

Private and Confidential

OFTO Build: Providing Additional Flexibility Through An Extended Framework – Stakeholder Engagement Response

Rock Transmission Partners' Response

Introduction

Rock Transmission Partners is a joint venture combining the expertise of Rock Infrastructure and Turquoise International. Rock Transmission Partners has been formed as a new entrant to participate in Ofgem's OFTO Build programme.

Rock Infrastructure is an independent developer of greenfield public private partnerships. Rock has extensive experience in the procurement and delivery of major infrastructure projects over a wide range of sectors and a strong track record of delivering innovation to optimise value for money for the public sector and consumers. Rock is committed to developing projects for investment by UK institutional investors who are attracted to the infrastructure asset class by its long-term, stable, index-linked cashflows. We are independent and provide transparency and best value structuring of transactions, without the conflict of other interests. Rock has a strong reputation with the UK Government and investors which further enhances deliverability. Recently Rock acted as the public sector development partner on the £600m Mersey Gateway Bridge PPP (PFI Magazine European Infrastructure Deal of the Year 2014 and IJ Global's European Road Deal of the Year 2014). Further details of Rock Infrastructure can be found at www.rockinfrastructure.com.

Turquoise International offers in-depth knowledge and expertise in the energy and environment industry, with a proven track record in capital fundraising, transaction advisory and investment management. The firm has significant experience in large power plant development, finance, construction, and operation including restructuring the assets of Northern Ireland Electricity into separate IPPs and advising the Thai Electricity Generating Authority on an IPP solicitation programme that brought in 4GW of capacity. David Casale (Director) was CEO and Board Director of a \$80m turnover integrated utility generating and distributing heat and power to 600,000 customers, and part of an IPP developer raising over £1bn of debt in the UK market for the acquisition of 4,000 MW of coal fired generation from National Power, as well as several years offshore construction experience in the Southern North Sea with Shell. Francis Wright (Managing Director) has recently advised on the development, financing and sale of 120 MW of solar assets in the UK. Further details of Turquoise can be found at www.turquoiseassociates.com.

Our Mission

We recognise that a step change in investment is needed in the infrastructure that connects offshore wind projects to the GB transmission system in order to allow the UK Government to meet its target that 15% of the UK's total energy needs are to be met from renewable sources by 2020.

We also recognise that new sources of capital (debt and equity) are required to finance this infrastructure.

Rock Transmission Partners has been formed to participate in Ofgem's OFTO Tender Round 4 that is proposed to be procured using an OFTO build model. Rock Transmission Partners has significant experience and expertise in raising long-term limited recourse finance for the construction of new infrastructure and believe that these skills can be applied to the upcoming OFTO build procurements. We understand how transactions should be structured, through the appropriate allocation and mitigation of risk, to ensure that the optimal cost of finance is obtained.

We believe that well-structured OFTO build transactions will be attractive investment opportunities for long-term direct investment (debt and equity) by institutional investors who,

to date, have not participated in the OFTO sector. This new capital should result in the low cost of capital that Ofgem desires, reducing costs to consumers, and reducing the construction funding requirements of offshore wind Generators. We are open to working with Generators and other potential contractors to deliver this mission.

Stakeholder Engagement Response

Ofgem has requested stakeholders' views on their approach to OFTO build, in particular on:

- (a) The key principles underpinning all OFTO build options; and
- (b) The illustrative options set out in the stakeholder engagement document.

Rock Transmission Partners' response to the two questions above is set out below.

(a) The key principles underpinning build options:

i. The OFTO is responsible under the industry codes and its licence for construction of the transmission assets, including ensuring its transmission system is compliant with industry codes and standards.

Rock Transmission Partners' Response: Agreed; but at each Tender stage Ofgem should adjust the baseline of documents such that the movement of relevant codes can be discussed in the context of a tender process. Value for money may be improved through protection for the OFTO from a step change in standards which has a material impact on costs as is the case on infrastructure PPP transactions.

ii. The Generator is responsible for initial project design and preliminary works and we therefore expect that under all options the Generator will undertake some activity associated with the transmission assets (e.g. consenting). To the extent possible, the OFTO should be responsible for managing consents and property rights during the construction period.

Rock Transmission Partners' Response: We agree that the Generator should remain responsible for initial project design, preliminary works and obtaining planning consents associated with this design. It will give investors' confidence that the scheme is deliverable if the consents associated with the initial design are in place.

Ofgem could drive innovation by permitting OFTO bidders to suggest alternative designs in the bid phase, provided that the bidders were responsible for obtaining any additional consents required by alternative designs. Ofgem would need to set clear parameters in the evaluation criteria which define the amount of deviation (and therefore the level of planning risk) it was prepared to accept in a scheme. Clearly, too much planning risk in a particular solution would not be acceptable to Ofgem as there would not be sufficient confidence that it was deliverable.

Debt funders will not take the risk that any necessary consents are obtained and therefore the grant of any additional consents will be a condition precedent to the OFTO Build financing.

The OFTO should be responsible for managing consents and property rights during the construction phase.

Rock Transmission Partners' Response: Agreed.

iii. The OFTO finances construction and ongoing operations of the transmission assets.

Rock Transmission Partners' Response: There is appetite amongst infrastructure investors (debt and equity) to finance the construction and ongoing operations of the transmission assets on a limited recourse basis. Facilitating the entry into the OFTO market of this capital will reduce the construction funding requirements of Generators and also increase competition (reducing the cost to consumers) – two of Ofgem's key objectives for the OFTO Build programme.

iv. The Generator will work with Ofgem to develop and agree an OFTO build option, which will be specified before tender marketing and tender commencement, so the 'rules' and the commercial package on offer for each tender are clear before a tender exercise commences.

Rock Transmission Partners' Response: It is essential that potential bidders for each OFTO Build project understand the tender rules prior to the commencement of the tender. This will allow potential bidders to decide whether they wish to participate in the relevant tender.

We suggest that Ofgem undertakes a consultation with other market participants, as well as the Generators, before deciding which OFTO build option is to be used as this would allow Ofgem to gauge the appetite for the different OFTO Build options set out in its stakeholder engagement. We appreciate that there may be project-specific reasons why a project is best suited to a particular procurement route for the construction of the transmission assets.

We consider that new entrants will be more attracted to the OFTO Build programme and more willing to invest time and resources, to build out their capability for bidding and delivering tenders, if there is a clear programme of opportunities that are to be procured in a way that they consider they can win. New entrants will be deterred from taking part in OFTO Build procurements that are similar to the Generator Build procurements that have been done to date due to the advantage that current market players would have in such procurements.

v. At Financial Close and Licence Grant the OFTO will pay the Generator the economic and efficient costs (as determined by Ofgem) associated with any works undertaken by the Generator up to that point.

Rock Transmission Partners' Response: We agree. These costs could be funded out of the first drawdown of the OFTO financing.

vi. Risks during the construction period should be borne by the party best placed to manage them, e.g. in options where the Generator manages construction activities it should take on the liability for risks during the construction period. We expect that there will be a clear relationship between the level of control and influence the OFTO is provided over construction by the Generator "EPC" contractor and the extent of the OFTO's construction liabilities, facilitating a low cost of capital and therefore a low Tender Revenue Stream (TRS) and TNUoS during operations.

Rock Transmission Partners' Response: Ofgem will receive the best possible TRS bids if risks are borne by the best party to manage that risk. The party bearing a risk should have the ability to manage that risk through the rights given to them in the legal documentation.

vii. Construction activity should be undertaken economically and efficiently to deliver value for consumers, in line with industry codes and standards.

Rock Transmission Partners' Response: Construction activity should be undertaken economically and efficiently to deliver value for consumers in line with industry codes and standards. We consider the optimal way of achieving this is for Ofgem to define the required standards as an output in the licence and for the private sector to determine the most efficient way of achieving these requirements whilst in a competitive tender process. The public sector should be open to innovation to drive further savings.

Rock Infrastructure recently acted as the public sector's development partner on the recent £600m Mersey Gateway Bridge PPP. The public sector achieved procurement savings of £250m (NPV) (when compared to affordability constraints) by running an efficient and effective procurement of the construction that gave bidders the flexibility to innovate.

We believe that a paralleled and optimal pricing tension could be achieved where the EPC contract is competed i.e. outside the "Generator Procurement" model. The optimal TRS bids will be received if the competitive tension in a bidding situation encourages EPC Contractors to provide their best pricing and most efficient construction methodologies.

viii. We propose that the allowed cost of the construction works, whether these are undertaken by the Generator or the OFTO, will be fixed as far as possible at Financial Close and Licence Grant and subject only to certain limited revenue adjustment allowed under the OFTO licence.

Rock Transmission Partners' Response: We agree that the construction price should be fixed at Financial Close and Licence Grant, with limited circumstances leading to a price adjustment. Including construction risk under the OFTO may lead to more discussions around what risk transfer would yield the best value for money and may lead to participants seeking to put certain risks back to the public sector.

ix. Any costs allowed as a revenue adjustment should reflect the actual costs incurred.

Rock Transmission Partners' Response: Agreed; the revenue adjustment should allow the OFTO to also recover a reasonable margin.

x. We would expect a tender to require OFTOs to bid a fixed price TRS under any of the OFTO build options, and the OFTO's revenue would be largely fixed at Financial Close and Licence Grant.

Rock Transmission Partners' Response: Agreed

xi. The OFTO will receive its revenue stream for a period of 20 years.

Rock Transmission Partners' Response: As demonstrated in the successful OFTOs granted to date, a 20 year revenue stream is attractive to long-term institutional investors. Institutional investors have been attracted to the OFTO sector as OFTO revenues are protected from changes in the rate of inflation. The revenue stream should continue to be index-linked. Longer licence periods would allow the cost of construction to be repaid over a longer period, reducing the monthly TRS payment.

xii. The OFTO's operation phase rights and obligations (as set out in its licence) will be largely the same as under Generator build subject to further consideration of the compatibility of current licence policy with OFTO build.

Rock Transmission Partners' Response: Agreed; the terms of the existing licence have been demonstrated to be bankable and should remain largely the same as under the Generator Build model, subject to any changes needed due to the inclusion of construction in the OFTO's responsibilities.

Some modifications to the rights and obligations of the OFTO may increase value for money and reduce costs to the consumers. There should be flexibility within the tender process to discuss potential innovation to facilitate these savings.

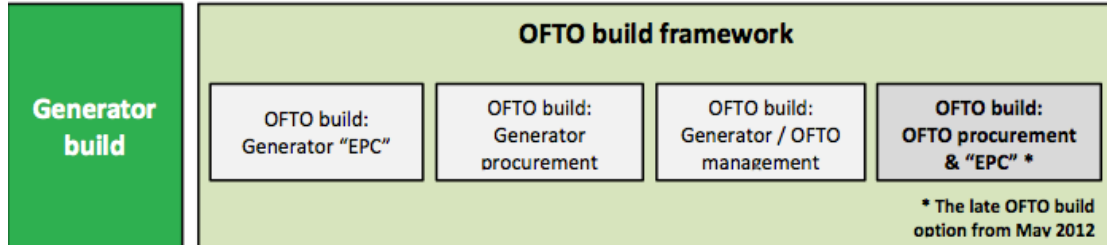
xiii. We would expect criteria and arrangements for handover of any transmission works or assets from the Generator to the OFTO to be clearly set within contractual agreements between the parties and enable the OFTO to manage its liabilities and obligations under its licence.

Rock Transmission Partners' Response: Agreed. The OFTO will need certainty over what will be handed to it on construction completion. The contractual arrangements should also provide the OFTO with protection against defects that manifest themselves after handover.

(b) Illustrative options

Ofgem has suggested four potential procurement options for OFTO Builds for illustrative purposes. It is recognised that in reality other options may also exist.

The four illustrative options set out in the OFTO Build framework are as follows:



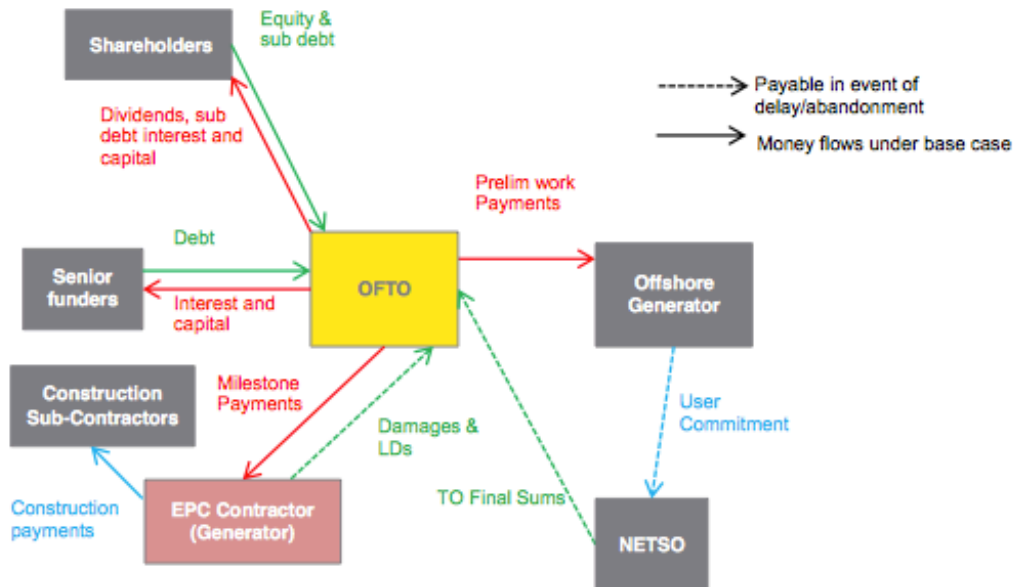
Finally, the OFTO procurement & EPC option is as set out in Ofgem’s May 2012 report entitled “Offshore Electricity Transmission: Updated proposals under the enduring regime”.

We welcome all of the options in the OFTO Build framework set out above. Our preference is for OFTO Builds to be procured using the OFTO procurement & EPC option (Late OFTO Build) as we consider that this option will allow Ofgem to successfully deliver on its objectives for the programme and maximise the benefits for consumers through lower electricity prices. This option should also result in lower user charges for the Generators and free up their capital for other activities.

i. Generator “EPC”

Under the Generator “EPC” option the Generator manages all supply chain procurement and transmission asset construction for the OFTO under an “EPC” contract, which provides protection to the OFTO from construction risk.

Figure 3 Money flows during construction for the Generator ‘EPC’ option



Rock Transmission Partners’ Comments

This option is the most similar to the Generator build model that has been used to date to procure OFTOs. The key difference is that the OFTO finances the construction of the transmission assets by the Generator, rather than acquiring assets from the Generator on completion of those assets.

Advantages

We consider that this option has the following advantages:

- Under this option, the Generator retains control over the construction of the transmission assets and therefore has the ability to manage construction to ensure that the transmission assets are constructed on time and to the right standards to allow payments under its CfD to commence on schedule although, as a result of this control, it will be required to provide construction support to the OFTO and its funders which will use its balance sheet and impact on the Generator's funding limits. Freeing up the balance sheet capacity of Generators for other projects is one of the OFTO Build's objectives which will not be met under this option – see "Disadvantages" below;
- The Liquidated Damages rate that would be payable by the OFTO to the Generator would be lower (reducing the risks borne by the EPC Contractor and therefore the risk contingencies in the construction cost) as it is not expected that the Generator will be permitted to claim Liquidated Damages from the OFTO if the delays to the completion of the transmission assets have been caused by the Generator in its capacity as the EPC Contractor; and;
- The interface risk is limited as the Generator is also acting as the EPC Contractor.

Disadvantages

We believe that this procurement method will not deliver the benefits that Ofgem hopes to deliver through the OFTO Build programme as:

- The OFTO and its investors will not have the ability to manage construction, but instead are expected to rely on the construction support package provided by the Generator or its Guarantor to protect them from construction risks. Although OFTOs will provide construction financing, construction risk remains with the Generator. This structure is similar to a corporate loan to the Generator/Guarantor and is therefore likely to be on the Generator's/Guarantor's balance sheet. This option will therefore not free up Generators' capital, which is one of the stated objectives of the OFTO Build Programme;
- Ofgem will not benefit from the asset management expertise of infrastructure investors. Instead, responsibility for resolving difficulties, such as construction delays, is likely to fall to Ofgem;
- This structure may also not be attractive to long-term institutional investors that have appetite to invest in the infrastructure sector as they would not possess the usual rights to step-in and manage construction to protect their investment as is customary in infrastructure transactions;
- As this is very similar to the existing Generator build model, OFTO Build procurements using the Generator EPC model are likely to attract the incumbent players in the OFTO market. This procurement option will not encourage new entrants as they will consider it to be difficult to compete with these existing market incumbents who have the benefit of market knowledge gained through participating in OFTO procurements to date;
- Scrutiny of the construction price and construction methodology of transmission assets would fall to Ofgem, rather than the market determining the most economic and efficient way of delivering the required transmission assets. This will place increased strain on Ofgem's resources and could lead to an inefficient procurement process. This type of OFTO Build procurement may therefore not lead to the lowest

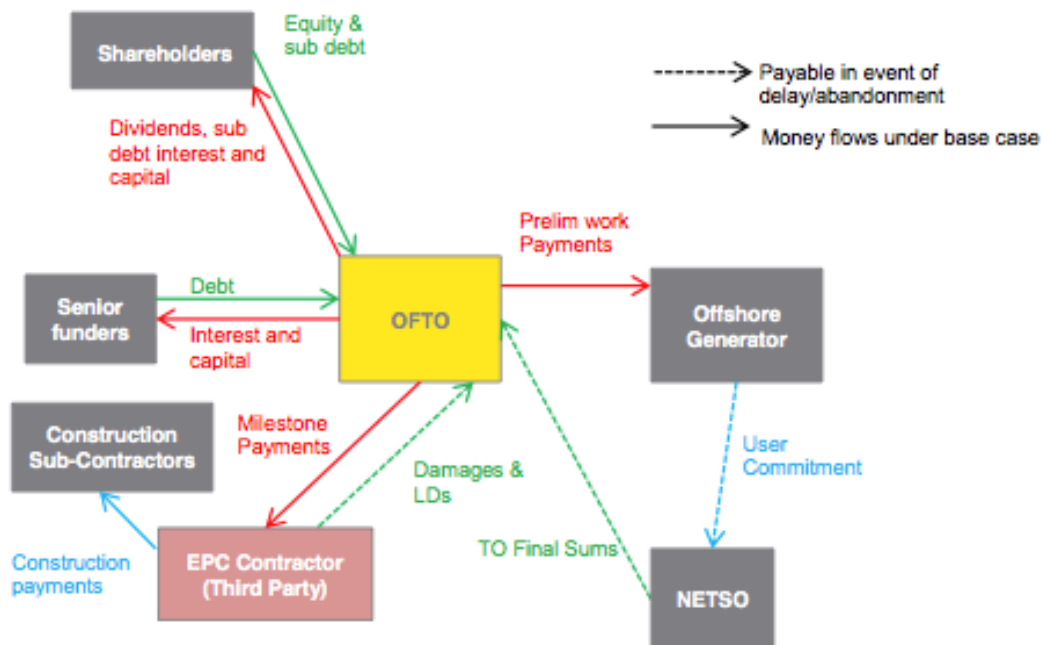
TRS payments, resulting in higher electricity prices for consumers and higher user charges for the Generators;

- It will be challenging for Ofgem to create a bankable EPC Contract with the Generator for each OFTO Tender prior to tender launch, particularly as there will not have been any funder engagement at this stage. The lack of a direct relationship between the OFTO and Generator could make the negotiation of this contract long and inefficient (which will increase bid costs);
- Each OFTO bidder will make different comments to the proposed EPC Contract with the Generator. These will need to be evaluated by Ofgem in order to fully assess the bidders' tenders, which could import challenge risk into the tender process; and
- It is not efficient for the OFTO's debt and equity investors to fund any revenue adjustments due to the EPC Contractor through contingencies in the OFTO's capital structure pending revenue commencement under the OFTO licence once the transmission assets become operational. The cost of these contingencies will be passed to consumers through a higher TRS payment. It would be preferable for the OFTO to receive a payment from NETSO during construction to pass-through to the EPC Contractor as is the case following the occurrence of a Compensation Event on an infrastructure PPP transaction.

ii. Generator procurement

Under the Generator procurement option it is anticipated that the Generator would carry out all supply chain procurement and the OFTO would likely procure an "EPC" contractor (or similar) to taken on the main construction contractor role and to take on oversight and delivery of the procured contracts.

Figure 5 Money flows during construction for the Generator procurement option



Rock Transmission Partners' Comments

It may not be possible for the OFTO to be able to obtain best terms from potential EPC Contractors if they are required to use a supply chain that has already been procured by the Generator. It is an established principle in PPPs in the infrastructure sector that EPC Contractors are able to manage their own supply chain due to the significant Liquidated

Damages that they incur if the works are not delivered on time and termination of the EPC Contract if the works are not completed by an agreed longstop date. They need to have confidence in their supply chain if they are to provide a construction wrap. In PPPs, public sector clients have limited rights to obtain information relating to supply chain changes. The public sector can only reject proposed alternative supply chain members if they are not on a pre-approved list.

Greater construction pricing and efficiencies may be possible if the EPC Contractor was able to select its own supply chain. EPC Contractors tend to have relationships with trusted sub-contractors that they work with repeatedly. EPC Contractors seek to generate economies of scale by obtaining sub-contractor prices that cover more than one tender in the OFTO Build programme.

This Generator procurement model may deter potential EPC Contractors from entering the OFTO Build market as it is not an arrangement that they are familiar with.

iii. Generator/OFTO management

Under the Generator/OFTO management option the Generator has the option to adopt one OFTO build option for some of the transmission assets and another OFTO build option for the remainder of the assets. For example, the Generator might manage procurement and construction of the offshore elements and the OFTO might manage procurement and construction of the onshore elements. However, the OFTO would be responsible for all the transmission assets under the terms of their licence.

Ofgem recognises that this option may introduce interfaces which would not exist in the other OFTO build options, and invites Generators interested in this option to discuss with them any such interfaces and solutions to manage them.

Rock Transmission Partners' Comments

This structure does introduce interface risks due to separating the works into different works packages, although this risk may be offset by more efficient pricing as each of the construction parties would be free to select only those aspects of the works that they are most comfortable with – thereby reducing the need for construction risk pricing and contingencies.

It may be appropriate to limit the proportion of the works that the Generator may undertake to avoid importing some of the disadvantages of the Generator EPC model into this structure.

iv. Late OFTO build (May 2012 report)

Under the OFTO build option, the Generator would obtain the connection offer and undertake high level design and pre-construction works. A prospective OFTO would bid their approach to the procurement, financing, construction, operation, maintenance and decommissioning of transmission assets, and the costs associated with carrying out these activities.

Rock Transmission Partners' Comments

We consider that this option should be Ofgem's preferred procurement method for the OFTO Build programme as it has a number of advantages that should see Ofgem maximise the benefits of the OFTO Build programme for Ofgem and consumers, as well as resulting in lower user charges for the Generators.

We consider that Late OFTO Build option has the following advantages:

Advantages

- The OFTO would be responsible for procuring the EPC Contractor. It could therefore select the EPC Contractor from the universe of contractors who possess the necessary technical expertise to carry out the works (both Generators and other

specialist transmission providers). The OFTO would be incentivised to ensure that it bids the best possible construction price as this will be a key determinant of the winning tender. The construction price (together with the construction methodology) will therefore be subject to extensive scrutiny from project sponsors and funders alike;

- Due to the potential competition between EPC Contractors, the OFTO will have a stronger negotiating position during EPC Contract negotiations and therefore should be able to obtain an appropriate risk allocation in the EPC Contract, ensuring that construction risk is transferred to the EPC Contractor in a way that represents best value for money. A robust security package from the EPC Contractor should ensure that the transmission assets are delivered on time and to budget. The Generator and Ofgem will benefit from extensive funder due diligence on the OFTOs proposals, giving confidence that the OFTO's proposals for construction and the operational phase of the licence will be deliverable. In addition, developers and investors experienced in project finance will be used to negotiating these contractual terms and will understand what is bankable;
- The OFTO is responsible for competing and selecting its sources of financing. It will have more leverage to obtain the best funding terms and acceptance of the terms of the EPC Contract, including the required construction support package from its funders, than if the EPC Contract is negotiated between Ofgem and the Generator as is the case under the Generator EPC model. This should result in a more effective and efficient transfer of risk;
- The OFTO bidders are closer to the funding market than Ofgem and will therefore be able to determine what EPC Contract terms and support package are required to obtain the financing that will result in the lowest TRS payments, based on prevailing market conditions; and
- This structure is most familiar to investors in the infrastructure and power project finance market who will be expecting a typical bankable risk allocation. This structure is most likely to attract new entrants from these similar markets. This competition should drive down financing costs, allowing Ofgem to pass the benefits onto consumers and users of the grid. These alternative sources of finance will also reduce the demand on Generators' funding capacity.

Our Approach

Clearly the Generator is an important stakeholder in any OFTO Build procurement and the tender process would need to be designed to ensure that it gave confidence to the Generator that the transmission assets would be constructed to the required standards on schedule by an EPC Contractor that had the necessary capabilities. Our approach would be to work with the Generator and Ofgem to ensure that Late OFTO Build procurements resulted in a robust and deliverable solution at the best available price.

We will leverage our experience of structuring infrastructure deals to structure a transaction that results in the optimal risk allocation that is acceptable to all stakeholders and optimises value for money.

Rock would welcome the opportunity to participate in the upcoming workshops that Ofgem is planning to run on the OFTO Build Programme, and discuss the OFTO programme and future progress with the Generators and other market participants.

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