

# Guidance on the Offshore Transmission Owner (OFTO) of Last Resort Mechanism

## Guidance

**Publication date:** 25 February 2014

**Contact:** Hannah Evans, Senior Policy Analyst

**Team:** Offshore Transmission

**Tel:** 020 7901 7358

**Email:** [offshoretransactions@ofgem.gov.uk](mailto:offshoretransactions@ofgem.gov.uk)

### Overview:

The regulatory regime for offshore electricity transmission enables the Gas and Electricity Markets Authority (the **Authority**) to grant an Offshore Transmission Licence (**OFTO Licence**) on the basis of a competitive tender process. Ofgem is responsible for managing this process.

We expect that the Offshore Transmission Owners (**OFTOs**) we appoint will perform to high standards and meet the requirements of users. However, in specific circumstances, such as the unlikely situation that an OFTO business fails, there is a risk of the generator becoming stranded and unable to export electricity to the onshore transmission network. To mitigate this risk, we introduced the OFTO of Last Resort mechanism, which allows us to appoint an OFTO outside of the competitive tender process.

This guidance outlines the steps we would follow prior to initiating an OFTO of Last Resort process, such as proactively engaging with the licensee and funders or other regulatory and statutory options such as Energy Administration. It then outlines the OFTO of Last Resort mechanism and steps we would expect to take to appoint an OFTO of Last Resort, focusing on the scenario where an OFTO business has failed.

## Context

---

With the government setting an ambitious target that 15 per cent of the UK's energy needs to be met from renewable sources by 2020, a dynamic approach was needed to deliver the substantial investment required in transmission. In the case of offshore wind, the Department of Energy and Climate Change (**DECC**), together with Ofgem, established the competitive regulatory regime for offshore transmission in June 2009. Under the regime we run the competitive tender process to select and licence Offshore Transmission Owners (**OFTOs**).

From the outset the offshore transmission regime has sought to encourage innovation and to attract new sources of technical expertise and finance, whilst ensuring that grid connections are delivered efficiently and effectively. The competitive regime was designed to be delivered in two parts, a Transitional and an Enduring Regime. Once we have granted OFTO Licences for all projects in the transitional tender rounds it will bring total investment in offshore transmission to approximately £2.5bn.

The investment opportunity in the Enduring Regime is expected to be significantly larger and is likely to deliver billions of pounds of investment in offshore transmission over the next decade. The Enduring Regime is also operating in the context of the proposed development of increasingly complex, integrated and coordinated offshore grid networks in the UK and the European Union.

We recognise that in specific circumstances, such as the failure of an existing OFTO business that risks a generator being stranded, it may be necessary to appoint an OFTO outside of the competitive process. It is for these reasons that the government and Ofgem have developed an OFTO of Last Resort mechanism.

This guidance is designed to provide clarity to potential bidders, funders, OFTOs, onshore Transmission Owners (**onshore TOs**) and other stakeholders on the process for appointing an OFTO of Last Resort.

## Document Revision History

---

Version	Date	Description
V1.0	February 2010	Initial Guidance document published.
V2.0	July 2011	Updated to reflect developments in the offshore transmission regime (such as the introduction of Generator Build in the Enduring Regime) and feedback from the first tender round.
V3.0	October 2012	Updated to reflect changes to the Electricity Act 1989 (the <b>Electricity Act</b> ) following the implementation of the Electricity and Gas (Internal Markets) Regulations 2011.
V4.0	February 2014	<p>This version contains no updates to our policy on OFTO of Last Resort. It has been amended to bring references to other documents up to date and improve consistency with other Tender Round 3 documents</p> <p>Updated context, executive summary, glossary associated documents and all other document links. Chapter 1: Changed the format of the chapter to improve clarity. Removed reference to consultation on ring fence conditions as this has now ended and been implemented in the standard licence conditions. Added chapter summaries and made minor housekeeping updates to Chapters 2-4. Minor changes to paragraphs 1.1 and 1.6 in Appendix 1.</p>

## Associated Documents

---

### Licences

- [Transmission Licence Standard Conditions](#)
- Licences granted to date are stored on the [E-Public Register](#)
- [Tender Round 2: Generic Offshore Transmission Owner \(OFTO\) Licence, Version 1.5, September 2013](#)
- [Consultation on the Generic Offshore Transmission Owner \(OFTO\) Licence for Tender Round 3, October 2013](#)

### Policy

- [Offshore Transmission: An investor perspective](#)
- [Offshore Electricity Transmission: Statement on future generator build tenders, July 2013](#)
- [Arrangements for responding in the event that a network company experiences deteriorating financial health: Decision Document and Updated Guidance Document, October 2009.](#)
- [Enforcement Guidelines on Complaints and Investigations](#)

## Contents

---

<b>Executive Summary</b>	<b>6</b>
<b>1. Introduction</b>	<b>8</b>
Changes since version 3.0 of this guidance	8
<b>2. Step one: proactive steps to prevent the need for further action</b>	<b>9</b>
Early warning signs – preparing for further action	9
Acting on information gathered	10
<b>3. Step two: seek to appoint an OFTO using various regulatory and statutory options</b>	<b>11</b>
Introduction	11
Open market sale/transfer of the assets by the OFTO	11
Energy Administration	11
Competitive tender process	12
<b>4. Step three: OFTO of Last Resort</b>	<b>13</b>
Scenarios in which the OFTO of Last Resort process can be initiated	13
The responsibilities of an OFTO of Last Resort	14
Who could be appointed as OFTO of Last Resort?	14
The process we expect to follow to appoint an OFTO of Last Resort	15
Pre-work to prepare for the OFTO of Last Resort process	16
Invite proposals	17
Evaluate proposals	18
Appoint OFTO of Last Resort	18
Certification under the Electricity Act	18
Actions post OFTO of Last Resort appointment	19
Treatment of assets where an OFTO of Last Resort is appointed	19
Ongoing review and expiry of an OFTO of Last Resort direction	19
<b>Appendix 1 - Licence revocation</b>	<b>21</b>
<b>Appendix 2 - Glossary</b>	<b>23</b>

## Executive Summary

---

Electricity generated from offshore renewable sources is expected to make an important contribution towards the UK achieving its renewable energy targets by 2020. As part of the regulatory regime introduced by government in June 2009 to ensure cost effective development of offshore transmission infrastructure, licences for offshore electricity transmission are granted by means of a competitive tender process run by Ofgem.

The 2013 Tender Regulations set out the tender process framework under the Enduring Regime for the granting of an OFTO Licence, including how Ofgem will run a competitive tender process for Generator Build and OFTO Build projects.

The aim of the OFTO of Last Resort mechanism is to minimise the risk of a generator becoming stranded or delayed in connecting to the onshore electricity network and provide certainty to all stakeholders that, should an OFTO business fail, another OFTO would be in place for the entire period of the original 20 year revenue term. The flexibility of the OFTO of Last Resort mechanism is intended to enable a seamless transition of obligations throughout the 20 year revenue term.

It may be necessary to appoint an OFTO of Last Resort where:

- an existing OFTO business fails or is unable to continue with its obligations and its OFTO Licence is revoked (which is the focus of this guidance); or
- we are unable to appoint an OFTO for a transitional or Generator Build project. In the event of an OFTO Build Tender Exercise failing to appoint an OFTO, the generator should be free to construct the Transmission Assets and take the project through a Generator Build Tender Exercise. In the very unlikely event that we are unable to appoint an OFTO following a Tender Exercise under the Generator Build model, then the option of appointing an OFTO of Last Resort to adopt the completed Transmission Assets would be available.

However we would only expect to use the OFTO of Last Resort process once other options for ensuring ongoing transmission have been exhausted, including:

- proactively engaging with the incumbent OFTO (including discussions with funders) to resolve any issues before they prevent them from continuing as the OFTO
- taking enforcement action to rectify performance issues and ensure licence compliance
- Energy Administration
- retendering the assets
- the OFTO selling/transferring the assets on the open market.

## **OFTO of Last Resort process**

To appoint an OFTO of Last Resort, we would invite proposals from transmission licensees. Based on their proposals, we would appoint the most appropriate transmission licensee as the OFTO of Last Resort. We would firstly look to appoint an existing OFTO, but if this isn't appropriate, we would look to appoint an onshore TO. The OFTO of Last Resort's responsibilities would broadly be the same as the incumbent OFTO.

We would seek to ensure that both the incumbent OFTO and the OFTO of Last Resort are fairly remunerated. We expect that the incumbent OFTO would receive a transfer value reflective of the net asset value after regulatory depreciation. In return, the OFTO of Last Resort will receive an annual revenue stream sufficient to fund an efficiently operating business and to meet the cost of purchasing the assets.

## **Interpretation of this document**

This document should be read together with the relevant standard and amended standard licence conditions<sup>1</sup>, in particular the revocation terms incorporated in Schedule 2 to the licence. Schedule 2 may differ between licences, as it is part of the terms of the licence, the form of which can be decided by the Authority.

This document should be taken as guidance only. The licence has precedence over the guidance in this document. If an OFTO of Last Resort process is required, we will be flexible in our approach to ensuring ongoing transmission based on the specific circumstances.

---

<sup>1</sup> Standard licence conditions: <http://www.ofgem.gov.uk/Licensing/Work/Pages/licence-conditions-consolidated.aspx>

Project specific amended standard licence conditions are available on the [E-Public Register](#)

## 1. Introduction

---

- 1.1. We would only consider appointing an OFTO of Last Resort once all other mechanisms for ensuring ongoing transmission have been exhausted. This document can therefore be split broadly into three sections, each representing a key step, which are:
- 1) Step one: proactively liaising with the incumbent OFTO to prevent the need for further regulatory or statutory action. The aim would be to resolve any outstanding issues (eg poor performance) to allow the incumbent OFTO to remain the licensee.
  - 2) Step two: considering a range of regulatory and statutory options to find an appropriate OFTO, such as Energy Administration, an open market sale of the assets by the OFTO or Ofgem re-tendering the assets.
  - 3) Step three: initiating an OFTO of Last Resort process and ultimately directing an existing transmission licensee as the OFTO of Last Resort.
- 1.2. Before discussing the steps outlined above, it is helpful to set out the changes to this guidance document since we published version 3.0.

### **Changes since version 3.0 of this guidance**

- 1.3. We have made a number of housekeeping changes to improve the clarity of the document including updating the context, executive summary, updating links to all associated documents and improving the glossary. We have also removed references to a consultation on ring fence conditions as this has now ended and been implemented in the standard licence conditions.



## 2. Step one: proactive steps to prevent the need for further action

---

### Chapter Summary

This chapter summarises the information available to the Authority to monitor the performance of OFTOs and sets out the first steps we would expect to take if this information indicated that an OFTO was in financial or operational difficulty.

### Early warning signs – preparing for further action

2.1. The information OFTOs are required to provide under their licence obligations along with general market information can provide early warning signs that an OFTO is in operational or financial difficulty. We describe five such early warning systems below.

1) **Availability performance reporting:** OFTOs are required, under amended standard condition E12-J4 of the OFTO Licence, to report to the Authority when availability performance deteriorates to certain levels. The OFTO must report to the Authority when:

- the OFTO expects a transmission services reduction of more than 21 days;
- transmission system availability falls, on average, below 80<sup>2</sup> per cent in a year
- transmission system availability falls, on average, below 85<sup>3</sup> per cent during a 24 month period.

As such, we will be aware where there is a decline in asset performance, and of the associated financial impact due to the availability incentive.

2) **Enforcement action:** Ofgem monitors licensees to ensure they abide by their licence conditions. If for example an OFTO was found in breach of its licence conditions, the options available to Ofgem include:

- issuing an enforcement order to ensure they comply with their licence conditions, and/or
- imposing financial penalties of such an amount as is reasonable in all of the circumstances of the case up to 10 per cent of turnover of the licensee's business.

---

<sup>2</sup> To note: this figure is 75 per cent for TR1 licences.

<sup>3</sup> To note: this figure is 80 per cent for TR1 licences.

- 3) **Ring fence conditions:** The broad objectives of these conditions include providing warning signals when symptoms of financial distress appear or potential threats are identified. For example, we require licensees to certify on an annual basis that they have adequate access to financial resources.
- 4) **Regulatory reporting:** The Regulatory Instructions and Guidance (**RIGs**) require the OFTO to provide information regarding the business on an annual basis. This allows us to monitor various indicators, such as whether an OFTO's cash position or ratios (such as annual debt service ratio cover and loan life cover ratio) are deteriorating.
- 5) **Market intelligence:** We monitor general market indicators with a view to establishing a broader picture of financial performance and health of licence holders. Such indicators include share prices, credit ratings and other publicly available information.

## Acting on information gathered

- 2.2. However, our action will depend on the amount of time we have to prepare. For example, where an OFTO reports to us that it expects a transmission services reduction of more than 21 days we would have time to consider the possible implications from this outage. If in light of the outage the OFTO notified us of any financial deterioration (eg a downgrade in credit rating), we would be in a position to engage with the OFTO and its funders, and to consider steps to address any issues. There may however be a very rapid deterioration in an OFTO's financial position. In this circumstance, we would have little time to prepare for further action and an OFTO of Last Resort process may be the only option. If an OFTO of Last Resort were required, we would be flexible in our approach to ensure we could appoint one as quickly as possible. Our objective will always be to protect the interests of consumers whilst ensuring an appropriate balance of risk and reward for the OFTO.
- 2.3. Where the information gathered indicates that difficulties have arisen or may arise in the operation of an OFTO business, the Authority would expect to have an active dialogue with affected stakeholders (including funders where appropriate) to seek to resolve issues. By taking these proactive steps, we anticipate that many issues would be resolved without further escalation.
- 2.4. If, for example, an OFTO was having difficulties meeting its licence obligations, we would expect to engage with all interested parties. We would look to understand key issues and obstacles to deliverability whilst exploring appropriate solutions that retain appropriate incentives and balance of risk between the parties.
- 2.5. We believe that this approach would reduce the risk of licence revocation and thereby avoid the requirement for further action, such as Energy Administration or OFTO of Last Resort.

## 3. Step two: seek to appoint an OFTO using various regulatory and statutory options

---

### Chapter Summary

This chapter summarises the options available to the Authority to appoint a new OFTO other than the OFTO of Last Resort process.

### Introduction

- 3.1. If the steps outlined in Chapter 1 fail to resolve the issue, we would consider further action. This could include:
  - an open market sale/transfer of the assets by the OFTO;
  - Energy Administration arrangements initiated by the Secretary of State, or by the Authority with the consent of the Secretary of State.
- 3.2. We may also consider a competitive tender process, where a Tender Exercise has failed to identify an OFTO. Each of these points are discussed below in more detail.

### Open market sale/transfer of the assets by the OFTO

- 3.3. An OFTO may be unable to resolve certain financial or operational issues. In this situation, a viable resolution could be for the OFTO to sell the assets to a company that is able to resolve these issues. If the assets were sold, the OFTO would have to transfer the licence to the purchaser. Section 7A of the Electricity Act governs the transfer of licences, including the requirement to obtain Authority consent to the transfer.

### Energy Administration

- 3.4. Energy Administration arrangements may apply in the event of financial distress. This would include potential financial distress where significant additional expenditure is expected to rectify equipment failings that are leading to failure to meet performance standards. We consider the Energy Administration arrangements to be the primary mechanism for dealing with the majority of financial issues that an OFTO may face. We would anticipate being required to act in relation to an application for an Energy Administration order in advance of any licence revocation action.

- 3.5. There are a number of stages in an Energy Administration. These are set out in detail in an Ofgem guidance document<sup>4</sup>, but to summarise:
- 1) DECC, or the Authority with the consent of DECC, would apply to the Court for an energy administration order.
  - 2) The energy administrator would operate the assets, with the objective of ensuring the system continues to be maintained and developed as an economical system such that ultimately it becomes unnecessary for the energy administration order to remain in force.
  - 3) In the event that an OFTO is unlikely to be rescued as a going concern then other companies may express an interest in purchasing the assets. Energy Administration would end with the rescue of the OFTO as a going concern or the sale and transfer of its assets to another company.
- 3.6. We acknowledge that given that the energy administrators would have an obligation to seek the best value for the assets, they may request that we run an OFTO of Last Resort process. We recognise that in certain circumstances this may be the only viable option for ensuring ongoing transmission.

### Competitive tender process

- 3.7. If we are unable to appoint an OFTO following a Tender Exercise, we may run a further Tender Exercise to appoint an OFTO. We would be keen to understand why we were unable to appoint an OFTO for the first Tender Exercise, and where possible we would try to resolve any issues through the design of the tender process. Due to the success of the first two tender rounds in attracting investment, we consider that the risk of being unable to appoint an OFTO for a Generator Build project through a Tender Exercise has diminished.

---

<sup>4</sup> [Arrangements for responding in the event that a network company experiences deteriorating financial health](#)

## 4. Step three: OFTO of Last Resort

---

### Chapter Summary

This chapter focuses on the OFTO of Last Resort mechanism, considering:

- the scenarios in which the OFTO of Last Resort process can be initiated
- the responsibilities of an OFTO of Last Resort
- who could be appointed as OFTO of Last Resort
- the process we expect to follow to appoint an OFTO of Last Resort
- actions post OFTO of Last Resort appointment.

### Scenarios in which the OFTO of Last Resort process can be initiated

- 4.1. We may initiate an OFTO of Last Resort process if:
  - following a Generator Build Tender Exercise we have been unable to appoint an OFTO
  - we intend to revoke an OFTO Licence. This could be:
    - a. prior to the completion of the construction of the Transmission Assets (this would only apply to an OFTO appointed following an OFTO Build Tender Exercise)
    - b. after the Transmission Assets are fully constructed and commissioned and an OFTO has been appointed.
  - we intend to revoke an OFTO of Last Resort direction given to another transmission licensee (eg following a request by a licensee to revoke an existing direction)
- 4.2. Events that could lead to revocation and thus potentially an OFTO of Last Resort process are set out in Schedule 2 of the licence<sup>5</sup>. Appendix 1 sets out further details on licence revocation, including examples of events that could lead to revocation.
- 4.3. An OFTO of Last Resort process cannot be used if, following an OFTO Build Tender Exercise, we have been unable to appoint an OFTO. The reasons for this are set out in our consultation document on the enduring regulatory regime<sup>6</sup>. These include that if we are unable to appoint an OFTO following a

---

<sup>5</sup> OFTO Licences, once granted, are available on the [E-Public Register](#).

<sup>6</sup> For further detail on these proposals, please refer to "[Providing additional flexibility in the](#)

Tender Exercise, it may demonstrate that the market does not see an economic case for investment. Further, there would not be a significant risk of stranding the generation assets in this situation, as even if the wind farm was under construction, it would likely be at a very early stage. Also, appointing an OFTO of Last Resort in such circumstances would likely involve a significant risk premium being required to compensate the OFTO of Last Resort.

- 4.4. If we were unable to appoint an OFTO following an OFTO Build Tender Exercise, the generator would have the option of building the Transmission Assets and entering the project under a Generator Build Tender Exercise. As noted in the introduction, if we were unable to appoint an OFTO following a Generator Build Tender Exercise, the option of appointing an OFTO of Last Resort to adopt the completed Transmission Assets would be available.

### **The responsibilities of an OFTO of Last Resort**

- 4.5. The OFTO of Last Resort licensee's obligations would be broadly the same as the incumbent OFTO. There may be some modifications to the obligations and incentives from those that applied to the incumbent OFTO, such as how risks are allocated.
- 4.6. As set out in standard conditions B18 and E21, we can direct a transmission licensee to be an OFTO of Last Resort for a term of up to five years. However, upon expiry of that term, we can give a further direction to the same company, meaning that it could be an OFTO of Last Resort for more than five years.

### **Who could be appointed as OFTO of Last Resort?**

- 4.7. Any electricity transmission licensee is eligible to be appointed an OFTO of Last Resort. We would firstly consider whether there is a suitable existing OFTO to be OFTO of Last Resort. If there is no suitable OFTO, we shall consider existing onshore TOs.
- 4.8. Our power to direct these licensees is set out in each licence (standard condition B18 for onshore TOs and E21 for OFTOs).
- 4.9. Standard conditions E21 and B18 state that the Authority cannot appoint a licensee as OFTO of Last Resort if it considers that the licensee could not comply with the direction without materially prejudicing its ability to continue to carry out its activities in relation to its existing licence.

---

[enduring regulatory regime for offshore electricity transmission: Initial joint decision statement](#) For further detail on these proposals please refer to (November 2010)

- 4.10. We would ensure that the licensee that is appointed OFTO of Last Resort:
- is capable of operating the Transmission Assets in an economic and efficient manner
  - is able to finance the activities which are imposed by the direction (it should be noted that the Authority has an obligation under the Electricity Act “to secure that licence holders are able to finance the activities which are the subject of obligations imposed”<sup>7</sup> on them by or under statute), including efficiently incurred obligations with third parties (such as providing for the decommissioning security)
  - is able to recover the costs of operating the Transmission Assets in an economic and efficient manner, including a reasonable rate of return.
- 4.11. Where a single entity controls multiple OFTOs, and one of those OFTOs is subject to revocation and the OFTO of Last Resort process, we would not necessarily preclude the other controlled licensees from submitting proposals to be the relevant OFTO of Last Resort. However, we would need to be satisfied that the licensee was sufficiently robust to take on that role and that it would not lead to inappropriate incentives on an OFTO that could be, for example, facing some form of financial distress.
- 4.12. There may be no transmission licensees (onshore or offshore) that meet these conditions. In this situation we would not appoint an OFTO of Last Resort. However, we consider that this scenario is very unlikely, given that the number of potential OFTOs that could become an OFTO of Last Resort will continue growing and that the onshore TOs could also take on the role. If no transmission licensee could immediately meet these conditions, we would also expect to keep under ongoing review the possibility that an existing transmission licensee could become the OFTO of Last Resort in due course.

### **The process we expect to follow to appoint an OFTO of Last Resort**

- 4.13. In the majority of cases we would seek to retain a competitive element to the OFTO of Last Resort process to ensure value to consumers. In some instances, for example if there is only one suitable OFTO to invite proposals from, we would be unable to retain a competitive element, but would nonetheless seek to ensure that the prospective OFTO of Last Resort’s cost proposals were economic and efficient. However, we consider that as the pool of OFTOs increases, the risk that there would not be sufficient licensees to invite proposals from will diminish. Figure 1 sets out the key process steps that would be followed, following an event that triggers the OFTO of Last Resort process (such as licence revocation). The following sections look in more detail at the steps involved.

---

<sup>7</sup> Section 3A(2)(b) of the Electricity Act.

## Guidance on the Offshore Transmission Owner (OFTO) of Last Resort Mechanism

- 4.14. The appointment process will be flexible and we will continually reassess the risk of a generator being stranded and may adjust the process if the risk has diminished or increased. As such, we would expect to provide all relevant transmission licensees with regular updates so that they respond appropriately to change. If at any point the risk of stranding reduces significantly, we may halt the process.
- 4.15. A key variable that will determine the structure and duration of the OFTO of Last Resort process is whether, when the triggering event occurs, construction is complete and the assets are operational. If the Transmission Assets are still under construction (this is only possible under an OFTO Build Tender Exercise, where the OFTO would have been licensed prior to construction, therefore presenting the potential risk of failure of a licensed OFTO during the construction phase), the information requirements are likely to differ as the OFTO of Last Resort would be required to construct (or complete construction of) new (or part-built) assets. In contrast, where Transmission Assets are already operational, the process would reflect the expected acquisition of such operational assets.

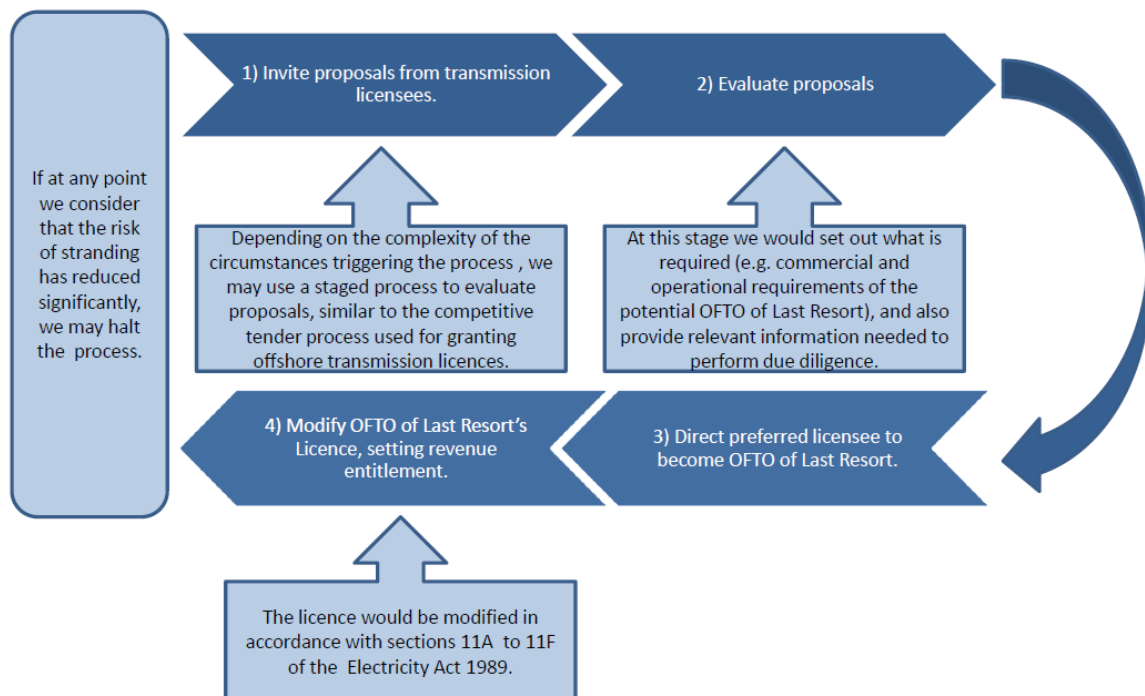


Figure 1: Process steps for appointing an OFTO of Last Resort

### Pre-work to prepare for the OFTO of Last Resort process

- 4.16. To assist the OFTO of Last Resort process, we will make all relevant information available to enable each licensee to develop an informed proposal. For example, we may require the incumbent OFTO to put forward their proposed transfer terms in relation to the Transmission Assets. Where appropriate and possible we would also provide a draft of the text that we



would expect to add to an OFTO's licence should they be appointed an OFTO of Last Resort. We would also need to make some assumptions to allow invited licensees to put forward their proposals on an equal basis. For example we may use an assumed date of asset transfer. Such information available to potential OFTOs of Last Resort might include:

- project information - such as technical information about the assets, relevant consents information, relevant contract information, assumed transfer date, assumed transfer value and, where applicable, outline transfer terms offered by the existing licensee
  - process information - such as the information provided by the licensee, the evaluation criteria, and the key process milestones.
- 4.17. It will be necessary to have an assumed transfer value prior to inviting bids. However, during the OFTO of Last Resort appointment process, we may revisit this assumed transfer value. In calculating the transfer value to determine the appropriate revenue stream, we would apply an approach that views the assets as having a depreciated regulatory asset value based on the economic and efficient costs attributable to those assets. We commonly use this approach when regulating onshore assets. We consider that this approach should ensure that the incumbent OFTO receives a fair price for the assets. We would also apply this approach in the context of the intent of the offshore transmission regime, notably that offshore transmission licensees should not be exposed to the risk of generator failure and that the initial terms of each offshore licence are in place for a period of 20 years.
- 4.18. Given the range of circumstances that could trigger an OFTO of Last Resort process, the types of information required from each licensee and the basis on which we would make decisions (criteria, timing etc) will vary on a case by case basis. As such, the process may differ to that set out in this document.

### **Invite proposals**

- 4.19. On activating the OFTO of Last Resort process, we will invite each relevant transmission licensee to set out their commercial and operational requirements in the event that they should become OFTO of Last Resort. As with the competitive tender process, we expect that such proposals would need to:
- demonstrate financial and operational capability
  - set out proposed approach to takeover and operations
  - detail the expected revenue requirement in assuming OFTO of Last Resort responsibilities
  - provide supporting information to demonstrate robustness of the proposals.

- 4.20. The request for proposals will be in a standard format, ensuring that we can make like-for-like comparisons of each licensee's capabilities. The deadline for the submission of proposals will depend on the circumstances under which the mechanism has been initiated.

### **Evaluate proposals**

- 4.21. The evaluation of individual proposals will be based around the requirements of the regulatory framework and relevant tender evaluation criteria that can be taken from the competitive tender process. When developing evaluation criteria, we would expect to do so on the basis of ensuring that proposals put forward by bidders are deliverable and offer value to consumers.
- 4.22. In some instances, we may consider that it is appropriate to adopt a staged process similar to the competitive Tender Exercise under the Tender Regulations. We will aim to identify a shortlist of viable licensees in the first instance, before appointing an OFTO of Last Resort. This would be particularly relevant where the circumstances triggering the process are complex and may require significant due diligence, or where several current licensees view the OFTO of Last Resort role as an attractive opportunity.

### **Appoint OFTO of Last Resort**

- 4.23. If at this stage the risk of stranding is still significant, we will direct our preferred licensee to become the OFTO of Last Resort. Prior to issuing the direction, we will publish a notice of our intention to direct an OFTO of Last Resort. The notice would include information such as the period the direction will be in effect for. Before any direction takes effect, we will modify the transmission licence of the OFTO of Last Resort to set its revenue entitlement and, where appropriate, implement risk adjustment mechanisms.
- 4.24. We will modify the licence in accordance with sections 11A to 11F of the Electricity Act<sup>8</sup>.

### **Certification under the Electricity Act**

- 4.25. Under section 10A of the Electricity Act each OFTO who holds a transmission licence and participates in the transmission of electricity is required to be certified as independent under section 10D. Depending on the circumstances of the OFTO of Last Resort, the licensee who becomes the OFTO of Last Resort may need to apply for certification or a review of the licensee's current certification may be required. The timescales for these certification processes will need to be factored into the OFTO of Last Resort process<sup>9</sup>.

---

<sup>8</sup> A sections 11A and 11B licence modification would in all cases be subject to a 28 day statutory consultation period. Following the consultation period, if the Authority decides to make changes to the licence there will be a period of 56 days before the licence changes come into effect.

<sup>9</sup> For further information see '[Certification of Transmission System Operators \(TSOs\) under the ownership unbundling requirements of the Third Package](#)'.

## Actions post OFTO of Last Resort appointment

### Treatment of assets where an OFTO of Last Resort is appointed

- 4.26. Following a Tender Exercise the Authority has powers under the Electricity Act<sup>10</sup> to make a property scheme to transfer property from the wind farm Developer to the successful bidder. However, these powers would not apply for the process of appointing an OFTO of Last Resort. We do however expect that if we appoint an OFTO of Last Resort, it would be on the basis that they are able to acquire the existing assets and property rights. We'd expect the incumbent OFTO and OFTO of Last Resort to agree the terms of the transfer of assets on a commercial basis so that the assets are transferred in full to the OFTO of Last Resort. We also expect the parties to have regard to the depreciated regulatory asset value approach used to calculate the revenue stream. Although we could not make a property scheme, we would not expect to appoint an OFTO of Last Resort unless we were confident that they would have all the necessary rights to provide Transmission Services. We expect that the incumbent OFTO would receive a transfer value reflective of the net asset value after regulatory depreciation. In return, the OFTO of Last Resort will receive an annual revenue stream sufficient to fund an efficiently operating business and to meet the cost of purchasing the assets.
- 4.27. Where an OFTO of Last Resort is appointed, the regulatory framework should incentivise both the incumbent OFTO and the OFTO of Last Resort to transfer assets in a timely manner. If they do not transfer the assets, the incumbent OFTO may be required to decommission the assets under the terms of the Crown Estate lease, incurring additional costs and loss of value. Moreover, if they are in breach of their licence conditions, we can impose financial penalties of up to 10 per cent of turnover of the licensee's business depending upon what is reasonable in all of the circumstances.

### Ongoing review and expiry of an OFTO of Last Resort direction

- 4.28. An OFTO of Last Resort direction may apply for the timescale that it was initially directed. However, a licensee can request that an OFTO of Last Resort direction applied to it be modified or revoked at any time, particularly where it can demonstrate that continuing to perform its obligations as OFTO of Last Resort would adversely affect its ability to meet its other authorised activities.
- 4.29. The duration of the direction (up to five years) provides an opportunity to appoint a new OFTO, a new OFTO of Last Resort or to extend the appointment of the existing OFTO of Last Resort. If we were to extend the appointment of the OFTO of Last Resort, we could adjust the terms and the revenue stream, similar to the price control reviews used for onshore networks. This would include an assessment of the economic and efficient costs of operating and maintaining the assets as well as any outstanding financial liabilities associated with the asset value. This would allow any efficiencies to be

---

<sup>10</sup> Schedule 2A (Property Schemes) to the Electricity Act.




## Guidance on the Offshore Transmission Owner (OFTO) of Last Resort Mechanism

passed back to consumers, or to increase the revenue stream in light of higher than expected efficient costs.

## Appendix 1 - Licence revocation

---

- 1.1. The timescale for deciding whether to revoke a licence would depend on the circumstances of the failure. The Authority must provide a minimum of 30 days' notice before revoking a licence in most cases but it is likely that the timescales will be longer. For example, if the licensee's availability declined gradually, before deciding to revoke the licence we would need to carefully consider whether the decline in performance is due to the licensee failing to operate the assets to a high standard, rather than there being some underlying problem that would exist regardless of whether a new OFTO was appointed. We may however revoke the licence with only 24 hours' notice under paragraph 1(f) of schedule 2 of the licence, if for example the licensee has an administration order under section 8 of the Insolvency Act 1989 made in relation to it. We may also revoke the licence with 7 days' notice if the licensee made a material misstatement of fact relating to its application for the licence.
- 1.2. We would expect to provide a draft revocation direction well in advance of any likely revocation date. We consider this approach would support our objective of protecting consumers and our statutory duty of securing that licensees are able to finance their authorised activities. By providing the licensee forward notice it will provide an opportunity for them to rectify any problems.
- 1.3. Where revocation is an option, we will take all reasonable steps to contact the relevant person at the licensee, whether that is a director or a receiver. This would enable us to raise and clarify any concerns we have and to explain the regulatory position and our powers.
- 1.4. This contact would also provide the relevant person with the opportunity to provide reasons why the licence should not be revoked. We will make clear the timescale for making such representations. The timescale will depend on the urgency of the situation and in particular the impact on customers and other industry parties of delaying any decision to allow time for further representations or for alternative solutions to the licensee's problems to be found. We expect directors and receivers will give appropriate priority to respond to any of our requests for a meeting.
- 1.5. We must publish reasons for revoking a licence. Once we have decided to revoke a licence, we will issue a notice of revocation and a notice giving reasons. Any confidential material is likely to be contained in a separate annex sent only to the licensee.
- 1.6. Examples that could lead to revocation and thus potentially an OFTO of Last Resort process include where:
  - both the OFTO and the Authority agreed that the licence should be revoked
  - the licensee has failed to comply with a final order or with a provisional order, or to pay any financial penalty by the due date



## Guidance on the Offshore Transmission Owner (OFTO) of Last Resort Mechanism

- the licensee fails to comply with an order made by the court under section 34 of the Competition Act 1998; an order made by the Authority under sections 158 or 160 of the Enterprise Act 2002; an order made by the Competition Commission<sup>11</sup> under sections 76, 81, 83, 84 and 161 of the Enterprise Act 2002; or an order made by the Secretary of State under sections 66, 147, 160 or 161 of the Enterprise Act 2002
- the licensee is in financial difficulty (subject to paragraphs 1(f), 2 and 3 of schedule 2 of the licence)
- the licensee has not been or has not continued to be certified by the Authority in accordance with section 10D of the Electricity Act as complying with section 10A of the Electricity Act
- the Authority is satisfied that the licensee made a material misstatement of fact in making its application for the licence.

---

<sup>11</sup> Due to become part of the Competition and Markets Authority in April 2014.

## Appendix 2 - Glossary

---

### A

#### Authority

The Gas and Electricity Markets Authority established by section 1(1) of the Utilities Act 2000. The Authority governs Ofgem.

### D

#### DECC

The Department of Energy and Climate Change, which is the government department responsible for, among other things, the introduction of the regulatory regime for offshore electricity transmission. It has responsibility for commencing the relevant sections of primary legislation and approves new and amended Tender Regulations.

### E

#### Electricity Act

Electricity Act 1989 as amended from time to time.

#### Enduring Regime

The regulatory regime for offshore transmission for any project qualifying for a Tender Exercise after 31 March 2012. This regime allows windfarm developers to choose between Generator Build and OFTO Build for the construction of offshore Transmission Assets.

#### Energy Administration

Administration is a mechanism for dealing with an insolvent company. An Energy Administration regime was established through primary legislation in the Energy Act 2004.

The principal role of the administrator under insolvency arrangements is to obtain the best possible outcome for the owners and creditors of a company. Reflecting the importance of energy networks to consumers, the aim of the Energy Administration scheme is to ensure that essential services to consumers remain secure and uninterrupted in the event of a company becoming insolvent. This includes ensuring that the relevant system is, and continues to be, maintained and developed as a safe, efficient and economical system.

### G

#### Generator Build

A model for the construction of offshore Transmission Assets. Under the Generator Build option, the Developer carries out the preliminary works, procurement and construction of the Transmission Assets. The OFTO operates, maintains and decommissions the Transmission Assets.

### O

#### Ofgem

Office of Gas and Electricity Markets. Ofgem supports the Authority in performing its statutory duties and functions.

### Offshore Transmission Licence (OFTO Licence)

The licence awarded under section 6(1)(b) of the Electricity Act 1989 following a Tender Exercise authorising an OFTO to participate in the transmission of electricity in respect of the relevant Offshore Transmission System. The licence sets out an OFTO's rights and obligations as the offshore Transmission Asset owner and operator.

### Offshore Transmission Owner (OFTO)

The holder of an Offshore Transmission Licence.

### OFTO Build

A model for the construction of offshore Transmission Assets. Under the OFTO Build option, the Developer obtains the connection offer and undertakes high level design and preliminary works. The OFTO constructs, operates, maintains and decommissions the Transmission Assets.

### OFTO of Last Resort

An OFTO appointed outside of a Tender Exercise from existing transmission licensees to provide Transmission Services in respect of particular offshore Transmission Assets in accordance with standard conditions B18 and E21 of the Transmission Licence where there is a significant likelihood that the developer whose generating station that is, or is to be, connected to those Transmission Assets would be unreasonably delayed or stranded.

## R

### Regulatory Instructions and Guidance (RIGs)

A guidance document which sets out the information a licensee must provide to the Authority on a monthly, quarterly or annual basis. In the Offshore Transmission Licence, the scope of the RIGs is defined in amended standard condition E12-D1.

## T

### Tender Exercise

The competitive process run by Ofgem in accordance with the Tender Regulations in order to identify a successful bidder to whom a particular Offshore Transmission Licence is to be granted.

### Tender Regulations

The Tender Regulations are made under section 6C of the Electricity Act 1989 and set out the legal framework and powers for the Authority to run a competitive tender process for the grant of an Offshore Transmission Licence in respect of an Offshore Transmission System. Currently the 2010 Tender Regulations (only for certain projects) and 2013 Tender Regulations are in force.

### Transitional Regime

The offshore transmission regulatory regime covering all projects that met the qualifying project requirements set out in the 2010 Tender Regulations before 31 March 2012.



### Transmission Assets

Are defined in paragraph 1(3)(a) of Schedule 2A of the Electricity Act 1989 as 'the transmission system in respect of which the offshore transmission licence is (or is to be) granted or anything which forms part of that system'. The Transmission System is expected to include subsea export cables, onshore export cables, onshore and offshore substations, and any other assets, consents, property arrangements or permits required by an incoming OFTO in order for it to fulfil its obligations as a transmission operator.

### Transmission Owner (TO)

An owner of a Transmission System.

### Transmission Services

Those services which are provided or are to be provided to the system operator by another transmission licensee pursuant to standard conditions D2 and E15 (Obligation to provide Transmission Services) of the Transmission Licence.

### Transmission System

Is defined in Section 4(4) of the Electricity Act 1989 as 'a system which consists (wholly or mainly) of high voltage lines and electrical plant, and is used for conveying electricity from a generating station to a substation, from one generating station to another or from one substation to another'.