

TRANSMISSION CAPITAL PARTNERS

Daniel Baker
Commercial, Networks
Ofgem

BY EMAIL ONLY

8th January 2021

Dear Daniel,

Offshore Transmission Owner (OFTO) Regime Tender Process – Consultation concerning developments to the tender process within the current OFTO regime

Transmission Capital Partners (“TCP”) – a joint venture formed of Amber Infrastructure Group (“Amber”) and Transmission Investment LLP (“TI”) with in-depth knowledge of financial, technical and regulatory issues associated with electricity transmission in the UK – is pleased to provide you with a response regarding the “*Offshore Transmission Owner (OFTO) Regime Tender Process – Consultation concerning developments to the tender process within the current OFTO regime*”.

TCP manages one of the largest offshore electricity transmission portfolios in terms of the capacity of offshore wind connected. Our managed portfolio of OFTO assets includes the connections to the Robin Rigg, Gunfleet Sands, Barrow, Ormonde, Lincs, Westermost Rough and Dudgeon offshore wind farms - a portfolio of over 1,000MW (circa £1.3bn in capital employed).

We are also preferred bidder on the OFTO assets for the Rampion and Beatrice wind farms, due to transfer in 2021, and East Anglia One (announced 22nd December 2020).

In addition, Amber and TI have a strong and proven track record in the procurement of large-scale infrastructure projects through their respective involvement in the Thames Tideway Tunnel (“Tideway”) and the France-Alderney-Britain (“FAB”) interconnector.

International Public Partnerships (“INPP”), a FTSE-250 listed investment company managed by Amber, is a primary investor in 130 infrastructure projects including all OFTOs managed by TCP, Tideway and in Cadent (formerly known as National Grid Gas).

We also remain strong advocates of introducing competition into the delivery of onshore transmission and TCP continues to support the development of the required arrangements *inter alia* through industry groups, responding to consultations such as these and, when called upon, providing evidence to parliament.

We welcome Ofgem’s review of the OFTO tender process. The projects in TR7 are all expected to be large (we understand the average asset transfer value of each project is expected to be circa £665m).

Ofgem notes in the consultation document the successes of the current tender process in generating significant savings for consumers.

These successes combine to demonstrate the robustness of the process. As projects get larger, more complex and further from shore, it is even more important that this robustness is maintained.

TRANSMISSION CAPITAL PARTNERS

The OFTO regime is now regarded as an example of a successful competitive process in a monopoly utility network area and has allowed the development of a mature asset class with a number of successful operators. It is held up as an example upon which to base competition in other hitherto monopoly utility network areas. Notably there are now plans to introduce competition in the delivery of:

- Onshore electricity transmission (via the Early Competition model);
- Other RII0-2 regulated gas and electricity networks
- Provision of transmission network stability and voltage management services; and
- Water network assets (via the Direct Procurement for Customers model).

It is important not only for the success of the OFTO sector, but also for these other sectors, that the robustness of the OFTO model is retained, and that it continues to produce high quality and cost competitive OFTOs in the future.

Our responses to the targeted changes in Part A of the consultation document are attached as Annex A.

Yours sincerely,

Paul Bennett
Commercial Director

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TRANSMISSION CAPITAL PARTNERS

Annex A – Responses to Targeted Changes

NO.	QUESTION	RESPONSE
TENDER PROCESS CHANGES		
<i>Data Room</i>		
2.28	Would allowing earlier access to the developer's data room assist bidders?	<p>Bidders would not gain significantly from earlier access to the developer's data room as the early data room will be sparsely populated and of limited use for DD purposes.</p> <p>We would prefer that the developer populates the data room more fully earlier in the process and discloses where documents are still under development or unable to be shared at that stage. Certain critical documents must be made available to bidders by a deadline in advance of the bid submission to allow bidders to adequately assess the risk profile of the project and increase the certainty to Ofgem that the bids will be fully reflective of the final TRS.</p>
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?	<p>Developers need to create and maintain a full list of contract documentation indicating whether it is currently available in the data room.</p> <p>We would welcome an earlier cut-off date at ITT stage after which the Developer would not be able to add further documents to the data room as this incentivises developers to ensure earlier data completeness.</p> <p>PB processes are often delayed by the late disclosure of material documents in the data room, requiring rapid assessment and potential re-negotiation of commercial positions / requests for changes to the TRS.</p>
<i>Site Visits</i>		
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	<p>This would be beneficial to help firm up O&M activities, to understand any site-specific maintenance requirements and prompt technical issues/questions that otherwise may not come to light until the PB stage.</p> <p>In general, onshore should be logistically easy, require minimal induction and not be too time consuming although some of the future Scottish sites no doubt involve a lot of travel. This has been</p>

TRANSMISSION CAPITAL PARTNERS

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	<p>practical, what could be done in advance of bidders submitting their tenders to deal with this issue in a pragmatic way?</p>	<p>made available in the past and was well received.</p> <p>Offshore will be more challenging for the following reasons:</p> <ul style="list-style-type: none"> • Whilst in general GWO certification is accepted by all Developers, there are site specific requirements such as DONUT descender and Chester Step Test which not all bidders may have. • Weather can make planning difficult over the winter period and potentially result in a lot of waiting on weather (and wasted time). • For those sites using SOVs, it would be much more challenging to organise short visits, helicopter transfers would be impractical. • Where there are multiple OSPs, do they all get visited? (Hornsea I has four). <p>Perhaps there isn't a one size fits all. For easy sites (close to shore, 1-2 OSPs, short transfer) it may well make sense. For more difficult sites (SoVs, multiple platforms) perhaps a video tour can be made, with bidders highlighting in advance any specific features that they would like to be examined in more detail. We initially used a video tour for Beatrice when Covid restrictions made the offshore visit impossible and this was very useful, even when it was a fairly amateur affair. A more professional and targeted production would be even more useful.</p>
<i>Cost Assessment</i>		
2.31	<p>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?</p>	<p>We do not believe there is a benefit to delaying the bid stage until all costs are settled.</p> <p>The time allowed to transfer the transmission assets to an OFTO is limited by the provisions of the generator commissioning clause in the Energy Act and begins when generation completion is reached. Delaying the start of the ITT process would put further pressure on both developers and bidders in PB negotiations.</p> <p>Agreement on the FTV, whilst required for final OFTO funder approvals, is not usually on the critical path at PB stage and so we do not see a need for this to be advanced.</p> <p>We believe that the bidding timeline should be structured to maximise the time available at PB stage whilst seeking to conduct the PB stage as efficiently and quickly as possible.</p>

TRANSMISSION CAPITAL PARTNERS

NO.	QUESTION	RESPONSE
<i>Transfer & Interface Agreements</i>		
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?	<p>As a bidder TCP does not support this. Delaying involvement of the bidders until the documents are more advanced tips the negotiation of these key documents more towards the developer, who already enjoy a considerable advantage from producing the first drafts of both documents, and the fact that bids are required to be based on the versions of these documents produced at ITT stage.</p> <p>Indeed we have seen a gradual shift in the risk profile of the documents at ITT stage to shift risk onto bidders which is difficult to rectify at PB stage. The majority of negotiation and discussion around these documents arise from the outstanding issues relating to land, construction and defects. These can only be properly negotiated once the extent of these issues is clear and the OFTO is able to assess the cost and risk associated with them. Developers need to be encouraged to prioritise resolving these issues to ensure that bidders have a clear picture in advance of the ITT.</p> <p>Prompt management and resolution of construction, land and defects issues allows the ITT to produce the lowest cost outcome for consumers.</p>
2.33	If so, what could Ofgem do to ensure that it is effectively managed without needing much extra time in this phase?	<p>We would consider that the PB stage would be conducted more efficiently if developers were required to adopt more standard form transfer and interface agreements, with an appropriate risk balance between developer and bidder. We have seen a gradual but steady shift in the risk balance in the documents produced at ITT stage which now seek to require the bidders to accept more risk on issues which arise pre-completion and which the bidder has limited ability to due diligence even at PB stage.</p> <p>Deviation from the standard form should only be on the basis that the project inherently carries a different risk profile and not to suit the risk profile of the developer. This means that negotiation of the documents in the PB stage can be focused on changes arising out of due diligence and disclosure.</p>
2.34	If not, what could be done in the alternative in order to provide bidders with the necessary certainty from a pricing perspective, without doing so to the consumer detriment, and also expedite the conclusion of finalising the	<p>The main elements of the Transfer Agreement and Interface Agreement are fairly standardised and similar from OFTO to OFTO. The main areas for establishing certainty for bidders are for developers to disclose and prioritise resolving issues relating to the construction, land and defects.</p> <p>Prompt disclosure and resolution of these issues allows bidders to accurately assess risk and pricing,</p>

TRANSMISSION CAPITAL PARTNERS

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	necessary transaction agreements?	ensuring that the process results in the lowest possible cost for consumers.
<i>Evaluation Approach</i>		
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?	<p>We only support the principle of a qualitative assessment where there is an incremental benefit to the consumer in increased quality in a bid.</p> <p>Most aspects of a bid, notably deliverability of finance solution, general capability and experience, should be, as is now the case, threshold tests. Bidders should only be able to demonstrate that they can deliver these aspects and not be qualitatively marked on them.</p> <p>Bidders should be required to provide robust evidence that they meet the threshold requirements to avoid risks being transferred to consumers. We were pleased to see that Ofgem had increased the required evidence in respect of decommissioning for the East Anglia One tender and would welcome further improvements to the assessment criteria for the thresholds</p> <p>There is one aspect which may clearly lead to incremental benefit to the consumer – the expected availability achieved by the OFTO assets. Whilst availability expectations feed into the TRS bid already, they do not reflect the value to the consumer (as the generation lost due to unavailability far exceeds the OFTO revenue lost). Taking into account a qualitative assessment of whether a bidder is likely to achieve its bid availability, perhaps taking into account past performance against forecast (if any), could provide a better reflection of value to consumer of a bid.</p>
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?	<p>We would not expect bidders' engineering solutions to vary significantly in cost terms in order to provide more robust solutions for consumers, particularly if the qualitative assessment is proportionate to the benefit achievable. In general, and as noted above, availability is the key issue for consumers. Ensuring best availability will typically be a combination of adopting good working practices and having strong contingency measures in place to deal with unexpected events. In general, these should not come at a high cost for consumers (indeed we already factor them into our TRS bid).</p>
2.37	Could such an approach deliver more environmentally conscientious approaches to operations and maintenance?	<p>In general, OFTO operations and maintenance has limited environmental impact. However, there is always scope to be as environmentally conscientious as reasonably possible and so requiring either as part of the tender process or as an OFTO licence requirement that bidders meet appropriately</p>

TRANSMISSION CAPITAL PARTNERS

NO.	QUESTION	RESPONSE
		high environmental standards could be desirable. For example, requiring that bidders/OFTOs are certified to comply with ISO 14001.
<i>Funding</i>		
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?	<p>It is true that some funders find the long period, from credit committee approval (prior to the ITT submission) to the Estimated Transfer Date, challenging. Certain funders, such as some private placement institutions, are unable to participate in the OFTO procurement process as they are unable to hold their pricing for an extended period of time. Deferring the funding competition to the PB stage may entice them to participate in the funding.</p> <p>However, rather than deferring the funding competition to the PB stage, TCP think it would be better to attract these funders into the existing procurement process by introducing a mechanism that allows them to adjust pricing to reflect prevailing market conditions at the time of PB.</p> <p>Indeed, TCP believes running a funding competition during the PB phase, rather than the ITT phase, presents a number of practical challenges that could lead to poor value for UK consumers and inaccuracies in the bid evaluation process. Developing a solution for an ITT submission requires co-ordination between the technical, insurance, equity and debt components. Technical assumptions are fed into the process which in turn affect the way funders consider and price the transaction, which then in turn can affect the equity pricing. During the ITT stage, TCP continually seeks to optimise these interrelations to submit the most competitive and best value solution to be evaluated. We therefore think it will be challenging to disaggregate the debt funding component without losing some of the value created through the optimisation of the debt solution with other components.</p> <p>In addition, funders attribute value to the quality and track record of sponsors, which would be lost if debt pricing was not competed on during the ITT stage.</p> <p>Indeed, adopting a deferred funding competition could lead to certain bid assumptions being re-opened at the PB stage, or, if they couldn't be re-opened, lead to inefficient debt pricing. We therefore think that running the debt funding competition during the ITT stage will continue to drive best value for the UK consumer and allow a fair evaluation between different bidders.</p>
2.39	Would deferring debt funding competitions until the PB is appointed reduce the costs of	Deferring the debt funding competition until the PB stage is unlikely to create substantial savings to the bid process. Much of the due diligence and analysis that is produced at the ITT stage, for the

TRANSMISSION CAPITAL PARTNERS

NO.	QUESTION	RESPONSE
	bid preparation and be attractive to new equity investors?	benefit of the debt funders, is used by equity investors to assess their investment. Whilst there is likely to be some time and minor cost saving, we believe this would unlikely offset the benefits lost from moving the funding competition to 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?	As noted above, deferring the funding process may reduce the time required for bidders to prepare their tender submission as they will no longer need to co-ordinate the due diligence process across a group of funders. However, this time saving is likely to be marginal as the due diligence process (i.e. the preparing and reviewing of due diligence reports) is required by the equity investor in order to appropriately price their submission. It is likely that anytime saved could be lost on an extended PB period whilst the due diligence is being completed.
<i>Reserve Bidder</i>		
2.41	Should Ofgem exercise its powers to withdraw the appointment of the PB where deadlines are not met?	<p>Before Ofgem considered exercising powers, it should put in place a robust and transparent process to establish which party was responsible for deadlines not being met, and whether the responsible party is capable of remedying the situation.</p> <p>This process should consider the reason for any delays, taking evidence from both PB and developer.</p> <p>In our experience developers' responses vary and delays are often experienced with slow or incomplete responses to queries and late additions to documents requiring DD and consequent commercial resolution.</p> <p>PBs are highly incentivised to complete the transactions as soon as practical for three main reasons:</p> <ol style="list-style-type: none"> (1) there is no revenue and only mounting costs arising from delays; (2) the longer the period between ITT and transfer the more difficult it is to maintain contract and insurance arrangements at the level assumed at the time of the bid, increasing overall risk; (3) the longer the period between ITT and transfer the harder it becomes for investors and lenders to ensure the same quantum and terms for capital, increasing overall risk. <p>For these reasons we do not believe it likely that the PB would seek to unnecessarily delay transfer.</p> <p>It is important that the balance of negotiations at PB stage is not tilted in favour of developers. Issues will arise at the PB stage that could not have been due-diligenced by bidders at the ITT stage, and</p>

TRANSMISSION CAPITAL PARTNERS

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		<p>bidders should not feel that they have to accept developer positions on these issues for fear of a reserve bidder being appointed. To do so would put a strong incentive on developers not to disclose problems until PB stage.</p> <p>Additionally, the incentive of the developer to complete the transfer quickly is weaker than it is for the OFTO as with the start of operations of the generator they are in receipt of revenues. It is our perception that developers prefer to focus on resolving issues and completing work on the generation assets, as well as shifting focus to their next project, and the OFTO transfer becomes less of a focus for them over time.</p>
2.42	Should Ofgem set a deadline by which all confirmatory due diligence and/or final approvals from funders must take place?	<p>No for the reasons set out above, this would provide the wrong incentives to developers who would be incentivised not to disclose issues until the PB stage and then to seek to time-out bidders on negotiations if they did not accept the developer position on these issues.</p> <p>As explained and recognised by other responses in this consultation, there are too many factors which are not within any parties' control, and whilst some stakeholders may have expressed views about the PBs not progressing transactions in a timely fashion, there are usually very good reasons behind such delays. It is important to remember that no single party would want to unnecessarily delay any transaction where significant costs and resources are being involved.</p> <p>Setting such a deadline will put the PBs into a difficult position vis-à-vis its funders too, where the funders may use it as a leverage to push the PBs into certain terms which would not be in the best interests of the consumers if such terms ultimately affects the effectiveness and efficiency of operating the transmission assets in the long term.</p>
2.43	How could we ensure that it is not the developer that is behind delays leading to deadlines being missed?	As indicated in 2.41 Ofgem should develop a robust and transparent process allowing it to investigate the reason for delays.
2.44	What considerations would be needed to maintain the ability of the reserve bidder to mobilise quickly?	<p>In the OFTO programme reserve bidders have not been mobilised at all. Reserve bidders will have limited resources and cannot be expected to maintain mobilisation capability without compensation.</p> <p>We believe that any process to replace the PB should allow the existing PB to remedy delays, as this would still provide the shortest time to complete the transfer and the lowest cost to consumers.</p>

TRANSMISSION CAPITAL PARTNERS

NO.	QUESTION	RESPONSE
		Reserve bidders could be given notice to mobilise at the start of any remedy period, although Ofgem should consider how the Reserve Bidder would be compensated for their costs should the original PB remedy the delay.
REFERENCE INTEREST RATES – SWITCH FROM LIBOR TO SONIA		
3.6	Is your expectation that SONIA-based products will be used for TR7?	Yes, we expect SONIA-based products will be used for TR7 as LIBOR is expected to be discontinued by the end of 2021 and the market has already begun to transition to SONIA-based products.
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.	Having spoken to market makers of SONIA-based interest rate swaps, we believe the most appropriate screen from Bloomberg is “YCSW0141 Index”. Using “BBT1” and selecting “BSEF” as the venue and “GBP” as the currency should provide the most accurate market prices.
3.8	How do you expect bid margins and charges to SONIA to differ to those bid to LIBOR?	<p>We would expect that a SONIA based solution would be economically neutral to all parties and the effective interest rate paid by OFTO would remain unchanged compared to those bid to LIBOR.</p> <p>We note that the SONIA rate is slightly lower than LIBOR and so a straight switch to SONIA with no other changes would result in a “value transfer” between lending banks and hedge providers which would not be acceptable to all parties.</p> <p>Steps therefore need to be taken to achieve economic neutrality to all parties (banks, hedge providers and OFTO) so that the all-in interest rate paid by OFTO, and hence the TRS, would remain unchanged.</p> <p>This is normally expected to be achieved by adjusting both the margin on the bank debt and the fixed leg on the interest rate swap by an amount equal to the delta between SONIA and LIBOR (the “basis”).</p> <p>The fixed leg on the interest rate swap paid by the borrower rate would be reduced by the basis. The margin on the bank loan paid by the borrower would be increased by the basis. The effect is that payments under the loan and the swaps should be unchanged (lower fixed leg on swap matched by lower SONIA receipts under swap, higher margin on loan matched by reduced base</p>

TRANSMISSION CAPITAL PARTNERS

NO.	QUESTION	RESPONSE
		<p>rate on loan).</p> <p>The Bank of England has proposed a few approaches to agreeing the basis difference; we would expect to calculate the basis as the difference in rate for forward LIBOR and SONIA swaps of a tenor matching the WAL of the loan.</p> <p>We do not expect any additional execution charges to be charged due to the use of SONIA.</p> <p>This approach is based on a clear 'no better no worse principle'. The basis can be objectively calculated and can be benchmarked by Ofgem's financial adviser/rates provider if required.</p>
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?	<p>We note the developments and progress made by the CPI and CPIH indices as outlined by Ofgem in the consultation document and agree, that in time, the replacement of RPI is likely. However, we would discourage Ofgem prematurely switching from RPI to CPI/CPIH as financial instruments linked to these indices still lack the market liquidity and depth to drive best value for the UK consumer.</p>
4.7	In your view, would CPI/CPIH-linked indexation result in a net benefit or cost to consumers?	<p>A switch is unlikely to have a significant beneficial impact. The CPI/CPIH rate typically runs lower than RPI with this difference, often referred to as the CPI-RPI 'wedge', being up to c. 1% p.a. Whilst this suggests a benefit for consumers (as an OFTO's revenue would be forecast to grow by c.1% less p.a.), investors will likely bid a TRS based on a higher real rate of return in order to compensate for this reduction.</p> <p>In any case, whilst RPI-linked financial instruments remain more liquid than CPI/CPIH products (i.e. more market depth), they will likely be priced more efficiently. This means a premature switch to CPI/CPIH may lead to less efficient and competitive pricing for UK consumers.</p>
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?	<p>The biggest challenge is likely to be one of timing the switch between RPI to CPI/CPIH. As outlined above, a premature change could lead to lower value for money for UK consumers, but equally switching too late could have a similar affect. It is important that Ofgem maintain their well-earned reputation for providing a stable and transparent regulatory framework, which is integral to retain existing, and attracting future, investors.</p>

TRANSMISSION CAPITAL PARTNERS

NO.	QUESTION	RESPONSE
		It will be important to wait until there is a sufficient market of CPI/CPIH linked financial products that is at least as deep as the RPI market to allow for efficient pricing and avoid the UK consumer getting a worse deal.
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?	<p>The purpose of the insurance requirements, and the complimentary license protections, is to ensure that the offshore transmission system achieves the highest practical reliability at the lowest cost to consumers. In this case, although the direct beneficiary of the insurance is the OFTO, it provides protection to consumers by ensuring that unexpected events can be rectified in the shortest practical time at the lowest overall economic cost.</p> <p>If Ofgem reduces the requirements for insurance without requiring other mitigation from bidders / OFTOs then this will result in a transfer of risk from the OFTO to the consumer. The reason for this is that an OFTO unable to cover its losses for an event that is insurable but uninsured will not be able to call on any license protection (which covers uninsurable risks), and consequently is more likely to be economically unable to rectify the effects of the event, requiring the intervention of Ofgem at increased cost and risk to the consumer.</p> <p>We believe that if Ofgem is to allow bidders and OFTOs to reduce their insurance cover below LEG 3 then there should be a robust process to ensure that potential estimated maximum loss events could be covered via a combination of insurance, reserving or other methods. This would allow bidders to determine how they address insurable risks without exposing consumers to additional risk or cost.</p>
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 current insurance requirements are sufficiently detailed.