



taking care of the essentials

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Offshore Electricity Transmission: Consultation on Draft Model Sale and Purchase Agreement and Draft Data Room Guidelines for Transitional Tenders

Dear Richard,

Thank you for the opportunity to comment on the above consultation. This non confidential response is on behalf of the Centrica group of companies excluding Centrica Storage Ltd. By having projects within the transitional tender rounds Centrica is keen to assist making the transitional arrangements as smooth as possible. Below we outline some areas of concern in relation to the model SPA and offer some solutions for consideration.

Draft Model Sale and Purchase Agreement (SPA)

Centrica is concerned that in an effort to be attractive to potential OFTO's the draft model SPA contains terms that are overly favourable to the purchaser and does not reflect the fact that the vendor may be forced to sell at a price less than or equal to cost.

The draft model SPA broadly reflects what would be expected to be seen in a commercially negotiated transaction where the vendor and purchaser have negotiated price and terms of the sale of a business. However, this does not reflect the situation in the transitional regime where the vendor is selling an asset and, by not being able to influence the price, is unable to fully realise the business opportunity of the sale, and may even make a loss rather than being held neutral. Despite this reduced value for the vendors, the draft model SPA retains significant liabilities for them. Additionally, we question whether there is a business to be transferred as a going concern as it is only the sale of assets.

By selling a significant asset at cost price (or less) whilst exposing the company to potential future liabilities, there is a serious discrepancy with the vendor directors' fiduciary duty to act in the best interests of the vendor company and their statutory duty under section 172 of the Companies Act 2006 to act in a way that promotes the success of the company for the benefit of its members as a whole.

Centrica therefore believes that it would only be appropriate to have a model SPA that places liabilities on the vendor that are congruent with the value received.

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Centrica notes that it is not clear whether the SPA will be mandatory and how any negotiation around terms would be structured and decided. The cover letter for the consultation indicates that the developer and successful bidder *could* use the SPA whilst the 5 March 2009 Competitive Tender consultation indicated that the developer would be required to populate the model SPA. Could Ofgem please clarify?

Split Exchange and Completion

A split exchange and completion places disproportionate risk upon the vendor. Clause 3.5 apportions the risk of the assets to the vendor up until completion. Prior to completion, the vendor will be subject to serious operational restrictions and obligations (Clause 10) with the purchaser having no exposure. Centrica suggests that third party consents/novations/assignments should be sought ahead of signing the SPA to become effective upon completion.

Similarly, some option agreements for land might need to be exercised. It is not clear whether this should be done by the vendor prior to the OFTO appointment.

Warranties and Disclosure Letter

The warranties required to be provided by the vendor are extensive and are over and above what would appear in a commercially negotiated deal where the vendor is selling an asset at cost price. Given the extensive due diligence exercise that will be undertaken, it would be reasonable for the warranties to be considerably reduced. Centrica suggests that warranties should only be required for title and capacity.

The draft model SPA would result in an onerous process of engaging in a specific disclosure exercise against the warranties. All relevant information in the developer's possession would have been provided in the data room. The onus should be on the purchaser as part of their due diligence process to ensure they are satisfied with the asset. Centrica suggests that it would be reasonable to disclose the information in the data room against more limited warranties.

Consideration

Centrica believes that the method by which Ofgem will determine the value of the asset and hence the purchase price should be clearly set out in the agreement or a schedule to the agreement.

Centrica is concerned that there appears to have been a policy shift from a minimum receivable price for the vendor to a maximum payable price for the purchaser. Clause 17 is clear that the vendor ultimately receives 100% of the ex-post RAV as clause 17.2 requires the vendor to repay any payment in excess of the ex-post valuation. This effectively makes the process of an ex-ante RAV as a mechanism for an initial purchase price only. This is in contradiction to previous policy. For example, paragraph 5.4 of the Competitive Tender Process consultation of 6 October 2008 states:

Ofgem has confirmed previously that it will provide comfort on funding to those projects not yet constructed to the extent that offshore developers will be guaranteed to receive the greater of either 75 per cent of Ofgem's ex-ante RAV estimate or 100 per cent of the efficient economic cost incurred on an ex-post basis. This approach is designed to achieve an appropriate balance of incentives and risk - the key incentive for the developer being that all efficiently incurred costs will be remunerated and the key risk that any inefficient expenditure (only in excess of our 75 per cent ex-ante estimate) is not guaranteed to be remunerated.

Centrica does not believe this policy change has been flagged in any of the consultation documentation to date and, assuming this was not included in error, is concerned that Ofgem are attempting to introduce such a material change at this late stage.

Tax

As noted above, we question whether there is a necessarily a business that is capable of being sold as a going concern. What is being transferred will only be a business once in the hands of the purchaser. Given that this is a government required divestment of transmission by the generators, Ofgem and Her Majesty's Revenue and Customs (HMRC) should co-operate to make these sales as administratively simple as possible for those involved.

Clause 19.3 requires the purchaser to make a written application to HMRC for confirmation that the sale of the Business and Assets will be treated as a going concern prior to completion. It is unusual for HMRC to give a ruling on a going concern as they normally say it is a question of fact. However, as the sale is driven by legislation this may be possible, but it would be sensible for this request to come from the vendor rather than the purchaser. This is because it is the vendor's risk if VAT is not charged correctly (if due) on the transaction. It would therefore be Centrica's preference that the vendor, with the full and timely co-operation of the purchaser, was able to submit a written application prior to completion. If this is not possible, then some consideration needs to be given to the timing as the application could be made the day before completion.

Clause 19.5 caters for the event where HMRC rule in advance that the transaction is not a going concern and VAT is due. The timing of this should be clarified as it is not clear whether this means three days before the end of the relevant VAT period, or three days before the relevant VAT return is submitted.

Additionally, clause 19.6 appears to favour the purchaser by allowing the purchaser, in the event HMRC do not provide a ruling in advance of completion, to pay an amount equal to the VAT on the Consideration into an Escrow account where it will be held pending receipt of the ruling. Should HMRC rule that the transaction is VATable, but the ruling is not received until a later VAT period to the one covering the date of Completion (when the VAT payment is due to HMRC), this could result in detriment to the vendor. Either financial penalties would be incurred by the vendor if they do not account for the VAT at the correct time, or the vendor would be financially out of pocket if they choose to pay the VAT over in full but do not receive payment of the VAT from the purchaser until release from the Escrow. It would be Centrica's preference here that if a ruling is not obtained in advance, and if there is any doubt as to the transaction constituting a transfer of a going concern, that the vendor charges VAT and a credit note is issued on receipt of the ruling (should this be that going concern treatment is appropriate).

Conduct of Vendor Activities before Completion

Centrica notes that clause 10.7 relates to changing relevant permits and consents and prohibits the vendor from varying or modifying relevant permits and site consents. It does not appear clear how the change process would be followed were the generator to be in the process of varying existing consents. Who will the responsibility lie with for managing this?

For the access and assistance provisions there needs to be caution about how much access is provided to the purchaser where certain project information is linked to future projects. An example of this would be information relating to a shared corridor.

Confidentiality

It needs to be clear that the confidentiality provisions would properly protect information disclosed in the data room on an ongoing basis and not just during the tender process.

Transfer of Employees

Centrica does not envisage the transfer of employees.

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Additional Clauses

Centrica believes that there could be scope for the following areas within the model SPA:

Purchaser's Ongoing Obligations

Centrica believes that given that the SPA may be the only document governing the relationship between the OFTO and the generator, that it would be appropriate to include provisions and obligations relating to the maintenance of the asset. This should include restricting the downtime of the transmission asset where that downtime restricts the generator's ability to generate. It should also include an undertaking to coordinate planned maintenance with the generator's assets. Centrica would also like to see an obligation on the purchaser to maintain a satisfactory level of repair for the transmission asset. These ongoing purchaser obligations would be included as a new Part C to Schedule 10.

Purchaser Subcontracting to the Generator

There could be efficiencies where the generator has the ability to provide operation and maintenance for the OFTO to subcontract these services to the generator. This should be allowed for in the model SPA.

Draft Data Room Guidelines

The guidelines provided appear to be comprehensive. Centrica notes that specific aspects of the guidelines may not apply to certain projects (such as Employees and Pensions).

Centrica remains concerned about confidentiality issues with regard to the data room. The disclosure of certain information will need to be formally requested by Ofgem for this to be able to be provided in a timely manner. Additionally, the provision for intellectual property rights could in some circumstances, such as where these sit with third party contractors, be problematic. This process will require careful management.

In relation to the competition guideline (2.15.3), the requirement to include copies of all correspondence with any regulators in any jurisdiction which might affect the offshore transmission system or its value is excessive. This could capture copies of confidential representations relating to the regime or requests for advice. Centrica believes that this guideline should be confined to any current investigations only and limited to information which could be compelled to be produced.

Centrica would like to thank Ofgem for the opportunity to respond to this consultation. We note that Ofgem have previously indicated that they would run workshops for developers whose projects fall into the transitional regime to more fully understand the SPA and data room requirements. We look forward to attending these.

If you have any questions or comments relating to this response, please contact me on the number above or at chris.stewart@centrica.com

Yours sincerely,

By e-mail

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