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Offshore Electricity Transmission: Consultation on Draft Model Sale and Purchase Agreement (“Draft SPA”) and Draft Data Room Population Guidelines for Transitional Tenders (“Draft DR Guidelines”)

Dear Richard,

Thank you for the opportunity to comment on Ofgem’s proposals for the Draft SPA and the Draft DR Guidelines, as contained in Ofgem’s letter of 6 May 2009, and the Appendices thereto. You will be aware that we are very focussed on the appointment of an OFTO for two transitional projects, Thanet and Ormonde.

Although we remain fully committed in assisting Ofgem and DECC to implement a successful OFTO regime, there are a number of principle issues and specific areas within the Draft SPA and the Draft DR Guidelines which we believe must be considered and developed further if the OFTO regime is to succeed.

Some key areas of concern are as follows:

- The Draft SPA issued to bidders as part of the ITT must be in a form acceptable to the Vendor at the outset, rather than purely a “model” SPA prepared by Ofgem (and its advisors) which might reflect only some, and not all of a particular Vendor’s comments raised during this consultation stage;
- The Vendor must be entitled to freely negotiate the Draft SPA with the Purchaser, “structured dialogue” cannot be unduly restricted and the “relevant timescales” must be workable;
- The Draft SPA should reflect the particular circumstances of the sale, in that it reflects less of a sale of assets for profit but rather a transfer of assets at cost, and therefore matters such as the extent of warranties given by the Vendor should reflect this;
- A Vendor must not be exposed to delays beyond its control which will prevent it from transmitting electricity after the Go Live Date, such as delays which occur during the negotiation of the Draft SPA;

- Valuations must be made at the appropriate times, and based upon the appropriate parameters to ensure that a Vendor is fully and fairly compensated for all its development costs associated with the Assets and the Contracts which are the subject of the sale, as well as its related costs, including those incurred preparing and executing the Transition Plan and those incurred during the tender process; and
- In the same way that Ofgem has indicated that it would be beneficial for a bidder to indicate revenue implications of any changes to the Draft SPA, the Vendor should equally be entitled to indicate how particular changes to the Draft SPA requested by a bidder would affect the valuation of the Assets and Contracts which are the subject of the sale, if those changes were to be accepted by the Vendor.

In addition to the above, we attach two Schedules to this letter which set out our specific comments, Schedule 1 being our comments on the Draft SPA and Schedule 2 our comments on the Draft DR Guidelines.

Finally, please note that neither this letter, nor any of the comments contained in it should be taken as any express or implied acceptance by Vattenfall (or any of its affiliates or subsidiaries) of any of the terms of the Draft SPA or the Draft DR Guidelines, both of which will be considered and negotiated on a project by project basis.

I hope you find these comments useful and if there is any element of this response that you would like to discuss further then please do not hesitate to contact me.

Yours sincerely

Niclas Broman
Vattenfall Wind Power Limited

SCHEDULE 1 - THE DRAFT SPA

Introductory Notes:

1. Our comments appear in the same order in which the relevant issues are documented in the Draft SPA.
2. In relation to tax, property and employment issues within the Draft SPA, our comments appear in separate sections at the end of this Schedule.

Clause 2.1 - Conditions to Effective Date

- a. There seems to be some confusion within the document as to the Effective Date of the SPA. This concept is defined as the date on which the Conditions Precedent ("CPs") are satisfied. However if the CPs are not satisfied by the date to be inserted in Clause 2.10.1, then the SPA will not be effective and will terminate in accordance with Clause 2.11. Furthermore, the Draft SPA contains certain obligations which are stated to apply from signing of the SPA, rather than from the Effective Date. We assume that these anomalies will be addressed in subsequent iterations of the Draft SPA.

Clauses 2.5 to 2.8 - Satisfaction of Conditions

- a. Part A of Schedule 1 (CPs to Effective Date) includes conditions which relate to licensing and Framework Agreement arrangements. As such, these are CPs which the Purchaser ought to satisfy, and not both Parties as is currently drafted. In addition, and owing to their importance, delivery of evidence that these CPs have been satisfied ought to be to the Vendor's reasonable satisfaction.
- b. Part B of Schedule 1 (General CPs to Completion) includes a condition that certain legislation (sections 89 and 90 of the Energy Act 2004) is in full force and effect. It is not realistic to expect the Parties to satisfy or procure the satisfaction of any condition relating to implementation of legislation, and Clause 2.6 should be amended to reflect this.
- c. Part C of Schedule 1 includes the Vendor CPs to Completion, which are referred to in Clause 2.7. As the Vendor is selling the Assets and the Business under a statutory regime, it is not reasonable to expect the Vendor to bear the cost of procuring third party consents to transfers, both in terms of expenses and other premiums that may be payable to third parties. The exception to this would be if the Vendor is able to recover these (and other related costs) through the Ex Post Valuation procedure and specific guidance ought to be provided by Ofgem as to whether this is the intention.

Clause 2.10 - Failure to Satisfy or Comply with Conditions

- a. Clause 2.10.1 includes a proposed longstop date for satisfaction or waiver of CPs. We would recommend that certain parameters for this date, in relation to the signing of the SPA are included as a note in the Draft SPA. This date will need in built flexibility to reflect the changing circumstances of a project

under construction, including matters such as supply chain constraints, project issues and the management of time windows.

Clause 3.3 - Consideration

- a. Can Ofgem please explain the rationale of the apparently arbitrary payment of only 75% of the Initial Purchase Price. The Vendor would expect to receive the full 100%.

Clause 4 - Excluded Assets and Contracts

- a. We would expect the Draft SPA to contain, at the very least a note to the effect that certain Assets may not be capable of being physically divided and are thus incapable of being transferred in their entirety. In other words, only part of an Asset might be transferred to a Purchaser, and the other part will remain under the ownership, operation and maintenance of the Vendor. Clearly there are a number of consequences of this, all of which will need to be negotiated and agreed on a project by project basis, however explicit recognition of such eventuality should be included in the Draft SPA. In addition, it may be prejudicial to the Vendor to reveal contractual information about its retained assets.
- b. Connected to the issue in (a) is the possibility that a particular contract may include the construction of both Assets which are to be sold to the Purchaser and Excluded Assets which are to be retained by the Vendor. It may in certain cases be appropriate for the Vendor to retain the construction contracts (which would then be Excluded Contracts) and for the Purchaser to receive the benefit of collateral warranties from the construction contractor. Obviously the construction contract would need to make express provision for this. The Draft SPA should expressly acknowledge such arrangements, which will need to be agreed on a project by project basis.
- c. As regards insurance, if the Vendor intends to cancel any insurance policies relating to any Assets at the time of Completion (or if they are to lapse), then the Draft SPA should include a note that these will be Excluded Contracts. This will depend on the specific insurance policies for each project.

Clause 6 - Third Party Consents for Transfer of Assets and Contracts

- a. In respect of Clauses 6.1 and 6.7.2, the same point as is made in Item 2 (c) of this Schedule 1 will apply, namely that the Purchaser ought to be compensated in the Ex Post Valuation for its reasonable costs incurred in obtaining Third Party Consents.
- b. In respect of Clause 6.3, there must be a limitation on the Vendor's indemnity obligation. A necessary agreement or consent in relation to the Transfer of an Asset may not have been obtained, despite the Vendor having used all reasonable efforts to obtain it. In such circumstances, the Vendor's liability in respect of the indemnity should not exceed the amount of consideration paid by the Purchaser in respect of the particular Asset which is ultimately not transferred. The same principle also applies to the indemnity given by the Vendor pursuant to Clause 6.8 of the Draft SPA.

Clause 7.5 - Excluded Liabilities

- a. Under Clause 7.5.4, an Excluded Liability includes a liability in which the Vendor is entitled to be indemnified against under a policy of insurance. This needs to go further and extend not only to a liability that the Vendor is entitled to be indemnified against but one that the Vendor is actually indemnified against. Although a policy of insurance may on its face provide for an indemnity, an insurance company can, and frequently does dispute the extent of a claim.

Clause 10 (Generally) - Conduct of Vendor Activities Before Completion

We have a number of observations on Clause 10.

- a. The drafting should more clearly reflect that all of the obligations in Clause 10 will cease to apply on Completion. This appears to be the intention though it is not reflected in all of the sub-clauses.
- b. In addition, certain obligations in Clause 10 (for example those in Clauses 10.3, 10.4, 10.8, 10.10 and 10.14) should only apply as from the Effective Date (rather than from the date of the SPA), as the Purchaser should only be granted such degree of control/influence over the Business if it has already been awarded the transmission licence and is therefore reasonably likely to be able to proceed to Completion.
- c. There are cost implications associated with many of the obligations in Clause 10, such as providing the Purchaser with access to inspect the Assets and the Sites. Again there will be cost implications here which will need to be factored into the Ex Post Valuation.

Clauses 10.12 and 10.13 - Restrictions on Vendor Activities Before Completion

- a. Any restrictions should not:
 - i. Prevent security being granted in the event of a refinancing or security being granted in respect of financing which will be discharged on Completion, and this should be expressly recognised in Clause 10.12.2, and
 - ii. In Clause 10.12.13, there will be exceptions to the requirement that all transactions should be at arms length and full value, for example intra company loan arrangements. This should be noted in the Draft SPA.

Clause 11 - The Transition Plan

- a. The Vendor should be entitled to recover its reasonable costs and expenses associated with preparing and implementing the Transition Plan and this should be recognised in the Draft SPA and be included in the Ex Post Valuation.

Clause 17 - Deferred Consideration

We have a number of issues with Clause 17 as follows:

- a. When and how will Ofgem make the Ex Ante and the Ex Post Valuation. Although not an SPA point, guidance should be provided by Ofgem on what matters will and will not be considered when making these valuations.
- b. What mechanisms exist for challenging (by judicial review or otherwise) an Ex Ante or Ex Post Valuation?
- c. What is the mechanism for repayment in the event of a successful challenge?

Clause 18 - Post Completion Activities

- a. It would be reasonable to include a provision allowing the Vendor (and its advisors) reasonable access to the Assets and Sites post Completion. This is necessary to ascertain and evaluate either the cause of any technical problems experienced with the Assets, or loss or damage suffered to any of the Excluded Assets. On Completion, the Vendor may retain certain contractual rights (including a right to compensation) against, for example, construction contractors who installed the Assets.
- b. It would also be reasonable to expect the Purchaser to comply with any orders or instructions of the Vendor in the event of an emergency and any security procedures of the Vendor and this should be noted in the Draft SPA.
- c. The Draft SPA will also need detailed provisions relating to any assets which remain “shared” post Completion, particularly in relation to matters such as usage, operation and maintenance, access, insurance, health and safety (including the CDM Regulations) etc. This will only be necessary to the extent that such provisions are not already covered by the Interface Agreement to be entered into between the developer and the OFTO in accordance with the CUSC.

Schedule 1 - Conditions Precedent

- a. The evidence provided in Part A must be to the Vendor’s reasonable satisfaction.
- b. The transfer of assets, contracts, licences etc to the Purchaser should only be required to occur at Completion. Otherwise, transfer could occur even though Completion might not subsequently occur. Therefore any CPs which relate to transfer should allow the Vendor to provide documentation whose effectiveness is subject to Completion occurring under the SPA.
- c. In respect of transferring, assigning or novating Key Contracts (Part C, item 8), the Draft SPA will need to acknowledge that the Parties will need to negotiate whether all aspects of each Key Contract will be transferred etc. A Key Contract may relate to more than just the Assets and the Business and elements of it may need to be retained by the Vendor. Also, the Vendor may need to retain the benefit of defects liability warranties under a Key Contract, both in respect of the Assets and other assets (in case, for example, a defect with the Assets causes damage to assets owned by the Vendor post Completion). This may be done by providing collateral warranties from the contractor.

Schedule 8 - Warranties

- a. The extent and content of any warranties will be agreed on a project by project basis, however the Vendor should as a general principle only be offering very limited warranties. As currently drafted we believe that the extensive warranties go far beyond what is likely to be acceptable to a Vendor. The Vendor's warranties should be limited to matters such as its title to physical assets and contractual rights, and should exclude the quality of those assets and rights, as the Purchaser's recourse for any defect in this regard should be against the construction contractor and other relevant contractual counterparties, rather than against the Vendor.
- b. Specifically,
 - i. The back to back warranties of the kind referred to in Item 1.3 (Condition Of Assets) are unacceptable,
 - ii. The warranty as to capability of assignment in Item 4.3.1 cannot be given as certain assignments will require consent to be given,
 - iii. In respect of Item 4.3.2, the Purchaser will know which contracts it is obtaining and as part of its due diligence, and it should satisfy itself that the Agreement or Completion would not cause a particular contract to terminate,
 - iv. Certain warranties should be expressed as being "save as otherwise disclosed to the Purchaser" (for example, Items 1.4, 3.3, 5.1),
 - v. The warranty contained in Item 4.4 (Material information) should be limited to the information in the possession of the Vendor,
 - vi. Item 5.4 is duplicated in Item 11.3,
 - vii. As regards insurance (Item 11), there should be a note in the Draft SPA that the warranties will only apply to the extent that the Purchaser will receive the benefit of any of the Vendor's insurance policies,
 - viii. Item 12.6 should only be by reference to the Vendor's knowledge, and
 - ix. Item 12.7 should be deleted in its entirety as the Purchaser should rely on its inspection surveys and own due diligence.

Schedule 9 - Limitations of Liability

- a. Although we recognise that the specific limitations of liability will be determined on a project-by-project basis, Item 3.2 should be amended as contemplated by Item 3.3.
- b. We would expect to see a cap on the Vendor's aggregate liability.

Employment Provisions - Clause 10.13 together with Part B of Schedule 7 (Terms of Transfer of Employment) and paragraph 13 of Schedule 8 (Warranties)

- a. The stand-still provisions at Clause 10.13 prevent the Vendor and any "other entity in relation to the Business" from doing certain acts in connection with

Transferring Employees in the period pending Completion. The reference to “any other entity” is very wide and please note our comments in Item 16 (c) of this Schedule 1. In addition, the clause should be qualified so that the Vendor is not prevented from making business decisions in the “ordinary course of the business”. Clause 10.13.2 prevents, amongst other things, the Vendor from dismissing any of the Designated Employees’ employment in the period pending Completion; however, dismissals for gross misconduct should be excluded. Further, there may be occasions when the Vendor seeks to retain certain of its employees by redeploying them within its business, but, Clause 10.13 would prevent the Vendor from doing this in the period pending Completion. The clause should, therefore, be amended to specifically exclude any employees who “object” to the transfer.

- b. In respect of Clause 13 of Part B of Schedule 7, a new clause 13.4 should be inserted to ensure that the Purchaser indemnifies the Vendor in respect of “any claims in respect of which the Purchaser is able to recover under any insurance policy.” Further, an inaccurate cross-reference appears at clause 13.1 of Part B of Schedule 7 and the reference to “sub-paragraph 2.14” should be clarified.
- c. With regard to the warranties in Section 13 of Schedule 8 (Employees), some of the warranties should be narrowed in scope. The reference to “no entity” or “any entity” at Sections 13.2, 13.3.1 and 13.3.2 should be amended to refer to the Vendor. Section 13.4 should be restricted to the Vendor’s “reasonable knowledge” and a similar restriction should appear at Sections 13.5.1 and 13.5.2 in so far as these clauses relate to “threatened or anticipated” disputes/complaints; and these warranties should be confined to “Designated Employees” and former employees who were employed wholly or mainly in relation to the Business. The reference to “codes of practice” at Section 13.4 should also be deleted, as this is too wide.

Tax provisions - Generally

- a. A number of definitions are included, although they are not used in the Draft SPA and should therefore be deleted. In addition, abbreviations are used, but not defined, so further definitions may be required.
- b. We note that the inclusion of certain clauses in relation to taxation in the Draft SPA are merely suggestions and purely illustrative and may not be appropriate in all cases. The SPA will need to be tailored and the inclusion of various clauses considered on a case-by-case basis.
- c. In relation to VAT and the possible treatment of the transaction as a going concern (Clause 19), the Draft SPA provides that the Purchaser is required to obtain written confirmation from HMRC that the sale will be treated as a going concern. There is a risk that HMRC will not give such a ruling, given it has indicated that it will only give rulings where the application involves a genuine point of doubt, which is unlikely to be present in all cases. In addition, in order that the taxpayer can rely upon such a ruling, it would be more appropriate for it to be requested by the Vendor and for the Purchaser to indemnify the Vendor for its costs in so doing.

- d. In the event that the consideration is paid into an Escrow Account in accordance with Clause 19.6 of the Draft SPA, VAT may still remain due to HMRC. The Draft SPA does not deal with the issue of who bears the interest and/or penalties if VAT is not paid on time. Liability for such penalties and/or interest should not rest with the Vendor. We would assume that interest arising on the Escrow Account will be applied but this may not be sufficient to cover all the interest incurred on late payment of VAT.
- e. Owing to the nature of the transaction, the Vendor will resist giving any of the warranties contained in Section 15 of Schedule 8. Any tax warranties that the Vendor does concede should be qualified with "so far as the Vendor is aware". In addition, it is unreasonable for the Vendor to take the risk in relation to stamp duty land tax. Accordingly, Section 15.8 in Schedule 8 should be deleted.

Property Provisions - Generally

- a. *Schedule 5 Part D - Terms of Transfer, Assignment and Novation of Property Contracts*
 - i. Paragraph 3.1 - We query whether or not 5 business days is a long enough period for completion of the assignment of a lease once the necessary consents have been obtained. 10 business days may be more appropriate to give sufficient time for documents to be signed, and the apportionment of rent and outgoings to be determined and agreed.
 - ii. Paragraph 6 - Whether or not the Vendor is in a position to assign the lease with full title guarantee will depend on the particular project, and it would therefore be more appropriate to limit the covenants as to title being given.
 - iii. Paragraph 7 - We would suggest that the list of matters subject to which the lease will be assigned is extended to closer reflect the standard position on a property sale. This list should therefore include for example, existing rights and easements affecting the site, public requirements, notices or requirements of any competent authority, notices orders agreements or other matters relating to planning electricity transmission or environmental law, and matters disclosed in replies to any pre-contract enquiries raised by the Purchaser's solicitors.
- b. *Schedule 8 Section 12 (Property and Property Contracts)*
 - i. Paragraph 12.2 - The warranty as to the accuracy of replies to enquiries as at Completion should be limited such that disclosures between the date of signing the SPA and Completion are taken into account.
 - ii. Paragraph 12.4.1 - This warranty (as to there being no covenants, conditions, restrictions or other matters affecting the site which are unusual or onerous or prejudicially affect the use or occupation of the site) is potentially far reaching, and should therefore be qualified

such that the Vendor only warrants that there are no such matters affecting the use or occupation of the site in a material respect.

- iii. Any warranty relating to the Vendor giving a confirmation in relation to something which is the responsibility of a third party (e.g. paragraph 12.4.2) should be deleted.
- iv. Paragraph 12.7 - Any warranties relating to the condition of the sites should be deleted as the Purchaser should rely on its own inspection and enquiries.
- v. Rather than giving an unqualified warranty/absolute confirmation (e.g. no rights of occupation or enjoyment are being acquired in relation to the site), the relevant sections should be amended to give the warranty/confirmation, but only insofar as the Vendor is aware.

SCHEDULE 2 - THE DRAFT DR GUIDELINES

1. We would expect further guidance on how the Draft SPA initially prepared by the Vendor as part of the ITT will be developed and negotiated between the Vendor and successful bidder, to include matters such as direct negotiation between the parties and the relevant timescales.
2. In respect of all of the Information Categories in Sections 2.1 to 2.15 inclusive, these should be qualified and limited to information in the Vendor's possession only.
3. Certain categories of information should be clearly referable to only the Assets and contracts which are being transferred, e.g. Section 2.2.3, Sections 2.2.5 to 2.2.7 etc.
4. We would expect to see a note to the effect that the data room will be kept open throughout the entire tender process and the Vendor can add to, remove from or amend documents at any stage during the tender process.
5. We would expect there to be data room rules advising bidders on how they can obtain access to the data room documents.
6. In terms of information categories, these seem very extensive, however the Draft DR Guidelines do recognise that the precise information to be included in the data room will reflect the stage each project has reached and the information ultimately disclosed by a Vendor will be determined on a project by project basis.
7. We would expect to be included the details and processes that would oversee the completion of all construction activities related to the Assets prior to Completion.
8. We would expect to see Ofgem guidance on how the process of bidders questions and clarifications will be dealt with. This should include matters such as the timing of raising clarifications, the time for response, the form in which clarifications should take and details of any clarification meetings. The Vendor should be compensated for costs incurred in answering clarifications.
9. Ofgem/DECC may need to formally request the inclusion of certain documents in the data room so as to avoid a Vendor breaching any confidentiality obligations contained within those documents. In general terms, a Vendor will need to have due regard to any confidentiality obligations it has before considering whether or not to disclose a particular document.
10. Bidders should be alerted to the fact that certain documents might be redacted so as not to disclose certain information confidential to the Vendor.
11. Various items of information included needs the same qualification as in Section 2.4, "In relation to the transmission system only".

12. To the extent that any bidder is entitled to, and does rely on any information contained within the data room, then any applicable limitations of liability in any documents will apply.
13. Any categories of information which contain questions of subjectivity (e.g. Section 2.1.2 H) should be deleted and should be a matter for the Purchaser to ascertain.
14. There are various duplications which should be removed, e.g. Section 2.1.2 (H) and Section 2.1.3 (G), Section 2.1.2 (D) and Section 2.1.3 (D) etc.
15. Cross references errors should be corrected in further iterations. For example, the reference to "sections 2.4.1 - 2.4.3" in section 2.2.4 should be a reference to "sections 2.2.1 to 2.2.3". In section 2.12.2, the reference in the first line should be to section 2.12.1 and not section 2.14.1.