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Re: DTC response to Ofgem policy update, OFTO Build: Providing additional flexibility through an extended framework

Dear Elizabeth,

Thank you for the opportunity to respond to your consultation. We, Diamond Transmission Corporation (DTC), a wholly owned subsidiary of Mitsubishi Corporation (MC), would like to respond to the captioned consultation based on our experience of investing in and operating offshore transmission assets (OFTOs) and other power transmission businesses in Great Britain and Europe.

At this moment, we own four OFTOs in the UK (Walney 1, Walney 2, Sheringham Shoal and London Array) via Blue Transmission Investment Limited, and similar types of assets in Germany (BorWin 1, BorWin 2, DolWin 2 and HelWin 2). We are seeking further investment opportunities in the power transmission sector (including OFTOs), under the appropriate framework.

We believe Ofgem's work to develop a framework for OFTO-build projects is of critical importance to the continued development and success of the UK's offshore transmission market. Under the appropriate regulatory framework, we believe OFTO-build could help unlock additional value for consumers and deliver benefits to the wider UK energy market.

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

Technical Director – Diamond Transmission Corporation

DTC response to OFTO Build: Providing additional flexibility through an extended framework

DTC is supportive of Ofgem's proposal to introduce greater flexibility into the offshore transmission market through an extended framework of 'OFTO-build' options. Under the appropriate framework, we believe OFTO build could help unlock additional value for consumers and deliver benefits to the UK energy market.

In recent months, for example, there have been several partial sell-downs of offshore wind assets by generators, which may allow for the re-cycling capital for new offshore wind projects. The introduction of an extended OFTO build framework could result in a greater range of financing options for offshore transmission construction, as well as reducing the funding requirements for generators.

We appreciate that the appropriate OFTO-build model for a particular project must ultimately be generator led. However, DTC is willing to work with generators and Ofgem to assist in the development of what is the next key step in the continued success of the UK's offshore generation and transmission. As such, DTC would envisage OFTO-build potentially forming part of our investment strategy, given the appropriate framework.

In the remainder of this response we provide comments on specific aspects of Ofgem's policy document. The comments broadly fall under two categories:

- Allocation of risk and responsibility under the generator 'EPC' approach; and
- Management of contract procurement under the generator procurement and generator/OFTO management approaches.

We welcome views from Ofgem or generators on these comments and are open for discussion of how to further develop potential OFTO-build frameworks.

1. Allocation of risk and responsibility

Ofgem's policy document identifies three principal barriers to OFTO build from the perspective of the generators: delivery risk, cost, and capability. Generators may therefore favour the Generator "EPC" option, as it provides greater certainty over these perceived risks. Our comments on this option are provided below.

- **Responsibility and control:** Under this option, the generator retains a similar level of control over procurement and construction as under the generator build approach. However, as the OFTO has legal responsibility for construction (including compliant with industry codes and standards), this option may place a level of responsibility on the OFTO that is not necessarily equivalent to the level of control. It will be important, under this approach, that control and responsibility are clearly defined in the EPC terms and allocated proportionate to the responsibilities and risks borne by the investor.
- **Construction risk:** A project's cost of capital is proportionate to the level of risk borne by lenders and investors. Ofgem states that under the generator EPC approach, OFTO construction risk may be managed away under the terms of the EPC, such that the generator could insulate the OFTO. However, EPCs often involve a trade-off between risk and cost, and therefore some residual risk can be retained. Liability limits may also result in a transfer of residual risk, and the contract may not cover all eventualities. The EPC approach may not therefore manage away all construction risks, and therefore the cost of capital will be higher than under the generator build approach, commensurate with the level of risk borne by the OFTO. The terms of any EPC guarantees would need to be evaluated to determine residual construction risk borne by the OFTO.

- **Timing of final draft of construction contract:** The construction contract forms a major part of the ITT Tender Process, and so there is a requirement for a clearly defined process for issuing the document to allow for comments and a final update to be available at least eight weeks prior to the ITT submission. This would allow appropriate time to undertake due-diligence and for project finance institutions to evaluate the ITT submission.

2. Management of contract procurement

Ofgem's policy document states that, by procuring an EPC contractor, the OFTO would manage construction risk subject to the terms and protections of any construction contract(s) it enters into, whilst the generator will carry out all supply chain procurement. However, it is not entirely clear how this option may operate in practice.

The main procurement strategies for OFTO build projects are likely to include 'multi-contracts' and 'EPC/turnkey' contracts. We set out below our comments on these two different potential approaches.

- **Multi-contracts:** Under this approach, a high level of interface engineering and co-ordination is normally undertaken. This allows for more efficient procurement of individual contracts and associated interface engineering compared with traditional EPCs. Conversely, a full EPC can reduce the client's interface risk, as well as the required engineering resources and associated costs. The EPC contractor will source the required sub-contracts (with an associated administration charge) and the costs of interface engineering will be part of the EPC costs.

However, if the generator carries out all supply chain procurement, a traditional EPC contractor may be difficult to engage in a competitive tender, as a result of:

- a) a potentially limited number of EPC contractors being willing to bid without being awarded several of the generator's large multi-contracts by the generator; and
 - b) EPC contractors potentially being unwilling to accept liabilities and interface risks on contracts that are not directly negotiated and placed by the EPC contractor.
- **EPC/turnkey contracts:** If the generator engages a main contractor, i.e. a more traditional EPC approach, then the OFTO requires an owner's engineer and project management rather than engaging another EPC contractor.

We believe the management of contract procurement can be delivered if the OFTO either:

- a) undertakes the interface engineering and co-ordination of either the multi-contracts or an EPC contractor; or
- b) engages a specialist project management company to undertake interface engineering and co-ordination of either the multi-contracts or an EPC contractor.

Additionally, we believe that it would be imperative for the generator to provide details of all contracts procured at the start of the ITT phase in order to enable time for due-diligence and for the OFTO to engage a project management company via a competitive tendering exercise.

Ofgem states that construction risk may be managed via a robust security package under the terms of the EPC contract, against which it would be possible to secure low cost finance prior to the start of construction. However, as noted above, security packages will have to be included in the multi-contracts or main contract that has been procured by the generator and, as such, the OFTO's control over these contracts may be limited. It is normal practice to trade off the balance between risk and cost when

negotiating contracts and, as such, there is normally a level of risk that is retained by the client (in this case negotiated by the generator). The OFTO or a project management company may be reluctant to take on liabilities included in contracts that are procured by the generator and which they have no direct contractual control.