Making a positive difference
for energy consumers

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Date: 23 August 2019

Dear Gary,

Notice of consultation to modify conditions of the transmission licence proposed to be granted to the successful bidder for the Race Bank (RB) project

We have today commenced a consultation under section 8A of the Electricity Act 1989 on the proposed modifications to certain standard conditions of the transmission licence that may be granted to Diamond Transmission Partners RB Limited (the **Potential Licensee**). The transmission licence will be granted to the Potential Licensee if Diamond Transmission Partners (a consortium of Mitsubishi Corporation and HICL Infrastructure plc (the **Preferred Bidder**) becomes the successful bidder for the RB OFTO project (the **Project**).

The attached consultation notice is published on our website and sets out details of the proposed modifications, the closing date of the consultation and how to respond. We have posted hard copies to you as well as the Company Secretary of the Potential Licensee.

We are proposing to add a number of amended standard conditions to the transmission licence that may be granted to the Potential Licensee should the Preferred Bidder become the successful bidder for the Project. These proposed conditions are annexed to the section 8A notice.

In accordance with our statutory requirements and best practice we have brought the proposed modifications to the attention of persons likely to be affected and also provided copies of the notice to:

- Secretary of State for Business, Energy and Industrial Strategy;
- Citizens Advice;
- Citizens Advice Scotland
- The Health and Safety Executive (HSE);
- The Scottish Executive;
- The Welsh Assembly; and
- The Project Developer (Orsted A/S, Macquarie European Infrastructure Funds 5, Macquarie Capital and Sumitomo Corporation)

Project specific licence modifications

Amended Standard Condition E12-J3 (Restriction of Transmission Revenue: Allowed Pass-through Items)

We have added a pass-through mechanism (the **contingent event revenue adjustment** or **CEA**) to amended standard condition E12-J3 (Restriction of Transmission Revenue: Allowed Pass-through Items) (**E12-J3**).

Summary of Contingent Events
The CEA mechanism is a bespoke pass-through item for this licence. It allows the Authority to adjust the Potential Licensee's revenue entitlement should costs and/or expenses arise for the following contingent events:

A) The licensee has been required by the Secretary of State to increase the size of its security in respect of its decommissioning programme:

   i) to account for the payment of VAT; and/or

   ii) as a result of the disallowance of scrap value of certain decommissioned assets.

B) If remedial cable burial works on certain unburied sections of the subsea cables are permitted by a Marine Licence (as defined in amended standard condition (ASC) E12-J3 of the OFTO licence), the licensee incurring costs in connection with:

   i) a requirement placed on the licensee by a Marine Licence to remove cable burial works and cables, in part or in full, during decommissioning; and/or

   ii) resizing any letter of credit held as security in respect of its decommissioning programme, if required by the Secretary of State to increase the size of this security .

C) Any liability of the licensee to repair or replace a subsea cable damaged as a result of a fishing gear strike, as defined in ASC E12-J3 of the OFTO licence. This contingent event will only be triggered if a Marine Licence does not allow remedial burial works on certain sections of the cables, these work cannot be completed, or the MMO does not make a decision within 3 years. In addition, this contingent event will only be triggered where the following conditions are met: damage is caused to an unprotected section of cable specified in the Annex to E12-J3; and the licensee has taken all reasonable steps to prevent a fishing gear strike.

D) The licensee incurring costs as a result of putting in place secondary cable protection measures to protect unburied cable sections from a fishing gear strike, where required in accordance with good industry practice and in accordance with ASC E12-J3. This contingent event will only be triggered if a Marine Licence does not allow remedial burial works on certain sections of the cable, these works are permitted but cannot be completed, or the MMO does not make a decision within 3 years.

The offshore regime incentivises licensees to manage costs efficiently over a 20-year period but also recognises that licensees may not be best placed to manage risks where they are not sufficiently within their control. There are therefore a number of pre-defined revenue adjustment mechanisms in the licence that seek to optimally reallocate risk for a small number of known, but unpredictable, factors.

The Authority considers that the most appropriate way of providing the Potential Licensee with a method to recoup costs and/or expenses (as the case may be) resulting from the contingent events in connection with this Project, is by including a CEA term in the licence.

The Office of Gas and Electricity Markets
10 South Colonnade Canary Wharf London E14 4PU **Tel** 020 7901 7000 **Fax** 020 7901 7066 **www.ofgem.gov.uk**

Rationale for Contingent Event Revenue Adjustment Mechanism
The use of such a licence adjustment mechanism is necessary and appropriate in this case for the following reasons:

1. The Preferred Bidder was not aware (and could not reasonably be expected to have been aware) of either the contingent event and/or the materiality of the relevant contingent event (as the case may be) prior to and for the purposes of submitting its Invitation to Tender (**ITT**) submission.

   1.1. With respect to contingent event A:

      1.1.1. All bidders at the ITT stage were provided with the policy existing at the ITT stage to base their submissions on and therefore did not factor in the implications of potential changes to the payment of VAT and/or the disallowance of scrap value under the decommissioning plan. It was unclear what permanent changes were to be made to the Department for Business, Energy and Industrial Strategy (BEIS) policy on decommissioning reserves; if any, and hence it was not clear the extent to which the Potential Licensee may be impacted. We will keep this situation under review in relation to existing licensees; and

      1.1.2. It allows us the flexibility to respond appropriately as the BEIS policy on decommissioning reserves evolves.

   1.2. With respect to contingent events B, C and D, the Preferred Bidder has pursued and secured from the developer a cable protection agreement to allow for specific works to be completed and a level of protection against specific, uncertain events that may arise in relation to the Marine Licence. However, this agreement does not fully mitigate residual risk for the Potential Licensee. Having considered the agreement reached and the associated costs that may be borne by the Potential Licensee, we have decided that a contingent event is an appropriate mechanism to allow the Potential Licensee to mitigate any residual risk that may arise from the project specific circumstances defined in the OFTO licence, whilst not diminishing their incentive to manage and operate the assets in accordance with good industry practice.

2. It has not been possible for the Preferred Bidder to resolve or fully mitigate the contingent events by way of commercial agreement with relevant parties or by any other mechanism which would provide an appropriate recourse; and

3. Contigent event A is both contingent and material, in that:

   3.1. It was not certain that the contingent event(s) would materialise and continue during the 20-year revenue period as this decommissioning policy was subject to consultation by BEIS during the ITT stage. Now that the BEIS decommissioning policy is firm, it is still not certain that the contingent event(s) will continue during the 20-year revenue period since it is not certain whether or not the existing policy will remain during this time.
   3.2. There are uncertain costs and/or expenses (as the case may be) which could not be forecast and which may be incurred by the Potential Licensee as a result of the contingent event(s); and
   3.3. It is likely that if the contingent event(s) arises it would have a material impact on the costs and/or expenses (as the case may be) incurred by the Potential Licensee.

4. Contingent events B, C and D are both contigent and material, in that:

   4.1. It is not certain that the contingent event(s) would materialise and continue during the 20-year revenue period;

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4.2. There are uncertain costs and/or expenses (as the case may be) which could not be forecast and which may be incurred by the Potential Licensee as a result of the contingent event(s); and
4.3. It is likely that if the contingent event(s) arises it would have a material impact on the costs and/or expenses (as the case may be) incurred by the Potential Licensee.

Amended Standard Condition E12-J4 (Restriction of Transmission Revenue: Annual Revenue Adjustments)

We have added an additional exclusion limb to paragraph 8 of amended standard condition E12-J4 (Restriction of Transmission Revenue: Annual Revenue Adjustments) which lists the circumstances under which a transmission service reduction on the Potential Licensee's transmission assets is not included in the calculation of the availability incentive. The inclusion of the bespoke exclusion in limb (e) of paragraph 8, subject to certain provisions, will ensure that the Potential Licensee's revenue is not adversely affected should transmission service reductions occur as a result of damage caused by a fishing gear strike at an unprotected cable section specified in Annex A to E12-J3. This bespoke exclusion would only be triggered if a Marine Licence does not permit remedial burial works specified sections of the cabe to be undertaken, these works are permitted cannot be completed, or the Marine Management Organisation does not make a decision within 3 years.

Having considered all of the circumstances, we have decided that it is appropriate and proportionate to include this bespoke exclusion limb, in the limited circumstances prescribed, to protect the Potential Licensee against revenue losses that may occur as a result of these project specific circumstances.

Tender revenue stream

Amended standard condition E12-J2 (Restriction of Transmission Revenue: Revenue from Transmission Owner Services) sets out the proposed tender revenue stream for the Project for the purposes of the section 8A consultation (the **s8A TRS**). The s8A TRS is based on the tender revenue stream bid by the Preferred Bidder at the ITT stage of the tender process, which has been updated as appropriate to reflect further information available to the Preferred Bidder since the date of the ITT submission, including the draft final transfer value for the Project. The s8A TRS assumes that 100% of the draft final transfer value will be paid to the project developer on asset transfer. Details of the transfer value which is reflected in the s8A TRS are set out in the draft cost assessment report for the Project, which is published on our website today (www.ofgem.gov.uk).

If you have any queries regarding the information contained within this letter you should contact Lucy Edmonds on 020 7901 1850 or by email to offshorelicensing@ofgem.gov.uk

Yours sincerely,

Rebecca Barnett,
Deputy Director, Commercial and Assurance

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