



*Energy and
Infrastructure
Round-up*

H1 2022

PAUL

HASTINGS

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Market Activity

Contrary to perceptions about the wider market, H1 2022 was significantly more active for European energy and infrastructure transactions than H1 2021.

404 European M&A transactions closed during H1 2022 compared to 319 in H1 2021.

49% of the H1 2022 transactions were in renewables compared to 57% in 2021.

Transport, telecommunications and other energy transactions each represented approximately 10% of transaction volumes for H1 2022 (as was the case in 2021).

The most active jurisdictions during H1 2022 were the UK (23% versus 27% in 2021), Italy (12% versus 10% in 2021),

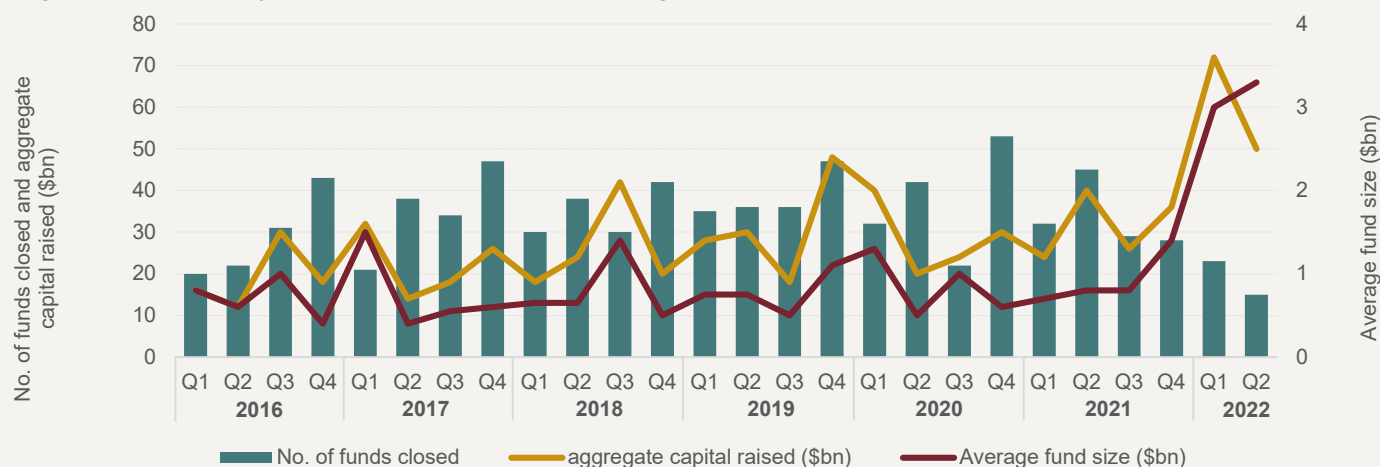
Spain (12% versus 15% in 2021) and France (11% versus 7% in 2021).

86 European refinancings were completed during H1 2022 compared to 96 during H1 2021.

The most active jurisdictions for refinancing were the UK (29% versus 23% in 2021), Italy (19% versus 15% in 2021), Spain (9% versus 21% in 2021) and France (9% versus 17% in 2021).

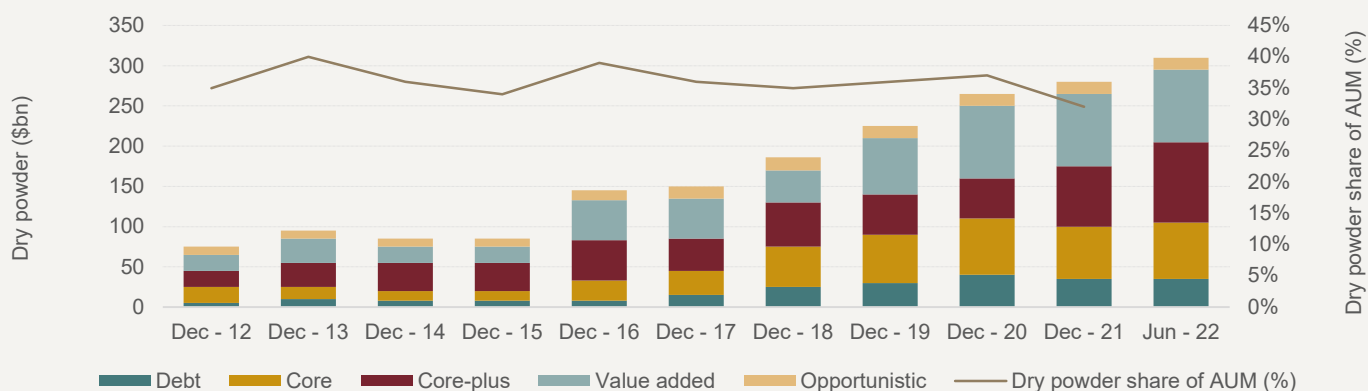
The most active refinancing sectors were renewables (40% versus 46% in 2021), transport (17% versus 11% in 2021), telecommunications (16% versus 9% in 2021), energy (12% versus 14% in 2021) and social infrastructure (9% in H1 2022 and 2021).

Fig.1: Global quarterly unlisted infrastructure fundraising, Q1 2016 – Q2 2022



Source: Preqin Pro

Fig.2: Unlisted infrastructure: dry powder by primary strategy, Dec 2012 – Jun 2022



Source: Preqin Pro

Market Commentary

Ten years ago inflation was, for a short while, a hot topic for infrastructure investors. That was because loose monetary policy during the global financial crisis was expected to trigger an inflationary cycle. However, as it turned out, the only sustained inflationary effect was to asset prices, caused by the low interest rate (and therefore yield) environment that followed. Because that outcome was so benign, few investors were focused on inflation in the early stages of the pandemic. This was not helped by central banks maintaining, for as long as they did, that the inflationary effects were only transitory. Clearly any such investor complacency would now appear misguided. The current inflation rate (9.4% for June 2022 in the UK), is more than double the previous peak following the global financial crisis (4.5% in 2011). Importantly there are a number of key differences between the situation today versus a decade ago:

1. The level of quantitative easing (effectively governments printing money) during the pandemic was unprecedented – \$14 trillion globally – and far exceeded the stimulus package produced in response to the global financial crisis.
2. Economic stimulus during 2020/21 was injected much more directly into the consumer economy, making it more difficult to unwind.
3. A decade ago globalisation was still having a deflationary effect on the costs of goods, whereas that trend is now reversing.
4. Lock-down measures, which had no equivalent 10 years ago, caused significant supply chain disruption with a consequential increase in prices.
5. The war in Ukraine is having a much more direct effect on energy prices today than the ongoing Middle Eastern and African conflicts a decade ago.
6. Similarly, and unlike the Middle Eastern and African conflicts, the war in Ukraine is having a much wider effect on grain prices and exacerbating Covid induced supply chain issues.
7. Debt service costs are now increasing, whereas a decade ago a refinancing would reduce all-in debt costs (as compared to all-in debt costs preceding the financial crisis).
8. ESG, which has only recently become such a key investment factor, may now restrict the ability to charge customers the full uplift entitlement of inflation linked revenue.

The good news is that energy and infrastructure and other real assets are supposed to out-perform in a high inflationary environment. It is surely no coincidence that we've seen the recent launch of a number of core infrastructure mega-funds. One reason for outperformance is the level of revenue which has a hard or soft link to inflation. As a rough guide 70% of assets in a typical infrastructure portfolio would include inflation protection. But that varies significantly by sector, jurisdiction and asset specific revenue models. As a general overview:

- Regulated utilities: Regulated utilities generally earn a prescribed return based on their invested capital. The allowed return on capital may be priced in real or nominal terms depending on the jurisdiction. However, in either case, regulated utility revenues should ultimately adjust for inflation as a result of adjustments to the allowed revenue to reflect the actual inflation rate, or by the nominal allowed returns being adjusted to reflect an increase (or decrease) in the cost of debt. Regulated utilities are therefore one of the most insulated and attractive asset classes during high inflationary periods.



- **Power and Renewables:** In this sector the relationship between inflation, power prices and revenues is more complex. The direct and indirect level of revenue protection will depend on a generator's revenue model. If a generating company benefits from legacy government subsidy schemes, such as feed in tariffs, these would typically include inflation adjustments. Similarly many power purchase agreements include fixed pricing with a direct adjustment for inflation – although more recent power purchase agreements have cap and floor mechanisms or similar structures that provide more limited protection. In relation to merchant risk, there's no direct protection except to the extent power prices correlate with the wider macro-economic environment. The conventional view is that a high growth economy will increase energy prices due to the increase in demand. And high inflation often correlates with increasing energy prices because it is one of the components in calculating headline inflation. However, a recession usually triggers a collapse in energy prices. Even if we are heading from stagflation into a recession, the war in Ukraine and the associated crisis in energy supply may mean that energy prices remain high. BEIS has estimated that demand for electricity will double over the next 13 years which in part is the result of energy transition into electric vehicles and heat pumps. But of course renewable power companies may not see much benefit from higher energy prices. For example, under the contracts for differences regime a generating company will be required to pay back to the LCCC counterparty the excess of the current energy price over the original strike price (albeit the strike price adjusts for inflation). Similarly, the surge in energy prices triggered liquidity calls for some power companies, as their out of the money positions under power hedging arrangements required them to post significant amounts of cash-collateral.
- **Transport:** GDP linked assets are less likely to benefit from either regulated or automatic contractual entitlements to increase revenues in line with inflation. However, the pricing power that these assets command due to their market position and high barriers to entry should mean that the increases can be passed through to customers, albeit usually with a lag of a number of years. In the short term it will be demand, driven by trade flow and passenger numbers, that will determine revenue (and cost) adjustments, as the sector still has not fully normalised following the pandemic and as a result of the war in Ukraine.
- **Digital infrastructure:** It is much more difficult to generalise about this sector. The data-centre market is so hot that, even if customer contracts do not include inflation adjustments, most market participants expect rents to increase faster than the rate of inflation. Whether a fibre company can pass inflation through to customers will depend on its pricing power and level of competition within its coverage area (urban or rural) as well as any concession terms or regulations that control pricing.

Tower companies will typically include revenue escalators in their customer contracts which, in the US tend to increase at a fixed rate of 3% and at the relevant CPI/RPI inflation rate in other markets.

- **Social infrastructure:** Social infrastructure tends to be procured on a PPP basis (i.e., with the public sector making "availability payments") or to have long-term lease/rental contracts. In both cases the revenue model would usually include inflation adjustments, meaning the sector is reasonably well protected (but often subject to pass-through mechanisms under their financing agreement). However, private sector care homes and student accommodation businesses that do not include nomination arrangements (or similar) will be exposed to customer demand and the ability to pay.

Equally important to this analysis is the sensitivity to input costs. Some of the sectors above, such as social infrastructure and transportation, are much more exposed to increases in operating costs such as wage increases. Equally assets in any sector that are in development or have significant ongoing capex costs (if not added to a regulated asset base) will be exposed to increases in commodity prices and construction costs. So profitability may reduce even for those assets with revenue protection.

Based on our conversations with investors, many are expecting casualties directly attributable to the change in macro-economic environment. Certainly financial sponsors are going to have to work much harder over the next decade to achieve real double digit returns – not only because of the price multiples paid for assets in recent years but also because higher financing costs will reduce asset prices. Some over-exuberance from sponsors at the auctions might be disguised through the use of continuation vehicles or through whole portfolio exits combining under and over-performing assets. And some well managed businesses will have softened the blow by locking-in long-term low-cost debt, such as bonds or private placement notes, which are fully portable (i.e., without a change of control prepayment trigger), which was the conventional approach to infrastructure finance. So when, as is predicted, private equity investors eventually mark-down the fair value of their investments in line with public markets, it will be another important test of whether the non-cyclicality, inflation protections and discipline of locking-in returns, means infrastructure assets can avoid similar revaluations. Thankfully (for everyone other than the bidders) the first transaction de-railed by inflation was actually the result in a price hike. CKI was rumoured at a very late stage to have significantly increased the price of UK Power Networks to reflect the benefit of its regulated revenue adjusting for inflation – resulting in bidders walking away. But that is very much the opening chapter for this part of the cycle.

Divestiture as a remedy in telecoms: a brief analysis of recent competition law decisions in the telecommunications market

The Competition and Markets Authority (the "CMA") has wide-reaching powers to remedy a merger or proposed merger that would result in a substantial lessening of competition. One such remedy, being divestiture, has particularly become of interest within the telecommunications industry, as seen in the proposed Cellnex acquisition of CK Hutchison infrastructure.

Cellnex agreed a series of transactions in November 2020 to acquire 24,600 sites from CK Hutchison across Austria, Denmark, Ireland, Italy, Sweden and the UK in a deal worth around €10 billion. The UK component, which would see the purchase of 6,000 passive telecom infrastructure sites, attracted the interest of the CMA who were worried about the potential impact such a transaction could have on competition within the industry and possible price increases for MNOs. As such, on 3 March 2022, the CMA issued its final report in response to the anticipated acquisition. The CMA approved the acquisition but only subject to the divestment by Cellnex of approximately 1,100 to 1,300 of its macro sites, which overlap geographically with CK Hutchison's UK sites.

Divestiture as a remedy within competition law in Europe is becoming increasingly common where the alternative would be an outright prohibition on the transaction. Indeed, Cellnex were required by the Autorité de la concurrence (France's national competition regulator) to divest over 2,500 active "rooftop" sites and over 300 active "other" sites as a condition to obtaining Autorité clearance for the acquisition of Hivory Towers; a €5.2 billion deal in October 2021 which saw Cellnex both acquire Hivory's 10,500 towers in France, and agree to invest €900 million to build 2,500 new sites within the decade.

So, what constitutes an effective divestiture proposal? Guidance published by the CMA in December 2018 raised three broad categories of risks that will be of consideration:

composition risks, purchaser risks and asset risks. Composition risks consider the scope of the divestiture package; is it too constrained such that it will not attract an appropriate purchaser, or not allow a purchaser to operate effectively as a true competitor? Purchaser risks involve a situation where there is no suitable purchaser to take on the divested package, or where the entity seeking clearance has the flexibility to sell to an inappropriate purchaser. Indeed, both of these risks would have played a significant role in the blocking by the Commission of the proposed 2015 Three/O2 merger, and is why pre-approval of the proposed purchaser of the divested package is common. The final identified risk, asset risks, provide a further interesting consideration that entities seeking competition clearance will have to explore. This is the risk that the competitive capability of a divestiture package will deteriorate before the divestiture completes. Whilst more applicable for the sale of a carved-out business as a going concern than the divestiture of pure real estate or infrastructure assets, this risk may emerge more prominently in competition referrals in the coming years. As key market players such as Cellnex look to expand their investment in the telecommunications market, opportunities in divestiture packages may materialise where remedies offered to appease competition authorities become increasingly rounded and viable for a suitable investor.

Action point: Need for competition clearance (if any) should be established at early stages of transaction planning and, where substantive competition issues arise, possible requirement for divestiture of assets should be considered



The Taxonomy Complementary Climate Delegated Act provides that certain fossil gas and nuclear energy activities will be deemed to be environmentally sustainable provided that they meet the required technical screening criteria

The Taxonomy Regulation (Regulation (EU) 2020/852) which entered into force on 12 July 2020 is one limb of the European Commission's package of reforms aimed at channeling private capital into sustainable economic activities.

One aspect of the Taxonomy Regulation is that it establishes an EU-wide classification system intended to provide businesses and investors with a common means to identify to what degree economic activities can be considered environmentally sustainable (or "green") for the purposes of establishing the degree of environmental sustainability of an investment.

Pursuant to the Taxonomy Regulation an economic activity will be deemed to be environmentally sustainable if it meets the following four criteria:

1. It contributes substantially to one or more of the six specified environmental objectives (being climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and protection and restoration of biodiversity and ecosystems).
2. It does not significantly harm any of the environmental objectives listed above.
3. It is carried out in compliance with minimum safeguards.
4. It complies with the relevant "technical screening criteria".



The Taxonomy Regulation itself does not specify the technical screening criteria and instead delegates authority to the European Commission to adopt such criteria. The technical screening criteria are key to the classification system established by the Taxonomy Regulation as they set out the specific conditions that a particular economic activity must meet in order to be deemed "environmentally sustainable" for the purposes of this legislation.

The Taxonomy Climate Delegated Act (Regulation (EU) 2021/2139) which entered into force on 29 December 2021 sets out technical screening criteria for numerous economic activities in relation to climate change mitigation and climate change adaptation. However, the Taxonomy Climate Delegated Act does not cover any economic activities in the nuclear energy and fossil gas sectors.

On 2 February 2022, the European Commission published a draft Taxonomy Complementary Climate Delegated Act (the "TCCDA") which controversially provides that the following nuclear energy and fossil gas activities will be deemed to substantially contribute to climate change mitigation and climate change adaptation provided they meet the technical screening criteria specified in this legislation (in addition to the other criteria set out above):

Fossil gas activities

- Construction or operation of electricity generation facilities that produce electricity using fossil gaseous fuels;
- construction, refurbishment, and operation of combined heat/cool and power generation facilities using fossil gaseous fuels; and
- construction, refurbishment and operation of heat generation facilities that produce heat/cool using fossil gaseous fuels connected to efficient district heating and cooling.

Nuclear energy activities

- Research, development, demonstration and deployment of innovative electricity generation facilities that produce energy from nuclear processes with minimal waste from the fuel cycle;
- construction and safe operation of new nuclear installations (for which the construction permit has been issued by 2045) to produce electricity or process heat, including for the purposes of district heating or industrial processes such as hydrogen production, as well as their safety upgrades; and
- modification of existing nuclear installations for the purposes of extension of the service time of safe operation of nuclear installations that produce electricity or heat from nuclear energy (where such modifications are authorised by 2040).

The technical screening criteria set out in the TDCCA include for facilities granted a construction permit before 31 December 2030:

- limits on life-cycle greenhouse gas ("GHG") emissions from generation;
- power being replaced if not generated from renewable energy sources;
- the facility replaces existing high emitting generation using fossil fuels;
- the newly installed production capacity must not exceed the capacity of the replaced facility by more than 15%;
- the facility is designed and constructed to use renewable and/or low-carbon gaseous fuels and the switch to full use of such fuels must take place by 31 December 2035;
- the replacement of an existing facility leads to a reduction in emissions of at least 55% of GHG over the lifetime of the newly installed facility; and
- where the facility is located in a Member State that uses coal for energy generation that Member State has committed to phase-out the use of coal to produce energy.

The TCCDA has been met with significant opposition from environmental campaigners, investors and certain EU governments. Their view is that to enable certain nuclear energy and fossil gas activities to be classified as environmentally sustainable undermines the credibility of the Taxonomy Regulation and is likely to divert investment from renewables with some saying it is "no less than institutional greenwashing".

The TDCCA was published on 9 March 2022 following which the European Parliament and the Council of Europe had a four month period to review, and if they saw fit, object to the proposed legislation. On 14 June 2022, in a joint meeting of ECON and the Environment Public Health and Food Safety Committee, members of the European Parliament adopted an objection to the proposal to include specific nuclear energy and fossil gas activities as environmentally sustainable activities for the purposes of the Taxonomy Regulation. However, on 6 July 2022, overturning the vote at the Committee level, the plenary of the European Parliament supported the European Commission's controversial proposal to label certain nuclear energy and fossil gas activities as "environmentally sustainable" and no objection was raised by the Council of Europe by the 11 July 2022 deadline. Consequently, the TCCDA will enter into force and apply as of 1 January 2023, allowing financial market participants to classify investments in economic activities related to fossil gas and nuclear energy which meet the relevant criteria as "environmentally sustainable" for the purposes of the Taxonomy Regulation.

Action point: Investors should review significant opportunities opened up in the fossil gas and nuclear energy sectors by the Taxonomy Regulation

Proposed European Green Bond Regulation

On 6 July 2021, as part of its plan on sustainable finance to meet the goals of the Paris Agreement and the European Green Deal, the European Commission published its proposal for a regulation on European green bonds (the "Proposed Regulation"). The aim of the Proposed Regulation is to set a "gold standard" for green bonds by introducing a uniform regulatory framework that standardises current market practice. The Proposed Regulation envisages that the European green bond standard will be a voluntary regime that can be applied by all EU and non-EU issuers, including corporates, sovereigns and financial institutions.

There are three key aspects to the Proposed Regulation: (1) the alignment of the use of proceeds of European green bonds to Regulation (EU) 2020/852 (the "Taxonomy Regulation"); (2) additional reporting requirements for the issuers of European green bonds; and (3) the regulation of the external review process in respect of European green bonds.

Pursuant to the Proposed Regulation, in order for a bond to meet the European green bond standard:

- funds raised by the bond issue must be used only for environmentally sustainable economic activities that align with the Taxonomy Regulation;
- pre-issuance, the issuer must complete a European Green Bond Factsheet (based on the template set out in the Proposed Regulation) which must be reviewed by an external reviewer to confirm that it complies with the European green bond requirements;
- following issuance (and until full allocation of the proceeds of the bond issue), the issuer must prepare an annual European Green Bond Annual Allocation Report (based on the template set out in the Proposed Regulation) which confirms the allocation of the proceeds of the bond issue;
- following issuance and full allocation of the proceeds of the bond issue, the issuer must prepare a final European Green Bond Annual Allocation Report (based on the template set out in the Proposed Regulation) which must be reviewed by an external reviewer to confirm that the issuer has allocated the proceeds in compliance with the European green bond requirements and with the intended use of proceeds set out in the European Green Bond Factsheet for that bond issue; subject to limited exceptions, such external reviewers will need to be registered with the European Securities and Markets Authority as approved external reviewers for this purpose; and
- following full allocation of the proceeds of the bond issue (and at least once during the lifetime of the bond), the issuer must prepare a European Green Bond Impact Report (based on the template set out in the Proposed Regulation), which contains information on the activities / projects financed by the proceeds of the bond issue and reflects the influence such activities / projects have in regard to the environmental objectives disclosed by the issuer in the pre-issuance documentation.



As the Proposed Regulation makes its way through the EU legislative process, a number of amendments have been proposed to the Proposed Regulation including, most recently, by the Committee of Economic and Monetary Affairs of the European Parliament ("ECON") in its report dated 16 May 2022. ECON's proposals seek to better regulate the entire green bond market to reduce "green washing" and include:

- extending reporting and disclosure requirements to all bonds which are marketed as green or environmentally sustainable and not just bonds the proceeds of which are applied to activities / projects aligned with the Taxonomy Regulation, which should enable investors to better compare European green bonds with other green bonds;
- that all issuers of European green bonds have verified transition plans to prevent "brown" issuers (i.e. those with highly polluting industries) from using the European green bond label to pretend to be greener than they really are;
- that all issuers from countries that are on the EU's grey or blacklist of tax havens are prohibited from issuing European green bonds;
- increased liability and sanctions in the event of non-compliance with the Proposed Regulation; and
- that when an issuer of European green bonds intends to allocate proceeds of the bond issue to nuclear energy activities or fossil gas activities, a statement must appear prominently on the first page of the European Green Bond Factsheet to this effect.

Only time will tell which of the proposed amendments to the Proposed Regulation will be adopted before this regulation becomes law. However, once the Proposed Regulation (as amended) is in effect and assuming the European green bond standard remains a voluntary regime, it will be interesting to see whether issuers of green bonds opt to comply with the more stringent and extensive disclosure and reporting requirements set out in the Proposed Regulation so that their green bonds can be classified as European green bonds, or whether they will continue to follow other market-based practices which are less onerous. The approach taken by issuers of green bonds is likely to be driven by the extent to which investor appetite focuses on green bonds carrying the European green bond label.

Action point: Potential issuers of, and investors in, green bonds to monitor developments of the Proposed Regulation

Other Recent Developments in ESG



On 27 June 2022, the European Securities and Markets Authority (the "ESMA") published its letter to the European Commission, which sets out its findings from the Call for Evidence to gather information on the nature and scale of ESG rating providers in the European Union (the "EU"). The principal finding is that there are currently 59 ESG rating providers active in the EU, which comprise a small number of very large non-EU ESG rating providers and a large number of significantly smaller EU ESG rating providers. The letter notes that the predominant business model is investor pays but provision of ESG ratings on an issuer-pays basis is more prevalent than expected and that users of ESG ratings typically contract with several ESG rating providers simultaneously. The key reasons for contracting with several ESG rating providers simultaneously are to increase coverage, either by asset class or geographically, or in order to receive different nature of ESG assessments. The letter identifies that the most common shortcomings of ESG rating providers is a lack of coverage of a specific industry or a type of entity, insufficient granularity of data, and a lack of transparency around methodologies used. The ESMA concludes in the letter that it will continue to support the European Commission in its assessment of the need for introducing regulatory safeguards for ESG ratings. It seems likely that in the not too distant future ESG rating providers operating in the EU will be subject to regulation.

The Green Bond Principles, the Social Bond Principles, the Sustainability Bond Guidelines and the Sustainability-Linked Bond Principles (together the "Principles") are a collection of voluntary guidelines and recommendations established by the International Capital Market Association (the "IMCA") which outline best practices when issuing bonds serving social and/or environmental purposes and provide the global standard for a \$2.4 trillion bond market. On 28 June 2022, the IMCA announced new and updated publications in respect of the Principles which, among other things, include: (a) new definitions for green bond securitisation and social bond securitisation; (b) an updated registry of approximately 300 key performance indicators for sustainability-linked bonds, the

fastest-growing segment of the sustainable bond market; and (c) a new Climate Transition Finance Methodologies registry with a list of tools to specifically help issuers, investors, or financial intermediaries validate their emission reduction trajectories/pathways as "science-based".

On 29 June 2022, the Financial Services Authority (the "FSA") published Feedback Statement FS22/4 and Primary Market Bulletin 41 relating to ESG data and rating providers and ESG-labelled debt markets. Similar to the ESMA, the FSA sees a "clear rationale for oversight of certain ESG data and rating providers" and supports the UK Government's consideration of bringing ESG data and rating providers within its regulatory perimeter. The FSA states that it is taking a measured approach to ESG-labelled debt instruments, with the aim of setting clear guard-rails as the market continues to develop. The FSA: (a) encourages issuers of ESG labelled use of proceeds debt instruments to consider voluntarily applying or adopting relevant industry standards, such as the Principles; (b) reminds issuers, their advisors and other relevant market participants of their existing obligations to ensure any advertisement is not inaccurate or misleading, and is consistent with the information contained in the prospectus; and (c) encourages issuers and their advisors to consider verifiers' and assurance providers' expertise and professional standards, and to engage with second party opinion providers and verifiers who adhere to appropriate standards of professional conduct.

Action points: Users of ESG data and rating providers to monitor developments in regulation of such providers in the UK and EU. Issuers of, and investors in, green bonds should familiarise themselves with the new and updated publications in respect of the IMCA Principles. Issuers of ESG-labelled debt instruments to consider the guidance issued by the FSA

First Annual Report in Respect of the NS&I Act

The National Security and Investment Act (the "NS&I Act") came into full effect on 4 January 2022 and, on 16 June 2022, the Department for Business, Energy and Industrial Strategy published its first annual report in respect of the NS&I Act covering the period from commencement of the NS&I Act to 31 March 2022 (the "Report").

The Report includes some interesting statistics relating to notifications under the NS&I Act during the period to which it relates (the "Relevant Period") including:

- during the Relevant Period, a total of 222 notifications were made under the NS&I Act (196 were mandatory notifications, 25 were voluntary notifications and one was a retrospective validation application (being an application for a notifiable acquisition that has already completed without approval (and is therefore legally void) to be retrospectively recognized as being valid in law));
- during the Relevant Period, a total of 8 notifications were rejected (one was a voluntary notification and 7 were mandatory notifications). A number of mandatory notifications were rejected because they should have been voluntary notifications and, in one instance, a retrospective validation application. Other notifications were rejected because they did not include enough information about the acquisition or parties to it, or the notification covered multiple qualifying acquisitions that should instead have been submitted as two notifications;
- during the Relevant Period following acceptance of a notification, 24 working days has been the median number of working days to issue a call-in notice in respect of mandatory notifications and 23 working days has been the median number of working days to issue a call-in notice in respect of voluntary notifications;
- during the Relevant Period, mandatory notifications have been made in respect of each of the 17 sensitive sectors specified by the NS&I Act with the largest number of mandatory notifications relating to the defense sector;
- during the Relevant Period, a total of 17 call-in notices were given (13 were in respect of mandatory notifications and 4 were in respect of voluntary notifications); and

- during the Relevant Period in respect of the 17 call-in notices given, 3 final notifications were issued (the other call-in assessments were ongoing as at 31 March 2022).

The Impact Assessment conducted ahead of introducing the NS&I Act estimated that each year there would be between 1,000 and 1,830 notifications and between 70 to 95 call-in notices issued. If the trend during the Relevant Period continues, it would appear that the number of notifications made and call-in notices issued will be less than expected, which may have the advantage of enabling the Investment Security Unit ("ISU") to respond to notifications faster than anticipated. Indeed, the trend for the Relevant Period is that the ISU is issuing call-in notices in a shorter period of time than that prescribed by the NS&I Act, being 30 working days.

Time will tell if the trends shown during the Relevant Period continue but what is clear from the data in the Report is that only a small percentage of transactions notified under the NS&I have been called-in for in-depth review (17 out of 222), which is in line with the Government's intention to have a wide-reaching regime that catches a large number of deals the majority of which are cleared quickly. Given the short period which it covers, the Report gives no meaningful indication of how quickly final notifications (clearances) or final orders (remedies) will be issued in respect of called-in transactions, which will be useful information for those involved in deals with substantive national security risks. It is expected that the next annual report will include this information.

The Report also notes that following publication of the Report, the Government will publish "Market Guidance Notes" which will give practical advice about using the system to help businesses and advisers when dealing with the requirements of the NS&I Act. Once available, these guidance notes should be a useful addition to the growing body of information available on the NS&I Act in this early stage of its life.

Action point: Investors should obtain advice on NS&I Act filings and call-in rights, and timing implications, at early stages of transaction planning

Memorandum of Understanding between BEIS and the CMA on the operation of the NS&I Act

On the 16 June 2022, a memorandum of understanding between the Department for Business, Energy and Industrial Strategy ("BEIS") and the Competition and Markets Authority (the "CMA") on the operation of the NS&I Act was published which establishes a framework for co-operation, coordination and information sharing between the CMA and BEIS with the aim of enabling a closer working relationship between the CMA and BEIS to assist them in effectively discharging their respective regulatory functions (the "Memorandum"). The principles set out in the Memorandum will be relevant to transactions that are subject to assessment by BEIS under the NS&I Act and also subject to assessment by the CMA under the Enterprise Act 2002 (the "EA 2002"). While not legally binding the Memorandum is a statement of intent which will be taken into account by the relevant staff at the CMA and BEIS when investigating transactions.

The Memorandum notes that under the NS&I Act, the CMA is empowered to disclose information to BEIS for the purposes of facilitating the exercise by BEIS of its functions under the NS&I Act and that under the EA 2002, BEIS is empowered to disclose information to the CMA for the purposes of facilitating the exercise by the CMA of its functions under the EA 2002. The Memorandum gives specific examples of when BEIS or the CMA should consider disclosing information to the other (and the nature of the information to be disclosed) which are focused on situations where both the CMA and BEIS are investigating (or may be interested in) the same transaction.

The Memorandum also refers to the duty of the CMA under the NS&I Act to provide such information and assistance as requested by BEIS to enable BEIS to exercise its functions under the NS&I Act. The Memorandum provides that prior to issuing a formal request for information or assistance under

the NS&I Act, BEIS will engage with the CMA to discuss the content and timing of such request and states that BEIS will aim to give the CMA at least five working days to respond to any formal request.

The Memorandum provides that, in regard to transactions in respect of which the CMA is likely to have an interest, before issuing any interim orders, final orders or final notifications under the NS&I Act, BEIS will inform the CMA in advance and consider any representations from the CMA. The Memorandum includes an equivalent provision in regard to the issuing of any interim orders, derogations or final orders or the accepting of any undertakings by the CMA under the EA 2002 in relation to transactions in which BEIS is likely to have an interest. The Memorandum also contains provisions aimed at avoiding potential conflicts between the remedies imposed (or accepted) by the CMA and BEIS in regard to the same transaction, including the alignment of review processes by the two authorities by extending time periods where required.

For those involved in transactions subject to investigation by the CMA and BEIS, it is anticipated that the Memorandum will avoid conflicting remedies being imposed (or accepted) by the CMA and BEIS in respect of the same transaction. On a practical level, parties should consider whether an alignment of the review processes by the CMA and BEIS is likely and any timing implications which this may have on any transaction timetable.

Action point: Investors to note protocol for sharing of information between regulators and co-ordination of remedies for transactions subject to NS&I Act and UK competition review



Launch of the UK Government's low carbon subsidy scheme for hydrogen

The UK Government understands that hydrogen will play a vital role in delivering the UK's commitment to reach net zero by 2050. To help achieve this commitment, on 20 July 2022, the UK Government launched the world's first national low carbon subsidy scheme for hydrogen (the "Scheme"), which will help fund up to 1GW of electrolytic ("green") hydrogen production in the UK by 2025 with an aim of facilitating 10GW of low carbon hydrogen production in the UK by 2030. The UK Government expects that at least half of this 10GW target will come from electrolytic hydrogen, drawing on the scale-up of UK offshore wind and other renewables and new nuclear.

Funding for the Scheme will come from ongoing contracts-for-difference revenue support from the UK Government's Hydrogen Business Model and also grant funding from the Net Zero Hydrogen Fund for the upfront costs of developing and building low carbon hydrogen projects.

The first allocation round under the Scheme is now open and eligible projects must submit an Expression of Interest to the UK Government by 7 September 2022. To be eligible for the first allocation round, projects must meet the following criteria:

- the production plant must be located entirely in the UK and the project representative's business must be registered in the UK;
- the project must have a commercial operation date by end of 2025;
- the project must have Technology Readiness Level 7 or more;

- the project must be a new build hydrogen production facility and an electrolytic hydrogen production facility;
- there must be at least one qualifying offtaker identified in respect of the project;
- an electrolyser supplier(s) must have been identified in respect of the project;
- the project must have a minimum hydrogen production capacity of 5MW;
- the project must meet the requirements of the Low Carbon Hydrogen Standard; and
- the project must have demonstrated access to finance.

It is anticipated that award of contracts for successful projects in respect of the first allocation round will be from July 2023. The UK Government hopes to support at least 250MW of green hydrogen production via the first allocation round (although it retains the right to allocate less if it does not see sufficient projects coming forward that meet the eligibility criteria and present value for money to it). In order to meet the target of 1GW of green hydrogen production by 2025, there will be a second allocation round under the Scheme, which will commence in 2023 with award of contracts in 2024.

Action point: Consider eligibility of green hydrogen projects under the Scheme and consider submitting an Expression of Interest by the 7 September 2022 deadline



Ofgem proposed reforms to Great Britain's energy system

Ofgem has published a paper on key aspects of Great Britain's energy system where they consider significant reform is required. This is focused on ensuring the delivery of a low carbon and low cost energy system.

Three areas of challenge have been identified:

1. The need for coordination to ensure that major infrastructure assets are built at the right time. This requires strategic planning across all energy assets at both national and local level.
2. The need to optimise the energy system to match the demand for electricity with the supply of clean energy from renewables. Currently, when such renewable supply is insufficient, more expensive power sources set the price for the whole electricity market (the marginal price challenge). Further, the cheapest source of clean power (wind farms) are usually located in locations far from the largest centres of electricity demand. The challenge of flexing electricity demand to match more closely the availability of cheap clean power is currently constrained by the lack of granular market signals to indicate demand by time and place. Unlocking this locational flexibility could save billions of pounds.
3. Maximising the opportunity for consumers to engage with new opportunities in the energy market, so as to reduce energy costs given the recent unprecedented rise in energy prices.

In response to these challenges, Ofgem has recommended three reforms. Firstly, they are proposing strategic planning at national and local levels with the establishment of a powerful Future System Operator ("FSO"), jointly with the government. The FSO will be tasked with leading national planning on the development of the strategic electricity and gas networks needed to transition to a net zero energy system.

Secondly, Ofgem is proposing a reform of the electricity wholesale market to bring down costs. They are recommending that the marginal price challenge is fixed by splitting the wholesale market into two markets, one for intermittent/green power, paid for at a fixed price based on average costs, and the other for firm power, paid at market prices as now. Alternatively, they suggest the expansion of the use of contracts for differences. Ofgem also recommend that the

challenge created by the lack of granular market signals, to match demand to supply of cheap power, is to split Great Britain's electricity wholesale market into zones, allowing prices to differ by location (locational marginal pricing). Alternative options include network charges varying through the day, or the introduction of locational signals into the balancing market and greater use of flexibility markets to relieve certain specific network constraints.

Thirdly, Ofgem is recommending stabilising, reforming and transforming the retail market, including ensuring suppliers deliver on their obligations to customers and are supporting delivery of the government's energy bills support package. Ofgem also intend to introduce a tougher regulatory approach, to ensure suppliers pursue financial resilient business models, and to adapt the price cap to make it more resilient to market volatility.

Action Point: Ofgem encourages views and feedback to the proposals to be submitted to NetZeroBritain@ofgem.gov.uk by 8 August 2022



Additional Paul Hastings Energy and Infrastructure Insights

Set out below are links to our previous publications covering the energy and infrastructure sector during 2022.

M&A Today: Trends and Insights in the Energy Industry

With increased focus on ESG at all levels of the market, large corporates and financial investors alike are exploring and seeking to accelerate growth in alternative energy solutions, through acquisitions and strategic investments, with a particular focus on new technologies. This is happening against a backdrop of evolving sector and reporting regulations, changing energy market dynamics and a challenging environment for achieving returns on investment in the sector.

Our Energy Transition M&A partners gathered to discuss. [Click here](#) to access a recording of the discussion.

COP 26: Aspiration and Reality

The greatest challenge facing the global energy sector is limiting global warming to 1.5 to 2 degrees above pre-industrial levels by 2030 and achieving net zero by 2050. How will governments facilitate the delivery and funding of the transition to clean energy, given increasing global demand and energy security concerns? [Click here](#) to read the full article.

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