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*Promoting choice and value for  
all gas and electricity customers*

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**BY EMAIL AND POST**

Date: 08 August 2011

Dear Chris,

**Notice of consultation to modify conditions of the offshore transmission licence of the successful bidder for the Barrow project**

We have today commenced a consultation under section 8A of the Electricity Act 1989 on the proposed modifications to certain standard conditions of the offshore transmission licence that may be granted to TC Barrow OFTO Limited (the **Preferred Bidder**) if it becomes the successful bidder for the Barrow project (the **Project**).

The attached consultation notice is published on our website and sets out details of the proposed modifications, the closing date of the consultation and how to respond. We posted hard copies to both you and the Company Secretary.

In accordance with our statutory requirements and best practice we have brought the proposed modifications to the attention of persons likely to be affected and also provided copies of the notice to:

- The Secretary of State;
- Consumer Focus;
- The Scottish Executive;
- The Welsh Assembly; and
- The project developer (DONG Energy).

We are proposing to add a number of amended standard conditions to the offshore transmission licence that may be granted to the Preferred Bidder should they become the successful bidder for the Project. These proposed conditions are annexed to the section 8A notice.

Some of the amended standard conditions we are proposing to add to the licence contain formulae. Some elements of these formulae will differ depending on when the licence is granted. The reason for this is that the revenue stream will last 18.5 years (compared to 20 years for other offshore transmission licences). The revenue stream is 18.5 years as the Project has a lease for a term of approximately 18.5 years from the expected date of licence grant (the revenue stream cannot extend beyond this period as the licensee will be unable to operate the assets without the lease). The difference in the formulae is minor

and affects the calculation of the proportion of revenue term ( $PR_t$ )<sup>1</sup> and the transmission system availability payment (**TSAP**)<sup>2</sup>.

If the licence is granted prior to 1 October 2011, it will contain the following formulae:

- $PR_{19}$  (for the  $PR_t$  calculation) and years 21 to 25,  $BR_{19}$  and  $PR_{19}$  for the calculation of TSAP.

If the licence is granted on or after 1 October 2011, we will grant the licence with the following alternative formulae:

- $PR_{19}$  (for the  $PR_t$  calculation) and years 20 to 24,  $BR_{20}$  and  $PR_{20}$  for the calculation of TSAP.

The reason that the flexibility described above is required is that:

- a. the revenue stream will last 18.5 years;
- b. relevant years in the licence are defined as being from April to March;
- c. some of the formulae in amended standard conditions E12-J2 (Restriction of Transmission Revenue: revenue from transmission owner services) (**E12-J2**) and E12-J4 (Restriction of transmission revenue: Annual revenue adjustments) refer to the final years of the revenue stream; and
- d. as such, if the licence is granted prior to 1 October, then the revenue stream will end prior to 1 April and if it is granted on or after 1 October then the revenue stream will end on or after 1 April, and hence the formulae references concerned with the end of the revenue stream need to be to different years depending on when the licence is granted.

There is a risk that licence grant will occur on or after 1 October, due to the statutory timescale involved with the section 8A consultation and the standstill period which we will hold prior to licence grant.

#### Licence refinements

We have added a cost pass through mechanism (the **contingent event adjustment** or **CEA**) to amended standard condition E12-J3 (Restriction of transmission revenue: Allowed pass-through items) (**E12-J3**).

The CEA mechanism is a bespoke cost pass through item which we propose to insert into the licence for the Project. It allows the Authority to adjust the licensee's revenue entitlement should costs and/or expenses arise for the following contingent event:

1. potential liability for VAT on the Crown Estate decommissioning security costs (the **decommissioning VAT issue**).

Where circumstances in relation to the contingent event change, the Authority also has the ability to amend the value of the amount passed through. For example, if the expected annual costs and/or expenses resulting from the contingent event reduce, the Authority would expect to reduce the value of the amount passed through.

The CEA mechanism is consistent with our general policy position on uncertainty mechanisms for adjusting OFTO revenue. The offshore regime provides a strong incentive for OFTOs to manage costs efficiently over a 20 year period but also recognises that OFTOs may not be best placed to manage such risks where they are not sufficiently within their control. There are therefore a number of pre-defined licence adjustment mechanisms in the licence that seek to optimally reallocate risk for a small number of known, but unpredictable factors. We consider that the most appropriate method for allowing provision for costs and/or expenses resulting from the decommissioning VAT issue is by including a

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<sup>1</sup> E12-J2: Restriction of Transmission Revenue: revenue from transmission owner services ("**E12-J2**")

<sup>2</sup> TSAP appears in E12-J4: Restriction of transmission revenue: Annual revenue adjustments ("**E12-J4**")

CEA term in the licence. The use of such a licence adjustment mechanism is necessary in this case for the following reasons:

1. the Preferred Bidder was not aware (and could not reasonably be expected to have been aware) of the decommissioning VAT issue or the materiality of the decommissioning VAT issue prior to and for the purpose of that preferred bidder submitting its Invitation to Tender submission;
2. it has not been possible for the Preferred Bidder to resolve or fully mitigate the decommissioning VAT issue by way of commercial agreement with relevant parties or by any other mechanism which would provide appropriate recourse;
3. the decommissioning VAT issue is both contingent and material, in that:
  - a. it is not certain that the decommissioning VAT issue will materialise during the 20 year revenue period;
  - b. there are uncertain costs which cannot be forecast and which may be incurred by the the Preferred Bidder as a result of the decommissioning VAT issue materialising; and
  - c. it is likely that if the decommissioning VAT issue did arise it would have a material impact on the costs and/or expenses incurred by the Preferred Bidder.

#### Tender revenue stream

Proposed amended standard condition E12-J2 sets out the proposed tender revenue stream for the Project for the purposes of the section 8A consultation (the **s8A TRS**). The s8A TRS is based on the tender revenue stream bid by Transmission Capital Partners at the Invitation to Tender stage of the tender process, which has been updated to reflect further information available to Transmission Capital Partners since the date of the ITT submission, including the updated transfer value for the Project. Details of the transfer value which is reflected in the s8A TRS are set out in the draft cost assessment report for the Project, which was published on our website today ([www.ofgem.gov.uk](http://www.ofgem.gov.uk)).

Yours sincerely

**Stephanie McGregor**  
**Director, Offshore Transmission**