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Date: 6 July 2023

Dear Mr. Rooke,

**Final determination in relation to notice of an income adjusting event from Gwynt y Môr OFTO plc**

1. On 18 June 2021, the Authority received a notice (the **Notice**) from Gwynt y Môr OFTO plc (the **Licensee**) in respect of an event, which the Licensee considers to be an income adjusting event (**IAE**) pursuant to Amended Standard Condition E12-J3 (Restriction of Transmission Revenue: Allowed Pass-through Items) of its Licence (the **Condition**).
2. The Authority has considered the claim and has determined that the event set out in the Notice constitutes an IAE for the reasons given in this letter. In relation to the relevant year 2020/21, the allowed income adjustment ( $IAT_t$ ) shall be £9,172,194.38.<sup>1</sup> In relation to the relevant year 2021/22, the allowed income adjustment ( $IAT_t$ ) shall be £2,203,652.12.<sup>2</sup>
3. In this letter, we also describe the details of the event set out in the Notice, provide a summary of the IAE provisions, describe the process we have followed to reach the Authority's determination and discuss representations made by both the Licensee and Gwynt y Môr Offshore Wind Farm Limited.

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<sup>1</sup> Pursuant to paragraph 21(c)(i) of the Condition, three million pounds (£3 million) is deducted from the final adjustment.

<sup>2</sup> The division by year reflects the financial year in which invoices were submitted to/paid by the Licensee.

## Background

4. The Licensee is the holder of an offshore electricity transmission licence, granted on 11 February 2015 under section 6(1)(b) of the Electricity Act 1989 (the **Licence**). The Licensee provided the Notice to the Authority pursuant to paragraph 14 of the Condition, in respect of an increase in costs and/or expenses incurred by the Licensee that it considers was caused by an IAE.
5. Pursuant to paragraph 16 of the Condition, the Notice gave particulars of:
  - a) the event to which the Notice relates and why the Licensee considers the event to be an IAE;
  - b) the amount of any change in costs and/or expenses that can be demonstrated by the Licensee to have been caused by the event and how the amount of these costs and/or expenses has been calculated;
  - c) the amount of any allowed revenue adjustment proposed as a consequence of that event and how this allowed revenue adjustment has been calculated; and
  - d) any other analysis or information that the Licensee considers sufficient to enable the Authority and the relevant parties to fully assess the event to which the Notice relates.
6. The event in the Notice relates to a cable failure on the subsea cable of Export Circuit 3 (**SSEC3**) on 15 October 2020 (the **Cable Failure**).
7. The Licensee first became aware of breaks in the spare Fibre Optic Cable (**FOC**) in SSEC3 in January 2020. The Licensee monitored the FOC for further signs of failure – a number of breaks in the FOC developed on both the spare and main FOC between January 2020 and the Cable Failure in October 2020.
8. Because of the Cable Failure, extensive repair work was necessary on the transmission assets. The Notice relates to the costs and expenses of the repair works and related costs required by the Licensee in relation to the Cable Failure.
9. The Notice sets out that there has been an overall change to the costs and expenses of the Licensee of £14,951,912.29, as a result of the Cable Failure. In March 2022, the Licensee submitted revised cost information and confirmed the overall change to the costs and expenses of the Licensee as £14,928,357.40.
10. The Licensee considers that the Cable Failure is an IAE pursuant to sub-paragraph 15(c) of the Condition. In particular, the Licensee submits that the Cable Failure and the consequential costs were not reasonably foreseeable at tender due diligence or at financial close when the revenue calculations were fixed.

11. Pursuant to paragraph 17 of the Condition, on 18 August 2021 the Authority requested that the supporting evidence provided by the Licensee in the Notice be supplemented with additional information to enable the Authority to assess whether an IAE had occurred in respect of the Cable Failure and the amount of any change in costs and/or expenses caused by the Cable Failure. The Licensee responded to this request on 17 September 2021. The Licensee additionally provided further information on:

- i. 4 November 2021;
- ii. 9 November 2021;
- iii. 24 November 2021;
- iv. 6 January 2022;
- v. 4 March 2022;
- vi. 8 April 2022;
- vii. 29 April 2022;
- viii. 12 May 2022;
- ix. 24 May 2022;
- x. 29 & 30 October 2022, and
- xi. 3 November 2022.

### **Publication of the Notice and consultation**

12. Paragraph 19 of the Condition requires the Authority to publish the Notice, excluding any confidential information, following its receipt. Paragraph 21 of the Condition requires that the Authority consult with the Licensee and such other persons as it considers desirable before making its determination.

13. The Licensee considered that the details of the Cable Failure and certain commercial arrangements should be kept confidential because it might seriously prejudice its ability to recover incurred costs from other parties, and that this could affect the size of the claims.

14. Under paragraph 20 of the Condition, the Authority has the discretion to determine the confidentiality of information in the Notice by balancing the need for disclosure to enable relevant parties fully to assess the Cable Failure against the risk of seriously prejudicing the interests of a person to which it relates. In the specific circumstances of the Cable

Failure, the Authority agreed that the publication of certain information about it and related commercial arrangements might seriously prejudice the interests of the Licensee in respect of its commercial discussions and therefore redacted that information. The Authority published the redacted Notice on 3 August 2021.<sup>3</sup>

15. In accordance with paragraph 21 of the Condition, the Authority consulted with the Licensee in relation to the Minded-to determination (**MTD**).<sup>4</sup> The Licensee submitted representations on 4 March 2022, with further clarifications submitted on 8 April 2022, 29 April 2022, 24 May 2022 27 July 2022, and 16 January 2023. The Licensee restated its representation of 16 January 23 in an email dated 6 April 2023.

16. The Authority also consulted with the developer of the wind farm, Gwynt y Môr Offshore Wind Farm Limited (the **Developer**), as it was responsible for the construction of the transmission assets.<sup>5</sup> Having sought an extension to the response date, which was granted, the Developer submitted representations on 15 March 2022.

17. Based on the facts and circumstances of this Cable Failure, the Authority does not consider it desirable to consult with any other party before making its determination. This is on the basis that the fact-specific nature of the claim limited the likelihood that any other party would have any additional information in this case that might be relevant to our determination on whether an IAE had occurred and, if so, the proposed level of adjustment.

### **Income Adjusting Event**

18. Paragraph 15 of the Condition defines what constitutes an IAE, as follows:

*An income adjusting event in relevant year  $t$  may arise from any of the following:*

- a) an event or circumstance constituting Force Majeure;*
- b) an event or circumstance resulting from an amendment to the STC not allowed for when allowed transmission owner revenues of the Licensee were determined for the relevant year  $t$ ; and*
- c) an event or circumstance other than listed above which, in the opinion of the Authority, is an income adjusting event and is approved by it as such in accordance with paragraph 21 of this licence condition,*

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<sup>3</sup> Notice available at [Publication of notice of an Income Adjusting Event from Gwynt y Môr OFTO plc | Ofgem](#)

<sup>4</sup> A Minded-to decision was sent to the Licensee on 24 January 2022.

<sup>5</sup> A copy of the Minded-to decision was sent to the developer on 24 January 2022.

*where the event or circumstance has, for relevant year t, increased or decreased costs and/or expenses by more than £1,000,000 (the "threshold amount").*

19. As noted in paragraph 10 above, the Licensee claims that the Cable Failure is an IAE pursuant to sub-paragraph 15(c) of the Condition (**Limb (c)**). In its email of 30 June 2021, the Licensee confirmed that *"the IAE claim is being made under limb (c), not limb (a), as such the OFTO will not be providing evidence to support a claim under limb (a)"*.

20. Under Limb (c), the Authority may approve any other event or circumstance not covered by sub-paragraphs 15(a) and (b) which, in the opinion of the Authority, is an IAE. The Condition does not expressly set out any particular qualifying criteria for determining whether an event constitutes an IAE under this limb. In our determination on an IAE claim from Blue Transmission London Array Limited dated 27 October 2016<sup>6</sup> (the **BTLAL Determination**), we set out our approach for assessing claims under Limb (c) (see, in particular, pp. 4-6 of the BTLAL Determination).

### **Limb (c) of the Condition**

21. In assessing whether an event or circumstance is an IAE under Limb (c), we have considered, consistent with the BTLAL Determination, whether it is appropriate for the Licensee to manage the risk of the event. To determine this, we have considered the extent to which the Licensee was, or should have been, in a position to foresee the event or circumstances and the level of control it had to mitigate the impact of such event.

22. We considered the following factors:

- a) whether the Licensee knew of the event or circumstance before it arose or ought to have known of it;
- b) whether the risk of damage of that type was reasonably foreseeable (even if the particular way in which the damage has occurred may not have been);
- c) whether there are nevertheless exceptional factors in the relevant case that mean that the event or circumstance, or its consequences, could not have been reasonably foreseeable; and
- d) the ability of the Licensee to manage the risk or impact by putting in place and pursuing risk management arrangements such as insurance, commercial recourse against third parties and/or operating practices.

23. As noted in the BTLAL Determination, we consider that such an approach is consistent with the overarching design of the OFTO regime and with the Authority's statutory duties,

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<sup>6</sup> [https://www.ofgem.gov.uk/system/files/docs/2016/10/btlal\\_iae\\_determination\\_final.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/10/btlal_iae_determination_final.pdf)

in particular its principal objective to protect the interests of existing and future consumers in relation to electricity conveyed by transmission systems.<sup>7</sup> For example, we do not consider it to be in the interests of consumers to pass through those costs arising from a type of damage that was (or should have been) foreseeable to a bidder/OFTO, solely because the precise damage of that type that occurred was not foreseeable. Whilst we recognise that the charging regime will in part or whole allocate costs for IAEs to offshore windfarm developers, we refer to consumers bearing these costs in the sense that all costs passed through into network charges are ultimately borne by consumers through their energy payments.

24. We therefore consider it appropriate to adopt a narrower, rather than a broader, construction of Limb (c) in this regard. Such an approach also seeks to ensure that bidders are properly incentivised to conduct due diligence in respect of the assets, to put in place appropriate commercial arrangements prior to asset transfer and to pursue any relevant third parties who may be liable (such as developers, manufacturers, installers, and insurers). The OFTO regime facilitates commercial transactions for large-scale infrastructure investment. We consider that the OFTO is responsible for managing its investment including adopting what it considers are suitable risk management measures.

#### **Determination on whether the Cable Failure constitutes an IAE under Limb (c)**

25. The Authority determines that the Cable Failure constitutes an event or circumstance that is an IAE pursuant to Limb (c).<sup>8</sup> The reasons for this decision are as follows:

*a) Whether the Licensee knew of the event or circumstance before it arose or ought to have known of it*

26. We have considered the likely cause of the Cable Failure. In addition, and as the Licensee considers the claim should be determined to be an IAE under Limb (c) because the Cable Failure was 'Uninsurable', we have considered whether the Cable Failure was caused by a 'Latent Defect' (as defined in the Licence and reproduced at paragraph 49 of this document).

27. The Licensee submitted independent technical reports produced by RINA Tech UK Limited (the **RINA reports**) and Southampton Dielectric Consultants (the **SDC reports**) (the **Technical Reports**).

28. The first SDC report (prepared before the cable was recovered from the seabed and analysed by RINA) concluded "*it is very likely*" that the Cable Failure is "*associated with quality of the repair of a subsea cable joint in 2015 or as a result of disturbance to the*

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<sup>7</sup> Section 3A of the Electricity Act 1989.

<sup>8</sup> For the avoidance of doubt, the Authority also does not consider that the Event constitutes an IAE under sub-paragraph 15(b) of the Condition.

*cable when the jointed cable was returned to the seabed” that resulted in an increased induced voltage on the FOC, leading to a further break on the FOC; it was that further break that led to the Cable Failure. However, that report went on to provide that the facts can only be confirmed when the damaged cable is analysed. Later analysis of the damaged cable undertaken by RINA did not consider this to be a possible reason for the Cable Failure.<sup>9</sup>*

29. The RINA report analysed the damaged cable and concluded that the Cable Failure was likely caused by damage to the sheath of the spare fibre optic cable (**FOC**), which subsequently allowed water ingress leading to corrosion and resulting in the Cable Failure. The RINA report (May 2021) noted there were “*[a] large number of localised features ... observed on the polyethylene sheath of the spare FOC. Some of these features had breached the thickness of the sheath. The exact mechanism by which these features occurred is the subject of further investigation*” (p.2). One possible explanation was identified to be “*localised inconsistency in the conductivity of the [polyethylene] sheath*” (May 2021, p.48). Further investigation undertaken by SDC concluded “*There may have been inhomogeneities in the sheath material that gave rise to conductive spots such as agglomerations of carbon black*” (May 2020, pp.153). Further analysis by RINA in October 2021 demonstrated samples of the spare SSEC3 cable polyethylene sheath breaking down when voltage was applied in salt water. The report noted that “*there is sometimes a much more localised variation on a millimetre-by-millimetre scale. This would account for the localised heating and blistering*”.
30. On the basis of the Technical Reports, we accept that it is likely that electrical activity caused by inconsistent conductivity within the spare FOC led to a breach in the waterproofing abilities of the polyethylene (**PE**) sheath that in turn allowed water to penetrate into the metallic armour. This resulted in the armour corroding and further increasing resistance within the FOC. The increased resistance led to heat that melted the armour wires surrounding the FOC causing the electrical current to find an alternative path through the steel tube housing the fibres. Heating caused by the current flowing through the steel tube damaged both the steel tube and the plastic protective coating of the FOC, resulting in breaks in the FOC. The breaks in the FOC caused the induced current to flow through the power core lead sheath, which in turn damaged the power core insulation, which ultimately resulted in the Cable Failure. Based on the SDC reports, we consider inhomogeneities resulting from poor control of the mixing of semiconducting (**semicon**) material as a result of poor workmanship during the manufacturing process are most likely the primary reason for the inconsistent conductivity of the PE sheath, which ultimately led to water ingress and the failure of the power core failure.

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<sup>9</sup> Paragraph 150 to 155 of the SDC report refers.

31. In addition, the RINA report (May 2021, p.48):

- i. noted *"It is possible that a manufacture-related bubble which originally breached the majority of the sheath thickness could subsequently have developed during the life of the cable to breach the full thickness, for example either as a result of localised heating or mechanical effects such as movement during thermal cycling."*

Consistent with this analysis, we consider the manufacturing-related bubble could have contributed to or accelerated the Cable Failure, but on its own is unlikely to have caused the Cable Failure.

- ii. considered it *"highly unlikely that any path breaching the sheath was present from the time of manufacture"* and *"The extent of the degradation of the spare FOC sheath, and the extent of corrosion of the aluminium wire armour, suggests that the degradation had occurred over a prolonged period of months (rather than days or weeks), but less than multiple years. During much of this time the fibres would remain intact"*.

32. It is our view, supported by the SDC report, that the PE sheath had manufacturing imperfections (described in paragraph 30, above) that caused the PE sheath to break down over time. The time over which the issue would become apparent is related to the loading on the cable; higher loading would lead to higher induced voltage, that in turn leads to a higher current flowing across two points that leads to higher thermal degradation thus damage to the sheath of the spare fibre optic cable, allowing water ingress.

33. Therefore, on the basis of our assessment of the evidence, we conclude that the Cable Failure most likely resulted from a defect in the cable sheath, reflecting a defect in material workmanship.

34. The Licensee states that it could not *"reasonably have known about the specific fault that arose in relation to the Cable Failure"* and considers that the Authority *"is able to draw the same conclusion for this IAE, as the cable failures on SSEC2<sup>10</sup> and SSEC3 have similar causes"*.

35. Overall, we are satisfied that the Licensee could not reasonably have known about the defect in the cable sheath and/or breaks on the spare FOC prior to asset transfer or their identification in January and/or February 2020. We understand the FOC break on the section of SSEC3 that ultimately failed on 15 October 2020 was not visible to the Licensee prior to the Cable Failure; indeed, notwithstanding the Licensee's monitoring, the FOC

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<sup>10</sup> [Link](#) to our decision that the failure of Subsea Export Cable 2 (SSEC2) was not an Income Adjusting Event.



break that led to the Cable Failure was only identified by a test undertaken fifteen minutes before the Cable Failure.

36. The Licensee had some visibility of the circumstances leading to the Cable Failure before it arose. We consider that, if the Licensee was able to mitigate that risk (considered further below), this would be a factor weighing against the Cable Failure being found to be an IAE under Limb (c). We are content that the Licensee did not know of the event or circumstances leading to the Cable Failure at the time that the offshore transmission assets were transferred to it, nor ought to have known of them; this is a factor, in the context of a latent defect, weighing in favour of the Cable Failure being found to be an IAE under Limb (c).

### Representations

37. In its representations, the Developer:

- i. stated that the information disclosed to it under a Freedom of Information Act request *"does not support the assumption that the flaws leading to failure of the cable were defective work in the construction or at the time of installation"*; and
- ii. notes the comments in the RINA report that the *"flaw only evolved over several months not years"* and *"corrosion leading to the fault must have occurred some years after the OFTO took control and ownership of the asset"* and so concludes there was no indication that there was a fault present at time of manufacture.

38. The Developer noted that it had not had full sight of the underlying technical reports at the time of its representations. We understand the Licensee has since provided the Developer with copies of the relevant technical reports, in response to a request by the Developer.

39. We do not agree with the Developer's analysis. We set out our view as to the cause of the failure in the paragraphs above, which takes into consideration the information provided in the independent Technical Reports, including the information highlighted by the Developer. In particular, we consider the Developer is incorrect to conclude that, because the degradation or 'path' in the Cable was not present at the time of manufacture, that rules out a defect in the Cable (including its material workmanship); we have concluded to the contrary for the reasons set out above.

### *b) Whether the risk of damage of that type was reasonably foreseeable*

40. The Licensee notes the statement at paragraphs 71 to 73 of the SSEC2 Determination, where *"the Authority reconfirmed its view that latent defects should be anticipated by the*

*Licensee and are therefore reasonably foreseeable [...] and the Licensee anticipates that the Authority will draw the same conclusion in determining this IAE claim".* The Authority considers that risks arising from defects in the construction of the transmission assets are reasonably foreseeable risks associated with operating the assets over the 20-year revenue period. The Licensee has not provided any information that would cause us to reconsider our position in the particular circumstances of this case.

#### Representations

41. Neither the Licensee nor the Developer made any representations in respect of this factor.

*c) Whether there are exceptional factors in the relevant case that mean that the event or circumstance, or its consequences, could not have been reasonably foreseeable*

42. The Licensee considers the fact *"that multiple fibre optic cable (FOC) breaks have occurred over a five km length of SSEC3 over a period of at least 10 months prior to the Cable Failure"* means the event is exceptional.

43. We do not consider that the fact of numerous FOC breaks renders the case exceptional in terms of assessing reasonable foreseeability in respect of this claim; in particular, the Cable Failure that is subject to this claim was caused by a single FOC failure, not the multiple FOC failures the Licensee refers to. We do not consider the failure of the FOC leading to the Cable Failure as exceptional.

44. In summary, we do not consider that there are exceptional factors relating to the Cable Failure that mean that it or its consequences should be treated as being not reasonably foreseeable. Together with the preceding factor, reasonable foreseeability is a factor weighing against the Cable Failure being found to be an IAE under Limb (c).

#### Representations

45. Neither the Licensee nor the Developer made any representations in respect of this factor.

*d) The ability of the OFTO to manage the risk or impact by putting in place and pursuing risk management arrangements such as insurance, commercial recourse against third parties and/or operating practices*

46. Similar to any other transaction involving a purchase of assets, a licensee should enter into such transactions with the awareness that it is assuming any risks arising from damage or defects that it has not been able to discover through its due diligence. The

OFTO regime was not designed to insulate licensees from all such risks.<sup>11</sup> Even if a licensee believes, having conducted a reasonable level of due diligence, that the construction of the assets had been undertaken properly and to the level of reasonable skill and care expected, we do not consider it appropriate for the licensee generally to be able to pass on the risks arising from defective work in the construction of the assets to consumers.

47. As outlined above, we consider that risks arising from defects in the construction of the transmission assets are reasonably foreseeable risks associated with operating the assets over the 20-year revenue period. We consider that failure of the cable arising from a Latent Defect is the type of risk that is reasonably foreseeable to a licensee and should be within its contemplation when it submits tenders under the generator build regime, however such defect may materialise.

48. We therefore expect licensees to pursue third parties for remedies in respect of their negligent or substandard work and to put in place other commercial arrangements and risk management practices to ensure they can bear the consequences of such risks in the event there may not be any such recourse.

### Insurance<sup>12</sup>

49. One important aspect of the fourth factor in the BTLAL Determination is the ability of a licensee to protect itself through insurance. We expect licensees to put in place appropriate insurance arrangements to manage risks and satisfy themselves that the insurance cover is suitable for their needs.

50. On 17 November 2020, the Condition was modified<sup>13</sup> to provide clarity regarding the Authority's approach to quantification of IAEs where the effects of a latent defect are found to be 'uninsurable'. 'Uninsurable' means that "*the Authority determines either that:*

- i. Insurance is not available to the licensee in respect of all or part of its Transmission Assets in the Worldwide Offshore Transmission Asset Insurance Market with reputable insurers of good standing in respect of a Risk; or*

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<sup>11</sup> The framework for the OFTO regime also reflects this through the STC which deems the OFTO, for the purpose of the STC, to have been the party that developed the transmission assets from the point of asset transfer (paragraph 6.3 of Section G).

<sup>12</sup> Please see SSEC3 IAE claim Section C - Extent of Insurance Cover and evidence of uninsurability of the [Notice](#) (redacted) published on 3 August 2021 for more information.

<sup>13</sup> [Link](#) to modification Notice and Schedule dated 17 November 2020. Please refer to amended standard condition E12-J1 of the Licence.

- ii. *the Insurance premium payable for insuring that Risk is at such a level that the Risk is deemed as not being insurable in the Worldwide Offshore Transmission Asset Insurance Market with reputable insurers of good standing”.*

Where (amongst other definitions):

- i. *“Risk” means the “physical loss or damage requiring replacement or rectification of Transmission Assets, which is caused by a Latent Defect resulting from material workmanship design plan or specification”;*
- ii. *“Insurance” means the “indemnity which would normally be covered by an Operational All Risk insurance policy with a LEG 3/06 exclusion, or equivalent, which includes indemnity for the full cost of replacement or rectification of the Offshore Transmission Assets (but not improvement) rendered necessary by damage which is the consequence of a Latent Defect”, and*
- iii. *“Latent Defect” means “a flaw in Offshore Transmission Assets, which:*
  - a. *is an actual defect in material workmanship design plan or specification, not the damage resulting from the defect; and*
  - b. *existed but which would not have been apparent to an efficient licensee in the position of the licensee at the time the Offshore Transmission Assets were transferred to it”.*

51. The Licensee considers the claim should be determined to be an IAE under limb (c) because the Cable Failure was ‘Uninsurable’, as defined above.

52. On 15 October 2018, the Licensee secured coverage with a standard exclusion (LEG 3/96) for defects in material workmanship, design, plan and specification, with coverage for resultant physical damage (**LEG 3**). We are content that LEG 3/96 cover is materially equivalent to or better than LEG 3/06 cover, as referred to in the definition of Uninsurable. The insurance policy also excluded loss or damage to the export cables arising directly or indirectly from the same root causes which gave rise to cable failures in 2015 (the **2015 Root Cause Exclusion**). The 2015 Root Cause Exclusion was added to the Licensee’s insurance policy as a result of two cable failures in 2015.<sup>14</sup>

53. On 15 October 2019, the Licensee renewed its insurance policy. On 21 February 2020, the Licensee *“notified its insurers, via its broker, that all fibres in SSEC3 had been reported as broken”* and its *“Insurers responded by reminding the OFTO [of] the policy exclusion for damage to export cables from failures with the same root cause as the*

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<sup>14</sup> The exclusion excluded cover for “loss or damage to the export cables arising directly or indirectly from the same root causes which gave rise to the following cable failures: (1) SSEC1 – (Date of loss 2 March 2015) – Root cause as confirmed by Edif ERA report dated October 2015. (2) SSEC2 – (Date of loss 25 September 2015) – Root cause as confirmed by Edif ERA report dated May 2016”.

*SSEC1 and SSEC2 claims (both in 2015)” and “Insurers have indicated to the Licensee’s insurance broker that they would want to know the ‘root cause’ of the failure before agreeing to fund a repair”.*

54. At renewal on 15 October 2020, [redacted].

55. We note that the Licensee discussed renewal placement with a total of 35 insurers (listed at paragraph C2.33 of the Notice) prior to renewal on 15 October 2020. Those insurers that declined to offer terms did so because they:

- i. were not active in the OFTO insurance market;
- ii. were selective about the OFTOs they would insure; and/or
- iii. had concerns about cable issues.

56. We have considered whether the Licensee’s approach to renewal in 2020 satisfies us that the relevant latent defect risk leading to the Cable Failure was Uninsurable. In particular, we sought expert advice as to whether the conditions in the definition of Uninsurable (reproduced at paragraph 49 (above)) had been met. Our expert advisers stated that it is more probable than not (i) that the OFTO would not have been able to obtain LEG03/06 coverage (or equivalent) as per the expiring policy for 100% of the placement, and the majority of insurers would not be willing to offer LEG03/06 (or equivalent) on economic terms; and (ii) any provision of LEG03/06 without the 2015 Root Cause Exclusion would not have been on commercially viable terms.

57. Our expert insurance advisers suggested Ofgem seek evidence that the Licensee took all reasonable steps to secure LEG 3 (or equivalent) coverage at renewal, including that the Licensee started the process to seek insurance renewal as early as possible. Our experts were of the view that *“planning for the renewal should start 3 to 6 months from renewal with a structured marketing plan being presented to the OFTO, agreed and then implemented”*. The Licensee has demonstrated to our satisfaction that it began the process to secure insurance cover in sufficient time: on 2 October 2020 and in conversations with Ofgem prior to the event occurring, the Licensee confirmed *“it had been working closely with its insurance broker, since June 2020 to arrange renewal of the OFTO’s property damage insurance [...] due to expire on 14 October 2020”*.

58. On 9 November 2021, the Licensee confirmed those insurers that were providing LEG 3 cover (the **Insurers**) had communicated their preliminary decision to decline cover for the Cable Failure in reliance on the 2015 Root Cause Exclusion. The Insurers considered

the event was excluded as the chain of events that followed the water ingress were the same as the chain of events that led to the 2015 failure events.<sup>15</sup>

59. We have considered whether the proximate causes of the Cable Failure were the “*same root causes which gave rise to cable failures in 2015*” (as defined in the 2015 Root Cause Exclusion). We are satisfied on the balance of probabilities, on the basis of the information provided by the Licensee and our own analysis following receipt of expert insurance advice, that the Cable Failure fell to be excluded pursuant to the 2015 Root Cause Exclusion, given the common existence of a latent defect (being a *defect in material workmanship*) on SSEC3 and SSEC2 that led to water ingress through breach(es) of the polyethylene sheaths of the FOCs in each cable, which led to the same chain of events that ultimately resulted in the failure of the power cores in each cable.

60. In light of the analysis undertaken by our insurance experts based on the information provided by the Licensee, we consider that the Licensee has demonstrated that insurance (defined in the Licence as “*Operational All Risk insurance policy with a LEG 3/06 exclusion, or equivalent*”) was not available for the Cable Failure at the relevant time, either because LEG 3 insurance could not be secured, or because the Cable Failure was specifically excluded from insurance cover as a result of general exclusions (listed at paragraph 53) or the specific ‘2015 Root Cause Exclusion’ on all LEG 3 policies that Licensee had been able to place (noting that the Licensee accepted all offers of cover it received except one where the insurer excluded cover for the offshore transmission cables completely; no offers were refused based on price).

61. We conclude that the Licensee was unable to manage the risk or impact – which we have concluded in section (a) above is a Latent Defect – by putting in place insurance, i.e. the event was ‘Uninsurable’, as defined in the Licence and reproduced at paragraph 49, above.

#### Representations

62. In its representations, the Developer considered that the Authority had made an error in the MTD, and it was “*highly questionable*” that there was no insurance cover due to the 2015 Root Cause Exclusion. We note the Licensee’s insurance arrangements are commercially confidential and thus the Developer did not have full sight of the details of those arrangements. We have set out the Licensee’s insurance arrangements in sufficient detail above to support our conclusion that the Licensee was unable to manage the risk or impact by putting in place insurance, i.e. the event was ‘Uninsurable’, as defined in the Licence.

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<sup>15</sup> [Link](#) to SSEC1 IAE decision. [Link](#) to SSEC2 IAE decision.

63. The Developer was also of the view that “*the cause of the failure to SSEC3 was a very different type of fault from previous failures on the Licensee’s offshore transmission system i.e. SSEC1 and SSEC2 failures which are the subject of previous decisions*”. We disagree with the Developer’s view, for the reasons set out above.

#### Other risk management arrangements

64. Under the fourth factor in the BTLAL Determination, insurance is not the only relevant risk management arrangement to be considered by the Authority. We have also considered the ability of the Licensee to manage the risk or impact by putting in place and pursuing other risk management arrangements such as commercial recourse against third parties and/or operating practices.

65. We note all construction warranties have expired. The Licensee confirmed it does not have any route of recourse to the Developer.<sup>16</sup> We conclude there are no other reasonable commercial arrangements available that allow the Licensee to recover its costs.

### **Conclusion**

66. In summary, we consider that the general risk of damage of the type that occurred from the Cable Failure was reasonably foreseeable. However, against that factor, we note that the Cable Failure itself was the product of a Latent Defect, and the Licensee therefore did not know, nor ought to have known, of the defect at the time the assets were transferred to it. Importantly, we are satisfied that the Licensee did not have the opportunity to manage the risk or impact of the Cable Failure, in particular because of the actual or effective unavailability of insurance for the Cable Failure. Applying the weight we consider appropriate to those separate factors, we consider that it is not appropriate to require the Licensee to manage the risk of the event; we therefore consider the event is an IAE under Limb (c).

### **Allowed income adjustment (IAT<sub>t</sub>)**

67. Paragraph 21 of the Condition requires that the Authority determine (after consultation with the Licensee and such other persons as it considers desirable):

- i. whether any or all of the costs and/or expenses given in the Notice were caused or saved by an income adjusting event;

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<sup>16</sup> Please see paragraph A2.2(d)(i) of the [Notice](#).

- ii. whether the event or circumstance has increased or decreased the costs and/or expenses given in the Notice by more than the threshold amount;

*(i) whether any or all of the costs and/or expenses given in the Notice were caused or saved by an income adjusting event*

68. As noted above, the Notice sets out that there has been an overall change to the costs and expenses of the Licensee of £14,951,912.29 as a result of the Cable Failure. On 4 November 2021, the Licensee submitted revised cost information and confirmed the overall change to the costs and expenses of the Licensee as £14,928,357.40.

69. Costs totalling £552,511 representing costs that do not relate to this IAE, including costs relating to replacement cable not required to undertake the repair are deducted from the total awarded.<sup>17</sup>

70. In addition, and pursuant to paragraph 21(c)(i) of the Condition, given that the Income Adjusting Event has been found above to relate to an Uninsurable Event or circumstance, three million pounds (£3 million) is deducted from the final adjustment.<sup>18</sup>

71. We have provided the Licensee with a separate detailed breakdown of the costs granted and deducted as described above.

### Representations

72. In January 2022, the Authority set out its position (in the MTD) that it was minded-to deduct costs totalling £241,920.85 relating to internal staff costs incurred under a professional services agreement. This agreement sets out charges for people resources that were provided for additional services above and beyond the delivery of the Licensee's day-to-day obligations. The Licensee considers that the Cable Failure is an abnormal event and therefore providing additional services to resolve the cable failure is an additional service.

73. On 4 March 2022 the Licensee objected to our approach to the internal staff costs in its representations in response to the MTD. The Licensee submitted further representations on 16 January 2023, and restated those representations on 6 April 2023.

74. We reviewed the further representations the Licensee restated on 6 April 2023, against the Condition and our Decision on Income Adjusting Events dated 28 November 2018

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<sup>17</sup> This figure has changed from the minded-to determination to correct an error – Ofgem incorrectly allocated replacement cable costs relating to this repair to a future repair.

<sup>18</sup> Being the amount of the insurance deductible set out in the invitation to tender questionnaire submitted in respect of this licence pursuant to the tender regulations.



(the 2018 Guidance)<sup>19</sup>. Following this review, we concluded these costs should be awarded pursuant to paragraph 21c)(i) of the Condition which states "*ensures that the financial position and performance of the licensee are, insofar as is reasonably practicable, the same as if that income adjusting event had not taken place,*" and consistent with paragraph 3.13 of the 2018 Guidance, which states "*the policy puts the Licensee in the position it would have been in had it taken out comprehensive insurance cover and its insurance remained in place*".

75. It is our view that the Licensee would not have incurred these additional staff costs had the IAE not occurred, and therefore that the costs should be awarded.

*(ii) whether the event or circumstance has increased or decreased the costs and/or expenses given in the Notice by more than the threshold amount*

76. We confirm the costs incurred as a result of an IAE exceed the threshold amount of £1,000,000 in each relevant financial year.

77. This letter constitutes the Authority's determination in relation to the Notice for the purposes of paragraph 23 of the Condition.

78. Please contact [yvonne.naughton@ofgem.gov.uk](mailto:yvonne.naughton@ofgem.gov.uk) if you have any questions about this determination.

Yours sincerely,

**Stuart Borland**  
**Deputy Director, Offshore Network Regulation**

**For and on behalf of the Gas and Electricity Markets Authority**

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<sup>19</sup> [Income Adjusting Events policy in Offshore Transmission Owner Licences | Ofgem](#)