

Macquarie Corporate Holdings Pty Limited (UK Branch)

A Member of the Macquarie Group of Companies

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9 November 2018

Matthew Ball
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Dear Matthew,

Consultation: Extending competition in electricity transmission: commercial and regulatory framework for the SPV model

We would like to thank you for providing us with the opportunity to respond to your consultation in relation to extending competition in electricity transmission. Please find below the response of Macquarie Capital.

Responses to questions set out in Chapter Three:

Question 1: What are your views on the commercial framework as set out in the accompanying Agilia report?

The commercial framework is generally acceptable. Increased certainty at bid stage around construction readiness would help to attract more bidders and reduce the risks of delay. The more developed the projects are at the time of tendering, the broader range of investors they will attract to maximise competitive tension. If the TO still requires flexibility to transfer some risks around land acquisition, permits and consents to bidders, we would expect appropriate cost compensation mechanisms in the DA to cover refusals or delays by authorities which are outside of the bidders control. Given that the 25 year revenue period may be reduced due to delays in construction, the compensation for delays outside of bidders control will be important to prevent unnecessary contingencies in SPV bids.

Question 2: Do you agree with the scope of our role in the SPV model?

We generally agree with Ofgem's role in the SPV model. We consider it appropriate for Ofgem to approve the DA during the tender to attract bidders and to provide regulatory guidance for revenue and cost adjustments for events outside of the SPV's control.

Given Ofgem's intention to only have a statutory relationship with the TO without any direct agreement with the SPV, it is important to have a clearly-defined process for obtaining changes to the revenue allowance and cost / termination compensation.

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Question 3: Do you agree with the scope of the Independent Technical Advisor? Do you have examples you can share of Independent Technical Advisors working well or not so well, and any examples of lessons learned from this approach?

We generally agree that it is appropriate to have an Independent Technical Advisor ("ITA") involved in verification of technical risk and certification of milestones and design / construction progress. However the joint appointment of the ITA and duty of care / responsibility to Ofgem, the TO and SPV should be carefully managed to avoid any potential conflict of interest.

We would expect the role of the ITA in availability determination and performance incentives / deductions to be limited to verification of results against a clearly defined, objective availability payment mechanism. We also agree that it may be appropriate for the ITA to be involved in technical disputes between the SPV and TO; however we would expect to this be part of a clearly defined dispute resolution mechanism to avoid any conflicts of interest.

Question 4: What are your views on operational period incentives for the SPV?

The proposed package of operational period incentives for the SPV is generally acceptable. An availability-based incentive system, including a cap on the SPV's annual revenue deductions is appropriate and we would consider a 10% cap in line with the OFTO regime to be appropriate. The greenhouse gas incentive should be considered in the context of the project but is generally acceptable. No additional incentives/penalties would be required in our view.

Question 5: What are your views on where there may be consumer value in a target cost rather than fixed price model?

Generally we consider that a fixed price cost model with a limited number of reopeners for changes outside of the SPV's control provides the best value during the design and construction process as it allocates construction risks to the party best placed to price and manage those risks. Risks associated with early development stage of the projects are less suitable for the SPV to manage during construction in this model. For example, where flexibility is required by the TO in the design or construction process that may require changes in the scope, we would expect there to be a clearly defined cost recovery mechanism.

Question 6: What are your views on possible TO and SPV enhanced alignment options?

Of the two proposals, we view the Alliance model as the preferred alignment option that will incentivise the TO to develop the most efficient design and construction readiness of the projects. We would consider a pain-gain share mechanism may be more appropriate such that the TO provides protection for risks which are in its control (eg. preliminary design risk) as well as being incentivised by the upside.

We do not currently consider that there would be a material benefit to the proposal for the TO to have a minority interest in the SPV. This may in fact disrupt the SPV's governance processes and ability to deliver the most competitive cost of capital.

Question 7: Are there any other points we should consider within the commercial framework?

We have not identified any points other than those discussed above to consider within the commercial framework.

Responses to questions set out in Chapter Four:

Question 1: What are your views on the regulatory framework as set out in this consultation, and how it interacts with the commercial framework?

Overall we view the proposed regulatory framework as suitable. The proposed regulatory support including availability and cost recovery events similar to the OFTO will support the bankability of the Projects.

Given the interface between the SPV and TO in each period, it is important to demonstrate clear regulatory protections around the breach by the TO and the ability to claim compensation due to failures by the TO.

Question 2: Do you agree with the scope of TO obligations during the pre-tender, tender, construction period, and operational period?

We generally agree with the scope of the TO during each period.

Question 3: Do you agree with our approach to structuring the TO's allowances, including both base revenue and cost adjustments?

It is important to clearly define which events lead to a compensation on cost and time / revenue in order to avoid unnecessary contingencies or costs included in SPV bids. We would expect the DA to include a clear process and timelines for approval of price adjustments by the TO. To avoid any uncertainty the price adjustments (except for those arising out of the detrimental actions of the TO or the breach of the DA by the TO) should generally mirror the licence adjustments and the DA should clearly set out the mechanism for paying the SPV independent of Ofgem's decision.

Question 4: Do you agree with our proposed approach to operational period incentives, including interactions with the TO's price control incentives?

We generally agree with the approach to operational period incentives. We consider an availability incentive similar to the OFTOs with target level and a cap on deduction to be appropriate.

Question 5: What are your views on our proposed arrangements for the period after the end of the SPV's revenue term?

We consider that the proposed arrangements for the period after the end of the SPV's revenue term is acceptable. A clear handback procedure and release of liabilities at the end of the revenue term should be set out in the DA.

Should the revenue term be determined to be different than 25 years, it is important for bidders to understand with certainty how residual value will be set and how the assets will be set as part of the tender process.

Question 6: What are your views on our conflict mitigation proposals? - Would the TO conflict mitigations proposed sufficiently mitigate conflict where a TO bidder seeks to participate in an SPV tender in its own geographical area? - And if not, what different/additional arrangements would be needed?

If the incumbent TO is permitted to participate in the SPV tender process, it is important that the tender process and information delivery is open and transparent and the preferred bidder selection process is clearly defined and objective. The TO may prefer to use an independent third party to undertake the SPV tender process to achieve this.

We have not identified any additional separation and conflict of interest arrangements between the SPV bidder teams and TO during the tender process.

Responses to questions set out in Chapter Five:

Question 1: Do you agree with our proposed procurement principles?

We generally agree with the procurement principles. A clear and transparent tender process will assist in attracting a broad group of investors. This should include pre-defined objective evaluation criteria for pre-qualification and preferred bidder selection, in particular the robustness and non-price based components.

In our view, the number of consortia invited to the final tender offer stage should be limited to three in order to manage tender costs and resources, both for the TO and the bidders.

Question 2: Are there any other areas where we should be setting firm requirements regarding procurement of the SPV, or where additional guidance would be helpful?

We agree with Ofgem's proposal to appoint an entity to oversee the implementation of the tender. This will help to manage the timing and delivery of information as well as provide confidence to bidders around the independent conflict-free assessment process. We agree that tender cost compensation would be expected by bidders in the event that the tender is cancelled by the TO or Ofgem

We would not have any objection to a third party undertaking the SPV tender in behalf of the TO.

Question 3: Are there any areas included in this chapter where we should not be setting requirements regarding procurement of the SPV?

We have not identified any areas where Ofgem should not be setting the requirements.

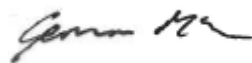
We would be delighted to discuss these thoughts in an open and constructive manner with Ofgem.

Yours faithfully

On behalf of Macquarie Corporate Holdings Pty Limited (UK Branch)



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Gemma McRann
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