

To offshore transmission owners,
current and prospective bidders
for Offshore Transmission
Licences and
other interested parties

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Date: 28 July 2023

Dear Colleague,

Decision on proposed modifications to Offshore Transmission Licences

Introduction

- 1.1 In November 2022, we¹ conducted a statutory consultation (the **Consultation**)² on proposed modifications to the amended standard conditions of the Offshore Transmission (**OFTO**) licences under section 11A of the Electricity Act 1989 (the **Act**). The modifications fell into the following areas:
- a) Modifications for all OFTO licences to Amended Standard Condition E12-J3 (Restriction of Transmission Revenue: Allowed Pass-through Items)(**ASC E12-J3**), to create two new pass-through terms that would allow all Offshore Transmission Owners (**OFTOs**) to claim for the cost of carrying out Health Reviews of their transmission assets, and Investment Works then needed to extend the lifetime of those assets;
 - b) Modifications for all OFTO licences to Part A of Amended Standard Condition E12-J4 (Restriction of Transmission Revenue: Annual Revenue Adjustments)(**ASC E12-J4**), to allow all OFTOs to claim adjustments for availability lost as a direct result of carrying out Health Reviews and, if necessary, Investment Works;
 - c) Modifications to ASC E12-J3, to allow OFTOs licensed in tender rounds 1 (**TR1**) to 3 (**TR3**) to seek to recover additional costs or expenses incurred in the event that Value Added Tax (**VAT**) is applied to decommissioning costs where this is not already provided for in the licence elsewhere and/or as a result of the disallowance of scrap value from the decommissioning security.

¹ The terms "the Authority", "we" and "us" are used interchangeably in this document.

² <https://www.ofgem.gov.uk/publications/statutory-consultation-proposed-modifications-offshore-transmission-owner-ofto-licences>

- 1.2 Following careful consideration of the representations made, we have decided to proceed with the licence modifications described in paragraph 1.1 (a) to (c) above, with no alterations.
- 1.3 The Consultation also included proposed modifications to:
 - a) Part C of ASC E12-J4 (**ASC E12-J4 Part C**) to make it clear that all OFTOs can seek to recover costs where they have entered into an agreement with the system operator under Standard Licence Condition E17: Obligations in relation to offers for connection etc (**SLC E17**) and the OFTO has incurred costs as a result of that agreement; and
 - b) Minor changes to Amended Standard Condition E12-A1: Definitions and Interpretation (**ASC E12-A1**) in four OFTO licences, to make changes required to ensure that the licences are consistent with UK law at the end of the transition period following the United Kingdom's (**UK**) exit from the European Union.
- 1.4 The Authority decided to proceed with the modifications described in paragraph 1.3 above separately. Decision Notices were published on 28 June 2023.³

Consultation responses

- 2.1 We received seventeen responses (representing thirty-three Licensees/Interested Parties) to the Consultation. All non-confidential responses have been published alongside this decision on the Ofgem website.
- 2.2 An assessment of the representations made, together with our views on the points raised and whether they impact the licence drafting, is set out in the following paragraphs in this letter under the headings of the relevant amended standard condition. References to the various modifications use the same titles as set out in the Consultation.

Modifications to ASC E12-J3 (cost of Health Review and Investment Works)

- 3.1 The Authority has decided that costs that are economically and efficiently incurred by OFTOs as a direct result of carrying out health reviews (reviews designed to identify the additional investment needed to extend the lifetime of their transmission assets) should be reimbursed. The Authority has also decided that OFTOs should be reimbursed for costs that are incurred economically and efficiently as a direct result of carrying out investment works, which are beyond the scope of the current revenue stream.
- 3.2 Under existing licences costs may, in certain defined circumstances, be "passed-through" to consumers. These include costs for (among others) Income Adjusting Events (**IAEs**) and Contingent Event Adjustments (**CEAs**).
- 3.3 The Authority proposed to introduce two new pass-through terms for additional costs incurred when carrying out the health review and, if applicable, the investment works. We proposed to amend ASC E12-J3 to state that an OFTO may submit a claim for the cost of the health review and, if applicable, the investment works to the Authority for consideration. The costs must be directly attributable to the health review and the investment works (if applicable) in each case and must (as mentioned above) have been incurred economically and efficiently.
- 3.4 Several generators considered that they should retain the right to decline the proposed extension and the right to approve the scope and content of the OFTO health review.

³ [Decision on proposed modifications to offshore electricity transmission licences | Ofgem](#)

- 3.5 Our response: The Authority agrees that generators should have a say in the process for approving investment works, because they ultimately meet most of the costs involved. The decision document issued by the Authority in July 2021⁴ stated that “the output of the OFTO health reviews will however need to be made available to Ofgem and, as necessary, the generator, to ensure an economic and efficient investment decision can be made for each OFTO asset.” The Authority expects generators first to share their health reviews of their assets at T-6 (six years before the end of the tender revenue stream) with the OFTO, and to input into discussions about the areas to be covered by the OFTO asset review at T-5 (five years before the end of the tender revenue stream). We also expect generators to be involved in discussions about the outcome of the OFTO review and any investment works that are subsequently needed. Extensions can only take place where this is agreed by both the OFTO and generator.
- 3.6 Several generators also considered that the most effective solution would be for ownership of the OFTO asset to return to the generator. In their view this would simplify the process as generators would perform health reviews and investment works at their own cost without any pass-through to consumers.
- 3.7 Our response: It would not be possible to return assets to the generators without changes to primary and/or secondary legislation. The Authority wishes to make progress for early tender rounds on the current basis. We have therefore agreed with the Department for Energy Security and Net Zero that they will consider the merits of this proposal, alongside other options, over the medium-term.
- 3.8 One generator considered that OFTOs should bear the cost of health reviews. The decision document issued by the Authority in July 2021⁵ stated that “unforeseen costs that are economic and efficiently incurred by the OFTOs in carrying out the requirements of the asset health review should be reimbursed.”
- 3.9 Our response: The Authority is not minded to change our position. Most OFTOs, especially those in early tender rounds, operate on tight margins and these costs were not foreseen when their revenue streams were set.
- 3.10 One OFTO said they were unsure why costs for asset health reviews should be subject to an economic and efficient test, and that this might create uncertainty for the OFTOs concerned.
- 3.11 Our response: The Authority accepts that this will be a greater concern for investment works than health reviews given the respective anticipated costs, but believes it will also be important to ensure that the health reviews have been conducted efficiently and economically, and that all costs incurred are directly attributable to the review and in line with guidance. We are not therefore minded to change our position.
- 3.12 Two generators considered that there should be a public and transparent procurement process for the party carrying out the health review, and that health reviews should be conducted by an independent body. One OFTO raised a concern about the proposed definition of investment works and how this related to the guidance. One respondent suggested that the reviews might usefully be broken into two parts.
- 3.13 Our response: The Authority expects to open detailed discussions with generators and OFTOs about the way forward on health reviews in the autumn of 2023, with a view then to preparing guidance for the industry. Issues such as who carries out the reviews and their structure may be discussed at this time. The first review by a

⁴ [End of Tender Revenue Stream Decision](#)

⁵ [End of Tender Revenue Stream Decision](https://www.ofgem.gov.uk/publications/end-tender-revenue-stream-decision)<https://www.ofgem.gov.uk/publications/end-tender-revenue-stream-decision>

generator of their assets is expected to take place in 2024, with three further generator reviews expected in 2025. OFTO health reviews will each take place one year after their generator review, and we do not expect investment works to take place until the last three year period before the end of the tender revenue stream in each case.

- 3.14 One generator considered that the Authority should take account of the live Connection and Use of System Code (CUSC) Modification Proposal (CMP) CMP344: 'Clarification of Transmission Licensee revenue recovery and the treatment of revenue adjustments in the Charging Methodology'. This modification was sent back by the Authority in 2021, as we could not form a decision due to several deficiencies in the Final Modification Report (FMR).
- 3.15 Our response: We have received a second FMR for CMP344 along with individual industry responses to the Authority. We want to make progress on the licence modifications now, rather than wait for the CMP344 process to reach a conclusion. We will consider any implications of the Authority's decision on CMP344 for the OFTO regime carefully, once that decision has been taken.
- 3.16 All OFTOs welcomed the proposed new pass-through terms, while stressing that investment works in particular would require OFTOs to incur and fund significant expenditure months in advance of being reimbursed.
- 3.17 Our response: The Authority understands this concern in relation to investment works, which have been informally forecast by OFTOs to cost around £1-5m per OFTO. We consider that claims for investment works should be capable of being processed promptly, given that the Authority will already have been involved in discussions about the scope and likely cost of those works. In addition, it is possible for OFTOs to submit claims for investment works in the same year as the costs are incurred. Provided OFTOs submit their claims as early as possible, we consider that many claims for investment works costs should be capable of being processed in the same calendar year as the costs are incurred, in time for the OFTOs to submit their annual regulatory returns to the National Grid Electricity System Operator (**ESO**).
- 3.18 The Authority will however keep this issue under review. The OFTO licence already allows partial awards to be made for IAE claims, and one option could be to introduce a mirror provision allowing partial awards to also be made for investment works claims. We will consider whether to put this proposal forward for discussion in the next suitable consultation document.
- 3.19 Several OFTOs proposed that the cost of investment works should be pre-approved by the Authority and paid in a lump sum at the start of the financial year, thus removing cash flow or funding issues. They proposed that any adjustments between the forecast cost and actual cost could be made in the following year.
- 3.20 Our response: The Authority notes that under current licence requirements, IAE and CEA claims can only be submitted to the Authority for consideration after the costs have been incurred. IAE claims to date have been for amounts significantly higher than those anticipated for the investment works. The Authority believes that claims for investment works should be dealt with in the same way, and is not therefore minded to accept this proposal.
- 3.21 Two OFTOs proposed that investment works should be pass-through costs, with OFTOs invoicing ESO for the costs incurred.
- 3.22 Our response: This would be a change to the proposed arrangements, where OFTOs submit claims to the Authority for consideration and only then, if the claims are approved, reclaim the costs from the ESO. We believe it is right that the Authority should assess claims before any monies due can be reclaimed from the ESO, and is not therefore minded to accept this proposal.

- 3.23 Having considered the representations made, the Authority has decided to proceed with the proposed modifications to ASC E12-J3 regarding the cost of health reviews and investment works.

Modifications to ASC E12-J3 (application of VAT to decommissioning costs and/or disallowance of scrap value from the decommissioning security)

- 4.1 All OFTO licences granted from TR3 onwards provide a mechanism that allows OFTOs to claim an adjustment in the event that VAT is applied to decommissioning costs. All OFTO licences granted from tender round 4 (**TR4**) onwards provide a mechanism that allows OFTOs to claim for costs incurred as a result of the disallowance of scrap value from the decommissioning security.
- 4.2 The Authority therefore proposed modifications in the Consultation to:
- a) Include specific protection that covers additional costs, unforeseen at licence grant, which may be incurred as a result of VAT being applied to the decommissioning security, consistent with protection included in licences granted in TR3 onwards. The Authority proposed to amend all OFTO licences issued in TR1 and TR2, apart from two that already contained bespoke provisions on VAT, so that all OFTOs could claim an adjustment in the event that VAT is applied to decommissioning costs and ensure consistency across all OFTO licences, and
 - b) Include specific protection that covers additional costs or expenses, unforeseen at licence grant, which may be incurred as a result of the disallowance of any scrap value of recovered material from the decommissioning security, consistent with protection included in licences granted in TR4 onwards. The Authority proposed to amend all OFTO licences issued in TR1 to TR3, so that all OFTOs could claim for additional costs or expenses incurred as a result of the disallowance of scrap value from the decommissioning security and ensure consistency across all OFTO licences.
- 4.3 Three respondents (representing ten OFTO Licensees) welcomed the proposed modifications but raised concerns that other reviews of the decommissioning plan could also add to the cost of decommissioning, and not only the changes identified to VAT and scrap values. In addition, three respondents (representing thirteen OFTO Licensees) were of the view that OFTOs should be reimbursed for any changes to decommissioning plans required by BEIS⁶ or The Crown Estate, such as any requirement to remove assets from the seabed.
- 4.4 Our response: The Authority does not consider it is appropriate to protect an OFTO from all costs related to changes to its decommissioning plan. The OFTO licence presently allows revenue adjustments to be made where the OFTO has provided evidence of additional costs/expenses which have arisen due to a change in legislation on decommissioning requirements and where these additional costs/expenses are not covered by the tender revenue stream. We expect to commence further discussions in relation to decommissioning costs with interested parties in autumn 2023.
- 4.5 Three respondents (representing ten OFTO Licensees) were of the view that the proposed modifications did not adequately address the change in legislative requirements, noting there could be several reviews of the decommissioning plan before the changes concerning VAT and scrap are added. These respondents proposed further modifications to ASC E12-J3 to remove the link to the 'plan for the decommissioning of the Offshore Transmission Assets as provided to the Authority as part of the licensee's ITT'.

⁶ Department for Business, Energy & Industrial Strategy (BEIS) now the Department for Energy Security and Net Zero

- 4.6 Our response: The Authority's intention is to provide protection only to the extent that an OFTO incurs additional costs concerning VAT and/or scrap compared to the costs it has assumed for these elements at the time its bid was submitted as part of the Offshore Transmission Tender process. The modifications proposed by the Authority would make the licences concerned consistent with those granted to all other OFTOs licensed from TR3 onwards.
- 4.7 Having considered the representations made, the Authority has decided to proceed with the proposed modifications to the decommissioning provisions in ASC E12-J3.

Modification to Part A of ASC E12-J4 (availability lost during health reviews and investment works)

- 5.1 The Authority has decided that all OFTOs should be able to claim an adjustment for availability lost as a direct result of carrying out health reviews of their transmission assets, and as a direct result of investment works needed to extend the lifetime of those assets.
- 5.2 The Authority proposed to modify ASC E12-J4 to state that for health reviews and investment works, OFTOs may claim an adjustment for lost availability for outages of up to and including 7 days in each case, without needing the prior approval of the Authority. This was designed to broadly mirror arrangements that are already in place for exceptional events under ASC E12-J4, where OFTOs may reclaim adjustments for outages in specified circumstances without needing the prior approval of the Authority. These outages are often (but not always) for periods of less than 7 days.
- 5.3 The Authority proposed that, where longer outages of more than 7 days have occurred, the OFTO should be required to submit claims to the Authority for consideration, under arrangements similar to those that are already in place for exceptional events under ASC E12-J4. This would be the case for both health reviews and the investment works. These arrangements would allow the Authority to require further information or analysis from the OFTO where necessary in connection with their claim, and to make an adjustment based on the extent to which the OFTO had followed Good Industry Practice, the guidance and any directions issued by the Authority.
- 5.4 There was general support from OFTOs and generators for these proposals, although several detailed points were raised.
- 5.5 Two generators considered that outages for health reviews should be capped at a cumulative 7 days, unless approved by Ofgem.
- 5.6 Our response: OFTOs informally forecasted that most health reviews should take 4 to 7 days. Any reviews that take longer than 7 days will be carefully assessed by the Authority and we will set any adjustments to cover only works that have been carried out economically and efficiently.
- 5.7 Two generators considered that each generator and OFTO should mutually agree the timing of outages to minimise the impact on the generator concerned, including whether it is possible to inspect assets while the system is still energised or during routine maintenance.
- 5.8 Our response: The Authority agrees that OFTOs should discuss the timing of outages with generators and look to minimise the impact on them where possible.

- 5.9 Two generators asked whether it might be possible to allow generators to claim for lost revenue due to the unavailability of transmission assets during the health review and investment works.
- 5.10 Our response: The overarching aim of these amendments is to enable the licence extensions to take place, rather than make fundamental changes to the regime. The Authority has decided therefore to hold to the present position that offshore generators cannot claim for lost availability.
- 5.11 One generator considered that Ofgem should review desktop reviews in advance and then set the number of days allowed for the outage. This would require the Authority to examine desktop reviews for all OFTOs and set the number of days allowed for the outage in advance.
- 5.12 Our response: OFTOs can already claim adjustments for specified outages under E12-J4 without needing Authority approval. The Authority believes that advance reviews for what seems likely to be short outages in the main for health reviews would be excessive.
- 5.13 Two generators asked the Authority to introduce requirements to prevent OFTOs allowing assets to degrade to the point of requiring significant investment.
- 5.14 Our response: The Authority notes that the licence requires OFTOs to maintain system availability throughout the licence period and also that, if an OFTO were to cut back on maintenance within the licence period, they would run an increased risk of failure events – for which they might be compensated by the Authority, but only if we concluded that the OFTO had followed Good Industry Practice and any directions or guidance issued by the Authority.
- 5.15 Two OFTOs considered that the Authority should agree the duration of outages in advance and classify these in a way that meant OFTOs did not have to submit Exceptional Event (EE) claims.
- 5.16 Our response: As mentioned above in paragraph 5.6, the Authority expects that most health reviews will take less than 7 days to conduct and OFTOs will be able to claim an adjustment for these outages without needing prior approval from the Authority. OFTOs will only have to submit claims to the Authority where cumulative outages exceed 7 days. We believe that this strikes the right balance and, as mentioned above in paragraph 5.2, this is designed to broadly mirror arrangements that are already in place for EE claims.
- 5.17 Having considered the representations made, the Authority has decided to proceed with the modifications to Part A of ASC E12-J4 as proposed.

Licence modification decisions

- 6.1 Modification decision notices together with relevant schedules have been published alongside this letter.

Next steps

- 7.1 In accordance with section 11A(9) of the Electricity Act 1989, these licence modifications will come into effect from 22 September 2023.
- 7.2 If you have any questions in relation to this letter please contact Stephen Taylor, Networks at Stephen.Taylor@ofgem.gov.uk.

Yours sincerely

A handwritten signature in black ink, consisting of a stylized initial 'S' followed by a long, horizontal, slightly wavy line.

Stuart Borland

Deputy Director, Offshore Network Regulation

For and on behalf of the Gas and Electricity Markets Authority