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Our ref: GyMIAE2021/22SSEC3/Stage2repair
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Date: 19 March 2024

Dear Mr. Rooke,

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

1. On 24 June 2022 and 16 March 2023, the Authority received notices (the “**First Notice**” and “**Second Notice**” respectively, together the “**Notices**”) 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 claims and has determined that the event or circumstance set out in the Notices 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 £1,415,258.29. In relation to the relevant year 2021/22, the allowed income adjustment (IAT_t) shall be £3,825,797.94. In relation to the relevant year 2022/23, the allowed income adjustment (IAT_t) shall be £10,308,457.01. These costs are awarded in addition to the costs awarded in the determination dated 6 July 2023 (the “**July 2023 determination**”).¹
3. In this letter, we also describe the details of the event set out in the Notices, provide a summary of the IAE provisions and describe the process we have followed to reach the

¹ [Gwynt y Mor OFTO plc – determination under paragraph 23 of Amended Standard Condition E12-J3 | Ofgem](#)

Authority's determination and discuss representations made by both the Licensee and Gwynt y Môr Offshore Wind Farm Limited.

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 Notices 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 Notices gave details 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 assess fully the event to which the Notice relates.
6. The Licensee first became aware of breaks in the Fibre Optic Cable ("**FOC**") in Subsea Export Circuit 3 ("**SSEC3**") in January 2020. The Licensee monitored the FOC for further signs of failure. A number of breaks in the FOC developed between January 2020 and 15 October 2020, when SSEC3 failed (the "**Cable Failure**"). FOC breaks continued to develop on SSEC3, the latest being discovered in February and April 2022.
7. The Licensee repaired the Cable Failure and restored transmission services, at reduced capacity (the "**service cap**"), on 7 March 2021. On 6 July 2023, Ofgem determined that the latent defect leading to the Cable Failure constituted an IAE (the "**July 2023 determination**").
8. The Licensee applied the service cap, as it was concerned that restoration of transmission services at full capacity would cause a further cable failure, resulting from the known FOC breaks on SSEC3.
9. A further repair was undertaken between 9 June 2022 and 13 July 2022 to remove the remaining known FOC breaks and restore transmission services to full capacity (the "**Stage 2 Repair**").

10. The Notices relate to costs and expenses:

- i. relevant to the Cable Failure but not included in the July 2023 determination, totalling £419,883.56, and
- ii. incurred as a result of the need to repair the remaining FOC breaks caused by the defect in SSEC3 and restore transmission services to full capacity (the "**Stage 2 Repair costs**"), totalling £15,129,629.68.

The Notices set out that there has been an overall change to the costs and expenses of the Licensee of £15,549,513.24.

11. The Licensee considers that the event or circumstance necessitating the Stage 2 Repair is an IAE pursuant to sub-paragraph 15(c) of the Condition. The Licensee considers that the need for the Stage 2 Repair and the consequential costs were not reasonably foreseeable at tender due diligence or at financial close when the revenue calculations were fixed, and that the costs of doing so were not insurable.

12. Pursuant to paragraph 17 of the Condition, and as requested by the Authority, the Licensee provided further information on 25 November 2022, 9 January 2023, 16 February 2023, 9 June 2023, 29 August 2023 and 22 December 2023.

Publication of the Notice and consultation

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

14. The Licensee considered that the details of the Stage 2 Repair 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.

15. 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 to fully assess the Stage 2 Repair against the risk of seriously prejudicing the interests of a person to which it relates. In the specific circumstances of the Stage 2 Repair, 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 First Notice on 25 November 2022² and the Second Notice on 25 April 2023.³

16. In accordance with paragraph 21 of the Condition, the Authority consulted with the Licensee in relation to the Minded-to determination (**MTD**).⁴ The Licensee submitted representations on 26 February 2024. The Licensee “*did not consider it needs to make any representations on the minded to decision*” but its “*approach would change if Ofgem’s decision changed materially because of any representations from the Developer*”.
17. The Authority also consulted with the developer of the wind farm, Gwynt y Môr Offshore Wind Farm Limited (the “**Developer**”), on various aspects of this determination, as we consider it may have representations to make that are relevant to this determination. The Developer submitted representations on 8 March 2024.
18. Based on the facts and circumstances of this Stage 2 Repair, the Authority did 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 limits the likelihood that any other party would be impacted by our determination or have any additional information in this case that might be relevant to our determination on whether any or all of the costs and/or expenses given in the notices were caused by an income adjusting event; and, if so, the proposed level of adjustment.

Income Adjusting Event

19. 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,*

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”).

20. As noted in paragraph 9 above, the Licensee claims that the event or circumstance necessitating the Stage 2 Repair 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*

² Notice available at [Publication of notice of an Income Adjusting Event from Gwynt y Môr OFTO Limited | Ofgem](#).

³ Notice available at [Publication of notice of an Income Adjusting Event from Gwynt y Môr OFTO Limited | Ofgem](#)

⁴ A Minded-to-decision was sent to the Licensee on 23 February 2024.

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)".⁵

21. 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 2016⁶ (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

22. 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.

23. 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.

24. 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, in particular its principal objective to protect the interests of existing and future consumers in relation to electricity conveyed by transmission systems.⁷ For example, we do not consider it to be in the interests of consumers to pass through those costs arising

⁵ [Link](#) to modification Notice and Schedule dated 17 November 2020.

⁶ [Link](#) to BTLAL Determination.

⁷ Section 3A of the Electricity Act 1989.

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.⁸ 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 costs relevant to but not included in the July 2023 determination were incurred as a result of an IAE under Limb c)

25. Some costs relating to the Cable Failure had not been incurred when the July 2023 determination was made. Costs totalling £354,755.38 for the year 2021/22 and £65,128.17 for the year 2022/23, and included in the First Notice, are now granted, for the reasons set out in the July 2023 determination. The application of any further deductible, pursuant to paragraph 21 of the Condition, is not required, as these costs relate to the same event set out in the July 2023 determination and the deductible has already been applied.

Determination on whether the event or circumstance necessitating the Stage 2 Repair constitutes an IAE under Limb c)

26. The Stage 2 Repair was necessitated because (as addressed further below) there were breaches in the polyethylene sheath of the cable, allowing water ingress, which in turn led to multiple breaks in a fibre optic cable ("FOC") in SSEC3. The Authority has determined that this latent defect in the sheath of the cable, leading to breaches of the sheath and FOC breaks, constitutes an "event or circumstance" that is an IAE pursuant to Limb c).⁹ The reasons for this decision are as follows.

⁸ We note there is a current modification to the Connection and Use of System Code ("CUSC") - CMP344 – that aims to clarify the treatment of revenue adjustments in the Charging Methodology. [Link](#) to Ofgem's letter dated 12 February 2024.

⁹ 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.

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

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

28. Paragraphs 30 to 33 of the July 2023 determination set out our conclusions, based on the Technical Reports, as to the cause of the Cable Failure.¹⁰ In particular, paragraph 30 of the July 2023 determination provides:

"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."

29. Analysis by Ofgem's engineering experts is that there is established industry knowledge that the presence of a latent defect in FOCs leading to a break will continue to manifest further breaks caused by such defect. It is therefore likely, as is supported by the analysis in the Technical Reports into the FOC breaks which were the subject of the July 2023 determination, that the further FOC breaks observed on SSEC3 were a product of the same root cause that led to the Cable Failure. The relevant event or circumstance is the latent defect on SSEC3, being a defect in material workmanship caused by inhomogeneities resulting from poor control of the mixing of semiconducting material as a result of poor workmanship during the manufacturing process, leading to breaches in

¹⁰ For clarity, throughout our decision-making process we have understood both the main and spare FOC were damaged as a result of the latent defect. However, in correspondence dated 29 and 31 October and 2 November 2022, the Licensee confirmed that only one FOC, being FOC 9168, is damaged, albeit FOC 9168 is crossed at 'nkt subsea joint 3' and changes from being the spare FOC to the main FOC (or vice versa). This does not affect our previous decision.

the polyethylene sheath of the FOC, allowing water ingress, and leading to breaks in the FOC of SSEC3.

30. We are content that the Licensee did not know of this event or circumstance at the time that the offshore transmission assets were transferred to it or at any time prior to the identification of the FOC breaks in January and/or February 2020, nor ought to have known of them. This is therefore a factor in support of the event or circumstance being found to be an IAE.

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

31. The Licensee noted the statement at paragraphs 71 to 73 of the 'SSEC2 Determination'¹¹, 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".

32. The Licensee is correct. The Authority continues to 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. This is therefore a factor which makes it less likely that the event or circumstance would be found to be an IAE.

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

33. Ofgem has considered whether the nature and frequency of the FOC breaks across SSEC3 is such as to render the relevant event or circumstance 'exceptional', such that it is not appropriate to treat the event or circumstance, or its consequences, as reasonably foreseeable. Given that, for reasons explained further below, Ofgem is content that the event or circumstances would be an IAE even if it were found to be reasonably foreseeable, it is not necessary to consider whether the exceptionality test is met; however, Ofgem can see arguments in favour of the event or circumstance, or its consequences, being exceptional in this instance and thus unforeseeable, which would only strengthen that conclusion.

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

34. 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

¹¹ [Link](#) to our decision that the failure of Subsea Export Cable 2 ("SSEC2") was not an Income Adjusting Event.

OFTO regime was not designed to insulate licensees from all such risks.¹² 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 to be able to pass on the risks arising from defective work in the construction of the assets to consumers.

35. 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 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.

36. We 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*¹³

37. 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.

38. On 28 November 2018, we published a policy decision to clarify how the IAE provision would respond where an event was 'Uninsurable' (the "**IAE Policy**").¹⁴ Paragraph 3.5 of the IAE Policy confirmed that the Condition "*will continue to provide uninsurability protection where the OFTO is unable effectively to mitigate the effects of latent defect risk (including, through no fault of its own, that risk become Uninsurable as defined ...)*". Further to a licence modification with effect from 14 January 2021, 'Uninsurable' is defined in amended standard condition E12-J1 of the OFTO licence. The effect of the licence modification was that, if an IAE claim were allowed in circumstances where the relevant event was "Uninsurable", then (under modified paragraph 21 of the Condition), the Authority would deduct from the passed-through costs an amount equivalent to the insurance deductible identified in the OFTO's initial bid.

¹² 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).

¹³ 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.

¹⁴ Link to published document [Income Adjusting Events policy in Offshore Transmission Owner Licences | Ofgem](#)

39. The Licensee considers the claim should be determined to be an IAE under Limb c) in particular because the event or circumstance was 'Uninsurable'. In the Notices, the Licensee "*confirms that its position set out in the 2021 IAE Notice [the subject of the July 2023 determination] remains the same in respect of (i) why the event was beyond the Licensee's control, and (ii) why the Licensee's claim for uninsurability is legitimate and there has been no relevant change in the Licensee's insurance position*". The Licensee's position is that its insurers have refused to cover the costs which are the subject of the Notices.
40. 'Insurance' is defined as part of the definition of 'Uninsurable' in Amended Standard Condition E12-J1 of the Licence as an "*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*". As addressed further below, Ofgem has considered whether the costs incurred by the Licensee should have been recoverable (subject to any terms of the particular policy) under a policy with a LEG 3/06 exclusion (or equivalent). If it should have been so recoverable, Ofgem has asked whether the Licensee is at fault for failing to have in place such insurance coverage. If the Licensee was at fault, this would mitigate strongly against the event or circumstance being an IAE.
41. First, Ofgem has considered whether the costs of responding to the event or circumstance (i.e. the breach of polyethylene sheath, leading to water ingress, and FOC breaks) by way of the Stage 2 Repair would be recoverable under a policy with a LEG 3/06 exclusion.
42. Based on advice from our expert insurance advisers with reference to the Licensee's insurance policies, we understand that where the Stage 2 Repair is necessary to repair direct physical loss or physical damage to the cable (which had already occurred when the cable was put back into service on 7 March 2021), then an Operational All Risk insurance policy with a LEG 3/06 exclusion, or equivalent (as is contemplated in the definition of "Insurance" in Amended Standard Condition E12-J1) would respond to the full costs of that repair, irrespective of whether that repair incidentally removes defects (i.e. without apportionment between damage and defect repairs).
43. We also understand that such insurance would be unlikely to cover repair costs (i) to remove defects in the cable which *may* give rise to direct physical loss or damage, but which have not yet done so; and (ii) to direct physical loss or damage that occurred only after the cable was put back into service on 7 March 2021, in circumstances where a reasonable insured will usually be obligated under due diligence provisions to prevent or minimise the extent of loss or damage once the insured is on notice of circumstances that may result in such loss or damage.

44. We have therefore considered whether the costs caused by the relevant 'event or circumstance' in the present case, namely the Stage 2 Repair Costs, are costs that would be expected to be covered by insurance. Insofar as the Stage 2 Repair was repairing breaches of the polyethylene sheath and FOC breaks, we are content that the repair was a response to physical loss or physical damage, and any further remedy of defects was only incidental to that repair.

45. After the cable was put back into service on 7 March 2021, the Licensee restored transmission services on SSEC3 but at reduced capacity (the **service cap**). Further FOC breaks were discovered in February and April 2022, after transmission services were restored.

46. The figure below (provided by the Licensee in the First Notice) shows where the various FOC breaks are located and the date they were discovered.



47. In consequence, the Stage 2 Repair was extended to run from a point 5km (KP5.0) from the Transition Joint Bay to a point 12.km (KP12.5) from the Transition Joint Bay (whereas previously the repair was proposed to extend from a point 6km (KP6.6) from the Transition Joint Bay to KP12.5).

48. We have therefore considered whether the additional costs of the repair (in consequence of the repair also covering KP5.0 to KP6.6) might not in any event be covered by insurance. The Licensee contends that the FOC breaks discovered after the cable was put back into service on 7 March 2021 had started to develop before that date (i.e. pre October 2020), therefore would be covered by an Operational All Risk insurance policy with a LEG 3/06 exclusion, or equivalent (as is contemplated in the definition of "Insurance" in Amended Standard Condition E12-J1); where there was physical damage, i.e. a breach of the polyethylene sheath, prior to October 2020, then that would constitute direct physical damage (even without it yet extending to a FOC break or power core failure). Notwithstanding this view, we are content that we do not need to reach a final decision on this point for the purpose of the present analysis. The purpose of this analysis is to consider whether the 'event or circumstance', being the latent defect in the sheath of the cable, leading to breaches of the sheath and FOC breaks, is an IAE applying the

BTLAL factors, which here involves asking whether it is an event or circumstance to which the availability of insurance is relevant. We are satisfied that the inquiry is relevant for the purposes of identifying whether there is an IAE, irrespective of whether a limited proportion of the costs would not be recoverable under any particular insurance policy.

49. It is therefore necessary to consider why the Licensee was unable to recover any such costs from insurers in the present case.
50. 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 2015.¹⁵
51. The Licensee renewed that policy on 15 October 2019.
52. At renewal on 15 October 2020, the Licensee was unable to renew [redacted] cover on equivalent terms as 15 October 2019, [redacted] the providers of the LEG 3 cover maintained the '2015 Root Cause Exclusion'.
53. The Licensee has found the costs of the Stage 2 Repair not to be covered by insurance, either because LEG 3 cover was not available, [redacted] because the insurer has relied upon the 2015 Root Cause Exclusion.
54. We have additionally considered whether insurers [redacted] were likely entitled to rely upon the 2015 Root Cause Exclusion to refuse cover in the manner that they have, i.e. whether the loss or damage, reflected here in the costs of the Stage 2 Repair, arose directly or indirectly from the same root causes which gave rise to the cable failures in 2015: "*Root cause as confirmed by Edif ERA report dated October 2015*" and "*Root cause as confirmed by Edif ERA report dated May 2016*". As per the Edif ERA Report into the SSEC2 Failure, the sequence of events which led to the cable failure commenced with (i) breach of the semi-conducting sheath of the optical fibre; which led to (ii) ingress of seawater under the sheath of the FOC; and which led to (iii) corrosion of the aluminium wire armour of the fibre optic due to seawater and a standing voltage on the aluminium armour and, in due course, break of the FOC. Those are the same mechanisms that were present with the FOC breaks observed on SSEC3, leading to the Stage 2 Repair. We are

¹⁵ 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*".

therefore satisfied that there appears to be a proper basis for the insurers' exclusion of the Stage 2 Repair costs pursuant to the 2015 Root Cause Exclusion.

55. We conclude that the Licensee was unable to manage the risk or impact of this 'event or circumstance' by putting in place insurance.

Other risk management arrangements

56. 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.

57. We note all construction warranties have expired. The Licensee confirmed it does not have any route of recourse to Gwynt Y Môr Offshore Windfarm Limited.¹⁶ We conclude there are no further commercial arrangements available that allow the Licensee to recover its costs of needing to undertake the Stage 2 Repair.

Representations

58. In its representations, the Developer considered Ofgem has inconsistently applied the factors set out in the BTLAL determination, and paragraph 23 above. The Developer made the following contentions:

- i. *"Ofgem's approach to IAEs now depends entirely on the uninsurability of subsea cables"* (Developer's emphasis); and
- ii. In the BTLAL Determination, because the risk of the relevant type of damage was reasonably foreseeable (the first of the four factors mentioned in the Determination) this was the *"ultimately decisive"* factor in that Determination and that where this factor it met then a *"narrow interpretation"* of limb c) should be engaged and an IAE should not be granted.
- iii. The third factor in the BTLAL Determination (*"whether the Licensee knew of the event or circumstance before it arose or ought to have known of it"*) was not addressed in the BTLAL Determination
- iv. The current decision is not consistent with the BTLAL Determination because Ofgem *"now appears to interpret the BTLAL factors (and subsequent uninsurability guidance) such that "uninsurability" trumps any other criteria"*;

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

59. We disagree with the analysis provided by the Developer, and retain the view that Ofgem has consistently applied the BTLAL Determination in assessing this IAE claim under Limb c).

60. The BTLAL Determination refers to Ofgem *“considering it appropriate to adopt a narrower, rather than a broader, construction of Limb (c)”* (rather than a *“narrow approach”* or *“narrow interpretation”* as is variously used in the Developer’s representations). It is clear from the context that what was being referred to in the BTLAL Determination as a *“narrower ... construction”* was not whether the first of the factors had been met but rather the entire approach of assessing whether an event or circumstance is an IAE under Limb (c) (which is set more fully on page 4 of the BTLAL Determination, including the four factors). The sentence which follows the statement that Ofgem is adopting a *“narrower ... construction”* makes clear such approach does not concentrate on the first BTLAL factor alone but includes the factors in the round: *“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).”*

61. Ofgem policy has not changed from this *“narrow approach”*. The BTLAL Determination does not indicate that we will consider the factors in turn, nor that one factor ‘trumps’ another. In November 2018, and after consultation, we clarified our policy that IAE would respond where an event or circumstance was ‘Uninsurable’. In November 2020 and after consultation we modified all OFTO licences to clarify what was meant by ‘Uninsurability’. We continue to consider this approach and the approach taken to this determination is consistent with a *“narrow approach”* to IAEs and with the four factors set out in the BTLAL determination.¹⁷

Conclusion

62. In summary, we consider that the risk of damage of the type that resulted in the need for the Stage 2 Repair was reasonably foreseeable (although we have not taken a view on whether the rate of FOC breaks was exceptional and thus not reasonably foreseeable). Importantly, we are satisfied that the Licensee did not have the opportunity to manage the risk or impact of needing to undertake the Stage 2 Repair, in particular because of the actual or effective unavailability of insurance for the repair of the defective cable. Applying the weight we consider appropriate to those separate factors, we consider that

¹⁷ Link to [Income Adjusting Events policy in Offshore Transmission Owner Licences | Ofgem](#) and [Decision on modifications to future Offshore Transmission Licences | Ofgem](#)

it is not appropriate to require the Licensee to manage the risk of the event. Therefore, we consider the event is an IAE under Limb c).

Allowed income adjustment (IAT_t)

63. 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;
- 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.

Costs for 2020/2021

64. Pursuant to paragraph 18 of the Condition, we have considered whether costs incurred in financial year 2020/21 and claimed in the First Notice, can be awarded as part of this determination.

65. We have concluded they can because these costs:

- i. relate to the replacement cable used in the Stage 2 Repair and had to be ordered and delivered before that repair could begin, and
- ii. were submitted as part of the Notice that led to the July 2023 determination but could not be decided upon it was unclear exactly how much cable would be used to complete the Stage 2 Repair. The Licensee therefore rightly notified Ofgem of the costs having been incurred within the timeframe required by paragraph 18 of the Condition, and determination in relation to these costs was deferred to the present determination.

Costs of the Stage 2 Repair

66. In the Notices, the Licensee has provided a breakdown of the costs incurred in relation to the Stage 2 Repair. Paragraph 21(c) of the Condition sets out Ofgem's role in assessing the amount of the proposed income adjustment. Ofgem is required to ensure that the amount of the proposed income adjustment *"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"*. That is subject to two express caveats, namely (i) where the income adjusting event relates to an Uninsurable event or circumstance, it is reduced by an amount equivalent to an insurance deductible in the

Licensee's bid; and (ii) it is reduced by costs and/or expenses that have been recovered by other routes of recourse; both reductions are subject to the caveat that they do not apply where "the Authority has already applied such reductions to a previous income adjustment related to the same event or circumstance as that set out in the notice pursuant to paragraph 14".

67. We have reviewed the costs set out in the Notices and we are satisfied that an income adjustment in the amount claimed will ensure that the financial position and performance of the Licensee will, insofar as is reasonably practicable, be the same as if the income adjusting event had not taken place. However, it is appropriate to address further four aspects of the claimed costs.

68. First, there is a degree of duplication of costs arising from the Licensee undertaking two repair campaigns, as opposed to a single repair. The costs were, however, caused by the IAE, and are therefore recoverable under the Licence. For the avoidance of doubt, Ofgem is also satisfied that the Licensee could not undertake all repairs in one campaign as it did not hold sufficient replacement cable, and nor could it reasonably be expected to have done so.¹⁸

69. Second, a delay to the agreed delivery date for the replacement cable meant that some equipment that was critical to the load-out had to wait on stand-by, causing the Licensee to incur costs totalling £393,662.57. We have asked whether the Licensee is able to reclaim these costs under the replacement cable contract. We understand that the Licensee is not able to do so, and that there was no provision for liquidated damages in the contract. For completeness, Ofgem notes that it has investigated with the Licensee why there was no availability of liquidated damages. The Licensee explained that there were various factors in determining the preferred cable supplier including price, delivery, terms and conditions offered and technical specification of the cable. An important factor for the Licensee in its selection of supplier was that the supplier offered a coilable cable, not offered by the alternative supplier, meaning that the cable could be stored without requiring a dedicated turntable, which would have been an additional expense and complication for the operation. The Licensee considered that avoiding the cost and potential delays of procuring a turntable was a material benefit.

Representations

¹⁸ Paragraph 3.42 of Ofgem's cost assessment guidance states "In general, we consider that the length of spare cable required for a subsea cable fault repair should be no more than 1km and, therefore, this is the length of spare cable which we would usually allow as part of the FTV. In cases where the developer considers that a longer length of cable is necessary to conduct a repair, and therefore that a longer length is required to be transferred to the OFTO and included in the FTV, it is the responsibility of the developer to provide this justification according to the specific characteristics of the project". [Link](#) to Cost Assessment guidance.

70. In its representations, the Developer considered the lack of Liquidated Damages in the contract is not good industry practice, stating; *“The fact that a cable was ordered for delivery in November 2021 (and delayed until March 2022), but with no liquidated damages or other reduction in IAE costs (information only recently revealed as part of the Stage 2 MtD and supporting documents shared with the Developer) is not good industry practice, nor consistent with the licence obligations on the OFTO (namely, to ensure the efficient operation - and availability - of the transmission assets).”* We disagree with the Developer for the reasons set out above in paragraph 69. We consider the Licensee has sufficiently justified why it considered the contract with no provision for liquidated damages (LDs) compared to other contracts that offered LDs was, on balance, the better cable supply option at the time.

71. Third, the Licensee has provided a breakdown of the costs recovered from the CAR Insurer in the balance of stage 2 repair costs. The Licensee has already deducted the recovered costs of £4,691,623.00, which would otherwise been claimed, from the total cost claimed.

72. Fourth, we have considered whether a further insurance deductible of £3,000,000 falls to be applied. The relevant test is whether such a reduction has already been applied *“to a previous income adjustment related to the same event or circumstance as that set out in the notice pursuant to paragraph 14”*. An insurance deductible of £3,000,000 was applied in the July 2023 determination. The question is whether that relates to the same ‘event or circumstance’ as addressed in the present determination. We note that the July 2023 determination identified the relevant event or circumstance as the latent defect that gave rise to the ‘Cable Failure’. However, at root, the costs involved in responding to the Cable Failure are responsive to the same event or circumstance considered in the present determination i.e. dealing with the consequences of a breach in the polyethylene sheath caused by a latent defect, leading to water ingress, and causing a FOC break. We are therefore content that the two determinations are covered by the same insurance deductible. We take reassurance in that regard from the fact that our expert insurance advisers have confirmed that, in the event that the costs were the subject of an insurance claim, only one deductible would likely be applicable as an insurer would treat this as one claim regardless of the repair campaign being conducted in multiple stages.

Representations

73. In its representations, the Developer questioned Ofgem’s approach to the application of the deductible in respect of a staged repair. The Developer does not explain why it holds this view. Our approach not to apply a second deductible to the stage 2 repair costs is based on advice from our expert insurance advisers. Without further information it is unclear on which grounds Ofgem would challenge its expert advice – therefore we hold

the view that there is no basis to revisit the analysis in paragraph 72 or the expert insurance advice referred to therein.

74. Pursuant to paragraph 21 of the Condition, the Licensee has demonstrated to our satisfaction that costs totalling £15,549,513.24 were incurred as a result of the IAE. We confirm the costs incurred as a result of the IAE exceed the threshold amount of £1,000,000 in each relevant financial year.

75. This letter constitutes the Authority's determination in relation to the Notices for the purposes of paragraph 23 of the Condition. If you have any questions or wish to discuss this determination further, please contact Yvonne Naughton at yvonne.naughton@ofgem.gov.uk.

Yours sincerely,

Rebecca Barnett
Director of Major Projects

For and on behalf of the
Gas and Electricity Markets Authority