SCOTTISHPOWER
RENEWABLES

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Sent by email only to Okon.Enyenihi@ofgem.gov.uk

Dear Okon,

PROPOSED INTEREST DURING CONSTRUCTION FOR OFFSHORE TRANSMISSION [AND PROPOSAL TO EXTEND ANNUAL METHODOLOGY TO INTERCONNECTORS GRANTED THE CAP AND FLOOR REGIME]

Thank you for the opportunity to respond to the above consultation of 21st December 2017. SPR have responded previously to Ofgem consultations and proposals on IDC for offshore transmission and we conclude that in general our view remains the same.

In principle SPR acknowledge the aim of applying a cap on Interest During Construction (IDC) to offshore projects' grid assets and that it is appropriate that assets are transferred to the OFTO at a fair and efficient price which reflects the cost to the developer in creating them. However, there is no economic or consumer protection rationale for setting a stringent cap. For example, if developers incur inefficiently high costs of capital, or the IDC payment exceeds their true costs, they will be exposed to this via corresponding higher TNUoS charges, so they already face an incentive to make efficient investment decisions.

Given the Contracts for Difference (CfD) regime which caps the income of the project for 15 of its 25 years, we remain concerned at the level of risk that the developer takes during the construction of the transmission assets and whether the IDC rate adequately rewards the developer for this risk, particularly given the level of disallowed costs that Ofgem are consistently levying on projects.

As the CfD regime involves an auction, developers require to have a greater level of certainty of costs and returns, or to at least have a reasonable return for any risks. We therefore remain of the view that projects should be allowed to use the project overall Internal Rate of Return (IRR) as the IDC rate to ensure that there is consistency of the return for all parts of the project. Therefore, SPR continue to challenge the cap as a concept.

With respect to the new proposal for IDC, we consider a review is required of the period of debt that a developer requires to finance the construction of the grid assets. Currently Ofgem look at the cost of 2 year debt (averaged over a 10 year period) which for earlier offshore projects constructed close to shore was a suitable time period. Projects now entering construction are being built further offshore tending to be of a larger scale and therefore highly likely to involve more complicated technical solutions which will increase the period of construction to in excess of 3 years from the date that the project receives its Final Investment Decision.

In conclusion, SPR remains unconvinced by Ofgem's case for capping the IDC rate on the grounds of consumer value for money. Seeking to require the assets to be transferred below their true cost does not make them any cheaper for the developer to build where over or under-payment of IDC will affect the timing of the developer's cash flow but not the overall return to the project.

Given that newer projects have construction periods that are now naturally longer we would propose that the cost of 3 year debt (again averaged over a 10 year period) be included in the overall calculation. We believe that this would have a minor increase in the IDC rate calculated by Ofgem's advisors but would be more reflective of the projects that are being constructed currently and in the future.

Finally, in light of the CfD regime, the maturity of offshore development and the evolution of project design, we would encourage Ofgem to consider future decisions such as changes to IDC rates to follow industry engagement at a forum or workshop level which would benefit from a collective sharing of expertise and to recognise similar experiences.

If you have any questions please don't hesitate to contact me directly on the above telephone number.

Yours sincerely,

Joseph Dunn

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