

TRANSMISSION CAPITAL PARTNERS

Matthew Ball
New Transmission Investment, Systems and Network
10 South Colonnade
Canary Wharf, London
E14 4PU

9th November 2018

Dear Matthew,

Consultation on Extending Competition in Electricity Transmission: Commercial and Regulatory Framework for the SPV Model

Transmission Capital Partners manages one of the largest offshore electricity transmission portfolios in terms of the capacity of offshore wind connected. Our managed portfolio of Offshore Transmission Owner (OFTO) assets includes the connections to the Robin Rigg, Gunfleet Sands, Barrow, Ormonde, Lincs and Westermost Rough offshore wind farms - a portfolio of over 1000MW (circa £800m in capital employed). In addition Transmission Capital Partners will take over its seventh OFTO, the Dudgeon OFTO, on 13th November 2018.

We remain strong advocates of introducing competition into the delivery of onshore transmission and we continue 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. I am also personally pleased to have the opportunity to participate in the ECIT Industry Group.

We are generally very supportive of the proposals outlined in the consultation document, and our comments set out below, and our responses in the attached annex, seek only to respond to the specific questions you have raised and to provide lessons from our experience of other similar regimes.

We would like to highlight the following areas:

- i) **Conflicts of Interest:** For the SPV tender process to be competitive and be attractive to new entrants there should be no conflicts of interest, whether real or perceived. We do not see how the incumbent TO, or an affiliate of it, can be allowed to take part in the process without such a conflict of interest. We also have concerns around the use of information obtained by an incumbent TO in a tender process, specifically it being used by an affiliate of that TO in a separate process. The simplest and most effective way of dealing with this is to not allow the three incumbent TOs to take part in SPV tenders.
- ii) **TO incentives:** There need to be incentives on TOs not to prevent projects being delivered through the SPV route. A specific financial incentive on timely SPV asset delivery (perhaps upside only) may also be needed and provide value-for-money for consumers.

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- iii) **SPV delivery incentive:** We understand that there must be a financial incentive on the SPV to encourage timely delivery of the SPV assets. A delay in commencement of the SPV revenue stream under the Delivery Agreement would provide this incentive. We do not consider it also necessary (nor would it make any practical difference to the efficacy of incentives on the SPV) to shorten the revenue period. We expect this would lead to increased costs to consumers.
- iv) **Consents and land rights:** In order for this to be a “late” model (which we understand is Ofgem’s intention), it will be important that the incumbent TO is responsible for obtaining all consents and land rights (employer consents) that it would not normally be possible to pass down to an EPC contractor as a contractor consent. If all employer consents have not already been obtained at the point of appointment of the SPV, the SPV should be held harmless against any delay or cost implications of these consents being obtained.
- v) **Post year 25:** There could be significant consumer benefits in allowing the SPV to continue to manage the SPV asset after the end of the initial 25-year revenue period. The OFTO regime has shown how competition in operations and maintenance can bring down costs in this area. It is probable that the SPV could continue to operate and maintain the SPV assets post-year 25 at a lower cost than the incumbent TO.
- vi) **Quality and deliverability of SPV bids:** We are pleased Ofgem recognises that the quality of SPV bids will be as important, if not more, than the price of SPV bids. If the SPV regime is to thrive and deliver value to consumers over the long-term then it will be important that the winning bidders have the capability and incentives to deliver, manage, and handover the SPV assets after 25 years to an appropriately high standard.

Our response to your specific questions is attached as Annex 1.

Yours sincerely,



Chris Veal

Director, Transmission Capital Partners GP Limited,
On behalf of Transmission Capital Partners Limited Partnership

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Annex A – Responses to specific questions

Chapter 3 – Commercial Framework	
Question 1: What are your views on the commercial framework as set out in the accompanying Agilia report?	We agree with the commercial framework as set out in the Agilia report subject to the few detailed comments we have included in the last section of this table.
Question 2: Do you agree with the scope of our role in the SPV model?	<p>We do agree with the broad scope of the Ofgem role. We have concerns though as to the interaction of the Ofgem role and the terms of the Delivery Agreement (see our response to Chapter 4 Question 2 below).</p> <p>In addition, while we accept that Ofgem needs to retain discretion on the TO's ability to pass on costs to customers, we feel this element of the structure is a critical area of risk given the TO's obligation to make payments to the SPV. Further clarity from Ofgem on the framework for agreeing to pass costs on to customers would reduce risk for both TO and ultimately the SPV.</p>
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?	<p>Through its investment in the Tideway project TCP has (via Amber) direct and ongoing experience of an ITA working relationship.</p> <p>On Tideway, the ITA obligations are ascribed to it under the Liaison Agreement (itself governing the relationship between Thames Water, Secretary of State, Ofwat and Tideway – the Liaison Committee members) and in the ITA Deed.</p> <p>On Tideway the ITA role comprises:</p> <ul style="list-style-type: none"> - reviewing Tideway and Thames Water's technical reports and submissions that are provided to the Liaison Committee. - reviewing and commenting on the cost and scheduling aspects of any proposed variation, and informing Ofwat, Secretary of State, Tideway and Thames Water as to its verification of the allowable expenditure. <p>Ultimately the ITA owes a duty of care to Ofwat, the Secretary of State, Tideway and Thames Water. The ITA is able to carry out any additional or varied services for Tideway, the Secretary of State, Ofwat or Thames Water (should they request additional services) required for the implementation of the Project.</p> <p>We agree with the concept of the independent technical advisor acting for both the TA and SPV, however we believe Ofgem's involvement with the ITA would also be valuable, if not necessary.</p> <p>In the case of Tideway, Lenders were able to get comfortable with relying on the views of the ITA without seeking separate verification (which obviously would not work) but without receiving a formal duty of care from the ITA.</p>
Question 4: What are your views on operational period incentives for the SPV?	We agree that an availability incentive is the correct performance incentive. This incentive mechanism has worked well in the OFTO sector in incentivising very high levels of availability even where there is no excess capacity of primary plant. We also agree that the

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	<p>level of availability should be determined on a project by project basis.</p>
<p>Question 5: What are your views on where there may be consumer value in a target cost rather than fixed price model?</p>	<p>We agree that this option should be available should it be demonstrable on a project-by-project basis that better value for money for consumers could be obtained by its use. It will be important though to ensure that all involved parties (TO, SPV, SPV's contractors) have the correct incentives to minimise outturn cost.</p>
<p>Question 6: What are your views on possible TO and SPV enhanced alignment options?</p>	<p>We are not in favour of the TO having equity in the SPV for many reasons. Whilst in theory it may make the TO more amenable to the existence of the SPV, it would also create many issues in respect of:</p> <ul style="list-style-type: none"> • Conflicts of interest (notably the TO being on both sides of the Delivery Agreement); • Confidentiality (the TO may also be a bidder competing against the SPV investors on other projects); • Alignment of incentives within the SPV (given the TO's wider interests). <p>We do recognise the need to ensure that the TO is incentivised to facilitate the timely delivery of the SPV. The TO should be incentivised to ensure the success of the SPV model through:</p> <ul style="list-style-type: none"> • Not being able to bid for SPV opportunities itself (see our response to Chapter 4 Question 6 below); • Being incentivised through the rate of return it would obtain via the Competition Proxy model to prefer the SPV model; and • Reputational impact of an unsuccessful SPV process. <p>It may also be necessary to provide a specific financial incentive (perhaps upside only) to the TO, linked to timely delivery of the SPV assets.</p>
<p>Question 7: Are there any other points we should consider within the commercial framework?</p>	<p>We note that there are four sets of events which are proposed as exceptions to the principle of fixed priced delivery of the assets. Whilst we agree that these are the four relevant areas we would like further clarity on the <i>"Specified cost and output adjusting events"</i> and whether these would include a general force majeure type relief for costs that are <i>"uncontrollable events, which are not the fault of the SPV, that are not foreseeable and are low probability but high impact"</i>. There is likely to be considerable focus on the drafting of such provisions in the Delivery Agreement given the history of the application of the Income Adjusting Event term in OFTO licences.</p> <p>We would welcome Ofgem guidance/oversight on the suitable financial security arrangements (if any) that a TO could request of the SPV under the Delivery Agreement. We would argue that these may only be necessary in respect of handback provisions but would appreciate Ofgem's guidance in this area.</p> <p>The consultation refers to revenue during construction being allowed only on an <i>"exceptional basis where the TO can demonstrate a clear customer benefit from doing so"</i>. Many</p>

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	<p>investors, particularly those that invest with the lowest costs of capital, will require early yield from their investments. We believe that revenue during construction will attract the widest group of investors to assets, and should therefore be in the customer interest in most instances.</p>
<p>Chapter 4 – Regulatory Framework</p>	
<p>Question 1: What are your views on the regulatory framework as set out in this consultation, and how it interacts with the commercial framework?</p>	<p>We agree that this regulatory framework is a good approach in general. Our main concerns centre on the conflicts of interest that could arise in respect of a TO affiliated bidder. We respond on this in our response to Question 6 below.</p>
<p>Question 2: Do you agree with the scope of TO obligations during the pre-tender, tender, construction period, and operational period?</p>	<p>We generally agree with scope of TO obligations during the pre-tender, tender, construction period, and operational period.</p> <p>We agree that bidders should be allowed to recover a proportion of their costs in participating in the tender where that tender is cancelled. We would argue that the proportion should be 100% but subject to these being reasonably incurred and subject to a pre-disclosed cap.</p> <p>We are not entirely clear on what the proposal is in respect of the changes in the SPV’s revenue under the Delivery Agreement and consequential changes to the TO’s revenue allowance in respect of the SPV. We note that Ofgem requires that it retains discretion over the latter but the SPV will require that the Delivery Agreement is the determinant of the former.</p> <p>One concern would be if the Delivery Agreement were structured in such a way as to only allow changes in the SPV’s revenue if Ofgem also allows these to be reflected in the TO’s revenue stream. This would remove the incentive on the TO to get a fair settlement from Ofgem (as it would essentially become a pass-through) and would leave the SPV with a risk it is not directly able to manage (as it has no direct relationship with Ofgem).</p> <p>We agree that the ITA could have a role here in seeking to avoid a mismatch but would not remove this risk altogether. We would welcome further clarity on this issue. [This applies equally to Chapter 4 Question 4 below]</p> <p>We believe the pre-construction work that the TO is obligated to carry out could be a critical area of interface risk between TO and SPV as the TO may be incentivised to minimise the expenditure on these works. The responsibilities of the TO in this respect should be clearly defined.</p>
<p>Question 3: Do you agree with our approach to structuring the TO’s allowances, including both base revenue and cost adjustments?</p>	<p>We agree that this approach is sensible. We note that the revenue and cost adjustments may be project specific and we would welcome further information and dialogue on how these project specific arrangements are to be devised (we assume by the TO but approved by Ofgem) and at what stage (i.e. specified at an early stage in the tender process or negotiated during preferred bidder stage).</p>

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<p>Question 4: Do you agree with our proposed approach to operational period incentives, including interactions with the TO's price control incentives?</p>	<p>See our response to Chapter 4 Question 2 above.</p> <p>We agree that an availability incentive is the correct approach and that, subject to the TO's own actions, this should generally be a pass through for the TO. However, the SPV should only be incentivised against availability that it can manage. As such the role of the TO in retaining "operational control" of the assets needs to be clear. We assume that it is intended that "operational control" is as defined in para 4.49 of the consultation document and that as stated in para 4.50:</p> <p><i>"We consider that, within the requirements described above, we expect the SPV would have responsibility for the day-to-day O&M of the assets, and that it should be allowed to perform its functions under the DA without undue interference from the TO."</i></p> <p>As such the SPV would be planning outages on its assets so as to maximise its performance under its availability incentive. The TO will have outage planning obligations under the STC which will also cover the assets managed by the SPV and so it will be important that the Delivery Agreement addresses how the TO can discharge its obligations under the STC whilst allowing the SPV to maximise its performance under its availability incentive.</p>
<p>Question 5: What are your views on our proposed arrangements for the period after the end of the SPV's revenue term?</p>	<p>We agree that handback provisions are required if the TO is to take over the maintenance of the assets at this time (we note that there is no mention of performance security around these handback provisions but we assume that this would need be considered in the Delivery Agreement).</p> <p>An alternative to handback would be to allow the SPV to continue to manage the SPV assets for a lower revenue stream (i.e. one that reflects a zero RAV post-year 25) with a suitable availability incentive, and that the Delivery Agreement could incorporate such an extension option. This is one of the options under the OFTO regime if there is continuing need for the OFTO assets. We would expect at the very least that Ofgem benchmarks the TO's revenue allowance against the revenue that the SPV would require if it were to continue to manage the assets after this point.</p>
<p>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?</p>	<p>We do not consider that the TO conflict mitigations proposed would be sufficient where a TO bidder seeks to participate in an SPV tender in its own geographical area. We consider that these measures would not be sufficient to address the actual and perceived conflicts of interest.</p> <p>Ofwat in its consideration of the same issue in respect of water Direct Procurement for Customers (DPC) concluded that¹:</p> <p><i>"In general, existing appointees and associated companies should not be able to bid into their own tender process. We consider that there are significant real and perceived conflicts of interest that may distort the competitive process if we allowed this. In order to maximise potential competition and therefore benefits to customers</i></p>

¹ Delivering Water 2020: Consulting on our methodology for the 2019 price review, Page 145, Ofwat, July 2017

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	<p><i>in terms of innovation, financing and other costs, it will be vital that potential bidders perceive that competition is open to all. While, in theory, the potential and actual conflicts of interests could be managed by strict governance arrangements and “Chinese walls” between appointee and DPC bidder, these arrangements introduce additional complexity and may reduce or confuse the accountability of the procurer and/or provider of services. We want to ensure that the appointee plays a complete role as the buyer of services as this will help ensure best value for customers.”</i></p> <p>A clear actual conflict is that it is very likely that the TO running the procurement process will know whether or not a bid is from its own TO bidder affiliate and if it is then be biased towards it. Another example is in setting pre-qualification requirements that favour its own TO bidder affiliate (or equally disfavour others).</p> <p>We consider that allowing a TO bidder to participate in an SPV tender in its own geographical area will have a detrimental effect on competition overall and therefore value-for-money for consumers. We also believe that a TO with an unsuccessful TO-affiliate bidder may be less inclined to see the success of the SPV than if it had not participated (as a bidder) in the bidding process.</p> <p>We have concerns as to whether TO bidders should be allowed to bid in any SPV tender process, whether within their own area or not. TOs will be privy to commercially confidential information from bidders as part of the TO bid process which could provide them with a competitive advantage in bidding in other TO’s areas. In our view, TOs should accept that the benefit of having a monopoly right in GB should be accompanied by a recognition that this precludes them from competing in GB in the same field.</p> <p>In respect of the proposed conflict mitigation measures, and whilst we do not consider these would ever be sufficient, we would appreciate further clarity on:</p> <ul style="list-style-type: none"> i) Whether a TO affiliated bidder would have access to services (under contract) from the TO in respect of supplier relationships, engineering, design, project management, asset management etc.; ii) What the restrictions would be on employee transfer.
<p>Question 7: Do you think that any changes to industry codes or standards are needed, or would be beneficial, for the SPV model?</p>	<p>We have no specific suggestions as to beneficial code changes at this stage.</p>
<p>Chapter 5 – Procurement Principles</p>	
<p>Question 1: Do you agree with our proposed procurement principles?</p>	<p>We generally agree with the procurement principles set out in Table 8.</p> <p>In respect of more specific points:</p> <ul style="list-style-type: none"> i) Whilst we agree that robustness of price should be a consideration in selection of Preferred Bidder, this inevitably leads to subjectivity in the decision-making

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	<p>process and therefore heightens concerns over conflicts of interest.</p> <p>ii) We note Ofgem’s position that the approach under which a Third Party runs the SPV tender needs to be approved by Ofgem. We are not sure why this is not the default approach as a third party running the SPV tender (based on a preliminary design and specification provided by the TO) would assist with the conflicts of interest which arise with a TO affiliated bidder. The TO would need to be involved in negotiating the Delivery Agreement with the Preferred Bidder but this approach would closely mirror the tried and tested OFTO approach in which an independent body (in the OFTO case Ofgem) runs the tender and then at the Preferred Bidder stage the Transfer Agreement is negotiated between the Preferred Bidder and the Offshore Wind Farm Developer.</p>
<p>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?</p>	<p>We would expect there to be principles set out in respect of the period between ITT submission and financial close in respect of:</p> <p>i) TRS adjustments due to new information; and ii) Market Rate Adjustments.</p> <p>We have no further points (to that outlined in our response to Chapter 5 Question 1 above).</p> <p>Either in the procurement process itself or more likely in a draft Delivery Agreement there will need to be clearly set out the risk allocation between the TO and the SPV and the revenue profile (for example whether there is revenue paid during construction).</p>
<p>Question 3: Are there any areas included in this chapter where we should not be setting requirements regarding procurement of the SPV?</p>	<p>We have no further points (to that outlined in our response to Chapter 5 Question 1 above).</p>
<p>Agilia Table</p>	
<p>Page 10: Incentive to commission (and page 37 Contract Duration)</p>	<p>We note that the proposed commercial regime is for an operational period of 25 years but which is shortened to the extent that the operations date is delayed. We understand the need for an incentive to achieve a timely operations date but also note that the SPV will already have an incentive for this if its revenue does not commence prior to the operations period commencing even if it still has access to a 25-year operational period. This is because it will be incurring additional debt and equity financing costs without recourse to the TO for these. To reduce the operational period as well means that delay liquidated damages from the SPV’s contractor(s) will need to cover both:</p> <p>i) Additional financing costs; and ii) Lost revenue.</p> <p>This will inevitably increase project costs offered by contractors. An</p>

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	<p>alternative would be to simply delay the commencement of revenues.</p> <p>In fact, not having a full 25-year operational period may increase costs for consumers as it may force debt terms to have longer tails than would otherwise be the case.</p> <p>There should also be events for which the SPV would get time relief, for example force majeure, modifications necessary to land rights and consents (for which the SPV is not at fault) and failure by the TO to timely fulfil its obligations under the Delivery Agreement.</p>
Page 13: Refinancing	<p>Whilst we understand the basis for the refinancing gain share between the SPV and consumers we would like further clarity on:</p> <ul style="list-style-type: none"> i) How this will be achieved; ii) How it will be equally applied to project financed and corporate financed SPVs; and iii) How Ofgem will take it into account when assessing the delivery route (Competition Proxy v SPV) for the assets.
Page 15: Handback	<p>What security/performance guarantees will be required for these provisions?</p>
Page 18: Independent Technical Assessor (ITA)	<p>We note that there is no need for the equivalent of an ITA in the OFTO regime in respect of <i>“assessing the annual performance of the SPV during service period to establish any availability payments and performance incentives/deductions”</i>. This is carried out by the OFTO self-reporting under its availability incentive.</p>
Page 20: Design Risk	<p>We would value further detail on what the role of the “preliminary design” is – is it just for information? Has it been used as the basis for the consenting envelope? Why is one needed at all?</p> <p>It would be useful if the documentation was more explicit on the cost / time relief in the event that the free-issued land and consents from the TO needed amendment whilst the SPV design is still within the preliminary design envelope.</p>
Page 23: Land Assembly and Planning and consents risks	<p>We note that if post SPV appointment, there is a need to acquire additional land or further consents, that would normally be classified as “employer consents”, then any delays or costs associated with this should be allowed to be passed through to the TO.</p>
Page 25 Construction Security	<p>See our response in relation to Page 10: Incentive to commission, any additional penalties payable by the SPV to the TO for delay will only increase costs further to the consumer without necessarily materially strengthening the incentives on the SPV to complete on time.</p>
Page 29 – Cost and Output Adjusting Events	<p>Agilia states that <i>“Both the SPV and the TO will be comforted to the extent that decision making under the TO licence and the Delivery Agreement can be made reciprocal”</i>. The SPV would take comfort if any decision to allow the SPV cost/output adjustments were</p>

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	<p>reflected through the TO licence but not the other way around. The SPV will want to be able to argue its case directly with the body which ultimately decides on these matters (initially the TO if mutual agreement can be reached but ultimately the body(ies) specified in the dispute resolution procedure in the Delivery Agreement.</p>
Page 30 – Third Party Asset Holders	<p>We would welcome further clarity on the type of issues which would arise in dealing with “Third Party Asset Holders”. For example, will these be minor issues which are capable of being passed down to contractors to deal with (without delay or cost increases) or are they more significant? Agilia will be aware that it would not normally be possible for a project to reach financial close without all major consents, land rights, crossing agreements etc. in place at time of financial close.</p>
Page 30 – Construction Completion	<p>It would be useful to clarify further the TO obligations under the Delivery Agreement for example in the area of making staff (and if necessary system outages) available in order to allow timely commissioning of the assets, and what relief will be available to the SPV if the TO does not fulfil these obligations.</p>
Page 41 – Asset Ownership and financier security	<p>The statement that the TO retaining operational control “<i>is in line with HSB and OFTO build principles</i>” is a surprise to us. In respect of both the HSB and OFTO projects, these will be delivered, financed owned and operated by the same party (the transmission licensee) and therefore are not parallels that can be used to justify the ownership of the transmission assets by the TO.</p> <p>However, we do not disagree with the TO retaining ownership of the transmission assets for the reasons given (the need to be able to protect the transmission assets in case of SPV insolvency).</p>
Page 43 – Insurance and Uninsurability	<p>Business interruption insurance is an operational insurance and would not be required during construction (this being covered by Delay in start-up insurance).</p>