

Future Interconnection Team, Networks
Ofgem
10 South Collonade
Canary Wharf
London
E14 4PU

21st March 2023

Dear Sirs,

NU-Link Response to Ofgem's Consultation on its Minded-to Decision on Timelines and Incentives Changes for the Third Cap and Floor Window for Interconnectors (the "Consultation")

Thank you for the opportunity to respond to the Consultation. It is encouraging that Ofgem is considering how to make the regime more flexible and more certain for developers in this Window compared to the previous Windows.

In summary, the proposals themselves seem workable and in theory provide a number of ways of achieving relief from delays to commercial operations that are beyond the control of the developers.

The adoption of more project specific Regime Start Dates is to be welcomed and the guarantee of a 25 year regime in all circumstances is very helpful.

The Payback Mechanism proposed to adjust the risk-reward balance between developers and consumers in the event of any delay that is not Pre-Operational Force Majeure or Reasonable Delay Event, seems reasonable and is unlikely to cause developers to abandon or refuse to proceed with potential investments.

However, NU-Link does have serious concerns regarding the retention and application of Ofgem's rights to carry out a needs case reassessment if commercial operations commence after the Backstop Date is passed. This "cliff edge" risk needs to have only a remote chance of being triggered for developers to not be unduly concerned.

Unfortunately, a fundamental misunderstanding of the time it takes to develop these complex projects has resulted in a choice of a Backstop Date that is more likely than not of being breached due to the crystallisation of normal risks during project delivery; which will not be Pre-Operational Force Majeure and cannot be Reasonable Delay Events giving that the commercial operations date will be beyond the Backstop Date.

This is exacerbated by the delays to the IPA decision date when projects will know whether they will indeed be awarded a cap and floor agreement in principle from Ofgem.

In NU-Link's response it lays out why the "typical" project timeline should reasonably be expected to result in a 2030 commissioning date and explains why a Backstop Date that deals with undue delays more realistically should be set as 2037. Without these adjustments developers will have to assess the project as being a riskier investment than those under Window 1 or 2. This is at odds with the objectives Ofgem set at the outset and

will be a barrier to the UK Government's ambition of achieving 18GW of interconnection and this will not be in consumers' interest.

The rest of this response seeks to provide answers to each of the questions asked in the consultation.

This response should be read in conjunction with NU-Link's separate response to Ofgem's statutory consultation on the proposal to modify the standard conditions of the electricity interconnector licence to give effect to the policy proposed in the Consultation.

Should you wish to discuss any aspect of this response please do not hesitate to contact me or David Chamberlain.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Steve Jennings', with a stylized flourish at the end.

Steve Jennings

On behalf of the NU-Link Consortium

1. Do you agree with the proposals of the modified Regime Start Date and modified Backstop Date concepts as part of the Timelines and Incentives changes to the Third Cap and Floor Window for Interconnectors?

The stated objective in the consultation is to:

- increase flexibility for developers; and
- manage adverse consequences where delays outside of the developers' control have arisen;
- maintain or improve the risk-reward balance between consumers and developers,
- provide certainty and flexibility to developers.

The stated objectives seem reasonable and NU-Link has considered its comments in light of these objectives.

The main elements to the proposals as NU-Link understands it are:

1. a developer will always expect to see a 25 year regime, regardless of whether the project is delayed or not;
2. Where a project is delayed, and no relief is granted, the delay will trigger a mechanism in the final years of the regime that has a duration equal to the initial delay – called the Exposure Period, where any floor top-up payments received during that period will have to be repaid from revenues received in the years which follow until all top-up payments received during the Exposure Period have been repaid on an NPV neutral basis – (the "Payback Mechanism").
3. Relief from the Payback Mechanism will be possible through either Pre-Operational Force Majeure or Reasonable Delay Event processes depending on whether the project delay extends beyond the Backstop Date;
4. If a project is delayed beyond the Backstop Date, Ofgem may review the needs case assessment and can withdraw the cap and floor agreement.

In summary NU-Link believes that

- Allowing a project to receive a 25 year regime duration regardless of when the project actually commissions is to be welcomed.
- Introducing a mechanism to repay any floor top-up payments that reflect the duration of any delay to commercial operations beyond the Regime Start Date established at IPA, does put consumers back into the same position they would have been in compared to the operation of the regime for Window 1&2 projects, yet crucially the proposals here do maintain reliable floor cash flows underwritten by consumers, which funders rely on. Equity providers ultimately retain some risk through delays to potential distributions towards the end of the regime;

- The interaction between the RSD at IPA, the Reasonable Delay Event and the Backstop Date is designed to provide possible relief from a broader range of delay events than those incorporated in the Pre-Operational Force Majeure definition; this is to be welcomed. However, this is a complicated process and provides little certainty to developers at the outset and as such will do little to improve developers' confidence such relief can be relied on. Especially so, given this option would only apply to delays to projects that have a delay with a new RSD before 2032. NU-Link's assessment is that this is unlikely to apply to the majority of Window 3 applicants as explained below. Therefore, without a shift to the indicative commercial operations date of a typical project of 2028 and the Backstop Date of 2032 NU-Link sees this being of little value and a distraction.
- Cliff edge risks arise due to the potential needs case to be reassessed if there is a delay beyond 2032¹. This is a major hurdle for developers. Particularly so given that Window 3 applicants will not know if they will be awarded a cap and floor agreement until the end of 2023. This is discussed in more detail below.

In the Window 3 application guidance Ofgem asserts that a "typical" indicative start date for a developer applying for a cap and floor agreement in Window 3 would be 2028.

This suggests Ofgem believes that it is possible to deliver a "typical" interconnector to commercial operation by 2028.

NU-Link believes this assumption is plainly unrealistic.

The minimum period to construct a converter (without any consenting or special ground stabilisation works) is 48 months. To achieve a 2028 commercial operation date would require a developer to commence construction by early 2024.

A developer would need to have carried out seabed surveys, UXO surveys, obtained certainty on the connection location, obtained offshore and onshore consents and permits, prepared its technical specification, carried out a procurement event, awarded EPC contracts for cable and converters and secured necessary finance and regulatory approvals in both countries – the "Enabling Works".

The Enabling Works comprise almost the entirety of the development costs. Ofgem only intends (although has not committed) to publish its decision on which interconnectors will be granted a cap and floor agreement in principle towards December 2023. This means virtually all of the project's development costs would have been incurred prior to Ofgem concluding whether the project should be awarded a cap and floor agreement. This makes 2028 an unrealistic expectation and ultimately disables the effectiveness of the RDE proposals.

A typical development schedule would normally see a developer only commit to some early stage costs before confirmation from Ofgem on whether it will award the project a cap and floor agreement in principle. Applying this to the decision timeline

¹ For delays not classed as Pre-Operational Force Majeure

Ofgem proposed for Window 3 would result in a project ready to commence construction c. 3 years post IPA decision.

To this a minimum of 4 years construction should be added which gives the earliest realistic “typical” RSD IPA as 2030.

Ofgem agreed it would accept applications from projects in Window 3 that could justify a later commercial operation date than 2028 provided this was before the end of 2032.

NU-Link believes that with a realistic “typical” project having an indicative RSD of 2030 it calls into question the sensibility of then also having a Backstop Date of 2032 and renders the Reasonable Delay Event process largely irrelevant, since it has little scope for any practical application, and in reality, developers will not place any reliance on this being a reliable mitigation to any delays encountered.

However, the main issue with the proposals exists with the needs case review that may occur if the Regime Start Date occurs after the end of 2032. Once the RSD becomes known – i.e. after commissioning – all of the development and construction funds are sunk. Therefore, the reservation of Ofgem’s rights to withdraw the cap and floor regime is a serious threat to developers’ appetite for investment.

The Backstop Date should be set at a more realistic date, targeted at “undue or excessive delays” where a low probability of being reached exists. However, in the absence of any comfort on whether Ofgem will agree to any application for Pre-Operational Force Majeure, the Backstop Date of 2032 unfortunately has a high probability of being triggered even for a small and relatively minor, but probable, delays. To have the threat of the cap and floor regime being removed increases the risk developers face rather than reduces the risk. This will lead to fewer projects, rather than more, and developers will demand higher returns to absorb this heightened risk. Neither of these will help the UK Government meet its 18 GW target of interconnection and is not in the interests of consumers.

This is easily solved if the Backstop Date is shifted to a date which is unlikely to be reached unless the delay was catastrophic or to use the language of the consultation “excessive”.

Shifting the backstop date to a later date i.e. 2037 will reduce the probability of triggering the cliff edge risk for developers, with consumers protected from any delay beyond the RSD FPA by the proposed Payback Mechanism. Developers would consider such an adjustment as maintaining the balance of risk and reward between consumers and developers and meet the objectives set out in the consultation of creating flexibility and certainty and this would reduce the risk premium developers would otherwise seek, ultimately shifting the supply of interconnection in favour of consumers.

- 2. Do you believe that there are any improvements that could be made to the development of the modified Regime Start Date and modified Backstop Date concepts?**

Correcting the commercial operations date for a “typical” project to 2030 and moving the backstop date to 2037 (or removing it completely) would decompress and alleviate the immediate cliff edge risk of removal of a cap and floor agreement in principle.

Widening the definition of Pre-Operational Force Majeure to include those events that would have fallen within Reasonable Delay Event would simplify the proposals somewhat too.

3. Do you agree with the proposal to implement a Payback Mechanism for Delays as a proportionate incentive to encourage developers to deliver projects on time and protect consumers from the impacts of delays?

NU-Link can see that any floor top-up payments repaid during the Payback Period which occur during the Exposure period ensures consumers are not exposed to risk than greater than the current regime.

However, NU-Link does not believe the Payback Mechanism in itself is a motivating factor in delivering the project on time and to budget. A project delivered late is likely to suffer from higher than budgeted costs, may have some costs disallowed at PCR Stage, will begin distributions to sponsors later than planned or result in delays to refinancing. All of these effects reduce project IRR and equity IRR and are adequate drivers to deliver the project on time and in budget and their impacts will likely be greater than the proposed payback mechanism.

4. Do you believe that there are any improvements that could be made to the development of the Payback Mechanism for Delays?

None identified.

5. Do you agree with the proposal to implement a Reasonable Delay Event mechanism as a means of assessing and managing delays in early project development?

No. The RDE mechanism adds complexity which can easily be dealt with by a wider Pre-Operational Force Majeure definition and a more realistic backstop date of 2037.

6. Do you believe that there are any improvements that could be made to the development of the Reasonable Delay Event?

Yes – widen the Pre-Operational Force Majeure definition and deliver the policy objectives, a process which developers are already familiar with.

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21st March 2023

Dear Sirs,

NU-Link's Response to the Notice of Statutory Consultation on a Proposal to Modify the Standard Licence Conditions of the Electricity Interconnector Licence

This response should be read in conjunction with NU-Link's response to Ofgem's *"consultation on its minded-to decision on timelines and incentives changes for the third cap and floor window for interconnectors"* published on 24th February 2023.

NU-Link believes there are two issues with the drafting that is the subject of the statutory consultation:

1. Definition of Pre-Operational Force Majeure

Specifically excluded as an event of pre-operational force majeure is the *"performance or non-performance by an electricity transmission licensee or equivalent entity"*. Whilst this reflects the policy adopted in June 2021 NU-Link would note that one of the biggest risks causing a potential delay is the fact that the electricity transmission licensee could cause commercial operation to be later than the Regime Start Date agreed at FPA stage.

Practically there is little the Interconnector Licensee can do if the electricity transmission licensee simply does not progress the works in the timetable set out in the connection agreement. Where the Interconnector Licensee is the cause of the delay and that delay itself is not an event of pre-operational force majeure then it seems reasonable for any consequential delay by the electricity transmission licensee to be excluded as an event of pre-operational force majeure, but where this is not the case the developer ought to be given relief from the poor performance or non performance of the electricity licensee which in the current climate now appears to be a more regular occurrence.

NU-Link proposes the definition of pre-operational force majeure be amended to delete the words *"performance or non-performance by an electricity transmission licensee or equivalent entity"*.

This modification should be made to the standard licence condition proposed and should be mirrored in the policy decision letter that follows a similar process in circumstances where the interconnector licensee has not yet has the relevant conditions switched on its licence.

2. The definition of the Backstop Date

This should be changed to **2037**. This modification should be made to the standard licence condition proposed and should be mirrored in the policy decision letter that follows a similar process in circumstances where the interconnector licensee has not yet had the relevant conditions switched on.

Should you wish to discuss any aspect of this response please do not hesitate to contact me or David Chamberlain

Yours faithfully

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On behalf of the NU-Link Consortium