17th July 2025

Quarry Battery Company
LDES Financial Framework consultation response

Executive Summary

The Glyn Rhonwy PSH project is being developed by Quarry Battery Company Ltd (QBC), and is funded by Octopus Energy Generation (OEG).

Octopus Energy Generation is a leading global investor in renewable energy and part of the Octopus Energy Group. With a strong focus on accelerating the energy transition, the team manages over £7 billion of assets on behalf of institutional investors and third-party capital partners. Octopus Energy Generation invests across the lifecycle of clean energy assets—including development, construction, and operations—spanning technologies such as solar, onshore wind, offshore wind, battery storage, and innovative green tech solutions. The platform is known for pioneering approaches to energy investment, including its flexible funding models and customer-centric strategies, while supporting the rapid scale-up of green energy infrastructure across the UK, Europe, and beyond.

In the financial framework consultation, Ofgem has presented developer return levels similar to that of Window 3 interconnectors, while shifting additional risks from consumers to developers compared to Window 3 P2P/OHA. Ofgem notes in the consultation documents that LDES developers are likely facing higher risks than that of P2P or OHA. As a result we are concerned that the overall economics do not appear to work, and either the C&F return envelope will have to increase or the terms will have to fall back to that of Window 3.

We are concerned that if the C&F approach fails to be adapted in the manner proposed, without any relief on the rates suggested, then any projects that are accepted by Ofgem risk failure at FID, or may require further support that was not clear at the start. We consider that this presents a risk to consumers through non-delivery or delay of the LDES that the UK requires. We have benchmarked Ofgem's proposals to other cap and floor assets (point-to-point ("P2P") interconnectors and offshore hybrid assets ("OHA")) and find LDES assets are consistently higher risk than other cap and floor assets. We do not believe this has been reflected in Ofgem's setting of the risk-return proposals for LDES assets under the cap and floor regime.

The table below compares the differences between the regime proposed for LDES and the historic regimes for P2P and OHA. The final column summarises the differences and how they relate to investor risk.

Risk	LDES	P2P Interconnectors	OHA	Assessment
Revenue	LDES revenues are comprised of trades in wholesale market and balancing mechanism. Floor is set using 'buildings block approach' using BBB 15-year+ index. Floor can also be set based on debt requirements subject to clawback on 'excess' floor revenues. Cap set using 'building blocks approach' with soft cap rate of 10%.	Interconnector revenues are comprised of sales of capacity. Floor is set using 'buildings block approach' using blend of A and BBB 15-year+ index. Floor can also be set based on debt requirements subject to clawback on 'excess' floor revenues. Cap is set using 'buildings block approach'. Cap is a hard cap.	Same as P2P interconnectors but higher floor rate of BBB 15-year+ index plus risk premium of 150bp. We understand floor can also be set based on debt requirements subject to clawback on 'excess' floor revenues (subject to request). Cap rate is set using different framework.	OHAs are lowest risk due to highest floor and not having to bear trading risk. LDES likely higher risk due to presence of trading risk associated with revenues as unlikely it is sufficiently compensated by assuming a higher credit rating of BBB over A/BBB.
Cost	Ofgem proposal for costs to be assessed with respect to ex-ante efficient cost targets. Cost re-opener for opex included.	Interconnectors subject to post-construction review where costs are assessed on ex-post basis. Cost re-opener for opex included.	We understand same as P2P.	LDES higher risk as material changes during construction will have an adverse impact on costs which will not be reflected in the efficient cost targets.
Inflation	Cap and floor indexed to expected inflation	Cap and floor indexed to outturn inflation	Same as P2P.	LDES higher risk as bears inflation risk unlike interconnectors.
Delivery	Explicit delivery incentive included in addition to delivery incentive of delays potentially not being reflected in cap and floor length and revenues only being earned during operations.	Delivery incentive of delays potentially not being reflected in cap and floor length and revenues only being earned during operations.	Same as P2P.	LDES higher risk due to presence of explicit delivery incentive.

Risk	LDES	P2P Interconnectors	OHA	Assessment
Tax	Tax set based on ex-ante basis for buildings block approach and actual tax based on debt requirements.	Same as LDES	Same as P2P.	No difference
Financing	Buildings block approach assumes notional financing assumptions. The floor set based on debt requirements reflects actual financing requirements. Potential gearing cap and financial resilience requirements.	Buildings block approach assumes notional financing assumptions. The floor set based on debt requirements reflects actual financing requirements.	Same as P2P.	LDES faces higher restrictions and requirements than interconnectors.
Regulatory	New regime for asset class.	Established regime for asset class.	New regime but partially reflected in higher floor offered.	LDES is higher risk as no compensation for higher risk.

We have some overarching comments with respect to Ofgem's proposals as well, to be specific:

- We agree that "inflation leveraging" is a risk to consumers that Ofgem can manage, and we propose a less risky solution in the answers below;
- An ongoing Cap post the C&F period is likely to increase equity return requirements into the C&F window for our project, which may increase the near term cost to consumers, [redacted]
- The CAPM approach should not include National Grid, as they do not take merchant risk, and should also exclude Iberdrola – who is focussed on network infrastructure and retail power rather than generation (only c. 20% of its profits comes from renewable energy and sustainable generation);
- The 10% sharing incentive above Cap offers very little equity upside, in a market that can be very volatile when modelled accurately. This both transfers risk to the developer and acts as a perverse disincentive to risky but valuable trading approaches aimed at reducing consumer BM costs.

If Ofgem decide to go ahead with the basket of changes described, then we will have to revise our project CFFM accordingly and we believe this will ultimately come as a net cost to consumers either through non-delivery of essential projects, or by securing LDES at suboptimal cost.

Please see our answers below to the specific consultation questions.

Q1. What are your views on our proposal 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 are supportive of the flexible approach adopted by Ofgem in setting the cap and floor levels, this is in line with the approach adopted for other asset classes that Ofgem regulates, namely interconnectors (both point-to-point ("P2P") and offshore hybrid assets ("OHA"). However, the overarching principle adopted by Ofgem has to be that any approach followed by Ofgem ensures an appropriate and proportionate risk-return balance between investors and consumers. We currently have concerns that Ofgem have not achieved the right balance in its current proposals.

A flexible approach will also enable Ofgem to meet its stated an objective of technological diversity. This is because different technologies face different types of risk. Therefore, allowing some flexibility ensures that Ofgem can attract a variety of projects and not be reliant on a single technology type.

Q2. 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?

We believe Ofgem's current framework does not take account of technology specific risks to a sufficient extent. For example, pumped storage hydro (PSH) vs Battery Energy Storage Systems (BESS). These asset types have very different construction risks: for example PSH typically has a longer and more complex construction process compared to BESS. This means that Ofgem's proposed delivery incentive is likely to be more material for PSH than BESS.

The deliverability incentive suggested is a fixed 25 basis points per year, but this disproportionately affects projects with long build times – e.g. a 25% delay on a 4 year project will cost 25bp, compounded over the 4 year target construction period plus the additional year delay, whereas a 25% delay on a 12 months BESS may only cost 6.25bp compounded only across 15 months (12 month target build plus 3 month delay).

One of the success criteria of the LDES C&F is that it should succeed in building the PSH asset class which is particularly challenging given its capital intensity and long expected lifetime. Currently, it appears that Ofgem have not appropriately considered these technology differences and we believe Ofgem needs to recalibrate its proposals.

Q3. 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?

We acknowledge that comparing bids can be difficult due to differences in technology, strategy and project size. We propose that projects with comparable technology are benchmarked to each other on a variety of metrics e.g., rates of return requested and customer support per MW. This ensures projects with similar risk profile are benchmarked to each other and therefore any comparison is meaningful and relevant.

Q4. What are your views on the proposed truth telling incentives? Do you think these will effectively discourage inflated or strategic bidding?

We acknowledge truth telling incentives can be useful in encouraging developers to reveal the true costs. This is particularly useful when there is a lack of comparable projects and companies e.g., regulation of onshore networks. However, in this context we believe this is less relevant given the large number of projects participating in LDES Window 1. This creates competitive tension and therefore gives developers the incentive to bid as competitively (and as truthfully) as possible.

Layering on top truth telling incentives therefore is likely to have limited value in revealing the true cost of projects, instead it may encourage developers to bid more aggressively and potentially result in inefficiently low cost estimates and hence unfinanceable bids being submitted, this is often referred to as the winner's curse. This would, ultimately, be to consumers' detriment as it would increase project attrition and potentially create a supply gap.

We already observe this phenomenon in other competitive processes without truth-telling incentives e.g., CfD auctions whereby bidders are incentivised to bid as aggressively as possible and potentially provide undeliverable bids. This has resulted in projects pulling out subsequent to submitting their bids e.g., Hornsea 4. Therefore, Ofgem needs to ensure that its truth telling incentives do not further exacerbate the incentive for strategic bidding created by the competitive process. For example, there is a lack of detail in Ofgem's consultation on how it will determine whether bids are 'uninvestable'. We believe Ofgem could try to counteract these strategic bids through introducing penalties for withdrawing once the project has received a project assessment.

Therefore, we propose that Ofgem dilute or remove the truth-telling incentives as they are not necessary in our view due to the competitive process. Instead, Ofgem should focus on ensuring the regime itself is financeable and bankable. It could achieve this through setting an appropriate risk-reward balance e.g., setting a bankable floor, appropriate risk protections and sharing factor above the cap. For example, in our initial submission, we proposed a 50% sharing factor. There is also precedent for this sharing factor from the regulatory regime for Eleclink.

Additionally, we believe Ofgem's proposal on inflation indexation further encourages developers to engage in strategic bidding as developers who take a more optimistic view on inflation (i.e. assume inflation will be below the long-term target or believe it can be managed in a costless manner) are more likely to be able to bid lower. We believe this is an unintended consequence of Ofgem's proposed approach as Ofgem potentially will be rewarding developers for taking risk on macroeconomic assumptions and not linked to consumer outcomes. This has not been considered by Ofgem in its analysis and we encourage Ofgem to consider this when setting its final proposals. We understand Ofgem proposed this due to the identified problem of the inflation leverage effect, we have proposed our solution on this in our response to Question 5.

Q5. What are your views on our proposed approach to floor setting?

We agree with Ofgem's framework for setting the administrative floor. This is consistent with the approach adopted for interconnectors. In terms of the specific parameters, we agree with Ofgem's choice of BBB index 15 year+. This is aligned with our proposal as we believe our project would achieve a level of creditworthiness comparable to a BBB credit rating under our proposal. However, achieving an investment grade credit rating is dependent on several factors namely the regulatory regime adopted.

Under Ofgem's proposals, we do not believe that we would be able to achieve an investment grade credit rating as we are exposed to higher risks than interconnectors. For example, P2Ps and OHAs are not exposed to inflation risk whereas Ofgem have proposed that LDES developers would be exposed to the difference between expected and outturn inflation. This is a substantial risk transfer and Ofgem have not included any further remuneration for this risk transfer (which is not costless). We calculate that depending on background inflation, and asset performance, the proposed change could reduce equity returns by up to 1% over the course of the C&F period (assuming no impact on the cost of debt). The proposal manifests as a new risk to capital providers (both debt and equity). This puts upward pressure on both the cost of debt and cost of equity for LDES developers, which will ultimately be funded by consumers through higher consumer support and prices. We do not believe this is in consumers' interests.

LDES developers already face higher risk than P2P interconnectors due to the novelty of the regime being applied to this asset class. This is sometimes referred to as first-of-a-kind risk. We do not observe Ofgem acknowledging this and instead they appear to have further increased the risk differential between interconnectors and LDES assets by further allocating risks to LDES assets e.g., delivery incentives. We provide a table in the executive summary above which compares risks to LDES against those faced by P2P and OHA.

We understand Ofgem's concern with the inflation leverage effect. However, we believe this should be solved by setting a split floor comprising a nominal and index component. The nominal component would cover nominal debt payments and the indexed component would reflect the equity portion of the RAV, opex, capex and tax. The administration of such an arrangement does not appear to be onerous, and helps to secure equity at lower cost, which in turn translates to a lower floor and lower cost to consumers.

In our submission, we proposed to set a cap and floor for [redacted] This is aligned with [redacted] Ofgem's proposals for Competitively Appointed Transmission Owners (CATOs). Ofgem appear not to have considered this flexibility in its proposals as we believe extending the cap and floor period would lower the cost to consumers.

With respect to the ACOD floor, we agree with Ofgem that this should be an option for project finance developers. However, we have three concerns with Ofgem's current proposals:

1. **Annuitisation:** As highlighted in our submission, annuitisation as utilised in setting the administrative floor, is not required for setting the ACOD floor as the floor should match debt requirements, which are not annuitised. This creates the risk of projects not being able to meet debt covenants. Therefore, Ofgem should remove this step from the CFFM.
2. **Treatment of excess floor:** Ofgem have highlighted that if the ACOD floor is above the competitive floor and the company draws on the ACOD floor it will need to repay the difference between the ACOD and competitive floor before being able to pay equity distributions. We agree that any excess floor payments should be repaid before paying any equity distributions as set out in our submission. However, we believe the excess floor should be set with respect to the administrative floor. This is the approach adopted for interconnectors and ensures consistent treatment between LDES and interconnectors. Otherwise, this further increases the risk for LDES relative to interconnectors.
3. **Treatment of lower floor:** In our submission, we proposed an ACOD floor which is below the administrative floor in [redacted] out of [redacted] years. It is currently unclear how Ofgem would treat this in its framework and reflect this benefit to consumers e.g., would this benefit be recognised in calculating the amount to be repaid to consumers if there are excess floor payments in earlier years.

Q6. What are your views on our proposed performance-linked measures to access the floor and incentives below floor?

The Minimum Availability Target (MAT) is proposed to be set on a project by project basis, either through an independent witness or by Ofgem with reference to system stress events. We fully accept the principle that only those projects that are actually able to serve the market should qualify for ongoing support, however we are concerned that there is insufficient detail on the likely final shape of the MAT. Ofgem should ensure that the MAT does not unfairly penalise projects. In our eligibility application we described our "operational philosophy" as having high availability and primarily seeking to serve the BM. Does this mean we would be held to a higher MAT than other PSH projects? If so – will the higher MAT expected of us give us a higher scoring when comparing one project to another? Setting the MAT on a project by project basis probably makes sense, but those projects that can achieve high availability should have that reflected in their scoring. A MAT of 80% as used for interconnectors seems like a natural place to start, this could also be scaled by each project's P50 availability i.e. lower P50 availability projects would have a lower MAT.

We welcome Ofgem's recognition that the MAT has implications for project-financed LDES. We agree with Ofgem that it would be appropriate to allow projects to keep their floor payments for a certain period of time, even in cases when the actual availability falls below the MAT (with associated repayments later on). This is consistent with our original submission.

Q7. Does the proposed cap design provide the right balance between incentivising efficient operation and sharing upside with consumer?

We agree with Ofgem's framework for setting the cap except for its approach to inflation indexation as discussed in our response to Question 5. The overarching 'building blocks' framework is consistent with the approach adopted by interconnectors and is in line with our proposal. However, we have concerns with the risk-reward balance e.g, inflation indexation and the sharing factor proposed with the current cap rate.

As described in our response to question 5, we believe the issue of the inflation leverage effect should be addressed through a split approach and not passing inflation risk to developers for no extra remuneration.

In our proposal, we proposed a cap rate of [redacted] (based on Window 3 interconnectors) and a [redacted]% sharing factor. In our view this provided an adequate incentive for developers to maximise the use of the asset given the risks we are exposed to. Therefore, we believe the 10% sharing factor proposed is too low.

We have not been able to review CEPA's analysis that Ofgem cite in the consultation document and would strongly encourage Ofgem to share the advice received in setting this crucial factor. However, we suspect CEPA has used a forecasting model that either does not include BM in the revenue stack, or misunderstands it. BM modelling is very difficult and this was covered in our response to the CBA consultation. It is our belief that poor forecasting of the BM is a major barrier and part of the market failure that faces LDES assets. We want Ofgem to be mindful of inadequate BM forecasting when setting policy, especially where the modelling is being relied on to such an extent. We believe CEPA's modelling is likely to be based upon a pedestrian approach to LDES trading (wholesale arbitrage) and led them to conclude that 10% is adequate. However we intend to trade primarily on the BM, and this will have a higher benefit to consumers than wholesale arbitrage alone, however the 10% sharing is insufficient to incentivise the risk profile of BM trading. We are concerned that the 10% level proposed will have the consequence of increasing cost to consumers in the following ways:

- Equity return requirements moved to short term rather than longer term. Since equity would only benefit 10%, it is unlikely to take BM trading risks on as frequently as originally imagined. Equity will be looking for a return through the occurrence of a "bumper year" or two along the way. If these events are significantly muted by paying out 90% above the cap, then equity must instead look for ongoing returns from the floor, increasing the blended WACC for the project and so raising the Floor.
- We believe our project will have the highest impact in the BM, where it can most regularly reduce curtailment of renewables, displace expensive peaker plant and reduce the cost of grid balancing for the consumer. However if returns are 90% shared to the consumer above the Cap, then as soon as returns are nearing the Cap, it will shift trading behaviour to a more defensive strategy that focuses on the wholesale market where volumes are deeper and buy sell spreads are lower but more certain. This would be to the detriment of consumers.

Q8. What are your views on the use of the CAPM and the proposed input assumptions (e.g. equity beta, RFR, TMR) for calculating the cost of equity for LDES? Are there refinements or alternatives you would recommend?

As described above, an appropriate risk-reward balance needs to be struck between the cap parameters (cap rate and sharing factor). Therefore, the cap rate needs to be consistent with sharing factor assumed and vice versa. We are, in principle, happy to accept a lower cap rate in return for a higher sharing factor and vice versa.

Based on the proposed sharing factor, we believe the CAPM parameters should be adjusted. We acknowledge that Ofgem's desire to adopt consistent market parameters (risk-free rate and total market return) across the assets it regulates. These parameters are debated at length in other forums e.g., RIIO, therefore we do not discuss this here as we do not believe there is anything incremental which can be added in this forum.

We have a concern with Ofgem's approach to setting beta, namely its selection of comparator companies. LDES and interconnectors do not necessarily need to have consistent comparators as they are different assets with different risk profiles even if they operate under similar regulatory regimes. For example, LDES assets bear trading risk whereas interconnectors do not as they sell capacity and therefore traders i.e. the buyers of their capacity take this risk. This means that LDES assets are exposed to higher market and operational risks. These risks and differences have been summarised in the Exec. Summary above.

With respect to the comparators, we believe National Grid and Iberdrola should be removed from the comparator set if the current sharing factor is retained. National Grid owns predominately network assets, which are not exposed to the merchant or trading risks that LDES assets are. Iberdrola is also not relevant as it is predominately a retail and network business (c. 80% of profits from these two businesses). Both of these businesses differ substantially in their risk profile to LDES.

Additionally, we believe Ofgem should consider adding additional comparators to its comparator set including Centrica (which has a substantial trading arm) and other businesses with substantial trading operations e.g., BP, Shell and commodity traders such as Glencore. These businesses are engaged in trading activities like LDES assets are, and therefore are more comparable than businesses such as Iberdrola and National Grid.

Q9. 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?

We agree with Ofgem's approach to devex, capex, spares, repex and decommex. We would welcome further detail on Ofgem's cost assessment process. For example, as a developer, we have an explicit incentive to minimise our devex due to uncertainty with the project and limited capital available therefore we expect it is all efficiently incurred.

On IDC, we believe Ofgem should guard against strategic bids on this variable. For example, some developers e.g., developers with large balance sheets may be able to absorb financing costs during construction to a higher extent than project financed developers such as ourselves. Therefore, by allowing developers to suggest an IDC, Ofgem create the potential of disadvantaging smaller developers in favour of larger developers. This creates an unlevel playing field for developers.

On the transaction costs proposed by Ofgem, we agree with the debt transaction costs. However, we believe there should be flexibility on equity transaction costs. For example, our project will be equity financed by [redacted]. We believe Ofgem should be flexible on these parameters and allow developers to provide their evidence on these costs.

Q10. Do you agree with limiting reopeners during the operational phase to opex (after 10 years) and decommissioning (if there's a legal change)?

We agree that limiting reopeners in this way is a risk that is better held by developers than by the consumer. The main opex risk to us is the purchase price of electricity, but since all C&F number will be based on net revenue (sales less cost of sales) rather than gross revenues, this risk is already addressed.

We believe there may be some value in adopting a financing re-opener if Ofgem adopt a longer C&F period as we proposed in our eligibility stage financial model. This ensures consumers can benefit if we are able re-finance at lower rates and protects developers if rates materially increase. This could be designed based on a specific trigger point e.g., yields on benchmark index change more than 100bps and there is a refinancing. This reduces the administrative burden on Ofgem and developers.

Q11. What are your views on the treatment of decommissioning costs and IDC - particularly around timing of recovery, project delays, and legislative changes?

Decommissioning costs – the possibility of re-opening in the case of legal or legislative changes is welcomed.

We agree IDC should be recovered during the operations phase of the project.

We welcome Ofgem clarifying how it will handle the expected alignment of RPI with CPIH in 2030. There is currently some ambiguity on how this would be handled as it impacts Ofgem's approach to setting the cost of capital parameters.

Q12. 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?

IDC – The approach appears reasonable as it allows each project to bid in actual IDC costs in the case this is higher than the administratively determined cost. Technologies should bid the rate they will face, so yes – riskier technologies should be able to bid a higher rate, and less risky technologies should bid a lower rate. Each technology class should be compared against its peers rather than against all projects, as otherwise Ofgem may fail to meet its objective of technological diversity.

However, as described previously, Ofgem should guard against strategic bids on IDC. For example, some developers e.g., developers with large balance sheets may be able to absorb financing costs during construction to a higher extent than project financed developers. Therefore, by allowing developers to suggest an IDC, Ofgem create the potential of disadvantaging smaller developers in favour of larger developers. This creates an unlevel playing field for developers.

Q13. What are your views on the types of cost efficiency and delivery performance incentives included in the regime?

On cost efficiency – we welcome the principle of incentivising cost accuracy, rewarding cost efficiency and penalising cost overruns. However, we prefer the approach adopted by Ofgem for interconnectors i.e. an ex-post review of costs. This ensures efficient costs are recovered and de-risks projects by not assuming some arbitrary target for projects which may be difficult to benchmark. This ensures projects are delivered at lowest cost. We would expect Ofgem to continue to apply similar principles to the LDES PCR process from the interconnector PCR process, which aims to allow costs that are deemed efficiently incurred and that could have been reasonably foreseen.

On-time delivery – we believe an explicit incentive is not required. Developers already have an incentive to deliver projects on time from the setting of the regime start date (and losing the C&F support if delayed) and being able to earn revenues from operations. This is the approach adopted for interconnectors (for example Greenlink lost a portion of its 25-year Cap and Floor regime due to delays in the commissioning date). Therefore introducing an explicit delivery incentive appears unnecessary given there are already strong inherent incentives present in the regime. This is not akin to onshore networks (which face a delivery incentive under the ASTI framework and has been proposed for RIIO-ET3), which may require a delivery incentive in order to deliver projects in a timely manner. This is because these companies can earn substantial revenues and cash flows during the construction phase due to how costs are recovered under the RIIO regime.[1] This is not the case for LDES projects as revenues are only recovered once projects are operational.

Additionally, the proposed approach puts undue risk on PSH which contain significant underground construction risks. This in turn makes the scheme biased against projects with greater construction uncertainty. Furthermore the 25 basis points per year approach is biased against long construction period assets where a 25% delay might be a year or more. Conversely the same 25% delay on a short project would not be penalised as much.

[1] Under the RIIO regime, networks earn revenue on capital invested irrespective of the projects being delivered in a timely manner. This is because it can be difficult to isolate individual projects and these companies are regulated under a corporate finance approach.

We propose that time based penalties across technology classes are potentially significant sources of bias against those projects with high construction risk or long construction times, and that there is a risk that the C&F policy will consequently fail to deliver such projects. We understand that there is up to 2 years of grace in the case of force majeure, however investors would need confidence that "force majeure" would include the discovery of unexpected ground conditions and other such construction risks that are very difficult to fully assess prior to construction.

Q14. What is your preferred approach to cost incentives (e.g. cost sharing vs. outturn comparison), and how should these be appropriately calibrated?

We have priced our original proposal presented at the eligibility stage on the Window 3 rules. We understand both approaches proposed by Ofgem do not fully align with the approach used for interconnectors as there is no efficient cost target set at project assessment which projects are expected to achieve. Instead, the efficiency of all incurred costs are assessed ex-post. This ensures costs are not set with respect to an arbitrary benchmark and can take account of issues which arise during the construction phase (and cannot be reasonably foreseen) e.g., supply chain issues.

We therefore recommend Ofgem adopt an approach consistent with its approach for interconnectors.

Based on the options presented by Ofgem in the consultation document, we understand the two approaches presented and believe that the "outturn comparison" contains less risk for debt providers and so is probably better than "cost sharing" at achieving project delivery at lowest cost for consumers. However, our view is that the interconnector approach would be the most optimal solution.

Q15. Does our proposed mix of gearing caps, ringfencing, and financial reporting strike the right balance between financial resilience and flexibility for LDES projects? If not, what would you change?

The terms upon which Ofgem can refuse the transfer (sale) of a C&F LDES asset to a third party should be clear, or else investors cannot assess the risk and cost of such a restriction.

We disagree with Ofgem's gearing cap suggestion. Companies should be free to adopt a capital structure that it chooses. This is because developers are better placed to understand the optimal capital structure that should be adopted and enable the project to be delivered at lowest cost. For example, Ofgem have previously cited the consumer benefit of introducing OFTOs[2], in particular the cost of capital saving associated with these assets. These assets have adopted highly leveraged structures e.g., 95% to deliver these benefits to consumers. Therefore, restricting LDES developers' gearing potentially reduces or removes these benefits.

If Ofgem is concerned by financial resilience of projects, it can handle this at source by rejecting projects which cannot demonstrate they are able to meet key financial covenants (e.g., a debt service coverage ratio of greater than 1.2x) or able to achieve financial metrics in line with an investment grade credit rating. This is in line with Ofgem's approach for onshore networks which does not place restrictions on capital structure.

[2] https://www.ofgem.gov.uk/publications/evaluation-ofto-tender-round-2-and-3-benefits

Interconnectors also do not face similar restrictions, for example NeuConnect and GreenLink have adopted highly leveraged structures which have been approved by Ofgem. Therefore, we question why LDES assets should be treated differently.

We accept Ofgem's proposals on ringfencing, early warning and reporting. These appear sensible and appropriate protections for consumers.

Q16. Which charges - TNUoS or BSUoS - do you consider more appropriate for funding cap and floor payments and receipts, and why?

We agree with the minded-to position that BSUoS charges are more appropriate, since many of the LDES assets should help reduce grid balancing costs, and increasing TNUoS for large generators but not distribution assets could be seen as unfair by the market.

Q17. What are your views on including a residual value at the end of the cap and floor period, and how should this affect depreciation and investor returns?

We presented [redacted] This has the effect of reducing the Floor and financing requirements which consequently reduces the cost to consumer. We believe this option should be considered as we believe there would be residual value beyond year 25 which could be shared with consumers by adopting a longer asset life assumption while not creating any additional risk for the project.

Including a residual value introduces stranding risk for developers. This would require careful consideration in setting the cap and floor. For example, we would expect this increases the cap and floor rates assumed, all else equal. This would need to be balanced against higher depreciation payments and lower cost of capital (due to lower stranding risk).

Q18. What policy mechanisms should be introduced to support investability now and post regime or recovery of residual value beyond the C&F period?

In our view, Ofgem have not introduced any significant mechanisms to support investability as a) they have increased the risk of LDES assets relative to interconnectors b) set a sharing factor below expectations and c) proposed several provisions and restrictions e.g., gearing cap, post regime cap and downward biased incentives. Therefore, we believe Ofgem needs to reconsider the investability of its proposals by either a) increasing the returns provided and/or b) decreasing the risk exposure of developers. We have set out various amendments Ofgem could make to improve the investability of its proposals to our responses in the questions above.

We accept the premise of recovering residual value and excess floor payments beyond the C&F period as consumers will pay for the asset upfront. We set out our proposal for the recovery of excess floor payments post C&F period in the financial model accompanying our response.

With respect to the recovery of residual value, this should not be too burdensome for developers and set at an appropriate level. We propose Ofgem should set this based on the outturn returns achieved by the project with

some sharing factor above the level. This is consistent with the approach adopted for ElecLink and IFA. We propose an appropriate starting point would be an IRR of c. 13% on an unlevered pre-tax basis with a sharing factor of 50% consistent with Eleclink's framework.[3] This IRR should be assessed against the project's IRR to date (including impact of any cap and floor payments) and needs to consider all costs incurred by the project e.g., maintenance capex in the post-cap and floor period. This ensures that the returns reflect the project's actual returns and that if the project does earn significant excess returns then consumers benefit in any upside beyond the cap and floor period.

We are happy to discuss this further with Ofgem on the appropriate design. In particular, we understand there are some points of learning from the Eleclink framework that it would be best to incorporate into any future post-regime processes.

Q19. 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?

We have already provided a comment on the accuracy of the calculation of the ACOD floor in terms of matching the ACOD floor to debt requirements in our response to Question 5. We strongly recommend Ofgem consider incorporating this into its financial model as we have in our proposal.

[3] https://www.getlinkgroup.com/content/uploads/2023/08/23022023-resultats-annuels-getlink-version-anglaise-2.pdf