Blue Transmission Investments Limited
The American Barns
Banbury Road
Lighthorne
Warwickshire
CV35 0AE

Giedre Kaminskaite-Salters
Ofgem
9 Millbank
London SW1P 3GE

Iain Cameron
General Manager
Iain.Cameron@frontierpower.biz
Direct tel +44 (0)845 3938146
Mobile +44 (0)7768 558996

17 February 2012

Offshore Electricity Transmission: Consultation on tender exercises under enduring regime

Dear Madam,

We are delighted to provide below the response of Blue Transmission to the Ofgem's consultation on tender exercises under enduring regime. This response has been drafted in cooperation with Blue Transmission's main partners, Frontier Power Limited, Barclays Infrastructure Funds Management Limited, Mitsubishi Corporation and Macquarie Capital Group Limited.
Please do not hesitate to contact us if you want to discuss any of the issues outlined below.

Chapter: Two

Question 1: Do you have any views on the approach outlined in paragraph 2.8, namely to focus on a single OFTO build and not to develop the early OFTO build option further at this stage?

Blue Transmission agrees with the approach to not develop the early OFTO build option. However Blue Transmission is convinced that the late OFTO-built option is fully deliverable and that we will be able to gather the required companies and competencies into a consortium able to carry out the projects. As has been demonstrated from OFTO Round 1, Blue Transmission has a deep understanding of the asset class, technical requirements, risk profile and required financing structuring. Moreover we are engaged in detailed discussions with construction companies, equipment manufacturers and engineering companies which will be able to form the construction JV to carry out the project and to provide the required security package and support.

Chapter: Three

Question 1: What your views on the proposed arrangements for triggering a tender exercise?

This approach appears acceptable, so long as when it is OFTO-build the ITT process is long enough to facilitate the greater scope of bidding.

Question2: What are your views on whether our proposal on generator security will ensure the appropriate level of commitment from a generator?

Blue Transmission Investments Limited
The American Barns
Banbury Road
Lighthorne
Warwickshire
CV35 0AE

OFTO assumes that the security will cover compensation to the OFTO bidders for a change in Generator stance during the process. It would be unacceptable from an OFTO perspective to have a change at the option of the Generator without compensation. If compensation cannot be provided then the Generator should have no option to change once an election is made. This is in the context of extremely high bid costs in an OFTO-build scenario (much higher than Generator build scenario). However Blue Transmission is more concerned by the fact that the Generator does not have at the outset any incentive to choose the OFTO-built option, Indeed we understand that currently this choice is fully down to the Generator and we believe that from the Generators' point of view the advantages of the OFTO-built option (cheaper costs, innovation, reduced funding requirement...etc) are not perceived as sufficient to compensate for the disadvantages (mainly loss of control over the delivery of the assets). That is why we believe that for the OFTO-built option to have any chance of actually being used, the Generator should be offered additional incentive like for example cash compensation should the OFTO be late in completing the assets. Given we do not believe this would be efficient for the OFTO to bear the costs of such incentives (see response to question 29), this compensation will need to be paid by the NETSO and socialised through to all the system users.

Question 3: Do you agree with our proposed approach to the tender specification for an OFTO build tender exercise?

The proposed tender specification appears acceptable, however, OFTOs will not want to bid until planning consent has been achieved given the extent of bid cost risk associated with these projects.

Question 4: Are the proposed arrangements for pre-construction works the most appropriate for investors and generators?

The approach appears acceptable. In particular all permits and licences related to pre-construction should be obtained by Generators.

Question 5: What other information, if any, in addition to that referred to within the tender specification and pre-construction works sections, would be needed within the data room for the project?

N/A

Question 6: What do you think would be the best approach to ensuring bidders have access to and confidence in a seabed survey undertaken by the generator?

Our preference is for an independent survey to be performed which can be relied on by the OFTO. It is critical that the scope and method of undertaking offshore surveys of the proposed export cable route are undertaken to an agreed standard and specification to ensure that all OFTO bidders are able to use the same base set of assumptions for cable risk assessment and burial assessment. We agree with the proposal to use an independent third party expert to produce a set of survey specifications and we would welcome the opportunity to participate in the development of these specifications.

Blue Transmission Investments Limited
The American Barns
Banbury Road
Lighthorne
Warwickshire
CV35 0AE

Question 7: With reference to the approach to seabed surveys outlined within paragraph 3.22, what might be the best approach to developing an independent generic survey specification that would be acceptable to both generators and potential bidders?

The Generators should to the full extent possible consult with potential OFTOs to determine the optimal scope for suverys. Prior to ITT, the Generator could also send a scope of work to OFTO bidders and bidders could provide feedback on the scope to ensure all bidder requirements were accounted for in advance.

Question 8: Do you agree that ensuring procurement is undertaken by the OFTO through the tender process would be the most economic and efficient approach?

Generator should have the opportunity to place "factory orders" and pay any necessary deposits (based upon the preferred bidder's design specification and supply chain solution) ahead of financial close in order to lock in the manufacturing timetable. We develop this concept further in our response to Q11.

Question 9: What are your views on whether there are supply chain constraints associated with the manufacture and delivery of some key offshore transmission assets? If there are constraints, do these vary significantly in relation to project design?

We believe that there are supply chain constraints for submarine cable (DC and AC) and HVDC converters in particular. These constraints will undoubtably be less for AC projects which have shorter cable routes than for HVDC projects which have longer cable routes.

Question 10: What are your views on the examples of alternative approaches for supply chain engagement under OFTO build outlined in this chapter?

We agree with Ofgem's conclusions in paragraph 3.30 and paragraph 3.35. It is our view that serious OFTO bidders will not have problems engaging with ey players in the supply chain.

Question 11: Are there any other approaches we should consider under OFTO build to enable the supply chain to be engaged in time to ensure project delivery timescales are met, whilst maximising opportunities for competition through the tender process?

In our response to Q8 we introduced the idea that once the preferred OFTO bidder has been selected and the design specification and suppliers for key elements of the transmission system (eg cables, HVDC converters, SVCs, transformers) are fixed, the generator should have the option to place orders for the long lead time items using supply contracts developed by the OFTO. Such orders would not otherwise be placed by the OFTO until financial close. If orders could be placed and deposits could be paid by the generator before the OFTO reaches financial close, then many months could be saved in the overall delivery time for the project. Obviously consideration would need to be given to how such supply contracts would then be transferred to the successful OFTO bidder at

BLUE TRANSMISSION

Blue Transmission Investments Limited
The American Barns
Banbury Road
Lighthorne
Warwickshire
CV35 0AE

financial close and what would happen if the preferred OFTO bidder did not reach financial close, in which case perhaps the generator should then be permitted to continue with the project under the "generator build" option. This, of course raises questions about whether it is viable to keep an OFTO reserve bidder in place after the point at which the generator has placed early orders.
Question 12: Should there be any restrictions on interactions between parties, either before or during a tender exercise in order to ensure fair and effective competition and best value for consumers?

Bidders should receive the same information and have the same interaction with Developers. Other restrictions can be managed in a normal commercial manner in accordance with other bid processes (eg NDAs, Chinese Walls, Exclusivity Arrangements arranged on a commercial basis)

Question 13: Do you agree that the current 20 year revenue stream provides the best value to consumers under the enduring regime (OFTO build or Generator build)? If not, what alternatives should we consider?

N/A

Question 14: What are your views on our proposed treatment of risk relating to:

- Delay to licence grant?
- Weather delay?

Delay to licence grant and weather delays (although not all will be classified as Force Majeure) are inevitable. Delays outside of the control of the OFTO, which delay to licence grant and weather delays are part of, should not be to OFTO account, because otherwise OFTOs will price in expected delays to the TRS to ensure they are covered in any circumstance and this does not lead to efficient like-for-like bid comparison (because all OFTOs will take a different view). Assuming "allowable" days for "weather-related delay" is a bid assumption provided by Ofgem then this may assist to mitigate the issue

Question 15: Are there other areas of risk which would be more efficiently managed (for consumers) through a risk sharing mechanism rather than factored into bidders' TRS bids? If so, can you suggest how these risks might be shared?

We propose that "cable installation risk" should be considered as another item for a risk sharing mechanism. Delays and additional costs may be incurred as a result of seabed conditions that may not be detectable by the pre-construction seabed surveys leading to cable burial issues, including cable damage during construction and additional burial methods.

Question 16: Is the current approach to recovering bid costs appropriate for OFTO build? If not, what alternative approach to recovering bid costs would you recommend?

Bid costs at risk will limit competition at this phase in the process if there is no recovery for loss, especially given the size and complexity fo the projects envisaged which means bid costs will be very substantial. We would propose that costs associated with construction / design at ITT Submission be reimbursed for all bidders and not only the successful bidder. Moreover all bidders should receive

Blue Transmission Investments Limited
The American Barns
Banbury Road
Lighthorne
Warwickshire
CV35 0AE

full compensation for all costs incurred should the planning application not being received (see answer to question 21), if the process is cancelled by decision of the developer or if the developer is allowed to bid as an OFTO.

Question 17: Are there any aspects of the current transitional arrangements or within the proposals for OFTO build, including revenue term, bid requirements and risk profile, which may prevent access to certain sources of finance in the enduring regime?

One key aspect that could prove problematic is the requirement to have committed debt finance for a long period of time. Currently banks can provide commitments for maximum periods of 3 to 6 months (depending on the bank) hence Ofgem should not require bidders to hold terms for more than 3 or 4 months as bidders cannot take the risk of having their debt funding falling away while they are still committed towards Ofgem.
The other aspect which has proved problematic on transitional projects and which will have even more impact during the Enduring regime is the risk relating to seabed conditions. Bidders having access to detailed and reliable seabed conditions is key to the bidders to be able to price efficiently this risk. However even with detailed information there still may be some unforeseen ground conditions that could have a huge impact in terms of costs increase and delays. Funders and potentially construction companies may not be able to fully absorb this risk so this risk should be given further consideration and mitigation. See response to questions 5 and 15 for more details.

Question 18: Do you have any comments on the issues associated with incorporating a refinancing gain share mechanism and how such a mechanism could be structured?

Please see response to question 10 of Chapter 4.

Question 19: Do you have any preferences from amongst the options outlined for how the PQ stage should operate?

N/A

Question 20: Are there any other ways that a PQ stage might operate in order to meet the objectives set out at the start of the 'Tender stages and timings' section?

N/A

Question 21: Do you have any preferences from the options outlined for how the ITT stage might operate?

The OFTO would prefer just one pre-ITT phase due to onerous resourcing, cost and internal approval requirements associated with two phases, meaning Option 3 is less preferable from our point of view.

Option 1 implies that a preferred bidder is chosen 4 months later than in Option 2 which could be an issue. Indeed given the transmission assets need to be completed before the generation assets and that the OFTO building process from financial close is long and not substantially shorter than the generation assets building process, delaying the closing of the OFTO transaction by 4 months could

Blue Transmission Investments Limited
The American Barns
Banbury Road
Lighthorne
Warwickshire
CV35 0AE

potentially jeopardise the timely completion of the OFTO assets. Hence Option 2 seems preferable over Option 1.

OFTO agrees with the principle that once appointed preferred bidder then preferred bidder work/negotiations are actually able to commence (ie no "on hold" period).

Based on the above, it would appear that Option 2, a single ITT phase starting as early as possible during the planning application process would work best

However we do not think any OFTO would be ready to take the risk of the planning application not being accepted and hence the bidding process not concluding and needing to be started again and hence all bidders (and not only the successful bidder) should be compensated for bid costs incurred should the bidding process be cancelled due to the planning application not being accepted.

Question 22: Are there any other ways that the ITT stage might operate to ensure its efficiency and effectiveness?

N/A

Question 23: What are your views on the proposals for involving generators in evaluation of bids? In particular, what key technical aspects of bids would be most important for generators to evaluate?

Generators should be involved in the technical evaluation of the bids in particular to gain confidence in the design specification of the major components of the system, for which they may wish to place early orders as set out in our response to Q11. However bids presented to Generators should be made anonymous to ensure fair competition and that the identity of the bidders will not influence the Generators' evaluation.

Question 24: What are your views on the proposals for involving NETSO in evaluation of bids? In particular, what key technical aspects of bids are most important for NETSO to evaluate?

NETSO should be involved in technical evaluation with particular focus on grid compliance, including reactive compensation, voltage control and waveform harmonics. However bids presented to NETSO should be made anonymous to ensure fair competition and that the identity of the bidders will not influence NETSO's evaluation.

Question 25: Are there areas on which you think allowing variant bids under OFTO build would add value to the process and to consumers?

Variant bids would allow bidders to propose innovative solutions potentially bringing cheaper and more efficient processes and ultimately better value to end consumers. Variant bids may be viable so long as evaluation criteria are clearly specified from the outset and there was sufficient Q&A across all bids to benchmark variant bids in a consistent manner. Variant bids, by definition, may also include combination bidding (eg the option to bid for 2 or 3 at one time in an all or nothing

Blue Transmission Investments Limited
The American Barns
Banbury Road
Lighthorne
Warwickshire
CV35 0AE

approach). This would mean synergies could be bid (which was not the case in Round 1 due to the framework dictated by Ofgem).

Question 26: What are your views on generators recovering efficiently incurred pre-construction costs at the point at which the transmission construction works are completed?

This approach appears sensible.

Question 27: Do you have any early views on the appropriateness of design incentives for transmission asset lifecycle design, eg transmission availability, quality of installation and transmission losses?

Maximum permissible transmission losses should be specified in the tender documents which should also set out how transmission losses lower than the maximum permissible will be evaluated and rated.
Regarding lifecycle design, transmission availability and quality of installation, we believe that the OFTO is already sufficiently incentivised by the fact that it will own, operate and maintain the assets as well as being responsible for any loss of availability through penalties.

Question 28: What are your views on whether the current approach to indexation, and in particular the proportion of the TRS subject to indexation, provides the best value to consumers? How might any alternative approaches be managed?

We believe that bidders should have the option to propose in their the proportion of TRS subject to indexation, This could allow the removal of the RPI swap currently used in the OFTO financial structures and would also allow the bidders to propose alternative funding solutions and bring value to end consumer through innovation. Such an approach means that, for the bids to be comparable, the financial value of the bids should be evaluated on a NPV basis rather than on a day-one TRS basis. Careful consideration should also be given to the discount rate to be used in the NPV calculations which should be in line with the WACC expected from bidders: if the discount rate is too low, the bidders will have an incentive to choose a low proportion of the TRS subject to indexation when if the discount rate is too high, the bidders will have an incentive to choose a high proportion of the TRS subject to indexation.

Question 29: Do you agree that additional delivery incentives for OFTOs are not necessary?

No revenue for non-delivery of the asset should be sufficient to incentivise the OFTO to meet delivery deadlines. However if a legitimate case for compensation of the developer can be made, then liquidated damages (additional to those used to compensate for delays an increased costs which are required to make the structure bankable) to pay this compensation could be sourced from the construction companies up to a certain point, but these additional liquidated damages will have a substantial cost which will negatively impact the affordability of the bids and increase their costs. However given the size of the projects envisaged and the amount of liquidated damages required, above a certain threshold, construction companies will have balance sheet capacities issues and will not be able to provide the sufficient amount of security.

Blue Transmission Investments Limited
The American Barns
Banbury Road
Lighthorne
Warwickshire
CV35 0AE

Question 30: What are your views on what approach to decommissioning of assets would provide best ongoing value to consumers?

N/A

Chapter: Four

Question 1: What are your views on whether there are benefits under Generator build to the generator undertaking the seabed survey against a comprehensive generic survey specification agreed by industry?

As seabed surveys and cable reburial are significant cost drivers for OFTOs we agree that generators should undertake seabed surveys against a comprehensive generic survey specification agreed by industry. This could allow for less confirmatory due diligence items and more comparable bids from a technical perspective.

Question 2: Do you agree with the approach that Ofgem continues to run tender rounds for groups of projects, not necessarily limited to one per year, or would you recommend an alternative approach?

This is approach is fine.

Question 3: Do you think there are further efficiencies we could make to the tender process and the transaction procedures for Generator build which would increase their efficiency and provide greater certainty to bidders and funders?

Crossing agreements and third party surveys are key areas where lack of information at bid stage has led to TRS changes post bid, which, in many circumstances, are material. As such, a requirement on the Generators to deliver this level of due diligence to OFTOs in the bid phase would assist to reduce the PB to close process and provide Ofgem with the ability to accurately assess the bid.

Question 4: Are there any changes to the information supplied in the data room which would improve the efficiency of the process for Generator build?

Refer to Question 3 above

Question 5: What are your views on the benefits of involving generators in evaluation of bids as outlined in this section?

Generators should not be involved in the evaluation of OFTO bids for acquisition of "generator built" OFTO assets. This is primarily because they may have a conflict of interest if they are providing commercial offers for O&M services to OFTO bidders. Moreover in a post construction bid environment, Generator bid review is less relevant and potentially adds more time to the process for little gain.

Blue Transmission Investments Limited
The American Barns
Banbury Road
Lighthorne
Warwickshire
CV35 0AE

Question 6: Do you have any suggestions on amendments which would improve the efficiency of the process for finalisation of transfer documentation and which would maximise value to consumers?

Refer item 7 below

Question 7: What do you consider might be the implications of a share sale approach as opposed to a transfer of assets as has been seen to date?

A structure where the Developers transfer a company with contracts, consents and assets may be easier from a consent/contract assignment perspective to execute. However, if there are consent issues around Developer change of control then this approach may not be feasible.

Question 8: Do you agree that the current split between costs priced into the TRS and those allowed as pass throughs provides best value for consumers?

There are some items that are identified prior to Financial Close that are construction related and may or may not occur. If Ofgem were to confirm these costs were pass-through in the event they do occur this would be the most efficient approach for the end consumer. Moreover we consider that there are some risks, including cable burial remediation during the 20 year period, that may be more efficiently managed for consumers is they were allowed as pass throughs as it is extremely difficult for an OFTO bidder to evaluate the costs of such re-burial even with accurate en extensive seabed conditions information.

Question 9: Are there any aspects of the current arrangements for transitional tender exercises or within the changes we have proposed above, including revenue term, bid requirements and risk profile, which may prevent access to certain sources of finance under Generator build?

The market for OFTO funding is changing, which is driven by market changes, as such, this may have implications for OFTO bidding going forward. However, the current licence term, risk profile etc does not impact this trend.

Question 10: Do you have any comments on the issues associated with incorporating a refinancing gain share mechanism for Generator build and how such a mechanism could be structured?

We are not against the inclusion of a refinancing gain share mechanism, but to be of any substantial benefit to the end consumers through a greater range of financing options being able to be used, this mechanism should also include some "pain sharing" through which Ofgem will bear the costs of market related (and not project-specific performance) variations. This is particularly relevant given the current dynamics in the financial markets by which long-term debt is becoming less and less available when medium term debt is still available for reasonable amounts. We estimate that before the Global Financing Crisis, more than 50 banks were involved in the European project finance market, the vast majority of them providing long term funding. This number decreased to ~30 post the first phase of the Global Financing Crisis in 2009 with banks exiting the business following changes of strategy, restructuring, mergers and acquisitions. This number further reduced to ~20 by mid-2011 due to continuing worsening economical and market conditions and the introduction of more stringent regulations. This number could drop to ~10 or less this year mainly due to banks

Blue Transmission Investments Limited
The American Barns
Banbury Road
Lighthorne
Warwickshire
CV35 0AE

implementing further the new regulations (mainly Basel III) and fully taking into account the real cost of providing long-term debt.
We estimate that currently the maximum long-term bank debt capacity for a given single deal in the UK is up to £500m maximum and could lower quickly over the next few months. Moreover the pricing will be less competitive the closer the required amount gets to the higher limit.
It should be noted that the available capacity for short to medium term debt funding (up to 7-year maturity) is much more important than for long-term funding and that the number of banks still active in this market is also higher. We therefore think that Ofgem should encourage the use of medium term funding for OFTO assets by sharing some of the refinancing risk. Indeed using medium term funding to finance long term projects introduces substantial refinancing risk which needs to be borne by the OFTO or Ofgem/ the end consumer, and the OFTO is not necessarily the best placed to bear the full refinancing risk. The OFTO should be able to bear refinancing risk but it will need to price this risk through increased equity returns and more conservative base case refinancing assumptions which means this is likely not to provide optimal value for money to end consumer.
The refinancing risk can broadly be split between base rate market risk (changes in LIBOR-based base rate), performance/credit risk (impacting the price of the new debt sourced) and market liquidity risk, although these last two factors cannot always be easily split. Performance/credit risk should clearly be borne by the OFTO and base rate market risk should clearly borne by Ofgem/ the end consumer. Otherwise in order to ensure the robustness of the financial structure, the OFTO will need to enter at financial close in long term swaps which will need to be refinanced anyway at the same time as the underlying medium term debt: the OFTO will thus pay for the long-term nature if the swaps but will not benefit from it. Market liquidity should also be borne by the Ofgem/ the end consumer but, given performance/credit risk and market liquidity risk cannot always be easily split and the OFTO should also be incentivised to source the best funding terms available, a sharing of the refinancing impact according to a mechanism to be determined seems to be the best way to share this risk while still incentivising all parties to reach the best mutual outcome.
So to make short to medium term funding the best value for money for Ofgem/ the end consumer, Ofgem should be ready to implement alongside a refinancing gain shring mechanism a clear refinancing risk sharing mechanism at the closing of the deal.Such an approach should also be taken into account right from the start of the procurement process and Ofgem should make clear that it is supportive of such an approach by indicating bids based on short to medium debt funding will be considered as compliant or can be proposed as variants

We suggest that the approach set out in the Standardisation of PFI Contracts Version 4 (SoPC4), issued by the HMT, for calculating refinancing gain share should be used as a starting point for application to the OFTO regime. Exact percentages and shares of benefit between Ofgem and the OFTO can be discussed at a later stage.

Chapter: Five

Question 1: Are you satisfied with the practical relevance of our definition of the terms 'phase' and 'stage'?

From an OFTO perspective, stages in a particular phase can be considered one qualifying project.

Blue Transmission Investments Limited
The American Barns
Banbury Road
Lighthorne
Warwickshire
CV35 0AE

Question 2: What are your views on the measures we propose to determine whether a stage or phase within a site/zone qualifies for a single tender exercise?

It is highly likely that two stages in the same phase (irrespective of whether they are electrically linked) will have synergies. However, if they are bid separately, in the first bid no synergies can be bid because there is no certainty the second phase will be won. OFTOs can probably bid synergies to the extent there is certainty of being appointed preferred bidder across both projects. In addition, in general, larger projects are less costly so bidding two stages in one should, ceteris paribus, yield a lower TRS than the sum of the two TRSs. Thus even if there is a long time period between two stages of the same phase, then they should be subject to a single tender exercise.

Question 3: What are your views on whether running a separate tender exercise for each phase within a site/zone would best meet the objectives of the enduring regulatory regime?

Refer to question 2 in this section. However this question may need further consideration when conclusions from the offshore coordination project are clearer.

Yours faithfully
on behalf of Blue Transmission