

An aerial photograph showing a winding asphalt road that curves through a landscape of vibrant yellow and green fields. The fields are divided into sections by thin, dark lines, possibly furrows or small paths. The road starts from the bottom left and curves towards the top right, disappearing into the distance. The overall scene is bright and colorful, suggesting a sunny day in a rural or agricultural area.

Early Competition

Risk Allocation and Post-Preliminary Works
Cost Assessment

Pre-Read Material

In advance of the webinar please review and consider this pre-read presentation.

In the webinar we will discuss how our proposed Post-Preliminary Works Cost Assessment (PPWCA) process could be structured and how it might work in practice to ensure that information is available to bidders and that consumers are adequately protected.

Throughout this Pre-Read we have provided a handful of questions related to the PPWCA which we would like you to consider in advance.

We will discuss these questions in the webinar and this discussion will help us further develop our views on the PPWCA in advance of our planned Phase 3 Consultation.

All content is to facilitate webinar discussion and remains indicative and subject to change.

Further information will be provided in the session on 24/25 September 2020.

Phase 2 Consultation

In the session we will briefly recap on the Phase 2 consultation position in respect of the PPWCA.

Table 1 below sets out our current preferred option, showing what is requested of bidders in their final bid and when costs in each category are expected to be fixed.

	Final bid	Post preliminary work	Post construction completion
Post-prelims cost assessment with debt competition			
1. Underlying costs	I	X	
2. Overheads/margins	X		
3. Equity cost	X		
4. Debt cost	A	X (FC)	

Key:

- I stage at which bidder provides indicative cost
- A stage at which procuring authority provides an assumption
- X stage at which bidder is committed to a cost item
- (FC) financial close for any third party debt

Phase 2 Consultation

In the session we will briefly recap on the Phase 2 consultation position in respect of the PPWCA.

'Underlying costs - without a detailed design, completed ground investigations or consents it is inappropriate to ask bidders to commit to underlying costs in their final bids. For example, as further design work is done, routes may change and solutions evolve. This would lead to changes in the quantities of labour and materials required for a proposed solution. Requiring bidders to provide committed costs for this cost category can lead to inclusion of significant risk premiums to cover the underlying uncertainties.'

Only indicative underlying costs will be requested in the final bids. The successful bidder would become committed to their underlying costs once preliminary works are completed.

The method for finalising underlying costs once preliminary works are completed is an important issue. It must ensure consumers are not exposed to the risk of an uncapped increase in construction or operating costs. A robust cost assessment process will be required to ensure only permissible changes are included.'

Phase 2 Consultation

In the session we will briefly recap on the Phase 2 consultation position in respect of the PPWCA.

‘To deliver value for consumers under the current preferred option, it is essential that the cost assessment mechanism for updating the underlying costs, from indicative to fixed, is robust.

We do not currently have a preferred option with regard to the cost assessment mechanism and we have set out some of the potential options below. Each of these would potentially also have some type of cap and/or collar in respect of refining the balance of risk between the bidder and consumers.

- Economic and efficient review – at the point costs become committed, the procurement body/Ofgem would consider whether the costs being presented are those of an economic and efficient solution provider. In making such an assessment, they would be able to call on the indicative costs provided at bid and a comparison of the accompanying initial design against the detailed design. There is a potential concern, expressed by some through our stakeholder engagement, that such an assessment may be considered subjective*
- Cost containment – rather than assess all underlying costs at the cost assessment point, it may be possible to determine some costs that can be fixed in the final bid and others that are indexed or benchmarked in an agreed manner. This could help avoid any perceived subjectivity, or*
- Pain/gain share – any difference in cost at the cost assessment point from the indicative amount in the final bid could be shared between the consumer and the successful bidder. This would incentivise the bidder to:
 - o try and accurately forecast costs in their final bid, and*
 - o minimise cost increases/find cost saving in their detailed design.’**

Phase 2 Consultation Feedback

In the session we will briefly recap on the Phase 2 consultation feedback in respect of the PPWCA.

'Stakeholders highlighted several considerations on a cost assessment mechanism for fixing underlying costs:

- Appropriate payments following successful completion of post-tender milestones will incentivise efficient delivery of the selected projects. Post-tender milestone payments should clearly be laid out in the Invitation to Tender (ITT) stage*
- The cost assessment mechanism must avoid unduly penalising the developer for costs beyond their control, at least for large value projects*
- Established cost assessment processes in place under the OFTO and interconnector cap and floor regimes demonstrate how costs can be evaluated objectively on a case-by-case basis*
- Certain points such as robust checks, appropriate level of assurance etc., need to be given consideration during cost assessments*
- All participants involved in the development of onshore transmission network should be subject to identical processes for fixing underlying costs after preliminary works are completed.*

For one stakeholder, the economic and efficient review of the OFTO regime has proven lengthy and contentious.'

PPWCA Process Interactions

In the session we will start to discuss how the PPWCA might interact with earlier process steps.

Pre-Tender
Stage

What information will bidders require pre-tender in respect of the PPWCA?

Tender Stage

What information will the Procurement Body need to record in respect of the PPWCA?

PWs Stage

Will any pre-PPWCA actions be required in the PWs stage?

PPWCA Structure and Parameters

In the session we will start to discuss the potential structure of and parameters within the PPWCA.

We indicated the PPWCA would be undertaken towards the end of the PWs stage - in undertaking this process there are some key questions as follows.

- Who should undertake and decide upon the outcome of the PPWCA?
- Should there be an appeals process and/or a dispute resolution process in respect of the PPWCA?
- Should there be a minimum trigger threshold i.e. should there be a deadband where cost changes (upwards and/or downwards) do not trigger the PPWCA?
- How should the PPWCA determine whether or not a cost change is fully or partially 'permissible' and therefore results in an upward or downward adjustment to the TRS?
- Should there be an upward adjustment cap/and or a downward adjustment collar in the PPWCA?
- If so, should there be any exclusions to this cap and/or collar?
- How should the PPWCA process consider any delivery stage contingency sums within the TRS?

PPWCA Discussion Exercise

In the session we will discuss an example shared risk in the context of the PPWCA.

In our Phase 2 Consultation we noted that we anticipate that consents risk should be a shared risk and we noted that *'consenting will be undertaken as part of preliminary works before a final consented design is known and before final solution costs are fixed [and] from this point the bidder would be expected to maintain their price, including in relation to delivery of planning conditions.'*

Considering your earlier views and the discussion to date how can we ensure that the PPWCA process ensures that consenting risk is 'correctly' assessed and only 'permissible' circumstances and resulting cost changes flow through into TRS adjustments?

What circumstances do you think should and should not result in permissible adjustments?

For example:

- As a result of surveys required to submit a planning application?
- As a result of launching a planning appeal?
- As a result of defending against third-party planning challenge?
- As a result of changes to solution design to achieve planning consents?
- As a result of planning conditions?

Are there any common principles which could be applied to all such circumstances?

PPWCA Discussion Exercise Example

In the session we will discuss an example shared risk in the context of the PPWCA.

Tender Stage

Is it reasonable to expect bidders to have researched publicly available information and undertaken high-level design and desktop studies?

Is it reasonable to expect bidders to understand the relevant consenting processes and the requirements to develop and submit competent consenting applications, as well as the costs of doing so?

Is there anything else bidders should reasonably be expected to do in respect of consenting at this stage?

Should bidders therefore bid on the basis of the above and the technical tender evaluation should then assess the cost and programme considering the above?

PPWCA Discussion Exercise Example

In the session we will discuss an example shared risk in the context of the PPWCA.

Preliminary Works Stage

Should the PPWCA process review the bid submission and the preliminary works circumstances to determine what cost changes and TRS adjustments are permissible, potentially subject to a cost adjustment cap?

Should TRS adjustments not be permissible if resulting from bidders not undertaking reasonable actions e.g. arising from good industry practice not being following for the consenting process?

If consenting obligations change in an unforeseeable manner then should TRS adjustments be permissible in relation to the impacts of such changes?

On appeals it is unlikely efficient to have appeal cost risk priced into the TRS so should the efficient cost of appealing or defending against an appeal be considered as permissible for TRS adjustments? What about where this is due to the actions of the bidder e.g. if they have not followed good industry practice?

On planning conditions, should reasonably foreseeable planning conditions for the proposed solution not be permissible, whereas reasonably unforeseeable planning conditions should be permissible?

Should there be no adjustments allowed in respect of a change to the cost of undertaking the consenting process and if so should there be an exception for the cost of appeals in some circumstances?

Post-PPWCA Risk Considerations

In the session we will start to discuss how risk sharing could remain relevant after the PPWCA.

Delivery Stage

Assumption that Post-PPWCA any further TRS Adjustments would only be through relevant Income Adjusting Events?

Operational Stage

Assumption that Post-PPWCA any further TRS Adjustments would only be through relevant Income Adjusting Events and Incentive Performance?

Decommission Stage

Assumption that Post-PPWCA any further TRS Adjustments would only be through relevant Income Adjusting Events?

Next steps

- Please take time to answer our short feedback poll, at www.sli.do using code #RACA to allow us to further improve your experience for future events.
- Alternatively, please contact us by email at: Box.earlycompetition@nationalgrideso.com
- The slides and any notes from this session will be made available on our website.
- Our next milestone is the Early Competition Phase 3 Consultation document which we expect to publish in December 2020.

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