



FAB PROJECT

An interconnector to provide electricity
between France and Britain via Alderney



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Okon Enyenihi
Electricity Transmission
Ofgem
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Dear Okon,

Consultation on the Proposed Interest During Construction for Offshore Transmission and proposal to extend annual methodology to Interconnectors granted the Cap and Floor Regime

FAB Link Ltd (FAB Link), in partnership with the French national grid company RTE, is leading on the development of the FAB interconnector, a 1400MW electricity interconnector between France and Britain via Alderney (the “FAB” project). FAB Link was granted an Initial Project Assessment (IPA) in July 2015 and is scheduled to submit its Final Project Assessment (FPA) application in mid-2017.

We note that there were no specific questions in the consultation document dated 21st December 2016 and that views generally were being sought on the proposals. This response only provides our views on the proposed amendments to interconnectors.

Primarily, it should be stated that the consultation document was not clear on what the exact proposals for interest during construction (IDC) for interconnectors were, nor the rationale for changes from the current methodology. We have sought to clarify this with Ofgem and our response is also based upon these clarifications.



FAB Link Limited is a Guernsey registered company (registered number 54637) and has its registered office at
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It seems that the proposal is two-fold:

1. Amend the Cap & Floor IDC figure applied to an interconnector project from a value calculated based upon market indices at the specific project date of final investment decision (FID) to an annual value that would be fixed for the particular financial year in which FID occurs.
2. Amend the calculation methodology and inputs to the interconnector IDC calculation from that developed through policy and implemented for preceding interconnector projects under the Cap & Floor regime to the calculation used for OFTOs.

Whilst it does not explicitly state this, we assume that any change proposed through this consultation does not affect any other element of the Cap & Floor regime, such as the calculation methodology and inputs to the determination of the return at the cap and the return at the floor. We would appreciate Ofgem confirmation that this understanding is correct.

The consultation document is misleading in that it is contradictory and vague suggesting that only (1) above is being considered and that (2) is simply an update of the market indices. We deal with each of these in turn below.

1. Fixed Date to Annual Value change for IDC

We have no objection to this proposal.

Ofgem propose to move to annual updates of IDC for interconnectors. There will be winners and losers in this depending upon the direction of movement of the markets and the timing of the FID within the year in comparison to the previous financial year. Nevertheless, it does seem that this will provide clarity on what the figure will be for the year in which a project expects to achieve FID.

There does not seem to be any justification provided as to why the IDC process for interconnectors should be the same as used for OFTOs as these are different investment models with different regulatory treatment.

Nevertheless, there does not seem to be a specific disadvantage to interconnectors or the UK consumer to moving to an annual figure.

2. IDC Calculation Methodology & Inputs for Interconnectors

As stated above, the consultation document does not explicitly set out the changes that Ofgem is actually proposing to the methodology of calculating IDC for interconnectors. The changes comprise an amendment to the IDC methodology which has been developed since 2013 for the Cap & Floor regime and consulted on at length. It appears to us (although as Ofgem hasn't published any comparison of the current and proposed figures for interconnectors we cannot be absolutely sure) that these changes are significantly

detrimental to interconnectors. (e.g. an interconnector built over 5 years with a flat capital cost profile would see a reduction of approximately 3% in its Cap & Floor levels.)

The consultation document is not a sufficiently clear and precise explanation of the changes proposed and therefore Ofgem should not consider due consultation to have taken place in advance of decision making based upon this consultation. We would request that Ofgem consult properly on these proposed changes so that the interested stakeholders are clear on the proposals and the rationale behind these.

We set out below the changes to the IDC calculation for interconnectors that we understand would be implemented if the proposals are approved. None of these are highlighted in the consultation document.

A. Market Risk Premium:

There is a change proposed in how this is determined for the purposes of interconnector IDC. The existing Cap & Floor methodology sources Total Market Returns (TMR) from the Credit Suisse Source Book and then calculates the market risk premium arithmetically by subtracting the risk free rate and UK RPI adjustment. The newly proposed methodology reads the market risk premium directly from the Credit Suisse Source Book which is then reduced to account for the tax rate.

This leads to a reduction in the like for like market risk premium of approximately 10% which is not explained in the consultation document.

B. Gearing:

There is a proposed detrimental update in the gearing to be applied from 33.41% debt to 41.2% debt which lowers the Vanilla WACC. Whilst it was stated historically that IDC values would be updated generally, it was not clear how this parameter would be subject to market updates. This has been assumed (perhaps mistakenly) to be kept constant because the entry in the Ofgem Cap & Floor model is a fixed input with no reference to market data, and the figure derived for the NEMO¹ project in 2014 has been unchanged in Ofgem consultations including the consultations for the first² and the second window³ until now.

¹ Decision on the cap and floor regime for the GB-Belgium interconnector project Nemo, 2 December 2014, Ofgem: "We have also set the IDC notional gearing at 33.41 per cent based on an updated view of the calculations underlying the Grant Thornton Report, and the equity beta at 1.04. We have taken this decision given the stable nature of these variables, and the additional certainty this provides for the Nemo investors."

² Proposal to roll out a cap and floor regime to near-term projects, 23 May 2014, Ofgem

³ Cap and floor regime summary for the second window, 11 May 2016, Ofgem

C. Equity Beta:

There is a proposed detrimental update in the equity beta to be applied from 1.04 to 0.93 debt which lowers the Vanilla WACC. The same points associated with the gearing input above applies to the equity beta and seem to stem from the selection of comparator companies.

D. Comparator Companies:

The figures set out in the consultation document state that the gearing and equity beta values are derived from the set of comparator companies used in previous decisions. We request that Ofgem clarifies its proposal for which companies make up the comparator group for interconnectors. For NEMO, the first cap & floor interconnector project the comparator group was clearly specified to be a small set of integrated utilities (Centrica Plc, E.ON AG, RWE AG and SSE PLC)^{4,5}.

We also request that Ofgem sets out what the proposed indices (gearing and equity beta) are for the proposed comparator group, and the current group if there has been a change. The ratios determined following the NEMO review in December 2014 were 33.41% and 1.04 for gearing and equity beta respectively⁶. The NSL project FPA consultation also proposed the same values as recently as October 2016⁷ albeit the FID date for NSL was in 2015.

Overall the changes to align the IDC calculation methodology to the OFTO method and the revised inputs used in this calculation are not clearly explained in the consultation document. The proposed amendments show a significantly detrimental treatment for interconnectors that are yet to take FID. It is not clear to what degree the degradation is due to market movements, whether those market movements should be considered, and what is due to changes in methodology in the interconnector IDC calculation for cap & floor interconnectors.

We request that Ofgem make their decision on the change to annual figures but maintain the pre-existing calculation method and reference inputs for interconnectors until such time as Ofgem have provided clarity through consultation on the points raised here.

Yours sincerely,



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⁴ Proposed interest during construction approach for offshore transmission and Project NEMO, Ofgem 18 October 2013

⁵ A review of interest during construction for generator build offshore transmission projects and project NEMO – Stage 2: Policy development and illustrative IDCs, Grant Thornton, 18 October 2013

⁶ Decision on the cap and floor regime for the GB-Belgium interconnector project Nemo, 2 December 2014, Ofgem

⁷ Final Project Assessment of the NSL interconnector to Norway – Consultation, 18 October 2016, Ofgem.