

All offshore transmission owners,
preferred bidders, qualifying
bidders and other interested
parties

Email: offshorelicensing@ofgem.gov.uk

Date: 4 January 2024

Dear Colleague,

Update to open letter on the Authority's approach towards Exceptional Events for offshore transmission owners

In October 2014, we¹ published guidance on the Authority's approach towards exceptional events for Offshore Transmission Owners (**OFTO**).²

The October 2014 open letter outlined the general approach that the Authority expected to take towards the evaluation of Exceptional Event claims under the OFTO licence. As a number of such claims have been assessed by the Authority since October 2014, we are publishing this update to the Open Letter in order to provide further clarity to OFTOs and other interested parties. The content of this update reflects the decisions on Exceptional Event claims taken to date by the Authority.

The approach outlined in this letter applies specifically to holders of an offshore electricity transmission licence and does not constitute a general policy position across all transmission licences. It details our current approach. We will continue to review our approach in the future and will issue revised guidance should it be necessary to do so.

Background - the OFTO Availability Incentive

The availability incentive, under amended standard condition E12-J4 of the offshore transmission licence, adjusts the OFTO's revenue depending on performance. It also places obligations on the OFTO to maintain the assets in line with Good Industry Practice.³ The revenue adjustment is based on an OFTO's performance against a 98% availability target: it rewards OFTOs by up to 5% of annual revenue if they exceed the annual availability target, and penalises them by up to 10% of annual revenue if they fall below it.

¹ The Gas and Electricity Markets Authority (the 'Authority'). In this letter the terms, 'Authority', 'Ofgem', 'we' and 'us' are used interchangeably.

² Published on our website at: <https://www.ofgem.gov.uk/publications-and-updates/open-letter-authority%E2%80%99s-approach-towards-exceptional-events-offshore-transmission-owners>.

³ Good Industry Practice is defined as: 'in relation to any undertaking and any circumstances, the exercise of that degree of skill, diligence, prudence and foresight which would reasonably and ordinarily be expected from a skilled and experienced operator engaged in the same type of undertaking under the same or similar circumstances.'

The incentive contains mechanisms to allow OFTOs relief from financial losses under certain circumstances:

- events on the offshore generator's system that may impact the OFTO. There are four generic exclusions from the incentive, which are consistent with onshore transmission licences;
- the occurrence of project-specific events, if relevant. At its discretion, the Authority may include bespoke project-specific exclusions from the incentive. These have been added to some offshore transmission licences granted to date; and
- the occurrence of an exceptional event. If the Authority is satisfied an event or circumstance has occurred that is beyond the reasonable control of the OFTO, which results in or causes a transmission service reduction, the impact of the event may be excluded from incentive calculations.

These relief mechanisms recognise that an OFTO should only be expected to manage or mitigate risks that are within its reasonable control and not to mitigate, or attempt to mitigate, all operational risks. During the operational phase, the mechanism incentivises OFTOs to take efficient measures to maintain system availability. It also allows for efficient bids during the tender phase that reflect this allocation of risks.

Recourse under the above licence mechanisms should not be seen as a replacement for the requirement for OFTOs to manage all risks within their reasonable control throughout the 20-year revenue term.

This letter outlines the Authority's approach towards three aspects of our evaluation of exceptional events:

- the definition of 'event' in relation to exceptional events;
- how we determine what events are exceptional; and
- how we decide the level of any adjustment to make to the OFTO's reported system performance.

Definition of 'event' in relation to exceptional events

In considering whether an exceptional event has occurred, the Authority will consider the circumstances around two 'events'. The 'trigger event' is the event, or series of actions, occurrences or developments, that led to the 'failure event' resulting in a transmission service reduction.

- the trigger event is, in effect, all the relevant triggers and contributory factors to any automatic or manual procedure to switch out transmission equipment. There may be a number of triggers and contributory factors that result in, cause or contribute to the Transmission Service Reduction. In determining whether an Exceptional Event has occurred, the Authority will consider the circumstances or series of actions, occurrences or developments, that led to the Transmission Service Reduction i.e. all of the relevant contributory factors that led to, resulted in, caused or contributed to the Transmission Service Reduction. They may be associated with a wide time window, depending on what has occurred.
- the failure event would be the operation of automatic protection systems or a manual procedure to switch out certain transmission equipment such as the cable, a transformer, or a busbar in the substation. This would normally be associated with a specific, narrow time window. The failure event is the event within 14 days

of which the OFTO is required to notify the Authority under paragraph 9(b) of amended standard condition E12-J4⁴.

What events are exceptional?

In determining whether an exceptional event has occurred the Authority will consider the relevant facts and circumstances at the time.

The licence defines several relevant triggers and contributory factors that are considered to be beyond an OFTO's reasonable control:

“an act of God, an act of the public enemy, war declared or undeclared, threat of war, terrorist act, blockade, revolution, riot, insurrection, civil commotion, public demonstration, sabotage, act of vandalism, fire (not related to weather), governmental restraint, Act of Parliament, other legislation, bye law or directive (not being any order, regulation or direction under section 32, 33, 34 and 35 of the Act) or decision of a Court of competent authority or the European Commission or any other body having jurisdiction over the activities of the licensee provided that lack of funds shall not be interpreted as a cause beyond the reasonable control of the licensee. For the avoidance of doubt, weather conditions which are reasonably expected to occur at the location of the event or circumstance are not considered to be beyond the reasonable control of the licensee.”

This list of events is 'without limitation' and the Authority has the discretion to consider any other 'event or circumstance that is beyond the reasonable control of the OFTO. Broadly the Authority will consider two key questions when determining whether such an event was beyond an OFTO's reasonable control:

- **Whether it was reasonable for an OFTO to know about all the relevant triggers or contributory factors for an event.** We consider that the OFTO's knowledge of any relevant triggers or contributory factors will affect whether the OFTO was in a position to take action that would ultimately prevent a transmission service reduction. We will consider not only whether an OFTO *did* know of any such factors, but also whether it is *reasonable* for an OFTO to have known.
- **Whether it was reasonable for an OFTO to control or change some or all of these relevant triggers.** If the OFTO knew, or should have known the relevant triggers or contributory factors, we need to establish whether it is reasonable for an OFTO to have taken action in respect of any of these and ultimately prevent the transmission service reduction from occurring. For an event to be beyond an OFTO's reasonable control the OFTO must demonstrate that its actions or inactions (including those of its agents, employees, contractors etc. working on its behalf) in respect of the trigger event did not materially contribute to the failure event.

Normal operational risk

As per previous exceptional event decisions issued by the Authority, it is the clear policy intent of the offshore regime that the OFTO assumes normal operational risk of the transferred assets at licence grant. Accordingly, when a licensee takes on responsibility for its OFTO assets, it is responsible for (1) operating the asset from the point of asset transfer, (2) maintaining the asset, and (3) managing the normal risks arising from owning, operating and maintaining the asset.

A mere fault or failure of apparatus is not listed in the definition of an Exceptional Event as an example of an event which is to be treated as beyond the reasonable control of the OFTO. Further, it is not an event which is commensurate with the examples of exceptional events that are listed in the definition. The fact that assets may be the subject of occasional

⁴ Paragraph 10 (b) of E12-J4 for Tender Round 1 licences

failure is part and parcel of the normal operational risk assumed by the OFTO at asset transfer.

Ofgem must be satisfied on the basis of the available evidence that an event was exceptional. An event or circumstance that was not expected by a Licensee is not in of itself an event or circumstance that is exceptional. Categories of risk may be reasonably foreseeable, even if the specific fault was not expected.

Adjustment to reported system incentive performance

If we determine that an event or circumstance was beyond an OFTO's reasonable control, we will direct the level of adjustment to an OFTO's incentivised performance (i.e. annual availability) that we consider appropriate. This direction is based on the extent to which we are satisfied that the OFTO has taken reasonable steps, consistent with Good Industry Practice, to manage the impact of the event on the availability of services (both in anticipation of the event and after the event has occurred). Our focus is therefore on the impact of the transmission service reduction and whether the OFTO did everything it could to manage the reduction in all the circumstances.

In considering whether the OFTO acted in accordance with Good Industry Practice we will take into account whether its actions were reasonable, proportionate and efficient in the specific circumstances surrounding the restoration of transmission services. Where relevant, we will draw on industry norms and benchmarks. To inform our analysis we may engage external (e.g. technical) expertise if required.

The level of adjustment the Authority directs will be in Megawatt Hours (MWh), as an OFTO's annual availability is measured in MWh. However, our adjustment will financially impact the OFTO through the incentive mechanism discussed above. There may be circumstances where the Authority would expect the OFTO to have in place insurance or commercial agreements to mitigate the financial impact of any transmission service reduction. In such circumstances we may, subject to the facts at the time, take these commercial arrangements, or their absence, into account when directing any adjustment to the availability incentive.

For the avoidance of doubt, the existence of any such commercial arrangements will not in itself prevent the Authority from evaluating any event notified to us by a OFTO as an exceptional event.

Our information requirements for evaluation

Based on the above, we require an OFTO to provide us with all relevant information under paragraph 9(c) of amended standard condition E12-J4.⁵ As a minimum we expect that an OFTO should:

- explain:
 - the immediate cause of the transmission service reduction;
 - all the relevant triggers and contributory factors (i.e. the trigger event), and
 - the degree of control the OFTO had over the event (i.e. to justify why an event was beyond its reasonable control).
- explain the steps it took to restore availability, including the timescales and resources deployed during this period.

⁵ Paragraph 10 (c) of E12-J4 for Tender Round 1 licences.

- provide details of any relevant insurance or commercial arrangements available to it.

The Authority will determine on a case by case basis what additional information, if any, we require for our evaluation. If an OFTO does not provide information requested by the Authority, this will be taken into account as part of our evaluation of any exceptional events notified. The Authority will review all information received from OFTOs in respect of any exceptional event notified by OFTOs in light of all relevant circumstances at the time.

Should you have any questions please do not hesitate to contact us at offshorelicensing@ofgem.gov.uk

Yours faithfully,

Yvonne Naughton
Head of OFTO Licensing and Compliance