

**Ofgem  
10 South Colonnade  
Canary Wharf  
London  
E14 4PU**

22 January 2021

**Dear Dan Baker,**

**Ref: Offshore Transmission Owner (OFTO) Regime Tender Process**

Equitix Limited (Equitix) welcomes the Office for Gas and Electricity Markets' (Ofgem) Consultation on the OFTO Regime Tender Process, which is timely for the forthcoming Tender Round 7 (TR7) procurement.

We note that the consultation omitted to address or review guidance on what would happen at the end of the OFTO Licence revenue period, which drives the residual value assumptions that bidders make in their offers. In addition, given the ongoing HMRC challenge on the capital allowance position for operational OFTOs, we were disappointed to see that Ofgem was not consulting on this given this has the ability to significantly affect the robustness of the ITT Submission that bidders are putting forward.

We have set out in the attached note our responses to the key questions contained in the consultation document.

Yours sincerely,

A handwritten signature in black ink, appearing to be a stylized 'S' or similar character, followed by a long horizontal flourish.

For and on behalf of  
**Equitix Ltd**

## Part A: Targeted Changes

### 2. Tender Process Changes

#### *Data room*

#### 2.28 Would allowing earlier access to the developer's data room assist bidders?

The ITT Stage is typically 12 weeks long, this is broken down into six weeks to produce due diligence (DD) reports and six weeks for funders to prepare and go through their credit committee process. These six weeks are sufficient for Advisors to review the data room and produce reports for funders as long the data room is populated with all the key information from the Developer at the start of the PB Stage. Having early access to the information would allow more time for funders to go through their credit committee processes.

#### 2.29 What would indicate that the data room is more complete/contains the necessary finalised documentation to enable the ITT stage to commence and what would assist/improve pre-tender submission due diligence?

The signposting document is helpful as it provides an update on the project status, helps bidders to navigate the data room and sometimes highlights missing information. Our Advisors have standardised checklists with each DD item assigned high/med/low importance for the ITT Stage and they use a traffic light system to track what is complete, part available and what is missing. This gives a clear picture of the status of DD and the key areas outstanding.

Standard schedules could be developed and completed by each of the developers alongside the signposting document and the Data Room should not be opened until the all of the high importance items have been provided or, if due to the construction programme, they are not available an expected date should be provided. Ofgem should ensure bidders and lenders have sufficient time to review this information and go through their respective approval processes.

#### *Site visits*

#### 2.30 Would it be viable or practical for site visits to both offshore and onshore substations to be conducted as part of the tendering process and would this assist due diligence to reduce uncertainties and improve the firmness of bid pricing? In the event that this is not viable or practical, what could be done in advance of bidders submitting their tenders to deal with this issue in a pragmatic way?

Site visits could be delayed until the Preferred Bidder Stage without a material impact on the DD. Visits at the ITT Stage tend to be high level. Whereas site visits at the PB Stage tend to be over a number of days, so bidders and their advisors and operators can do a much more in-depth tour and target the confirmatory DD more effectively.

#### *Cost assessment*

#### 2.31 Would there be a benefit to moving the timing of the cost assessment process so that the ITT bid phase is delayed until all costs (bar settlement of claims and/or future costs yet incurred) are settled? What are the risks of doing so and how might these be mitigated?

The ITV to FTV process is well known and understood by Developers, Bidders and Ofgem we do not consider this change necessary. However, delaying would provide Ofgem with more price certainty as TRS adjustments would be minimised at the PB Stage.

#### *Transfer and Interface Agreements*

#### 2.32 Would respondents support Ofgem's proposals to delay the submission of ITT bids until the transfer and interface agreements are substantially concluded, with Ofgem delaying the submissions of ITTs until such time as they are considerably more advanced?

Delaying the submission of the ITT bids until the transfer and interface agreements are substantially concluded would incentivise the developers to develop the agreements as far as practicable at the ITT Stage and reduce the development time needed at the start of the PB Stage to add in the project specifics.

It is hard to reach a commercial agreement at the ITT Stage, when the Developers are negotiating with multiple bidders. A significant proportion of the points will be common but also some points will be more important to certain bidders. If the agreements and schedules are developed as far as possible at the ITT Stage this should expedite the commercial and bidder specific negotiations at the PB Stage.

This approach would result in higher at risk bid costs for bidders due to additional legal advice and may deter new entrants.

2.33 If so, what could Ofgem do to ensure that it is effectively managed without needing much extra time in this phase?

Ofgem could issue guidance to the Developer on the expected status of the Transfer and Interface Agreements. This could be followed by a review the drafts of each agreement by Ofgem or its Advisors with the Developer prior to it being issued to bidders to ensure project specific features are captured. Typically, the developers tends to incorporate this detail at the PB Stage, despite information being available at the ITT Stage. For example, this could include a list of joint construction contracts and how it will be dealt with i.e. who will retain the contract and the rights the other party has under the transfer agreement to make a claim.

### *Evaluation Approach*

2.35 Would respondents support in principle a qualitative assessment of all elements of a bidder's bid with each section forming part of the overall evaluation score, and why?

We would be supportive of a qualitative assessment of all elements of a bidder's bid as we believe the robustness and deliverability of each of the bids should be considered, as these are long-term regulated assets. Consideration should be given to robustness of the Bidders assumptions especially around high risk assumptions being made that the bidder is taking, which goes against Ofgem's and / or HMRC guidance in the case of tax.

For example, bidders who deviate from HMRC's guidance on capital allowance allocations should score poorly on robustness, especially in light of HMRC challenging capital allowance assumptions on operational OFTO projects.

2.36 Would doing so lead to bidders proposing engineering solutions that come at high consumer cost for marginal (if any) consumer benefit when compared to robust, yet less costly alternatives?

Qualitative assessment could lead to bidders proposing alternative engineering solutions. For example, a number of innovative asset management techniques that can improve safety and inform the owners of the asset health have an upfront cost. When the PB award is based on the lowest TRS value these options are often left out of the Submission to ensure it is as competitive as possible.

2.37 Could such an approach deliver more environmentally conscientious approaches to operations and maintenance?

Qualitative assessment could lead to a more environmentally conscientious approach, for example it could allow bidders to consider the use of electric boats and other environmentally friendly solutions such as the use of drones rather than sending vessels out to the offshore platforms.

### *Funding*

2.38 Do respondents consider that deferring debt finance to the PB stage could open up the market to more sources of finance and drive better value for consumers, including Green Finance and, if so, what benefits would that bring to consumers?

OFTO's are attractive assets for funders who have continued to offer attractive terms despite the COVID-19 pandemic. We do not agree that deferring the debt finance to the PB Stage would open up additional pools of liquidity, but recognise it could give a greater opportunity to institutional investors who cannot always hold their terms until the expected date of asset transfer. Given that financing costs make up the most significant part of the TRS, delaying the funding competition will remove the competitive tension at the bid stage used to align funders to the lowest common denominator. This will be harder to achieve at the PB Stage.

### 2.39 Would deferring debt funding competitions until the PB is appointed reduce the costs of bid preparation and be attractive to new equity investors?

Deferring the debt funding competition would reduce bid preparation costs but if Ofgem still requires due diligence to be carried out, the savings will be marginal and the bid costs are unlikely to create a barrier to entry for new entrants. Tender Round 5 and 6 have demonstrated that there are significant barriers to entry for new entrants and other incumbent bidders. A small reduction in bid costs is unlikely to make a material difference. Ofgem will also lose the rigour of lender due diligence at the ITT Stage and increase the potential for greater TRS adjustments at the PB Stage.

### 2.40 Would securing funding later in the process have an impact – positive, negative or none – on the overall time to conduct the tender and transaction process?

We don't believe this would have an impact as the funding competition could be run whilst the due diligence is being updated at the start of the PB Stage.

## *Reserve Bidder*

### 2.41 Should Ofgem exercise its powers to withdraw the appointment of the PB where deadlines are not met?

Our experience is that typically delays are due to contractors not providing information or being unable to agree a final commercial position until due diligence is complete and issues are known so final negotiations can take place. Reverting to the PB is unlikely to change this position as it is likely to be common to all bidders.

### 2.42 Should Ofgem set a deadline by which all confirmatory due diligence and/or final approvals from funders must take place?

Confirmatory due diligence is reliant on full and complete information from the developer and they are heavily reliant on their supply chain. If Ofgem is to consider a deadline for confirmatory due diligence then it should also set a deadline for developers to provide all final construction documents and give a reasonable period for bidders to complete confirmatory due diligence. If a preferred bidder misses the deadline, Ofgem should consider how it could be confident that the reserve bidder wouldn't be in the same position.

### 2.43 How could we ensure that it is not the developer that is behind delays leading to deadlines being missed?

Transparent communication from the developer and the preferred bidder should identify where the issue is and Ofgem's advisors should be able to advise Ofgem of what is causing the delays.

### 2.44 What considerations would be needed to maintain the ability of the reserve bidder to mobilise quickly?

The key to being able to mobilise quickly would be having information, i.e. data room and updated Transfer and Interface Agreement, ready for review so confirmatory due diligence can be completed while the reserve bidder re-engages with funders.

It would be useful if the Developer could provide a documents list with the status clearly set out, so the incoming bidder can still benefit from any third party engagement, which has already been undertaken. For example, the incoming bidder should be provided with the latest Crown Estate (CE) lease so they can step into the negotiations and any technical documents developed with NGEN as part of the OTSDUW Completion Report deliverables should be transferable to the reserve bidder.

BEIS currently requires bidders to submit a decommissioning plan with two weeks of the PB announcement, having passed the ITT bid criteria bidders should have demonstrated they could meet this deadline however BEIS would need to work with the reserved bidder to ensure that their plan could still be approved in the revised timeline to asset transfer.

## 3. Reference interest

### 3.6 Is your expectation that SONIA-based products will be used for TR7?

We suggest Ofgem engages with lenders directly on this point.

3.7 What do you consider would be the most appropriate information screens to be used by Ofgem to inform ITT assumptions and benchmarking? Please provide examples/evidence to back up any preferences.

We suggest Ofgem engages with lenders directly on this point.

3.8 How do you expect bid margins and charges to SONIA to differ to those bid to LIBOR? rates – switch from LIBOR to SONIA

We suggest Ofgem engages with lenders directly on this point.

#### 4. CPI or RPI indexation of revenue

4.6 For OFTO projects, would a switch to CPI/CPIH or the addition of CPI/CPIH as an alternative option impact on your strategy for revenue indexation and, if so, what would the impacts be?

We would be prepared to consider switching to CPI/CPIH if it was an alternative option set out in the ITT document. This would be evaluated against alternative options to compare the impact on the competitiveness of our bid, availability and impact of CPI/CPIH linked revenue style swaps etc.

4.7 In your view, would CPI/CPIH-linked indexation result in a net benefit or cost to consumers?

We have not undertaken detailed analysis on CPI/CPIH-linked inflation at this time.

4.8 What challenges could you foresee that a change of index or the addition of an alternative indexation option could bring? How would you suggest that any challenges are overcome and/or mitigated?

We have not undertaken detailed analysis on CPI/CPIH-linked inflation at this time.

#### 5. Approach to Insurance Requirements

5.7 What are your views on the ITT evaluation continuing to require bidders to take out LEG3 or an equivalent package of cover in ITT bids, or do you consider it would be preferable to allow bidders to decide on the risks that they regard as acceptable?

The insurance market in general is hardening and this has resulted in sharp rises in insurance costs and a reduction of capacity in the market. The pool of insurers that participate in the OFTO market is already limited and therefore if the market continues to harden there is the potential risk that bidders will not be able to place property damage insurance with LEG3 coverage. It would be useful for Ofgem to address this in the ITT document to make sure it is clear to all bidders how they will manage this in the event this risk materialises.

5.8 Should the ITT requirements be more prescriptive about some elements of the insurance cover – and if so, which aspects and what benefits would this bring?

We believe the requirements for the Property Damage insurance are clearly set out and there is no further need for guidance for other insurance policies required by the OFTO.