CHAPTER: Two

Question 1: *What are your views on the proposed detailed interpretations of new, separable and high value (the 'criteria')?*

Carillion's view on the proposed interpretations are outlined below;

New and separable

We understand the rationale behind the interpretations and support Ofgem's position. However, in terms of scope, we believe that it should be possible to separate the assets on an overhead line, i.e. the steel tower and the OHL fittings and conductor could be classed as separable. Alternatively, the steel towers could transfer at the start of the concession, at a pre-agreed value dependent upon asset condition and an acceptable risk profile, so that the CATO has responsibility for the whole asset.

This could mean that OHL refurbishment projects that meet the value criteria could also fall under the CATO regime - the steel tower assets would remain in the ownership of the TO and the OHL fittings and conductor would be owned by the CATO.

This option would open up further projects to the CATO regime, offering further value to consumers.

Value

We believe that the value lower limit of £100m is broadly of the right order. We believe that OFGEM should also consider the following;

1. Once the programme is well established (and procurement costs fall), setting a reduced lower limit, e.g. £75m. We have seen in other sectors (e.g. PPPs) how smaller schemes can be procured efficiently once the procurement programme is bedded in. This would allow more projects to fall under the CATO regime and generate greater savings for consumers.
2. The bundling of small value projects that meet the new and separable criteria, together to form a bundle of projects that has an overall value that would meet the value criteria. There would need to be some additional criteria set here to ensure commercial viability, i.e. projects should be of similar type, i.e. substation, OHL, etc. or geographic close together, such that project synergies generate value. Again, we have seen this succeed in the PPP sector, e.g. bundled school projects.

Question 2: *Under what circumstances do you think asset transfer from an existing asset owner to a CATO would be required, recognising the principle that projects identified for tendering should be new?*

Please see our comments in response to Question 1, where we stated that we believe it could be possible for the TO to retain ownership of the tower and the CATO to own the OHL fittings and conductor or for ownership of the towers to transfer from the existing asset owner to a CATO. For this to happen there would need to be an exercise to assess and agree the condition and asset value of the towers in order to determine the transfer price. It would also be necessary to review the viability and cost of transferring wayleave rights etc. to the CATO.

Based on the current definition of separable assets we cannot envisage any other scenario where asset transfer would be required.

Question 3: *What are your views on our proposal that electrical separability should not be required at each interface, but that the SO can propose it to us if it thinks there is a cost-benefit justification based on system operability?*

We agree with your proposal, on the basis that electrical separability should only be required if there is a cost benefit justification.

Question 4*: What are your views on the suggested process and roles for identifying projects for tendering?*

- *We have proposed specific roles for the SO – do you think there are any additional roles the SO could take on to support competition?*
- *What's the most appropriate way to ensure that the network options assessment (NOA) considers the widest range of network options, including those that would be tendered?*

We have reviewed your proposals in terms of the role of the SO in identifying projects, and have no further comments to add.

Question 5: *What incentives and obligations should the SO and TOs have for undertaking preliminary works for tendered projects, and is there any value in considering a success fee incentive?*

We believe that there should be an incentive for the SO and TOs to complete all of the preliminary work for tendered projects. This would include agreeing all planning permission, consents, wayleaves and accesses.

In our experience, it is the lack of agreement or completion of these of activities that causes the greatest cost pressure on projects at delivery stage. Ensuring that these activities are complete, will mitigate cost risk to the CATO which will be reflected in the tendered price.

Whilst there are benefits in SO and TOs negotiating wayleaves, consents and accesses during the preliminary stage. Wayleaves and accesses should be jointly negotiated by the SO/TO and CATO to ensure they are aligned to construction methodology to reduce cost escalation and risk to the CATO during delivery stage.

Question 6: Should CATOs pay for the preliminary works at the point of transfer?

Our view is that the SO and/or TO should expect to be reimbursed for preliminary work at the point of transfer. This reimbursement could be either by the CATO or via a funding mechanism that OFGEM puts in place.

If the works are reimbursed by the CATO there should be a recognition that the cost would be added to the CATO tendered cost. In this instance there would also need to be a "reasonableness test" applied to any costs and a level playing field for all bidders.

The preliminary work needs to be done satisfactorily and appropriate guarantees / warranties provided. As outlined in our response to Question 5 there are significant cost implications if this is not done correctly, i.e. cost overruns and/or programme delays due to lack of consents or access in place.

We have discussed in our response to Chapter 3, Question 1 the use of a risk register that could be used to manage cost sharing factors. The risk register could be of a tripartite nature with the CATO/OFGEM and the SO/TO sharing in the risk and rewards of the risk register. This would incentive all parties to work collaboratively to drive cost and increase value.

CHAPTER: Three

Question 1: *What are your views on our proposed late CATO build tender model? Including:*
- the basis of bids;
- the use of cost sharing factors; and
- what risks, if any, it would not be efficient for a CATO to manage during construction.

From an overarching perspective we believe that the early CATO build model would provide better value for consumers as it allows tenderers to develop innovative solutions and take a more pragmatic view on risk as they are responsible for developing the solution.

We recognise that due to the long lead time of projects it will be necessary to adopt a late build model first. We feel this approach is sensible as it allows the marketplace to "cut its teeth" on projects that have already been developed by the incumbent SO/TO. This will lead to lessons learnt being applied to early CATO build projects.

Our views on the proposed late CATO build tender model are as follow;

<u>The basis of bids</u>
We believe that the basis of bids is acceptable. The model is similar to many others that we operate on PPP projects globally.

<u>Use of cost sharing factors</u>
We believe that the proposed model, i.e. a limited number of reopeners for anything that cannot be efficiently priced during the tender is workable.

As an alternative approach, we would propose developing a risk register for issues that would require jointly managing and controlling risk, or that could not be efficiently priced during the tender. This would include items such as system outages, access to site, detailed design issues due to SI, etc. This risk could be managed collectively and the benefit shared, i.e. all parties incentivised to reduce cost. The SO/TO could also be involved in this process. This would ensure that they were incentivised to complete all preliminary work.

<u>Risks not efficient for the CATO to manage during construction</u>
Risks that we do not believe it efficient for the CATO to manage during construction include system outages, access to site and detailed design issues due to SI.

In our experience the issue what can cause greatest cost increase in the construction phase is access. In many instances, specifically on linear projects, access to the work area or easement is not agreed in advance of the works with the grantor. Agreement of this access at a late stage in the project can lead to either cost escalation or to an alternative longer access being agreed which could impact the programme.

The use of a tripartite risk register as outlined above could help mitigate this risk.

Question 2: *What are your views on our proposed early CATO build tender model? Including:*
- what tender specification would best facilitate innovative but deliverable bids; and
- how we can best manage cost uncertainty after the tender.

Our views on the proposed late CATO build tender model are as follow;

What tender specification would best facilitate innovative but deliverable bids?
The specification that would best facilitate innovation would be a performance specification, rather than a specification linked to current TO standards. This would allow CATOs to innovate and to utilise tried and trusted systems and products from outside of the UK. The commercial model, i.e. payment based on availability, means that the CATO will be incentivised to deliver the required availability profile.

How we can best manage cost uncertainty after the tender?
Due to the scope, nature and timings of CATO projects there is always an element of cost uncertainty between tender award and achieving financial close (FC). The timings between these two activities can extend to many months which can exasperate cost uncertainty.

Items that can lead to cost uncertainty can include;

LME (London Metal Exchange Risk) – price re-benched at FC. CATO takes risk post FC
Forex - price re-benched at FC. CATO takes risk post FC. Alternatively payment in multiple currencies

Inflation – the level of risk here depends on the timescales of the project. It is either a risk to be managed by the CATO or an agreed indiex could be applied to uplift prices at FC.

System access dates – we would propose to use either the cost sharing proposal or a risk register to manage this issue.

Question 3: *Do you have any views on the best way to tender projects using high voltage direct current (HVDC) technology?*

We are conscious that there are limited numbers of HVDC suppliers in the market place, and that the lead time for equipment may limit the ability to optimise price and programme.

One potential solution for bidders is to ensure that a HVDS supplier is a CATO SPV member, thus ensuring that they are incentivised during the tender.

Question 4: *Do you have any views on our proposal to prioritise late CATO build? Do you have any views on specific circumstances where early CATO build might lead to better outcomes than late CATO build?*

As outlined previously, from an overarching perspective, we believe that the early CATO build model would provide better value for consumers as it allows tenderers to develop innovative solutions and take a more pragmatic view on risk as they are responsible for developing the whole solution.

The prioritisation of late CATO build does provide a sensible "runway", allowing earlier CATO project delivery and a reduced risk solution when compared to the early CATO build at this stage. It also ensures that lessons learnt from late CATO build projects can be applied to early build projects.

Prioritising late CATO build may also ensure that projects move to the construction phase expediently ensuring that competent, experienced resources, who may otherwise leave the industry, or seek work outside of the UK, can be utilised.

Question 5: *Do you have any views on how we could mitigate the risk of a CATO not being in place?*

In our experience the only reason that a CATO would not be in place would be if financial close could not be reached. This would generally be for legal or financial/funding reasons (Carillion has financially closed more than 65 PPP projects to date and this has not been an issue, even during the financial crisis).

In the unlikely event that it did happen, there could be the option for OFGEM to take the EPC price and supply chain offered by the tenderer and place a contract directly with the EPC supply chain via the incumbent TO, who would become the CATO of last resort.

Question 6: *What are your views on our proposed revenue package for CATOs? Including:*
- *the proposed duration of the revenue term, including how it links to the asset cost recovery period and whether operations and maintenance costs can be fixed over this period; and*
- *our proposed approach to indexation, refinancing and enabling new asset investment.*

We support Ofgem's proposed revenue package.

- In terms of asset cost recovery, the proposed concession length is less than the expected asset lives. This could be dealt with in a number of ways:
    - Hand-back requirements included in the contract, with a deduction mechanism at the end of the contract if the CATO is not maintaining the assets to the required standard – this is a well-established approach in PPPs
    - A pre-agreed asset transfer payment at the end of the contract, based on minimum asset condition requirements.
- O&M costs be fixed over the 25yr period fairly easily. Life cycle maintenance can be managed through reserving mechanisms.
- We support the approach to indexation, refinancing and new asset investment.

Question 7: *What are your views on our proposed package of financial incentives for CATOs? Including:*
- *how we could structure an availability-based incentive to ensure CATOs operate their assets with a 'whole network' view;*
- *the proportion of a CATO's annual revenue that should be at risk; and*
- *whether there are circumstances under which 'payment on completion' would not be appropriate to incentivise timely asset delivery.*

We agree that it is important that CATOs operate their assets with a "whole network" view. An availability-based incentive would ensure that CATOs take a holistic view of their network. This incentive could be paid using the transmission tariff for additional load carried, over and above that specified and agreed during contract negotiations. Any additional payment would need to reflect any impact on asset life.

Question 8: *Are there other types of incentives not covered in this chapter that you think should apply to CATOs?*

No none.

CHAPTER: Four

Question 1: *Are there any risks or conflicts of interest arising from the SO's role that we haven't identified?*

Question 2: *Are there any risks or conflicts of interest arising from the participation of incumbent onshore TOs that we haven't identified?*

Question 3: *Are there any additional conflicts of interest that we haven't identified?*

Question 4: *What measures do you think would be appropriate to mitigate the risks and conflicts of interest? What additional conflict mitigation measures would be needed if the SO takes on a broader role in supporting competition?*

We have reviewed this chapter and believe that all of the risks and conflicts of interest along with subsequent mitigations have been identified.