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

Attn: Matthew Ball, New Transmission Investment 9th November 2018

Dear Matthew

Extending competition in electricity transmission: commercial and regulatory framework for the SPV Model

We have reviewed Ofgem's consultation paper on the commercial and regulatory framework for the Special Purpose Vehicle (SPV) model of competition in onshore electricity transmission, and Equitix is pleased to provide the following feedback;

As you know, Equitix is an investor in four OFTOs (Greater Gabbard, Thanet, Gwynt y Môr and Humber Gateway), actively bidding the future OFTO pipeline, and an established investor in both the transmission and renewable energy sectors. We are keenly awaiting the proposed Competitively Appointed Transmission Owner (CATO) regime, to deliver benefits to consumers from introducing competition into the delivery of certain onshore electricity transmission projects. We understand that the required legislation may not be passed in time for the HSB project to be procured as a CATO, and therefore welcome the development of the Special Purpose Vehicle Model.

Equitix is an independent investor and experienced Asset Manager with a track record of developing and selecting market-leading partners to deliver Infrastructure Assets. We have an outstanding record of leading consortiums through all stages of infrastructure developments from successfully bidding to achieving contract award and financial close, construction and operations of our infrastructure assets.

Equitix has specifically targeted investments in the renewable energy and offshore transmission sectors and has successfully bid and invested in four OFTOs. Equitix has also invested in Sheringham Shoal Wind farm, owns and operates onshore wind farms and solar portfolios on sites across the UK. We are also active in the energy-from-waste sector and own interests in a number of assets including York and West Yorkshire waste PFI, Northumberland Waste, Welland Bio-power and the Full Circle Generation gasification project in Belfast.

Following our success in the OFTO market, competitively tendered onshore transmission assets via the SPV model are considered a natural progression for our business going forward, making best use of our highly experienced team and business relationships. We are already in discussion with a range of potential partners (from the UK and overseas) who have indicated considerable appetite to bid for onshore electricity transmission projects in the UK. In order for us to progress these discussions we would like to understand a list of likely projects and programme. We attach at Annex 1 responses to specific consultation questions, we look forward to finding out more and would be pleased to meet to discuss in more detail.

Yours faithfully,

Geoff Jackson

CEO, Equitix Ltd

Annex 1 Consultation response

3. Commercial Framework

Questions

Question 1: What are your views on the commercial framework as set out in the accompanying Agilia report?

We consider the SPV commercial framework set out in the Agilia report to be reasonably appropriate, with specific comments noted below in response to the specific consultation questions;

Question 2: Do you agree with the scope of our role in the SPV model?

Ofgem's required scope will be dependent on the TO's incentive to perform due to the license obligations, and the TO's ability, resources and knowhow to develop the documentation and run a fair and efficient competition for the SPV model. It might be appropriate for Ofgem to provide support and resources to the TO. We would suggest Ofgem should be responsible for drafting the DA and tender documentation to establish a standard form, which would then be subject to project specific amendments which would be identified by the TO as required for bidders to review and comment on a project by project basis.

It is clearly important that the TO has sufficient incentive to drive forward the process efficiently at the pre-tender and tender stages. Whilst licence obligations should in principle serve this purpose, Ofgem should satisfy itself that this is the case.

Question 3: 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?

We recognise the requirement for a jointly appointed Independent Technical Advisor (ITA), and the selection of a suitably experienced and knowledgeable ITA will be critical to the success of the project, particularly for any changes to the design and agreeing the construction completion tests and confirming milestones have been met. We would have thought that the ITA may require additional support from Ofgem to agree revenue changes or price adjustments, and Ofgem will ultimately be responsible for changes to the licence and potentially in case of dispute.

Question 4: What are your views on operational period incentives for the SPV?

We consider the availability payments as established on OFTO to be a suitable incentive payment mechanism, with an agreed target (typically [98%]), with deductions capped at a level [90%] which is commensurate with the impact of the SPV failing to meet its obligations (i.e. where it causes the TO to be in breach of its licence conditions). We would be happy to consider an upside sharing above an agreed level of performance. Ofgem should consider providing guidance on what they expect from the milestones and KPIs to be agreed between the TO and bidder, to prevent delay if it fails to meet Ofgem requirements.

We believe that an incentive for the leakage of SF_6, could be applied but we feel a competent contractor should design the system to ensure the system is robust and a competent operator should continuously monitor SF_6 density to provide accurate and reliable information about gas conditions and possible leaks. This approach and monitoring by the ITA should be sufficient to ensure SF_6 leaks are prevented and a financial incentive is not required.

Question 5: What are your views on where there may be consumer value in a target cost rather than fixed price model?

We would recommend that the project is clearly scoped, with minimal interface and known risk to allow the SPV to accurately price at a fixed cost, and avoid target costs where possible as this will lead to varied assumptions and pricing which would be difficult to evaluate and may not offer value to consumers. Target cost should only be used where the scope or risk is unknown/ undefined and can therefore not be accurately priced, with clear assumptions for all bidders.

Question 6: What are your views on possible TO and SPV enhanced alignment options?

We are not opposed to the TO taking a minority equity stake in the project, as is the case in many other PPP structures and sectors (including Education and Health) where the authority invests between 10-20% (although usually at the lower end due to their own financial constraints). The Authority has to fund their share of equity at the same time as the main shareholder. Further, the Authority only receives rights commensurate with a minor shareholder - similar to an observer role on the board with minimal reserved matters to protect their economic interest in the company.

We have experience of this minority equity stake helping to align the partnership (in this case between the TO with the SPV) and to incentivise efficient behaviour and best practice, however potential conflict issues will need to be identified and managed through the shareholder agreement.

In our view the equity would provide sufficient incentive to the TO, and we are unclear how the alliance agreement would work, and may possibly over complicate without adding value?

Question 7: Are there any other points we should consider within the commercial framework?

We note the SPV will be expected to take all, or defined risks. One exception in addition to change in law/pass through 'specified cost and output adjusting events (uncontrollable events, which are not the fault of the SPV, that are not foreseeable and are low probability but high impact)'. We would recommend Ofgem provide clarity on what risks are defined for the SPV to take, and which would be considered as cost and output adjusting events.

We understand the energy administration will apply to the TO as the licensed entity, and not the SPV. We would like clarification on how the SPV would be paid in the interim period in the event the TO becomes insolvent, and if we have look through to the SO, e.g. pending the appointment of a replacement TO under the energy administration regime? We would also note that given the TO is a party to the DA, with no look through to the SO? Whilst it is likely that the project credit rating will be sufficient for funders even on a long term (i.e. >25 years) basis, it might be negatively viewed versus recourse to the SO and therefore affect the cost of finance. It would be useful to hear the views of likely funders with respect to this credit risk.

We note that the TO will retain ownership of the transmission assets and the operational control, therefore the SPV's responsibility and risk allocation together with their ability to make asset management decisions will need to clearly set out in the DA. Given that no security over the transmission assets will be permitted or granted to financiers who will take security over the shares in the SPV and/or the SPV contractual rights, we fully support the need for a funders direct agreement (as expressly contemplated at page 40 of the Agilia report) affording the opportunity for the Financier to step-in.

We would query the basis for the 25-year revenue assumption? Our understanding is that the useful life of the assets will be significantly longer than this and long term finance (> 25years) is available in the current market. Should this be determined on a project-by-project basis, as there could be value in extending the concession or providing a regulated residual value?

We also recognise the benefit of Ofgem and Ofwat working closely together to share learning and develop a combined model/ commercial framework.

4. Regulatory Framework

Questions

Question 1: What are your views on the regulatory framework as set out in this consultation, and how it interacts with the commercial framework?

We consider the regulatory framework generally appropriate for the commercial framework, provided the obligations are clearly passed to the TO through the licence, and that the TO is suitably resourced with the required Knowhow to deliver the requirements in a timely and efficient manner. We would raise the following additional specific queries and comments;

Question 2: Do you agree with the scope of TO obligations during the pre-tender, tender, construction period, and operational period?

We consider the scope appropriate provided the TO has the ability, resources knowhow and incentive to deliver its obligations in a timely and efficient manner. We would recommend that Ofgem provides standard form documentation and clear guidance on requirements, programme and timeframe for the TO to achieve the key deliverables. This will ensure the process is reliable and bidders can have certainty to build and maintain momentum, which should not be at risk due to the tender documentation, DA or final needs case failing to meet Ofgem's approvals, or as a result of TO delay in preparing the documentation.

It is important that the DA is constructed to ensure that the SPV is made whole for loss attributable to the TO, for example where revenue is delayed because of delays in connection as a result of a constraint within the TOs network.

Question 3: Do you agree with our approach to structuring the TO's allowances, including both base revenue and cost adjustments?

We generally agree with the approach for payment, although Ofgem will need to consider the ramifications of delayed delivery/COD as if SPV is only paid following commissioning (some exceptions for long/complex construction programmes) we would assume 'standard' relief and compensation events will apply under the DA which will flow through to the construction sub-contract. Given the proposed procurement principle that only limited changes can be made to the DA during the tender process, it will be important that this is resolved in advance.

Regarding cost adjustments we would require further clarity from Ofgem as to which risks should be priced into bids, and what risks should not be unnecessarily be priced, and what would be allowable adjustments thus ensuring best value for customers. We would also be reliant on the TOs ability to agree cost adjustments upfront in a timely manner, and not to be dependent on the cost adjustments to be agreed in advance with Ofgem (and associated increase to the TO's revenue) which could introduce delay and potential cash flow issues to the SPV.

Question 4: Do you agree with our proposed approach to operational period incentives, including interactions with the TO's price control incentives?

We agree the project-specific incentives should be ring fenced from the TO's wider incentive and obligations under its Licence. We believe further detail is require to determine how the project's performance and incentives are managed through the DA and ultimately through the TO's Licence to prevent delay in the SPV receiving the incentive payments. In particular, consideration should also be given to how Ofgem will manage any claims or disputes through the TO Licence and the DA with the SPV, please refer to our response to Q7.

Question 5: What are your views on our proposed arrangements for the period after the end of the SPV’s revenue term?

We would query if Ofgem has considered matching the SPV revenue term (and associated financing) to the useful life of the asset, and/or providing a regulated residual value. We note that the day-to-day operations and maintenance will transfer from the SPV to the TO at the end of the SPV revenue term, has Ofgem considered if the TO may want the option to retain the SPV services?

It is important that handback requirements are developed as part of the DA, which should include expectations of condition and performance along with the basis of any penalties and/or compensation to be paid and the process of arbitration to be applied in resolving disputes.

Question 6: 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?

In our view, the simplest option would be to exclude an incumbent TO from bidding in its own geographical area, thus avoiding the need for conflict mitigations.

Question 7: Do you think that any changes to industry codes or standards are needed, or would be beneficial, for the SPV model?

We do not consider there are any code changes required. However, we consider the SPV should be protected from any future impacts of code changes, particularly where TOs become accountable or incentivised for constraint costs.

5. Procurement principles

__Questions__

Question 1: Do you agree with our proposed procurement principles?

We generally agree with the procurement principles, however we would recommend that Ofgem provides standard form documentation, clear guidance on requirements and approach to tender evaluation, programme and timeframe for the TO to achieve the key deliverables. This will ensure the process is reliable and bidders can have certainty to build and maintain momentum, and this should not be at risk due to the tender documentation, DA or final needs case failing to meet Ofgem approvals. The TO and the bidders will need to understand how Ofgem will view the risk profile, costs and deliverability of the TO's preferred bidder.

Question 2: Are there any other areas where we should be setting firm requirements regarding procurement of the SPV, or where additional guidance would be helpful?

In addition to the response above, we believe Ofgem should consider guidance for construction milestones and payments.

Question 3: Are there any areas included in this chapter where we should not be setting requirements regarding procurement of the SPV?

No comment.