

**“EXTENDING COMPETITION IN ELECTRICITY TRANSMISSION: COMMERCIAL AND REGULATORY FRAMEWORK FOR THE SPV MODEL”**

**SPT response to Ofgem’s consultation questions**

We have set out our response to Ofgem’s consultation questions in this document.

Our particular concerns include the following:

- Commercial framework - The framework draws on PFI/PF2 experience but electricity transmission engages very different legal, factual and operational considerations compared to PFI/PF2 projects. There is a material risk of mismatch between the obligations of: (a) the TO to the SO and, (b) the SPV to the TO. The framework also puts existing efficiencies at risk.
- Regulatory framework - The TO retains material risk despite being forced to delegate the performance of obligations to the SPV. The framework for the day-to-day operation of the network is unclear within the consultation. We do not agree with the proposed cost adjustment structure, which creates the risk of the TO being compelled to provide extra revenue to the SPV without being allowed to recover the extra costs under the licence. The introduction of the SPV model necessitates a careful review of the CUSC, STC and Grid Code, e.g. as regards liabilities.
- Procurement principles - The consultation characterises the SPV appointment process as TO led with the TO taking key decisions and responsible for legal compliance. This over-simplifies the position. Ofgem plays a critical role in the appointment process, and approves all key decisions. Ofgem must manage the risk of legal challenge. The risk of legal challenge against Ofgem, (e.g. judicial review of a decision to approve a preferred bidder), is material.

**Commercial Framework**

**Q1: What are your views on the commercial framework as set out in the accompanying Agilia report?**

We have a number of concerns with the commercial framework.

- (i) It draws on PFI/PF2 experience but electricity transmission engages very different legal, factual and operational considerations compared to PFI/PF2 projects.
- (ii) It does not appear to take into account the detailed framework already in place for making transmission assets available.
- (iii) There is a material risk of mismatch between the obligations of: (a) the TO to the SO and (b) the SPV to the TO.
- (iv) It does not appear to address the complexities of transmission system operation.
- (v) Costs and pricing are likely to be opaque.
- (vi) It puts at risk existing efficiencies.
- (vii) The lack of efficiencies to offset the costs of the SPV model.

We also explain that SPT already deploys a range of methods to introduce competition and innovation.

The framework draws on PFI/PF2 experience but electricity transmission engages very different legal, factual and operational considerations compared to PFI/PF2 projects.

We are concerned that the Agilia report draws too heavily on experience from projects for discrete assets such as schools and hospitals and does not reflect the way that electricity transmission works in practice.

The framework does not appear to take into account the detailed framework already in place for the making available of transmission assets

Electricity transmission in GB is delivered by two different types of transmission licensee:

- the System Operator (**SO**), National Grid, who ‘co-ordinates, and directs, the flow of electricity’<sup>1</sup>; and
- the Transmission Owners (**TOs**) who own the transmission assets in their respective areas and ‘make’ those assets ‘available’ to the SO<sup>2</sup>.

Both the SO and TOs are required to ‘develop and maintain an efficient, co-ordinated and economical system of electricity transmission’<sup>3</sup>. The transmission services which the TOs are required to provide to the SO are also more specifically described in their licences.

Considerable additional detail about how both the SO and all the TOs shall comply with their various obligations is set out in the STC. Amongst other things, these details include specification of how planned or emergency outages will be handled and what liability they each will carry, e.g. when part of a network is unavailable. The STC also places various obligations on both SO and all TOs to communicate with each other, in real time, so that the entire national transmission network in GB operates as a single, synchronised, grid.

For electrical safety, as well as security of supply reasons, that unified co-ordination is essential.

There is a material risk of mismatch between the obligations of: (a) the TO to the SO; (b) the SPV to the TO

As we understand the framework:

- The SPV will contract with the TO;
- The TOs will remain responsible for the provision of the relevant SPV services to the SO under the STC.
- The TOs will remain responsible for the SPV’s activities under their licences and the EA’89.

There is a material risk of mismatches in obligations and outcomes under this arrangement. By way of example:

- TOs may not be able to back off their obligations in full.
- The BETTA arrangements are subject to change, via the code modification processes. It is unclear how and to what extent these changes will be passed on to the SPV.
- TOs are exposed to potentially unrecoverable costs. We note that the Delivery Agreement (**DA**) will be entered into by the TO and the SPV, and that the TO will have the direct contractual relationship with the SPV. Under certain cost adjusting events scenarios it is the TO’s responsibility to adjust the SPV’s revenue accordingly as set out within the DA. A corresponding pass through from Ofgem is explicitly ruled out in the consultation. Such an arrangement clearly adds further risk and exposure to the TO, who is being expected to both implement and manage this complex commercial arrangement with the SPV.

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<sup>1</sup> A role described in section 4(3A)(a) of the Electricity Act 1989 (EA’89) and performed by National Grid.

<sup>2</sup> Section 4(3A)(b) of the EA’89.

<sup>3</sup> Amongst other things, see S9(2) EA’89.

### The commercial framework does not appear to address the complexities of transmission system operation

We are unable to identify any public analysis on the part of Ofgem that addresses how the SPV arrangements will address the complexities inherent in system operation. As an example, we cannot identify any detailed analysis in the consultation that reflects a review of the SPV's role in the context of each of the STC obligations noted above.

It may be that Ofgem considers that such work should be carried out in the context of the development of the DA. Ofgem commits to producing Delivery Agreement Guidance, (**DAG**), which will include the finalised version of the DA commercial agreement. Given the importance of both the DAG and DA, it is essential that both documents are subject to a full consultation exercise, allowing all parties to offer comments before the DA framework is finalised.

Further consultation is essential to ensure that any decision to introduce the SPV is best calculated to promote efficiency and economy on the part of transmission licensees, and to ensure that any SPV arrangements protect the public from dangers arising from the generation, transmission, distribution and supply of electricity. The extent of this work should not be underestimated.

### Costs and pricing are likely to be opaque

Even if it were possible to attract a number of bidders to a SPV tender, bidding fixed prices can make it more difficult to identify the different cost drivers in electricity transmission. For example, our experience suggests that agreeing liquidated damages can lead to price inflation, which is difficult to counter in a set price model.

### It puts at risk existing efficiencies

In relation to the necessary construction activities, it is important to recognise that significant competition already exists in the existing regulatory model. SPT competitively awards a significant proportion of the construction and maintenance of onshore transmission, frequently issuing tenders to the market and looking for new ways to drive further efficiencies, ultimately to the benefit of consumers.

The framework is in contrast to the existing price control where consumers benefit by a sharing factor of 50% on any cost efficiencies the TO's can achieve against their revenue allowance. This incentive appears to be absent in the SPV model, adding to consumer detriment.

### The lack of efficiencies to offset the costs of the SPV model

We do not consider there to be any clear cost efficiencies presented in either the consultation document or associated Impact Assessment (IA).

In fact, given:

- the complicated nature of the relationship between the TO and the SPV;
- the proposed introduction of enhanced securities;
- the elements of design risk requiring to be backed off;
- the potential for novation/collateral warranties;
- the additional interfaces and relationships to be managed given Ofgem and the ITA's oversight roles;

the direct cost and indirect consequences (e.g. time and resources) will be "baked in" to a long term contract price. This is likely to be higher than the cost of existing means of delivery of transmission services.

We dispute Ofgem claims that the move to the SPV model can bring "*10% capital and operational cost savings*". The evidence based data and analysis on which Ofgem has reached these

assumptions is not evident in the IA which we would have expected to see as part of the consultation exercise. It is incumbent on Ofgem to provide further clarification as to what data sources have been used in making these assumptions. In particular, evidence from the OFTO regime is absent, yet this sector is cited as a basis for much of the current approach. That said it is SPT's view that OFTOs operate under a different regulatory environment and price control structure, rendering them weak comparators.

#### SPT already deploys a range of methods to introduce competition and innovation

SPT currently tenders a significant proportion of the construction and maintenance of our onshore transmission network on the open market.

The activities which SPT carries out in-house include both some of the more complex maintenance activities and the synchronised operation of the network with the SO. Those operational and maintenance activities are deliberately delivered in-house due to the critical nature of the work and the efficient way in which we mobilise our teams across Scotland, to safely operate and maintain our transmission network. SPT uses in-house staff to operate the network, given the specialised and technical nature of this work. SPT also uses in-house resource to undertake maintenance activities for our overhead lines and substations, which require network outages to be planned with the SO years in advance. SPT uses outsourcing arrangements where it can / wherever appropriate, including where it is demonstrably more efficient, for example in relation to tree cutting.

Since 2010, SPT has moved towards a disaggregated model of contracting for less specialised, maintenance activities. This is where separate contracts for individual disciplines are openly tendered and awarded (civils, building works, cable supply and install, balance of plant, OHL works, OHL access, enabling works, demolition and frameworks for all main plant). This change has allowed SPT to expand our supply base to target more specialised smaller contractors, widening the supplier options (and therefore competition), and reducing supply chain reliance on a smaller number of large contractors. It also helps SPT to keep the performance of supply chain work to a high standard.

As SPT tenders for work in bulk, to deliver services across our entire transmission network, we fundamentally disagree that the proposed SPV would be able to deliver its smaller, contracts for a lesser cost than SPT's current approach, particularly when the SPV is tendering for work on a very small section of transmission network. SPT contracts are particularly attractive to the market, because of their scale and continuity. This results in greater competition between bidding parties, thereby encouraging cost efficiencies that a SPV would not be able to replicate.

We make separate comment in relation to the IA in our accompanying letter.

#### **Q2: Do you agree with the scope of our role in the SPV model?**

Our fundamental objection is, as set out in our covering letter, that the SPV model is an unlawful divestment of regulatory responsibility by Ofgem. Subject to that overriding observation, our comments on the detail are as follows.

In summary:

- (i) Ofgem's role has not been articulated in sufficient detail.
- (ii) The proposed arrangements increase costs.
- (iii) The roles of Ofgem and other parties, such as the ITA, are not clearly delineated.

#### Ofgem's role has not been articulated in sufficient detail.

The consultation document leaves many unanswered questions. For example, in relation to the tender exercise, is the intention that Ofgem will scrutinise the financial/technical/commercial position of the

bids alongside the TO in detail? Does Ofgem intend to set pre-qualifying requirements, similar to that of a TO, for an entity wishing to bid for the SPV? What happens in the event that Ofgem disagrees with the TO's selection of preferred bidder?

We would also welcome further clarification on Ofgem's role as 'overseer' of the SPV model and how it sits alongside the proposed ITA, who appears to have a similar role, during the construction, operational and hand-over periods. To what extent will Ofgem get involved in commercial negotiations between the TO and the SPV?

#### The proposed arrangements increase costs

There is no doubt that this more complex relationship between Ofgem, the TO and the SPV will lead to administrative and resource burdens, on the TO and Ofgem. We cannot see how this more complex relationship can deliver any net benefits to consumers. Ofgem have failed to provide details of these benefits in either the consultation document or Impact Assessment.

#### Lack of clearly delineated roles

On a more general point, we consider that the roles and responsibilities of all parties involved in the SPV model, i.e. Ofgem, the TO, the SPV and the ITA remain unclear and we urge Ofgem to include a more detailed breakdown of the roles and responsibilities of all parties within the DAG as a matter of priority. Given the importance of the DAG and DA, we expect both documents to be subject to a full consultation exercise, allowing all parties to offer comments before the DA framework is finalised.

### **Q3: 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?**

In summary there are a range of matters that must be clarified including:

- (i) the stage of appointment of the ITA;
- (ii) what happens if the ITA arrangement comes to an end?;
- (iii) management of deadlock;
- (iv) process for recourse to the ITA;
- (v) enforceability of and challenge to ITA decisions;
- (vi) potential for mismatch between Ofgem and ITA determinations;
- (vii) is the ITA a quasi judicial role?;
- (viii) the independence of the IA.

In light of the complex nature of the TO and SPV relationship, it is sensible that there is a mechanism that provides for the resolution of disputes. There is potential for disagreement in the requirements and outcomes sought by each TO as each party has a different value proposition. The TO is seeking procurement of a robust, enduring and efficient asset to a well understood and acceptable standard, whilst the SPV is aiming to deliver an asset at low cost with cash flow and margins maintained. The ill-defined allocation of responsibility in the operation of the transmission network further increases the likelihood of a dispute arising.

#### Stage of appointment

It is unclear at what stage the ITA is appointed. The operating costs and the legal exposure of the ITA is likely to be significant and this may need to be a factor in determining the successful appointee.

The consultation seems to envisage involvement by the ITA during construction, maintenance and operation, up to and including providing specialist support during the hand back of assets. Is it intended to make an appointment for the full period of construction and operation?

#### What happens if the ITA arrangement comes to an end?

Could the SPV arrangement proceed in the event of the ITA arrangement coming to an end, either because the parties could not agree the appointment or the relationship ended during operation?

#### Management of deadlock

The DAG document will need to set out a comprehensive framework so as to avoid the ITA mechanism leading to deadlock. We note that there are no proposed arrangements for deadlock resolution between the TO and the SPV, which the ITA is unable to resolve. Given the complexity of the TO and SPV, this is an omission that will need to be addressed and fully clarified in the DAG.

#### Process for recourse to the ITA

The consultation and the Agilia report describes, at a high level, the tasks and responsibilities to be assigned to the ITA. However, the documents fail to provide a clear framework according to which either the SPV or the TO might have recourse to the ITA. Is there a staged resolution process? The guidance to date on the ITA is silent on the process or mechanisms through which the ITA could provide certainty to the TO, the SPV or other interested parties in resolving difference opinion.

#### Enforceability of and challenge to ITA decisions

To what extent is a determination of the ITA binding? Is it subject to a review or other appeal? How is a determination of the ITA enforced? The consultation documents do not examine the extent of the jurisdiction enjoyed by the ITA. What remedies can the ITA order? For example, it is unclear whether the ITA would have the power to oblige either party to continue to perform its duties or execute works pending resolution of the dispute.

#### Potential for mismatch between Ofgem and ITA determinations

The jurisdiction of the ITA should also speak to the relationship that the TO maintains with Ofgem and the SO under the TO's obligation to satisfy its statutory obligations and compliance with the relevant regulatory codes. For example, if Ofgem under those regimes finds the TO to be in breach of obligations that the TO has assigned to the SPV, is the ITA at liberty to disagree?

#### Is the ITA a quasi-judicial role?

The role seems akin to the Engineer that is commonly seen in EPC contracting. This, however, remains unclear. Ofgem must give guidance on whether the role of the ITA is primarily a source of technical assistance or whether it operates in a quasi-judicial function. Understanding the precise function of the ITA would be key to ascertaining who would be suitable for the role. For example, we assume that the role could be assigned to either an individual or firm.

#### Independence of the ITA

We also have concerns about the perceived independence of the ITA given that the arrangement is to be financed through the SPV. It is also suggested that the ITA might provide a function to other relevant parties including Ofgem and the SPV's financiers.

There is a risk that by answering to all parties involved in this complex commercial structure, the independence of the ITA is prejudiced. Is the primary duty of the ITA to pursue objectives set by Ofgem or is it the impartial resolution of disputes? It is unspecified which of Ofgem's objectives the ITA is enlisted to protect. Moreover, if the ITA owes its primary duty to Ofgem, it is not an impartial, and therefore appropriate, arbiter of contractual disputes between the TO and the SPV.

Given the cost impact of compensation and relief events, together with the associated potential for delay, confidence in the ITA to reach a satisfactory resolution would be fundamental to investor confidence in the SPV model.

#### Costs of the ITA

The Impact Assessment suggests the estimated costs of this appointment over the lifetime of the project as being between £0.5m and £1m GBP, with little detail as to how these figures were derived and what they include. For example, do these figures solely account for overseeing the delivery of the construction and operation of the asset or do they also account for any potential disputes between the TO and the SPV during the operational period, and difficulties or disputes during the complex transaction of hand-over? The number of disputes that may be referred to the ITA, and the efficiency with which they could be resolved, could not be accurately quantified at this point given the unprecedented nature of the role. It is precarious to presume that an ITA would commit to a fixed price for the full period of 25+ years. In determining the value of this model to consumers, it is important that all costs are reflected and transparently detailed in the Impact Assessment.

#### **Q4: What are your views on operational period incentives for the SPV?**

As Ofgem is aware TOs are under a range of important incentives under the RIIO arrangements. SPT accepts these incentives on the basis that it has control over the activities required to meet the incentives. The compulsory delegation of the TO's functions to an SPV under a contract, determined by Ofgem, cuts across this.

SPT's position is that all relevant incentives will have to be reviewed and be capable of being backed off to the SPV, with appropriate indemnities in place so SPT is kept whole for any losses arising due to SPV acts and omissions.

This likely means that the SPV's incentives will have to match those which flow from the TO's licence conditions. This would allow the TO and the SPV to share the incentive to maintain availability as well as recognise that the TO will continue to be subject to a statutory obligation under its licence, whilst the SPV will be subject to a contractual obligation under the DA.

In terms of availability, the operational incentives framework should reflect whether an outage is beyond the control of the TO or contractor, for example, as a result of a major storm that an asset could not reasonably have withstood. It should also recognise that there may be occasions where the SPV's conduct has an impact on the TO's performance, in which case the TO should not be penalised under the incentive regime.

Overall, the use of incentives for the SPV model is unclear. Is the proposal that the SPV and the TO would share equally in the reward for maintaining baseline operation?

Clear details on the incentives available, and how they can be updated when the TO's incentives are updated, will be an important part of the DA. We therefore expect specific details on the proposed incentives available during the operational period to be detailed in the DAG, and the mechanisms fully consulted upon before being finalised.

#### **Q5: What are your views on where there may be consumer value in a target cost rather than fixed price model?**

It is appropriate that all pricing models are considered. Fixed price will drive certainty, subject to certain pre agreed re-openers or works variations required, but does remove certain elements of price

transparency. In terms of target cost, again this model has both positive and negative elements, in particular where margin is assumed in any upside for the SPV.

It is unclear if Ofgem envisage a consumer share in a target model approach or if this limited to the arrangements between the SPV and TO. In either scenario, we would have concerns that the SPV would prioritise margin over long term quality, and if target cost is to be considered, then the benefit of it should be linked to the long term operation of the asset over the full period of its use and not simply the relatively artificial period of 25 years of SPV control. Any “upside” paid to the SPV should also be in accordance with achievement of the pre-determined maintenance standards and availability outcomes for the asset. To protect consumers, those maintenance standards and availability outcomes must be identical to those which SPT are required to follow, which Ofgem has assessed as being efficient through various price controls.

We also believe that it may be prudent to consider re-measurable contracts in certain cases, in particular for the construction of particular assets. The signal to the market should be that this is for the SPV to propose in producing an efficient bid.

Given the complexity of the proposed SPV model, SPT considers that cost overruns and delays during the tendering exercise and the construction, operation and maintenance periods are inevitable. Ofgem evidently agrees, given that the proposed SPV model regulatory framework is not being applied to the Hinkley Seabank project and offers provisions for the TO to allow for price reopeners for the SPV. Where price reopeners exist, it is inevitable they will be claimed as we have already seen on a number of occasions under the OFTO regime, and this will need to be borne in mind when considering the appropriate pricing model. The level and frequency of these claims will also have an impact on the likely costs and benefits of any SPV model overall, as well as the overall resourcing required by all parties, including Ofgem.

The Chancellor of the Exchequer’s announced in the latest Budget, in October 2018, the abolition of PFI and PF2 contracts given the compelling evidence that these contracts neither deliver value for taxpayers, nor genuinely transfer risk to the private sector. In light of this we call upon Ofgem to review their onshore competition proposals as both PFI and PF2 contracting have strongly influenced Ofgem’s design of the SPV model.

**Q6: What are your views on possible TO and SPV enhanced alignment options?**

Overall, the consultation documents provide little clarity on the respective duties of the parties under the DA. It is therefore difficult to anticipate how the enhanced alignment options might create an effective incentive to each of the TO and the SPV. Further development of the potential for and relative advantages of, both of these models will require a more detailed understanding of the practical, legal and commercial responsibilities of each party.

The proposed alliance agreement is predicated on an ‘incentive pot’ which distributes ‘an element of savings’ between the TO and the SPV. Crucially, the Agilia report does not explain how the savings are identified, how they are collected and how they are distributed between the parties.

An alliance model is predicated on the common sharing of objectives and goals i.e. in effect the TO (owner and operator) having the same objective as the SPV (construction, operation and maintenance). As the TO, our primary concern is to ensure that after the 25 year operational period, we obtain an asset that is delivered safely, efficiently, i.e. on time and in budget, and which will continue to enhance network integrity and stability, maintaining security and quality of supply. On the other hand, the SPV is providing a service for an asset with a potentially sub-optimal operational lifespan, and will be focussed on margin throughout the construction phase and operational phase. These goals may not be mutually inclusive and could create risk of divergence without real opportunity for alignment.



Allowing the TO an equity stake in the SPV might help alignment and should be considered further as part of the next phase of work. However, this would depend on a range of factors such as the rights attaching to the shareholding.

**Q7: Are there any other points we should consider within the commercial framework?**

Ofgem needs to be mindful of the challenges introducing the SPV model could bring. These challenges include: (i) SPV financial risk; (ii) availability of SPV bidders; (iii) assumptions about capex spend (iv) funders' security requirements.

SPV financial risk

With the financial risk largely being allocated to the SPV, to what extent have Ofgem reviewed (from a qualitative and quantitative perspective) the construction market and assessed the financial covenants of potential market players to ensure against cashflow/insolvency issues?

It will be essential that the financial standing of potential SPV bidders is stress tested within the tendering process to provide a measure of confidence that the successful SPV will be able to discharge its obligations and deliver the agreed outputs over the 25 year operational period – particularly in cases where bidders are very highly geared.

However, it must be accepted that a financial stress test during the bidding process does not guarantee solvency throughout the 25 year term, and arrangements are required to ensure that the SPV remains financially robust throughout the 25 year appointment term.

Availability of a wide pool of bidders

Are Ofgem confident that the UK construction market or indeed international market will be able to deliver such SPVs? If so, Ofgem's assessment of this should be made publically available.

Assumptions about capex spend

Ofgem's assumption of an even capex spread over the lifetime of the construction period is not reflective of commercial reality or project milestones. Given the risk allocation on finance, we would expect to see significant cash flow requirements at the start of the project to allow contractor mobilisation and management of their own supply chain.

An example of an issue here is Brexit. Has Ofgem considered the impact of Brexit on the availability of resource in the UK supply chain? Does Ofgem expect more international contractors to tender for these type of works, and if so, will Brexit have an impact on this?

Funders' security requirements

Have Ofgem fully tested their proposals with the funding market, e.g. whether funders of a project finance model will be willing to rely solely on the DA for their rights to recovery, or will they also look for payment guarantees from, for example, the SO?

## Response to Ofgem Questions: Regulatory Framework

### Q1: What are your views on the regulatory framework as set out in this consultation, and how it interacts with the commercial framework?

We highlight the following points:

- (i) The SPV model is an unlawful divestment of regulatory responsibility by Ofgem.
- (ii) The SPV proposal unlawfully circumvents the EA'89 statutory licensing regime.
- (iii) TO retains material risk despite being forced to delegate the performance of obligations.
- (iv) It is difficult to see how all relevant TO obligations will be passed through to the SPV.
- (v) Complex and potentially contradictory enforcement mechanisms will add cost.
- (vi) References to Ofwat direct procurement should be approached with caution.

#### The SPV model is an unlawful divestment of regulatory responsibility by Ofgem

We refer to our comments in our covering letter. Ofgem's inability to take enforcement action against the SPV is a fundamental structural defect in the SPV model. We do not see how Ofgem's proposed divestment of powers in respect of significant transmission assets is compatible with Ofgem's legal duties.

#### The SPV proposal unlawfully circumvents the EA'89 statutory licensing regime

The SPV's activities mean that it requires a transmission licence. The SPV proposals appear designed to circumvent this requirement. As we have explained above and in our covering letter, we do not agree that it is lawful for the regulatory framework to be adapted and applied in this way. Our response highlights various ways in which the statutory and regulatory framework would be frustrated by the application of the SPV model.

Clearly the potential for any such frustration should be a source of significant concern as it goes to the heart of Ofgem's ability to ensure the licensee provides an economic, co-ordinated and efficient transmission network that works in consumers' interests.

#### TO retains material risk despite being forced to delegate the performance of their obligations

TOs will be subject to a set of statutory and licence obligations and will have a very limited ability to control compliance with these obligations. TOs will face the risk of a disconnect between: (i) their statutory and licence obligations; and (ii) the obligations of the SPV to the TO.

#### It is difficult to see how all relevant TO obligations will be passed through to the SPV

It is unlikely that the suite of SPV documents, including any DA could be written in a way which fully 'passed through' the various obligations which the TO is under; e.g. section 9 of EA'89 and the Standard Conditions of its licence.

A reason for this is that it is difficult to see how an SPV could accept the same level of obligations as a TO.

A TO has an important statutory protection: Ofgem must have regard to the TO's need to be able to finance its activities. That protection means that the TOs are able to take on relatively absolute obligations to provide continued, safe and effective transmission services. The SPV would operate under a contract, the DA, which could not be backed with similar protections. Indeed the ability of the SPV to re-open its revenue stream appears to be limited. It will therefore be unable to accept similarly absolute obligations.

### Complex and potentially contradictory enforcement and dispute resolution mechanisms will add cost

A further concern is that the resolution of disputes between Ofgem, TOs and the SPV may be extremely complex and will add cost. For example, what would happen if the SPV fails to maintain a transmission tower? The failure of the tower would lead to an unplanned outage, a potentially material set of balancing mechanism costs, increased risk of loss of power to numerous customers and damage to the wider transmission network.

In such circumstances, the TO may face loss in the form of payments under the RIIO incentive mechanisms and fines resulting from Ofgem enforcement action.<sup>4</sup> The TO may be able to make a claim against the SPV under the DA for any loss that it suffers. However, this claim may encounter difficulties:

- (i) the DA is not likely to make adequate provision for the claim. It is difficult to see how a DA with open ended liability would attract bidders at sensible cost. It follows that liability would have to be capped well below the limit applicable to Ofgem financial penalties and incentive payments.
- (ii) In reality there may be ambiguity around the circumstances of the outage or the liability of the SPV which makes a claim difficult to pursue; and
- (iii) the SPV will choose to contest its liability, either via the ITA or through some other means, e.g. robust defence of a court action raised by the TO.

From experience of the operation of construction and maintenance contracts, it is entirely possible that there could be ambiguity and it is highly likely that the SPV would contest liability.

At or around the same time the TO may face legal proceedings including:

- (i) Enforcement action by Ofgem. Ofgem could find that the TO was in breach of its statutory and/or licence obligations.
- (ii) Claim for breach of contract from NGET or another TO under the STC or the TO's construction agreement with the SO.

As currently proposed, under the SPV model, the same failure could give rise to at least three distinct legal proceedings. Even if the terms of the DA were identical to the TO's statutory, and licence obligations, the STC and other obligations (which is unlikely for the reasons described above), those legal proceedings would be decided by different people, potentially applying different legal standards. It is not possible to draft the DA to remove the risk to the TO of multiple actions which ultimately leave it exposed to legal and financial risk through no fault of its own.

It is difficult to see how such a scenario leads to regulatory certainty or minimises costs.

### References to Ofwat direct procurement should be approached with caution

Ofgem makes reference, in the consultation document, to the direct procurement activities of the water sector. However, we understand that there are some important differences in the regulatory arrangements under which Ofwat is developing its Direct Procurement for Customers. In particular, the prohibitions on unlicensed transmission (amongst other things) contained in section 4 of the Electricity Act 1989, do not appear to have an equivalent in the Water Industry Act 1991. This would mean that whilst water companies do operate under 'appointments', it is not a criminal offence for someone to provide water infrastructure without a licence. As Ofgem are aware, it is a criminal offence for someone to engage in electricity transmission without a licence. The regulatory regime for water may therefore be more permissive than that for electricity. We note other important differences between water and electricity in response to question 6 below.

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<sup>4</sup> Note that we fail to see how fines would be lawful in circumstances where the TO was in no way at fault.

## **Q2: Do you agree with the scope of TO obligations during the pre-tender, tender, construction period, and operational period?**

Despite the limited details within the consultation document, the scope of obligations on the TO at all stages in the project are complex and extensive, increasing the likelihood of additional delays and costs when compared to the current regime.

We note the similarities between the 'late' CATO model and the proposed SPV model, in that the TO continues to be responsible for the relevant pre-construction activities. The proposed approach will not improve upon the existing approach for delivering important strategic infrastructure. In fact, we consider that the proposed process will potentially add delay and is likely to reduce efficiency and co-ordination compared to the existing process. The pre-tender approach being proposed is a linear model and relies on completing each stage to reduce risk and uncertainty. However the current process provides much more flexibility and allows for TOs to deliver the design, planning and consenting activities in parallel, minimising risk and maximising efficiencies.

The preparation of the tender documentation and the drafting of the DA will be a timely, resource intensive and complex exercise for the TO. It will be important to understand what role, if any, Ofgem intends to take in this important exercise and if it intends to offer support and advice to the TO during this drafting exercise?

### **Pre-Tender Phase**

#### **Planning Permission**

The Agilia paper refers at page 4 to the SPV carrying out detailed design in accordance with the preliminary design and specification set by the TO, and adopting as its own the preliminary design.

One difficulty with this is that it seems to ignore the fact that the TO is subject to statutory duties under section 9 and also Schedule 9 of the Electricity Act 1989. The Section 9 and Schedule 9 duties are to be discharged by the TO. Scottish Ministers are also under a duty in Schedule 9 in considering any relevant proposal for section 37 consent to consider the extent to which there has been compliance with the Schedule 9 duty. There does not seem to be a similar obligation imposing those statutory duties on the SPV. The difficulty envisaged with this is that it will be the TO (as the party applying for section 37 consent) who will have to discharge the duties but will have to do so in a situation where the actual detailed design has been 'delegated' to the SPV, and with no recourse to the TO.

A further difficulty with what is proposed by the consultation document is that it will be the TO which has to defend the SPV's detailed design at the planning permission application stage and invariably through public inquiry. There is potential that this will create duplication of effort. For example, there will have been initial design and environmental work by the TO and it would seem there will have to have been similar input by the SPV and its consultants in developing the design and taking it through the Environmental Impact Assessment process. It is difficult to see how the detailed design work by the SPV can be disengaged from the Environmental Impact Assessment process and public, stakeholder engagement.

The consultation is not clear in what happens if during the planning permission application process, some changes to the detailed design are required or it would be sensible to offer them up. Would the TO have the right to do so or are the proposals made by the SPV 'frozen' at the stage?

#### **Land Rights**

Land use is another area which will undoubtedly bring potential complexities, delay and additional costs. A critical issue to deliver transmission projects is gaining land access to enable construction work on an approved route.

#### **Stakeholder concerns**

We anticipate that landowners will be at best reluctant, and at worst, unwilling, to grant rights in favour of, or which are capable of, being transferred to an unknown third party. SPT has worked hard over

many years to build positive relationships with landowners and communities alike. We would be concerned if our good reputation is tarnished due to the activities of a third party, associated with SPT, who may not dedicate the same amount of time and endeavour to community engagement. Bearing in mind that after the 25 year operational period, we will then take over operational responsibility for the asset, this will undoubtedly make relationships with landowners more complex.

#### Voluntary acquisition of land rights

The proposed SPV model envisages that land assembly and the acquisition of land rights will be achieved pre-tender on the basis of the preliminary design work undertaken by SPT. The design of any major transmission project is environmentally led and requires to be subject to environmental impact assessment. The nature and extent of the land and rights required to deliver the project can therefore only be accurately identified at a point where that assessment has been completed and the design is at a very advanced stage.

Securing voluntary land rights can only be undertaken once there is detail on the line route, limits of deviation, exclusion zones and access routes to the land. If voluntary land rights are secured without the benefit of that detailed design, it is highly likely that subsequent fresh land rights will need to be secured to reflect the finalised design.

Securing voluntary land rights at the pre-tender stage also means that the SPV would have very limited opportunities to innovate on an existing design.

#### Compulsory acquisition of land rights

Where land rights cannot be obtained on a voluntary basis, SPT has statutory powers (by virtue of Schedule 4 of the Electricity Act 1989) to obtain those rights by compulsory acquisition, where appropriate. SPT may promote a Compulsory Purchase Order for the acquisition of land, or a Necessary Wayleave for the acquisition of rights over land (together referred to as “CP Powers”).

Page 17 of the consultation document suggests that the TO will identify parcels of land required to construct and operate the transmission assets. The Agilia report suggests on page 3 this will be done at the pre tender and tender phase. SPT’s view is that it would be premature to acquire private land at this stage in the process, particularly by virtue of CP Powers.

The use of CP Powers must be proportionate. CP Powers interfere with private property rights and their use must be balanced against the landowners’ right to their private property as set out in the European Convention on Human Rights. It is therefore essential that land is not over-acquired. Seeking to acquire land at this stage increases the risk of that.

The extent of land required will be informed by issues such as environmental impact mitigation, compliance with planning permission conditions, and variations made through the planning permission application process. None of these essential factors will be known at the preliminary design stage. Seeking to acquire land at this stage, particularly by virtue of CP Powers, would risk giving the impression to landowners and members of the public that the route and design is fixed, and that there can be no adjustments. This would potentially undermine their right to participate meaningfully in the consenting process.

#### **Tendering Phase**

We note that the proposed tender assessment criteria and process does not include a project specific impact assessment. A cost benefit analysis assessment should therefore be included as part of the proposed tender process. Such a step is important to understand what benefits, if any, introducing competition will bring to a project, compared to the current regime. Whilst this may lengthen the process, the delay is unlikely to be material and it is fundamental to ascertain whether extending competition in this way will actually deliver consumer benefits, before the tendering exercise is embarked upon. We would expect this step to be built into Ofgem’s proposed tender assessment criteria within the DA.

As the TO will undertake the high level design (the extent of which is unclear) and consenting activities before passing to the appointed SPV, it will be the responsibility of the SPV to undertake the detailed design work. This could be an issue for potential bidders during the tender exercise and

could lead to cost uncertainty on the basis that it may not be possible for fixed bids to be submitted, given unknown risks in relation to the finalised design. This could lead to delays during the tendering phase if the Invitation to Tender (ITT) stage does not result in fixed price bids or even in comparable bids.

Another area which could bring additional delay and costs is Ofgem's suggestion that if the initial tender exercise fails to identify a preferred bidder, the default action is for the TO to run a new tender exercise, or re-run the tender from a previous stage, taking into account the reasons for the original tender's failure. We note that Ofgem intends to take a role in approving the tender documentation, before the tender exercise can proceed. Given Ofgem's role in approving the tender documentation, we see no reason why the tender exercise should be rerun, leading to further delays in delivering strategic infrastructure. Where a tender exercise fails to identify a preferred bidder, the TO should 'step-in' and deliver the asset under the principles of the relevant RIIO framework at that time.

We note that Ofgem intends to have a role in approving both the appointment of the preferred bidder, at the conclusion of the ITT stage, and the final contract award at the end of the preferred bidder stage. We would be keen to understand what would happen in a scenario where Ofgem did not agree with the suitability of the TO's preferred bidder. In such a scenario, would Ofgem refuse to approve the appointment and expect the tender to be re-run? As set out above, we disagree with the proposal that any tender should be expected to be re-run, given that Ofgem's approval of the tender documentation has already been secured, before any tender exercise commences.

### **Construction Period**

Our understanding of the documentation is that the TO will not have a role during the construction period, and that all responsibilities will lie with the SPV in finalising the design and then constructing the asset. If Ofgem does intend or expect TO involvement during the construction stage, then this should be set out clearly in the draft DAG, allowing us the opportunity to comment on any new proposals.

### **Operational Period**

The involvement of third parties in an operational role introduces a risk to the reliability of the transmission system and security of supply. Therefore, the clear allocation of roles and responsibilities between the TO and the SPV during the operational phase are crucial. We consider that the details of these roles and responsibilities are currently insufficient and unclear. For example, these SWW networks are likely to have various points of interconnection with the wider transmission network and serve multiple customers. As we explained in our response to question 1 above, it is essential that the transmission system as a whole is operated on a co-ordinated synchronised basis.

In real time it may be necessary to 'switch' (or 'turn off') all or part of the SWW network in order to manage the flow across the wider network. Alternatively, it may sometimes be necessary to increase the flow through all or part of the SWW network.

Therefore in real time, the SWW network:

- a) needs to be as responsive to System Operator instructions as the rest of the TO's network is; and
- b) needs to be managed and operated as an integral part of the wider GB network.

If it isn't, then system safety and security will be significantly compromised. The TO is also likely to be in breach of its various statutory, licence and contractual obligations. Ofgem has not yet made clear what arrangements it anticipates being put in place to ensure that, in real time, both of those essential outcomes can be assured.

Does Ofgem intend for the TO to retain sole control of the SWW network through the existing TO's control room? If so, it is unclear in what sense the SPV could be understood to operate the network. Alternatively, does Ofgem anticipate dual control through the TO's control room and a new SPV control room? In this scenario, SO instructions would presumably be directed through the TO's control room and the TO would pass them to the SPV who would execute them via its own control room. This scenario carries an increased risk of delay or confusion in the execution of SO instructions, reducing the responsiveness, safety and security of the national network overall. The TO would also have to be

able to oversee and override the SPV's control commands so as to manage unforeseen events, and ensure it does not breach of its various performance obligations. This would unavoidably duplicate the costs of running the control rooms.

In the first instance, we would welcome a clear description of what is meant by "operational control" in relation to the SPV and the explicit operational responsibilities the TO is expected to undertake, in relation to the SPV.

Given that the TO will have the direct contractual role with the SPV, we are keen to understand what powers are to be granted to the TO to 'step-in' or terminate the SPV's operational control of the asset? Again, we would expect the draft DAG to be explicitly clear on the circumstances in which the TO would be able to use such powers. We are also keen to understand what elements of the SPV's performance the TO is expected to report to Ofgem on.

**Q3: Do you agree with our approach to structuring the TO's allowances, including both base revenue and cost adjustments?**

Further direction on the threshold and scope of each cost adjustment needs to be provided by Ofgem.

However, we note that the DA will be entered into by the TO and the SPV, and the TO will have the direct contractual role with the SPV. It is therefore the TO's responsibility to adjust the SPV's costs as set out within the DA, yet Ofgem cannot guarantee that they will mirror the changes to the TO's licence, approving any adjustments the TO has agreed to the SPV's costs. Such an arrangement simply adds further risk and exposure to the TO, who is being expected to both implement and manage this complex commercial arrangement with the SPV.

It is essential that where a cost adjustment is payable under the DA it is recoverable by the TO. Ofgem need to be final arbiters in this to protect consumers but the timing of their decision must be in advance of payments being incurred by the TO under the DA, if the cost adjustment is unacceptable to Ofgem.

**Q4: Do you agree with our proposed approach to operational period incentives, including interactions with the TO's price control incentives?**

A fixed 25 year contract provides less scope for Ofgem to operate incentive regulation, or fine tune the rewards at successive price control reviews. Incentive regulation both encourages companies to innovate to cut costs and subsequently transfer the benefits to the consumer. This approach has been instrumental in facilitating the achievement in GB of some of the lowest transmission costs worldwide, without compromising on quality of supply.

The proposal to use an Availability incentive during the operational period (paras 3.40-3.42) highlights the inconsistency of the regulatory framework being proposed.

The completed assets are likely to be part of the main interconnected transmission system (MITS). A suite of incentives established in the RIIO framework exists to drive the right behaviours by TO's in the management of these assets. Availability is a reputational incentive only. It is difficult to understand why Ofgem consider this as the key incentive appropriate for such assets. Clearly a better fit would be with the current RIIO price control incentives. The focus on "Availability" based on the OFTO regime and other sectors emphasises Ofgem's lack of appreciation of the nature of the assets they are seeking to bring under this framework.

In the MITS, availability metrics are reported annually in the C17 System Performance report published by the SO. These show Availability decreasing as a consequence of the amount of work required to deliver the new connections and upgrading of the electricity system. A target on availability

is not a binary output and needs to be considered in the context of the current and future operability of the network.

Similarly SF6 targets are an incentive for TO's in the current price control but as a percentage leakage rate, reflecting the increase in SF6 that is being brought onto the network to connect new generation.

Ofgem acknowledge at para 3.43 that an appropriate set of incentives should be considered on a case-by-case basis but their starting position is another red flag for consumers to indicate their interests are at risk should this framework be established.

**Q5: What are your views on our proposed arrangements for the period after the end of the SPV's revenue term?**

The handover of the asset at the end of the 25 year operational period will be a complex transaction. It is not clear from the consultation document what criteria the SPV will be expected to adhere to in handing the asset over to the TO.

Ofgem need to confirm if incentives will be put in place, encouraging the SPV to ensure the handover is timely and reasonable. Further details are required on certain scenarios, for example, if the TO cannot 'fully' accept the asset, due to unresolved disagreements between both parties, does this preclude full payment for the SPV? Is it the responsibility of the ITA to resolve all disputes, bearing in mind that disputes between the TO and the SPV may be unrelated to the asset, for example, land damage, final consents etc. We would expect provisions for deadlock to also be put in place, should the ITA be unable to help both parties reach agreement, and these should be set out within the draft DAG for stakeholders to offer comment on.

Given that the TO will be expected to continue to operate the asset following handover, does Ofgem intend to include a liability period post-handover? Is the intention at hand-over that as well as the asset, the SPV's staff also move to the TO?

**Q6: 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?**

We do not agree that the current proposals on conflict mitigation will help achieve more effective competition.

It is incongruous for a TO to operate an SPV in its own area because it seems inevitable that doing so will deliver a worse outcome for consumers than delivery under the existing price control arrangements.

Ofgem must keep its proposed arrangements under review, ensuring that remains focused on the overall outcomes for consumers, not simply rely on assumed headline costs.

Notwithstanding this position, we note that the conflict mitigation proposals set out in the consultation document go further than those Ofgem developed in relation to CATO and, in effect, place existing transmission providers at a material disadvantage.

In an SPV scenario, in order to compete within its own area, the TO would have to establish a legally separate business unit as well as adopting particularly distinct managerial, financial, physical, staff and IT systems. The requirement for legal separation adds little to a level playing field, particularly



where the various substantive systems are already distinct. However, it does bring all the added cost and complexity of splitting regulatory responsibility and control.

We recognise the need to keep certain, commercially sensitive, information confidential, but we have particular concerns about how the proposals to keep separate information about the management of the SPV and the teams of staff who would be involved in the project would work in practice. By way of examples, how could the TO then ensure that its whole network was operated as an effective whole? How could it answer for its performance if no one team had visibility of the overall performance of its network and if the technical understanding and knowledge of a project could not be used as part of monitoring that project? How could we ensure that the TOs were not, in effect, excluded from bringing the benefits of their skills and experience to the new competition arrangements?

Further, we note that Ofwat currently prohibits associated companies bidding for certain works within their group's area. However, Ofwat's guidance<sup>5</sup> invites companies *'to consider the use of DPC for large-scale enhancement projects that are expected to cost over £100 million...[Ofwat] are not expecting companies to use DPC for every scheme that meets this threshold, rather they should consider for each relevant scheme which delivery approach has the potential to drive the greatest possible benefits for customers.'*

The whole premise of Ofwat's Direct Procurement for Customers (**DPC**) approach is that companies assess the most suitable form of delivery (in house or third party) for each project. In doing so the companies are themselves able to take into account the full range of strategic, economic, financial commercial and managerial features. The benefits of in house delivery can be fully assessed case-by-case, in light of the technical and commercial context. Ofwat is allowing companies the chance to produce the most efficient outcome rather than excluding in-house delivery from the outset.

Allowing for similar flexibility, and so ensuring that the benefits of in-house delivery are not lost, will be important in making sure the best outcomes are delivered for electricity consumers too.

Finally, we assume that whatever system of competition is introduced and whatever conflict mitigation obligations TO are placed under, the playing field will be level between all parties. As currently proposed, this would mean that any SPV would also have to be fully arms-length from any other utility provider, including meeting the unbundling certification requirements as OFTOs must. It is not clear that those necessary restrictions on SPV ownership and activity have been factored into the work to date.

**Q7: Do you think that any changes to industry codes or standards are needed, or would be beneficial, for the SPV model?**

Until we have a clear view of the full suite of roles and responsibilities the SPV would have throughout the project lifecycle, it is not possible for us to reach a final view on this question. However, it is clear that the STC and its associated procedures, the CUSC and the Grid Code would need careful line-by-line review. There is also a need for a wider review of the industry codes.

For example, both the Connection and Use of System Code (**CUSC**) and the STC contains provisions on liability which recognise the complex relationships which exist in electricity transmission. A customer could cause a TO loss, and vice versa. However, the codes are structured in a way which means that customers and TOs have no direct contractual relationship. It is a long standing approach, approved by Ofgem, that the liability of the various parties should be limited. Tortious/delictual claims

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<sup>5</sup> Ofwat Information Notice on Direct Procurement for Customers (DPC) - <https://www.ofwat.gov.uk/wp-content/uploads/2018/06/IN-1810-Direct-procurement-for-customers-DPC-setting-expectations-for-a-high-quality-and-well-evidenced-case.pdf>

could circumvent these limitations. Accordingly both the CUSC and the STC contain complex, complementary, provisions designed to control the ways in which claims are brought and to ensure that limitations of liability cannot be circumvented.

Without further amendment to the CUSC and the STC, the SPV would have no such protection and could be exposed to uncontrolled claims in the event its actions caused any damage. That could have significant cost implications for the SPV and the overall commercial viability.<sup>6</sup>

Once full details of the proposed approach to SPV are known, it will be important that Ofgem undertakes a detailed review of all relevant codes and licence conditions to check for any further issues which may arise and to identify if there is an effective way to resolve them.

Looking more widely, it will be important to ensure that other legal instruments such as the Electricity Safety, Quality and Continuity Regulations 2002 operate appropriately in the context of the SPV proposals.

We do consider that there may need to be recognition of the SPV arrangements in the Operation Codes of the Grid Code in relation to outages and safety management processes which run between the TO and SO. However, this will be dependent on what is meant by 'operation' in the context of the SPV. The consultation is unclear on this. However, as mentioned in response above, further clarification is also required as to how the SPV is expected to 'operate' the asset. Is it envisaged that the SPV will have its own control room or will it be working in partnership with the TO's control room?

We would also welcome clarification on what is meant by "operational control" by the TO and the explicit operational responsibilities the TO is expected to undertake.

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<sup>6</sup> As to liability under the BETTA arrangements see: (i) Limitation of Liability under the STC and CUSC An Ofgem consultation document October 2004 236/04, <https://www.ofgem.gov.uk/ofgem-publications/54915/8588-23604pdf>

(ii) Limitation of Liability under the STC and CUSC An Ofgem conclusions document December 2004, <https://www.ofgem.gov.uk/ofgem-publications/54842/9094-27404.pdf>

## Response to Ofgem Questions: Procurement Principles

### Q1: Do you agree with our proposed procurement principles?

#### Ofgem has not addressed the implications of playing the critical decision making role in the appointment process

Paragraph 5.1 of the consultation describes the TO's role as *“designing, running, and concluding a tender that results in the appointment of an SPV.”*

However, the terms of the consultation and the draft licence conditions at Appendix 1 of the consultation contemplate that Ofgem ultimately takes all of the key decisions:

- Ofgem will publish Procurement Guidance and Delivery Agreement Guidance which will constrain the TO's discretion.
- Ofgem approves the SPV Tender Documentation, which is drafted with reference to the Ofgem Procurement Guidance.
- Ofgem approves the Delivery Agreement, which is drafted with reference to the Ofgem Delivery Agreement Guidance.
- Ofgem approves the appointment of the Preferred Bidder.
- Ofgem approves the entry into the SPV Delivery Agreement with the Preferred Bidder.

#### Procurement law and legal challenge is a risk that Ofgem must manage

Paragraph 5.4 of the consultation appears to place the responsibility for the design and operation of a legally compliant tender on the TO. This over-simplifies matters. There is a real risk of challenge to Ofgem's decisions.

Bidders who do not succeed will inevitably consider challenges. The proposed SPV structure creates significant complications because it contemplates a procurement by a TO subject to significant input and decision making by Ofgem.

Ofgem does not appear to have addressed the risks arising in this regard. For example:

- In Ofgem's view what legal regime governs the procurement? Is it EU/UK procurement law, public law or both? The risk of legal proceedings against Ofgem must be significant. This is because Ofgem has the ultimate decision-making power at all key stages.
- What would happen if a disappointed bidder challenged the appointment of another bidder by: (i) a claim against the TO under procurement law; and (ii) against Ofgem under public law. Has Ofgem considered how such proceedings would be handled?
- If Ofgem made a decision that the TO disagreed with, would Ofgem ensure cost recovery for costs such as: (i) an award of damages against the TO arising from that Ofgem decision; and (ii) the costs of defending proceedings.

#### The Procurement Guidance must be the subject of full consultation

Whilst noting the proposed procurement principles, we await publication of the Procurement Guidance which we expect will provide further details of the procurement principles and the procurement process to be followed, for the TO to appoint an SPV. As per the Delivery Agreement Guidance, in finalising the Procurement Guidance, we would expect Ofgem to undertake a full consultation exercise with key stakeholders to ensure the finalised Guidance is fit for purpose.

#### Application of procurement law to the SPV should be clarified

Given the scale and complexity of projects eligible for competition, we would primarily be expecting large contractors to become involved in the tender exercise for the SPV.

For sound public policy reasons, the Utilities (Contracts) Regulations 2016 (SI 2016/274) place certain restrictions on TOs' procurement. It seems likely that any SPV competition will need to be compliant with these regulations.

Further, if the SPV itself is not bound by the Regulations, to avoid the SPV arrangements circumventing these regulations, it seems likely that DA would have to be drafted so as to require the SPV to behave as if it were bound. It is not clear that this has been included in the assessment of SPV to date.

**Q2: Are there any other areas where we should be setting firm requirements regarding procurement of the SPV, or where additional guidance would be helpful?**

As part of the Procurement Guidance (PG) to be published, it would also be helpful to set out what aspects won't fall under the scope of Ofgem's procurement requirements. For example, will Technical Services which support tendering and contract activities, be outside of Ofgem's area of interest?

We would also welcome further details on the actual activities Ofgem will undertake in approving the TO's tender documentation and overseeing the tendering exercise. A detailed timeline of Ofgem's activities and responsibilities throughout the tendering exercise should be included in the Procurement Guidance.

**Q3: Are there any areas included in this chapter where we should not be setting requirements regarding procurement of the SPV?**

We have no comments to add.

## **APPENDIX: COMMENTS ON DRAFT SPV LICENCE CONDITION**

We note the draft licence condition attached to the consultation and that Ofgem plans to provide further drafts for comment. It will be essential that we have time to consider the full suite of proposed licence changes as a whole.

SPT shall provide comment on the draft SPV licence condition during Ofgem's upcoming workshops.