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15th November 2013

Dear Helen,

Diamond Transmission Corporation
Response to Consultation - Proposed interest during construction approach for offshore transmission and Project NEMO

We would like to thank you for providing us with the opportunity to respond to your consultation.

Diamond Transmission Corporation (DTC), a wholly owned subsidiary of Mitsubishi Corporation, is part of the Blue Transmission consortium comprising Barclays Infrastructure Funds Management Limited and DTC.

Blue Transmission Investments Limited is the owner of four Offshore Transmission (OFTO) businesses: Blue Transmission Walney 1 Limited, Blue Transmission Walney 2 Limited, Blue Transmission Sheringham Shoal Limited and Blue Transmission London Array Limited and our response set out below is based upon experience gained in bidding for, completing the transfer and running the OFTO assets of these four businesses:

If you have any follow up queries please do not hesitate to contact me on 07785 527154 or at gary.thornton@diamondtransmissioncorp.com.

Regards,



Gary Thornton B Eng(Hons), C Eng, FIET
Technical Director – Diamond Transmission Corporation

Questions for response

Question1: Is the use of WACC and CAPM appropriate for calculating IDC here?

DTC consider that the methodology using the WACC and CAPM is appropriate for calculating the IDC. However consideration should be given to reviewing the methodology when the secondary market matures and publicly held transaction data is available.

The illustrative cap for IDC is the lower end of the range produced by the methodology. Applying the lower range will increase the risk for investors and potentially impact the successful delivery of the projects through development and construction phases.

It is therefore suggested that the 2 year average of the A and BBB rated bonds and 10-year UK Gilt is used in place of minus one standard deviation, subject to further stakeholder review and also subject to a selection methodology (closer to the time of FID) which does not produce a determination which is inconsistent with the risk profile as per responses below.

Question 2: Is our minded-to approach to accounting for risk bias for offshore transmission and NEMO appropriate?

DTC agree with the Development Risk methodology of using the cost of capital of companies exclusively dealing in oil and gas exploration compared to integrated companies dealing in exploration and operation as a way of determining the development risk for Project NEMO and the additional 0.54% allowance. In any case we would consider a cost of capital determination that exceeds that of a typical merchant power generation plant (in the operational or development phase).

DTC consider there are Construction Risks both in offshore transmission and interconnector projects with greater risk for interconnectors. Technology risks apply to both offshore transmission and interconnectors. While in the longer term the technology used for Offshore Transmission and Project NEMO might be expected to converge subject to market developments (e.g. through the application of HVDC), however there is not yet a formally defined methodology by which Ofgem assesses efficiently incurred cost for Project NEMO, where as an established regime already exists for Offshore Transmission.

Although a cost assessment methodology does exist for offshore transmission which may provide a degree of risk reduction / management, in practice some costs have been disallowed resulting in a risk that has to be considered. Therefore we consider a construction risk allowance should be applied to offshore transmission at the minimum construction risk premium as stated in the Grant Thornton report i.e. 0.91%, and at a higher rate for interconnectors to acknowledge:

- (a) The greater technology risks (higher rated HVDC connections than for offshore transmission systems)
- (b) Market or political / governmental risks during construction, or increased regulatory / legislative risks (two sets of authorities / governments compared to one)
- (c) The less certain return on construction costs, i.e. a construction premium towards the higher rate of 1.6%

Additionally, we would also question the approach or view that PFI projects be used as an element in the evaluation of Construction risk, particularly for Project NEMO. PFI is no doubt a good basis for comparison in the context of the UK OFTO's, but the risk / reward profile for Nemo is potentially quite different.

Question 3: Do you agree with our minded-to approach of applying the IDC cap and rate for offshore transmission and NEMO?

DTC welcome the application of the IDC cap and rate methodology in giving transparency and predictability with the rate being agreed at FID and that rate applying to the whole construction phase.

However given the greater risk during the development phase we believe that the IDC rates should be different for the development phase compared to the construction phase so that it is relevant of the costs during each phase as opposed to the ratio proposed by Grant Thornton in determining the 0.91% risk premium.

In any case, within the IDC rates we would propose that the higher end of the allowance range for construction is applied in order to establish the premium uplift % in relation to Project NEMO. This would also support (and be consistent with) the risk / return differential proposition (and DTC's response) in Question 2.