

# SPV Model Stakeholder Event October 2018



**New Transmission Investment**  
29/10/2018

Welcome and agenda	10.00 – 10.10
Overview of the SPV model	10.10 – 10.40
Open Q&A	10.40 – 11.00
Roundtables and feedback	11.00 – 12.20
Next steps and close	12.20 – 12.30
Networking opportunity	12.30 – 13.00

# Why introduce competition?

We use competition to drive value for consumers in networks in various ways:

- **Offshore transmission** – well-established OFTO regime for tendering for operation of transmission links between offshore windfarms and the main network
  - £700m-1.3bn+ savings from OFTO regime since 2009
- **Onshore transmission** – developing models to introduce competition and competitive forces for new, separable and high value projects
  - decision to apply **competition proxy model** on **Hinkley-Seabank** onshore electricity transmission link (estimated £50-100m saving on a £650m project)
  - Implementing **CATO regime** (developed but paused because of lack of parliamentary time – may be legislative slot in 2019)
  - Implementing the **SPV model**, which looks to ensure the appropriate market rate is paid for delivering new, separable and high value (“qualifying”) onshore projects, by allowing a third party SPV, appointed via competition, to deliver the qualifying project on behalf of the regional TO
  - Introducing competition into delivery of new, separable and high value onshore network projects across electricity and gas (transmission and distribution) – already signalled intent in RIIO-2.
- **Price control** - competition provides market tested benchmarks that we are using in the RIIO-2 price control
- **Innovation** - competition brings in third parties with innovative business models and/or technical approaches

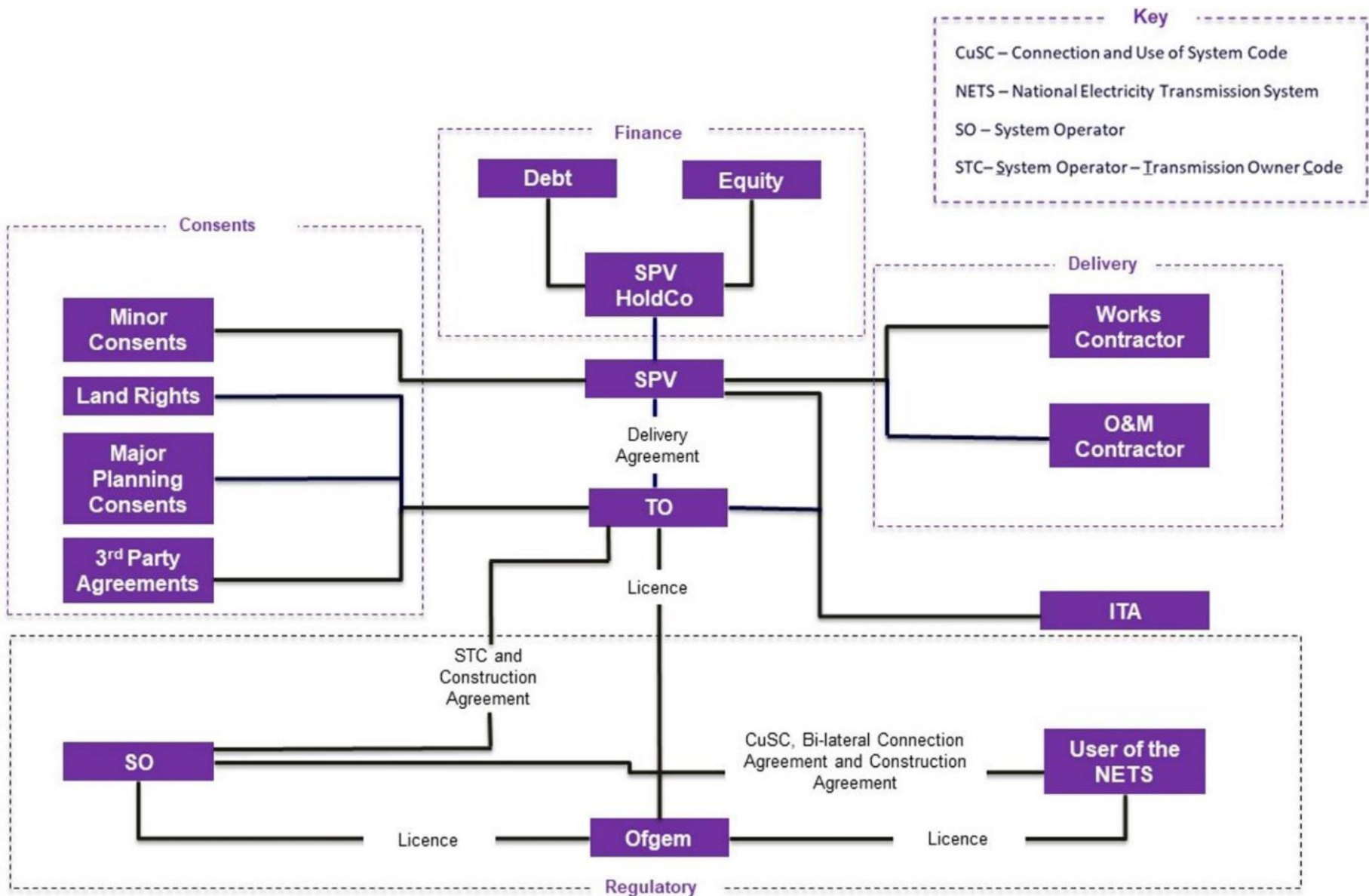
# Overview of the SPV Model (1)

- SPV is responsible on a day to day basis for financing, construction, O&M of the project
  - under long-term contract to TO, ie SPV is not a licenced entity
- Regional TO runs the tender to appoint the SPV. TO retains responsibility for the project under the Ofgem licence
  - also retains responsibility under the industry codes and standards.
- The TO licence will cover how obligations, incentives and protections apply, as well as revenue recovery
- Success of the model dependent on efficient design and delivery of the SPV competition. We're therefore publishing our expectations around various areas, **which will be subject to Ofgem approval** before commencement of the SPV tender:
  - **Commercial framework** – sets out roles and responsibilities and risk allocation between SPV and TO, in the form of a Delivery Agreement (DA)
  - **Regulatory framework** – project-specific revenue entitlement, incentives and obligations for the TO, based on the DA
  - **Procurement** – expectations around how the procurement process is run efficiently and fairly, including mitigating conflicts of interest

# Overview of the SPV Model (2)

Area	SPV model
How is the revenue set?	<ul style="list-style-type: none"> <li>• Project-specific, annual allowance</li> <li>• Competition determines tender revenue stream (cost of capital, capex and opex)</li> <li>• Default is fixed price but potential for target price on a project-specific basis where particularly risky elements</li> <li>• Some limited protections / price adjustments</li> </ul>
Length of term	<ul style="list-style-type: none"> <li>• 25 year operational period</li> </ul>
Delivery / Performance incentives	<p>Project-specific and likely common across TO / SPV:</p> <ul style="list-style-type: none"> <li>• 98%+ availability target               <ul style="list-style-type: none"> <li>• Upside &amp; downside (annual downside capped at c10%; upside c5%)</li> </ul> </li> <li>• SF6 emissions penalties.</li> <li>• Revenue starts at construction completion unless long (&gt;5 years) or complex construction period.</li> <li>• Considering 'Alliance agreement' upside only incentive.</li> </ul> <p>TO specific incentives:</p> <ul style="list-style-type: none"> <li>• New asset investment (unless meets criteria for competition)</li> </ul>

# Overview of the SPV Model (3)



# Commercial framework (1)

- Goal is an efficient allocation of risk between the TOs, the SPV, and consumers.
- Focus is on 'late model' competition – ie SPV not responsible for securing planning consent or preliminary design

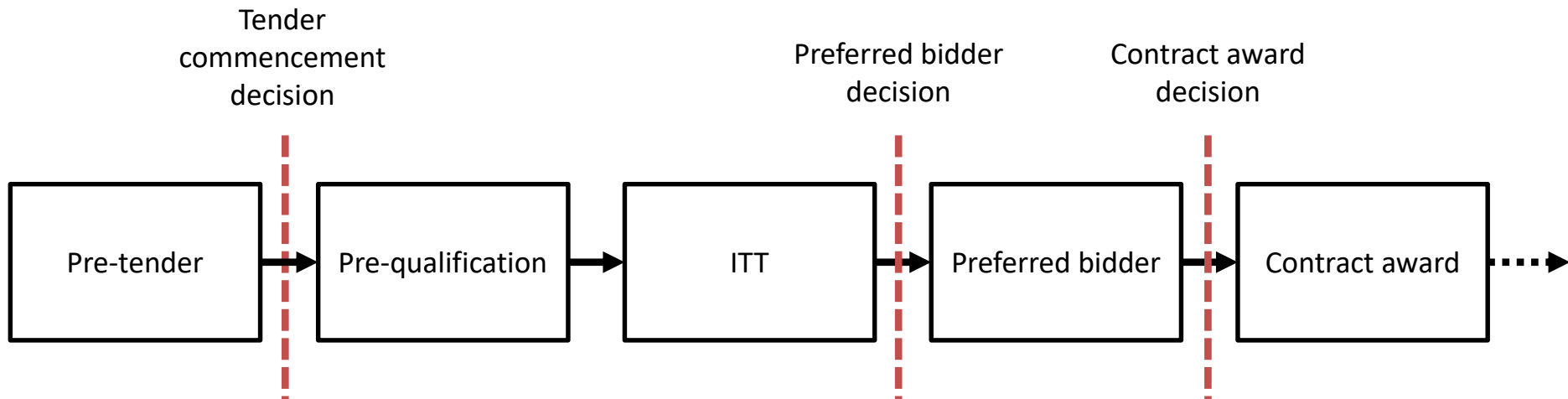
DA Area	Summary
Construction Risks	<ul style="list-style-type: none"><li>• SPV will carry out the construction and operation for a fixed price (in general)</li><li>• TO may propose an alternative to a fixed price model (where pricing may be on a capped or target cost basis), where appropriate and justified.</li></ul>
Payments	<ul style="list-style-type: none"><li>• SPV's full revenue entitlement commences on completion of asset commissioning and continues to expiry of the term of the DA.</li><li>• The revenue will be paid in full subject only to payment deductions and incentives as set out within the terms of the DA.</li><li>• TO may propose Revenue during Construction In limited circumstances, eg long and/or complex construction periods</li></ul>

DA Area	Summary
Price Adjustments	<ul style="list-style-type: none"> <li>• General principle is that the SPV should take all, or defined, risks.</li> <li>• Four sets of events which are proposed as exceptions:               <ol style="list-style-type: none"> <li>1. specified cost and output adjusting events (uncontrollable events, not foreseeable, low probability but high impact);</li> <li>2. events that are pass through costs (e.g. changes in business rates);</li> <li>3. certain changes in law;</li> <li>4. certain breaches of the DA by the TO.</li> </ol> </li> </ul>
Handback	<ul style="list-style-type: none"> <li>• DA will set out handback condition and a robust process and criteria.</li> </ul>
Termination	<ul style="list-style-type: none"> <li>• Termination rights on similar basis to PF2.</li> </ul>
Independent Technical Advisor (ITA)	<ul style="list-style-type: none"> <li>• TO and SPV jointly appoint an 'Independent Technical Advisor' (ITA) to provide various functions.</li> </ul>



- SPV model is implemented through the relevant TO's licence.
- The TO's licence will contain areas such as:
  - The obligations on the TO to design and run the SPV tender.
  - How the TO will recover the SPV's annual revenue stream, and the process for changes to that cost recovery.
  - How the TO will report to us during the construction and operational phases.
  - How the TO should mitigate conflicts of interest.

## Ofgem's role:



- Benefit to bidders, consumers, and the overall regime if SPV model tenders are broadly similar between TOs.
- Nonetheless, TOs should have enough freedom to take into account project specifics, and be legally compliant with relevant legislation.

Area	Principle
<b>Overall length</b>	We consider 12-15 months to be an appropriate end-to-end tender length, depending on the nature of the assets to be tendered.
<b>Selection of Preferred Bidder</b>	Selection of preferred bidder must be on the basis of most economically advantageous tender, not simply cost. Expect price to have a material weighting in overall decision.
<b>DA</b>	Only limited changes should be permissible to the DA during the course of the tender.
<b>Transfer of relevant pre-construction works</b>	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. TO should prepare a draft transfer agreement for any works to be transferred to the SPV, consistent with the DA.

# Open Q&A

## Format:

- Tables to discuss topics below, guiding questions provided.
- Each table to nominate Chair, Scribe, and Feedback person.
- 15 minutes for each topic
- 5 minutes feedback at the end

## Topics:

1. Commercial framework
2. Regulatory framework
3. Procurement framework and other

## Commercial framework:

- Do you agree with the proposed delivery and performance incentives?
  - What are your thoughts on how to best align TO and SPV incentives?
  - What are your views on the proposed price adjustment provisions?
- Do you agree with the initial scope of the ITA?
  - In what scenarios should a TO consider a target price approach?
  - Are there any gaps in the proposed commercial framework?
  - Are there areas where we should be clearer?

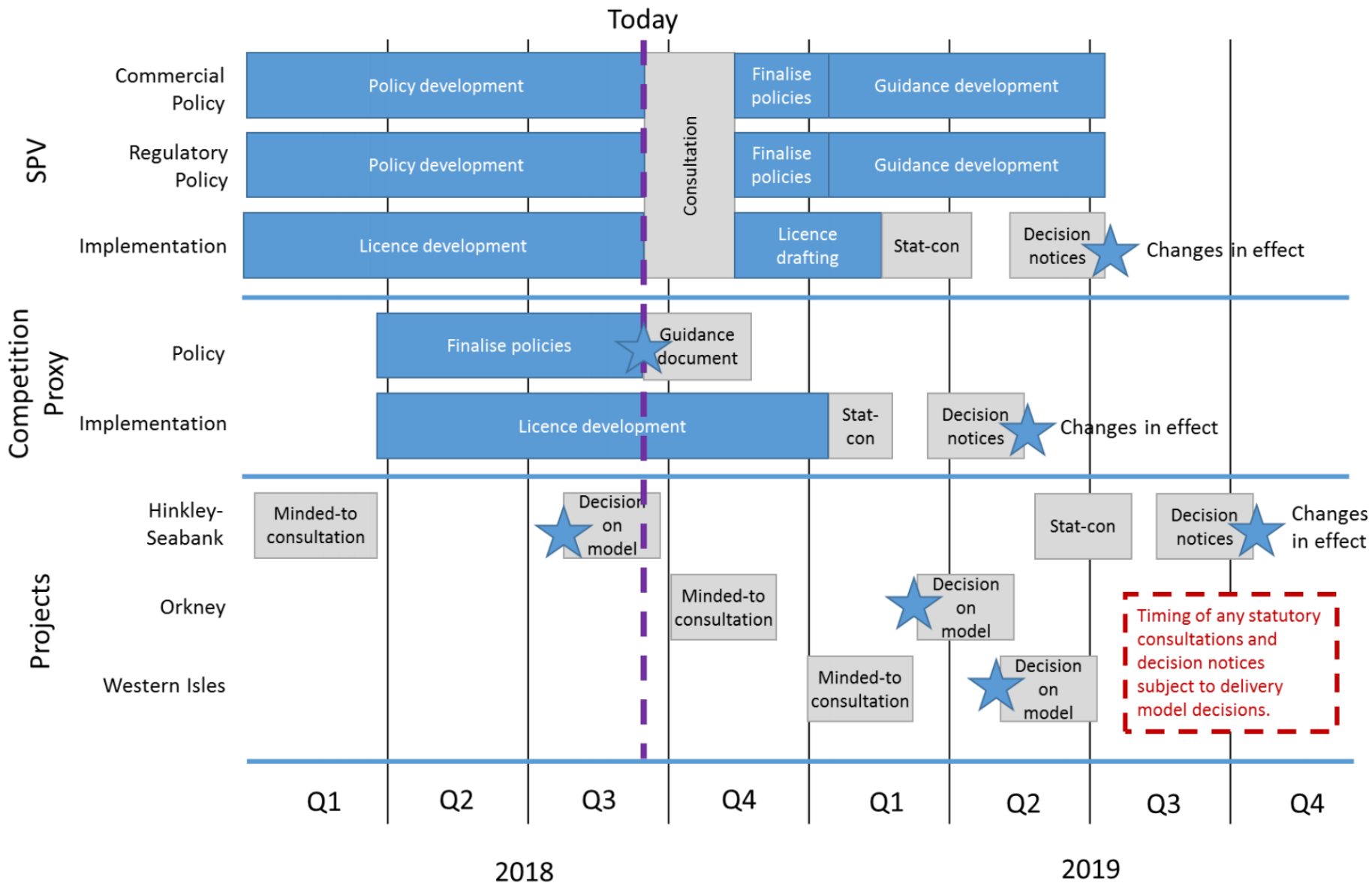
## Regulatory framework:

- Does the proposed framework provide sufficient certainty of SPV payments?
- How far should our conflict mitigation arrangements go between the TO and any possible bidding arm?
- Are there areas not covered by the regulatory framework that should be?
- Are there any gaps in the proposed commercial framework?
- Are there areas where we should be clearer?

## Procurement principles and other areas:

- Which areas should we be mandating the TO follows?
- Which areas should we allow more flexibility in?
- Are there other areas we should be looking to cover in our policy development?

# Next steps (1)





## ECIT industry group

- We are looking for participants to join a group to provide advice and guidance on the development and delivery of the SPV model of competition.
- Invite responses by 5<sup>th</sup> November.
- First group meeting on 19<sup>th</sup> November.
- Structure and scope of the group will be first topic of conversation.

## Projects we are assessing

- We are currently considering 3 project needs cases:
  - Orkney
  - Western Isles
  - Shetland
- Expect to consider 'Eastern HVDC' needs case in 2019
- Next Networks Options Assessment (NOA) will be published in January 2019.

- We are available to discuss the SPV model before and after the consultation.
- Contact: [NTIMailbox@ofgem.gov.uk](mailto:NTIMailbox@ofgem.gov.uk)

**Our core purpose is to ensure that all consumers can get good value and service from the energy market. In support of this we favour market solutions where practical, incentive regulation for monopolies and an approach that seeks to enable innovation and beneficial change whilst protecting consumers.**

**We will ensure that Ofgem will operate as an efficient organisation, driven by skilled and empowered staff, that will act quickly, predictably and effectively in the consumer interest, based on independent and transparent insight into consumers' experiences and the operation of energy systems and markets.**