

Balfour Beatty Investments Limited
350 Euston Road
Regent's Place
London
NW1 3AX

+44 (0) 20 7121 3700
www.balfourbeattyinvestments.com

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Mr James Norman
Head of New Transmission Investment, Commercial, Networks
By email to: James Norman at offshorelicensing@ofgem.gov.uk

Dear James

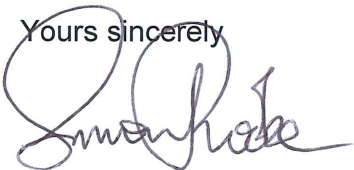
OFTO Tender Process – Consultation for Future Tender Rounds

Balfour Beatty Investments (“BBI”) is pleased to provide its comments on this consultation for the proposed changes to future OFTO tender rounds. BBI is an experienced OFTO owner and operator and has been participating in the OFTO market since the regime’s inception in 2009. Our objective is to be a leading player in the UK’s offshore renewable energy sector and thus we have developed critical offshore transmission bidding, management and operational capabilities throughout Balfour Beatty organisation.

We believe that while the current tender process can benefit from some changes, the overall process is robust and meets Ofgem’s objectives for the OFTO regime. Furthermore, we believe that the proposed changes, especially those under a ‘significant change’ package, could potentially undermine Ofgem’s objectives especially around ensuring that the OFTOs are robust and can deliver transmission services successfully over the licence period.

BBI has provided specific response to each consultation question at Annex 1 and would welcome a further meeting with Ofgem to discuss our responses and underlying rationale for our views.

Yours sincerely



Simon Rooke
Investment Director
On behalf of Balfour Beatty Investments

Enc Annex 1 - Response to specific questions

Annex1
Responses to specific consultation questions

Q1: Have we identified (in Chapter 1) the right drivers for possible change to the OFTO tender process? Are there other drivers for change we should consider?

Yes, we believe that Ofgem has identified the right drivers for possible change to the tender process. We think that Ofgem should consider the following additional drivers for the review:

1. Operational experience from existing OFTOs could enable Ofgem to evaluate whether it is asking the right questions to determine if it is shortlisting bidders that are likely to offer robust and considered bids.
2. Whether OFTO-built transmission assets will ever become a reality.
3. Streamlining warranty packages offered by the Developers to address issues in early operating years (this is partially addressed by the Income Adjusting Event consultation issued in early 2018).
4. Whether the developers have done enough to address the sort of latent defects that have impacted previous OFTOs.

Q2: Are the objectives of our review appropriate? Are there any other objectives that we should consider?

Yes, we think that the objectives of the review are appropriate; however, we think that Ofgem should also take into consideration the following:

1. Ensuring that it can demonstrate to the Generators that it has done a robust job of selling the asset which could leave the Generator's assets stranded if not operated appropriately and that the Generators remain in a "no worse" position as a result of the transaction.
2. Demonstrating that it has secured the overall best outcome from the sale for all parties – the Generator, the OFTO and the consumers.

We believe that the tender process in its current shape is already relatively streamlined and efficient and could be improved further with only slight modifications. We also think that the current tender process helps Ofgem to achieve the right balance of attracting qualified and knowledgeable OFTO owners and operators, while maintaining competitive tension to ensure that the best value is achieved. We believe that while the proposed moderate and significant change packages may improve the achievement of one of Ofgem's objectives, this would be at the expense of achieving other stated objectives.

We do not agree with Ofgem's implication that industry consolidation should be viewed as a negative occurrence and avoided; for example, consolidation in the DNO industry allowed a number of improvements to be delivered. Additionally, we believe that the successful delivery of the transmission services over the licence period in this highly technical industry is achievable by engaging with highly experienced operators, rather than relying on a large number of competitors. Finally, increasing the number of bidders will put pressure on the wider OFTO supply chain, i.e. O&M providers, insurers, and funders. Many have already expressed concerns regarding the amount of work required to support existing bidders and

some are considering switching to making a common offer to all bidders, which will lead to the inevitable loss of valuable innovation.

Furthermore, we are aware that a number of new players tried to enter the OFTO market but failed to progress beyond EPQ stage or withdrew from the ITT process. This implies that the current process does attract new entrants to the sector and, while we do not know the exact reasons for why these entrants failed to progress further, these might not have been due to the structure of the current tender process. The new bidders could have:

- (a) Underestimated the complexities of the assets tendered and resources required to operate those assets.
- (b) Realised that the bidding costs were relatively high for what now are secondary market equity returns; effectively there is a high opportunity cost of securing these assets.
- (c) Judged the pipeline of projects to be limited to justify developing internal capability to deliver these bids.

Finally, we think that the proposed modifications (both under moderate and significant change packages) could actually make the overall process less efficient and streamlined because there is a potential that the proposed changes could lead to a more protracted Preferred Bidder ('PB') stage. This is because in the absence of assessing the robustness of the written response or even absence of the written response (as per significant change package), Ofgem might inadvertently pick a winning bidder that has not fully considered and priced in all of the project's risks at the ITT stage or even secured a fully supported funding solution. This will lead to potential delays during the PB stage if the winning bidder reopens its price or has to re-negotiate the risk positions with the funders.

Q3: With respect to the existing tender process arrangements:

- (a) Are any different or additional arrangements needed to mitigate the risk of OFTOs not being financially or operationally robust?

The current evaluation of robustness seems to put a lot of emphasis on the likelihood of bidder's price increasing before Financial Close. We think that it would be more appropriate for Ofgem to consider robustness from the perspective of how well prepared the bidders are to deal with the issues that could arise during operations.

Ofgem also does not provide any guidance on minimum levels of financial robustness that the bidders need to achieve. It would be helpful if Ofgem could provide some guidance on the minimum threshold, similar to the guidance provided on criteria it considers when evaluating bidders' operational skills.

Ofgem should also consider providing further clarity / guidance during the ITT stage on which project-specific risks should be transferred to the OFTOs and which risks should be retained by the developer. This could be achieved by Ofgem getting more involved during the ITT bid stage to ensure that all of the bidders adopt the same assumptions regarding the risks which cannot be priced efficiently during the ITT stage. For example, a common problem during the ITT stage is that the cables are not properly buried and there is limited information on how to rectify these issues; this means that the risk is difficult to price. In these instances Ofgem could ask all bidders to assume that the risk of cable burial and additional surveys would sit with the Developer; the bidders could be asked to only provide a cost per additional survey should it be required. At PB stage, if it transpires that the OFTO will have to become responsible for additional surveys, the negotiation would be only around the number of surveys required, rather than number and price.

These measures can help ensure that:

- (a) All of the bidders use the same set of the assumptions for contingent events and thus the bids can be evaluated on a common basis;
 - (b) The OFTOs are based on a financially robust position; and
 - (c) The project risks are clear and properly understood by all stakeholders (including funders and rating agencies) and are appropriately costed.
- (b) In particular, do you consider that our tender process would be robust to a Carillion-type scenario? Are there additional questions we should ask at EPQ or ITT?

The current structure of the tender process is robust to a Carillion-type scenario. Additional questions are likely to offer limited value since they represent a snapshot in time rather than a view for the term of the Licence.

The issues that have led to Carillion's demise are complex but they may have, in part at least, been a consequence of the increasing pressure to award complex long-term projects on price alone rather than value (which includes deliverability and robustness). The OFTO sector is not immune to this development and Ofgem should be aware of this risk when it considers changes to the procurement process.

(c) Do you have any other specific feedback on the existing tender process?

As mentioned above, we believe that the current tender process allows Ofgem to meet its objectives for the regime; however, we also think that the process could be improved further with a few minor adjustments.

1. Meetings with developers to discuss Transaction Documents during the bidding process are not particularly helpful and do not help speed up the negotiations at PB stage. Therefore, we suggest that bidders submit their comments on the Transaction Documents with the bid on the basis of DD undertaken rather than submitting general comments in the early stages of the ITT process. Once the PB is selected, the PB's comments can be passed on to the developer – this will help reduce the workload and meeting time for all parties.
2. Cut out repetitive questions as follows:
 - (a) Questions asked at EPQ do not need to be repeated at ITT;
 - (b) Questions should not be repeated across various ITT Sections – there is a lot of overlap between assumptions discussed in Section 8 and the rest of the sections;
 - On this basis we propose that the bidders should submit a business plan, instead of Sections 1-6, which could then supported by Section 8.
 - We have to produce the business plan for our funders / TAs, so it would be easy to then adopt it for the final bid.
 - The business plan can lay out the summary of all of the sections (1 through 6) currently submitted as a part of the bid.
 - Inclusion of Section 8 would ensure that the robustness criteria are still met.

We agree that the ITT stage should only ask questions related to specific project – organisational style questions can be asked at EPQ stage or reflected in the business plan.

We believe that the bidding costs could be reduced but slightly; however, we generally consider that the costs incurred by the bidders at ITT stage are appropriate for the risk being transferred.

Q4: With respect to the moderate change package:

(a) Do you believe this option would be an improvement over the current tender process?

We believe that the current tender process already allows Ofgem to meet all of its stated objectives and could be improved further with only slight modifications. We believe that while the moderate change option could result in some cost savings for Ofgem, especially if only the two lowest priced bids are evaluated for robustness, the bidders will not realise any savings as they will have to undertake the same level of due diligence as per current tender process in order to deliver the firm TRS

(b) Do you agree with our assessment of this package against the objectives?

We agree that the proposed approach could lead to bidders delivering less robust bids. This could potentially create a situation where a new entrant could misprice the project due to lack of understanding of the assets and inherent risks. While Ofgem might argue that this is an issue for sponsors to resolve, it may ultimately lead to a failed OFTO, countering Ofgem's objective of having robust OFTOs that can deliver transmission services successfully over the licence period. Additionally, it would negatively impact the Generator, who relies on the transmission assets as its only route to export the electricity to the market.

We do not agree that 100% weighting on price will provide the best **value** to the consumers. Two scenarios may arise if only the price is considered (also applicable to the significant change package):

1. A new, inexperienced entrant, under-prices the bid and cannot complete the transaction leaving Ofgem with a protracted or even a failed bid process
2. Ofgem forces an inexperienced bidder to maintain its bid position which creates an OFTO with a higher risk of failure, potentially resulting in an OFTO of Last Resort if a major failure event occurs.

We believe that introducing 100% weighting on price increases a likelihood of creating a Carillion type situation in the OFTO industry because Ofgem would have no visibility on the assumptions bidders have made to reduce costs. This will counter the first objective of the regime to ensure that OFTOs are robust and can deliver services successfully over the licence period.

We do not believe that relaxing the limits on the number of bidders will allow more new entrants to progress to ITT. We agree with Ofgem that some bidders might choose not to participate in an ITT process with more than 5 bidders, especially since the bid costs will not decrease. This will counter Ofgem's objective to attract more market participants to the OFTO market.

While Ofgem might create a more streamlined and efficient tender evaluation process and potentially save cost of running these tenders, we agree that the proposed changes at ITT stage will make no material difference to the bidders. Even if the robustness is no longer considered in the final score, the bidders would still incur similar level of bid costs as under the current tender model because the amount of due diligence would not decrease and the bulk of the bid costs is made up of funder due diligence and legal advisory fees paid to third party advisors.

- (c) Do you consider that there are questions that could be removed from the ITT questionnaire (for example, where there is overlap with the EPQ, or where the approach is mandated elsewhere)? For what reason and benefit could they be removed?

We believe that there is a lot of repetition of information from other sections within Section 8; therefore, we believe our proposal for the bidders to submit a business plan with a detailed Section 8 would help reduce the time it takes bidders to develop other sections of the bid and then repeat them in Section 8.

If Ofgem decides not to proceed with business plan & Section 8 combination, we propose the following changes to the ITT questionnaire as a minimum:

1. Supporting documentation for Section 2 can be confirmatory – we do not see that these documents could hold up FC process even if they have to be developed during the PB stage
2. Section 3D could be eliminated or at least the last two questions removed as they do not add value to the response
3. Section 4 of the document should be changed so that the questions asked reflect the variety of operating models adopted by bidders. Currently, the questions within this section are asked in a certain way that implies that all OFTOs use the same approach to asset management, which is not correct. As our proposed operational structure differs to the one implied by the questions asked, we find that that our responses become repetitive or cannot be easily organised into a logical narrative. For example:
 - (a) Our selected O&M provider is in charge of asset condition monitoring, required planned and unplanned maintenance regime development and asset replacement planning (referred to in Question 4A). Therefore, for us it makes sense to describe our approach to these activities when answering questions in Section 4B which deal with details of the O&M arrangements and activities.
 - (b) Under our operational structure, the OFTO SPV rather than O&M provider is in charge of procuring insurances. Therefore, in our case it is not logical to discuss insurance arrangements (4B a) vi.) when discussing O&M arrangements.
 - (c) Question 4A a) v. asks about spares holding and management and then questions 4B f) iv. and v. ask about spare cable availability and general spares availability for a MFE. Under our proposed operating structure we have to refer back to our answers to question 4A a) v. when discussing questions in 4B.
4. It is also not clear what is being asked for in Section 4B when the bidders are asked to “describe the relationship to the associated O&M assumptions and cost provisions provided in response to Section 8, in alignment with the cost breakdown template forming part of the proforma cost templates,” if this information is again provided in Section 8 in detail.
5. There are a number of questions in Sections 6 and 8 which are similar or partly repetitive. These could be streamlined further to avoid duplication, as follows:
 - (a) Questions 6H and 8 h) iv. both require bidders to detail how they would maintain competitive pricing of the financing proposed from PB appointment to FC;
 - (b) Questions 6I and 8 h) vi. both require bidders to detail how they would maintain competitive pricing (including mitigation strategies for dealing with any increase in

the cost of funding) in respect of a delay to the ETD of up to 3 months or where Ofgem requests a review of the preferred funding solution;

- (c) Questions 6E and 8 h) v. both require bidders to explain assumptions (which including any associated sensitivities and supporting information) that underpin the approach used in arriving at the proportion of the TRS to be indexed to RPI over the length of the revenue term.

- 6. Section 7 – it would be helpful if Ofgem provided some guidance on which cost line items it expects will change with increase or decrease in the FTV.

We consider that Ofgem should add more weight to the robustness of bidders' proposals during the operations phase by including a graded assessment of operational robustness through shareholder sensitivities. Although Ofgem does ask for some shareholder sensitivities in Section 8B, this section is not currently graded. This will also allow Ofgem to further evaluate financial robustness of the bid and reassure Ofgem that the equity holders are suitably incentivised to continue operating the OFTO even if a number of major failure events occur.

- (d) [Are there any amendments to this package that would improve it?](#)

We believe that making small modifications to the tender document and process as described in part (c) above should improve this package.

- (e) [What are your views on the most appropriate ways to mitigate the challenges of this package?](#)

We believe that the following can help mitigate the foreseen challenges of this package:

1. In order to encourage more bidders to participate in the process that is open to unrestricted number of bidders, Ofgem will need to ensure that the bidders' costs are kept as low as possible. Ofgem could do so by getting more involved in the bid process and encouraging the developers to provide certain Vendor Due Diligence for all bidders (see our response to Question 6 below). Ofgem could also provide guidance around foreseen project risks and how risks should be allocated among all parties. While this will increase Ofgem's tendering costs, this increase should be partially offset by decreased bid evaluation costs.
2. Reduced quality of the ITT bids relative to the current process will be an inevitable outcome. We also agree that it might be challenging to determine whether on a cumulative basis the conditional aspects will take the bid below the required threshold. Additionally, we think that the potential impact on consumers / generator may not be realised for some time when it will be too late to limit the damage.

This can be partially overcome by retaining the pass / fail scoring of the robustness of each bid against clearly defined threshold limits. Ofgem can also set a threshold for overall conditionality acceptable, for example by allowing only a certain number of conditional responses per bid. The overall robustness of the bid, while not used as a part of the total score, can then be assessed against the price offered. To prevent the bias in selecting the lowest priced bidder regardless of robustness score, Ofgem can have two teams evaluating the bids – one evaluating the robustness and one the price, with bids not reaching the robustness threshold discounted. Ofgem can then pick the

lowest priced bid and decide whether the robustness ranking of that bid is sufficient to offer the best value.

- (f) [Are there other considerations we should have taken into account that present practical or other challenges to implementation?](#)

Yes, we believe that the following could present challenges to the proposal to make current Section 8 a threshold rather than a part of the final score:

1. Ofgem will need to establish what parts of the bid would be subject to passing a certain threshold and advise / consult on what constitutes appropriate threshold for both, consumers (which might want the cheapest bid) and the developer / generator (which might want a more robust but potentially more expensive operator). Additionally, Ofgem might potentially open itself up to legal challenges if it were to set threshold levels which prove not to be sufficient to guarantee robust OFTO performance in the future.
2. In setting out threshold levels for various parts of the bid, Ofgem might need to have an intermediate step, where bidders would set out their approach to key project risks and have Ofgem provide feedback on whether it meets the required threshold. Otherwise, Ofgem might end up in a situation where none of the bidders meet the required threshold.
3. As seen on all of the previous bids there are always a few outstanding issues from the ITT process that can only be resolved at PB. Ofgem will need to ensure that the bidders robustly address these items within their bids and that any increases in the TRS at PB stage do not undermine the assessed robustness (i.e. any increase in TRS at the PB stage such that its bid no longer represents the best value offer).
4. Finally, while we accept that the asset class is no longer new for the existing bidders, the new entrants may have difficulty accessing the learning that the existing bidders have. Therefore, we believe that new entrants should still have to prove that they are able to deliver robust operational package.

In terms of the proposal to only assess the two lowest price bids at ITT to determine whether they meet the thresholds, we believe that this option is open to alternative interpretation of the threshold by various bidders (and thus potentially abuse) and can lead to potential challenges by other bidders in the future.

- (g) [Where we were to allow conditionality only on particular elements of a bid, how should we take into account conditionality in bids which cumulatively raises concern about the overall robustness of the bid?](#)

As described in our response to (e) above, Ofgem can set a threshold for overall conditionality acceptable within the bid. Ofgem should then request the bidders to have a conditionality summary where the bidders will list the individual and total impact of all conditional items included. Ofgem might need to include an intermediate step in the bidding process, where bidders would set out their approach to key project risks and have Ofgem provide feedback on whether it meets the required threshold or how Ofgem would risk-price these items in the evaluation of the bids. Otherwise, Ofgem might end up in a situation where none of the bidders meet the required threshold.

- (h) Where possible, please quantify or describe qualitatively any benefits or burdens from this package of change.

We believe that the current tender process with minor changes proposed in our responses meets all of the Ofgem's set objectives; therefore, we do not see many benefits from introducing the moderate change package.

There will be no / or very limited impact on bidders' costs as the same level of due diligence would have to be undertaken. Ofgem's tendering costs could potentially be reduced; however, some of the proposed changes could actually prevent Ofgem from achieving its set objectives. For example, the number of bidders willing to participate in this process could decrease and experienced bidders who have proven their ability to successfully deliver transmission services might exit the market. These changes could subsequently lead to consumers not receiving the best value from the process over the whole revenue period.

Q5: With respect to the significant change package:

(a) Do you believe this option would be an improvement over the current tender process?

As stated above, we believe that the current tender process already allows Ofgem to meet all of its stated objectives and could be improved further with only slight modifications. We do not think that this option would be an improvement over the current tender process and believe that it could actually prevent Ofgem from achieving some of its stated objectives.

(b) Do you agree with our assessment of this package against the objectives?

1. We agree that there will be increased risk that the PB's arrangements to operate and maintain the OFTO might not be sufficiently robust, leading to either a failure of the tender process or a failure of the OFTO to fulfil its duties once licenced. While the proposed safeguards and consequential changes might help to partially mitigate this risk, they would counter some of the other objectives of the regime as described below.
2. We do not agree that 100% weighting on price will keep the TRS low. Especially when combined with the proposed safeguards, we think that the overall levels of TRS will actually increase. This is because:
 - (a) The bidders will have to undertake significantly more due diligence at the ITT stage (if it starts later), which will increase the bid costs at risk. This, combined with the proposed increase in the number of bidders, will most likely increase the cost of equity for future bids and the bidders would seek to recover these costs.
 - (b) The bidders, especially the experienced bidders familiar with the risk profiles of the assets, will most likely build in more contingencies into the TRS to price in every potential risk. The inclusion of the contingencies for the risks that might never materialise will not provide best value for consumers, which is one of the key objectives of the regime. This is particularly relevant for environmental, marine and technical aspects that are typically further developed at PB Stage.
 - (c) The bidders would have to price in the cost of the bid bond and further contingency costs to account for potential pain share.
3. We do not agree that that removing limits on those moving to ITT will mean that a higher number of bidders for these assets will emerge as existing bidders might chose not to participate due to higher at risk costs. Should this be the case, Ofgem might be left with unexperienced bidders who might not be able appropriately price in all of the risks, thus increasing chances of OFTO failure.
4. Additionally, it is not clear whether the OFTO supply chain will be able to commit the required resources to support the increased number of bidders, which might limit the number of bidders able to submit fully deliverable proposals.
5. Currently, bidders ask a significant number of questions at the ITT stage and this may be because the developers do not have a complete set of information. Delaying the start of the ITT process may help them to provide a more complete information package, but there is no guarantee that this will be the case. This leaves a risk that the generator clause is triggered before the parties are ready to transfer the assets.

We believe that the tender process as currently designed is robust and can be made more efficient with minor modifications.

(c) Are there any amendments to this package that would improve it?

We believe that it essential that some element of robustness assessment is retained as these complex and critical infrastructure assets require knowledgeable and experienced operators. Therefore, we propose that only small modifications to the tender document and process as described in our response to Question 4 part (c) are considered by Ofgem.

(d) What are your views on the most appropriate ways to mitigate the challenges of this package?

If Ofgem decides to proceed with the significant changes package, it could mitigate some of the challenges by asking developers to retain all known and unknown project risks at ITT stage so that bidders can price against “standard services delivery” considering only asset specific physical / location characteristics.

The bidders can then rely on VDD and undertake a full technical DD at PB Stage. The TRS can then be adjusted on the basis of new information discovered from detailed DD, including legal and environmental DD. This will enable the bidders to deliver the binding revenue stream under the significant change package with limited level of DD undertaken. However, this is unlikely to be very appealing to the developers.

(e) Are there other considerations we should have taken into account that present practical or other challenges to implementation?

While we agree that the regime is now well established, we disagree that it can be well understood by new entrants:

1. How can Ofgem ensure that new bidders can robustly operate these assets for 20 years without submitting fully worked up operating proposal?
2. How can Ofgem ensure that bidders submit fully credit approved funding proposals, notwithstanding any reasonable bid bond requirement?

(f) What do you think of potential bid bond arrangements, pain/gain share mechanism and consequential changes to allow efficient unconditional bids?

Potential bid bond arrangements

We believe that robustness score is still the most appropriate safeguard to ensure that the bidders submit only robust and deliverable bids. In our view, the disadvantages of using bid bond arrangements in the OFTO tender process will outweigh the benefits due to a number of reasons, including:

1. Poor value for money: any meaningful size of the bid bond will encourage bidders to build in surplus risk contingencies into the TRS to mitigate the risk the bid bond being called. This is particularly relevant to bidders who are familiar with the sector specific risks and understand the complexities of structuring robust OFTO business plans. In addition, the cost of procuring the bid bond will be priced by the bidders in the TRS.
2. Reduced deliverability of the bids: in the short term, bidders new to the OFTO sector may be tempted to disregard detailed independent external due diligence and risk management processes in order to minimise their bid costs at risk. This may lead to aggressive pricing of the bids and funding structures that are undeliverable at the PB stage.

3. Potential barrier for new entrants: the proposed bid bond arrangement could disincentivise new market participants from joining the OFTO tender process and could encourage existing bidders to exit the market. Some of the new bidders may view that offering a bid bond in the context of a new sector is too risky because of their unfamiliarity with the project and sector specific risks.
4. Inadequate risk transfer may lead bidders to withdraw: the consultation paper does not provide any details in relation to the likely terms and size of the proposed bid bond and how various delay events outside of bidders' control will be dealt with. These details are fundamental as some bidders could decide to withdraw from the OFTO market if they are required to bear risks they cannot control (including acceptance of loosely defined bond trigger events) or in case the bid bond is inadequately sized.
5. Balance sheet capacity: the bond providers require collateral security against the bid bond, which will consume credit lines available to bidders. The bidders with smaller balance sheets may be constrained in their ability to provide bid bonds on a sustainable basis and could choose to deploy capital and resources on projects they have already secured as opposed to limit their borrowing capacity on tenders at competitive stage.

Pain/gain share mechanism

Most of the OFTO projects were historically acquired through highly leveraged non-recourse project finance structures with a limited level of shareholder capital. This approach continues to deliver the best value for money to consumers and lowest TRS as the cost of senior debt is comparatively lower to other source of finance. The bidders' ability to absorb changes in the bond spreads is extremely limited as even small increases in spreads would result in a substantial erosion of the shareholder cashflows making the OFTO less robust in dealing with operational risks and its funding structure undeliverable. Therefore, an introduction of the pain and gain sharing mechanism on the bond credit spreads is likely to translate into a lower level of debt gearing on OFTOs and inclusion of risk provisions in the TRS delivering poor value for money to consumers.

Whilst the bidders are supported by bond arrangers during the tender process, the pricing of the bonds is driven by factors outside of bidders' control. Such factors include the general macroeconomic environment, investor appetite for comparable regulated transmission and distribution bonds, size of the bond issuance, operational performance of the existing OFTOs, project specific risks and the timing of the bond issuance.

- (g) **Where possible, please quantify or describe qualitatively any benefits or burdens from this package of change.**

We do not see any benefit in eliminating written part of the bid that shows robustness of bidders' approach. Experienced bidders will always undertake proper due diligence to bid a committed TRS, whether these due diligence activities are evaluated by Ofgem. If there are certain parts of writing the bid that the new entrants might find difficult, these can be reviewed by Ofgem and the specific problem areas addressed (see our response to Question 4 (c)).

Eliminating a written response that assesses robustness of bidder's approach to operations and finance creates a hazard that less knowledgeable bidders will win these projects on the basis of bidding a low TRS due to lack of understanding of the inherent risks of these assets. This will inevitably create issues at PB stage or during operating period.

Q6: Are there other packages of change that we should consider that would better deliver against the objectives?

Ofgem could consider making the following changes to help it reach its objectives:

1. Restructure the licence to give an opportunity to the OFTOs to revise their TRS (similar to a price review allowed for onshore transmission owners) over the operating period to encourage innovation. Over the course of the 20 years the OFTO may have to invest in new technology / processes to either keep pace with new “standard industry practices” or reduce ongoing operating costs. Allowing the OFTOs to re-profile its TRS (without breaching its funding covenants) to make the required upfront investment which then results in a lower TRS in subsequent years.
2. Play more of a role in encouraging efficient project design and implementation by the developers prior to asset transfer so that poor choices during design or construction phases do not increase costs during operational phase (e.g. the developer does not shift project costs from construction to operational phase). This could potentially be achieved by the OFTO bidders commenting on how the project design / construction / commercial structure negatively impacts operating costs and what potential changes could make the project more cost effective to operate.
3. Further remove ambiguity from the bid evaluation process and make the PB stage more efficient by providing a set of common bidding assumptions around the items that cannot be fully confirmed during the ITT stage; for example, assumptions around potential works or surveys that might be required to address cable burial issues.

Q7: With respect to the other tender process changes considered that could apply to either the current tender process or any of the potential packages for change:

- (a) Does Vendor Due Diligence (VDD) in practice reduce the total cost of a tender process? Are there any benefits in broad VDD? Are there benefits in a more focussed approach to VDD (for example a Certificate of Title)? Under what conditions and to what extent would bidders base their bid on VDD?

Yes, we found that the provision of a Certificate of Title does slightly reduce the bid costs (c.10% reduction in bid costs at risk depending on complexity of the onshore property arrangements), especially if the bidders can place reliance on the Certificate of Title provided and the liability cap is sufficiently high.

We could also consider placing reliance on the following VDD reports / information packages if these could be provided by the developer's advisers:

1. VDD report covering marine aspects of the assets, especially around seabed topography and conditions, final depth of cable burial analysis and marine aspects of the Offshore Substation Platforms.
2. Detailed summary of key features (amount, variations, liability caps, warranties) of all construction contracts transferring to the OFTO which can be subsequently reviewed by the bidders' and funders' legal advisers
3. Summary of all permits / consents / licences to be transferred to the OFTO and clarity around split of obligations and future environmental liabilities to be reviewed by the bidders' and funders' legal advisers

Due to a number of cable related issues encountered in the OFTO sector and the high value of the assets tendered, we would want to undertake our own technical due diligence, especially since the liability caps offered by the technical advisers are usually too small to protect the bidders from the impact of any potential omissions.

- (b) [Are there other cost-effective ways in which the bidder data room could be improved to the benefit of all parties? Are there specific ways to further standardise the structure?](#)

We believe that the data room and associated search functions have improved significantly over the tender rounds and find the layout and structure of the data room generally easy to navigate. However, the following improvements could be made:

1. From our experience each developer is able to define the structure of the data room as they prefer. We find that Ørsted has the most intuitive and easily navigable data room structures so would propose that this structure is used as a template by all other developers. This will help achieve consistency across all projects and save time that it currently takes bidders and advisers to familiarise themselves with each project.
2. During the ITT stage a lot of time is spent reviewing asset testing information; therefore, having Type, FATs and SATs in separate subfolders could be useful.
3. It would be helpful if Ofgem could provide a worksheet (similar to the worksheet provided for clarifications) for the documents which are uploaded on to the data room. This would allow for much quicker and more efficient management of new uploads to the data room on our end. Additionally, having an overarching document that links the master document index to the location within the data room would be really useful – especially if it is available at the start of the process.
4. We also think that the clarification process could be managed more efficiently. Currently, clarification responses come out at random time intervals; we would find it easier if the clarification responses could come out at set time each week. We understand that it might not be practical towards the end of the bidding process; but during the early / mid stages it would allow bidders and their advisers to be aware of when clarifications are expected to come out and plan the time and resources accordingly.

- (c) [What changes, if any, should we consider to our current bond spread methodology? Would an appropriate pain/gain share mechanism for bond-financed bids allow us to fairly assess bond and bank-financed bids on the same committed finance basis?](#)

We consider that the current credit spread methodology is appropriate for establishing guidance pricing for the bonds. Under the public bond financed approach the debt investors do not provide committed credit spreads. Bidders' continuous monitoring of the funding market, Gilt and LIBOR reference rates, engagement with prospective investors (as well as bond arrangers) and banks throughout PB stage ensures, in our view, the best value for money for consumers. Furthermore, our bond arrangers' reputation depends on each deal that they complete; this is sufficient incentive for them to perform well.

If Ofgem introduced a sharing arrangement for circumstances to encourage bidders to improve on the guidance bond credit spreads it could result in undeserved windfall gains for the OFTO. Therefore, on balance we do not consider it is an appropriate change to implement. Please see our response to question 5(f) in relation to the pain share mechanism for bond financed bids.

- (d) Do you consider that we could adequately rely on a more confirmatory approach to questions? Are there particular documents or questions we could consider not requiring the bidder to produce, but instead confirm?

Yes, we think that Ofgem could rely on a confirmatory approach to the following elements:

1. The proposed SPV ownership and structure has not changed since EPQ submission (replaces Section 2).
2. The documents included in appendices for Section 2 (shareholder agreement, articles of association and equity and loan notes) will be ready in time for Section 8A consultation.
3. The bidders understand and will comply with all of the relevant statutory and regulatory arrangements if selected PB, including unbundling requirements (currently Section 4C and Section 6K). This can become a part of the EPQ questionnaire similar in style to the current Section 2 of the EPQ template and removed from the ITT documents.
4. The bidders have procured all of the relevant technical, legal and insurance advice in preparing the bid rather than requiring the bidders to submit all of the due diligence reports. This will remove the need for a numerous versions of the DD reports issued by our advisors and could potentially reduce third party costs.

- (e) Are there particular documents/requirements that are better left to the PB stage?

As discussed in our answer to Question 3 above, the process of negotiating Transaction Documents with the developer during the ITT stage does not speed up the negotiations at PB stage. The process is not beneficial because:

1. The bidders are only able to submit general comments on the documents as the due diligence process is still ongoing.
2. The developers usually either do not respond to comments or reject them in the final version of the documents.
3. There is no scope to have a continuous dialogue around the documents; the negotiations are limited to a few hours when not much can be achieved. Even if there was an opportunity to have unrestricted access to the developer's commercial team, it would place a significant burden on the developer at the ITT stage to negotiate with all the bidders on all of the points, which might be unique to each.

Therefore, we suggest that bidders submit their comments on the Transaction Documents with the bid on the basis of DD undertaken rather than submitting general comments in the early stages of the ITT process. Once the PB is selected, the PB's comments can be passed on to the developer – this will help reduce the workload and meeting time for all parties.

- Q8: Do you think the approach of Ofgem, developers, and bidders to the tender process will need to change as projects become larger, further from shore and more expensive? What do you see as challenges from this change?**

Yes, we believe that each party might want to consider the following:

1. Ofgem might want to consider ways in which to encourage the OFTOs to explore and implement innovative ideas and methodologies as discussed in our response to Question 6.

2. Developers would need to be more proactive in assessing new technologies to address technical challenges of building more complex projects further from the shore. Commercial positions (construction and project warranties, split of environmental responsibilities, etc.) would also have to be reviewed.
3. Bidders would have to address significant increases in funding requirements by potentially looking at new sources of funding, as well as operational challenges presented by larger and more remote assets by exploring and implementing new technologies.

Q9: With respect to end of revenue term arrangements, where there continues to be a need for the OFTO, what factors should be taken into account when making decisions on OFTO revenue at the end of the normal 20 year term? When should we begin to make these decisions?

We believe that Generator's expectations and plans should influence the duration of the additional revenue term together with the estimated useful life of the physical assets. We think that relevant discussions should commence in year 15 of operations to allow appropriate planned maintenance activities to take place and for the OFTO to properly plan for a longer asset life.

Q10: Is there demonstrable evidence that we should consider changing the default revenue period away from 20 years for future projects? If so, what would be the most appropriate revenue period?

Extending the revenue period of the OFTOs beyond 20 years would provide a better value for money to consumers and ensure a more optimal spread of transmission charges across useful economic life of the windfarms. We believe that a 25-year revenue period would be the most appropriate for OFTOs as the appetite and pricing of debt from both bond investors and commercial banks for senior debt is likely to be maintained despite an increase in the average life of the debt. This, combined with the fact that the prevailing level of the blended cost of capital for OFTOs is below the current public sector discount rate used, means that the assessment will favour longer debt tenors.