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By email only to LDES@ofgem.gov.uk with title Financial Framework Consultation Response from Shell

Dear LDES team

Subject: Financial Framework: LDES Window 1 Cap and Floor regime.

Shell welcomes the opportunity to provide input into OFGEM's LDES financial framework for LDES Window 1.

Whilst we have not applied for a cap and floor (C&F) in Window 1, we are keen that there is a robust methodology for awarding a C&F subsidy. Shell has supported the deployment of electricity storage in Great Britain by providing long-term structures, such as the seven-year toll for the Bramley Battery Energy Storage System (BESS)[1].

We understand that Ofgem prefers merchant deployment where possible, as this provides the clearest incentive for LDES to operate efficiently in the wholesale market. And that Ofgem is planning to introduce the C&F to support projects that are not financeable on the basis of wholesale and capacity market revenue.

To best address potential defects, the design of the C&F should prioritise the allocation of support to projects that are closest to merchant deployment, which would mean projects that request a wider cap and floor. We are supportive of a framework that rewards a low floor and the ability for asset owners to benefit from a higher and softer cap, to drive performance

[1] Insight: UK battery deal helps Shell provide greater power supply flexibility | Shell Global

and good asset management. In addition, the Capacity Mechanism already provides a 15-year revenue floor – so understanding the interaction between these two mechanisms will be key to ensuring cost effective deployment.

If you have any questions regarding our responses, we would be happy to discuss in more detail. Our response does not include any confidential information.

Yours sincerely,

[redacted]
Regulatory Affairs Manager

Question 1: What are your views on our proposals to move beyond focusing solely on project return rates at the C&F levels, towards a more flexible approach that allows projects to tailor key parameters to the needs of their LDES project archetype?

We believe that, if possible, projects should be funded on a merchant basis. Where this is not possible then developers should be able to propose a cap and floor which enables them to deliver the LDES project. This is a win-win as it limits the consumer funds required to deliver the project. Therefore, we support the proposal to allow projects to tailor key parameters.

Question 2: How well does the proposed competitive framework accommodate the differing risk profiles of various LDES technologies? Are there any technology-specific considerations that should be better reflected?

While it will be easier to compare BESS with BESS and PSH with PSH, it will be necessary to be able to rank the 171 projects having considered their Economic Assessment, Strategic Assessment and Financial Assessment. Ofgem's assessment of the projects should be shared publicly when final decisions are made.

Question 3: How can OFGEM best ensure comparability between bids given the bespoke nature of the proposed parameters? Are there specific normalisation techniques or benchmarks you would recommend?

It might be worth considering a points system for different locations and technologies relative to how they contribute to Clean Power 2030. We believe that Ofgem should prioritise allocation of support to projects that are able to deploy on a more merchant basis, with a wider cap and floor.

Question 4: What are your views on the proposed truth telling incentives? Do you think these will effectively discourage inflated or strategic bidding?

Supportive of a higher cap for projects which are the most competitive. We think it would be beneficial to have the incentive set in tranches rather than one cut off point as projects may not try if they are unsure if they will meet the threshold.

We understand that the original soft cap multiplier was to reward assets for being available. This seems like a sensible incentive for an increased soft cap multiplier as it ensures assets owners maintain the asset over its lifetime.

We also support projects being able to have a higher cap where they have requested a lower floor than the administrative floor.

Question 5: What are your views on our proposed approach to floor setting?
The five criteria to set a floor look sensible. We are also supportive of projects requesting a floor lower than the administrative floor where they can justify that the project will be viable under these circumstances. Clarity on the interaction with the Capacity Mechanism will be key as this already provides projects with a 15-year floor.

Question 6: What are your views on our proposed performance-linked measures to access the floor and incentives below floor?
We are supportive of having a minimum Availability Target ahead of floor payments being made. We suggest this level is set on an annual average basis.

Question 7: Does the proposed cap design provide the right balance between incentivizing efficient operation and sharing upside with consumer?
As noted in our answer to question 4, we are supportive of a soft cap to incentivise asset owners to maintain the asset to a high quality and encourage participation in as many markets as possible to increase revenue capability. We think the standard cap of 10% is quite low and would be interested to understand how this compares to other countries.

Question 8: What are your views on the use of the CAPM and the proposed input assumptions (e.g. equity beta, RFR, TRM) for calculating the cost of equity for LDES? Are there refinements or alternatives you would recommend?
For CAPM we think that LDES projects are riskier than interconnectors and therefore should have a higher Risk-Free Rate, despite the differences noted in the consultation (inclusion of a soft cap, revenue assessed over the term of C&F, and a higher floor level).

Question 9: What are your views on the proposed capital cost components for determining the RAV and C&F levels, including the equity and debt transaction cost allowances?
The proposed capital cost components look sensible.

Question 10: Do you agree with limiting reopeners during the operational phase to opex (after 10 years) and decommissioning (if there's a legal change)?
Proposed reopeners once every 10 years look sensible.

Question 11: What are your views on the treatment of decommissioning costs and IDC (interest during construction) – particularly around timing of recovery, project delays, and legislative changes?
It will be difficult to compare decommissioning costs across the different technology types and different expected length of life. Need to ensure this does not distort the project selection criteria.

Question 12: What are your views on the proposed IDC rate approach and the option for projects to bid their own rate? Should riskier technologies receive a different rate?
We believe the IDC rates look low, including using the interconnector gearing assumption. We suggest discussing with banks and other lenders.

Question 13: What are your views on the types of cost efficiency and delivery performance incentives included in the regime?
The cost-efficient incentive to adjust the RAV up or down to cover efficient and economic costs with a 50:50 split seems sensible. The second 'outturn cost comparison approach' where increased amount will be recovered if floors are triggered, creates uncertainty on the project, so is less desirable.

Question 14: What is your preferred approach to cost incentives (e.g. cost sharing vs. outturn comparison), and how should these be appropriately calibrated?
Please see answer to question 13.

Question 15: Does our proposed mix of generating caps, ringfencing, and financial reporting strike the right balance between financial resilience and flexibility for LDES projects? If not, what would you change?
We are supportive of the proposed 80% gearing cap, the asset ringfencing provisions (such as approval for asset disposal) and regular financial reporting.

Question 16: Which charges – TNUoS or BSUoS, do you consider more appropriate for funding cap and floor payments and receipts, and why?
We are supportive of a new charge being introduced, rather than using TNUoS or BSUoS, to ensure that the costs of funding the scheme are transparent.

The purpose of TNUoS is to recover the costs of building and maintaining the transmission network, where interconnectors are an extension of that transmission network. The purpose of BSUoS is to recover the costs to NESO associated with balancing the electricity transmission system. Funding LDES through the proposed C&F is more equivalent to funding provided to firm capacity under the Capacity Mechanism.

We would be most concerned with funding the C&F from BSUoS as this may make this charge more difficult to anticipate and would be most distortive. BSUoS is there to recover short-term balancing costs as opposed to subsidising long-term capital investments.

Question 17: What are your views on including a residual value at the end of the cap and floor period, and how should this effect depreciation and investor returns?
Pumped hydro plants have a life greater than 25 years so they will have a residual value. We are supportive of recovering previous floor payments in the period post 25 years, if the asset makes a return post 25 years.

Question 18: What policy mechanisms should be introduced to support invest ability now and post regime or recover of residual value beyond the C&F period?
We are not supportive of a cap beyond the 25-year C&F period. That said we are supportive of recovering any floor payments from future revenues.

Question 19: What are your views on our proposed financial model and handbook? Do you have any suggestions for simplifying it while keeping it clear and robust?
No additional comments.