

FAO: Nick Pittarello, Joshua Coomber, Richard Harrap

By email: Cap.Floor@ofgem.gov.uk

13 July 2023

Dear Nick,

Consultation on the Regulatory Framework for Offshore Hybrid Assets: Multi Purpose Interconnectors (MPI) and Non Standard Interconnectors (NSI)

Transmission Investment, as one of the UK's leading independent transmission companies, manages one of the largest offshore electricity transmission portfolios. We are a strong advocate of introducing competition into the delivery of transmission and we continue to support the development of the required arrangements *inter alia* through industry groups, responding to consultations such as these and providing evidence to Parliament.

Transmission Investment is also leading, in partnership with the French national grid company RTE, the development of a proposed 1,250MW HVDC interconnector between France and Britain via Alderney ("the FAB interconnector project") and is also developing alone a 700MW HVDC interconnector between Scotland and Northern Ireland ("the LirIC interconnector").

The Ofgem consultation outlines the complexity in seeking to set the regulatory framework for these hybrid offshore assets. The consultation is necessarily focussed on dealing with the near-term projects and implicitly assumes these in seeking to draw more generalised conclusions. The consultation admirably demonstrates, with great clarity, that any decision on the regulatory framework must be compatible with the market arrangements and the regulatory treatment of assets and revenues in the connecting country(ies).

We support the Ofgem option to compartmentalise the assets and would suggest that the approach of isolating the offshore platform from the point-to-point system would be preferable under an Offshore Bidding Zone market approach. However, it is important to recognise that firm policy conclusions, which work generally, cannot yet be drawn, due to the many open questions on market and asset configurations.

We support most of the principles for assessing the regulatory arrangements but would seek to clarify that support should only be given to commercially viable projects. Additionally, the framework must ensure a vibrant multi-party sector, supporting these near-term projects without disadvantaging projects in the future. Whatever policy is progressed, it is essentially that it is agnostic and non discriminatory between financing approaches and is flexible to apply to the current projects and for the future.

We also have strong concerns about what protections are in place to prevent sequential build being so delayed that assets, performing one of the licenced activities under an MPI licence, could be differently treated than if the project was launched under the appropriate non hybrid licence. This is particularly the case where a project begins as an MPI, however, one component is later not realised. For example, the potential for consumers to benefit from a

competition for the Offshore transmission component is lost by opting to be an MPI, but the interconnector element of the project is subsequently abandoned.

Our overall conclusion, however, is that it is not feasible at this time to generalise the approach to defining how projects are regulated until the market and connecting country approaches are understood for particular projects. We would suggest that the overriding principle is that for each asset compartment it should be neither materially advantageous nor detrimental under a hybrid licence compared to the standard licence for the activities undertaken within the compartment.

We respond the specific consultation questions in the attachment.

Yours faithfully,

A handwritten signature in blue ink, appearing to read 'Mark Fitch', with a long horizontal flourish extending to the right.

Mark Fitch
Corporate Development Director

ATTACHMENT – RESPONSES TO SPECIFIC QUESTIONS

Licensing Arrangements

Q1: Do you have any views on our proposal to use, when appropriate, a wider common term of an offshore hybrid asset that could apply to both: category 1 assets (non-standard interconnectors) and category 2 assets (MPIs)?

Q2: Do you have any views on our proposal to use the term of non-standard interconnectors (NSIs) for category 1 assets?

Q3: Taking into account the relevance of the provisions of the Electricity Act for the type of the licence that can be granted to an applicant, do you have any views on how we propose to license the operators of category 1 assets (non-standard interconnectors) and category 2 assets (MPIs)?

We support the additional clarity that comes with the revised terminology. While the consultation is focused on the pilot projects, we would suggest that the categories could be more fully defined. For example, it is possible to read Category 1 as to exclude non-GB generation connected to an interconnector where it does not provide Offshore transmission activities in the connecting jurisdiction. It would be helpful to clarify that a Non Standard interconnector would be the regime to apply to non-GB offshore generation that connects only to the GB market.

We have strong concerns regarding the potential for differential treatment of assets performing the same licenced activities under an MPI licence, where the proposal is for a sequential build of the assets. This is particularly the case where a project begins as an MPI, however, one or other element is later not realised. Where sequential build is expected, protections should be in place to prevent the use of the MPI licence to avoid obligations that would otherwise be applicable if the project was launched under the appropriate non hybrid licence. For example, by applying for an MPI licence, but subsequently abandoning the interconnection element, the potential for consumers to benefit from a competition for the Offshore transmission component of a project is lost, even though the project becomes a single activity OFTO. Protections could include requiring the project to be taken through a Late OFTO Build or Very Late tender competition, where the abandonment of the interconnector component becomes evident ahead of the procurement stage.

Regulatory Regime for MPIs and NSIs

Principles

Q4: Do our proposed principles capture the basis upon which the OHA Pilot Regulatory Framework should be designed and developed?

The first two principles **Economic Viability** and **Integration in Energy Systems** overlap. They would appear to double count the wider benefits of the project. Removing the reference to the wider benefits from the Economic Viability principle would focus the regulatory regime on supporting projects that have an underlying commercial viability in a range of wholesale market price scenarios, avoiding consumers backing 'white elephant' projects.

The **Consumer Protection** principle should recognise the potential for information asymmetry in RAB-regulated arrangements and the design should seek to avoid this, e.g. by the use of competitive processes or other information revealing strategies.

The **Level Playing Field** principle needs to recognise that the regulatory treatment should facilitate third party and TSO led projects both now and for the future. The approach taken in establishing these pilots should not provide a regulatory advantage over future projects, for

example, by giving these early projects certainty over revenues or additional rights that would not be afforded others in the future.

Cross-border sharing of costs and revenues

Q5: How should the cost and revenue sharing boundaries of an MPI or NSI be defined?

Q6: How should costs and benefits of MPIs and NSIs be shared with connecting countries?

The choice around the boundary for sharing cost and benefits appears to be interrelated to the market arrangements and specific asset configurations, therefore it may not be possible to define boundaries that fit consistently well for all.

Ofgem's preference for the whole system option appears to be flawed, as it seems to rely on the assumption that congestion revenues would occur asymmetrically on each part of the cable. This would appear to be contradicted later in the consultation, where under an OBZ arrangement (the preferred market arrangement) the congestion revenues are considered to be largely similar to a point-to-point interconnector. If that is the case, then the most appropriate approach would be to take the Figure 8 approach, where the offshore platform is compartmentalised and funded by the host jurisdiction, as part of the coordination of offshore wind.

Costs, revenues and risks

Q7: Do you agree that the Reasonable Delay Event mechanism should also apply to MPIs and NSIs?

Yes

Q8: Are there any additional risks faced by MPIs and NSIs relative to point-to-point interconnectors?

The risks faced by MPI and NSI compared to point-to-point interconnectors will vary depending on the configuration and the market arrangements that apply. It should not be automatically assumed that generically there are additional risks.

While there are uncertainties regarding the market arrangements and the allocation of revenues with respect to the connecting countries, these must be resolved to allow a decision to be made on the appropriate regulatory regime.

Ofgem must separate out the risks that apply to all projects, such as those pertaining to supply chain constraints that apply to all projects, and cost uncertainties etc, from those that are specific to an MPI project.

Ofgem suggest OHA have a higher coordination risk compared to other projects. This is no different to a Late OFTO Build project, where there is a risk the generation project is abandoned, or a CATO where the onshore transmission project is cancelled. Consumers would be liable for repayment of the costs incurred (net of commitment securities and potential reuse of the assets).

The regulatory regime should provide a framework to allow the OHA projects to be held whole where events occur outside the control of the project, e.g. connection of a new third party or changes in the market lead to changes in the costs, revenues, or incentives over performance. Lessons from the OFTO regime may be pertinent here, recognising that as offshore grids may also become impacted by connections and background changes, that may lead to projects needing to invest for the benefit of the wider system.

Proposed regulatory regime packages

Q9: Which of our proposed regime concepts- Pure RAB, Narrow Cap and Floor, Partial RAB or Cap and Floor with IRR, do you consider most appropriate and why?

Q10: Do you agree with applying the features of a RAB regime to the offshore converter platform element of an MPI project? Is there a better form of regime for the offshore converter platform element and, if so, what would be the rationale for it?

Q11: Which of our proposed offshore hybrid asset package options is most appropriate in your view and why? Within your response consider if there are other viable options not considered here, if we can disregard any options entirely, and which options best reflect the draft principles.

We would highlight the current Interconnector Cap and Floor regime has been successful in securing investment using benchmark rates of return. Also, Ofgem has previously highlighted the challenges with an IRR approach, when it adopted the current Cap and Floor methodology¹ *“With regard to the IRR and profit approaches, it was recognised that they were complex and potentially subject to distortion based on the developer’s accounting approach. They were also considered as the most challenging and least transparent to cost monitoring”*.

The IRR option lacks sufficient detail on how it would work in practice, e.g. would investors be guaranteed an IRR within the maximum and minimum range, or is it simply another way to ex-ante set the revenues for a project (and the actual IRR could stray outside of the initial targets)? We would support the overriding concept to allow investors to seek a project-specific target equity return, rather than all projects working to a generic benchmark return. This additional flexibility in setting the Cap and Floor, would be welcome, being especially important in a financial climate where the required returns on capital are volatile and on an upward trajectory away from regulatory benchmarks. Ofgem should learn the lessons from the original introduction of Cap and Floor to ensure the policy, from the start, supports the widest range of funding and financing options (balance sheet, project finance etc) for both current and future projects.

We generally support the proposed concepts provided that they are designed to be agnostic to financing approach (noting the IRR approach lacks sufficient detail to fully understand the implications of it). They should all be progressed, at this stage, because the appropriate package will likely depend on features including: the configuration of the assets, market arrangement on each end and revenue sharing arrangements agreed with the NRA etc. For example, where an Offshore Bidding Zone (with implicit trading), and OWF is only in GB, Ofgem notes the congestion revenues are expected to be the same as a point-to-point interconnector allowing a standard cap and floor arrangement. Varying any of these assumptions, however, requires adjustments to maintain value equivalence for all the project parties and components.

We would note the concept of Narrow Cap and Floor appears to provide helpful flexibility for projects to move towards Cap and Floor, where the adjustment factor is 1 (no scaling down) or RAB -style maximum revenue, where the adjustment factor is 0 (Cap and Floor are the same level).

We are concerned, however, that the introduction of the hybrid licence may reduce benefits to consumers, where the normal incentives for an asset compartment is different to the standard

¹ <https://www.ofgem.gov.uk/publications/preliminary-conclusions-regulatory-regime-project-nemo-and-future-subsea-electricity-interconnector-investment>

licence approach. For example, where an Offshore platform attracts a RAB based revenue, it would appear prudent to apply the same treatment as for an OFTO, including the revenue stream, availability incentive etc. Ofgem should also investigate how this model could utilise competition by market testing to reduce the prevalence of information asymmetry between the regulator and project, e.g. by running transparent debt financing competitions.

Design parameters of the regime

Q12: Do you agree that these regime parameters would be applicable for MPI and NSI pilot projects as described above? If not, what changes should be considered?

Yes, in most cases, noting an NSI that connects only to OWF(s) and not to another market region may require more specific treatment that may not align fully with these parameters (as it would not enjoy congestion revenues as envisaged where two markets are joined).

Q13: Should the offshore converter platform be treated differently?

Yes, and the regime should provide equivalent treatment to the OFTO regime to avoid creating a preference for one or other licence type.

Q14: What would be an appropriate availability target for MPIs and NSIs? Could a similar methodology as used for interconnectors be applied?

Yes, subject to understanding the potential interactions with the OWF connecting platform.

Q15: What would be an appropriate regime length for the cost recovery of the offshore converter platform? Would it be appropriate to align the regime length to the one for the cable or can it differ?

Yes, the timeframes should align such they should end at the same time to enable a clean renegotiation of the arrangements at the equivalent of the End of TRS point. This may necessitate differing regime lengths where the assets are commissioned at different points in time.

Anticipatory Investment

Q16: Do you support, in principle, the extension of AI policy to MPIs?

Q17: Do you support our minded-to position that AI policy should not apply to NSIs?

We support the principle of applying AI to MPI and NSI projects.

Q18: Do you agree with the set of scenarios set out for simultaneous and sequential build projects, and our conclusions on where AI policy could/could not apply?

Ofgem have not set out why in the first scenario the Later User, building the interconnection element, must be the MPI Initial User. Where this is not the case, and a different party is the Later User we would expect the same principles to apply with AI incurred by the OWF/OFTO on the Offshore Platform/Cable would be recovered either by inclusion in the cost assessment of the interconnector Cap and Floor calculation, or if abandoned, through a TNUoS residual.

Q19: Do you agree with our suggestions surrounding AI risk mitigation and assurance for MPI developers, namely extending User Commitment (or analogous) arrangements to the later user and developing a process analogous to the Early-Stage Assessment?

Q20: Do you agree with our suggested high-level mechanisms for the recovery of AI cost from the later user, and from the consumer in the instance where the later user fails to connect or reduces the capacity of its project?

We do not agree that AI can be recovered through the Cap and Floor mechanism, because while revenues remain within the Cap and Floor these costs work to lower the returns of the project. We would agree with Ofgem's option that AI that is not recoverable through TNUoS charges (offset by User Commitment or similar mechanism), should be dealt with as a direct RAB style revenue that is outside of the Cap and Floor arrangements.

Q21: If the RAB model applies, would AI policy still be required for the assets covered by the RAB, given that the consumer would in theory cover these costs?

Yes, the AI policy should apply, such that there is a User Commitment or other analogous mechanism to seek to increase the likelihood of a project commissioning, but with a fallback to recovery from consumers of any outstanding costs of the AI (including any ongoing operating costs).

Ownership unbundling

Q22: Do you have any views on how the ownership unbundling requirements applicable to MPI and NSI operators may influence the delivery of these assets (and/or delivery of offshore generators connected to MPI assets)?

Regulatory safeguards and compliance requirements for MPIs and NSIs

Q23: Do you have any views as to the regulatory safeguards and compliance requirements that should apply to MPI licence holders, taking into account the dual activity (interconnection and transmission) that they will perform?

Q24: Do you agree that the inclusion of a RAB as part of the regulatory regime for MPIs should be subject to appropriate safeguards, including appropriate compliance requirements? If no, please explain why. If yes, do you have any specific suggestions?

Q25: Would the regulatory safeguards as well as compliance and independence arrangements already applicable to standard interconnector licence holders constituting subsidiary companies under a single parent company be sufficient if MPI licence holders were added, as subsidiary companies, to this corporate structure? If yes, please explain why. If not, what additional safeguards should be implemented?

We agree that NSI should be treated on an equivalent basis to Interconnector licensees as they are performing the same activities within the GB jurisdiction.

To avoid preference for (or against) from proceeding under the MPI licence, MPI assets within each compartment should be subject to at least the equivalent safeguards that apply to the assets under a non hybrid licence. These should include protections against cross-subsidy between asset compartments and equivalent obligations, e.g. on connecting third parties etc, where activities/assets enjoy RAB-based revenues.

Charging

Q26: Do you agree with the above principles relating to connection and onshore charges for offshore generators connecting to an MPI or NSI?

Yes.

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