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Simon Rooke
Balfour Beatty Equitix Consortium
c/o Balfour Beatty Investments Limited
6th Floor
350 Euston Road
London
NW1 3AX

Direct Dial: 020 7901 1850
Email: offshorelicensing@ofgem.gov.uk

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Dear Simon,

Notice of consultation to modify conditions of the transmission licence proposed to be granted to the successful bidder for the Humber Gateway (HG) 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 transmission licence that may be granted to HG OFTO Limited (the **Potential Licensee**). The transmission licence will be granted to the Potential Licensee if Balfour Beatty Equitix Consortium (a consortium of Balfour Beatty Investments Limited and Equitix Limited) (the **Preferred Bidder**) becomes the successful bidder for the HG 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 have posted hard copies to you as well as the Company Secretary of the Potential Licensee.

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

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:

- Secretary of State for Business, Energy and Industrial Strategy;
- Citizens Advice;
- The Health and Safety Executive (HSE);
- The Scottish Executive;
- The Welsh Assembly; and
- The Project Developer (E.on Climate & Renewables UK Humber Wind Limited)

Project specific Licence modifications

Amended Standard Condition E12-J3 (Restriction of Transmission Revenue: Allowed Pass-through Items)

We have added a pass through mechanism (the **contingent event revenue 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 pass through item for this licence. It allows the Authority to adjust the Potential Licensee's revenue entitlement should:

i. losses arise for the following contingent event:

   a. the licensee incurring losses as a result of:

      (i) the introduction of new tax legislation in the United Kingdom, or

      (ii) any change (including any retrospective change) in tax law in the United Kingdom (including legislation and case law) or in the published interpretation or practice of HM Revenue & Customs,

   which implement the proposals by the Organisation of Economic Co-operation and Development (OECD) in respect of the Base Erosion and Profit Shifting (BEPS) project, to the extent it relates to the loss, restriction, deferral or reduction of the entitlement of a taxpayer to claim a deduction in respect of interest in computing taxation liabilities;

or,

ii. costs and/or expenses arise from the following contingent event:

   a. the licensee has been required by the Secretary of State to increase the size of its security in respect of its decommissioning programme to account for the payment of VAT.

The offshore regime incentivises licensees to manage costs efficiently over a 20-year period but also recognises that licensees 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 revenue 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 way of providing the Potential Licensee with a method to recoup costs and/or expenses or losses (as the case may be) resulting from the contingent events in connection with this Project, is by including a 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 either the contingent event and/or the materiality of the relevant contingent event (as the case may be) prior to and for the purposes of submitting its Invitation to Tender (**ITT**) submission;

2. it has not been possible for the Preferred Bidder to resolve or fully mitigate the contingent events by way of commercial agreement with relevant parties or by any other mechanism which would provide an appropriate solution; and

3. the contingent events are both contingent and material, in that:

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(a) it is not certain that the contingent events will materialise during the 20-year revenue period;

(b) there are uncertain costs and/or expenses or losses (as the case may be) which cannot be forecast and which may be incurred by the Potential Licensee as a result of the relevant contingent event; and

(c) it is likely that if the contingent events do arise they would have a material impact on the costs and/or expenses or losses (as the case may be) incurred by the Potential Licensee.

In respect of the first contingent event (i)(a) referred to above, typically tax changes are borne by offshore transmission owners, and therefore we expect existing licensees to manage the impact of any change to existing legislation in the United Kingdom as a result of implementing BEPS actions in the normal course of business. However, we consider that a CEA is appropriate in these circumstances as we clarified to all bidders at the ITT stage that they should base their submissions on existing legislation and therefore not to factor in the implications of BEPS as it is not yet clear how it will be implemented and the extent to which the Potential Licensee may be impacted.

In respect of the circumstances relating to the second contingent event (ii)(a) referred to above, we will keep this situation under review in relation to existing licensees.

Tender revenue stream

Amended standard condition E12-J2 (Restriction of Transmission Revenue: Revenue from Transmission Owner Services) 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 the Preferred Bidder at the ITT stage of the tender process, which has been updated to reflect further information available to the Preferred Bidder since the date of the ITT submission, including the draft final transfer value for the Project. The s8A TRS assumes that 100% of the draft final transfer value will be paid to the project developer on asset transfer. 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 is published on our website today (www.ofgem.gov.uk).

If you have any queries regarding the information contained within this letter you should contact Lucy Edmonds on 020 7901 1850 or by email to offshorelicensing@ofgem.gov.uk

Yours sincerely,

Stephen Beel,
Partner, Competitive Networks

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