

8 December 2015

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Dear Scott,

**Open Letter: Indexation for future OFTO and interconnector licences**

We would like to thank you for providing us with the opportunity to respond to your open letter. Please find below the response of Macquarie Capital to Ofgem's open letter in relation to indexation for future OFTO and interconnector licences.

Our response is only in relation to your request for views on any potential obstacles to such a change in approach to indexation, and whether this should impact on the timing of when a change should be applied, where you highlighted the questions set out below.

1. Would moving to CPI affect investor appetite for projects going forward and if so explain why and how these obstacles might be addressed?

*Macquarie's view:*

*Equity investors' appetite should not materially change, there is not a material difference in appetite between CPI and RPI linkage.*

2. Would a change to CPI affect the financeability of projects? Please indicate which project types you are considering and what the impacts may be.

*Macquarie's view:*

*On the debt side, CPI linked debt is less developed than RPI but we are seeing strong appetite and this is expected to develop further as more CfD projects come to market. Institutionals like pension funds have used RPI linked products as a proxy to hedge their CPI exposure and would see a better match to their liabilities with CPI linked products. However, these parties are typically not engaging at bid stage. Ofgem would need to consider these constraints in bid requirements for OFTOs, especially in terms of benchmarking (i.e. not traditional bank debt, but not a public bond raising either). Because the CPI market is less liquid, a change to CPI may also lead to increased cost for large projects like interconnectors.*

3. Please comment on whether CPI is in your view an appropriate index to move to or whether you have a preference for another measure of indexation (e.g. an alternative CPI-based measure) and why?

*Macquarie's view:*

*We do not have a preference for another measure of indexation. We believe that, as the CPI market is still developing, complex hybrid measures might not be helpful in attempting to attract sufficient liquidity.*

4. In your view what effect on the consumer or other industry participants (such as offshore windfarm generators) do you think a move to CPI would have?

*Macquarie's view:*

*This is highly dependent on CPI assumptions. And any potential negative impact should be managed by bidders determining their strategy on biddable indexation.*

5. For OFTO projects, would a change to CPI impact on your strategy for biddable indexation, and if so what are the impacts. In your view would this result in a benefit or additional cost to the consumer?

*Macquarie's view:*

*Strategy for biddable indexation on OFTOs may change as CPI linkage would create a different cash flow profile than RPI. Hedging products would also be less liquid than RPI hedging which may be reflected in pricing and would make us reconsider our bidding strategy. We would adjust the level of biddable indexation to optimise the bid price and hence the cost to the end consumer.*

6. Are there any other challenges you foresee a change of index may bring? How could these be resolved?

*Macquarie's view:*

*The key challenge would arise from the fact that the CPI market is currently developing. On processes like OFTO, Ofgem would need to set requirements that take into account that feature. However, it may also be an opportunity for Ofgem to benefit from the development of this market on the back of CfD projects. Given bidders determine their strategy on biddable indexation, any benefit should be captured on behalf of the end consumers.*

7. Are there any consequences to timing we should be aware of regarding a move to CPI (or another index) and how should we manage these?

*We have seen a recent acceleration in the development of the CPI market. With a few large CfD projects expected to come to market within the next months, we believe this market will deepen further. While we believe this could be beneficial for projects of a size similar to recent OFTOs (c.£200-300m), large interconnectors may suffer from reduced liquidity if competing with other large projects.*

We would be delighted to discuss these thoughts in an open and constructive manner with Ofgem.

Yours faithfully  
**On behalf of Macquarie Capital**

