Macquarie Capital (Europe) Limited
A Member of the Macquarie Group of Companies

Ropemaker Place
28 Ropemaker Street
London EC2Y 9HD
UNITED KINGDOM

Internet www.macquarie.com/eu

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MACQUARIE

James Norman
Head of New Transmission Investment Networks
Transmission Competition Policy
Ofgem
9 Millbank
LONDON SW1P 3GE

Dear James,

Re: Hinkley-Seabank - Consultation on Final Needs Case and potential delivery models

Macquarie Capital (Europe) Limited ("**Macquarie Capital**") welcomes Ofgem's assessment on the Hinkley-Seabank ("**HSB**") Final Needs Case and delivery method appraisal.

Macquarie Capital, its holding companies, subsidiaries and subsidiaries of such holding companies (the "**Macquarie Group**") is at the forefront of infrastructure, being the largest manager of infrastructure investments globally, and acts as principal investor in a wide range of asset classes. Macquarie Capital/Group has acted as both advisor and/or sponsor on five OFTO assets which have reached financial close. As part of the Mari Energy Transmission consortium we are shortlisted as a qualifying bidder to bid for several of the Tender Round 5 OFTO assets.

In addition to its OFTO experience, Macquarie Capital/Group has been involved in multiple greenfield infrastructure and energy project finance transactions, including MGT Teesside Biomass Plant, Mersey Gateway Bridge PPP, D4R7 Slovak Highway PPP, Dublin Waste to Energy, and numerous others. Macquarie Capital's Infrastructure Projects and Principals group specialises in concessions and projects, combining financial advisory services with principal investing across the capital structure. Macquarie Capital is pleased to respond to this HSB consultation and, more generally, has followed Ofgem's competition in onshore transmission consultations with interest.

Criteria for competition and needs case assessment:

Macquarie Capital supports Ofgem's initial conclusions regarding (i) the criteria for competition for each delivery model, and (ii) the needs case assessment for the HSB project.

We consider it important for Ofgem to retain the packaging criteria to provide it with the flexibility to choose the delivery model most likely to deliver a favourable outcome for the consumer. In this sense, we agree with Ofgem's view that the c.2% proportion of the HSB project relating to upgrade works could be carved out from the SPV model scope such that the project meets Ofgem's "new" criteria. We agree that electrical separability is not necessary for each interface so long as responsibilities for both sides of the boundary can be defined clearly. Interface agreements and site responsibility schedules have previously been used on OFTO projects to achieve this.

Overall, we would welcome further clarity on how Ofgem will decide between the delivery models proposed.

SPV model benefits:

Macquarie Capital considers that the SPV model has the potential to deliver a more favourable outcome for consumers than the Competition Proxy model or status quo for the following reasons:

- The SPV model introduces the widest scope of competition and an integrated approach across financing and delivery - it will naturally encourage the optimal allocation of risk between members of a bidding consortium.
- The wider scope of competition offered by the SPV model, and demonstrated by the OFTO regime, should deliver more favourable NPV outcomes for consumers when compared to counterfactuals or proxies.[1]
- There are numerous other precedents where the introduction of competition has delivered greater savings than originally envisaged (e.g. Thames Tideway, Fort McMurray West). As with the OFTO regime and these examples, the SPV model would provide an excellent form of price discovery.
- OFTO competition has resulted in increasing savings for the consumer over time with successive projects,[1] arising from new entrants as well as continued innovation and lessons learned by existing market participants. The SPV model offers this opportunity, whilst it is difficult to implement with the Competition Proxy model.
- The Competition Proxy model offers limited scope for competition because it seeks to apply a proxy cost of capital whilst relying on the cost assessment process for delivery costs. Determining the appropriate cost of capital benchmark may be challenging given the asset classes proposed in the consultation have different underlying risk profiles to HSB.

SPV model deliverability:

We consider that the SPV model procurement process is deliverable within the c.15 month timescale noted in Figure 2 of the consultation document:

- Having recently worked on the successful sale of National Grid's gas distribution business, Macquarie Capital has full confidence in National Grid's ability to run a fair and competitive tender process in a short timeframe to deliver substantial value for shareholders (or consumers in the case of HSB), exceeding initial targets. The sale process, run by National Grid and its advisors over a period of c.15 months, involved a number of international investors and required National Grid to efficiently work around complex issues by leveraging its internal resource/expertise and employing external advisors where necessary.
- The SPV model has similarities with the OFTO and CATO regimes developed by Ofgem. Substantial work has already been undertaken on data room content and tender specification/documentation, revenue models, performance incentives, and optimal risk allocation. This is largely, and promptly, applicable to the SPV model.
- The competitive process run by Scottish and Southern Electricity Networks for Shetland's electricity supply (where a National Grid entity was appointed the preferred bidder) offers another useful precedent, as does UK PPP/PFI and the other project examples mentioned above.
- Work required to populate a data room for bidders should not be substantially different from work required to develop needs case and project assessment submissions under the status quo, and should therefore not hinder timescales.

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[1] *https://www.ofgem.gov.uk/sites/default/files/docs/2014/05/cepa_bdo_tr1_benefits_assessment_final_report_0.pdf, and https://www.ofgem.gov.uk/system/files/docs/2016/03/ofgem_tr2_tr3_evaluation_final_report.pdf*

More generally, Macquarie Capital's experience from PPP/PFI projects is that a portion of design work typically occurs during the bid stage and prior to financial close, to achieve a fixed construction price and programme. There is therefore potential scope for the SPV model financial close date to be later than shown in Figure 2 of the consultation. We also note that bidders' varying approaches to construction procurement under the SPV model may result in different overall delivery timescales from the counterfactual programme (to meet the late 2024 and 2025 connection dates) shown in Figure 2.

We note that NGET would have a limited timeframe to replicate what the wider competitive market has achieved in order for the Competition Proxy model to deliver the same consumer benefits as the SPV model.

SPV model tender process:

Lastly, Macquarie Capital suggests the below considerations in relation to the SPV model tender process:

- We would recommend a two stage tender process (EPQ and ITT), proven by the OFTO regime, to fit within the above c.15 month timescale. Assuming some design works are required, the ITT stage could last c.6-9 months.
- We agree with Ofgem that the SPV competition should cover the "widest possible scope". Bidders should be allowed to form their own consortia for the financing and delivery of the HSB project.
- The number of consortia invited to the ITT stage should be limited to three in order to manage tender costs and resources, both for NGET and the bidders.
- Committed financing should be required as part of ITT bids in order to achieve maximum cost and execution certainty for NGET when appointing the preferred bidder. Given the HSB project size, and assuming a limited number of bidders, we believe there is sufficient capacity in the market to develop three committed financing solutions (one from each consortium).
- NGET retaining a specified equity stake in the SPV would introduce managerial and governance complexities, and clear conflicts of interest. In line with Ofgem's other proposal, it would be more appropriate to allow NGET to retain a proportion of the overall consumer savings derived from its role in procuring the SPV.
- We generally agree with the proposed role allocations between Ofgem, NGET and the SPV, set out in the consultation Tables 3 and 4.

We would like to thank you for providing us with the opportunity to respond to your consultation. Should you have any questions regarding our response we would be pleased to discuss these further in an open and constructive manner with Ofgem.

Yours faithfully,
On behalf of Macquarie Capital (Europe) Limited

Mark Bradshaw	**Angenika Kunne**
Senior Managing Director Macquarie Capital	Vice President Macquarie Capital