Appendix C: Summary of key amendments made to the draft Project Licence since October 2014

17 July 2015

This table provides an overview of the key amendments made to the draft Project Licence since the consultation in October 2014 and explains the rationale for each amendment. There have been other amendments to the draft Project Licence which are not described below as they are considered minor amendments primarily made to provide greater clarity or to ensure consistency with other documents governing the Thames Tideway Tunnel project. Terms used herein are as defined in the draft Project Licence.

	Provision	Proposed amendment	Reason for amendment
1.	**IP's principal duty** (Project Licence cover page)	The IP's principal duty has been made a condition of the Project Licence.	This is for clarification purposes to ensure that it is clear that a breach of the IP's principal duty is a breach of a Project Licence condition which may result in enforcement action being taken against the IP.
2.	**Timing of revised Revenue Statement** (Condition B, paragraph 5.5; Appendix 1, paragraphs A1.2, A8.1 and B1.2)	The timing of the revised Revenue Statement has been brought forward to 24 December (from 15 January).	This is to ensure that the IP allowed revenues are received by TWUL in time to be included in TWUL's bills to customers in the following financial year (1 April).
3.	**Restriction on amendment of certain provisions of**	The Project Licence has been amended so that Ofwat consent will be needed if amendments are proposed to elements of the Alliance Agreement relating to	The Alliance Agreement forms part of the overall incentive mechanism so changes to the incentives or financial liabilities under the Alliance Agreement will

	Provision	Proposed amendment	Reason for amendment
	the Alliance Agreement (Condition B, paragraph 5.7)	incentives or financial liabilities.	be subject to our consent in order to protect customers.
4.	**Timing of First Periodic Review** (Condition B, paragraph 6.2)	In the previous draft the First Periodic Review was scheduled to coincide with the first periodic review of the Incumbent Undertaker's wholesale activities to occur after the Post Construction Review. This has now been hardwired so that it will occur in 2029, except where Acceptance has not occurred by 1 January 2029, in which case it will be postponed to occur concurrently with the next periodic review of the Incumbent Undertaker's wholesale activities (i.e. 2034).	This is a consequential change necessitated by the decision to ask bidders to bid a cost of capital that will be in place until 1 April 2030 (see item 9 below).
5.	**Application of the provisions relating to the Reporter** (Condition B, paragraph 15.A1)	A new provision has been added which suspends the IP's obligations to appoint a Reporter until 6 months after Ofwat has given notice of its application.	During construction there will be an Independent Technical Assessor in place and we therefore do not consider it appropriate to require the IP to also appoint a Reporter.
6.	**Apportionment of Ofwat costs in determining a Mandatory Variation**	A new provision has been added clarifying that Ofwat's costs in determining a Mandatory Variation Dispute will be divided equally between the IP and the Incumbent Undertaker.	This was considered to be the most appropriate allocation of costs.

	Provision	Proposed amendment	Reason for amendment
	Dispute (Condition B, paragraph 20; Appendix 2, paragraph 9.5)		
7.	**Regulatory ring-fence** (Condition K)	Condition K requires the IP to conduct the business in a way that ensures it has available to it sufficient resources to carry out its regulated activities. This includes ensuring that transactions with associated companies are entered into on an arms' length basis. Condition K has been amended to so that any group companies that will provide financing to the IP (IP FinCo) will fall inside the regulatory ring-fence.	This amendment has been included to accommodate different bidder financing structures. Bidders proposed different financing structures and we wanted to ensure that any financing companies set up to provide funding to the IP fell within the scope of Condition K and the regulatory ring-fence. Specific consents requested by the preferred bidder under Condition K will be considered ahead of licence award
8.	**Revocation** (Condition O)	The Project Licence has been amended such that a transfer to a replacement IP will be governed by the transfer regime set out in Schedule 2 to the modified Water Industry Act 1991 rather than by an Ofwat direction.	This is to ensure that revocation of the Project Licence is dealt with in a manner that is more aligned with the revocation of undertakers' licences with the transfer of assets being dealt with by agreement under a transfer scheme.
9.	**BWACC** (Appendix 1, definition of "BWACC")	This is the Weighted Average Cost of Capital bid by the IP ("BWACC"). The definition of BWACC has been amended so that it will apply until 31 March 2030 instead of 1 April following the Post Construction Review.	Bidders raised concerns that the earlier drafting led to a concentration of risk at the Post Construction Review as a number of things occurred at that point – principally the Government Support Package falling away, the application of incentives through the RCV and Ofwat setting the applicable WACC to cover the

	Provision	Proposed amendment	Reason for amendment
			2-year period to 31 March 2030. It was expected that bidders would price in this concentration of risk into the BWACC. It was therefore considered to provide value for money to address this risk through extending the BWACC by circa 2-years to 31 March 2030 and thus in providing certainty remove the risk that the BWACC would reflect excessive risk at customers expense.
10.	**Excluded Project Spend** (Appendix 1, definition of "Excluded Project Spend")	A number of amendments have been made to the definition of Excluded Project Spend, some of which expand and others narrow the types of Excluded Project Spend. In the previous drafting, for example, it was not clear how settlement agreements; compromise agreements; and the right of withholding or set off would be treated. In addition, it has now been made clear that expenditure funded by payments received by the IP under the Alliance Agreement are Excluded Project Spend (to avoid double counting).	Changes were made largely to extend the definitions to reflect the development of the main works contracts and Alliance Agreement so as to remove ambiguities in the application of the definition.
11.	**Tax Building Block** (Appendix 1, paragraph A1.4)	The Tax Building Block has been amended such that following Handover any Income Tax is part of this building block.	It is expected that the IP may have to pay Corporation Tax from Handover. This amendment is to ensure that the IP will be able to recover income based taxes paid in the ordinary way (i.e. through the tax building block) and continue to be tax neutral.
12.	**Lease Chargeable**	If a Lease Chargeable Gain[1] arises, Ofwat will	Similar to the above, this change has been made to

	Provision	Proposed amendment	Reason for amendment
	Gain (Appendix 1, paragraphs A1.4, A13 and B1.3)	determine whether and to what extent such tax will be recovered through the Tax Building Block or the Allowable Project Spend (i.e. through the RCV), but (either way) this tax will be disregarded for the purposes of calculating the cost incentive. Note 1: The granting of a lease in respect of property may give rise to a taxable gain should there arise a difference between the cost of the property to be subject to the lease and the assessed market value	ensure that the IP would be able to recover any Lease Chargeable Gains for which it becomes liable.
13.	**Early charging** (Appendix 1, paragraph A1.5)	An early charging mechanism has been added in case of delays in Licence Award pursuant to which Ofwat may (at TWUL's request) estimate the IP Charges for the first and (if applicable) second Charging Years, which would then be collected by TWUL from its customers.	This is to address the risk of delay in Licence Award beyond 15 September 2015 so as to allow TWUL to start collecting IP Charges. The intention is that the collected amounts would then be paid to the IP, once appointed, thus smoothing bills for customers. The IP would still be required to calculate its Allowed Revenues with a subsequent adjustment through the Revenue Adjustment (RA) mechanism in paragraph 7 of Part A of Appendix 1. The previous approach to calculating and charging allowed revenues for the initial first charging years has been retained and will apply if the early charging mechanism is not triggered.
14.	**Calculation of Opening Projected RCV** (Appendix 1,	Changes have been made to the component parts used to calculate the Opening Projected RCV, in particular to ensure that all verified Allowable Project Spend incurred by the IP between April and	This amendment has been made to bring into the alignment the Project Licence with the Liaison Agreement and ITA process where project expenditure incurred by the IP will now be verified on

	Provision	Proposed amendment	Reason for amendment
	paragraph A3)	September (both inclusive) is captured. The earlier drafting only referred to Estimated Allowable Project Spend, which is by definition not yet verified spend, whereas part of the expenditure in this period will already have been verified (as verification will happen on a quarterly basis). Verified means verified by the Independent Technical Assessor.	a quarterly basis, rather than on an annual basis which was the assumption used in the previous draft of the Project Licence.
15.	**Accounting treatment of opex** (Appendix 1, paragraph A5.2)	A number of amendments have been made to the approach to the Opex Building Block in paragraph A5.2 of Appendix 1.	This amendment is to bring alignment between the definition of Excluded Project Spend and the narrative around the Opex Building Block.
16.	**Financing Cost Adjustment (FCA)** (Appendix 1, paragraphs A6 and B1.3 and associated new definitions)	In summary, the key amendments comprise: 1) A revision to provide that the FCA applies to the lower of the IP's actual gearing position and the notional gearing assumption (being 62.5% net debt/RCV) to optimise value for money for customers. The adjustment is now based on actual incremental net debt or notional net debt (whichever is the lower) based on a historic, rather than forecast basis, and applied with a two year lag with a time value of money adjustment. 2) Inclusion of a definition of Net Debt and an enhanced requirement for the IP to report on its calculation of the FCA to allow the revision stated in 1)	We have proposed amendments to the FCA mechanism where we consider there are value for money benefits to customers and where changes to the drafting could provide more clarity.

	Provision	Proposed amendment	Reason for amendment
		above to apply. 3) Amendment of the two year trailing average to a one year trailing average. This aligns with the incremental Net Debt calculation referred to in 1) above; it removes the mismatch that previously arose between actual debt raised by the IP and the iBoxx index and so provides better value for customers. 4) The iBoxx index utilised is changed from a 50:50 split between A and BBB to BBB only to reflect the most recent feedback from rating agencies that credit ratings during the construction phase are more likely to fall in the BBB category. 5) The FCA mechanism is extended to 31 March 2030, in order to align the FCA with the fact that the BWACC will now run until 31 March 2030. In addition, a mechanism has been included to allow for true up of the FCA for 2028-29 and 2029-30 post 2030. 6) The drafting around the calculation of the market cost of debt adjustment factor has been amended to remove an ambiguity in the previous text.	
17.	**Revenue Adjustment (RA)** (Appendix 1,	Improvements have been made to the calculation of the RA and to clarify that it will be subject to a present value adjustment based on the BWACC.	This is to provide greater clarity and ensure that any under-recovered revenue is NPV neutral for the IP.

	Provision	Proposed amendment	Reason for amendment
	paragraphs A7.2 and B5)		
18.	**Building block Reconciliation Adjustment (BBRA)** (Appendix 1, paragraph A8)	The BBRA has been extended to include adjustments of the Additional Return on Capital Building Block and the Additional Liquidity Building Block.	This is to ensure that all estimated components of the Allowed Revenue calculation are subject to an adjustment based on actuals and that the correct discount factor is used for different elements of the calculation.
19.	**Integration of the Revenue Adjustment and Reconciliation Adjustment into the Allowed Revenue calculation** (Appendix 1, new paragraphs A7.4 and A8.4)	Provisions have been added to clarify how the Revenue Adjustment and the Reconciliation Adjustment would be reflected in the Allowed Revenue calculation depending on whether they result in a positive or a negative figure.	This is to give greater clarify.
20.	**Adjustments to the base case forecasts** (Appendix 1, paragraph A9)	Amendments have been made to recognise that the base case forecast only applies to the period up until planned Acceptance rather than the Post Construction Review.	This is to ensure consistency of approach within the Project Licence.
21.	**WACC beyond the Administrative**	A number of amendments have been made to the provisions governing the approach to setting WACC	This is to provide greater certainty.

	Provision	Proposed amendment	Reason for amendment
	Penalty End Date (Appendix 1, paragraph A10.1 and new paragraph B8.2)	following the Administrative Penalty End Date. In summary, we have: 1) reflected the application of the BWACC until 31 March 2030 (subject to the Delay Adjustment); 2) included a mechanism for determining the WACC in case of project delays beyond 1 May 2029; 3) confirmed that Ofwat will have regard to its Economic Guidance when determining WACC for the period following the Administrative Penalty End Date.	
22.	**Increasing allowable project spend above the T/O** (Appendix 1, new paragraph A11.4.3)	The Project Licence has been amended such that the Additional Return on Capital (ARoC) and the Additional Liquidity (Ali) Building Blocks for Additional Allowable Project Spend will, whether under the Ex-Ante Approach or the Ex-Post Approach, be calculated on the same basis as the Return on Capital (RoC) and Liquidity (Li) Building Blocks for Allowable Project Spend, but using the Ofwat determined WACC and RCV applicable to the Additional Allowable Project Spend	This is to provide greater certainty and clarity as to the operation of the mechanism in circumstances where allowable project expenditure is above the Threshold Outturn.
23.	**Run off (depreciation)** (Appendix 1, paragraph B1 and	The Project Licence has been amended such that a run off will apply only if proposed by the IP and approved by Ofwat. Also, the run off has been removed from the formula in paragraph B1 as it can now only apply from 1 April following the First Periodic	This is to give more certainty as to the approach to run off that will be adopted.

	Provision	Proposed amendment	Reason for amendment
	new paragraph B11)	Review. For this reason the run off provisions have been moved into a new paragraph B11 which follows the paragraph on the Periodic Review.	
24.	**Calculation of RCV following the Post Construction Review** (Appendix 1, paragraphs B2 and B7)	The Project Licence has been amended such that there is now a two-step process for determining the RCV following the Post Construction Review – the first based on estimated values ('Provisional Post Construction Review RCV') and the second based on actual values ('Post Construction Review RCV') with a subsequent reconciliation adjustment.	This is to recognise that at the time of the Post Construction Review not all allowable project spend will have been incurred and/or verified. As a result of this change a reconciliation mechanism was also needed to take into account actual values, once known and verified.
25.	**Changing the sharing arrangements if costs are at or below the Original Base Case Forecast** (Appendix 1, paragraph B2)	The preferred bidder proposed an increased gain share to customers if actual costs come in below the Original Base Case Forecast. The effect of the change will mean that the incentive sharing rate if costs are above the Original Base Case Forecast will remain as 60:40, but if costs are below the Original Base Case Forecast, the sharing rate will be 70:30 in favour of customers.	This proposed amendment was accepted by Ofwat as it increases the sharing of cost saving in favour of customers whilst retaining sufficient incentive on the IP and is considered to potentially deliver better value for money for customers.
26.	**Return on Capital following the Post Construction Review**	The Project Licence has been amended to distinguish between the different approaches to calculating the return on capital in the first and each subsequent Charging Year following the Post Construction Review and to clarify what WACC would apply depending on	This is to recognise that at the time of the Post Construction Review not all allowable project spend will have been incurred and/or verified and to give greater clarity regarding the applicable WACC.

	Provision	Proposed amendment	Reason for amendment
	(Appendix 1, paragraph B3)	when Acceptance has occurred.	
27.	**Adjustments to the RCV at the Post Construction Review** (Appendix 1, paragraph B4)	The formulae for calculating the cost incentive have been amended, but without altering the underlying substance.	This is to bring alignment between the Project Licence and the Government Support Package (GSP).
		Amendments have been made to clarify that (i) the cost/incentive penalty would be calculated for the period until the later of the date of Acceptance and the Planned System Acceptance Date and that (ii) in the event of the project completing early, all project spend incurred by the IP following Acceptance would (for present purposes only) be deemed equal to zero.	Under the previous drafting, should the project complete early, the IP may have been subject to a cost penalty notwithstanding the fact that the project may have overall been completed on budget. This is because the cost incentive/penalty took into account project spend up until Acceptance, but disregarding the Annual Base Case Forecasts until the Planned System Acceptance Date. This was an unintentional consequence of the drafting and the proposed amendments seek to rectify this.
28.	**Delay Adjustment** (Appendix 1, paragraph B6)	The Delay Adjustment mechanism has been amended in particular to amend the Major Delay Period so that it only applies up to 31 March 2030.	The BWACC will apply until 31 March 2030. In case of project delays beyond the Planned System Acceptance Date, there will be a Delay Adjustment the effect of which is to adjust the WACC received by the IP. If however the project is delayed beyond 31 March 2030, there will be no need for a further Delay Adjustment as the revenue mechanism that will apply in the period after 31 March 2030 will be set by Ofwat in accordance with the Project Licence and may take

	Provision	Proposed amendment	Reason for amendment
			the delay into account.
29.	**Periodic Review** (Appendix 1, paragraph B10)	The Project Licence now confirms that Ofwat will have regard to its Economic Guidance when determining the Allowed Revenue for the First Periodic Review.	This is to provide greater certainty.
30.	**Non-Revenue Conditions** (Appendix 2)	The Project Licence has been amended to impose an obligation on the IP to use payments received under the Alliance Agreement towards funding allowable project expenditure. This has been further reinforced by the obligation to set out in the Revenue Statement the amounts received and forecast to be received by the IP under the Alliance Agreement.	This is to ensure that amounts received under the Alliance Agreement are used towards covering project costs.
31.	**Definitions** (Appendices 1 and 4)	Please refer to Appendix 4 for amendments to the defined terms.	This is to align the definitions in the Project Licence with other project documents.