

ofgem E-Serve

GB Offshore Transmission

Investment Opportunity – Tender Round 2

December 2012



RBC Capital Markets®

INTRODUCTION

This generic Preliminary Information Memorandum outlines an opportunity for investors to acquire electricity transmission assets under the regulatory regime governing the ownership and operation of offshore electricity transmission. This regime has been developed jointly by the Department of Energy and Climate Change (“DECC”) and the GB energy regulator the Office of Gas and Electricity Markets¹ (“Ofgem”). Ofgem E-Serve is the delivery arm of Ofgem.

Ofgem launched the first round of competitive tenders for offshore electricity transmission licences (“**Tender Round 1**”), under the ‘transitional’ regime, in July 2009. This is a process to identify offshore transmission licensees to own and manage transmission assets which have been, or are being, constructed by the developers of the relevant offshore wind generation projects. Six of the Tender Round 1 projects have now been closed with Offshore Transmission Owners (‘**OFTOs**’) now in place and a further three projects in this round have a selected Preferred Bidder. All nine projects for Tender Round 1 will have a total value of approximately £1.1 billion.

The second round of competitive tenders for offshore electricity transmission licences (“**Tender Round 2**”) is now underway. As in Tender Round 1, successful bidders in Tender Round 2 will receive a 20 year revenue stream in return for purchasing the transmission assets from the offshore wind generator and operating them in accordance with the requirements of the offshore transmission licence. Importantly, the revenue stream will be dependent upon transmission asset availability, rather than actual utilisation or wind farm availability. Two Tender Round 2 projects now have selected Preferred Bidders with the remaining two projects in this round undergoing, or about to undergo, a Tender Exercise.

In order to provide potential bidders with sufficient information about the opportunities available, a Preliminary Information Memorandum (“**PIM**”) is available for each of the transmission assets where tender exercises are commencing in Tender Round 2. The project specific PIMs should be read in connection with the overview and generic information provided by this document.

EXECUTIVE SUMMARY

Background

Following the Government’s decision that offshore electricity transmission licences should be granted to third parties by way of a competitive tender process, with the successful bidder becoming the OFTO, Ofgem was mandated by Government to run the tenders. The new offshore transmission licences will confer certain rights and responsibilities on OFTOs, including the right to a regulated revenue stream for a period of 20 years in return for the provision of transmission services.

The offshore transmission licensing regime is divided into two distinct phases: (i) the transitional regime involving tenders for transmission assets which are already built or are either actually or soon to be under construction, and (ii) the ‘enduring’ regime for transmission assets which do not meet the criteria for the ‘transitional’ regime, i.e. to have qualified as a transitional project before 31st March 2012.

Investment opportunity

Through the tender process interested parties have the opportunity to become the OFTO for offshore transmission assets currently being developed and constructed by offshore wind developers. The assets will be acquired at a transfer value determined by Ofgem E-Serve. Following transfer of ownership, the OFTO will own and manage the transmission assets (including the cables and associated connection equipment) between the offshore point of connection with the generator and the point of connection with the onshore network.

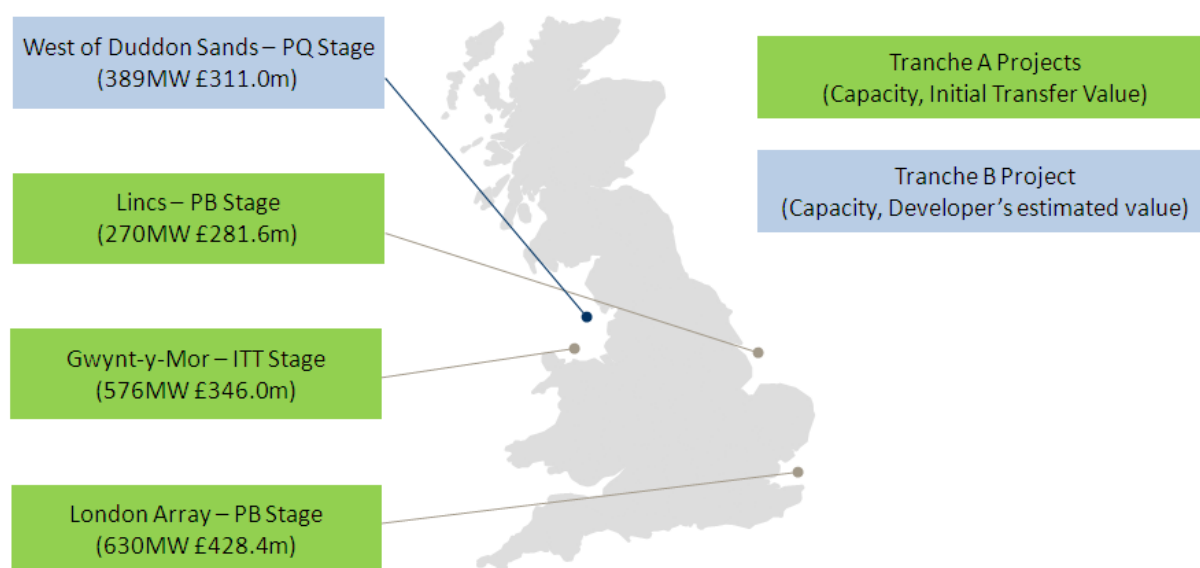
¹ The Gas and Electricity Markets Authority is the regulator of gas and electricity markets in Great Britain. Ofgem is the Office of Gas and Electricity Markets, which supports the Authority in performing its statutory duties and functions. It is the Authority which is responsible for exercising the relevant statutory powers.

During the process a prospective OFTO will bid a 20 year, RPI linked, revenue stream calculated on its required return on investment on the transfer value and the ongoing cost of financing, operating and managing the asset. After twenty years the licence may be extended, revoked or re-tendered.

Four projects, with an aggregate generating capacity of up to 1.8 GW, have qualified for Tender Round 2 (compared to nine projects and 2.1 GW in Tender Round 1). Ofgem E-Serve is running two tranches of tender exercises within Tender Round 2 (“**Tranche A**” and “**Tranche B**”). Tranche A, comprising three projects (for a total of 1.5 GW), which commenced in mid-November 2010 and Tranche B comprising one further project² (0.4 GW) is now commencing. Further details on the project in Tranche B can be found in the project specific PIM.

The identity and location of these projects are shown in Figure 1 below.

Figure 1: Location map of projects for Tender Round 2



² TR2b is now composed of the West of Duddon Sands project alone. The Humber Gateway and Race Bank projects were also originally part of this round, but will now instead qualify under the [Enduring Regime](#).

Investment Highlights

Tranche B of Tender Round 2 provides the final opportunity to acquire operational UK offshore electricity transmission assets under the Transitional Regime. Significant appetite has been demonstrated for these type of assets through Tender Round 1 and 2A, from both equity and debt investors. Over £4bn of commitments were provided at the Invitation to Tender (“ITT”) stage in Tender Round 1 for £1.1bn of assets. The assets in Tender Round 2 are on average significantly larger than the projects in Tender Round 1, providing additional scale to attract investors. Key investment highlights in respect of the assets and regime include the following:

- Strong political and regulatory support for UK offshore transmission
- Opportunity to establish presence ahead of the enduring regime
- Lenders now familiar with the regulatory regime and tender process
- Robust and transparent competitive process
- Construction risk for projects in transitional regime taken by developers
- Regulated revenue stream for a 20 year period
- Creditworthiness of revenue stream counterparty (NETSO)
- Upside potential
- Limited operational risk
- Limited interface risk

Tender Process

Ofgem E-Serve has developed the tender process to be robust, fair and transparent to developers and participants. The process has been demonstrated and established through Tender Round 1. At the early stages of the process limited resources are required by bidders to participate. Bidders need to pre-qualify in order to participate in the Qualification to Tender (“QTT”) stage where access to a project specific information memorandum will be provided. The tender process consists of five steps:

1. **Pre-qualification (“PQ”)**: Bidders are required to submit summary information on their experience and capabilities.
2. **QTT**: Bidders are required to provide submissions based upon a project specific information memorandum, on approach to financing and operation and maintenance proposals.
3. **ITT**: Short list of bidders provided with access to a data room to complete detailed due diligence and submit a tender.
4. **Best and Final Offer (Optional) (“BAFO”)**: Requiring some or all shortlisted bidders to resubmit their tender proposals – only required if Ofgem is unable to identify a preferred bidder at the ITT stage.
5. **Preferred Bidder, Successful Bidder and Licence Grant**: Identification of the party which is the preferred bidder (and reserve bidder as appropriate). Followed by a process to close prior to the grant of the licence.

For further details of how to participate in the PQ stage please refer to:

<http://www.ofgem.gov.uk/Networks/offtrans/rttt/Pages/rttt.aspx>

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 is committed to sourcing 15% of all energy from renewable sources by 2020. Given the relative maturity of renewable technologies and government policy in electricity generation compared with other sectors (i.e. transport and renewable heat), the UK Government aims to generate over 30% of the country's electricity from renewables by 2020, exceeding the legally binding target set by the EU.

Commitment to Offshore Wind

A key part in achieving this commitment is the UK Government's ongoing support for offshore wind generation. The UK is already a world leader in offshore wind power with more than 1.3GW of offshore wind capacity installed and operating. Electricity generation from wind turbines sited off the British coastline is set to increase significantly and become a major contributor to our energy supply. Under Government proposals, up to 48 GW of offshore wind generation and other marine technologies is expected to be developed in the next 10-15 years. This could generate enough electricity to supply more than 10 million homes.

To deliver this deployment, the UK Government has recently increased the level of financial support available to offshore wind generators. The Renewables Obligation ("RO") is the Government's prime incentive mechanism for deploying large-scale renewable generation. In April 2010, the end date of the RO was extended by ten years and is currently due to end in March 2037. Under these new arrangements, accredited generating stations are eligible to receive 20 years of RO support from the date of accreditation. In addition to this, the 2010 legislation also saw the introduction of enhanced RO support for offshore wind projects that are accredited under the scheme between April 2010 and April 2014, resulting in such projects receiving 2 Renewable Obligation Certificates ("ROCs") per MWh of net renewable generation (increasing from 1.5 ROCs per MWh). Lastly, the Renewables Obligation (Amendment) Order 2011 introduced provisions whereby offshore wind projects that are deployed over a number of years can register phases of generating stations with Ofgem E-Serve in order to maximise the amount of RO support they receive.

The Electricity Market Reform (EMR) measures which were introduced to Parliament on the 29 November 2012 through the Energy Bill also demonstrate the UK Government's commitment to delivering secure, clean and affordable electricity. One of the main measures to be delivered through EMR is Contracts for Difference (CfDs) which aim to stabilise the revenues for investors in low-carbon electricity generation projects, helping developers secure the large upfront capital investment required whilst protecting consumers.

Investment in Offshore Transmission

To meet the Government's target for renewable energy, it is estimated that over £15 - £20 billion in investment will be required in offshore electricity transmission infrastructure. This will provide connections for offshore wind farms at all stages of development from planning to operation. Much of this infrastructure, serving projects from the Crown Estate's ongoing Scottish Round, later 'Round 2' projects, 'Round 2' extensions and 'Round 3' initiatives, 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 the associated plant and equipment that connects offshore generating stations to the onshore electricity network. Ofgem E-Serve is the delivery arm of Ofgem.

The offshore transmission regime has been developed and refined by Ofgem and Government with stakeholder input over the past five years. 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:

- deliver fit for purpose transmission infrastructure to facilitate the connection of offshore generation and facilitate the realisation of significant carbon savings;
- provide certainty and best value to consumers through the competitive process; and
- attract new entrants to the sector.

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 OFTO. The Government also decided that Ofgem E-Serve would be the organisation that runs these tenders. Transitional tenders are for transmission assets which are already built, under construction by the developer or are taking steps towards construction, and where the developer meets certain qualifying project requirements.

Ofgem E-Serve and DECC are currently finalising the detailed regulatory arrangements for the enduring regime (including the competitive tendering process) which is expected to be concluded for the next round of projects scheduled to commence in summer 2013. Further detail can be found on the Ofgem website:

<http://www.ofgem.gov.uk/Networks/offtrans/Pages/Offshoretransmission.aspx>

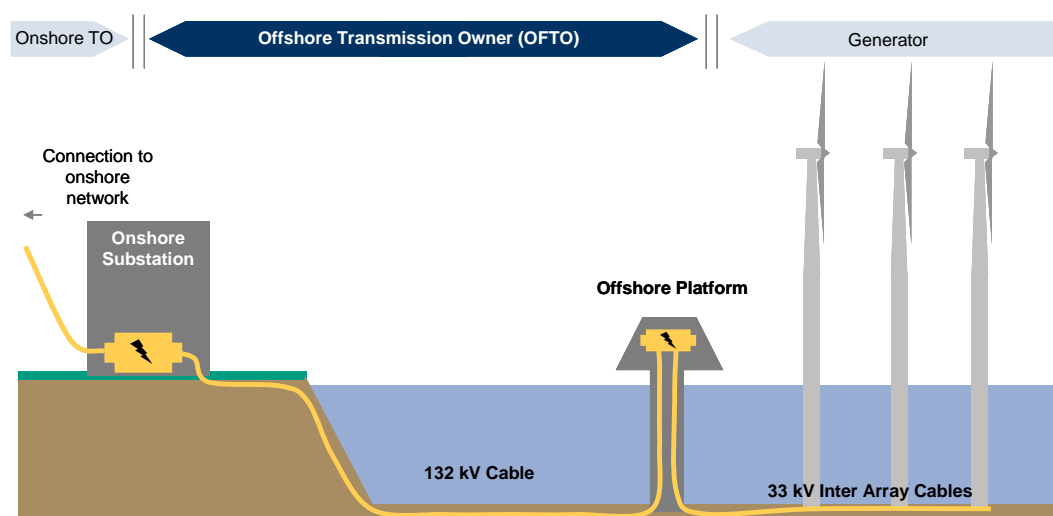
OVERVIEW OF THE INVESTMENT OPPORTUNITY

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 2 contains a generic diagram of what the transmission asset base to be transferred to the OFTO is likely to comprise. Please see the accompanying Tranche B project specific PIM for details of the individual assets and expected ownership boundaries.

Figure 2 – 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. 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.
- Ofgem E-Serve expects to provide the indicative transfer value for the ITT stage (based on its estimate of the economic and efficient costs of construction). Ofgem E-Serve may update this at later stages of the tender process. For the purposes of the PQ stage, Ofgem E-Serve has provided initial transfer values of the transmission assets based on developers own projections.
- At the ITT stage each prospective OFTO will bid a revenue stream, calculated on its required return on investment on the indicative 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**") in its capacity as the National Electricity Transmission System Operator ("**NETSO**")

Cost Assessment

Ofgem E-Serve will calculate the economic and efficient costs which ought to be, or ought to have been, incurred in connection with developing and constructing the Transmission Assets. This cost assessment will be used to determine the final transfer value for the transmission assets, when the Authority determines to grant the licence to the successful bidder.

For the purposes of commencing the Tranche B tender process, the developer has provided an initial estimate of the costs of developing and constructing the transmission assets. This is the "initial transfer value" for the qualifying project.

Ofgem E-Serve will undertake a detailed review of the initial transfer value information in order to identify the "indicative transfer value" i.e. an estimate by Ofgem of the economic and efficient costs of developing and constructing the transmission assets. The indicative transfer value will be released at the Invitation to Tender stage of the tender process, for bidders to incorporate in their tender revenue stream bids. The revenue stream bid by the successful OFTO at the ITT stage will be adjusted by the Authority at licence grant to account for any difference between the indicative transfer value and the final transfer value.

Adjustments to the Revenue Stream

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

- 10 per cent of the agreed revenue stream in any one year 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 E-Serve tender costs.

Qualification for the Second Transitional Tender Round

The legal framework for competitive tender exercises commenced within Tender Round 2 is provided in the Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2010 ("**Tender Regulations**").

To be determined as a qualifying project, a developer needs to demonstrate that it has:

- entered into a bilateral connection agreement with NGET (in its capacity as the NETSO), or entered into an agreement or accepted an offer of an agreement, with the relevant electricity distributor network owner (DNO) to which the transmission assets are or are intended to be connected;
- entered into an agreement for lease of the seabed with the Crown Estate Commissioners;
- obtained all necessary consents and property rights for the transmission assets to be constructed and maintained and ensured that any such consents or property rights which are capable of being assignable to the successful bidder are so assignable;
- completed construction of, or entered into all necessary contracts for the construction of the transmission assets and ensured that any such contracts are assignable to the successful bidder; and
- secured financing to construct the transmission assets.

Each qualifying project is required to demonstrate that it has met certain tender entry conditions before Ofgem E-Serve can commence a tender exercise for that project.

Table 1 lists the qualifying projects in Tranche A; the tender process for these projects commenced mid-November 2010. Table 2 lists the qualifying project which will be tendered in Tranche B from December 2012.

Table 1: Qualifying projects for Tender Round 2, Tranche A

Project	Developer	Size (MW)	Estimated Transfer Value
Lincs	Centrica/DONG/Siemens	270	£281.6m
London Array (Phase 1)	E.On / DONG / Masdar	630	£428.4m
Gwynt y Môr	RWE/Siemens/Stadtwerke Munchen	576	£346.0m
Total		1456	£1,056.0m

Table 2: Qualifying projects for Tender Round 2, Tranche B

Project	Developer	Size (MW)	Developer Estimate of Transfer Value
West of Duddon Sands	SP Renewables / DONG	389	£311.0m
Total		389	£311.0m

INVESTMENT HIGHLIGHTS

Strong political and regulatory support for UK offshore transmission

As part of the Coalition Government's commitment to renewable energy and, in particular, the very significant ongoing expansion of the UK's offshore wind industry, the independent ownership and operation of offshore transmission in the UK still enjoys strong political, regulatory and stakeholder support. DECC and Ofgem have been developing the regime for several years. Both DECC and Ofgem 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.

Opportunity to establish presence ahead of the enduring regime

The transitional regime provides investors with a rare opportunity to enter the GB regulated electricity transmission sector. Building on the success of Tender Round 1, investors should be able to approach the final Tender Round 2 qualifying project with confidence in the robustness of the regulatory regime and the integrity of the tender process. Successful bidders in the transitional regime will be well placed to participate in the much larger enduring regime. It is estimated that potentially over £20 billion in investment will be required in offshore electricity transmission infrastructure.

Lenders now familiar with offshore transmission regulatory regime and tender process

Through experience gained during Tender Round 1 and 2A, supporting lenders have developed their understanding of OFTO assets, the regulatory regime and tender process. Significant debt funding commitments were provided at the ITT stage as part of the total £4.1 billion of commitments. This demonstrates the high level of appetite for OFTO financing from debt providers.

Robust and transparent competitive process

The tender process is 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 E-Serve proposes to make the final appointment of the OFTO after completion of construction of the transmission assets, thus insulating the OFTO from delays and other associated construction risks (although there may be ongoing commissioning activities in relation to the transmission and generation assets after transfer). Where possible, the benefit of construction warranties in relation to the Transmission Assets will be passed through to the OFTO.

Regulated revenue stream for a 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 is set at 98% for Tender Round 2 projects, a figure which has generally been exceeded by interconnectors and other major electricity transmission lines whose performance is reported in the public domain.

At the end of the 20-year revenue stream period, the Authority will determine the most appropriate 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 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, the Authority 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. An OFTO's revenue stream will also not be dependent on the operational performance of the wind farm that it serves.

Limited interface risk

Owing to the capacity requirements of the wind farm, the transmission systems for several of the Tender Round 2 projects have been designed and configured in a number of phases, some of which are interconnected and some are electrically separate. OFTOs will be required to manage the outage programme associated with connecting and commissioning subsequent phases when the assets are operational. Where subsequent phases are electrically separate the interface risk resulting from connection and commissioning will be typically low. Where phases are interconnected it is expected that systems will be put in place to enable subsequent phases to be connected and commissioned while early phases are commissioned, operational and transferred to the OFTO.

Close cooperation and coordination with key stakeholders

The offshore electricity transmission regime has been developed in full consultation with all key stakeholders.

TRANSFER AGREEMENT

Ofgem E-Serve published guidance on the development and content of transfer agreements for Tender Round 2. The developer for the remaining Tender Round 2 qualifying project will be working to produce a project specific transfer agreement based on this guidance provided by Ofgem E-Serve.

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 E-Serve 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 3 summarises the current regulatory framework governing the implementation of electricity transmission in the UK.

Figure 2: Current Regulatory Framework

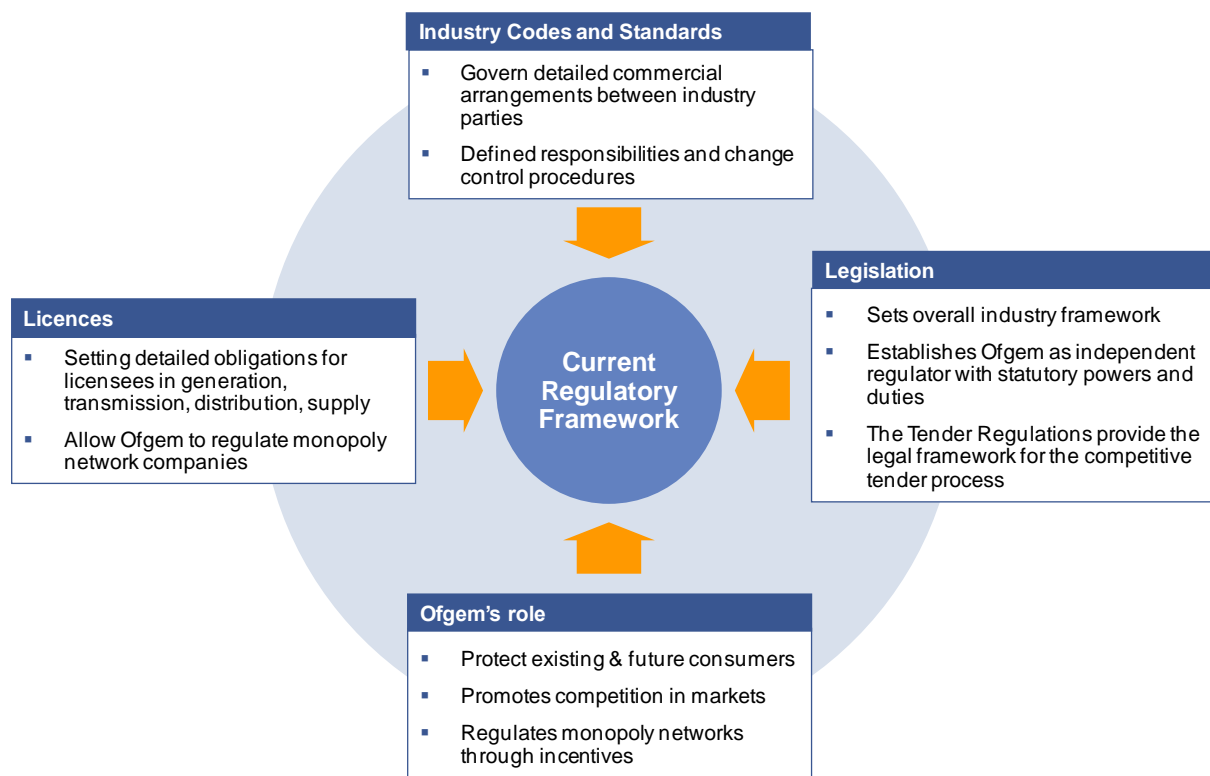


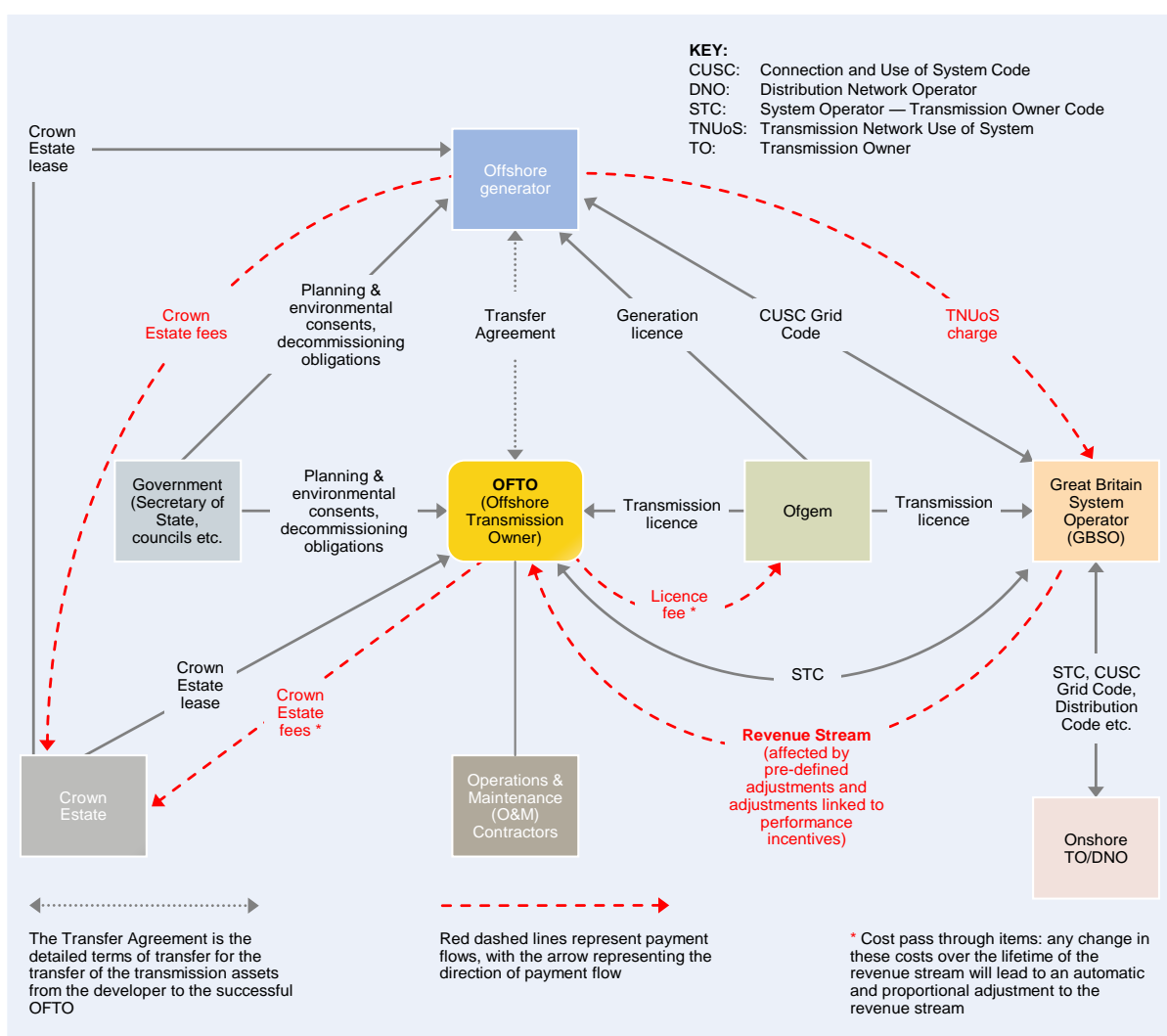
Figure 4 summarises the key industry codes which constitute the contractual framework by which owners, operators and users of the various parts of the electricity network in the GB are bound and interact with each other.

Figure 3: Key Industry Codes

nationalgrid STC	nationalgrid CUSC	nationalgrid Grid Codes	DCode Distribution Codes
<p>The STC Code defines the high-level relationship between the GB System Operator 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.</p>	<p>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.</p>	<p>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.</p> <p>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</p>	<p>Licensed 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 connection to, and use of, their electrical networks.</p>

The outline commercial structure is depicted in Figure 5.

Figure 4: Key Parties and Outline Commercial Structure



OVERVIEW OF THE TENDER EXERCISE

There will be a five stage tender process which will apply to Tranche B of Tender Round 2:

1. Pre-qualification

The first stage, PQ, will involve an evaluation of information submitted by each bidder against a set of criteria which Ofgem E-Serve will publish at the start of the PQ stage. The evaluation will be on a 'pass/fail' basis and will focus on a bidder'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.

The outcome of this stage will be a longlist of qualifying bidders who will be invited to participate in the QTT stage.

2. Qualification to Tender

The second stage, QTT, will involve an evaluation of each qualifying bidder's proposed approach to becoming an OFTO in respect of the qualifying project. Bidders' submissions will be evaluated based on their responses against a detailed set of criteria which Ofgem E-Serve will publish at the start of the QTT stage. This will include focus on their approach to financing and their operational and managerial proposals.

The outcome of this stage will be a shortlist of qualifying bidders for the qualifying project who will be invited to participate in the ITT stage.

3. Invitation to Tender

The main purpose of the ITT stage is to identify a preferred bidder for the qualifying project.

At the ITT stage shortlisted qualifying bidders will be granted access to the data room for the qualifying project, which will be populated predominantly with information provided by the developer. The data room will include sufficient information relating to the qualifying project to enable potential OFTOs to make an informed investment decision for each transmission asset. This will include information relating to contracts, leases, warranties, assets and liabilities, investment and operating plans, sea-bed surveys and evidence of compliance with all applicable legislation and regulations.

The stage will involve an evaluation of a tender submitted by each shortlisted qualifying bidder against a set of criteria which Ofgem E-Serve will publish at the start of the stage. This will involve an evaluation of the financial and non-financial deliverability of each qualifying bidder's submission, including the tender revenue stream submitted by each qualifying bidder to compensate it for the cost of acquisition, financing and operation of the transmission assets over the 20-year licence period.

The outcome of this stage will be a preferred bidder (and possibly also a reserve bidder) for the qualifying project.

4. Best and Final Offer (optional)

The purpose of the optional BAFO stage is to determine a preferred bidder for a qualifying project where Ofgem E-Serve has been unable to determine the preferred bidder at the end of the ITT stage. Where Ofgem E-Serve decides to run a BAFO stage for a tender exercise, it will ask a small number of qualifying bidders to submit information, including any updated tender revenue stream bid, which will be evaluated against a set of criteria which Ofgem E-Serve will publish at the start of the stage. This is not a mandatory stage.

The outcome of this stage will be a preferred bidder (and possibly also a reserve bidder) for the relevant qualifying project.

5. Preferred Bidder, Successful Bidder and Licence grant

After the preferred bidder is announced, Ofgem E-Serve will work with the preferred bidder and the developer to finalise arrangements for grant of the OFTO licence, transfer of the transmission assets from the developer to the successful OFTO, and financial close. Ofgem E-Serve expects that most of the issues arising during this stage will be for resolution on a commercial basis between the preferred bidder, the developer and any other relevant parties. This stage will also include a public 28 day consultation on the proposed modifications to each OFTO

licence in order to incorporate the OFTO-specific provisions in the licence under section 8A of the Electricity Act 1989 (as amended). Transfer of the assets will not occur until construction has been completed.

PROVISIONAL TIMELINES

Below are provisional timelines for the Tranche B tender exercise within the Tender Round 2. Ofgem E-Serve reserves the right to amend the timelines at its discretion and at any time during Tender Round 2.

Provisional timelines for the Tranche B tender exercise:

14 December 2012	Tender launch and release of PQ documents including PIMs
18 January 2013	PQ submission deadline
Late February 2013	QTT documents issued by Ofgem E-Serve
Late March 2013	Deadline for QTT submissions to Ofgem E-Serve
Early May 2013	ITT documents issued by Ofgem E-Serve
Mid July 2013	Deadline for ITT submissions to Ofgem E-Serve
Mid October 2013	Preferred bidder announcements

PROCESS & CONTACT PERSONS

This document forms part of the PQ 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/Networks/offtrans/Pages/Offshoretransmission.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 (as amended)

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.

Energy Bill

The Energy Bill was published on 29 November 2012 and includes an offshore transmission measure to enable generators constructing offshore transmission assets under the Generator build option to convey electricity for a defined period in certain circumstances. It provides an exception to the prohibition on transmission without a licence during generator commissioning activities and during the period leading to OFTO licence grant, while still ensuring that generators transfer the transmission assets to the OFTO in a timely manner.

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; and
- 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 or amended standard conditions relevant to a single licensee.

The general terms and draft amended standard conditions of an Offshore Transmission Licence are available on Ofgem's website together with the six licences that Ofgem has granted to date:

<http://www.ofgem.gov.uk/Networks/offtrans/pdc/cdr/Cons2010/Pages/Cons2010.aspx>

Standard conditions are published on the Authority's electronic public register.

Tender Regulations

The Tender Regulations which were made on 22 July 2010 and came into force on 29 July 2010, provide the legal framework for the competitive tender process³. The Tender Regulations set out Ofgem E-Serve's main role under in relation to the second transitional tender round, which is to:

- determine the projects (i.e. offshore transmission assets) that qualify for the tender round;
- run competitive tender exercises in order to determine successful bidders who will be granted Offshore Transmission Licences for each qualifying project (as summarised within this document and as detailed within the Tender Rules for the second transitional tender round);
- calculate the costs incurred in connection with transmission assets for a tender exercise; and
- publish rules for the tender round and publish a methodology for recovering Ofgem E-Serve's costs of running the tender round.

There are current proposals to replace the Tender Regulations with revised regulations which are expected to come into force in early 2013, subject to consultation. The revised regulations, if and when enacted, will be the Electricity (Competitive Tenders for Offshore Transmission Licences) Regulations 2013 (the New Tender Regulations). If enacted as currently drafted for consultation, the New Tender Regulations will apply to a qualifying project where the Authority has given notice in respect of the ITT stage on or after the date upon which the New Tender Regulations come into force. If the Authority has already given such notice prior to the date the New Tender Regulations come into force, the Tender Regulations will continue to apply. It is therefore currently anticipated that for the qualifying project in Tranche B of Tender Round 2, the PQ and QTT stages will be run under the existing Tender Regulations and the ITT stage will be run under the New Tender Regulations. However, Ofgem will confirm which regulations apply to a particular tender stage at the start of that stage.

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.

³ The Tender Regulations 2010 revoke the Tender Regulations 2009, which were in force at the start of the first transitional tender round

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 National Electricity 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 National Electricity 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 National Electricity 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 National Electricity Transmission System. It is designed to permit the development, maintenance and operation of the National Electricity Transmission System. Parties to the Grid Code are NGET and all users of the National Electricity 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 (National Electricity Transmission System SQSS)

The National Electricity SQSS sets out a coordinated set of criteria and methodologies that Transmission Licensees must use in the planning and operation of the National Electricity Transmission System. The criterion presented in the National Electricity Transmission System SQSS represents the minimum requirements for the planning and operation of the National Electricity 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 National Electricity Transmission System SQSS.

The National Electricity Transmission System SQSS 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/qbsgsscode/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 National Electricity 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.

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 National Electricity 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 National Electricity 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 National Electricity 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 DECC's website at:

http://www.decc.gov.uk/en/content/cms/what_we_do/uk_supply/energy_mix/renewable/policy/offshore/orei/orei.aspx

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