

Frontier Power Response to Ofgem Interconnector Policy Review WS1 Cap & Floor – Working Paper 1

Thank you for the opportunity to comment on this working paper. We are pleased to note that a number of the comments and suggestions made in our response to Ofgem’s mini-call for evidence last year have been reflected in the paper and proposals.

In giving our feedback below we have, where appropriate, referred to that earlier response rather than reiterating the detailed points.

Section 2

Question 1: Do you agree with the approach we have taken to workstream 1?

Yes, we think the approach of seeking evidence from interested stakeholders, and the qualitative and quantitative analyses, were an appropriate way to proceed and gain benefit from the practical experience of interconnector developers.

Question 2: Do you think we have missed any important strengths, weaknesses, opportunities weaknesses, or threats when critically assessing the cap and floor regime?

We think the analysis captures the main SWOT elements of the current C & F regime. Our earlier response highlighted a number of challenges with the current regime around development timescales and its risk to efficient project financing, issues with the window approach and the support needed from other NRAs. These appear to be considered in the ‘Weaknesses’ quadrant of the analysis and we would re-emphasise the importance of their resolution if project finance-backed projects are to succeed and the support and innovation which new entrants bring is to be maintained.

Section 3

Question 3: Do you agree with our conclusion that the cap and floor regime has met its objectives to date? Is there any other information you think we should take into consideration in our analysis?

Yes, as we explained in our first response, the regime has worked well to increase interconnector development by narrowing the gap between different regulatory approaches in different jurisdictions and in encouraging interest in interconnector development from new entrants who can bring innovation, experience and skill based on their work on other infrastructure projects.

Question 4: Do you agree that the principles of the cap and floor regime remain fit for purpose and suitable to potentially incentivise further GB interconnection?

It is not easy to separate the principles of the C & F regime from its detailed operation. Future fitness for purpose of the regime will depend on further developing the framework and mechanisms for project assessment and support.

We commented on the need for further development of the regime in our first response and do so further below in relation to section 4.

The need for this development is shown, for example, in the comments (para 3.21) about how, ‘*positive GB consumer welfare*’ was modelled to be delivered from all Window 1 and 2 projects. The Ofgem and Afry analysis set out in the WS2 Working Paper shows how it is less likely that future projects will show similarly positive welfare benefits, hence the need to take more account of the wider strategic benefits and to see how some of these can be quantified or monetised (and we note this is understood by the comments in para 4.8 of the Review.)

Section 4

We are pleased to note that most of the issues raised in our earlier response, such as the interaction of development timescales and fixed RSDs, and project concentration caused by the window approach, have been considered in the review and some of our suggestions for tackling the challenges, such as strengthening alignment with interconnected nation's regulators, are in line with the initial proposals.

Our comments below should be considered alongside the more detailed analysis of challenges and suggestions for tackling them made in our first response.

Question 5: Do you agree with our initial proposals with respect to potential changes to the assessment framework of the cap and floor regime? Specifically:

a) To consider a more coordinated and system-wide approach to application windows, potentially informed by a more proactive role for NGESO. Do you have any views on the options presented for our approach to potential future application windows?

We support an enhanced role for NGESO in broadly identifying how much future interconnection is needed and believe this would be enhanced by working with European regulators and bodies such as ENTSOe. We believe these will in any case be necessary to provide a basis for assessing the wider (non-arbitrage) interconnector benefits likely to be necessary in future.

We would not want the NGESO's input to become prescriptive in relation to the UK siting requirements for transmission connections. There is a well-established CION process for identifying and securing connection point agreements which already uses much public information about future UK transmission planning and requirements. Part of the benefit which new (non-TSO) project developers can bring is in being aware of site and technology opportunities to help manage the associated planning, consenting and construction risks.

We would therefore not support **Option 3**.

On balance we would prefer **Option 1** of consideration of applications in a case-by-case basis as and when projects are sufficiently mature. This removes the artificiality applied by window application timetables on development timescales of significantly different projects and the pressure which can be imposed on supply chains by the Window approach.

Our second preference would be **Option 4** provided the timing and approach remained consistent and predictable and was not subject to potentially frequent change or suspension of windows. With Option 4 and Option 2 we are strongly of the view that there should be sufficient time allowed between application for Initial Project Assessment and RSD, and we think ten years would be an appropriate time horizon. This would be realistic based on the timelines seen thus far for projects developed under Windows 1 and 2 including our experience with NeuConnect. We would still want to see an overall flexible approach to RSDs reassessment and project delivery bearing in mind that, as we said in our initial response, *'project delays may not necessarily reduce that [CBA] value and rushing to meet programme deadlines may actually reduce value through duplicated or unnecessary work or cause more permanent project damage.'* Following our proposed 10-year approach, if Window 3 invited developers to apply for Initial Project Assessment in early 2022, the backstop RSD should be set at early 2032.

We could live with **Option 2** provided that a significant buffer is built into the "pre-determined capacity level" to cover the risk of projects that may be successful at the IPA stage becoming delayed or cancelled and dropping out of the pre-determined capacity level window.

b) To review our eligibility criteria for any potential future regime, and to explore the potential to raise the maturity threshold for applicants.

We share all of the concerns raised by stakeholders regarding eligibility criteria and CBA methodology and we support the proposals to address these concerns.

- i) The CBA methodology needs to be clear and transparent and to address the wider impacts of future interconnectors and whether existing projects will be completed.
- ii) A review of the maturity threshold is timely and should reduce the uncertainty around approved projects not coming online. The purpose should be to take an overall assessment of the quality and likelihood of a project succeeding and delivering the claimed benefits. We suggest Ofgem criteria should include evidence of the following:
 - A UK connection point, preliminary route analysis and initial modelling
 - Positive engagement with the NRA and TSO in the connecting country
 - A capable development team experienced in major infrastructure developments and understanding of associated finance requirements
 - Financial backers that have the financial resources to fund the project through development and construction.

It is important that the maturity threshold is set such that project finance developers and their investors can bring forth projects for approval based on hundreds of thousand pounds of development work not several million pounds. Too high a threshold is highly likely to restrict new developments to TSOs with deep enough pockets and will remove the financial and technological innovation which independent developers can bring.

c) To consider changes to the current incentives mechanisms to help ensure timely delivery of projects. Do you have any suggestions for modifications or alternatives?

Again, we recognise and agree with all of the concerns raised in the stakeholder feedback.

We welcome the proposed clarification of the principles addressing delays in achieving RSDs due to force majeure.

Question 6: Do you agree with our initial proposals with respect to potential improvement to parts of the technical design of the cap and floor regime?

We have no additional comments on the technical design of the C & F regime as set out in the initial proposals.

Question 7: Do you have any suggestions for ways in which any potential future regime could work better for a broad range of developers?

The commitment to providing flexibility in requesting variations is welcome but we would still like some other issues addressed, particularly applicable to project finance, such as the sequencing and interaction of regulatory with project finance requirements which can lead to licence modifications coming after FPA and financial close causing investor uncertainty and increasing cost. Our initial response set out a number of these issues in more detail and we would be happy to have further dialogue, and, if possible, a meeting with the Ofgem team to explain our concerns and possible solutions more fully from a practitioner's perspective.

Question 8: Are there any other potential regime improvements that we should explore that are not considered in this section?

Our initial response noted that achieving sufficiently rapid development of interconnectors to meet environmental and supply security goals might require compromises between market mechanisms and asset-based regulatory approaches. The proposed developments of the C & F regime are encouraging but it may still be necessary at some stage to consider asset-based approaches albeit at lower revenue and lower risk for developers if the current incentive mechanisms prove inadequate.

In this context Ofgem's intention to maintain positive working relationships with NRAs in connecting countries and other European regulatory bodies is to be welcomed. This will remain key to the successful and efficient development all future interconnectors.

Section 5

Question 9: Do you agree with our conclusions? Please provide supporting information if available.

We have nothing to add to the comments we have already made on individual sections of the review.

Question 10: Do you agree with our initial proposals? Please provide supporting information if available.

We welcome the broad thrust of the initial proposals and have commented in more detail on some of them above. We believe that a transparency and clarity in the future C & F regime and consistency in its application for period of time will enhance the chances of meeting future interconnector objectives and the government's energy and environmental policies

Other

Question 11: Do you have any further feedback on our analysis, conclusions or proposals presented in this consultation document?

We have nothing to add to the comments we have already made on individual sections of the review.