

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

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Dear Colleague,

Open letter on the Authority's approach towards exceptional events for offshore transmission owners

On 18 June 2014 we published our decision that a cable failure at Walney 2 in November 2013 was caused by an exceptional event¹. This was the first decision of its kind since the introduction of the offshore regime. In order to provide clarity to offshore transmission owners (OFTOs) and other interested parties, this letter outlines the general approach that the Authority expects to take towards the evaluation of exceptional events under the OFTO licence. It expands on our previous guidance on outages taken as a result of planned and unplanned outages on onshore networks where these impact OFTOs², which is still applicable.

The approach outlined in this letter applies specifically to holders of an offshore electricity transmission licence and does not constitute a general policy position across all transmission licences.

Background - the OFTO Availability Incentive

The availability incentive (under amended standard condition E12-J4) adjusts the OFTO's revenue depending on performance. It also places obligations on the OFTO to maintain the assets in line with Good Industry Practice³. The revenue adjustment is based on an OFTO's performance against a 98% availability target: it rewards OFTOs by up to 5% of annual revenue if they exceed the annual availability target, and penalises them by up to 10% of annual revenue if they fall below it.

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

- events on the offshore generator's system that may impact the OFTO. There are four generic exclusions from the incentive, which are consistent with onshore transmission licences;

¹ <https://www.ofgem.gov.uk/publications-and-updates/blue-transmission-walney-2-direction-under-paragraph-10-amended-standard-condition-e12-j4>

² <https://www.ofgem.gov.uk/ofgem-publications/51620/dno-outages-policy-statementmay13.pdf>

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

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

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

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

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

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

Definition of 'event' in relation to exceptional events

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

- the trigger event is, in effect, all the relevant triggers and contributory factors to any automatic or manual procedure to switch out transmission equipment. It may be associated with a wide time window, depending on what has occurred.
- the failure event would be the operation of automatic protection systems or a manual procedure to switch out certain transmission equipment such as the cable, a transformer, or a busbar in the substation. This would normally be associated with a specific, narrow time window. The failure event is the event within 14 days of which the OFTO is required to notify the Authority under paragraph 9(b) of amended standard condition E12-J4⁴.

What events are exceptional

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

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

“an act of God, an act of the public enemy, war declared or undeclared, threat of war, terrorist act, blockade, revolution, riot, insurrection, civil commotion, public demonstration, sabotage, act of

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

vandalism, fire (not related to weather), governmental restraint, Act of Parliament, other legislation, bye law or directive (not being any order, regulation or direction under section 32, 33, 34 and 35 of the Act) or decision of a Court of competent authority or the European Commission or any other body having jurisdiction over the activities of the licensee provided that lack of funds shall not be interpreted as a cause beyond the reasonable control of the licensee. For the avoidance of doubt, weather conditions which are reasonably expected to occur at the location of the event or circumstance are not considered to be beyond the reasonable control of the licensee.”

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

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

Adjustment to reported system incentive performance

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

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

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

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

Our information requirements for evaluation

Based on the above, we require an OFTO to provide us with all relevant information under paragraph 9(c) of amended standard condition E12-J4⁵. As a minimum we expect that an OFTO should:

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

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

This letter details our current approach and we maintain the right to review this in the future, should it be necessary to do so.

Should you have any questions please do not hesitate to contact my colleague Gordon Hutcheson at gordon.hutcheson@ofgem.gov.uk or on 0141 331 6359.

Yours faithfully,

Min Zhu

Associate Director, Offshore Transmission

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