

## Offshore Transmission Tender Guidance Note: Generic Offshore Transmission Owner (OFTO) Licence

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Target audience: Stakeholders of the offshore transmission transitional tender round and those with an interest in future tender rounds.

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### Overview:

The purpose of this guidance note is to aid understanding of the regulatory framework and licence obligations that underpin the offshore regime. This document may be of interest to future market entrants, investors and stakeholders that require a detailed understanding of the incentives and obligations faced by OFTOs. This guidance note sets out how the policy framework for offshore transmission has been reflected in the offshore electricity transmission licence (the "Licence"). It describes each part of the Licence and also sets out how the Licence will be modified to include the conditions relating to the licensees' revenue entitlement.

The Licence has been produced to broadly reflect the structure and obligations contained in the onshore transmission licence. Therefore each offshore Licence can contain the following parts: Terms of the Licence, Schedules to the Terms, Standard Conditions, Amended Standard Conditions and Special Conditions.

We have produced this note to enable stakeholders to understand the mechanisms of the Licence and the underlying policy intent, with a focus on the OFTO specific licence provisions, which include the conditions that contain the revenue entitlement. It is not intended to be a substitute for understanding the Licence. This document will be kept under review, and we will, from time to time, update this guidance. If this guidance contradicts any element of the Licence, then the Licence shall take precedence.

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## Context

In June 2009 Ofgem and DECC published a final joint policy statement setting out the regulatory regime for offshore electricity transmission in Great Britain. Shortly afterwards, the new regime was commenced and the industry codes and Standard Licence Conditions were designated by Government. Since then, Ofgem has published and consulted on various drafts of the Licence that will apply to Offshore Transmission Owners (OFTOs). In March we published version 0.5 of the draft Licence on our website.

OFTOs will be largely subject to the same licence and code obligations as onshore transmission owners (TOs). As such, the structure of the Licence contains a number of common elements to existing onshore licences. Licences generally comprise the following parts: Terms of the Licence; Schedules to the Terms; Standard Conditions; Amended Standard Conditions; and Special Conditions.

We have produced this note to enable stakeholders to understand the mechanisms of the Licence and the underlying policy intent with a focus on the OFTO specific licence provisions, which include the conditions that contain the revenue entitlement. It is not intended to be a substitute for understanding the Licence. This note will be kept under review, and we expect, from time to time, to update this guidance. If this guidance contradicts any part of the Licence, then the Licence shall take precedence.

## Associated Documents

- [Enforcement Guidelines](#) (reference no. 232/07)
- [Offshore Electricity Transmission - A Joint Ofgem/DECC Regulatory Policy Update](#) - (reference no. 153/08)
- [Licence fee cost recovery principles](#) (April 2009)  
[Generic Offshore Transmission Owner \(OFTO\) special licence conditions \(version 0.3\), guidance note and licence model](#) (October 2009)
- [Arrangements for responding in the event that an energy network company experiences deteriorating financial health](#) - (reference no. 123/09)  
[Guidance note on process to asset transfer \(offshore electricity transmission\)](#) (October 2009) and [Addendum to Tender Guidance Note on Process to Asset Transfer](#) (February 2010)
- [Guidance on the Offshore Transmission Owner \(OFTO\) of Last Resort Mechanism](#) (February 2010)
- [Generic Offshore Transmission Owner \(OFTO\) special licence conditions \(version 0.5\), guidance note and licence model](#) (March 2010)
- [Review of the Ring Fence Conditions in Network Operator Licences](#) - (reference no. 30/10)
- [Gas and electricity licences - Proposed changes to the Application Regulations and Revocation Schedules of future licences](#) - (reference no. 74/10)
- [Licence modifications implementing the Code Governance Review Final Proposals](#) (July 2010)  
[Consultation on the certification of transmission system operators under the Third Package](#) - (reference no. 97/10)

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## 1. Introduction

### Background

1.1. Transitional OFTOs<sup>1</sup> will be granted a Licence at asset transfer<sup>2</sup>. The Licence will be granted under 6(1)(b) of the Electricity Act 1989 (the "Act"). Licences generally comprise the following parts:

- Terms of the Licence;
- Schedules to the Terms;
- Standard Conditions;
- Amended Standard Conditions; and
- Special Conditions.

1.2. This guidance note describes each of these components. Participants in the tender process should note that this guidance is not intended to be a substitute for understanding the Licence.

1.3. This guidance note also provides more detailed explanations of the mechanisms contained in the OFTO specific licence conditions relating largely to the licensee's revenue entitlement. This is to enable stakeholders to understand how the incentive mechanisms are calibrated.

### Terms of the Licence

1.4. The Terms of the Licence set out the legal powers under which the Authority grants the Licence; section 6(1)(b) of the Act for transmission licences. They also set out when the Licence comes into effect.

### Standard Conditions

1.5. The Standard Conditions cover obligations of all transmission licensees. For example, the Standard Conditions include a common obligation for licensees to comply with the System Operator - Transmission Owner Code (STC). The sections of the Standard Conditions relevant to OFTOs are section A (Interpretation, Application and Payments) and section E (Offshore Transmission Owner Standard Conditions).

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<sup>1</sup> Transitional OFTOs are those OFTOs to whom a transmission licence has been granted following a competitive tender process under the transitional regime

<sup>2</sup> Guidance note on process to asset transfer can be found here:  
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=1&refer=Networks/offtrans/rott>

1.6. A consolidated version of the Standard Conditions can be found [here](#)<sup>3</sup>, on the Electronic Public Register (EPR).

## **Amended Standard Conditions**

1.7. Standard Conditions of the Licence may be modified to meet the circumstances of a specific transmission business. This can include adding conditions to the Licence. The Standard Conditions can be modified using powers under the Act, for example through section 8A of the Act at licence grant, or through section 11 of the Act post licence grant. Such modified conditions have effect as modified standard conditions.

## **Special Conditions**

1.8. Special Conditions traditionally contain provisions that are specific to a licensee, such as the manner in which it is remunerated, and any performance obligations on the licensee. Special Conditions may be incorporated into a licence using powers under section 11 of the Act.

## **OFTO specific conditions**

1.9. We previously followed the traditional approach of developing the OFTO specific conditions as "special conditions". In the November 2008 joint Ofgem/DECC consultation we considered incorporating these conditions using the licence modification mechanism provided for in section 11 of the Act. The licence modification consultation was intended to commence as soon as each licence had been granted. However, we now consider that as the processes and mechanics of Tender Round 1 have developed, we require an approach that allows us to incorporate the OFTO specific conditions at licence grant; specifically, using the powers under section 8A of the Act to incorporate into each OFTO licence in amended standard conditions, the provisions that were developed as the OFTO specific special conditions. We consider that this approach is transparent and necessary to provide certainty to each offshore transmission licensee and their funders from the day the licence is granted regarding their revenue entitlements, allowing them to achieve financial close. The section 8A approach is better suited to the grant of an OFTO Licence where the revenue stream has been determined by a tender process and the revenue entitlement is required to be fixed on the day the licence is granted. The section 8A process requires that the licence modification consultation be carried out and concluded ahead of licence grant. This approach will not have a material impact on the content or intent of the OFTO specific provisions, nor will it have an impact on enforceability of the licence or on the revenue stream bid through the tender

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<sup>3</sup> <http://epr.ofgem.gov.uk/index.php?pk=folder380751>

process. Further detail on this approach is provided in chapter 4 (Amended Standard Conditions - General Information).

1.10. A copy of these OFTO specific conditions is published alongside this guidance note as Amended Standard Conditions.

## Enforcement Orders

1.11. Ofgem has certain enforcement powers under legislation governing the electricity markets in Great Britain. If it appears to the Authority that a licence holder is contravening, or is likely to contravene, any relevant condition or requirement, and it is not trivial, appropriate steps are not being taken to secure compliance, and its duties do not preclude it from doing so the Authority shall make such a provisional order if it considers the making of such an order to be requisite and secure compliance. Where the Authority is satisfied that the contravention is ongoing or is likely to occur, it shall confirm any relevant provisional order or make a final order to bring the breach to an end. The principal legislation comprises the Electricity Act 1989 and the Utilities Act 2000. As a competition authority, Ofgem also has concurrent powers with the Office of Fair Trading under the Competition Act 1998 as well as powers under the Enterprise Act 2002 in relation to those areas within our jurisdiction. In the event of the licensee breaching the Licence, the Authority may issue an enforcement order under section 25 of the Act. We consider it may also be useful to direct stakeholders to relevant documents. [The Enforcement guidelines on complaints and investigations](#)<sup>4</sup> may be of interest. These guidelines explain the process steps and enforcement action which the Authority may or may not take in various circumstances. Regarding making orders, the Authority must have regard to its general duties under the Act, which may or may not preclude the making of an order.

1.12. You may also wish to consider [Ofgem's Policy Statement](#)<sup>5</sup> on setting financial penalties which explains the criteria for applying a financial penalty for licence breaches and how the quantum of a penalty would be decided.

## Relevant developments

1.13. We provide an update on wider developments that are relevant to potential OFTOs, including:

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<sup>4</sup><http://www.ofgem.gov.uk/About%20us/enforcement/Documents1/Enforcement%20Guidelines%20post%20consultation.pdf>

<sup>5</sup> <http://www.ofgem.gov.uk/About%20us/Documents1/Utilities%20Act%20-%20Statement%20of%20policy%20with%20respect%20to%20financial%20penalties.pdf>

## Tender Guidance Note - Generic Offshore Transmission Licence

- Proposed and recent licence modifications,
- The package of European legislation on the liberalisation of EU gas and electricity markets (the “Third Package”), and
- The commencement of Go Live for transitional projects which allows us to grant licences.



## 2. Terms of the Licence

### Chapter Summary

The Terms of the Licence refer to the various parts to the Licence and the legal powers under which the Authority grants the Licence. There are also two Schedules to the Terms of the Licence, which specify the area where the licensee can participate in the transmission of electricity and set out the Licence revocation provisions.

### Terms of the Licence

2.1. The Terms are fixed by the Authority upon grant of the Licence. The Terms used in the Licence have been adapted from the Terms of the onshore transmission licences. The Terms refer to the parts of the Licence:

- Part I - the Terms of the Licence
- Part II - The Standard Conditions
- Part III - The Amended Standard Conditions
- Part IV - The Special Conditions
- Schedule 1 - Specified Area
- Schedule 2 - Revocation

2.2. The Licence is granted in perpetuity, unless revoked under Schedule 2, discussed below. The date that the Licence takes effect is stated in the Terms. If the Authority revokes the Licence, for a reason not set out in Schedule 2, it must give not less than 18 months notice in writing to the licensee, no earlier than 19 years<sup>6</sup> from the date of licence grant. The revenue stream is set for 20 years, but the Licence extends to 20.5 years to recognise the obligation on the licensee to discharge reporting obligations in respect of year 20.

### Schedule 1 - Specified Area

2.3. Schedule 1 is discussed alongside amended standard conditions E12 - B1 (Transmission system area) and E12 - B2 (Activities restrictions).

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<sup>6</sup> This timeframe has been set to enable the 20 year revenue stream to be fully recovered. We acknowledge that there may be project specific circumstances that necessitate a later date, such as where a project has phasing. In such circumstances we would set an appropriate timeframe to enable the 20 year revenue stream to be fully recovered.

## Schedule 2 - Revocation

### Revocation of the Offshore Transmission Licence

2.4. Schedule 2 to the Licence describes the circumstances in which the Authority may revoke the Licence. In advance of any revocation action, the Authority will consider the most appropriate course of action, in light of its statutory duties, to protect consumers from the consequences of revocation. Specific mechanisms already exist to address issues that may lead to revocation of the Licence and the Authority will consider whether other regulatory tools should be used instead to enforce compliance by a licensee with its statutory and licence obligations. As such this section should be read in conjunction with:

- The [guidance note](#)<sup>7</sup> on the OFTO of Last Resort Mechanism,
- The [Enforcement Guidelines](#)<sup>8</sup>,
- Consultation on the certification of transmission system operators under the Third Package<sup>9</sup>,
- Arrangements for responding in the event that an energy network company experiences deteriorating financial health<sup>10</sup>.

2.5. The Authority may at any time revoke the Licence by giving not less than 30 days' notice (24 hours' notice in the case of paragraph 1(f) of schedule 2). Revocation of the Licence by the Authority is not an automatic event, and in considering licence revocation the Authority would be mindful of its statutory 'better regulation' duties to ensure that its regulatory activities are transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed.

2.6. The Authority may revoke the licence in specified circumstances, including where:

- The licensee has requested that the Licence be revoked;
- The licensee fails to comply with an order made by the court under section 34 of the Competition Act 1998; an order made by the Authority under sections 158 or 160 of the Enterprise Act 2002; an order made by the Competition Commission

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<sup>7</sup><http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=24&refer=Networks/offtrans/rott>

<sup>8</sup><http://www.ofgem.gov.uk/About%20us/enforcement/Documents1/Enforcement%20Guidelines%20post%20consultation.pdf>

<sup>9</sup>[http://www.ofgem.gov.uk/Europe/Documents1/3rd%20pk%20unbundling%20con%20doc\\_FINAL.pdf](http://www.ofgem.gov.uk/Europe/Documents1/3rd%20pk%20unbundling%20con%20doc_FINAL.pdf)

<sup>10</sup>[http://www.ofgem.gov.uk/Networks/Policy/Documents1/GUIDANCE%20DOC%20\(DECISION%20DOC\)%20-%20FINAL.pdf](http://www.ofgem.gov.uk/Networks/Policy/Documents1/GUIDANCE%20DOC%20(DECISION%20DOC)%20-%20FINAL.pdf)

under sections 76, 81, 83, 84 and 161 of the Enterprise Act 2002; or an order made by the Secretary of State under sections 66, 147, 160 or 161 of the Enterprise Act 2002; and

- The licensee is unable to pay its debts (within the meaning of section 123(1) or (2) of the Insolvency Act 1986, but subject to paragraphs 2 and 3 of this schedule).

2.7. Where difficulties arise in the operation of an OFTO business, the Authority would expect to have an active dialogue with affected stakeholders (including funders where appropriate) to seek to resolve issues. By taking these active steps, we anticipate that many issues will be resolved without further escalation. However, if these proactive steps fail to reach a resolution, the Authority may still need to consider whether it is appropriate to revoke the Licence.

2.8. Before taking steps to revoke a Licence, where practicable the Authority may provide a draft revocation notice in advance of any likely revocation date. We consider this approach would support our objective of protecting consumers and our statutory duty of securing that licensees are able to finance their authorised activities. We would also expect that this would provide a basis for a licensee to involve external funders where relevant to take appropriate measures to remedy the issue.

2.9. The timescale for deciding whether to revoke a Licence will depend on the basis on which revocation might occur and the relevant factors and events leading to that point. It will also depend on the consequences of revocation. Ofgem will take all reasonable steps to contact the relevant person at the licensee, whether that is a director or a receiver. This will enable us to raise and clarify any concerns we have and to explain the regulatory position and our powers.

2.10. This contact will also provide the relevant person with the opportunity to provide reasons why the Licence should not be revoked. Ofgem would make clear the timescale for making such representations. This will depend on the urgency of the situation and in particular the impact on customers and other industry parties of delaying any decision to allow time for further representations or for alternative solutions to the licensee's problems to be found. Ofgem expects directors and receivers, where appropriate, to give appropriate priority to responding to any requests by us for dialogue.

2.11. Ofgem, as required by law, must publish reasons for revoking a Licence. Once we have decided to revoke, we will therefore issue a Notice of Revocation and, simultaneously, a Notice giving the reasons for the decision to revoke. Any confidential material is likely to be contained in a separate annex sent only to the licensee.

2.12. If the Authority intends to revoke the transmission licence of an OFTO, the Authority may appoint an OFTO of Last Resort. An OFTO of Last Resort obligation was introduced within all electricity transmission licences; Standard Condition E21

(Offshore Transmission Owner of Last Resort) in the case of OFTOs. This obligation enables the Authority to direct any transmission licensee to become OFTO of Last Resort where it considers that there is a (significant) risk of a generator becoming stranded or suffering delays to connection of the offshore wind farm to the onshore electricity network.

2.13. In deciding whether to use its powers to initiate the OFTO of Last Resort process, the Authority will need to strike an appropriate balance between the significant risk of stranding or delay and other measures that might be taken to address such risks. These other measures might include an open market sale/transfer of the assets by the OFTO; a new open market competitive tender process administered by the Authority, where a tender process has failed to identify an OFTO; and energy administration. The energy administration regime was established through primary legislation in the Energy Act 2004. The aim of the energy administration regime is to ensure that essential services to consumers remain secure and uninterrupted in the event of a protected energy company (which includes transmission licensees) becoming insolvent.

## 3. Standard Conditions

### Chapter Summary

The Standard Conditions of the Licence were modified by the Secretary of State in June 2009 for the purpose of facilitating offshore transmission. The Standard Conditions cover obligations of all transmission licensees, although for each transmission licensee only some of the sections from B to E have effect in their Licence. This chapter briefly describes the Standard Conditions applicable to OFTOs, sections A and E.

3.1. Transmission licences are granted with sections A and B in effect. The conditions in/not in effect can be directed using the powers under standard conditions A2, A3, A5 and A6, to suit the individual circumstances of the licensee. For the onshore TOs and SO, either section C or D was made effective via a direction. For OFTOs, on the day of licence grant we will issue:

- Section B Direction (using powers under standard condition A5) so that Section B does not have effect in the licence, and
- Section E Direction (using powers under standard condition A6) so that Section E does have effect in the licence.

3.2. Therefore, for OFTOs sections A and E will have effect once the two directions above have been issued.

### Standard Conditions - Section A

3.3. Section A of the Standard Conditions sets out the definitions and interpretation of words and expressions used in the Licence. It also clarifies which of the Standard Conditions have effect in the Licence. As noted above, we will issue directions under section A on the day of licence grant to ensure that sections E does have effect and section B does not have effect in the OFTO licence.

3.4. Standard Condition A4 (payments by Licensee to the Authority) obliges licensees to pay a licence fee to the Authority "an amount which is the relevant proportion of the estimated costs of the Authority during the year in question". However, "estimated costs" is defined in Standard Condition A4 as being "calculated in accordance with principles determined by the Authority". These principles, contained in the [Licence fee cost recovery principles](http://www.ofgem.gov.uk/Licensing/Work/Documents1/Revised%20licence%20fee%20cost%20recovery%20principles%202009.pdf)<sup>11</sup> currently set out that Ofgem will recover costs from transmission licensees "where the licensee has been issued with a

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<sup>11</sup><http://www.ofgem.gov.uk/Licensing/Work/Documents1/Revised%20licence%20fee%20cost%20recovery%20principles%202009.pdf>

Section C (system operator standard conditions) Direction which is still in effect". Most payment items identified in Standard Condition A4 do thus not currently apply to OFTOs. However, for a licence modification reference, where the Competition Commission issues a direction under section 177(3) of the Energy Act, Ofgem will recover the previous year's costs of that reference from licence holders as directed. All types of licence, including OFTO licences, could potentially be included. The Licence fee cost recovery principles may be amended from time to time. We will consult on those changes before implementing new principles.

## **Standard Conditions - Section E**

3.5. Section E of the Standard Conditions applies to OFTOs. Many of the conditions were based on conditions in sections B and D of the Standard Conditions of the Licence, which apply to onshore Transmission Owners (TOs), but were updated in places to reflect the specific circumstances that apply in offshore transmission.

3.6. These Standard Conditions were consulted on by the Secretary of State, prior to being modified in June 2009. The modifications made to these Standard Conditions are set out in the [Joint DECC-Ofgem statement](#)<sup>12</sup>.

3.7. We do not intend to discuss the standard conditions in any further detail in this document.

## **Modifications to licence conditions**

3.8. Once the Licence has been granted, any standard or other condition may be modified. The Authority may collectively modify licences of a type (e.g. transmission, distribution licences etc) under section 11A of the Act.

3.9. The Authority may modify any Standard, Amended Standard or Special Conditions of a particular licence, under section 11 of the Act. However, modifications can only be made under section 11 with the consent of the licensee, following a consultation period lasting a minimum of 28 days, during which time representations or objections with respect to the proposed modifications may be made.

3.10. The Authority may make modifications to the Standard Conditions of a particular licence during the licensing process if it considers it requisite to meet the

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<sup>12</sup><http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=83&refer=Networks/offtrans/pdc/cdr/cons2009>

circumstances of a particular case. These modifications would be introduced through powers under section 8A.

3.11. Further details on the section 8A consultation process, including the reason why we have decided to use section 8A to add the OFTO specific conditions, are provided in Chapter 4 (Amended Standard Conditions).

## 4. Amended Standard Conditions - General Information

### Chapter Summary

Standard Conditions of the Licence can be modified to meet the circumstances of a specific transmission business. This can include adding conditions to the Licence. The Standard Conditions can be amended using powers under the Electricity Act 1989 (the "Act"), for example through section 8A. This chapter briefly describes the function of Amended Standard Conditions and how we intend to amend the Standard Conditions of each OFTO licence. The following chapters discuss each section of the OFTO specific conditions, which are being proposed to be incorporated into the Licence as Amended Standard Conditions.

### Amended Standard Conditions

4.1. Standard Conditions of the Licence may be modified to meet the circumstances of a specific transmission business. For example, for OFTOs it is necessary to amend the Standard Conditions to allow for the conditions regarding revenue entitlement to be added to the Licence. Any amendments are made on a case by case basis at the Authority's discretion.

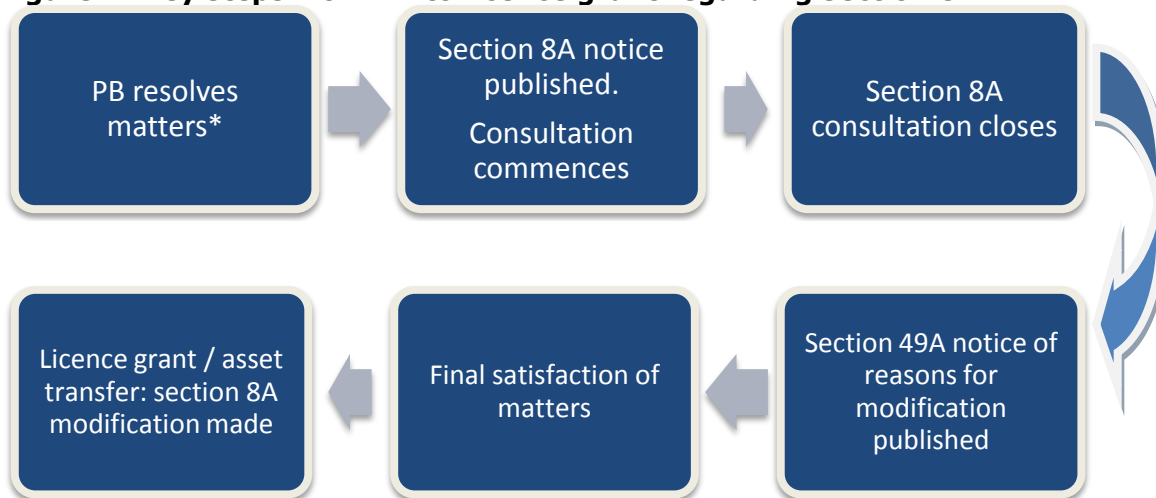
4.2. As noted in chapter 3 (Standard Conditions), we intend to add the OFTO specific conditions using the Authority's powers under section 8A of the Act. Under section 8A we intend to initiate the statutory consultation pre-licence grant, with the relevant conditions being part of the Licence at asset transfer and licence grant.

4.3. In the November 2008 joint Ofgem DECC policy consultation we considered options for adding the special conditions to the Licence, including using section 11 of the Act. However, in this scenario the revenue conditions would not have been part of the Licence from licence grant, as the 28 day consultation period required under section 11 could only commence from licence grant, with the conditions added some time after. Including the OFTO specific conditions from licence grant allows OFTOs and lenders to reach financial close, as there is certainty that the regulated revenue entitlement is in place. As such, we consider it necessary to follow a section 8A process, which allows these conditions to be part of the Licence from licence grant.

4.4. We expect the section 8A consultation to commence after the Preferred Bidder (PB) has resolved the matters to the Authority's satisfaction (other than certain matters which can only be resolved after the section 8A consultation), as detailed in the PB Notice that each PB will receive. The section 8A consultation will be for a minimum period of 28 days, during which time representations or objections with respect to the proposed modifications may be made. The decision on the modification would be taken prior to licence grant, with the conditions being part of the Licence at licence grant. The key steps are set out in figure 1.



**Figure 1: Key steps from PB to licence grant regarding section 8A**



\* Matters will be set out in the PB Notice. Certain matters can only be resolved after the section 8A consultation.

4.5. Published section 8A notices are available on the "industry governance > licensing" section of the Ofgem website.

## 5. Amended Standard Conditions: E12 – A1 to E12 – A3

### Chapter Summary

Amended Standard Conditions E12 - A1 to E12 - A3 set out the definitions and interpretations for the Amended Standard Conditions (E12 - A1), establish the process for adjusting the revenue stream to reflect the difference between market rates prior to asset transfer and those on the day of asset transfer (E12 - A2), and define the process for setting the Post Tender Revenue Adjustment (PTRA) (E12 - A3).

### Amended Standard Condition E12 - A1: Definitions and interpretation

5.1. This condition contains the definitions and interpretations for the Amended Standard Conditions.

### Amended Standard Condition E12 - A2: Market Rate Revenue Adjustment

5.2. This condition establishes the process for adjusting the revenue stream to reflect the difference between market rates assumed in the revenue bid prior to asset transfer and those on the day of asset transfer. This adjustment will be made by changing the value of the MRA term that appears in J2 of the Licence. The licensee is required, prior to licence grant, to prepare a market rate adjustment methodology statement outlining the proposed methodology to calculate this adjustment. This methodology statement must meet certain criteria, as outlined in the Licence, and be approved by the Authority. On the date of licence grant, the Authority will determine the market rate adjustment to the revenue stream (through the MRA term), in accordance with the approved methodology statement, and direct the appropriate value of the MRA term in the Licence.

5.3. This revenue stream adjustment mechanism ensures that the licensee remains revenue-neutral to underlying movements in the market rates for interest swap rates, retail price index swap rates, gilt rates, and index linked gilt rates that occur between the tender revenue confirmation process (which occurs before the section 8A consultation) and the day of licence grant.

## **Amended Standard Condition E12 - A3: Post Tender Revenue Adjustment**

5.4. For projects where, prior to the commencement of the section 8A consultation process, the Authority completes the ex post cost assessment<sup>13</sup> and reconfirms the revenue stream in light of any difference between the ex ante cost estimate<sup>14</sup> and ex post cost assessment, this condition will not be applicable.

5.5. For projects where it is not possible to complete the ex post cost assessment and to reconfirm the revenue stream prior to the commencement of the section 8A consultation process, the assets will transfer based on the ex ante cost estimate, with a minimum of 75 per cent of the ex ante cost estimate being paid by the OFTO to the developer<sup>15</sup>. The licensee's revenue entitlement will initially be based on 100 per cent of the ex ante cost estimate. The Authority will complete an ex post cost assessment once assets are complete. If the ex post cost assessment determines outturn costs different to those identified with the ex ante cost estimate, this condition enables the Authority to adjust the revenue entitlement accordingly.

5.6. If there is a need to modify the revenue stream under this condition, the Authority would propose a modification to the PTR term<sup>16</sup>, pursuant to section 11 of the Act. This would be initiated by the Authority giving notice of the proposed modification and allowing a minimum of 28 days within which representations or objections to the proposed modification may be made. This change should provide bidders comfort in the process followed to modify the PTR term, providing them a clear mechanism to make representations and objections to any proposed modification.

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<sup>13</sup> Ofgem will undertake its ex post cost assessment after completion of the relevant transmission assets, to determine the economic and efficient costs.

<sup>14</sup> For each transitional transmission asset Ofgem estimates the preliminary transfer value (ex-ante cost estimate) based upon the developers likely economic and efficient costs of construction.

<sup>15</sup> The deferred consideration (the remaining 25 per cent or other applicable balance; e.g. if the licensee paid the developer 85 per cent of the ex ante cost estimate at transfer, the applicable balance would be 15 per cent) would be paid on completion of the ex post cost assessment, with the revenue entitlement being adjusted via the process defined in this condition.

<sup>16</sup> The PTR term appears in Amended Standard Condition E12 - J2 and represents the adjustment to the Tender Revenue Stream based on the ex post cost assessment performed by the Authority after assets are commissioned.

## 6. Amended Standard Conditions: E12 - B1, E12 - B2 and Schedule 1

### Chapter Summary

This chapter discusses Amended Standard Conditions E12 - B1 and E12 - B2 and Schedule 1. These conditions and schedule relate to where and how the Licence may be operated in Great Britain.

### Schedule 1: Specified area

6.1. Schedule 1 describes the specified area as Great Britain, an area of waters in or adjacent to Great Britain which is between the mean low water mark and the seaward limits of the territorial sea, and an area of waters within an area designated under section 1(7) of the Continental Shelf Act 1964 and in any Renewable Energy Zone. This area is where the licensee can participate in the transmission of electricity, subject to the constraints imposed by Amended Standard Conditions E12 - B1 and E12 - B2.

### Amended Standard Condition E12 - B1: Transmission system area

6.2. The broad area defined in Schedule 1 is clarified by Amended Standard Condition E12 - B1, which sets out the specific transmission system and the location for which the Licence is granted. Amended Standard Condition E12 - B1 includes the onshore and offshore connection point and diagram of the transmission system area and transmission system circuit.

### Amended Standard Condition E12 - B2: Activities restrictions

6.3. Amended Standard Condition E12 - B2 focuses on how a licensee shall operate its assets. For example, the licensee shall not take on the role of the SO and shall only offer transmission services under the Licence within the transmission system area specified in Amended Standard Condition E12 - B1 of the Licence, unless required to act as OFTO of Last Resort.

## 7. Amended Standard Conditions: E12 - C1 to E12 - C4

### Chapter Summary

Amended Standard Conditions E12 - C1 to E12 - C4 set out the requirements for business separation between the OFTO and any GB wholesale electricity market affiliated business. The basis of the business separation requirements is to ensure that the appropriate systems, processes and information restrictions are in place so that no affiliated party can obtain an unfair commercial advantage in other markets.

### Amended Standard Condition E12 - C1: Conduct of the Transmission Business

7.1. Paragraph 1 of Amended Standard Condition E12 - C1 prohibits the licensee from behaving anti-competitively in conducting its business operations and ensures that no party gains an unfair commercial advantage due to the conduct of the offshore transmission business. Paragraph 2 of Amended Standard Condition E12 - C1 prohibits offshore licensees from sharing premises with the SO (sub-paragraph (a)) or with affiliates authorised to generate or supply electricity (sub-paragraph (b)).

7.2. Paragraph 2(b) of Amended Standard Condition E12 - C1 clarifies that the intent of this condition is not to prevent an OFTO with multiple licences from sharing premises, but rather to ensure business separation between an OFTO who may have access to sensitive wholesale electricity market information and generators and suppliers in the wholesale electricity market.

### Amended Standard Condition E12 - C2: Separation and Independence of Transmission Businesses

7.3. Amended Standard Condition E12 - C2 sets out that the licensee should have systems in place to comply with Standard Conditions E6 (Prohibition of cross-subsidies) and E7 (Restriction on Activity and Financial Ring Fencing) and Amended Standard Condition E12 - C1. This includes a requirement for the licensee to have in place an Authority-approved compliance statement regarding these systems.

### Amended Standard Condition E12 - C3: Restriction on use of certain information

7.4. Amended Standard Condition E12 - C3 prohibits the licensee from sharing information that could lead to any parties gaining an unfair commercial advantage. For example, if an affiliate of an OFTO is participating in a competitive tender process for offshore electricity transmission, this condition prohibits the OFTO sharing information that may provide an unfair commercial advantage to that affiliate. Additionally, this condition prohibits an OFTO sharing information with generators that may provide a bidding advantage to that generator when trading on the open market.

## **Amended Standard Condition E12 - C4: Appointment of compliance officer**

7.5. Amended Standard Condition E12 - C4 sets out that the licensee should implement appropriate measures to ensure compliance with this condition, Standard Conditions E6 (prohibition of cross subsidies) and E7 (financial ring fencing) and Amended Standard Conditions E12 - C1 to E12 - C3. This includes the requirement to appoint a compliance officer and to establish a committee to oversee compliance.

## 8. Amended Standard Condition E12 - D1

### Chapter Summary

The Amended Standard Conditions of section E12 - D set out the requirements the Authority has on the licensee to report information throughout the revenue period.

### **Amended Standard Condition E12 - D1: Offshore Regulatory Reporting**

8.1. The purpose of Amended Standard Condition E12 - D1 is to secure the collection of information to enable the Authority to monitor the revenue of the transmission business.

8.2. Paragraph 2 of Amended Standard Condition E12 - D1 refers to "offshore regulatory reporting - regulatory instructions and guidance", which will be issued by the Authority. The principles of these instructions and guidance will be based on those issued for onshore price controlled networks. However, any reporting requirements we develop will be proportionate to the size of OFTO transmission systems and the risks facing OFTOs, so will not necessarily be an exact replica of onshore documents.

## 9. Amended Standard Conditions: E12 - J1 to E12 - J10

### Chapter Summary

Amended Standard Conditions E12 - J1 to E12 - J10 primarily outline the licensee's revenue stream, including any elements that can change the revenue stream during its 20 year life, such as the availability incentive mechanism and pass through costs.

### Amended Standard Condition E12 - J1: Restriction of Transmission Revenue: Definitions

9.1. Amended Standard Condition E12 - J1 contains the definitions for section E12 - J of the Amended Standard Conditions.

### Amended Standard Condition E12 -J2: Restriction of Transmission Revenue: Revenue from transmission owner services

#### Offshore Transmission Owner Revenue

9.2. The offshore transmission owner revenue is calculated in accordance with the following formulae:

$$OFTO_t = BR_t + PT_t - PA_t - K_t$$

9.3. Where:

BR<sub>t</sub> means base transmission revenue, detailed below.

PT<sub>t</sub> means the allowed pass through costs, detailed below.

PA<sub>t</sub> means the revenue adjustment term, detailed below.

K<sub>t</sub> means the revenue correction factor (or "K factor"), detailed below.

#### Base Revenue

9.4. Base revenue is determined by the following elements:

$$BR_t = (TRS_t + MRA_t + PTRAT_t) \times PR_t \times RIT_t$$

9.5. Where:



TRSt means the Tender Revenue Stream.

MRAt means the market rate revenue adjustment, to account for the difference between assumed market rates prior to licence grant and actual market rates on the date that this condition comes into force.

PTRAt means the Post Tender Revenue Adjustment, which represents the adjustment to the Tender Revenue Stream based on the ex post cost assessment performed by the Authority after assets are commissioned. The explanation of Amended Standard Condition E12 - A3 in chapter 5 (Amended Standard Conditions: Section E12 - A) provides more information on why this term is included.

PRt means the Proportional Revenue term. The OFTO will receive the base revenue each year in full, except in the commencement relevant year and closing relevant year. In these years the revenues will be paid proportionate to the point in the year at which the revenue stream will commence or close using these formulas:

a. Commencement relevant year:

$$PR_1 = 1 - \left( \frac{\text{No of days from date of licence grant to start of commencement relevant year}}{365.25} \right)$$

b. Closing relevant year:

$$PR_{20} = \left( \frac{\text{No of days from date of licence grant to start of commencement relevant year}}{365.25} \right)$$

RITt means the Revenue Indexation Adjustment Term. This term accounts for the effect of inflation on the value of base revenue over the 20 year period.

The inflation adjustment term works on a calendar year basis (January to December) as the inflation rate applied to the licensee is lagged by three months during the period. That is, the licensee will be paid on a financial year basis, but to limit the variation that can occur for licensee revenues they must collect revenue based on the previous calendar year's inflation for the next financial year.

### **Correction (K) Factor**

9.6. The correction factor is designed to account for the difference between the revenue the OFTO forecast for the next regulatory period, and actual revenue required in that period. These errors will potentially lead to over or under collection of revenue in the current regulatory year. This over or under recovery will be adjusted for, by the K factor, in the following regulatory year. The exposure of the licensee to any potential forecasting variance has been limited in our design of the Amended Standard Conditions. The potential areas of forecast variance are:

- **Human error:** that is the licensee informing the SO of the incorrect amount of revenue it needs to collect in the next regulatory period.
- **Incremental capacity adjustment:** as set out in Amended Standard Condition E12 - J4, this revenue adjustment may potentially be applied in the regulatory year following the regulatory year in which the licensee provides extra capacity. Therefore the K factor may potentially be required to compensate for a part year incremental capacity adjustment revenue increment not foreseen by the licensee at the beginning of regulatory year.
- **Pass through costs:** as set out in Amended Standard Condition E12 - J3, these are costs the Authority allows to be passed through to consumers. Therefore these events will tend to occur during the regulatory year and will be passed through to consumers at the end of that year during the next Transmission Network Use of System (TNUoS) price setting process. As such the majority of these pass through costs should be historical and known, with limited scope for forecasting error (unless costs are not finalised by the end of the TNUoS charge setting process). Where an error is made in forecasting the revenue, the correction factor will correct this error.

9.7. The availability incentive, as set out in Amended Standard Condition E12 - J4, is applied to a calendar year, with a requirement on the licensee to report to the Authority its results 14 days after the end of each quarter (ending 31 March, 30 June, 30 September, 31 December). Therefore the revenue impact of the availability incentive will be known and available for inclusion in the revenue stream by mid January. As this element of base revenue will be finalised for inclusion into the revenue stream, it is not subject to forecasting risk and therefore will not be subject to the K factor.

9.8. In theory the licensee has a fixed revenue stream for the 20 year period which is equal to base revenue (BRt) multiplied by 20 (in real terms). Therefore, in time value of money terms the licensee will prefer to collect more revenue in earlier years as it will be of more value to them than in later years. To limit this behaviour the K factor operates each year to adjust any revenue over/under collection of revenue. In general, it does this by adjusting the following regulatory years revenue by the amount of over/under collected revenue plus Barclays Base interest rate to make the over/under collection revenue-neutral between relevant years. However, to disincentivise large over-collections, where revenues exceed the entitlement by more than four per cent then an interest of Barclays Base rate plus four per cent will be applied.

9.9. As well as the requirements of the K factor, Amended Standard Condition E12 - J5 prohibits the licensee from increasing transmission revenues above their base revenue requirement in the following regulatory year if they over collect revenue by more than three per cent in the current regulatory year.

## **Amended Standard Condition E12 - J3: Restriction of transmission revenue: Allowed pass-through items**

### **Pass through costs**

9.10. The Licence allows for the following pass through costs calculated as:

$$PT_t = LF_t + RB_t + CEL_t + DC_t + IAT_t + TPD_t + TCA_t + MCA_t$$

9.11. Where:

LFt means the licence fee cost adjustment term<sup>17</sup>.

RBt means the network fee cost adjustment term.

CELt means the Crown Estates licence cost adjustment term.

DCt means the decommissioning cost adjustment term.

IATt means the income adjusting event revenue adjustment term.

TPDt means the temporary physical disconnection term.

TCAt means the tender fee cost adjustment term.

MCAt means the Marine and Coastal Act 2009 cost adjustment term.

9.12. Each of these pass through events represents known yet unpredictable costs that, if determined by the Authority, should be passed through to consumers.

9.13. While each of these items represents a cost to the licensee, they are passed through to consumers once determined by the Authority. As such the licensee would only need to finance these costs in the short term. The Authority requires the licensee to present all relevant information to the Authority for consideration when applying for each pass through. This requirement ensures that the licensee provides all relevant information up-front for consideration.

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<sup>17</sup> The applicability of the Licence fee to OFTOs is discussed in chapter 3 (Standard Conditions).

9.14. To receive a cost pass through for an income adjusting event, an event or circumstance for that relevant year must have increased or decreased costs and/ or expenses by more than a set threshold (the STC threshold amount). The generic licence sets out two STC threshold amounts: £500,000 and £1,000,000. In each OFTO licence, only one threshold will appear, dependent on the size of the initial asset value of the transmission system. For projects whose initial transmission system is valued at less than £100 million, the threshold will be £500,000, and for transmission systems with an initial transmission system value of £100 million or more, the threshold will be £1,000,000.

## **Amended Standard Condition E12 - J4: Restriction of transmission revenue: Annual revenue adjustments**

### **Obligations**

9.15. Amended Standard Condition E12 - J4 requires the licensee to use reasonable endeavours to maintain availability and places obligations on the licensee regarding reporting to the Authority when availability performance deteriorates to certain levels. The licensee must report to the Authority when:

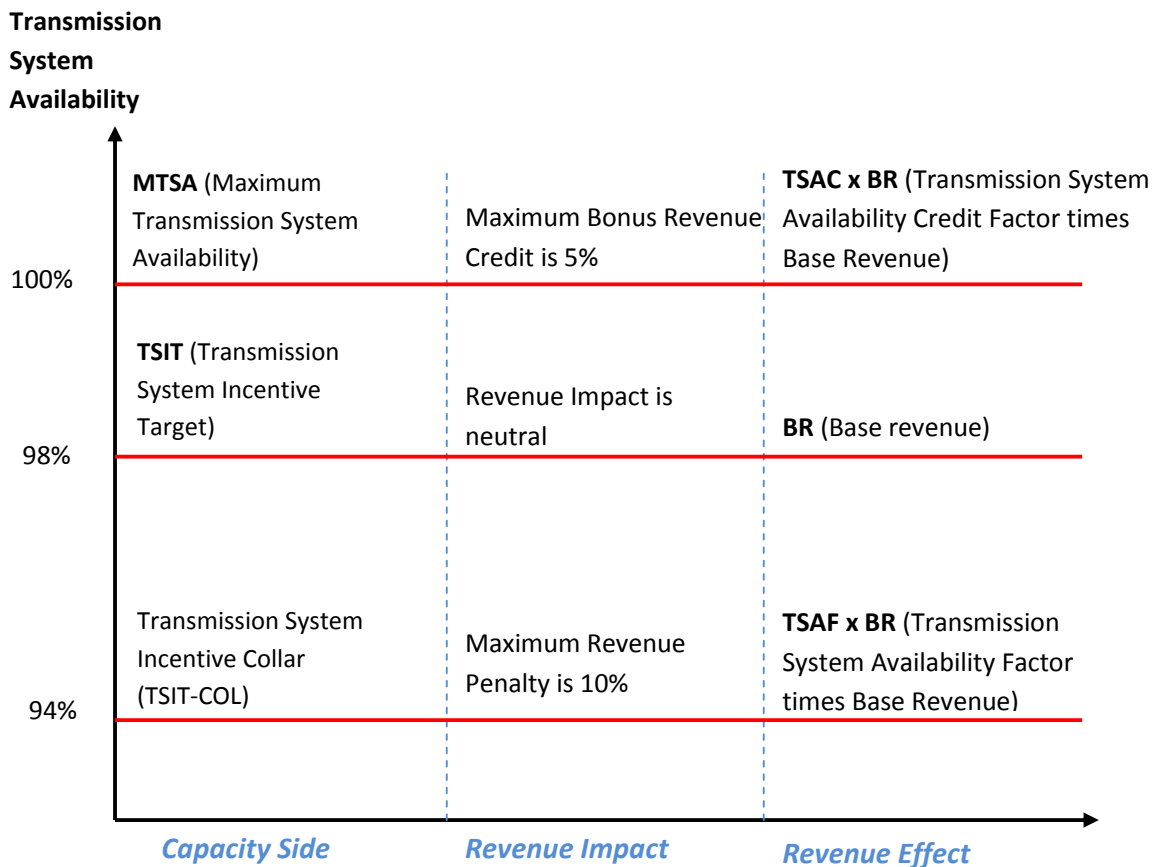
- The licensee expects a transmission services reduction of more than 21 days; including reporting steps being taken to minimise the service reduction and the timescale the licensee considers the service will remain reduced,
- Transmission system availability falls, on average, below 75 per cent in a year; and
- Transmission system availability falls, on average, below 80 per cent during a 24 month period.

9.16. Amended Standard Condition E12 - J4 obliges the licensee to report to the Authority their availability performance, 14 days after the end of each quarter (March, June, September and December).

### **Availability Incentive**

9.17. The availability incentive operates through the licensee's revenue stream to encourage the licensee to operate its transmission system in a manner that is beneficial to consumers. For OFTO's this is to ensure that it is incentivised to make its transmission systems available to generators for as much of the time per year as possible. This in turn means it will be able to export power to consumers any time the wind is blowing. An illustrative diagram of the Transmission System Availability Incentive Mechanism is shown in figure 2.

**Figure 2: Illustrative Transmission System Availability Incentive Mechanism**



9.18. The transmission system availability incentive (TSAIt) increases or decreases the revenue received by the licensee at year  $t$ , depending on their transmission availability performance. It is derived for each year from the difference between the penalty adjustment factor (TSAF $_t$ ) and the credit adjustment factor (TSAC $_t$ ) multiplied by the Base Transmission Revenue (BR $_t$ ) of the previous year. The base revenue is the revenue the licensee is entitled to as set in Amended Standard Condition E12 - J2.

9.19. Amended Standard Condition E12 - J4 sets a Monthly Transmission Availability Incentive Target (TSIT $_t$ ) to the licensee at 98 per cent, on average for a calendar year. This availability rate represents our expectations of the offshore transmission system over 20 years, based on availability performance in current operational offshore transmission systems and other comparable infrastructure. As such, future OFTO licences may contain a different rate, depending on the further performance data becoming available.

9.20. When the licensee's transmission availability performance equals the target (TSITt), the licensee earns the base revenue for the year. For the months when the licensee's performance exceeds the TSIT, the licensee will earn credits that can increase the base revenue, subject to the credit banking mechanisms, by an amount of up to about five per cent of base revenue.

9.21. When the licensee's monthly transmission availability is less than the transmission availability target but greater than the collar, the licensee will earn the base revenue minus a penalty factor of up to ten per cent of base revenue. The Incentive Collar (COL) is the level of monthly transmission system availability performance where the transmission availability penalty achieves the maximum penalty of ten per cent of base revenue. If the ten per cent maximum revenue penalty is breached, the additional penalty is spread over the next four revenue periods, offsetting any credits earned in the interim period. Any remaining penalty at the end of the five year period is netted from the availability bank. This was designed to limit the impact of large outages and maintain the value of the incentive over the remainder of the regulatory period.

9.22. A credit banking mechanism was created to lower revenue variability for the licensee and incentivise sustained good performance. This credit banking mechanism annually accrues all credits earned for each months performance, in the form of MWh of transmission availability, for five years before they can be cashed. Penalties, which are earned on a monthly basis, are then offset by any credits which have been accrued in the credit bank.

9.23. As the licensee is entitled to revenue over a 20 year period, the bonus credits that are earned in years 16 to 20 would only be cashed in years 21 to 25. Therefore at the end of year 20 these credits will be aggregated into a lump sum and cashed. This lump sum payment is called the Transmission System Availability Performance Payment (TSAP).

### **Incremental Capacity Adjustments**

9.24. It is possible that a present or future generator or user may make a request to the SO to provide additional capacity beyond its contracted capacity. In this case (and if requested by the SO) an OFTO would be required<sup>18</sup> to offer terms to the SO for providing the additional capacity. These terms should be consistent with licence obligations to operate in an economic and efficient manner<sup>19</sup>. Where the OFTO makes such capacity available, the revenue stream will be increased to compensate the OFTO for the additional availability.

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<sup>18</sup> Under the standards licence conditions and the STC.

<sup>19</sup> Provided that the capital investment required of the OFTO does not exceed 20 per cent of the transmission assets' initial purchase price.

9.25. There are two ways in which the OFTO may meet this request for additional capacity:

- By utilising its existing assets (i.e. by using some 'capacity headroom' that is not utilised by the existing contracted capacity requirements); or
- By making additional capital expenditure (CAPEX) to meet the user's increased capacity requirements.

9.26. Correspondent to these alternative approaches, there are two terms in the Amended Standard Conditions that can be used to make this adjustment:

- Incremental Capacity Utilisation Adjustment (ICUAt); and
- Additional Capacity Investment Adjustment (ACAt).

*Incremental Capacity Utilisation Adjustment (ICUAt)*

9.27. Where the OFTO is able to meet the SO's request for additional capacity using existing headroom in its asset's capability, it can be rewarded for delivering that additional capacity through the capacity utilisation adjustment revenue driver. The driver has been set ex ante on a £/kW hour basis. The revenue driver is based on the composite circuit rating of the transmission system in kW and has been set at a level to ensure that parties are correctly incentivised to make capacity available through their existing assets rather than to undertake unnecessary CAPEX.

*Additional Capacity Investment Adjustment (ACAt)*

9.28. Where an OFTO is best placed to meet the SO's request for additional capacity through extra CAPEX (i.e. CAPEX that the Authority determines is below the 20 per cent threshold), it can be rewarded for delivering that capacity through the Additional Capacity Investment Adjustment term.

9.29. In this case the licensee will submit a notice to the Authority setting out, with supporting evidence, the revenue adjustment that it considers is required to remunerate the costs incurred in providing the additional capacity. The licensee will include in its cost submission: the amount of additional capacity that it is contractually required to provide; the capital cost of making the investment; any corresponding increase in operation and maintenance costs; and the cost of financing the additional investment.

9.30. The licensee must demonstrate to the Authority's satisfaction that the costs have been incurred in an economic and efficient manner, and the Authority may issue a notice of its determination of the costs. This notice will have the effect of setting the value ACAt.

### **Amended Standard Condition E12 - J5: Restriction of transmission charges: Adjustments**

9.31. Amended Standard Condition E12 - J5 obliges the licensee to provide the Authority with reports for any under and over collection of revenue during the 20 year regulatory period. This allows the Authority to monitor the collection of revenues by the licensee.

9.32. The requirement on the licensee to provide information to the Authority if it over-collects revenue is supplemented by ensuring the licensee is unable to adjust their revenue to collect more than base revenue, following a year in which they over collected revenue by more than three per cent. This is an incentive in line with the K factor penalty rate in Amended Standard Condition E12 - J2 for the licensee to correctly calculate its revenues as outlined in paragraph 9.7.

### **Amended Standard Condition E12 - J6: Provision of Information to the System Operator**

9.33. Amended Standard Condition E12 - J6 requires the licensee to liaise with the SO regarding the TNUoS charge setting process it undertakes from 1 November each year. The licensee is required to ensure that the initial revenue requirement it advises the SO is kept up to date so that the SO collects the correct amount of revenue for the licensee through the TNUoS charges.

9.34. Any under or over collection of revenues due to the licensee informing the SO of the incorrect amount of revenue to collect on its behalf are subject to the requirements of the K factor in Amended Standard Condition E12 - J2 of the Licence and the reporting requirements under Amended Standard Condition E12 - J5.

9.35. We consider that it will be in the interests of the licensee to ensure that the finalised value of the calendar year availability incentive is passed to the SO for inclusion in the following years' revenue requirement following the Authority's assessment in mid-January, and the release of the December Retail Price Index values by the [Office of National Statistics](http://www.statistics.gov.uk)<sup>20</sup>.

### **Amended Standard Condition E12 - J7: Duration of Revenue Restriction Provisions**

9.36. Amended Standard Condition E12 - J7 outlines the process for the licensee to request the Authority to remove part or all of the revenue restrictions that are

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<sup>20</sup> <http://www.statistics.gov.uk/default.asp>



applied to the licensee's revenue by Amended Standard Conditions E12 - J1 to E12 - J5 of the Licence.

### **Amended Standard Condition E12 - J8: Allowances in respect of security costs**

9.37. The Secretary of State may require the licensee to operate in a certain manner during a security period. Amended Standard Condition E12 - J8 allows the Authority to compensate the licensee for any reasonable costs it has incurred in providing its services during this security period.

### **Amended Standard Condition E12 - J9: Basis of Transmission Owner Charges**

9.38. Amended Standard Condition E12 - J9 requires the licensee to set out its charging methodology for transmission owner services, for connection to the licensee's transmission system and for outage change. Amended Standard Condition E12 - J9 also covers the requirement for a pricing methodology for excluded services as defined in Amended Standard Condition E12 - J10 (Excluded Services).

### **Amended Standard Condition E12 - J10: Excluded Services**

9.39. Amended Standard Condition E12 - J10 sets out the transmission services that are covered by the revenue restriction conditions (in this case the revenue bid during the tender process) and the transmission services which are excluded from the revenue (Amended Standard Condition E12 - J2). These excluded services can be charged by the licensee at the market rate and will not be included in the amount that is covered by their regulated revenue.

## 10. Relevant developments

### Chapter Summary

This chapter sets out some developments that are relevant to potential OFTOs.

### Commencement of the regime

10.1. In June 2009 following extensive consultation the previous Secretary of State for Energy and Climate Change commenced powers to enable modifications to be made to the industry codes and licences for the purpose of offshore transmission ("Go-Active"). This also enabled Ofgem to begin the process of identifying OFTOs through competitive arrangements under tender regulations approved by the previous Secretary of State. In July 2010 the Secretary of State commenced the remaining statutory provisions ("Go Live") for the transitional regime. The regime is applicable to assets built by the generator that transfer to the successful bidder following the competitive tender, enabling Ofgem to grant a transmission licence to that successful bidder. The Government expects to fully commence the provisions of the Energy Acts 2004 and 2008 on an enduring basis following the conclusion of the consultation on the enduring regime<sup>21</sup>.

### Recent licence modifications and proposed modifications

10.2. Ring fence conditions<sup>22</sup> are designed to secure that licensees' assets, cash flows and other financial resources are applied to meet the needs of the regulated company. These are aimed at protecting consumers in the event of financial distress or failure in an energy network company whatever the cause. On 3 March 2010 we [consulted](#)<sup>23</sup> on a review of the ring fence conditions in network operator licences, including a proposed set of incremental changes to ensure that the arrangements are as robust as possible. We have received industry responses, which are available on the website. We are considering these responses and expect to consult again.

10.3. On 4 March 2010 we published a [letter](#)<sup>24</sup> setting out amendments to the revocation schedules of all future licences granted by the Authority. The amendment

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<sup>21</sup><http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=20&refer=NETWORKS/OFFTRANS/PDC/CDR/CONS2010>

<sup>22</sup> Standard conditions E4 (Disposal of relevant assets), E6 (Prohibition of cross-subsidies), E7 (Restriction on Activity and Financial Ring Fencing), E8 (Availability of Resources), E9 (Undertaking from ultimate controller), E10 (Indebtedness), and E11 (Credit Rating of Licensee).

<sup>23</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=268&refer=Networks/Policy>

<sup>24</sup><http://www.ofgem.gov.uk/Licensing/Work/Documents1/Amending%20licence%20terms%20letter%20-%20Final.pdf>

was to remove paragraph 1(g) of Schedule 2 and add the following text as paragraph:

“The Authority may at any time revoke the licence by giving no less than 7 days notice in writing to the licensee where the Authority is satisfied that there has been a material misstatement (of fact) by, or on behalf of the licensee, in making its application for the licence.”

10.4. As such, we have updated Schedule 2 of the OFTO Licence accordingly.

10.5. In November 2007, we launched a review of the arrangements for governing the industry codes. On 5 July 2010, Ofgem made transmission licence modifications to give effect to its final proposals on the code governance review. Five modifications were made, amending, in accordance with our principal objective, statutory duties and relevant modification processes, the conditions of the electricity transmission, electricity distribution and gas transporter licences. Further details can be found [here](#)<sup>25</sup>.

10.6. On 11 August 2010, the Secretary of State modified industry codes and licences to put in place enduring grid access reform and ensure that new generation is able to secure firm access dates in an appropriate timeframe. Details are set out on [DECC's website](#)<sup>26</sup>. These latest changes are in the consolidated transmission licence on the [electronic public register](#)<sup>27</sup>.

10.7. The modifications discussed above are not intended to be a comprehensive overview of all proposed and made modifications.

### **Third Package**

10.8. The Third Package entered into force on 3 September 2009. One of the areas covered by the Third Package is the unbundling of transmission system operators which essentially involves the structural separation of electricity generation and/or supply activities from transmission activities (set out in Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 (the “Electricity Directive”). Stakeholders should be aware of the relevant provisions of the Third Package. On 29 July 2010 we set out in a [consultation](#)<sup>28</sup> our initial view that offshore electricity transmission systems are caught by the definition of “transmission system” under

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<sup>25</sup><http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=CovletCGR.pdf&refer=Licensing/IndCodes/CGR>

<sup>26</sup> [http://www.decc.gov.uk/en/content/cms/consultations/improving\\_grid/improving\\_grid.aspx](http://www.decc.gov.uk/en/content/cms/consultations/improving_grid/improving_grid.aspx)

<sup>27</sup> <http://epr.ofgem.gov.uk/>

<sup>28</sup> [http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=3rd pk unbundling con doc\\_FINAL.pdf&refer=Europe](http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=3rd_pk_unbundling_con doc_FINAL.pdf&refer=Europe)

the Third Package and that offshore transmission owners are therefore subject to the unbundling requirements set out in the Electricity Directive (2009/72/EC). Please see the consultation for more details on the Third Package. DECC are also consulting on third package, having issued a [consultation and impact assessment](#)<sup>29</sup> on 27 July 2010. Please refer to the consultation for more details.

10.9. [Version 0.5 of the generic OFTO licence](#)<sup>30</sup> included an additional revocation provision, paragraph 1(e)(iii), relating to the unbundling requirements of the Third Package. Once the Third Package requirements have been transposed into the regulatory framework, we will consider whether there is an ongoing need to include this revocation provision.

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<sup>29</sup> [http://www.decc.gov.uk/en/content/cms/consultations/imp\\_eu\\_third/imp\\_eu\\_third.aspx](http://www.decc.gov.uk/en/content/cms/consultations/imp_eu_third/imp_eu_third.aspx)

<sup>30</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=29&refer=Networks/offtrans/rott>

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## Appendices

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## Appendix 1 – The Authority’s Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority (“the Authority”), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Acts of 2004, 2008 and 2010, as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.<sup>31</sup>

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly<sup>32</sup>.

1.4. The Authority’s principal objective is to protect the interests of existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems. The interests of consumers are their interests taken as a whole, including their interests in the reduction of greenhouse gases and in the security of the supply of gas and electricity to them.

1.5. The Authority is generally required to carry out its functions in the manner it considers is best calculated to further the principal objective, whenever appropriate by promoting effective competition between persons engaged in, or commercial activities connected with:

- the shipping, transportation or supply of gas conveyed through pipes;
- the generation, transmission, distribution or supply of electricity;
- the provision or use of electricity interconnectors.

1.6. Before deciding to carry out its functions in a particular manner with a view to promoting competition, the Authority will have to consider the extent to which the interests of consumers would be protected by that manner of carrying out those functions and whether there is any other manner (whether or not it would promote competition) in which the Authority could carry out those functions which would better protect those interests.

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<sup>31</sup> Entitled “Gas Supply” and “Electricity Supply” respectively.

<sup>32</sup> However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

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1.7. In performing these duties, the Authority must have regard to:

- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- the need to secure that all reasonable demands for electricity are met;
- the need to secure that licence holders are able to finance the activities which are the subject of obligations on them<sup>33</sup>; and
- the need to contribute to the achievement of sustainable development.

1.8. In performing these duties, the Authority must have regard to the interests of individuals who are disabled or chronically sick, or of pensionable age, with low incomes, or residing in rural areas.<sup>34</sup>

1.9. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

- promote efficiency and economy on the part of those licensed<sup>35</sup> under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and
- secure a diverse and viable long-term energy supply,
- and shall, in carrying out those functions, have regard to the effect on the environment.

1.10. In carrying out the functions referred to, the Authority must also have regard to:

- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

The Authority may, in carrying out a function under the Gas Act and the Electricity Act, have regard to any interests of consumers in relation to communications services and electronic communications apparatus or to water or sewerage services

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<sup>33</sup> Under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Acts in the case of Electricity Act functions.

<sup>34</sup> The Authority may have regard to other descriptions of consumers.

<sup>35</sup> Or persons authorised by exemptions to carry on any activity.

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(within the meaning of the Water Industry Act 1991), which are affected by the carrying out of that function.

1.11. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation<sup>36</sup> and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

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<sup>36</sup> Council Regulation (EC) 1/2003



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## Appendix 2 - Glossary

### **A**

#### Authority

The Gas and Electricity Markets Authority

#### ACA

Additional Capacity Investment Adjustment

### **B**

#### BR

Base Revenue

### **C**

#### $CEL_t$

Crown Estate licence cost adjustment term

#### COL

Collar of 4 per cent for the availability incentive.

### **D**

#### $DC_t$

Decommissioning cost adjustment term

#### DECC

Department of Energy and Climate Change

### **E**

#### EPR

Electronic Public Register

### **I**

#### $IAT_t$

Income adjusting event cost revenue adjustment term

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ICUA<sub>t</sub>

Incremental Capacity Utilisation Adjustment

**L**

LF<sub>t</sub>

Licence fee cost adjustment term

**M**

MCA<sub>t</sub>

Marine and Coastal Act 2009 cost adjustment term

MTSA<sub>t</sub>

Maximum Transmission System Availability

MRA

Market Rate Revenue Adjustment

**O**

Ofgem

Office of Gas and Electricity Markets

OFTO

Offshore Transmission Owner

**P**

PTRA

Post Tender Revenue Adjustment

**R**

RB<sub>t</sub>

Network cost adjustment term

**S**

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STC

System Operator - Transmission Owner Code

**T**

TO

Transmission Owner

TPD<sub>t</sub>

Temporary Physical Disconnection term

TCA<sub>t</sub>

Tender Fee Cost adjustment term

TSIT<sub>t</sub>

Transmission System Incentive Target

TSAF

Transmission System Availability Penalty Factor

TSAC

Transmission System Availability Credit Factor

TSAI

Transmission System Availability Incentive

TSAP

Transmission System Availability Payment

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## Appendix 3 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments.

1.2. Please send your comments to:

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