

Ofgem
10 South Colonnade
Canary Wharf
London
E14 4PU

By email: oftobuild@ofgem.gov.uk

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Consultation on initial proposals for an OFTO-Build model to deliver non-radial offshore transmission assets

I am writing to you on behalf of Transmission Capital Partners (“TCP”), a consortium comprising Amber Infrastructure Group and Transmission Investment, in response to the above consultation. TCP manages, on behalf of International Public Partnerships Limited (“INPP”), one of the largest UK offshore electricity transmission portfolios, and currently acts as the OFTO for eleven transmission assets (including Robin Rigg, Gunfleet Sands, Barrow, Ormonde, Lincs, Westermost Rough, Dudgeon, Beatrice, Rampion, East Anglia One and Moray East). TCP, with INPP, is one of the largest offshore wind transmission businesses in GB and currently has a portfolio of approximately 4GW transmission capacity and over £3bn capital deployed.

TCP welcomes the opportunity to provide evidence to assist Ofgem in developing proposals for an OFTO Build model for non-radial offshore transmission assets. TCP has been involved in the OFTO regime from the beginning, when Ofgem originally consulted on the establishment of OFTOs in 2009 and has subsequently participated in every OFTO tender process. TCP’s proactive approach to asset management sets it apart from other industry operators and ensures both the highest availability and longest possible life is achieved from the transmission assets under TCP’s management. Our commitment to the regime, and performance within it, assists the UK in meeting its Net Zero targets.

In principle, TCP believes the OFTO Build model is an appropriate model to facilitate the development of coordinated grids. Provided that the risks are well-defined and appropriately proportioned and allocated, there is potential to seek to replicate the success of the very competitive Generator-build OFTO model which currently exists.

In addition to the detailed responses set out in the Annex, TCP would like to draw your attention to the following core elements of its response:

- (i) The proposals throughout Ofgem’s consultation are linked, for example, the choice of which party takes on the procurement will then dictate the timing of the tender process, as well as how the risks should be allocated and managed between parties. In our view, if the OFTO undertakes procurement (option 1) then the tender can commence at consent submission so long as the Generator takes on the consenting risk and compensates the bidders for any bid costs if consents are not granted. Likewise, if the Generator undertakes procurement (option 2) then the tender can commence at (or before) consent grant, however the Generator should then take a significant proportion of the risks linked to procurement of those contracts (e.g. potential construction delays or cost overruns). It may be at this stage it is most appropriate to develop both options for further consideration, or to enable developers to have options which may be more or less appropriate depending on the detail of the project.
- (ii) A key principle throughout our consultation response is that in order for the model to be investible and bankable, the risks need to be understood, well-defined, and appropriately allocated and priced. If costs are not appropriately allocated, then there is a risk that value is lost through the need to increase price (e.g. in the bid at tender) to account for unknown risks. Risks should be allocated to the party that controls the risk (e.g. if the generator procures the contracts, they should then hold the risks related to the terms of those contracts). Risks need

to be identified, clearly allocated and priced to the party best able to manage them, to deliver the most economic outcome for the consumer.

- (iii) We recognise that these proposals are for the development of an OFTO Build model for non-radial offshore transmission assets. In our view, the proposals do not need to be limited only to non-radial transmission assets. Therefore, rather than limiting the scope, the proposals could also be used for radial transmission assets, where a developer felt this appropriate.

Thank you for the opportunity to respond to this consultation. We hope the contents of this letter are helpful and we would be pleased to discuss any points raised.

Yours sincerely,



Chris Veal

Director

#	Question	Response
Procurement under a late competition OFTO Build		
1	Which party should be responsible for procurement in the late competition OFTO build model and why?	<p>Which party carries out the procurement activities, OFTO or Generator, will have a bearing on the subsequent proposals in the consultation and will determine the most appropriate allocation of risk between the parties.</p> <p>TCP prefers Option 1, where the OFTO undertakes procurement, to ensure the OFTO is involved in the negotiation of contracts for the design, construction and operation of the assets. Our preference is to directly build effective relationships with the suppliers/contractors and ensure a common understanding of the contracts to be managed during the construction phase to best be able to manage cost and delay risks.</p> <p>Whoever is exposed to the risk of delivering the contract should be responsible for negotiating the contract to ensure that objectives are aligned to drive best life-cycle value and promote strong relationships between the parties. Option 1 (OFTO procures) would mean the party negotiating the contracts is heavily incentivised to get the procurement right, which is more limited in the case of Option 2 (Generator procures), where the developer may only be partially exposed to delivery risk in the future.</p> <p>The consultation focussed on procurement and consenting but lacks detail with respect to the development of the design during these stages. The speed of design and specification drives the speed of procurement and design choices impact on life-cycle costs.</p> <p>We note Ofgem’s concerns regarding long lead times and timely delivery given supply chain constraints. TCP does recognise the congestion in the supply chain and sees that a developer leading on the procurement workstream could bring advantages. However, we note from past experience on radial OFTOs, where a number of contracts are novated to the OFTO, that the contracts have not been negotiated in the best interest of the OFTO. An OFTO led procurement would mitigate this risk, providing the OFTO tender process allows for all procurement models, such as the early engagement model (where the design is developed in collaboration with the supply chain before concluding the final EPC contract). From a financial investor perspective, the developer-led procurement introduces risk into the procurement process, and as a consequence would result in additional time being</p>

		<p>required during the preferred bidder stage to thoroughly review and potentially re-negotiate aspects of the contracts.</p> <p>In TCP's view, for there to be an investable proposition for a financial investor, much of the risk would need to be backstopped, with only the appropriate risks residing with the OFTO and being priced into the solution. Such a risk-allocation would attract low-cost capital and deliver value for money for consumers. If the OFTO carries out procurement on its own, it would be able to better manage the OFTO risks, particularly in terms of passing risk through to the EPC contractor. This is based on relevant experience in the infrastructure sector, where members of TCP were able to negotiate pass-throughs of many risks to the EPC who were able to better manage these, creating a more optimal risk profile to attract low cost of capital, and ultimately more competitive pricing.</p> <p>TCP has been considering the appropriateness of a model similar to Thames Tideway Tunnel, whereby the team who carried out the procurement was transferred across to the consortium that delivered the project. This would enable those relationships to be built and maintained from procurement into construction but would need to be further considered in more detail alongside the rest of the proposals.</p> <p>In summary, TCP would favour an early competition model where the OFTO carries out the detailed design and procurement. If the Generator carries out the procurement under an OFTO-build model, in a late competition model, TCP suggests an approach where the management team is transferred alongside the contracts may be appropriate, and risks/incentives for delivery are appropriately allocated.</p>
<p>Tender process</p>		
<p>2</p>	<p>At what point should the OFTO tender process commence? Does option 1 or option 2 present the best approach?</p>	<p>This depends on which procurement model is pursued. If the OFTO-procure model is undertaken, then the tender process should start earlier to manage timelines and avoid delays. In order to help reduce timelines in this model, we would propose that the EPQ stage is undertaken ahead of the granting of consent. The EPQ stage has not been a large cost to bidders under the very late Generator-build OFTO model. If the non-radial OFTO Build EPQ stage is similar then costs could also be small, although we accept that there may be additional requirements covering the engineering, procurement and construction capabilities and experience of bidders. If consents were not to be granted, the OFTO would require compensation for the OFTO bid costs.</p> <p>If the Generator-procure model is pursued, then the tender process can commence at consent grant, however the OFTO should bear no risk in relation to this process.</p>

		<p>TCP's preferred model would have the OFTO involved at an earlier stage (in the design process), helping to manage risk across the project (cost, development, construction and operation). Therefore, we have a preference for the OFTO-procure model in combination with the ITT commencing at consents submission (with EPQ before this), provided the risk of consents not being granted sits with the Generator, and with appropriate compensation to the bidders for bid costs if not successfully granted.</p>
<p>3</p>	<p>Do you agree with the view that, providing stakeholder engagement is properly conducted ahead of consent submission, generators should have a reasonably clear view, at the time of consent submission, as to whether the consent is likely to be granted in the form requested, and that an OFTO would be comfortable to submit tender bids on this basis?</p>	<p>See response above.</p>
<p>Timely Delivery</p>		
<p>4</p>	<p>As compared with commercial liquidated damages, how effective are options 1 and 2 in incentivising timely delivery and managing the risk of delay? Could these options make OFTO build a meaningful option for the generators?</p>	<p>TCP do not think that the delay charge proposals presented will give the OFTO a greater incentive for timely delivery than it already has under the existing radial OFTO-Build regime. The delay charge, as presented, would appear to be more focussed on Generator compensation than OFTO incentivisation. We understand that Generators may seek the need for some compensation in case of delay, however what appears to be missing from the proposals is compensation the other way (e.g. in the case the Generator is not ready to generate, but the OFTO asset is ready for transmission). In the case of Generator delay, the OFTO would not be able to fully commission the transmission assets, and as such would be prevented from receiving revenue under the TRS.</p> <p>It would appear that the proposals set out in the consultation adds a third layer of delay penalty onto the OFTO, with the first being the delayed TRS revenue due to late commissioning of the transmission infrastructure, and the second being that any delay likely has a cost associated to it.</p> <p>Under the existing Generator-build OFTO regime for radial connections, Generators are having to assume a certain amount of delay risk which they can pass small portions of to the supply chain. Given current supply chain positions, EPC contracts almost always have capped Liability Damages ("LDs"), making it rare to have a position above 10% of the relevant Contract Price. The LDs received from the supply chain are likely to be small.</p>

		<p>There will be multiple supply chain contracts in place, and when the cause of delay comes from only one contractor, the delay LDs received by the developer from this contractor will be limited and will most likely have to finance the knock-on effect on other contractors in the form of prolongation costs. Contractors are usually not able to claim against each other and all claims will go to the developer (the OFTO in this case). Generally, the result of LD claims is that the developer sits on net losses.</p> <p>In our view, the key principle is that the risk the OFTO takes should reflect the control that it has over the event. The OFTO should not be required to underwrite the supply chain (particularly in a scenario where it has not been responsible for procurement).</p>
<p>5</p>	<p>How can the OFTO delay charge and consumer underwriting in option 1, as well as the TRS loss in option 2 be appropriately set and executed?</p>	<p>With respect to Option 1, before a delay charge mechanism is decided upon, it's essential to be clear what the delay charge would cover, and what the appropriate "carve outs" would be. For example, Force Majeure events would need to be defined. Any delay charge mechanism should be project specific rather than standardised, otherwise it incentivises parties to bid for larger projects where a standardised delay charge would have less of an impact overall. In addition, it will be important to consider the interaction between these delay charges and cost risks, recognising the need to avoid increasing the costs to consumers by requiring additional OFTO equity commitment or other risk bearing capital.</p> <p>Under Option 2, our preference would be for a capped, calibrated reduction, the impact of which (aka. TRS reduction) would need to be considered in relation to the financing. Our understanding is that the TRS reduction would be comparable to the existing OFTO availability incentive. Delay penalties would be proportional to the length of the delay subject to an annual and overall cap and only apply in the first year(s) of operations. For example, a 6-month delay may result in a 0.5% TRS reduction, or 12-month delay a 1% reduction for the first year of operations only. In the case of a delay which exceeds the annual cap, the penalty would be rolled up into the following years, subject to the overall cap.</p> <p>In our view the key principle across the timely delivery proposals is that any model should have the ability to split the risks appropriately between the Generator, OFTO and the consumer. If any of these parties were not allocated a level of risk, then the model wouldn't be attractive or feasible. The consumer needs to be present as back-stop otherwise projects will fail when costs escalate beyond a cap.</p> <p>In addition, in the case of a Force Majeure event, the costs would not be able to be passed down the supply chain. During this time, the OFTO will also be incurring additional financing costs. As mentioned, a key consideration is the drafting of the Force Majeure definition. For</p>

		<p>example, if the events are defined narrowly, and are therefore able to be priced, and possibly de-risked (for example by insurance), then some of the risk could be absorbed by the OFTO. However, overall Force Majeure events are best managed by the consumer, as the biggest party able to absorb the potential costs that arise as a result.</p>
<p>Cost increases during construction</p>		
<p>6</p>	<p>Which of the four proposals offers the most suitable option for the treatment of cost increases during construction?</p>	<p>At this stage, TCP does not have a preferred option, as more information is needed with respect to the pricing and allocation of risk. A comparison at this stage is challenging without further details of the proposed cap in Option 4, as well as the potential level of exposure in a pain-gain share.</p> <p>TCP is of the view that if the Generator has undertaken the procurement, then the exposure of the OFTO should be limited within the contractual structure that the Generator would have decided during procurement, as this is where a large amount of the cost risk is determined. The OFTO's ability to manage the exposure is therefore limited under a scenario where the Generator has undertaken the procurement.</p> <p>The key consideration for these options is to ensure that the level of exposure the OFTO faces should be reflective of which party was responsible for which stages of the process (e.g. procurement), and it should be capped to limit exposure ensuring the project is financeable and bankable.</p> <p>We would also encourage Ofgem to consider why there needs to be separate treatment of delays and cost overruns, and to consider whether these could be managed under the same model (as often a delay could incur further cost and vice versa).</p>
<p>7</p>	<p>What, in your view, is an appropriate calibration for the pain-gain share mechanism outlined in options 3 and 4?</p>	<p>An initial observation is that there needs to be a cap present such that a worst-case scenario can be taken into account without unlimited overruns for the OFTO and financial investors. As such we see Option 3 as a solution that would be difficult to sell to investment committees.</p> <p>For Option 4, one idea for calibration would be to tier the pain/gain mechanism. The appropriate tiering of exposure would need to be calibrated to the other aspects of the framework, including allocating more to Generators where they have undertaken the design and procurement reflecting the more limited ability of the OFTO to shape the management of construction within the chosen contractual arrangements.</p> <p>In principle the mechanism should be symmetric, as per the indicative example below:</p>

		<ul style="list-style-type: none"> - First loss sits with OFTO, up to a pre-agreed threshold amount or % overrun. - Second level is shared appropriately, with Generators (with weighting towards the Generator) to incentivise the Generator to assist the OFTO where possible up to a cap for both OFTO and Generator. - Third level is above the cap and absorbed by consumers as a backstop (e.g. beyond a cap %). <p>This would also act as an incentive in the other direction:</p> <ul style="list-style-type: none"> - First gain sits with OFTO, up to a pre-agreed threshold amount or % saving. - Second level is shared appropriately, with Generators with weighting towards the Generator) to incentivise the Generator to assist the OFTO where possible up to a cap for both OFTO and Generator. - Third level is above the cap and awarded to consumers.
<h3>Refinancing Gain Share</h3>		
8	<p>Should we expand the refinancing gain share mechanism to cover the conversion of equity to debt or the sale of equity? How could the mechanism work in principle?</p>	<p>TCP recognises that where consumers have needed to step-in, for example to cover a proportion of cost overruns, consideration should be given to the extension of the refinancing gain share mechanism to cover the conversion of equity to debt or the sale of equity. However, we are of the view that unless this has occurred, as the equity has taken the risk, it should be appropriately rewarded. Therefore, we are not in support of extending the refinancing gain share mechanism unless consumers have needed to provide construction funding. In such a case, the extended gain sharing mechanism should only apply to the additional construction funding provided by consumers.</p>
<h3>OFTO of Last Resort</h3>		
9	<p>What do you think is the best way to deal with a failure scenario during construction?</p>	<p>In the event of a construction failure, the asset value at transfer is likely to be close to zero, if not negative. Therefore, it is likely that a different type of development or operational structure would likely need to be adopted depending on the specific scenario and reason for failure.</p> <p>Rather than trying to develop a one size fits all approach, it may be more appropriate to ensure there is optionality in the regime to select the right risk profile for the project. Either having a clear and substantial incentive for an OFTO to take over, or a mechanism which</p>

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www.transmissioncapital.com

		allows for cost pass-through whilst getting the project back on track. In some circumstances it may also mean putting the project back out to tender.
10	In the event that the appointed OFTO cannot continue with the project, which party is best placed to take the build to completion? How should the transfer value for a partially completed project be set?	See above response.