

Our date
2018-03-06

Our reference

Administrative officer
Torkel Sjøner

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Ofgem
Attn.: Kate Kendall

Submitted via e-mail: offshorelicensing@ofgem.gov.uk

Response to Open Letter: Consultation on Income Adjusting Event policy in Offshore Transmission Licenses

Statoil welcomes the opportunity to respond to Ofgem's open letter of 6th February on the Income Adjusting Event Policy in Offshore Transmission Licenses.

Ofgem's open letter covers two, although related, independent proposals.

1. Proposed amendments to Ofgem's Income Adjusting Event (IAE) policy, and;
2. Proposed warranty/indemnity expectations and insurance requirements for future OFTO licensees.

The offshore wind industry has experienced several unfortunate subsea cable incidents over the last few years. Ofgem should however be cautious on drawing general conclusions based on these specific incidents. Unless the proposals to remedy the perceived deficiencies in the OFTO license are carefully assessed and drafted, the risk of introducing unintended and disproportional consequences are significant.

IAE policy

Ofgem has until now applied a strict IAE policy and have rejected all but one of the IAE requests by OFTOs. We support Ofgem's strict interpretation of the offshore transmission license and the decisions made. In Statoil's view it is important that prospective OFTOs and their insurers have incentives to do proper Due Diligence as part of the OFTO transaction process. On the one IAE request Ofgem did approve, uninsurability due to a "known" latent defect was given as justification. Ofgem now proposes to formalize this decision and amend the IAE policy and include uninsurability protection in the offshore transmission license.

In public private partnerships projects there are some precedents, as Ofgem points out, that the public may provide protection for certain risks that become uninsurable. However, the cost for retrospectively providing this protection to the OFTOs through the offshore transmission license will not be borne by the public, but by the developer/wind farm owner. Hence, Ofgem should assess if the cost for this protection should be socialized through the transmission charges.

Ofgem states that providing uninsurability protection will "reduce the probability of a discontinuity in service provision". While this may be true we believe that any concerns Ofgem may have on the financial strength of the OFTO's, should be mitigated by other means than levying extra cost on the offshore wind farm.

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As Ofgem rightly points at that the amended IAE policy creates new risks which need to be carefully assessed and mitigated. OFTO's weakened incentives to seek out - and insurers to continue to make available - insurance for latent defects are the obvious one. Statoil does also fear that a softened IAE policy may make it less beneficial for OFTOs to seek out insurance generally.

It is necessary to clarify the definition of "latent defect", and whether Ofgem intends to include all uninsurable latent defects as Income Adjusting Events.

If Ofgem proposes to approve uninsurable latent defects as IAE, it is essential that the offshore transmission license also includes requirements on the OFTO to make pre-emptive repairs to reduce the effects of the latent defects, if this is likely to result in a major disruption on the wind farm output. This is necessary following the proposed change to the IAE policy, regardless of the definition of "latent defect", as pre-emptive repairs in most scenarios will be the most cost-effective solution.

The proposed shift in IAE policy represent a shift in risk exposure and cost from OFTOs to wind farm operators. Ofgem should assess if this change is proportional. Even if Ofgem should conclude that it is further justification is needed before the IAE policy is implemented retrospectively.

For Statoil to be able to have a firm view of the proposed IAE policy, further clarifications are required. We therefore reserve our right to conclude our position before these clarifications are sufficiently addressed.

Minimum warranty/Indemnity expectations

Statoil does not see that Ofgem's proposal on minimum protection developers are expected to provide to OFTOs is justified with any kind of fundamental analyses and seems to be based on input from OFTO representatives only. If competition works we can assume that the most competent and efficient OFTO bidder, supported by a thorough Due Diligence process, provides the lowest bid and thus secure the lowest cost for the consumers.

Statoil typically apply a multi-contract procurement strategy, as we have experienced that this provides for best competition and lowest cost. Different contractors for manufacturing and installing the offshore export cables is therefore the norm. In such a scenario, there is no relationship between the warranties given from the cable supplier and the cable installer. Ofgem's proposed warranty seems to imply that there should be a link between the two, and that the contractors give a combined warranty. We are not aware that such a warranty is available at reasonable prices in the market. Statoil therefore query if Ofgem's proposal on minimum warranty/indemnity is feasible.

It is Statoil's view that warranties provided as part of the OFTO transfer agreement should be the result of a commercial negotiation between the purchaser and vendor of the transmission assets.

Statoil's conclusion is therefore that we do not support Ofgem's proposal that developers, in the OFTO transfer agreement, shall provide five-years warranties for all cost of repair and replacement of sub-sea cables from contractors or, if not available, to procure such warranties provide such warranties by itself.

Ofgem has concluded that these minimum protections should be included "... for TR5 and beyond". The Dudgeon project, where Statoil is the operator, is in the final stages of commercial negotiations with the preferred bidder.

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Ofgem's proposal to include these protections for TR5 projects introduces uncertainties, uncertainties Ofgem not will be able to provide clarity on in time for the Dudgeon OFTO transaction to complete as planned. In this context Ofgem's open letter has been very unhelpful during the negotiations and may endanger the timeline for finalizing the agreement. If implemented the proposal should not include projects at an advanced stage, and recommend that Ofgem at earliest implement any changes from TR6.

Kind regards

Statoil ASA



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