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Dear James

Frontier Power is an independent operator and asset manager of five OFTO assets that were competitively tendered and we are keen to participate in onshore transmission projects as soon as they are brought forward for competitive tendering by Ofgem.

Frontier Power welcomes Ofgem's proposals to introduce competitive tendering to onshore electricity transmission projects.

CHAPTER: Two

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

Response: We are generally supportive of the principles that projects should be new, separable and high value.

However, we are concerned about the threshold value of £100m being used as a hard criteria. We consider that there should be some flexibility applied around this value as we do not think that a project where the value is estimated as, say, £95m, should be excluded from tendering without further consideration. We suggest that a more appropriate threshold should be a range of £80-100m.

As a further measure to encourage competition, we suggest that Ofgem implements tender windows, as for OFTOs, in which bidders have the opportunity to bid for more than one CATO in a tender round. Clear notification of any tender, with accurate and complete tender information and a clear bidding process will assist bidders in their tender preparation and responses.

Calculation of the value of the project is also important in relation to any projects which may be considered under the threshold. Ofgem may consider disallowances or penalties for projects which are initially considered to be below any threshold, but subsequently exceed the predicted outturn costs to act as a disincentive to the SO to reserve any projects within its RIIO price control.

In certain US jurisdictions, an “open season” is permitted at certain times for potential bidders to identify projects and this may create additional competition, rather than relying upon the SO to identify applicable CATO 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?

Response: Whilst we agree with the principle that projects should be new, there may be circumstances when asset transfer from an existing asset owner to a CATO would be required. For example, if the project re-uses land and route corridors that are owned by an incumbent TO then these assets (including any associated rights) should transfer to the CATO for a fair value to be determined by Ofgem, if the relevant land and route corridor are wholly to be used by the CATO. If the route corridor is used by any existing transmission assets that will be replaced by the CATO, then these should also be included in the asset transfer for decommissioning as part of the scope of the CATO project.

Given the implicit coupling of transmission assets which may have impact upon a bidders project, in terms of access, operation, reliability and maintenance. Where there is transparent Regulatory Asset Values and if a bidder can establish a benefit from transfer of ownership of existing assets to improve the access, operation and reliability of the proposed project then a mechanism for transfer at cost value should be considered. This may permit overall better ownership, control and delineation of systems and lead to less fragmentation and more efficient operation and lower overall costs.

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?

Response: We agree with the proposal that electrical separability should not be required at each interface. Indeed, there are example of asset boundaries for OFTOs that are not electrically separable without dismantling equipment. As long as responsibilities across the boundary can be defined clearly in a Site Responsibility Schedule, then the exact location of the ownership boundary is not an issue. We do not agree that the SO should be permitted to propose an electrically separable boundary based on system operability.

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

Response: We are broadly in agreement with the suggested process and roles for identifying projects for tendering. We understand that the first round of tenders is likely to be derived from the RIIO-T1 SWW projects by applying the new, separable and high value criteria but we are concerned that an additional criterion to “consider the effects of tendering projects where incumbent TOs have already done pre-construction work” appears to be proposed. In order to maximise the opportunity to develop the market as fast as possible, we suggest that the only criteria that should be applied are the new, separable

and high value criteria and whether the incumbent TOs have done pre-construction work or not should be dealt with as part of the asset transfer cost assessment.

As proposed above under question 1, we would suggest that bidders may in certain periods be able to propose potential projects suitable for tendering, to ensure determination is not solely upon the SO's determination, particularly while there is no complete business separation between SO and TO.

- **We have proposed specific roles for the SO – do you think there are any additional roles the SO could take on to support competition?**

Response: We agree with the proposals for additional roles for the SO but in our view, these will only really effectively support competition if the SO is under separate governance or ownership from any of the incumbent TOs. Therefore we suggest that Ofgem pursues steps to ensure separate governance/ownership for the SO as a matter of urgency.

The SO and TO's ownership and control of information and historic cost information and land ownership, together with the possible support by central indirect functions means that without complete separation of the SO/TO relationship then full competition cannot be facilitated.

Policies, procedures, connection criteria and technical specifications should be freely available and licensed for usage by bidders such that there are no restrictions by the TO or SO upon usage of material in bidding, construction or operation of a project. The SO role may therefore be as custodian and licensor of such material to allow freedom of access by bidders. Historic construction information, site surveys and cost benchmarking data from previous constructions may assist in the preparation of bids and accurate assessment of risk.

- **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?**

Response: In our view, the most appropriate way to ensure this is if the SO is under separate governance or ownership from any of the incumbent TOs. Therefore we suggest that Ofgem pursues this as a matter of urgency.

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?

Response: We agree that timely and effective delivery of preliminary works are critical to the success of a tender and successful delivery of the project by the CATO. There should be clear licence obligations on the SO and TOs and a process for independently assessing the quality of the deliverables before finalising the cost assessment for the transfer value of the preliminary works. We think that the cost assessment process should provide sufficient incentives on the SO and TOs to deliver on time and to the appropriate quality. Service Levels should be provided for the accurate provision of data and information, as

delays or incomplete information will delay bids, increase costs and the risk provision. Any preliminary works or specifications should allow for technically neutral and international standard specifications of equipment to widen competition. The SO/ TO should be dis-incentivised from proposing complex or bespoke solutions except where demonstrably technically necessary. We do not think it would be appropriate to provide a success fee initiative, nor that this should be borne by bidders.

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

Response: Yes, subject to independent assessment of quality and a robust cost assessment process.

If as suggested there is to be little in the way of liability associated with the preliminary works, then the costs of any preliminary work should be without significant premium and certainly not in excess of services or information which may be purchased independently from third parties.

CHAPTER: Three

Question 1: What are your views on our proposed late CATO build tender model? Including:

- **the basis of bids;**

Response: We support the conclusion that late CATO build will be more effective for tenders in the short to medium term until the market has developed further and the risk associated with the planning consent phase are better understood by potential investors and market participants.

We would appreciate confirmation from Ofgem, that as a licensee under the Electricity Act 1989, a CATO's would have ability to exercise compulsory purchase, access and other powers as currently conferred upon incumbent SO/ TO's.

Furthermore assuming that a transmission licence would only be granted upon award, then given the competitive nature of the bidding process, the need to contain bidding costs and timetable as well as allowing most flexibility in bidding consortia, we assume that the Utility Procurement Regulations would not be applicable to any tender exercise.

- **the use of cost sharing factors; and**

Response: We support the proposal that bids should be fixed-price with a limited number of reopeners that can not be efficiently priced during the tender and are outside of the control of the CATO. We agree that applying sharing factors as under RIIO should not be required.

- **what risks, if any, it would not be efficient for a CATO to manage during construction.**

Response: If there is uncertainty of certain cost items at the time of the tender to the extent that the CATO can not pass these on to its contractors then it would be inefficient for the CATO to build in contingencies into a fixed price for these items. One example could be the risk of insufficient survey work having been undertaken ahead of the ITT, leading to significant uncertainty of ground conditions or archaeological finds. Such items should be dealt with as an adjustment to TRS with appropriate justification by the CATO and assessment by Ofgem.

Events which are beyond the control of a CATO, such as Force Majeure events, planning appeals, Judicial Reviews or significant unforeseen market disruption may affect a bidders business model and represent a significant risk. Existing TO's have larger cost structures and business models as well as interim price reviews, captive insurance arrangements and do not bid projects to a fixed price model. The more comfort and certainty a bidder has surrounding the ability to address unforeseen and uncontrollable costs, the less risk premium can be applied into any bid.

By way of example, additional allowances have been permitted by Ofgem in relation to "undergrounding" in areas of natural beauty or sensitive areas. The costs of undergrounding are significantly higher and so presumably, where this were to be a planning requirement subsequent to any successful bid, then adjustments would be permitted.

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**

Response: Due to the significant uncertainties around planning consents, we consider that the early CATO build tender model may not achieve the objective of creating a strong competitive field because there will be insufficient participation of new entrants, particularly financial investors, until the late CATO build model has been implemented and planning consent risks are clearly understood by new entrants.

Furthermore until bidders have confidence in the delivery and ability to support Preliminary Works by the SO and that proposed projects are viable (i.e that such generation asset will be built and on time) then this model will appear less attractive. Unless projects are relatively certain then in relation to the early CATO build tender model there is considerable risk of abortive cost being incurred which cannot be recovered via other regulated activities in the same was as incumbent TO's. Unless some recovery is possible there will be a disincentive or large risk premium placed against generation or technology which is considered unpopular, insufficiently proven or considered subject to political, planning, technology or construction risk which cannot be adequately quantified.

- **how we can best manage cost uncertainty after the tender.**

Response: Such items should be dealt with through a well-defined and limited number of TRS reopeners with appropriate justification by the CATO and assessment by Ofgem.

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

Response: We agree with the proposal that such projects could still be tendered by adapting the late CATO model to require the SO to procure certain long lead time components and transfer the contract(s) for these to the CATO, presumably prior to construction. However, such procurement by the SO should follow the form of contract(s) that would best enable the CATO to allocate the appropriate risks to the contract to ensure that the risk profile for the CATO is not adversely affected, which would increase the cost of capital for the CATO.

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?

Response: We agree that Ofgem should prioritise late CATO build.

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

Response: We think that if the risk allocation for the CATO is managed appropriately through the tender process, there is a very low risk of a CATO not being in place and therefore we consider that it would be inefficient for Ofgem to spend too much time devising measures to mitigate such a risk. For projects where a CATO fails during the operational phase, a CATO of last resort mechanism similar to the OFTO of last resort mechanism would be appropriate and wherever possible award to a reserve bidder should be considered ahead of award to a defined entity. Bidders should be required to ensure step-in rights and collateral warranties are included in any Project agreements to allow for any transfer. If bidders are to consider any RIIO-T1 projects then land rights, licences and surveys should be negotiated to be freely transferable to a third party by the incumbent SO/ TO.

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**

Response: Whilst we do not have any objections to Ofgem's proposal of 25 years for the fixed revenue stream, in our view, it would be preferable for the CATO to own and operate the asset for as long as possible and even up to the full 45 years. The main problem we see with the proposed 25 years is that it leaves a residual term of 20 years to be dealt with and uncertainty around the residual 20 years may well become the biggest differentiating factor in bids, which is not a desirable outcome.

We consider that the key determinant of the revenue term is the term of the most efficient financing that is achievable for the project rather than the need to fix O&M costs. By way of example, the Fort McMurray West project in Alberta has a fixed revenue term of around 35 years of operations and this length of term did not create an issue for bidders to achieve efficient financing certainty during the tender stage. It is likely that bank debt financing will have shorter duration than bond financing for large projects and therefore perhaps bidders should be permitted to submit different options for the revenue depending on the project characteristics and the condition of the financial markets at the time of bidding. Even if a refinancing is required before the end of the term, the refinancing gain-share mechanism proposed would ensure that any benefits of refinancing are shared with consumers at the time.

If as suggested, decommissioning may be an option at the end of the 25 year period or indeed at 45 years then this will need to be clearly set in any tender to ensure appropriate estimates and provision is made, particularly as the cost will be incurred at such a future period with the potential for no revenue or value for the asset and a lengthy de-commissioning period may be required. Therefore it may be more economic for any refurbishment or replacement to be bid for and undertaken by a subsequent bid process.

- **our proposed approach to indexation, refinancing and enabling new asset investment.**

Response: We support Ofgem's preference for partially indexed revenue stream with the proportion indexed determined by bidders. We do not have any issue with the proposal to move for RPI to CPI.

We agree with the intent to implement a refinancing gain share mechanism as long as the sharing is equitable.

We support the view that new asset investment should be undertaken by the CATO but we suggest that there should be a cap on the value of such a capex obligation similar to the OFTO model of 20% additional capex.

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;**

Response: We agree that an availability-based incentive is appropriate to incentivise efficient operations and asset reliability. The arrangements for OFTOs are well established and understood by investors and operators in the OFTO market and Ofgem should build upon these arrangements. We consider that the alternative operational incentive of "energy not supplied", which is under consideration by Ofgem, is not appropriate as it exposes CATOs to power flows that are not within their control.

Ofgem should consider the alignment of incentives upon RIIO licensees and that access for maintenance or conflicting incentives, may prejudice the operation and maintenance of a CATO's assets. If a connected TO de-energises a line with little notice or for an emergency then a CATO may not be able to use the period for maintenance and may equally be penalised for lack of availability.

- **the proportion of a CATO's annual revenue that should be at risk; and**

Response: We consider that the proposed level of 10% of revenue at risk may provide an appropriate incentive. However, depending on the level of capex and depreciation for the project it may be appropriate to have a lower percentage than 10%. We also suggest that there should be a carry forward mechanism of not more than 5 years as there is for OFTOs.

- **whether there are circumstances under which 'payment on completion' would not be appropriate to incentivise timely asset delivery.**

Response: We do not consider that there are circumstances under which 'payment on completion' would not be appropriate.

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

Response: We do not consider that there should be other types of incentives.

CHAPTER: Four

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

Response: We consider that Ofgem has identified the key risks and conflicts of interest.

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

Response: We consider that Ofgem has largely identified the key risks and conflicts of interest.

We would request consideration is given to any TO Construction Alliance to ensure that construction alliance members are not incentivised to bid exclusively with the TO for any CATO work or that additional financial rewards are recoverable based upon the risk/ reward of non-CATO work.

TO's also have arrangements with telecommunication providers which provides income or cost recovery for use of its assets. This may prejudice bidders when bidding against the TO.

Any bid process involving any aspect of the TO, needs to ensure entire business separation and that no indirect costs or services are borne by any regulated part of the business.

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

Response: We consider that Ofgem has largely identified the key conflicts of interest.

However, we would suggest further consideration is given to any guarantees, financial security or availability to funding based upon credit rating of any holding companies of any RIIO regulated entities. A TO incumbent bidding organisation may indirectly benefit if bidding, on the basis of a RIIO regulated company assisting in the maintenance of a holding company's credit rating. Equally such an entity may benefit from any exclusive insurance arrangements via use of captive insurance arrangements which are not freely available to other bidders. Therefore separation rules should consider the benefits of RIIO regulated entities within the overall Group structure of an incumbent TO.

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?

Response: We recognise Ofgem's focus on identifying conflicts of interest and ensuring the creation of a level playing field for all participants and whilst a mixture of obligations, prohibitions and scrutiny may go some way towards mitigating conflicts, we do not consider that these measures will be sufficient. In our view, the particular conflict between National Grid's SO and TO businesses will need to be managed through all of the additional measures set out in 4.10 of Chapter 4. Ultimately, full ownership separation between SO and TO will provide the best guarantee of removal of conflicts of interest and therefore we suggest that Ofgem pursues this in parallel with implementation of the CATO regime.

We cannot envisage that any RIIO funded group should be permitted to bid on any CATO unless they are subject to the same market conditions and bid restrictions if there is to be open competition in the provision of contestable transmission assets.

Yours sincerely,



Iain Cameron
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Frontier Power Limited

