignment mechanisms are necessarily required as we consider that the SPV model could deliver benefits for consumers without them. However, we are willing to consider their use if it can be shown that they would lead to a better outcome for consumers. As such we are interested in stakeholders' views on this matter.

4. Regulatory Framework

Section summary

This chapter sets out the detail of our proposed regulatory framework to implement the SPV model.

Questions

Question 1: What are your views on the regulatory framework as set out in this consultation, and how it interacts with the commercial framework?

Question 2: Do you agree with the scope of TO obligations during the pre-tender, tender, construction period, and operational period?

Question 3: Do you agree with our approach to structuring the TO's allowances, including both base revenue and cost adjustments?

Question 4: Do you agree with our proposed approach to operational period incentives, including interactions with the TO's price control incentives?

Question 5: What are your views on our proposed arrangements for the period after the end of the SPV's revenue term?

Question 6: What are your views on our conflict mitigation proposals?
- Would the TO conflict mitigations proposed sufficiently mitigate conflict where a TO bidder seeks to participate in an SPV tender in its own geographical area?
- And if not, what different/additional arrangements would be needed?

Question 7: Do you think that any changes to industry codes or standards are needed, or would be beneficial, for the SPV model?

Introduction

4.1. A core feature of the SPV model, as described in Chapter 2, is that the SPV model will be implemented through an existing TO's licence, and an SPV appointed by means of a competitive tender run by the TO. In this Chapter we set out detail on the key areas we intend to implement through the TO's licence to give effect to the SPV model.

4.2. For the avoidance of doubt, we do not intend to make any changes to the standard conditions of the TO's licences, or any part of the SO's licence, to give effect to the SPV model. Additionally, we do not expect to need to make any changes to industry codes or standards. However we invite stakeholders to comment on whether there are any beneficial changes that could be made in any of these areas.

Structural overview of the proposed licence conditions and guidance

4.3. As set out in Chapter 2, we propose to implement the SPV model through:

- 1) **A new TO special licence condition covering implementation of the SPV model (6M/J).**¹⁶
- 2) **Supporting guidance** – this would cover at least three core areas:
 - a. Licence Guidance (LG).
 - b. DA Guidance (DAG).
 - c. Procurement Guidance (PG).

4.4. Appendix 1 contains the initial drafting for the proposed new licence condition 6M/J. At this stage, we consider these draft licence conditions to be illustrative of how we could implement the regime. We intend to undertake further stakeholder engagement on the form and content of the proposed new special licence condition 6M/J following the close of this consultation, with a statutory consultation in early 2019.

Key areas of the regulatory framework considered in this chapter

4.5. This chapter considers each of the following areas of the regulatory framework:

- **TO Obligations during the Pre-tender stage** – the obligations we expect to place on the TO to ensure that the project, tender documentation, and DA are developed.
- **TO Obligations during the SPV Tender stage** – the obligations we expect to place on the TO to run an efficient and effective SPV tender. This also includes our role in the SPV Tender.
- **TO Obligations during the construction period** – the obligations and reporting requirements on the TO during the construction period of the SPV.
- **TO Obligations during the operational period** – the obligations and reporting requirements on the TO during the operational period of the SPV.
- **TO allowances for SPV payments** – how we propose to structure the TO's allowed revenue in the licence to account for payments to the SPV, and how we would assess and structure any adjustments to those allowances. This also includes how the TO would be funded for its role in the SPV model.

¹⁶ This would be 6M in the existing NGET licence, and 6J in the SPT and SHET licence, reflecting their differing existing licence conditions.

- **Integration with the TO's regulatory obligations and incentives** – how we propose to treat the assets subject to an SPV in the TO's wider incentives regime.
- **Arrangements for the period after the conclusion of the SPV's revenue term** – our proposals for the SPV's assets moving back into the TO's wider price control at the end of the SPV revenue period.
- **Conflict mitigation - TO or related entity bidding in 'own area' SPV tender** – our proposals for whether and how the TO could be part of an SPV bidding into an SPV Tender for an SPV in its own licence area.

TO Obligations during the Pre-tender stage

Key activities and outcomes

4.6. The SPV pre-tender stage begins after we have determined that a project should be delivered through the SPV model, and have notified the TO accordingly.

4.7. We consider that the key activities the TO should undertake during this stage are:

- **Continue to undertake relevant pre-construction activities.** Placing this obligation on the TO ensures that the project continues to be developed and can meet its expected commissioning date. In particular, this obligation must reflect that the TO should undertake its role in such a way that efficiently supports (rather than impedes) eventual delivery of the SPV model.
- **Produce an initial DA which complies with the DAG document, for approval by the Authority.** We propose to oblige the TO to produce a DA for the project as the key contract to be put in place between the TO and the SPV. We intend to publish the DAG for the TO to use as the basis for the DA. More information on the DA and the associated DAG document is set out in Chapter 3.
- **Produce the relevant tender documentation in line with the Procurement Guidance document, for approval by the Authority.** We intend that the TO would be required to develop the SPV tender documentation and tender processes during the pre-tender stage, for example the detailed tender process timings, the evaluation criteria, the project data room, and the materials for bidders. To support the TO in this work we expect to publish 'procurement principles' guidance, which the TO should take into account when designing and running an SPV Tender. More information on the procurement principles and the associated Procurement Guidance document is set out in Chapter 5.
- **Produce a Final Needs Case.** This activity would only apply where the project originally came to us before we had approved a Final Needs Case. Any Final Needs Case submission would follow the principles set out in the TO licence and SWW guidance document.
- **Provide updates to Ofgem on the progress of the Tender Documentation and DA.** We would place an obligation on the TO to provide us with updates on the progress of all of the documentation being developed by the TO. We would expect to provide the TO with our views ahead of documentation approval prior to a tender.

- **Market the SPV Tender.** We would expect the TO to take appropriate steps to market the SPV tender effectively ahead of running the tender itself. This should also include undertaking appropriate market sounding to ensure that the proposed DA is suitable for the relevant market.
- **Implement the agreed conflict mitigation measures, if relevant.** More information on our proposed conflict mitigation measures and timescales is set out from paragraph 4.56.

Timings within the pre-tender stage

4.8. As part of our decision to use the SPV delivery model for a particular project we will take into account the deliverability of the project in the context of running an SPV tender. Therefore we consider that provided that the TO undertakes its obligations efficiently, the project should be capable of being delivered in line with required timescales. We note that TO's already include an allocation of time for their procurement activities in their proposed project timelines at the point of needs case submission.

4.9. We do not intend to specify a date by which the TO should submit to us for approval the necessary documentation described in paragraph 4.7. Instead, the TO should define a timetable that would allow it to meet its regulatory and contractual obligations on time. We would expect to be actively involved in the process to develop the DA. We propose to work with individual TOs on a case-by-case basis to build an appropriate timetable.

Conclusion of the pre-tender stage

4.10. We consider that the pre-tender stage should conclude, and the tender stage commence, only where we are satisfied that the full range of documentation produced by the TO will produce an appropriate outcome from the SPV tender. We therefore expect to approve all documentation prior to the commencement of the SPV tender.

4.11. In summary, we consider that the pre-tender stage should only conclude where:

- We have approved the form and content of the SPV tender documentation;
- We have approved the form and content of the DA; and
- We are satisfied that there is a suitably robust final needs case for the project to proceed.

4.12. With regards to our approval of the SPV tender documentation and DA, we have considered the situation where, by exception, we approve some of the documentation, but not all of it. To ensure that the project is not unduly delayed, we could approve part of the documentation and oblige the TO to return at a specified date with amendments to the remainder of the documentation. For example, this could occur where we consider that minor amendments are outstanding to one or more documents, or where documentation for later tender stages (eg ITT) is well advanced but not finalised.

TO Obligations during the SPV Tender stage

Key activities and outcomes

4.13. Within the tender stage, we consider that there are two main activities the TO would need to undertake:

- **Continue to undertake relevant pre-construction activities, where relevant.** As for the pre-tender stage, placing this obligation on the TO ensures that the project continues to be developed and can meet its expected commissioning date. In particular, this obligation must reflect that the TO should undertake its role in such a way that it efficiently supports (rather than impedes) delivery of the SPV model.
- **Run and conclude an SPV Tender.** This is the main activity of the tender stage, and it will lead to the appointment of an SPV to take the project forward. The SPV tender should be run in line with the documentation approved by us in the pre-tender stage. We have set out more detail on the proposed procurement principles in Chapter 5.

SPV Tender failure

4.14. The situation may arise where an SPV Tender fails to lead to the appointment of a preferred bidder. For example, where there are no suitable bidders, where there are wider industry or financial problems, or where bidders withdraw from the tender process. We note that we consider this outcome very unlikely, particularly where there has been efficient marketing during the pre-tender stage and where the DA is designed appropriately.

4.15. We propose that the default action in any SPV Tender failure situation is for the TO, in agreement with us, to run a new SPV Tender, or re-run the tender from a previous stage, taking into account and addressing the particular reasons for the original SPV tender failure.

4.16. Under such a scenario, we propose to allow the TO the opportunity to submit new Tender Documentation and DA for our approval prior to proceeding. This should ensure that any amendments necessary to ensure that the new SPV Tender does not fail can be put in place.

SPV Tender cancellation

4.17. We propose that we build in the provision for an SPV Tender to be cancelled by us where appropriate. For example, this could occur where the need for the project falls away. We note that such an outcome is unlikely in general, but may occur for example where a project was dependent on relevant generation proceeding following a Contract for Differences (CfD) auction. We propose that the TO would be able to recover its costs in the event of tender cancellation, in line with our proposals described later in paragraph 4.46.

4.18. We also propose that bidders are allowed to recover a proportion of their costs of participating in the tender where that tender is cancelled. We would need to consider the method for calculating the amount allowed to be recovered, and the mechanism by which this could occur further. We expect to work with the TO to appropriately define any compensation in the tender documentation.

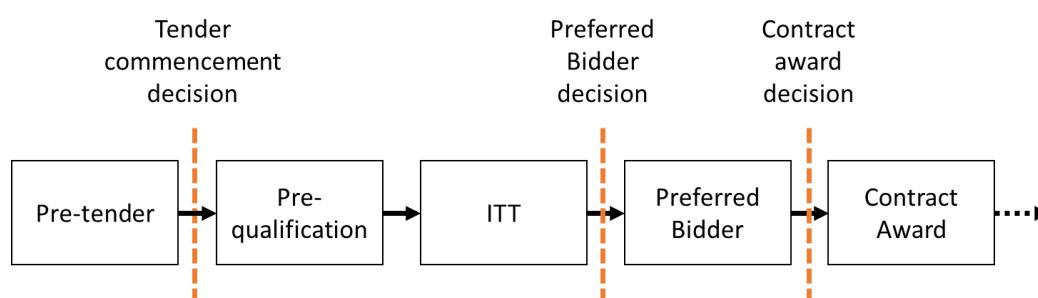
The role of the Authority in the SPV Tender

4.19. The SPV model is based on the principle that the TO is procuring an SPV to deliver a project on its behalf, and therefore has responsibility for designing the terms of and running the SPV tender. On this basis, we consider that our role should be limited to areas where consumers' interests are at stake in the process.

Approval before certain tender stages

4.20. We do not propose to have an approval role at every stage of the tender process. Instead, we propose that our role is limited to approving both the appointment of the TO's preferred bidder at the conclusion of the ITT stage, and the final contract award at the end of the PB stage. Our approval at these stages assures us, on behalf of consumers, that the TO is appointing a suitable party as an SPV for the project. In effect, we would be quality assuring the TO's decision making against the pre-agreed tender documentation. We propose that the SPV Tender period would conclude only when we have provided the relevant approvals. Figure 3 sets out diagrammatically (the dotted lines) the points where we consider we need to provide approval.

Figure 3 – Ofgem approval points in the SPV Tender



4.21. Notwithstanding the above, we propose that the TO reports to us on a regular basis about the progress of the SPV Tender. This could be supplemented by introducing a joint TO-Ofgem project board to monitor progress of the tender and adherence to the SPV tender terms agreed in the pre-tender stage; however, we do not consider such a board mandatory at this stage and would discuss the need for any board with the TO during the pre-tender stage.

Changes to the DA or tender documentation

4.22. In general, we do not expect significant changes to the DA would need to be made after our approval of the TO's proposed arrangements at the pre-tender stage. However, we understand that circumstances may change, for example due to changes to the details of the project being tendered, to industry arrangements in general, or through discussions with bidders that identify more efficient processes or arrangements.

4.23. The TO should notify us promptly of any potential changes it wishes to make to the DA, including the reason for proposing the change and any relevant analysis showing its impact to consumers. We may approve or reject the proposed change depending on our assessment of that proposed change. We would expect to undertake our assessment in a timely manner, such that the SPV tender can continue to proceed on time.

Contract award and the TO's licence

4.24. The SPV contract award decision would be the point at which we make changes to the TO's licence to reflect the associated revenue stream in the DA. In order to do this we would amend the TO's licence to insert the correct revenues.

TO Obligations during the construction period

Key activities and outcomes

Commencement of the construction period obligations

4.25. For the purposes of identifying the relevant licence conditions, we propose that the construction period will begin at the close of the SPV Tender period when the TO and SPV enter into and complete the DA. We note that there may be a gap between the appointment of the SPV and the start of the SPV's physical construction works. However, the proposed obligations contained within this section are relevant even prior to physical works taking place.

Construction period licence obligations scope

4.26. We consider that there are several key areas of activity for the SPV during the construction phase with consequential roles for the TO. These areas are:

- Design and construction related activities and relevant progress reporting.
- Change of scope and cost related activities (eg COAEs).
- Finance related activities and reporting.
- TO Regulatory related activities which impact on the SPV.

4.27. Within these activity areas, we have identified the areas that we consider should be reported to us by the TO, for either acknowledgement or for our approval. We have set out in Table 4 those key matters, our proposed role in those matters, as well as the triggers and proposed timescales for doing so.

Table 4 – Construction period key reporting requirements

Key matter to be reported to Ofgem	Trigger or regular timescale?	Ofgem to approve?
Construction progress reporting	Regular quarterly reporting, and significant event reporting when triggered.	No

Actual TO incurred costs	Annual reporting.	No – price control mechanism outside of SPV condition. (See 4.44).
COAE events reporting	Trigger in licence.	Yes – where we approve, a TRS change or payment would be required under the TO’s licence. ¹⁷ (See 4.38)
Debt refinancing reporting	Trigger in licence.	Yes – where we approve, a TRS change or payment would be required under the TO’s licence.
Disbursement of or change to any Revenue During Construction (RDC)	Annual or bi-annual reporting, with a trigger for change.	Yes – where we approve, a TRS change or payment would be required under the TO’s licence.
TO Conflict mitigation reporting	Annual compliance reporting, with a trigger for relevant non-compliance event.	No

End of construction period

4.28. As described in Chapter 3, the DA will contain a clear set of criteria for determining the completion of the construction period. We would define a completion of construction term in the TO licence to mirror the equivalent term in the DA.

TO Obligations during the operational period

Key activities and outcomes

Commencement of the operational period obligations

4.29. We propose that the commencement of operational period payments would be at the point of completion of construction, as defined in the DA for a particular project and in line with paragraph 4.28 above.

Operational period licence conditions scope

4.30. We have identified a set of key matters that we consider should be reported to us by the TO for either acknowledgement or for our approval. We have set out in Table 5 those key matters, our proposed role in those matters, and the triggers and timescales for doing so.

¹⁷ As set out in paragraph 3.17 and 4.38-4.39, this approval is in relation to the TO’s licence only, and we do not consider that this should impact the TO’s approval of the SPV’s costs under the DA.

Table 5 – Operational period key reporting requirements

Key matter	Trigger or regular timescale?	Ofgem to approve?
Allowed and forecast revenues for the SPV	Annual reporting.	No
Actual TO incurred costs	Annual reporting.	No – price control mechanism outside of SPV condition. (See 4.44).
COAE events reporting	Trigger in licence.	Yes – where we approve, a TRS change or payment would be required under the TO’s licence. ¹⁸ (See 4.38)
Availability reporting (where relevant)	Annual reporting.	Yes – where availability impacts on TO cost recovery.
Debt refinancing reporting	Trigger in licence.	Yes – where we approve, a TRS change or payment would be required under the TO’s licence.

TO allowances for SPV payments and implementation

4.31. A fundamental feature of the SPV Model is that the SPV is paid its TRS by the relevant TO, which is in turn compensated through its allowed revenue from consumers. We refer here to the TO’s allowed revenue as its TRS to clearly link it to the SPV revenue and to differentiate it from other TO revenue through the price control process. We have set out in Figure 2 in Chapter 3 the expected flow of payments from consumers to the SPV.

4.32. In summary, **the TO would be allowed to recover from consumers through its licence the revenues associated with both the construction and operational period, and the costs of implementing the model for a project.** We propose to treat the construction and operational period TO allowed revenues in different ways within the TO licence, reflecting that the structure of an SPV’s allowance under any given DA is more likely to vary across construction periods than operational periods. The following sections describe

¹⁸ As set out in paragraph 3.17 and 4.38-4.39, this approval is in relation to the TO’s licence only, and we do not consider that this should impact the TO’s approval of the SPV’s costs under the DA.

the approach for each period in turn. In all periods, our approaches ensure that we can adequately audit the TO's allowances.

Allowed revenue during the construction period

4.33. We propose that the TO is allowed to recover from consumers the appropriate Revenue during construction (RDC) paid to the SPV, where this has been included within the agreed DA. We consider that the scope and basis of the revenue allowed during the construction period may vary substantially on a project-by-project basis. Therefore, we propose to introduce a generic revenue term into the licence which would enable the recovery of RDC to the extent the DA allows for it. We would also introduce additional licence mechanics to reflect the cost adjustment mechanisms described later in this section.

4.34. Following our approval of the TO's appointment of the Preferred Bidder as the SPV, we would amend the TO's licence to formalise the project's costs in the TO's licence and to allow the TO to begin RDC cost recovery. We would seek to ensure that the allowed revenues are accepted into the TO's licence as close as reasonably practicable to the DA award to the SPV.

4.35. We have set out in Appendix 1 our proposed licence conditions to implement this approach, along with a description and breakdown of the proposed funding terms.

Allowed revenue during the operational period

4.36. We propose that the TO is allowed to recover from consumers the TRS bid by the appointed SPV and written into the DA between the TO and the SPV. We would also introduce additional licence mechanics to reflect the cost adjustment mechanisms described later in this section.

4.37. Following our approval of the TO's appointment of the Preferred Bidder as SPV we would amend the TO's licence to formalise the project's costs and allow the TO to recover those costs.

Price adjustment events across construction and operational periods

4.38. As set out in Chapter 2, the commercial framework includes mechanisms to allow an SPV to apply for an adjustment in costs in specified circumstances. We consider that this approach would promote value for money for consumers by allowing certain risks to not be unnecessarily priced into an SPV's bid, particularly in the context of a fixed price arrangement. It is important that the mechanisms are suitably reflected in the TO licence.

4.39. We propose to introduce a licence mechanism to allow the TO to recover, where we approve, the reasonable costs associated with price adjustment mechanisms reflected in a project's DA. As set out in paragraph 3.17, our approval of any cost adjustment or revenue change in the TO's licence is necessarily a separate decision to the adjustment to the SPV's costs (by the TO) under the terms of the DA. We therefore cannot guarantee that any decision to adjust SPV costs under the terms of the DA will automatically be mirrored by a decision by us to amend the TO's revenue accordingly under its licence.

4.40. As discussed in Chapter 3 from paragraph 3.28, we consider that the cost impact of claims by the SPV would fall into two categories under the licence:

1. **Claims that produce a one-off payment.**
2. **Claims that could require a change to the base TRS in the operational phase.**

Scenario 1 – One-off payments

4.41. Where a one-off payment is required (over a single or multiple contiguous years), we propose that the TO would be able to apply for a single adjustment of a specific revenue term in the new condition 6M/J for the relevant year. This provision would apply in both the construction and operational periods.

4.42. We consider that its not efficient to cover all price adjustment events in extensive licence drafting. Instead, we propose to introduce a licence mechanism that would allow the TO to apply to us for an adjustment to a new revenue term covering one-off type payments. The TO would need to set out why it considered the event to be a qualifying event under the relevant DA, and its proposed reasonable costs for that event. Where we approved, the relevant year’s allowed revenue would then be uplifted to recover the approved reasonable costs, in line with the TO’s licence.

Scenario 2 – Changes to the base TRS

4.43. For scenario 2, where a change to the base TRS is requested by the TO, we propose to introduce a provision within 6M/J to allow such an adjustment, where we approve the change. The TO would submit its proposed cost adjustment and reasoning for the adjustment for approval by us. We consider that this provision should only be able to be triggered from the financial year preceding the expected completion of construction, such that changes are not made to the base TRS frequently during the more uncertain construction period.

Recovery of TO costs of implementing the SPV model

4.44. We propose that the TO should be allowed to recover its cost associated with implementing and managing projects delivered under the SPV model.

4.45. We consider that there are two areas where costs could arise for TOs:

- Costs associated with developing and then running an SPV tender for any given project; and
- Costs associated with the ongoing management of the SPV.

4.46. For costs of running an SPV tender, we would develop a price control mechanism where the TO would submit its costs to us for approval at the end of the SPV Tender period. We would also allow the TO to recover reasonable costs in the event of tender cancellation through this mechanism, for example if the needs case fell away. We would assess the reasons for the tender cancellation as part of our approval or rejection of the TO’s proposed costs. For any projects where the TO incurs costs in RIIO-T1, we propose that the TO is reimbursed by a mechanism we will introduce in RIIO-T2.

4.47. For enduring management costs of an SPV, we would like to work with the TOs to develop an appropriate recovery mechanism. For example, this could be on a fixed cost per project basis, or a cost set as part of a price control. In all cases, we would want to be able to scrutinise the costs submitted by the TO to ensure that they are efficient.

Revenue reporting

4.48. We expect that the TO would report the allowed revenue through the relevant revenue reporting pack. We will consider this element further once the licence conditions are finalised.

Integration with the TO's regulatory obligations and incentives

Operational control

4.49. We have previously set out that the TO would retain operational control of the project under the SPV model. Only those parties holding a transmission licence can have operational control over electricity transmission assets in GB. To ensure that the TO can retain operational control, we consider it important that the TO has:

- **Ownership of the transmission assets.** The commercial framework in the Agilia report sets out that the SPV may not take ownership of or grant security over the project's transmission assets. However, financiers to the SPV may take security over the revenue granted under the DA.
- **Adequate contractual rights to information.** The TO must be suitably informed of the state of its assets, and operations and maintenance (O&M). The Agilia report sets out the proposed scope of reporting that the SPV should provide to the TO. We expect that the details of any particular reporting regime will be developed on a project-by-project basis.
- **Suitably scoped step-in and termination rights.** In the Agilia report, Agilia have set out the proposed step-in and termination rights for the TO in respect of the SPV.

4.50. We consider that, within the requirements described above, we expect the SPV would have responsibility for the day-to-day O&M of the assets, and that it should be allowed to perform its functions under the DA without undue interference from the TO.

Impact on TO price control incentives

4.51. As set out in Chapter 3, we expect that the DA will contain a set of project-specific incentives. These incentives in the DA will be reflected in the TO's licence to allow for any cost recovery. We consider that assets covered by the DA should not form a part of the TO's wider incentives regime, i.e. they would not contribute to the performance of the TO against its various financial and reputational outputs. The assets under the DA would effectively be ring-fenced from the wider TO incentive regime. This ensures that the TO is not exposed to adverse actions of the SPV, and that the incentives placed on the SPV can be made appropriate for the specific assets of the project.

4.52. We expect that one exception to this general approach could be the TO's 'conditions for connection' incentive, where those connection assets would not form a part of the assets delivered through the DA. We would work with the TO on a case-by-case basis to understand any other wider TO price control incentives that it would be appropriate to maintain for the assets covered by the DA.

Enforcement risk against the TO for circumstances caused by the SPV

4.53. Under the SPV model, the TO retains the ownership, and operational control, of the assets and responsibility for those assets under its licence. We consider that events may arise where the SPV's actions causes the TO to breach its licence. In that instance, we may need to take enforcement action against the TO in line with our enforcement guidance.¹⁹ We would expect to take proportionate enforcement action, considering the relevant factors of the event.

Arrangements for the period after the end of the SPV's revenue term

4.54. We do not intend to place any licence conditions in the TO's licence at this stage in relation to arrangements following the conclusion of the SPV's revenue term. As described in Chapter 3, the DA will contain clear handback criteria for the SPV to comply with and to govern handback of the assets at the end of its revenue term. Therefore we expect that the SPV will no longer be required after handback, and the proposed new condition 6M/J would no longer need to apply.

4.55. In summary, we expect the following to apply at the end of the SPV's operational period:

- The day-to-day operations and maintenance of the assets will transfer from the SPV to the TO.
- The project's assets will be fully depreciated for regulatory purposes, i.e. they will have a regulatory asset value of zero.
- Where the assets are still needed, any TO revenue associated with ongoing operations and maintenance would be determined in line with the prevailing price control arrangements.

Conflict mitigation - TO or related entity bidding in 'own area' SPV tender

4.56. Under its DPC model, Ofwat has chosen to effectively exclude the incumbent water companies from participating in a DPC tender in its geographical area. This is also an option we are considering for the SPV model. More specifically, we may wish to prevent the relevant incumbent TO, or an associated entity within the TO parent group (referred to jointly from

¹⁹ <https://www.ofgem.gov.uk/publications-and-updates/enforcement-guidelines>

now on as 'TO Bidder') from bidding into the SPV tender or being part of a bidding consortia.²⁰

4.57. Such an approach would have the benefit of clearly and simply mitigating any conflicts of interest that might arise from participation of the TO Bidder in the SPV tender. We consider that it may support maximum engagement in the SPV tender from the rest of the potential bidding market. Under such an approach we consider that TO Bidders would still be able to participate in tenders for projects outside their licence area.

4.58. However, allowing TO Bidders to participate in, and potentially win, an SPV tender within their own area may help ensure better outcomes for consumers through additional competition. If we were to allow this, significant concerns around conflicts of interest and fairness within the bidding process would clearly need to be addressed before the tender. In this section we set out further details on what conflict mitigation arrangements could be required under such a scenario. We invite stakeholders' views on those proposed arrangements and also on the wider question as to whether TO Bidders should be prevented from entering into a DA with the TO parent as set out in paragraph 4.56.

4.59. Our intention is to undertake further development of the SPV model's conflict mitigation arrangements following stakeholder responses to this consultation.

Potential conflict mitigation requirements where a TO Bidder is allowed to participate

4.60. Where a TO Bidder is allowed to participate in an 'own area' SPV tender, we would need to place a suite of conflict mitigation conditions on the TO running the SPV tender to provide sufficient reassurance to the market that the competition will be fair.

4.61. For the avoidance of doubt, a TO would not need to put into place the conflict mitigation arrangements described in this section where a TO Bidder did not intend to bid for the SPV or where they were bidding in an SPV tender outside of their licence area.

Previous conflict mitigation precedents from the CATO regime

4.62. We previously undertook substantial work in relation to the conflict mitigation a TO should put in place where their project is tendered through the CATO regime. In summary, our November 2016 policy decision document set out our decision across four broad areas:

- a) **Obligations on the conduct of the licensee when undertaking tender support activities** – the TO will be required to act transparently, in a way that does not give the TO bidding unit, or any other party, an unfair commercial advantage over any other participants in the tender process.
- b) **Business separation requirements between the TO and any bidding unit** – the TO must declare its intention to bid by a specified point, and implement the separation arrangements agreed in advance by us. The TO must have appropriate managerial, financial, physical, and IT separation, however there is no

²⁰ We note that we would need to consider further how such an approach could work with a TO equity stake incentive or Alliance Agreement approach.

requirement for full legal separation. There would be strong restrictions on employee transfer, anchored around key milestones in the overall tender process.

- c) **Restrictions on the use of information** – the TO must treat information related to tender support activities, and any other information it comes into possession of during a tender (for example information about the content of bids or bidder strategies),²¹ confidentially. The TO must not disclose such information to any bidding unit or other participant in a tender, outside of what is required as part of the tender process or under its licence.
- d) **Compliance approval and monitoring** – the TO would be required to submit a compliance methodology statement with its needs case submission. The TO would need to confirm its intention to bid and begin to implement conflict mitigation arrangements within eight weeks of us making an initial tender decision.²² The TO would be required to appoint a compliance officer to monitor and report on compliance with the agreed methodology statement.

SPV model conflict mitigation proposals – TO obligations

4.63. We consider that the conflict mitigation arrangements for the SPV model would follow similar principles but need to go beyond the arrangements required for the CATO regime. In particular, the measures (and proposed licence drafting) would need to be updated to reflect the significantly different distribution of roles in the SPV model process. As described in Chapter 2, one of the key differences between the SPV and CATO models is that the TO has the major responsibility of developing all of the tender related materials (technical and process), and running the tender itself, rather than Ofgem.

4.64. In Table 6 we have set out some proposals for potential conflict mitigation for the SPV model against the four broad areas set out in paragraph 4.62. Our intention is that these measures should apply from the point of Ofgem’s decision to apply the SPV model and extend for the term of the DA for a given SPV.

Table 6 – Overview of proposed approach to conflict mitigation

Conflict area	Proposed approach
Obligations on the conduct of the licensee	The TO will be required to act transparently, in a way that does not give the TO Bidder, or any other party, an unfair commercial advantage over any other participants in the entire tender process (both before, during, and after the SPV tender).
Business separation between the TO and bidding unit	The TO Bidder must be fully legally separate, with strong restrictions on managerial, financial, physical, IT separation, and employee transfer between the TO Bidder and the TO Parent. (See later section for further information)

²¹ In the context of the TO being required to answer questions from bidders into the CATO tender process.

²² For the avoidance of doubt, the TO would not be required to implement the arrangements if it was not intending to bid.

<p>Restrictions on the use of information</p>	<p>The TO must treat information related to the tender, any other information it comes into possession of during a tender (for example information about the content of bids or bidder strategies), and information received during the management of the SPV, confidentially. The TO must not disclose such information to any bidding unit or other participant in a tender, outside of what is required as part of the tender process.</p> <p>Any future TO bidder should not have access to information provided by any other bidder into an SPV Tender. As such, information systems should be separate between the TO and any TO bidder. We acknowledge that people involved in a TO Tender team may move, and we would expect appropriate restrictions on their movement to minimise information transfer.</p>
<p>Compliance approval and monitoring</p>	<p>The TO would be required to submit a compliance methodology statement with its needs case submission. The TO would need to confirm its intention to bid and begin to implement conflict mitigation arrangements within eight weeks of us making an initial tender decision.²³ The TO would be required to appoint a compliance officer to monitor and report on compliance with the agreed methodology statement.</p>

Timing and process

4.65. We propose that **the TO would need to provide us with a conflicts methodology statement no later than the point it submits its project needs case** (both at initial needs case, and where the project is suitably advanced, the final needs case). For projects currently in the late stages of development by the TO ahead of a needs case submission, we would instead allow the TO to provide us with a methodology statement by the time of our final decision on the delivery model, following a consultation.

4.66. Where the TO or any TO-related entity does not intend to bid into the SPV tender, it would be required to provide a written statement to that effect and would not be required to produce a conflict methodology statement.

4.67. Where we did not agree with the TO’s proposed conflicts methodology, we would provide the reasons for our disagreement, and we would expect the TO to appropriately modify the conflicts methodology statement. Where the TO does not provide us with a satisfactory conflicts methodology prior to our delivery model decision, we propose that the TO is excluded from the SPV tender.

4.68. We propose that **the TO should confirm its intention to bid and implement the agreed conflict mitigation measures within eight weeks of us making a decision on the delivery model for the project**. We propose that failure to notify us of an intention to

²³ For the avoidance of doubt, the TO would not be required to implement the arrangements if it was not intending to bid.

bid in time or failure to put the necessary conflict mitigation measures in place in time would lead to the TO Bidder being excluded from the SPV tender.

Business separation

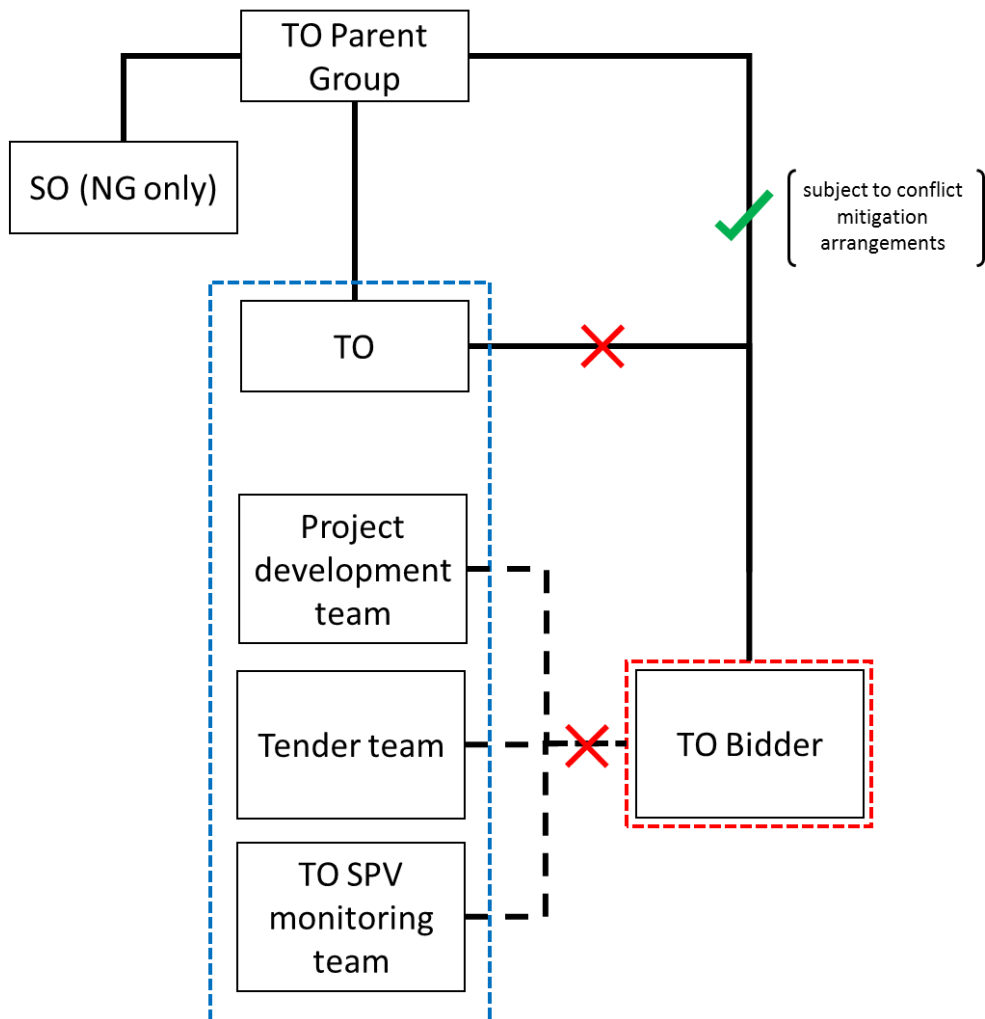
4.69. We consider that there are three groups of staff within the TO who need to be considered for the purposes of conflict mitigation. These are:

- **The project development team** – the team undertaking the pre-construction activities associated with the project. They will have developed and have access to substantial amounts of information on the project. They may also act to answer due diligence questions posed by bidders in the SPV tender in relation to the project.
- **The tender team** – the team associated with developing and then running the SPV tender.²⁴ This team may be the same as the project development team.
- **The TO's SPV compliance and monitoring team** – the team which undertakes the ongoing management of any appointed SPVs.

4.70. In Figure 4 we have set out diagrammatically the expected relationships between those teams as well as between and the TO Bidder and its parent group. We have annotated with a red 'X' where there should be total legal, managerial, financial, physical, and IT separation. Solid lines represent ownership links. Dotted black lines represent possible information links.

²⁴ In the CATO regime, we did not consider the 'tender team' as that role was with Ofgem.

Figure 4 – Links between teams within the TO and business separation requirements



4.71. In Table 7 we have set out a summary of the business separation proposals for the TO Bidder from the project development, tender and SPV monitoring teams within the TO's business.

Table 7 – Business separation proposals

Separation area	Proposed approach
Legal	As described in Table 6, we propose that the TO Bidder unit is completely legally separate from the other teams. The TO Bidder unit may reside under the TO parent group, depending on the ability of the TO to implement the other separation requirements outlined in the rest of this table.
Managerial	Reporting lines must be suitably separate such that there is no risk of conflicts appearing. As a minimum, we propose that the TO Bidder and the remainder of the TO should be managerially separate. This is likely to extend to board level, depending on the arrangements proposed.
Financial	We propose that the TO and the TO Bidder are financially separated, meaning that the costs incurred by the TO Bidder are not recovered from regulated revenue related to any other of the TO's activities or assets. Additionally, there are existing obligations on the TO in standard licence conditions B5 (Prohibition of cross-subsidies) and B6 (Restriction on Activity and Financial Ring Fencing).
Physical	We propose that the TO Bidder is required to be in a completely separate physical location from the remainder of the TO. There must be restricted access between the TO Bidder and the remainder of the TO.
IT	We propose that the TO and TO Bidder would be required to have separate IT systems. Strict rules should be put in place to prevent access by the TO Bidder to the systems that record, process and store information related to either the project's development information or the SPV tender itself. Similarly, the TO should not be able to access information related to the TO Bidder's strategy.
Employee transfer	We propose that the TO Bidder must not comprise any employees of the TO who were or are involved in a project's development or the SPV tender (full time or part time), from the date of implementation of separation arrangements. This date would be agreed with us as part of the TO's conflicts methodology. Similarly, there should be no transfer of employees from the TO Bidder to the TO until the completion of a tender, in order to mitigate the risk of the TO Bidder influencing the TO's approach to the tender. In line with the informational restrictions, we may also need to consider restrictions on employees from the TO tender and monitoring teams joining any TO Bidder for subsequent tenders.

5. Procurement principles

Section summary

This chapter sets out the detail of our proposed procurement principles to support successful implementation of the SPV model.

Questions

Question 1: Do you agree with our proposed procurement principles?

Question 2: Are there any other areas where we should be setting firm requirements regarding procurement of the SPV, or where additional guidance would be helpful?

Question 3: Are there any areas included in this chapter where we should not be setting requirements regarding procurement of the SPV?

Introduction and our role

5.1. Under the SPV model, the TO would be responsible for designing, running, and concluding a tender that results in the appointment of an SPV. The TO therefore has the responsibility for designing the tender processes and documentation for the SPV tender, and ensuring that these meet the legal requirements in relevant procurement legislation, such as the Utilities Contract Regulations.

5.2. We have set out earlier in this consultation the proposed scope of our role in setting the terms of the SPV tender. Our main role is that **we must have approved the tender documentation and DA prior to the TO commencing the SPV tender**. This ensures that we can be satisfied that the full range of documentation produced by the TO will produce an appropriate outcome from the SPV Tender.

5.3. As described in Chapter 4, we intend to develop and publish a **Procurement Guidance (PG)** document, setting out our view of the key principles a TO should follow when designing and running the SPV tender. We are providing this guidance as we consider that there is a benefit to bidders, consumers, and the overall regime if SPV model tenders have certain common characteristics or features enhancing reproducibility, irrespective of the TO running the tender.

5.4. This approach should allow the TO enough freedom to design a legally compliant tender taking into account the bespoke nature of any project assets, while ensuring a level of reproducibility.

5.5. We are considering appointing an entity to oversee the implementation of the tender and report to us on adherence to the PG and to the tender documentation approved at the pre-tender stage.

Third party run SPV Tender

5.6. We consider that the TO, if it wished to, could propose to Ofgem to allow a third party to undertake the SPV tender on its behalf. For example, the SO, or another suitably skilled and independent body. However, it would still be the TO and SPV that enter into the DA, and Ofgem that makes the modifications to the licence to enable recovery of costs by the TO. Any third party running the tender would only be able to, at its furthest extent, appoint a preferred bidder. The appointment of a third party to conduct the tender would not remove or reduce obligations in the TO’s licence on conduct.

5.7. Where the TO wished to appoint a third party to run the tender, it should make an appropriate representation to us, setting out why doing so would be in the interest of consumers.

Scope of this chapter

5.8. In this Chapter, we have set out our initial views on the broad procurement principles that a TO should follow when structuring, designing and running its SPV tender. We are seeking views on these broad principles now as the basis for developing the PG document in detail over the coming months.

Procurement principles

5.9. We have set out in Table 8 the key principles we propose should apply across the whole SPV tender. An overarching requirement is that the arrangements should comply with relevant procurement rules and legislation.

Table 8 – Procurement principles

Area	Principle
Overall length	We consider 12-15 months to be an appropriate end-to-end tender length, depending on the nature of the assets to be tendered.
Qualification stage	
Scope	Questions should cover experience and capability.
Evaluation	<p>TO should set out a robust, transparent and fair mechanism to support shortlisting decision. Shortlisted bidders should be required to meet some minimum threshold requirements in key areas (either in terms of a minimum score or Pass/Fail)</p> <p>TO should specify before the tender whether it will set any limits on number of bidders to be invited to ITT stage.</p>
ITT stage	

Scope	Bidders required to bid a fixed price (project TRS) as well as approach to design, build, finance and operation of the assets. Certain aspects of the TRS should be subject to annual indexation, using appropriate indices where this offers value for money.
Financing	TO should ensure that questions and evaluation strategy do not advantage one form of financing over another.
Selection of Preferred Bidder (and if appropriate reserve bidder)	<p>Selection of preferred bidder must be on the basis of most economically advantageous tender, not simply cost.</p> <p>Expect price to have a material weighting in overall decision. Weighting of price should be appropriately balanced by an assessment of the robustness of that price, and approach to design, build, finance and operation of the assets.</p> <p>TO must satisfy itself that preferred bidder can meet the contractual obligations under the DA.</p> <p>Winning bidder should be required to meet some minimum threshold requirements in key areas (either in terms of a minimum score or Pass/Fail).</p>
Other procurement areas	
Project data room	<p>TO must establish a secure, well-structured project data room containing all information reasonably required by bidders.</p> <p>The information included must be clear, comprehensive and only accessible by those who need to see it.</p> <p>TO must implement a fair and efficient clarifications process. The clarifications process should have some clear rules around how clarifications are put forward by bidders, and how these are answered, including any instances where questions or answers can be confidential.</p>
Disqualification, withdrawal, events of re-run, cancellation	<p>Criteria for bidder disqualification and terms of bidder withdrawal need to be clearly prescribed up front.</p> <p>Events of re-run (of a specific stage or entire tender) or of cancellation should be prescribed up front, and in line with policy described in Chapter 4 of this consultation.</p> <p>Ofgem should be notified in advance of any proposal to cancel or re-run a tender or to disqualify a bidder. Depending on the circumstances Ofgem approval may be required before action can be taken.</p>
Bidder costs	Default arrangements expected to be that unsuccessful bidders cannot recover costs (unless the tender is cancelled). However, Ofgem is willing to consider on a case by case basis options for unsuccessful bidders to recover costs where a strong cost benefit case can be made by the TO. Such a case would need to

	<p>include details on what scenarios would allow unsuccessful bidders to recover costs and what quantum of costs could be recovered.</p>
TO resourcing	<p>TO should have sufficient resources (people and money) to run the SPV tender efficiently at an economic cost.</p> <p>TO should have access to suitably skilled resources to carry out the procurement and contract management – if those skills are unavailable in-house they should seek them externally, at an economic and efficient cost.</p> <p>TO can propose another party to run the tender on their behalf but a detailed case for this would need to be made and it would need to be approved by Ofgem.</p>
DA	<p>General position is that only limited changes should be permissible to the DA during the course of the tender.</p> <p>TO should ensure robust, transparent and fair process is in place for sharing DA with bidders and for managing any comments / suggested amends by bidders.</p> <p>Propose that process for allowing comments/suggested amends by bidders should conclude a reasonable period of time before deadline for ITT submissions.</p>
Transfer of relevant pre-construction works	<p>TO should ensure relevant pre-construction works are transferable to SPV, or otherwise obtained in such a way to allow the SPV to benefit from them.</p> <p>TO should prepare a draft transfer agreement for any works to be transferred to the SPV, consistent with the DA.</p> <p>General position is that limited changes should be permissible to the transfer agreement during the course of the tender.</p> <p>TO should ensure that a robust, transparent and fair process is in place for sharing the transfer agreement with bidders, and for managing any comments / suggested amends by bidders.</p> <p>Process for allowing comments/suggested amends by bidders should conclude a reasonable period of time before deadline for ITT submissions.</p> <p>Where bidder comments/suggested amends are sought, these should be classified in terms of significance (eg low/medium/high priority or impact).</p>
Marketing	<p>TO must publish appropriate information on the project suitably in advance of tender to ensure market is appropriately aware of the opportunity.</p> <p>Expect TO to develop and submit to Ofgem an overall market engagement strategy for the project which sets out, amongst others: what information it will publish (and when), how it will</p>

	<p>engage with the market, how it will determine market appetite and respond to market questions/concerns, etc.</p> <p>TO must also publish key elements of the tender design (eg draft DA, draft tender rules) suitably in advance of tender to ensure market is appropriately aware of the opportunity.</p>
Confidentiality and intellectual property rights	<p>TO should have clear processes in place to manage intellectual property rights and to ensure confidentiality during the tender.</p>

Appendices

Index

Appendix	Name of appendix	Page no.
1	Draft illustrative licence conditions	57
2	Privacy notice on consultations	70

Appendix 1 – Draft illustrative licence conditions

Description of the proposed licence conditions

1.1. As set out in Chapter 4 of this consultation, we have developed a set of draft illustrative licence conditions for how we could seek to implement certain elements of the proposed regulatory framework into the TO's licence.

1.2. This Appendix 1 contains:

- Descriptions and explanations, where required, of the proposed new special licence condition 6M/J.
- A draft of our proposed new licence condition 6M/J to implement our regulatory framework into the TOs' licences.²⁵

1.3. We are seeking stakeholders' views on our illustrative changes to the TOs licences. We are then intending to hold a series of workshops over the autumn, after the close of this consultation, to develop the conditions further. We will inform stakeholders of dates nearer to the time.

Part A: TO obligations during the pre-tender stage

1.4. Further information on our proposed obligations of the TO during the pre-tender stage is set out in Chapter 4 of this document.

1.5. Part A of the draft condition set out below shows our proposed implementation of the activities described in paragraph 4.7.

1.6. The activities are listed as constituent parts of the new paragraph 6M.2. We have not yet decided on the names of the guidance documents, and as such have used short descriptors and square brackets as a holding signifier.

1.7. The criteria to conclude the pre-tender stage are listed within paragraph 6M.3. In particular, (c) aligns with the needs case drafting in the current 6I licence condition. We have included an additional paragraph 6M.3(d), which acts as the mechanism through which we would notify the licensee that the Tender Period may commence.

1.8. Paragraph 6M.4 as well as paragraphs 6M.3(a) and (b) implement the proposed policy aspects set out in 4.12 of this consultation. The drafting of paragraphs 6M.3(a) and (b) would allow us to approve either the whole or just a part of the relevant documents. Paragraph 6M.4 would then allow us to specify a date by which the TO must return with revised documentation where:

- We do not approve the whole documentation ("in whole"); or

²⁵ For clarity in this appendix, we refer to the proposed new paragraphs only as they would appear in 6M (eg 6M.1).

- We do not approve only part of the documentation (“or in part”).

Part B: TO obligations during the SPV tender stage

1.9. Our proposed implementation of the TO obligations during the SPV tender described in this section can be seen in Part B of the proposed licence conditions.

1.10. In line with our policy described in paragraph 4.23, paragraph 6M.6 would require the TO to seek approval for any material changes to the Delivery Agreement.

1.11. The drafting of paragraph 6M.7 aligns with our proposed policy that Ofgem would need to approve of the bidder before proceeding.

Part F: Reporting requirements on appointed SPVs

1.12. At this stage, we have provided an outline of the possible range of reporting obligations we may place on the TO.

Part G: TO allowances for SPV payments

Construction period

1.13. We have developed an indicative mechanism for how the TO could recover the relevant SPV revenues through its licence. Where possible, we have tried to align with condition structures already in place in the OFTO licence.

1.14. Our proposed new paragraph 6M.18 produces an overall allowed cost recovery for the TO on behalf of the SPV in the construction period, and is made up of multiple defined terms including:

- **A base RDC term (RDC_c).** This term reflects the base RDC allowed in the DA of any project named in the Table within Part G of the condition. We would expect to have full view of the terms of the relevant DA to ensure correct recovery of the allowances.
- **A revenue adjustment term (RAC_c).** This term would allow the TO to recover costs of any one-off payments associated with any cost and output adjusting events. More information on price adjustment mechanisms for the SPV is set out in Chapter 3.
- **An ITA cost recovery term ($ITAC_c$).** As described in Chapter 3 and 4, the SPV and the TO will be allowed to recover relevant costs in respect of the ITA for a given project.
- **A revenue collection correction term (KC_c).** This term is necessary to ensure that the forecast and actual costs are reconciled between years. As is present in the OFTO and TO licences, this would be subject to penalty interest rates where there is a significant over-recovery to incentivise accurate forecasting.

Operational period

1.15. We consider that the operational period TRS mechanics within the TO's licence should be consistent across all projects. This is because, provided the TO follows the commercial structure set out in Chapter 3, during the operational phase the SPV's revenue allowance under the DA, and therefore the TO's allowance, will be largely structured in the same way.

1.16. We propose that the operational revenue funding section of the licence broadly follows the structure developed for the OFTO licence. Our proposed new paragraph 6M.19 produces an overall allowed cost recovery for the TO on behalf of the SPV in the operational period, and is made up of multiple defined terms including:

- **A base Tender Revenue Stream term (TRS_t).** This term reflects the base TRS as bid by the SPV in the SPV tender. Changes to this term to reflect enduring changes to the base SPV TRS would require amending the defined revenue table in the funding condition.
- **Indexation terms (RI_t and BI_{TRS}).** As described in the Agilia report, allowing indexation to be included in bids allows more efficient pricing by removing inflation risk. These two terms would allow indexation against an appropriate index, and partial indexation for a given percentage of the TRS. This term would then mirror that in the SPV's DA.
- **A partial revenue term (PR_t).** To reflect that the base TRS may not start at the exact point of a new financial year, we propose to include a mechanism to account for partial TO allowance in the first and last financial year of the operational period. This mechanism would provide an allowance proportional to the number of days remaining within that financial year that the TRS should cover.
- **A revenue adjustment term (RA_t).** This term would allow the TO to recover costs of any one-off payments associated with any cost and output adjusting events. More information on uncertainty mechanisms for the SPV is set out in Chapter 3.
- **An ITA cost recovery term (ITA_t).** As described in Chapter 3, the SPV and the TO will be allowed to recover relevant costs in respect of the ITA for a given project.
- **A revenue collection correction term (K_t).** This term is necessary to ensure that the forecast and actual costs are reconciled between years. As is present in the OFTO and TO licences, this would be subject to penalty interest rates where there is a significant over-recovery to incentivise accurate forecasting.

Part H: Cost and Output adjusting events

1.17. The drafting of paragraphs 6M.20-6M.26 is designed to implement our policies on cost adjustments described in both Chapters 3 and 4 of this document.

1.18. In line with paragraph 4.40 and A1.16, we have specified the terms that can be amended by an application by the TO for price adjustment. We need to undertake further licence condition development to more precisely develop the specific criteria for when an application can be made.

1.19. We have sought to align the notice reporting requirements with that of the existing SWW condition 6I.19, which contains a similar provision around price adjusting events. We have adjusted this list to adjust for the particulars of the SPV model, for example, adding in a statement from the ITA.

Part K: Conduct of the licensee

1.20. We propose to place obligations in respect of the TO's conduct throughout the process. These indicatively would focus on the accuracy of the TO's submission and the manner in which it undertakes its activities.

Proposed new licence condition

Introduction

6M.1 The purpose of this condition is to set out the obligations of the licensee to run a tender to appoint an SPV to deliver the Relevant Assets as identified by the Authority pursuant to Special Condition 6I of the Electricity Transmission licence.

Part A: Obligations following a determination of Delivery Model

6M.2 In the period from the [notification/direction] of Delivery Model under 6I.42(d) to commencement of the Tender Period, the licensee will:

- (a) continue to undertake relevant pre-construction activities;
- (b) produce [SPV Tender Documentation] using [name/location of Procurement Guidance];
- (c) produce an [SPV Delivery Agreement] using [name/location of Delivery Agreement Guidance];
- (d) where requested to do so by the Authority, produce a Final Needs Case using [licence condition 6I and the SWW Guidance]; and
- (e) provide updates to the Authority regarding progress of the [SPV Tender Documentation] and [SPV Delivery Agreement], in a form to the Authority's satisfaction, at intervals agreed with the Authority and:
 - (i) as soon as reasonably practicable following the licensee becoming aware of a material change to the proposed Relevant Assets; and /or
 - (ii) as soon as reasonably practicable following a request to do so by the Authority.

6M.3 A Tender Period will commence only where:

- (a) the Authority, in whole or in part, approves the Tender Documentation produced by the licensee pursuant to 6M.2(b);
- (b) the Authority, in whole or in part, approves the SPV Delivery Agreement produced by the licensee pursuant to 6M.2(c);

- (c) the Authority, subject to timely provision of such information by the licensee, and following consultation with such other parties as the Authority considers may be affected by its determination, determines that the needs case, technical scope and timing of delivery are sufficiently well justified and represent long term value for money for existing and future consumers; and
- (d) the Authority notifies the licensee that the licensee may commence the Tender Period.

6M.4 Where the Authority, pursuant to 6M.3, and in whole or in part, does not approve the Tender Documentation and/or SPV Delivery Agreement, the licensee must[, in such timescales as the Authority may specify,] modify the Tender Documentation and/or SPV Delivery Agreement as appropriate and submit to the Authority for approval pursuant to 6M.3.

Part B: Obligations during the Tender Period

6M.5 From the date of the Tender Period commencing until conclusion of the Tender Period, the licensee will:

- (a) commence and conclude an SPV Tender in respect of the Relevant Assets[, using the Tender Documentation and SPV Delivery Agreement agreed with the Authority pursuant to 6M.3]; and
- (b) provide updates to the Authority regarding progress of the SPV Tender, in a form to the Authority's satisfaction, at intervals agreed with the Authority and:
 - (i) as soon as reasonably practicable following the licensee becoming aware of a material change to the proposed Relevant Assets; and /or
 - (ii) as soon as reasonably practicable following a request to do so by the Authority.

6M.6 The licensee must [notify/seek approval from] the Authority where the SPV Delivery Agreement is materially changed from the SPV Delivery Agreement approved by the Authority pursuant to 6M.3.

6M.7 The licensee must seek Authority approval for:

- (a) appointing a Preferred Bidder as soon as reasonably practicable following the conclusion of the relevant tender stage; and
- (b) agreeing an SPV Delivery Agreement with the Preferred Bidder as soon as reasonably practicable following the conclusion of the relevant tender stage.

6M.8 The Tender Period will conclude only where the licensee agrees an SPV Delivery Agreement with the Preferred Bidder approved by the Authority pursuant to 6M.7(b).

Part C: SPV Tender failure obligations

6M.9 Where the SPV Tender [fails], the licensee must, in agreement with the Authority, commence and conclude a new SPV Tender pursuant to Part B of this condition.

6M.10 The licensee may submit to the Authority, for approval by the Authority, amendments to the SPV Tender Documentation and SPV Delivery Agreement approved by the Authority pursuant to 6M.3, prior to the commencement of a new SPV Tender pursuant to 6M.9.

Part D: SPV Tender cancellation

6M.11 The Authority may direct the licensee to:

- (a) stop preparations for an SPV Tender, including the Tender Documentation and SPV Delivery Agreement; or
- (b) stop an ongoing SPV Tender.

Part E: Licensee compliance with an SPV Delivery Agreement

6M.12 The licensee will[, insofar as it does not conflict with any other statutory obligations of the licensee,] comply with the terms of any SPV Delivery Agreement entered into pursuant to a successful SPV Tender.

6M.13 The licensee must, within [30] calendar days of the breach occurring, report any breach or non-compliance with an SPV Delivery Agreement to the Authority.

Part F: Licensee reporting requirements on appointed SPVs

6M.14 During the Construction Period, the Licensee will provide the Authority with:

- (a) Progress reporting

6M.15 During the Operational Period, the licensee will provide the Authority with:

- (a) Actual incurred costs
- (b) Debt refinancing
- (c) Asset Health
- (d) Changes in SPV ownership
- (e) [SF6 – if needed]

Part G: Restriction of SPV Transmission Revenue

6M.16 The Licensee's allowed revenue is set out in this Part G.

6M.17 The licensee shall take all appropriate steps within its power to ensure that in any Relevant Year t or c , Regulated Transmission Revenue (AR_t or AR_c) shall not exceed the Allowed Transmission Owner SPV Revenue (SPV_t) or Allowed Transmission Owner SPV Construction Revenue (SPV_{C_c}) respectively calculated in accordance with the formulas in this section.

Construction period allowance

6M.18 For the purposes of this condition, for each project specified according to Table [X] of this condition, Allowed Transmission Owner SPV Construction Revenue ($SPVC_c$) shall take the value of zero in all years preceding the Construction Period Start Year, and thereafter the Allowed Transmission Owner SPV Construction Revenue ($SPVC_c$) is specified as follows:

$$SPVC_c = RDC_c + RAC_c + ITAC_c - KC_c$$

(1)

where:

- SPVC_c means Allowed Transmission Owner SPV Construction Revenue in the Relevant Year c.
- RDC_c means the Revenue during Construction due to an SPV listed in Table [X] in accordance with the relevant Delivery Agreement;
- RAC_c means the revenue adjustment term, whether of a positive or of a negative value, made in the Relevant Year c in respect of [any relevant cost and output adjusting events];
- ITAC_c means the revenue term, whether of a positive or of a negative value, made in the Relevant Year t in respect of [the cost of the ITA];
- KC_c means the revenue restriction correction factor, which is the difference between the Regulated Transmission Revenue (AR_{c-1}) and the allowed transmission revenue ($SPVC_{c-1}$) in the previous year, whether of a positive or of a negative value, which takes the value zero in the first Relevant Year ($c=1$). In subsequent years, it is calculated in accordance with the formula below:

$$K_c = (AR_{c-1} - SPVC_{c-1}) \times \left[1 + \frac{(I_c + PI_c)}{100} \right] \quad (6)$$

where:

- AR_{c-1} means the Regulated Transmission Revenue in respect of the Relevant Year t-1.
- SPVC_{c-1} means the Allowed Transmission Owner SPV Revenue in the Relevant Year t-1.
- I_c means the Average Specified Rate in the Relevant Year c.
- PI_c means the penalty interest rate in Relevant Year c, which is equal to:

(a) where

$$AR_{c-1} > 1.04 \times SPVC_{c-1} \quad (7)$$

the penalty interest rate shall be 4; and

(b) otherwise, it shall take the value zero.

Operational period allowance

6M.19 For the purposes of this condition, for each project specified according to Table [X] of this condition, Allowed Transmission Owner SPV Revenue (SPV_t) shall take the value of zero in all years preceding the Completion Year ($t=1$), and thereafter the Allowed Transmission Owner SPV Revenue (SPV_t) is specified as follows:

$$SPV_t = BR_t + RA_t + ITA_t + PA_t - K_t$$

(1)

where:

SPV_t means Allowed Transmission Owner SPV Revenue in the Relevant Year t.

BR_t means Base Transmission Owner SPV Revenue which shall be calculated as:

$$BR_t = PR_t(TRS_t(RIT_t \times BI_{TRS} + (1 - BI_{TRS})))$$

(2)

where:

TRS_t means the Tender Revenue Stream in accordance with Table [X];

BI_{TRS} represents the proportion of the Tender Revenue Stream to be indexed in accordance with Table [X];

PR_t means the proportion of revenue term which adjusts the Allowed Transmission Owner SPV Revenue (SPV_t) for partial years. It represents the proportion of TRS_t to be recoverable in that Relevant Year and shall take the value 1, except:

- (a) in respect of the period before the Completion Year where it shall take the value zero.
- (b) in respect of the Completion Year where it shall take the value determined by the following formula:

$$PR_1 = 1 - \left(\frac{\text{No of days between Completion Date and start of Completion Year}}{365.25} \right) \quad (3)$$

- (c) in respect of the Closing Relevant Year where it shall take the value determined by the following formula:

$$PR_{CYR+1} = \left(\frac{\text{No of days between Completion Date and start of Completion Year}}{365.25} \right) \quad (4)$$

- (d) in all Relevant Years subsequent to the Closing Relevant Year, where it shall take the value zero.

RIT_t is the revenue indexation adjustment term for the Relevant Year t, and shall be derived from the following formula:

$$RIT_t = \frac{RPI(\text{September})_{t-1}}{RPI(\text{base date})} \quad (5)$$

where:

RPI (September)_t means the Retail Prices Index Number for the month of September in Relevant Year t; and

RPI (base date) means the Retail Prices Index Number for the month in which the Base Date occurred;

however:

in the Completion Year and in each Relevant Year prior to the first indexation adjustment, RIT_t shall take the value 1; and

the first revenue indexation adjustment for Relevant Year t shall only occur when in Relevant Year t-1 the month of September has occurred since the Base Date.

RA_t means the revenue adjustment term, whether of a positive or of a negative value, made in the Relevant Year t in respect of [any relevant cost and output adjusting events];

ITA_t means the revenue term, whether of a positive or of a negative value, made in the Relevant Year t in respect of [the cost of the ITA];

PA_t means the performance availability revenue adjustment term, whether of a positive or of a negative value, made in the Relevant Year t in respect of annual revenue adjustments as derived in accordance with [any performance based incentives];

K_t means the revenue restriction correction factor, which is the difference between the Regulated Transmission Revenue (AR_{t-1}) and the allowed transmission revenue (SPV_{t-1}) in the previous year, whether of a positive or of a negative value, which takes the value zero in the first Relevant Year (t=1). In subsequent years, it is calculated in accordance with the formula below:

$$K_t = (AR_{t-1} - SPV_{t-1}) \times \left[1 + \frac{(I_t + PI_t)}{100} \right] \quad (6)$$

where:

AR_{t-1} means the Regulated Transmission Revenue in respect of the Relevant Year t-1.

SPV_{t-1} means the Allowed Transmission Owner SPV Revenue in the Relevant Year t-1.

I_t means the Average Specified Rate in the Relevant Year t.

PI_t means the penalty interest rate in Relevant Year t, which is equal to:

(c) where

$$AR_{t-1} > 1.04 \times OFTO_{t-1} \quad (7)$$

the penalty interest rate shall be 4; and

(d) otherwise, it shall take the value zero.

Table [X]

Project Name	Output description	TRS _t [Base TRS] £m (20XX/20XX) in accordance with the relevant Delivery Agreement	BI _{TRS} [indexation] in accordance with the relevant Delivery Agreement	Closing Relevant Year in accordance with the relevant Delivery Agreement
<i>Project Name</i>	<i>Description</i>	<i>XX.XXX</i>	<i>X.XX</i>	<i>XX</i>
<i>The Quaggy River megalink</i>	<i>2GW HVDC subsea cable between Lewisham and Hither Green</i>	<i>30.000</i>	<i>0.8</i>	<i>25</i>

Part H: Cost and Output Adjusting Events (COAEs)

(i) Qualifying events

6M.20 The Licensee can apply for changes to:

- (a) Table [X] (Base TRS)
- (b) [COAE Term in operational period (RA_t)]
- (c) [COAE Term in construction period (RA_c)]

6M.21 [Criteria for acceptance – policy to be developed further.]

(ii) Licensee’s notice to the Authority

6M.22 Where the licensee considers, and can provide supporting evidence, that a [COAE] has occurred in relation to an output specified in Table [X] of this condition, it must give notice of that event to the Authority as soon as is reasonably practicable after that event has occurred, and in any event within three months after the end of the Relevant Year in which it occurred (or by such later date as the Authority may notify to the licensee).

6M.23 A notice under paragraph 6M.[23] of this condition must:

- set out the reasons for the request, along with a description of the event to which the notice relates and why the licensee considers it to be a [COAE];
- where submitted in the construction period, describe progress made in relation to the original project plan for the delivery of the project;

- specify the costs that the licensee expects to be incurred or saved by the [COAE], and explain how the amount of those costs has been calculated including where relevant evidence on the change to the scope of the construction works;
- provide revised project development plans, design works, forecast costs for the affected project cost items, cost breakdowns for the affected project cost items, annual expenditure profiles, and the construction programme;
- specify whether the licensee expects the [COAE] to have an impact on the timeline for the delivery of the project and explain what actions it has or will take to mitigate the impact of the event on the scheduled delivery date;
- confirm that none of the costs that are the subject of the notice has been, or will be, notified to the Authority in relation to any other revenue recovery arrangements in this licence; and
- include any other analysis or information that the licensee considers may be relevant to the Authority's consideration of its request.

6M.24 The notice must also contain or be accompanied by:

- details of any relevant calculations of the licensee in which revised expenditure or output specifications have been estimated, and any relevant supporting information;
- a statement procured from the Independent Technical Adviser that assesses whether or not amendments in relation to the scope of the works, the costs and delivery timing fairly reflect the effects of the event;

(iii) Determination by the Authority

6M.25 Where the Authority receives notice from the licensee under paragraph 6M.[XX] to this condition, it will determine:

- (a) whether a Qualifying Event has occurred in relation to any Project specified in Table [X] of this condition; and
- (b) subject to paragraph 6M.[XX](a) of this condition, the adjustment that is to be given effect through one or more of:
 - (i) the modification of Table [X] in respect of the relevant project;
 - (ii) the Licensee's allowed recovery in respect of the revenue term RA_c in the financial year c.
 - (iii) the Licensee's allowed recovery in respect of the revenue term RA_t in the financial year t.

(iv) Revocation

6M.26 The Authority may, with the consent of the licensee, revoke a determination made under paragraph 6M.[25] of this condition.

Part I: SPV Failure obligations

6M.27 [Policy to be further developed.]

Part J: Conflict mitigation requirements

6M.28 [Policy to be further developed.]

Part K: Obligations on the conduct of the Licensee

6M.29 Where responding to Authority enquiries or providing updates to the Authority, the licensee must provide information, which is accurate, complete, and not misleading to the best of the knowledge and belief of the licensee, having made reasonable enquiries.

6M.30 In undertaking activity to produce the Tender Documentation and SPV Delivery Agreement, the licensee will do so:

- (a) in a timely, economic and efficient manner, having regard to the purpose of the Tender Documentation and SPV Delivery Agreement to facilitate the Licensee commencing and conducting an SPV Tender; and
- (b) in a transparent manner, which provides visibility of decision making rationale during the period covered by this condition 6[M]; and
- (c) in a manner which, to the extent possible, facilitates the transfer of all necessary [information and relevant rights and liabilities] in connection with the Relevant Assets to [the winner of the SPV Tender].

Part L: Definitions

6M.31 In this condition:

Relevant Assets means as defined in Special Condition 6I.

Delivery Model means as defined in Special Condition 6I.

Construction Period Start Date means [the date on which the SPV Delivery Agreement is [signed/closed] by the TO and the appointed SPV in relation to the Relevant Assets.

Completion Date means [the date of completion of the assets as set out in the relevant SPV Delivery Agreement].

Completion Year means [the financial year in which the Completion Date occurs].

Tender Period means [the period of the SPV Tender].

Tender Documentation means relevant documentation necessary for the commencement and successful running of an SPV Tender in respect of the Relevant Assets, prepared by the licensee[and approved by the Authority].

SPV Tender means a tender process run to appoint an SPV to deliver the Relevant Assets under the SPV Delivery Agreement.

SPV Delivery Agreement means an agreement between the licensee and the [winner] of the SPV Tender in respect of the Relevant Assets.

Appendix 2 – Privacy notice on consultations

Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, "Ofgem"). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. i.e. a consultation.

4. With whom we will be sharing your personal data

Our intention is not to share this with anyone. If we publish your response, we would not publish any of your personal details.

5. For how long we will keep your personal data, or criteria used to determine the retention period.

Your personal data will be held for as long as is required for the development of the relevant policy, and as a record of stakeholder engagement on those policies.

6. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete
- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data
- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3rd parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at <https://ico.org.uk/>, or telephone 0303 123 1113.

7. Your personal data will not be sent overseas

8. Your personal data will not be used for any automated decision making.

9. Your personal data will be stored in a secure government IT system.

10. More information For more information on how Ofgem processes your data, click on the link to our "[Ofgem privacy promise](#)".