UK Offshore Transmission

Investment Opportunity

July 2009

RBC Capital Markets®

INTRODUCTION

Ofgem will launch the first round of competitive tenders for offshore electricity transmission licences, with the publication of its Pre-Qualification ("**PQ**") document. This first round of tenders, known as the transitional regime, will identify offshore transmission licensees to own and operate transmission assets which have been, or are being, constructed by the developers of the relevant offshore wind generation projects. The first tender process under this transitional regime will grant licences for up to nine projects with a combined asset value of up to £1150 million.

Successful bidders will receive a 20 year revenue stream in return for purchasing the transmission assets from the offshore wind generator and operating them for the term of the licence. Importantly, the revenue stream will be dependent upon transmission asset availability, rather than actual utilisation.

In order to provide potential bidders with sufficient information about the opportunities available in this first round of tenders, Preliminary Information Memorandums ("**PIMs**") are available for each of the relevant transmission assets. This document is an overview which should be read in conjunction with the PIMs and updates the initial information published in April 2009.

BACKGROUND TO THE OPPORTUNITY

A Binding EU Renewable Energy Target

Under the EU Renewables Directive (2009/28/EC), which came into force in May 2009, the UK Government has committed itself to a legally-binding target of sourcing 15% of all energy use from renewable sources by 2020. Given the relative maturity of the renewable technologies and government policy in electricity generation compared with other sectors (i.e. transport and renewable heat), in order to meet this target the UK Government is aiming to generate over 30% of the country's electricity from renewables by 2020.

Commitment to Offshore Wind

A key part of this commitment is the UK Government's ongoing support for offshore wind generation. Indeed, the UK recently overtook Denmark as the country with the largest offshore wind deployment in the world with 597MW now installed. In late 2007 the Secretary of State for Business, Enterprise and Regulatory Reform ("**BERR**"), the department responsible for renewable energy prior to the creation of the Department of Energy and Climate Change ("**DECC**"), announced proposals to open up UK waters to up to 33 GW of offshore wind energy, a 25 GW increase on the 8 GW previously planned. This commitment was reaffirmed in the recent joint DECC/Ofgem Statement of 17th June 2009.

In order to deliver this deployment, the UK Government has recently increased the level of financial support available to offshore wind generators. The recent introduction of banding into the Renewable Obligation (" **RO**"), which has now been extended to 2037, has increased the number of ROCs offshore wind generators are eligible to receive per MWh of electricity generated from 1 to 1.5. In addition, the Government has stated its intention to provide further support under the RO to projects which meet certain eligibility criteria. Under the current proposals, projects which enter into a firm contract for delivery of wind turbine generators by 31 March 2010 and start construction by end of December 2011 should be eligible for 2.0 ROC / MWh while projects which enter a firm contract for delivery of wind turbine generators between 1 April 2010 and 31 March 2011 and start construction by end of December 2012 should be eligible for 1.75 ROC / MWh.

Investment in Offshore Transmission

In order to meet the Government's target for renewable energy, it is estimated that the investment in electricity transmission infrastructure required to connect the offshore wind farms which are already in operation, under construction or development and planned under the Crown Estate's current 'Round 3' initiative will be of the order of £15 billion. The majority of this infrastructure is yet to be built.

Regulating Offshore Transmission

Ofgem is the office which supports the Gas and Electricity Markets Authority (the "**Authority**"), the independent regulator of the gas and electricity markets in Great Britain. Since taking powers in the Energy Act 2004 ("**EA 2004**"), the Government has worked with Ofgem to establish an offshore transmission licensing regime to regulate the conveyance of electricity along high voltage lines offshore (defined in the EA 2004 as those with a nominal voltage of 132 kV or more) and associated plant and equipment which connect offshore generating stations to the onshore electricity network.

The offshore transmission regime has been developed and refined with stakeholder input over the past four years, and the consultation process for the design of the regulatory regime culminated in a final statement published in June 2009. This can be found via the following link: www.ofgem.gov.uk/Networks/offtrans/pdc/cdr/cons2009/Documents1/Main.pdf. The regime has been designed to ensure connection to the onshore grid in a timely and cost effective manner, whilst maintaining the integrity of the system as a whole and achieving best value for electricity consumers.

Competitive Tender

One of the key decisions made by the Government was that offshore electricity transmission licences would be granted by way of a competitive tender process, with the successful bidder becoming the Offshore Transmission Owner ("**OFTO**"). The Government also decided that Ofgem would be the body that runs these tenders. These licences will convey certain rights and responsibilities on OFTOs, including the right to a regulated revenue stream for an initial period of 20 years in return for the provision of transmission services. Ofgem has undertaken significant work on the design of this process and this document includes a summary of the process for the initial round of tenders for relatively well-advanced offshore wind projects which have transmission assets rated at 132 kV or more.

This first transitional tender will be for transmission assets which have been, or are to be, constructed by the offshore developer, and where the developer meets certain pre-conditions. The regulatory regime for these assets is known as the 'transitional' regime. The first licences are expected to be granted by June 2010. Projects which do not qualify for the transitional regime will be part of the 'enduring' regime.

The key difference between the enduring and transitional regimes is that for the transitional regime the potential OFTOs will bid a revenue stream in return for purchasing a completed transmission asset from the developer and operating it for the 20 year licence period, while for the enduring regime potential OFTOs will bid a revenue stream in return for actually constructing, as well as owning and operating, the relevant transmission assets.

Qualification for the First Transitional Tender

The criteria for an offshore wind project to be classified as a qualifying transitional project are set out in a new piece of secondary legislation – the Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2009 ("**Tender Regulations**"). To be determined as a transitional qualifying project, developers need to demonstrate that they have:

- entered into a bilateral connection agreement with the NETSO, or entered into an agreement or accepted an offer of an agreement, with the electricity distributor responsible for the distribution system to which the transmission assets are or are intended to be connected; and
- obtained all necessary consents and property rights for the transmission assets to be constructed and maintained; and
- completed construction of, or entered into all necessary contracts for the construction of the transmission assets; and
- it has secured financing to construct the transmission assets ('financial close' or equivalent, such as final investment decision and/or board approval).

Each project that has met Ofgem's qualifying project criteria is additionally required to demonstrate that it has met a number of tender entry conditions before it is confirmed as being in the first tender round. Again, these are required in accordance with the Tender Regulations. Each developer must:

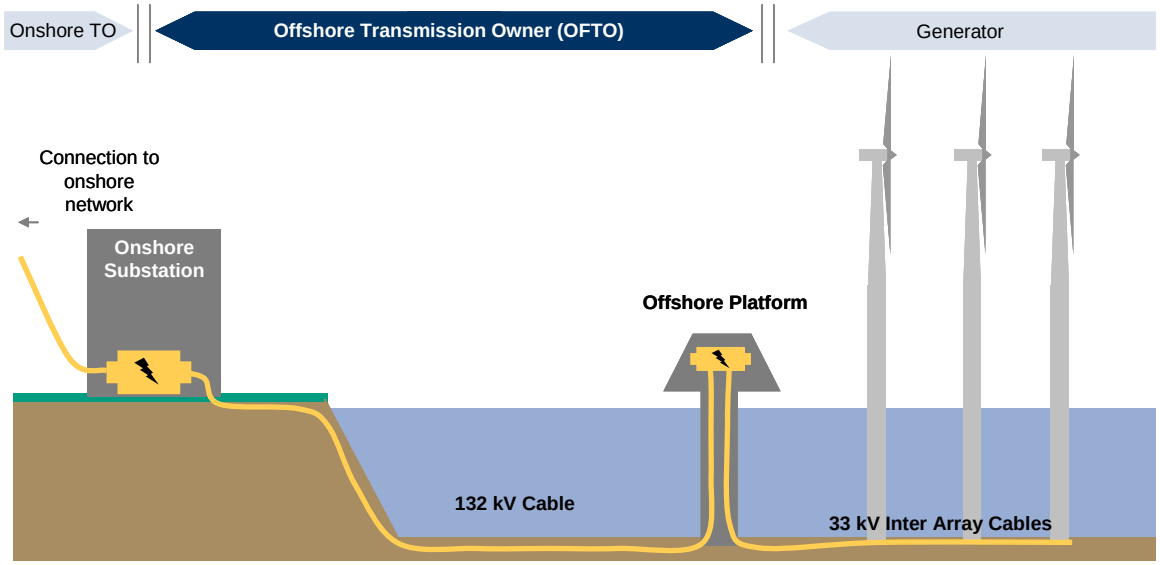
- provide information to Ofgem to enable it to issue an information memorandum and establish a data room;
- provide a written warranty to Ofgem that the information provided is to the best of its knowledge true, accurate and complete in all material respects;
- populate Ofgem's model Sale and Purchase Agreement to reflect the specific requirements and circumstances of the project, and provide an undertaking that it will work with Ofgem to finalise this document as soon as is reasonably practicable; and
- provide a number of other undertakings to Ofgem, specifically to
    - provide information and documentary updates where necessary to enable Ofgem to update the data room;
    - respond to queries from Ofgem and respond to clarifications submitted by bidders within reasonable timeframes;
    - transfer any property, rights or liabilities in or relating to the transmission assets to the successful bidder, in accordance with the Sale and Purchase Agreement; and
    - if applicable, put in place an appropriate internal information barrier to prevent information passing between the team working on the project and any bidding team.
- Those projects that have demonstrated that they have met the criteria to become a qualifying project are required to meet these tender entry conditions by a date specified by Ofgem.

OVERVIEW OF THE INVESTMENT OPPORTUNITY

The Transmission Assets

The OFTO will own the transmission assets between the offshore point of connection with the generator and the point of connection with the onshore transmission operator. This will include the cables and associated connection equipment. Figure 1 contains a generic diagram of what the transmission asset base to be transferred to the OFTO is likely to comprise. Please see accompanying PIMs for details of the individual assets and expected ownership boundaries.

Figure 1 – Diagram of the Generic Ownership Breakdown



The Tender and the Licence

The investment opportunity offers those parties interested in bidding, either solely or in a consortium, the ability to become an OFTO for one or more of the projects in the transitional regime. Key features of the investment proposition are as follows:

- Transmission licences will be granted to OFTOs based on a competitive tender process for each transmission asset, described in further detail below.
- For each transmission asset Ofgem has estimated the preliminary transfer value based upon the developers likely economic and efficient costs of construction (the "**Estimated Transfer Value**")[1]. The total Estimated Transfer Value for the 9 projects that may qualify for the first transitional tender process is around £1150 million. Details of Ofgem's view of the Estimated Transfer Value for each project are given in Table 1 below and in the accompanying PIMs.
- Each prospective OFTO will bid a revenue stream, calculated on its required return on investment on the Estimated Transfer Value (which will be the price at which a prospective OFTO must assume, for the purposes of the tender, it will acquire the relevant assets) and the ongoing cost of financing, operating and managing the relevant transmission asset.
- The successful OFTO will be awarded an offshore electricity transmission licence entitling it to this revenue stream for a 20 year period during which there is no automatic periodic price review. However, after 20 years the licence may be extended, revoked or re-tendered.
- Importantly, the revenue stream will not be dependent on utilisation. Rather, a portion of the OFTO's revenue stream will be based on maintaining a minimum availability of the offshore transmission assets.
- A performance bond to ensure continued operational performance will be required in the later stages of the 20 year period.
- The revenue stream will be paid to the OFTO by National Grid Electricity Transmission ("**NGET**").

Final Cost Assessment

For the purposes of commencing the tender process, Ofgem has provided its preliminary Estimated Transfer Values for qualifying projects, based on the information provided by developers and these may be adjusted. Given that for most projects the transmission assets are not yet constructed, Ofgem will undertake its final cost assessment after completion of the relevant transmission assets, to determine the economic and efficient costs. The revenue stream bid by the successful OFTO will be adjusted to take into account any changes to this value once the final assessment has taken place.

Adjustments to the Revenue Stream

In addition to adjustments to reflect the economic and efficient costs of the transmission assets, there may be further adjustments to the revenue stream during the ongoing operation of the transmission assets including:

- Up to a maximum of 10% of the agreed revenue stream will be exposed to an operational performance incentive/penalty mechanism.
- An OFTO will be entitled to additional revenue for investment in increased transmission line capacity (if needed) provided the additional investment does not exceed 20% of the initial capital cost.
- An OFTO will be entitled to pass-through certain predictable but uncertain costs, including changes to expected decommissioning costs, code changes, lease costs, licence fees and Ofgem tender costs.

[1] Please note that Barrow is operational and our cost assessment is underway.

The Transitional Tenders

Table 1 outlines those projects which have qualified for tender under the transitional regime.

Table 1 – Projects that have met the Qualifying Project criteria for the transitional regime

Project	Developer(s)	Estimated Transfer Value	MW	Expected Completion Date
Barrow	DONG Energy, Centrica	£36.5m	90	Operating
Robin Rigg	E.On	£58.7m	180	Sept 09
Gunfleet Sands I & II	DONG Energy	£46.4m	164	July 09
Sheringham Shoal	StatoilHydro, Statkraft	£186.8m	315	Q1 11
Ormonde	Vattenfall	£87.0m	150	July 11
Greater Gabbard	SSE/Airtricity, RWE Innogy	£343.7m	504	Mar 11
Thanet	Vattenfall	£189.0m	300	April 10
Walney 1	DONG Energy	£99.4m	178	Oct 10
Walney 2	DONG Energy	£104.4m	183	Jul 11
TOTAL		£1.151.9m	2,064	

The Estimated Transfer Value equates to the price that the preferred bidder should assume, for the purposes of its bid, it must pay the developer to acquire the completed transmission assets.

Table 2 lists those projects which Ofgem expects to qualify for the second and final round of transitional tenders, again based on information provided by project developers. The final transitional tender process is expected to be launched in mid-2010.

Table 2 – Projects Likely to Qualify for the Final Transitional Tender

Project	Developer(s)	MW
Docking Shoal	Centrica	500
Gwynt-y-Mor	RWE Innogy	750
Lincs	Centrica	250
London Array	E.On, DONG Energy, Masdar	1,000
Race Bank	Centrica	500
TOTAL		3,000

INVESTMENT HIGHLIGHTS

Strong political and regulatory support for UK offshore transmission

On the back of the UK Government's commitment to renewable energy and, in particular, the very significant expansion of the UK's offshore wind industry, the independent ownership and operation of offshore transmission in the UK enjoys strong political, regulatory and stakeholder support. DECC and Ofgem have been developing the regime for several years. Both have consulted widely and regularly on each stage of the development of the regime, and have taken account of respondents' views at all stages of the process.

First mover advantage

The transitional regime provides bidders with an unprecedented opportunity to enter the UK regulated electricity transmission sector. Successful bidders in the transitional regime will be well placed to participate in the much larger 'enduring' regime proposed for Round 2 projects which do not reach financial close by Go-Live, and for Round 3 projects. The aggregate cost of transmission assets for Round 3 is currently estimated at £10 – 12 billion (according to a study entitled 'Round 3 Offshore Wind Farm Connection Study' prepared for The Crown Estate by National Grid and Senergy econnect in late 2008).

Robust and transparent competitive process

Ofgem has, where practicable, developed its tender process in accordance with best practice principles in order to ensure that each round of the tender process is as fair and transparent as possible for all bidders. The process is also designed to provide a level playing field and to encourage the widest possible participation from potential investors, including new entrants to the GB electricity transmission market.

Construction risk for projects in transitional regime taken by developers

Ofgem proposes to make the final appointment of the OFTO, after completion of construction and certification of the assets, thus insulating the OFTO from delays and other associated construction risks. Where possible, construction warranties in relation to the Transmission Assets may be passed through to the OFTO.

Regulated revenue stream for a minimum 20 year period

The 20-year revenue stream bid for each successful bidder will be incorporated into its transmission licence, and will be fixed, subject to agreed adjustment mechanisms. The revenue stream will be availability based, and will not be subject to periodic review, provided operational performance remains satisfactory. The revenue stream will also not be exposed to any revenue or performance shortfalls from the offshore wind farms themselves. In the event that the wind farm ceases to operate NGET's obligation to pay the OFTO will continue. The default availability target will be set at 98%, a figure which has generally been exceeded by interconnectors and other major electricity transmission lines whose performance is reported in the public domain. The project specific figure will be confirmed at the next stage of the procurement.

At the end of the 20-year revenue stream period, the Authority will determine the most sensible course of action, taking into account the developer's ongoing demand for the asset and its statutory duties at the time. These options would include:

- the extension of the licence with a revised revenue stream (i.e. a traditional price-controlled approach) subject to an incremental capacity threshold;
- a tender; or
- revocation of the licence.

The revenue stream will be fully index linked based upon RPI.

Creditworthiness of revenue stream counterparty

The OFTO's revenue stream will be paid by NGET as National Electricity Transmission System Operator ("**NETSO**"), which is the regulated entity responsible for the operation of the transmission system in the UK. Its cost base (including payments it will be required to make to OFTOs) is eligible to be passed through to system users and ultimately consumers. NGET is rated A- by Standard & Poor's, A3 by Moody's and A- by Fitch Ratings. In keeping with its licence obligations, NGET will always have to meet specified credit rating requirements. Furthermore, when carrying out its functions, Ofgem must have regard to the need to ensure that licence holders are able to finance the activities which are the subject of statutory obligations placed upon them.

Upside potential

In addition to potential cost savings throughout the life cycle of the assets, OFTOs could have the opportunity to earn additional revenues for better than expected operational performance, increased capacity, certain non-regulated services and reactive power.

Limited operational risk

Operational risk associated with electricity transmission is typically low, and transmission assets typically incur relatively low ongoing operation and maintenance costs compared to their capital investment. OFTOs' revenue streams will also not be dependent on the operational performance of the wind farms which they serve.

Close cooperation and coordination with key stakeholders

The proposed regime has been developed in full consultation with all key stakeholders and potentially affected parties, including the NETSO, the onshore transmission owner and generator (both existing and potential).

SALE AND PURCHASE AGREEMENT ("SPA")

A generic model SPA has been published by Ofgem which can be found, along with associated commentary, on the Ofgem website. Offshore developers are currently using this model to create project specific SPAs to reflect the specific requirements and circumstances of their qualifying projects. As the tender process progresses, prospective OFTOs will have the chance to consider their response to these project specific documents. Further details in respect of this will be set out in the QTT and ITT documentation respectively.

OVERVIEW OF REGULATORY REGIME

In the electricity industry, the regulatory framework is set out in a number of instruments, including primary legislation, secondary legislation, licences granted by the Authority, industry codes and technical standards. Ofgem expects that some Bidders may not have previous experience of the Great Britain electricity market..

The aim of this section and Appendix 1 is to ensure that all Bidders have an overview of the regulatory and contractual framework.

Figure 2 summarises the current regulatory framework governing the implementation of electricity transmission in the UK.

Figure 2 – Current Regulatory Framework

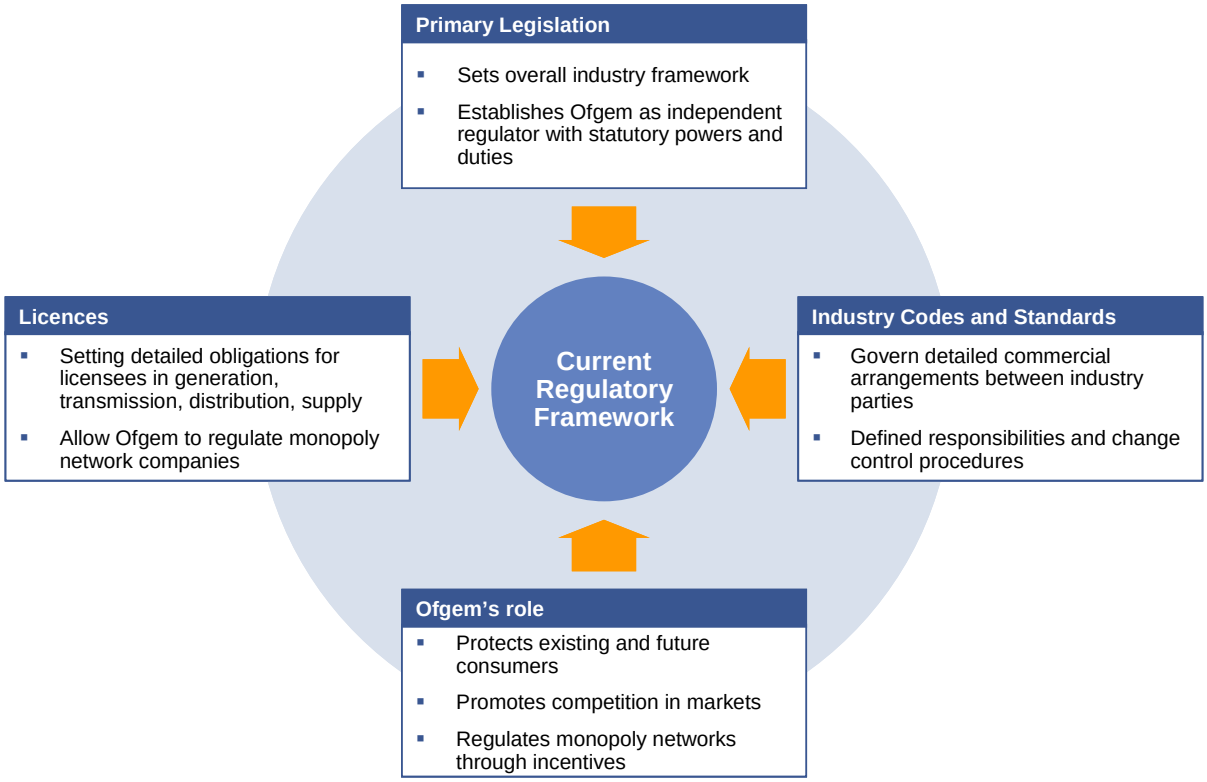


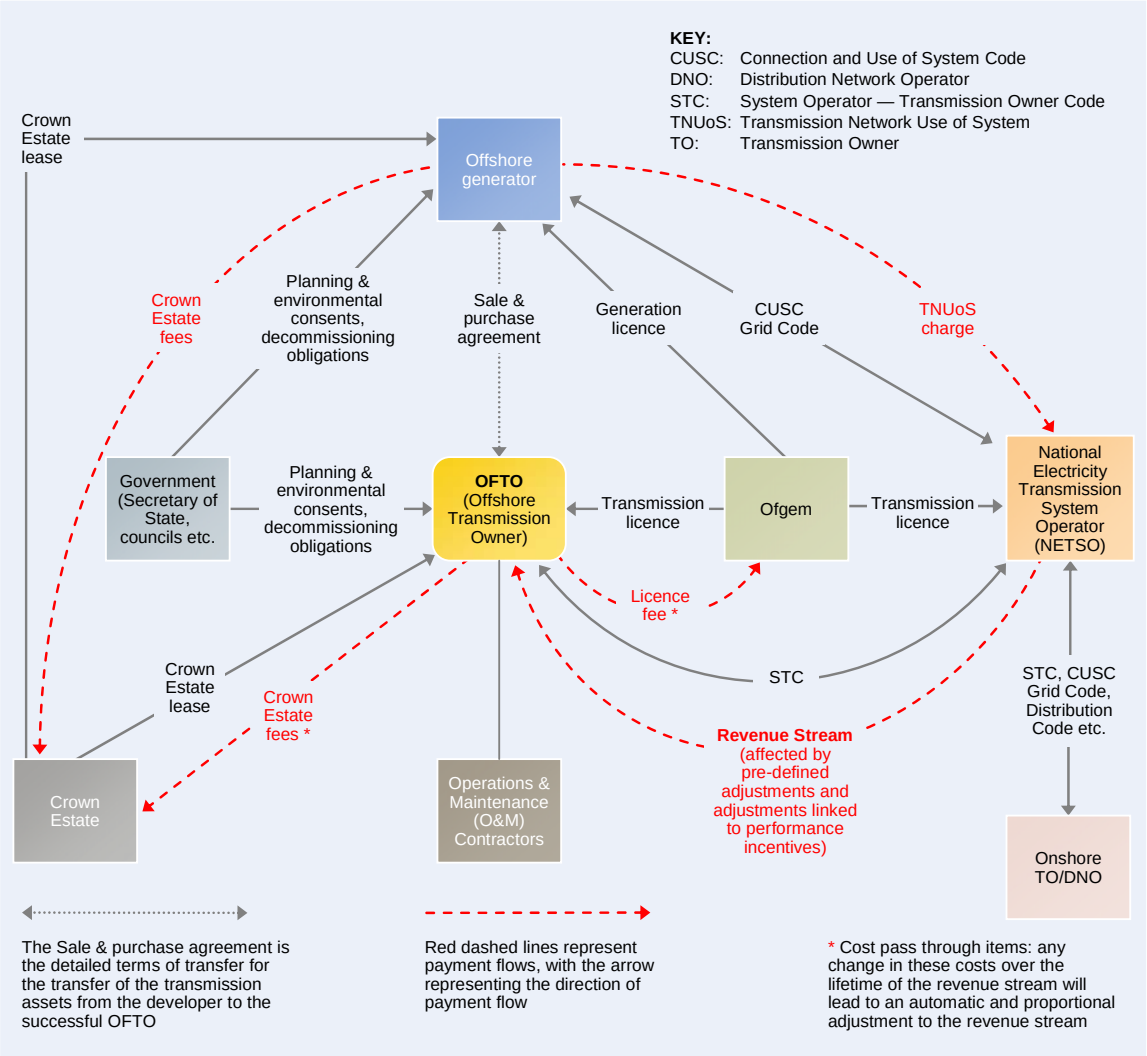
Figure 3 summarises the key industry codes which constitute the contractual framework by which owners, operators and users of the various parts of the electricity network in the UK are bound and interact with each other.

Figure 3 – Key Industry Codes

nationalgrid STC	nationalgrid CUSC	nationalgrid Grid Codes	DCode Distribution Codes
The STC Code defines the high-level relationship between the NETSO and the Transmission Owners. It is supported by a number of procedures (SOTO Code Procedures or STCPs) that set out in greater detail the roles, responsibilities, obligations and rights etc of the NETSO and the TOs.	The Connection and Use of System Code (CUSC), which constitutes the contractual framework for connection to, and use of, National Grid's high voltage transmission system.	The Grid Code is required to cover all material technical aspects relating to connections to and the operation and use of the transmission system or, in as far as relevant to the operation and use of the transmission system, the operation of the electric lines and electrical plant connected to it or to a distribution system. The Grid Code also specifies data which system users are obliged to provide to National Grid for use in the planning and operation of the transmission system	Licenced electricity distribution businesses, or Distribution Network Operators (DNOs), are obliged under Condition 21 of their licences to maintain a Distribution Code detailing the technical parameters and considerations relating to connexion to, and use of, their electrical networks.

The outline commercial structure is depicted in Figure 4.

Figure 4 – Key Parties and Outline Commercial Structure



Further detail is provided in Appendix I of this document.

SUMMARY OF TENDER PROCESS

The steps to be taken by Ofgem in selecting an OFTO for each project in the transitional regime are summarised in the following paragraphs.

Offshore transmission licences will be granted using the existing regulatory structure, amended as required for the offshore context. However the tender process has been designed to draw on the UK Government's Public-Private Partnership 'best practice', for example that used for contract procurement under the Private Finance Initiative.

There will be a five stage tender process, as follows:

1. Pre-qualification

The first stage, Pre-Qualification ("**PQ**"), will be a simple 'pass-fail' test based on an applicant's track record, including in respect of (a) its ability to access the necessary (equity and debt) funding to acquire the transmission assets for which it intends to bid and (b) its demonstration of the necessary management and operational capability. Applicants will be asked to identify the projects they are interested in bidding for, this will not be binding at this stage.

The outcome of this stage will be a longlist of qualifying applicants who will be invited to participate in the Qualification to Tender stage.

2. Qualification to Tender

The second stage, Qualification to Tender ("**QTT**"), will involve a detailed evaluation of each bidder's proposed approach to becoming an OFTO in respect of each project for which it intends to bid. Bidders will be scored based on their responses against a detailed set of objective criteria including in respect of their approach to financing and their operational and managerial proposal. The evaluation criteria and scores will be made available to bidders as part of the QTT document.

Ofgem anticipates that up to five bidders for each project will be invited to submit formal bids in the Invitation to Tender ("**ITT**") stage.

3. Invitation to Tender

The main purpose of the ITT stage is to permit Ofgem to identify a preferred bidder for each project, based on a fair and transparent competition. Each project will be subject to a separate tender.

At ITT stage a full data room for each project will be made available to shortlisted bidders, populated by Ofgem with information predominantly provided by the offshore developer. The final contents of the data room are expected to include, without limitation, all contracts, leases, warranties, details of assets and liabilities, investment and operating plans, sea-bed surveys and evidence of compliance with all applicable legislation, regulations, etc, in each case relating to the transmission assets. It is also expected that the data room will include sufficient information relating to the relevant generation project to enable potential OFTOs to make an informed investment decision.

Tenders received from shortlisted bidders in the ITT stage will also be scored. The most important element of tenders in respect of each project will be the fixed revenue stream each bidder requires to compensate it for the cost of acquisition, financing and operation of the transmission assets over the initial 20-year licence period. Bidders will be able to bid for more than one project, but such bids will be required to be submitted on a project-by-project basis. Bidders will also be able to submit 'variant' bids for any combination of projects for which they have been shortlisted, identifying the economic effect of any synergies or economies of scale that might be achievable.

4. Best and Final Offer

Where it is not possible to identify a clear preferred bidder after the ITT stage, Ofgem has reserved the right to ask a small number of bidders to submit their best and final offer ("**BAFO**") before making its final selection. The BAFO stage is not mandatory and will only be applied if considered necessary by Ofgem.

5. Preferred Bidder and Grant of Licence

When the preferred bidder is announced, Ofgem will proceed to finalise arrangements for grant of licence, transfer of the transmission assets from the developer to the successful OFTO and financial close. Transfer of the assets will not occur until construction has been completed, and so, in some cases, this may result in a period of time to transfer and closing. It is Ofgem's intent to keep the period between licence grant and financial close as short as possible and mechanisms for achieving this are under consideration.

INDICATIVE TIMELINE FOR FIRST TRANSITIONAL TENDER

The first transitional tender is expected to take approximately 12 months from the 'Go-Active' date which was the 24th June 2009. Figure 5 shows the indicative timeline for the first transitional tender.

22 July 2009	Tender launch
23 July 2009	Briefing Event - Bidder day
17 August 2009	Deadline for Clarifications queries to Ofgem
24 August 2009	PQ responses submitted
End September 2009	Notify applicants and publish qualifying long list
End September 2009	Pre-qualifying bidders enter into a Confidentiality Agreement
End September 2009	Publication of Information Memorandums and QTT documentation
End of October 2009	Deadline for QTT submissions
Mid December 2009	Notify qualifying applicants and publish qualifying bidder-short list
Mid December 2009	Publication of ITT documentation
Early March 2010	ITT responses submitted
April 2010	Preferred bidder decisions
June 2010	Licence grant decisions

PROCESS & CONTACT PERSONS

This document forms part of the Pre Qualification stage of the tender process. Further documents and other relevant information, including all consultation and related documents, may be accessed via the Ofgem website at: **http://www.ofgem.gov.uk/Pages/OfgemHome.aspx**.

The information in this document is provided for information purposes only. All enquiries or communications, including requests for additional information, should be sent to tendercoordinator@ofgem.gov.uk.

APPENDIX I

This appendix sets out a high level overview of the regulatory framework for electricity transmission.

UK Legislation

Electricity Act 1989

The Electricity Act is the primary piece of legislation for the electricity industry in Great Britain. Some relevant parts of the Electricity Act for an OFTO are:

1) It provides for the Authority's principal objectives;
2) It outlines the way in which the Authority must carry out its functions;
3) It provides for the granting of licences to transmit, distribute, generate and supply electricity in Great Britain;
4) It provides for the modification of such licences; and
5) It provides for the granting of transmission licences offshore by way of competitive tender run by the Authority.

Energy Act 2004

1) The Energy Act 2004 amended the Electricity Act to facilitate the introduction of the offshore electricity transmission regime, including the extension of the prohibition on the transmission of electricity to the offshore environment. It also enabled the Secretary of State to designate changes to relevant industry codes and the standard licence conditions of the Transmission Licence to accommodate offshore electricity transmission. The Energy Act 2004 also extended the onshore system operator role offshore.
2) The Energy Act 2004 applies a special insolvency regime to entities which operate or own essential energy infrastructure known as an Energy Administration. The objective of an Energy Administration is to secure that essential energy infrastructure (such as electricity transmission systems) is, and continues to be, maintained and developed as an economical system in the event of financial failure. Energy Administration would apply to OFTOs. The details of Energy Administration are set out in Part 3 Chapter 3 of the Energy Act 2004.

Energy Act 2008

The Energy Act 2008 amended the Electricity Act to provide further detail on the competitive Tender Process for the granting of Offshore Transmission Licences. This included the ability for the Authority to make a property transfer scheme (in respect of the transitional regime) if commercial negotiations for the transfer of assets between parties fail, in order to ensure that property is transferred from the developer of offshore wind generation assets to the successful bidder of the Tender Process, and also the ability for the Authority to recover its costs for running these tenders.

Licences

The Authority may grant licences in relation to the following activities in Great Britain under the Electricity Act:

1) Participation in the transmission of electricity;
2) Distribution of electricity;
3) Generation of electricity
4) Supply of electricity
5) Participation in the operation of an electricity interconnector

Licences issued by the Authority previously are available on the Authority's electronic public register, which can be found at: http://epr.ofgem.gov.uk/

The licences listed above contain:

A. General terms as to duration and revocation of the licence;

B. Standard conditions applicable to all licensees of the same class; and

C. Special conditions relevant to a single licensee.

The standard conditions and draft special conditions of an Offshore Transmission Licence are available on Ofgem's website:

http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=24&refer=Networks/offtrans/pdc/cdr/cons2009

Tender Regulations

The detail of the Tender Process for both the transitional and enduring regimes is set out in regulations (i.e. secondary legislation) made under the Electricity Act. The regulations, in summary, include the following:

1) A requirement for tenders to be run from a date set by the Authority in each year;

2) A requirement on the Authority to publish certain information and tender documentation;

3) A requirement on Bidders to respond within specified timeframes;

4) A requirement on the Authority to assess Bids in accordance with pre-determined criteria;

5) The process to identify a Preferred Bidder; and

6) A requirement on the Authority to publish rules for the tender process;; and

7) A requirement on the Authority to publish a methodology for recovering its costs of running the Tender Process.

European Union Legislation

EU Ministers agreed a Third Package of legislation on EU Gas and Electricity Markets at the EU Energy Council meeting on 10 October 2008, which was subsequently adopted, following negotiations with the European Parliament, on 25 June 2009. One of the areas covered by the Third Package is unbundling, which involves the separation of electricity generation and/or supply from transmission activities.

The Third Package provides that Member States should have the following three options for unbundling:

1) Require undertakings to divest either their generation and supply assets, or transmission assets (known as "full ownership unbundling"); or

2) Permit a separately owned Independent System Operator to take over operational control of the transmission assets of a vertically integrated undertaking, i.e. one which owns generation, supply and transmission assets (known as "Independent System Operator model"); or

3) Allow undertakings to remain vertically integrated but ensure the independence of the transmission operator by complying with a series of conditions (known as "Independent Transmission Operator model").

The unbundling requirements within the Third Package will need to be implemented two and a half years following entry into force of the Directive, which means that Member States will need to ensure compliance with the requirements by the end of 2011.

Industry Codes and Technical Standards

In addition to the legislation and licences, a large amount of the regulatory requirements for electricity transmission are contained within detailed industry codes and technical standards. These are collectively known as the standard framework documents. There are provisions contained in the relevant licences which oblige the licence holder to comply with the requirements of these documents.

Each of the industry codes has a separate defined process for:

1) Initiating a review of code obligations;
2) Proposing changes to code obligations;
3) Developing a code change proposal; and
4) Requesting a decision on a change proposal.

Bidders are required to satisfy themselves of the requirements of each relevant industry code and technical standard. However, for assistance, below is a short description of each. This should not be used as a substitute for Bidders referring to the primary sources of the information.

The Connection and Use of System Code (CUSC)

The CUSC is a legal document that constitutes the contractual framework for connection to or use of the GB Transmission System. Parties to the CUSC are the NETSO, generators, Distribution Licensees and suppliers (not an exhaustive list). It defines arrangements for:

1) Connection – it sets out arrangements that define the stages for connection. These include: application; connection; and termination of a connection agreement.
2) Use of system – it sets out arrangements that define the stages for application to, and termination of, a use of system agreement, including the different types of transmission access products available to user's of the GB Transmission System.
3) De-energisation and disconnection – it sets out arrangements that cater for de-energisation and disconnection of the system for safety issues and non payment reasons.

The CUSC is owned by NGET. A copy of the document is on NGET's website:

http://www.nationalgrid.com/uk/Electricity/Codes/systemcode/contracts/

A summary of the CUSC prepared by NGET can be found at:

http://www.nationalgrid.com/uk/Electricity/Codes/systemcode/cuscsummary/

The System Operator Transmission Owner Code (STC)

The STC defines the obligations and responsibilities of the Transmission Licensees and the NETSO. Current parties to the STC are NGET, Scottish Power Transmission Limited ("**SPTL**") and Scottish Hydro-Electric Transmission Limited ("**SHETL**") as Transmission Licensees. An OFTO, as a Transmission Licensee, will be required to be a party to the STC in accordance with its Offshore Transmission Licence.

The STC makes provision for certain interactions between the Transmission Licensees and the NETSO:

1) The provision of transmission services by the Transmission Licensees to the NETSO;
2) Directions from the NETSO to configure the GB Transmission System;
3) Transmission outage planning;
4) Joint transmission investment planning;
5) Governance of the STC and amendments to it (including accession to the STC); and
6) Dispute resolution.

The STC is owned by NGET, SPTL and SHETL. A copy of the document is on NGET's website:

http://www.nationalgrid.com/uk/Electricity/Codes/sotocode/Library/

A summary of the STC prepared by NGET can be found at:

http://www.nationalgrid.com/NR/exeres/005F0E90-234C-4DBB-BCAB-7F3700E92347.htm

Grid Code

The Grid Code is a technical code which sets out, among other things, the planning, connection conditions and testing requirements for the management of the GB Transmission System. It is designed to permit the development, maintenance and operation of the GB Transmission System. Parties to the Grid Code are NGET and all users of the GB Transmission System. OFTOs will be obliged by the STC to comply with specific sections of the Grid Code.

The Grid Code is owned by NGET. A copy of the document can be found on NGET's website:

http://www.nationalgrid.com/uk/Electricity/Codes/gridcode/gridcodedocs/.

The Great Britain Security and Quality of Supply Standard (GBSQSS)

The GBSQSS sets out a coordinated set of criteria and methodologies that Transmission Licensees must use in the planning and operation of the GB Transmission System. The criterion presented in the GBSQSS represents the minimum requirements for the planning and operation of the GB Transmission System. Additional criteria, for example covering more detailed and other aspects of quality of supply, are contained in the Grid Code and the STC, which should be read in conjunction with the GBSQSS.

The GBSQSS is subject an informal governance arrangements that were put in place by NGET, SPTL and SHETL. A copy of the document the associated review group can be found on NGET's website:

http://www.nationalgrid.com/uk/Electricity/Codes/gbsqsscode/DocLibrary/

Other Industry Codes and Charging Methodologies

The industry codes and charging methodologies described below are not applicable to an OFTO for this Project, however, we include a brief description of the documents and charging methodologies as they form part of the overall regulatory framework which applies to the electricity industry.

The Balancing and Settlement Code (BSC)

1) The BSC contains the governance arrangements for electricity balancing and settlement in Great Britain. The BSC is largely a commercially based code which focuses on balancing and settlement arrangements. Parties to the BSC are NGET, Distribution Licensees, trading parties, interconnector administrators and suppliers. The BSC sets out the detailed arrangements for:

   A. Balancing – allows each party to the BSC to advise the NETSO of its terms for making a change to its forecast export to or import from the GB Transmission System close to real time. The energy balancing aspect allows parties to make submissions to the NETSO to either buy or sell electricity into/out of the market at close to real time in order to keep the system from moving too far out of phase.

   B. Settlement – provides for the reconciliation of actual exports (from generators) and imports (from suppliers) with the forecast, contracted position. The settlement aspect relates to monitoring and metering the actual positions of generators and suppliers (and interconnectors) against their contracted positions and settling imbalances when actual delivery or offtake does not match contractual positions.

   C. Metering – specific standards are defined for equipment used to record electricity flows for use in the settlement processes.

2) The BSC is owned by Elexon. A copy of the document can be found on Elexon's website: http://www.elexon.co.uk/bscrelateddocs/bsc

The Distribution Connection and Use of System Agreement (DCUSA)

The DCUSA is a multi-party contract between Distribution Licensees, suppliers and generators which constitutes the contractual framework for the connection to and use of the electricity distribution network. It replaced numerous bilateral contracts to provide a consistent approach to the relationship between these parties within the electricity industry.

The DCUSA is owned by DCUSA Limited. A copy of the document can be found DCUSA Limited's website:

http://www.dcusa.co.uk/Public

The Distribution Code

1) The Distribution Code is another technical code that sets out the technical parameters for connection to and use of each Electricity Distribution Licensee's distribution systems. The obligation to be a party to the Distribution Code is set out in Condition 9 of an Electricity Distribution Licence.

2) The Distribution Code is owned by the Electricity Distribution Licensees. A copy can be found on http://www.dcode.org.uk

Transmission Charging

Assets that facilitate connection to the GB Transmission System are (normally) owned, built and maintained by the relevant Transmission Licensee, the cost of which is recovered through connection charges or Transmission Network Use of System ("**TNUoS**"). The NETSO is required to prepare charging methodologies in respect of these charges.

The NETSO charges all parties that connect to and use the GB Transmission System (e.g. generators and suppliers). The charges can be broken down as:

1) Connection charges;

2) TNUoS;

3) Balancing Services Use of System Charges ("**BSUoS**")

The methodology in respect of connection charges payable by a party wishing to connect to the GB Transmission System can be found at

http://www.nationalgrid.com/NR/rdonlyres/4811E6E0-3AA5-468F-9ADC-740FE9424180/24473/GBCCMI4R0FINAL.pdf.

The methodology in respect of use of system charges payable (TNUoS and BSUoS) can be found at

http://www.nationalgrid.com/NR/rdonlyres/BC5D87D0-4682-4C56-9375-7B932A1BD726/24713/UoSCMI4R0FINALBSUoS.pdf.

Distribution Charging

Each Distribution Licensee charges for connection to and use of its distribution system. They are required by their Electricity Distribution Licences to prepare a methodology in respect of the connection charges payable by a party seeking connection to its distribution system and a methodology in respect of the use of system charges payable by a party that uses its distribution system. These methodologies are available on the Distribution Licensee's website.

Miscellaneous parts of the Regulatory and Contractual Framework

Crown Estate Leases

As landowner of the seabed and areas of foreshore by virtue of the Crown Estate Act 1961, The Crown Estate's permission is necessary to place structures on or pass cables over the seabed and its foreshore. In addition to permission from the landowner potential developers also require statutory consents from a number of government departments responsible for the offshore wind development process. Only when all the necessary statutory consents are obtained will The Crown Estate grant a lease for development. The

Crown Estate will issue leases for the development of sites within the 12 nm (nautical mile) territorial limit, whilst the Energy Act 2004 gives it rights to issue leases for development beyond the territorial limit within Renewable Energy Zones (REZ) out to 200 nm.

Round one and two projects were initially granted full term leases of twenty-two and forty years respectively with a further three years allowed for decommissioning. However, on 6 July 2009, the Crown Estate announced that all wind farm operators will be given the opportunity to extend their lease terms to 50 years. For the largest round two projects of over 500MW, full term lease for fifty years were granted in the first place.

Decommissioning

Sections 105 to 114 of the Energy Act 2004 introduce a decommissioning scheme for offshore wind and marine energy installations. Under the terms of the Act, the Secretary of State may require a person who is responsible for one of these installations to submit (and eventually carry out) a decommissioning programme for the installation.

These decommissioning provisions reflect the Government's view – taking into account the UK's international obligations under UNCLOS (United Nations Convention on the Law of the Sea) and OSPAR – that anyone who constructs, extends, operates or uses an installation should be responsible for the costs of ensuring that it is decommissioned at the end of its useful life in accordance with the 'polluter pays' principle.

DECC believe that imposing a legal obligation on businesses to prepare and carry out a decommissioning programme – and potentially requiring them to provide financial security – reduces the risk of them defaulting on their decommissioning liabilities. At the same time, it does not want to hinder the development of offshore renewable energy installations.

DECC's approach is to seek decommissioning solutions which are consistent with its international obligations, as well as UK legislation, and which have a proper regard for safety, the environment, other legitimate uses of the sea and economic considerations. DECC will act in line with the principles of sustainable development, and aims to ensure that interested parties are given clear information on the operation of the decommissioning scheme. DECC intends that processes for approving decommissioning programmes should be open and transparent, and that decisions should be taken in an efficient way, with as little administrative work as possible.

Offshore wind farm developers are likely to have already prepared a decommissioning solution during the development of the offshore wind project.

Guidance notes on decommissioning are available on the Department for Business Innovation and Skills website at **http://www.berr.gov.uk/**.

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