

Interconnector developers and
other interested stakeholders

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Dear colleagues,

Cap and floor regime: An update on 'Window 1' interconnector projects

In August 2014 we confirmed our cap and floor regime for electricity interconnectors and opened our first application window ('Window 1'). Following our Initial Project Assessment (IPA) stage, we decided to grant five projects a cap and floor regime in principle, subject to certain conditions.¹ This letter provides an update on progress with these projects.

We are currently assessing three proposals as part of our Window 2 application round. We are providing this update so that market participants are clear about the current status of Window 1 interconnector projects in the context of our forthcoming Window 2 decisions.

Background

The first application window for our cap and floor regime opened in August 2014. Following consultation, we decided to grant a cap and floor regime in principle to five projects. These are detailed in Table 1 below.

Table 1: Cap and floor Window 1 projects

PROJECT NAME	DEVELOPERS	CONNECTING COUNTRY	CAPACITY (MW)
NSL	National Grid Interconnector Holdings (NGIH) and Statnett	Norway	1400
FAB Link	Transmission Investment and RTE	France	1400
IFA2	NGIH and RTE	France	1000
Viking Link	NGIH and Energinet.dk	Denmark	1000 ²
Greenlink	Element Power	Ireland	500

As part of our IPA decisions we placed a number of conditions on projects. These aimed to ensure that developers are incentivised to deliver projects in a timely and efficient manner. We also aimed to balance this with the practical challenges that developers may face whilst delivering these complex infrastructure projects.

¹ We decided to grant an IPA to NSL in March 2015; to FAB Link, IFA2 and Viking Link in July 2015; and to Greenlink in September 2015. All decisions are available at: <https://www.ofgem.gov.uk/electricity/transmission-networks/electricity-interconnectors>

² Viking Link's capacity as assessed at our IPA stage was 1000MW. We have since been made aware that this has increased to 1400MW, which is considered on p3 of this letter.

We are now in a position to provide an update on changes to Window 1 projects, to monitor progress against the conditions we set at our Window 1 IPA decisions, and to update these conditions to make them clearer.

Proposal to extend the deadline for Final Project Assessment (FPA) submission

Our August 2014 cap and floor rollout decision put in place a condition whereby projects that are successful at the IPA stage have two years to submit sufficient information for our FPA stage. The intent of this condition was to ensure that developers make timely progress with projects, and to recognise that the justification for a project may change over time.

When projects are late to submit information for the FPA then, at present, we would consider whether the award of a cap and floor still stands on a case-by-case basis. We may then confirm our approval, revisit aspects of the analysis, or remove the cap and floor regime from that project. We would consult on our updated analysis where required.

We want projects to progress on track so that consumers see the benefits of these projects in line with our Window 1 decisions. However, we also would not want our regulatory framework to act as a barrier to projects that would otherwise deliver benefits for consumers. As a result, we are allowing a 12-month extension to the deadline for FPA submission in cases where projects can demonstrate significant progress towards development.

Examples of factors that may constitute significant progress include taking a final investment decision (FID) prior to FPA; initiating the procurement process for the cable and converter stations; completing seabed surveys; and/or completing consenting and licensing work.

If any project fails to submit information for the FPA within this extended three-year deadline, then we will revisit the IPA for that individual project to ensure that it is still expected to benefit consumers. This would include updating our modelling to reflect any changes in electricity market conditions. We would then confirm our approval or remove the cap and floor regime from that project. We will consult on our updated IPA.

Proposed relief for delays to regime start date for force majeure

Our August 2014 decision noted that the cap and floor regime for the five Window 1 projects would start from the earlier of the actual connection date or 1 January 2021. This was put in place to incentivise timely delivery of projects at a time when the cap and floor regime was limited to 'near-term' projects only.

We noted that, in situations where projects are delivered later than 1 January 2021, the 25-year duration of the cap and floor regime will be reduced by the length of the delay. This will effectively give the regime an end-date of 31 December 2045, regardless of the operational date.

We do understand that sometimes delays are caused by specific external factors. Whilst the condition noted above remains in place, we will exclude the duration of any delays caused by force majeure events from the above provision. This builds on the licence conditions we have put in place for Nemo Link, as the first cap and floor project.³ We would expect Window 1 projects to benefit from similar licence terms in this regard (subject to our standard public consultation procedures).

The cap and floor levels will continue to be based upon the assessed expenditure over a 25-year period. This means that if a project is operational later than 1 January 2021, the

³ The licence conditions we have put in place for Nemo Link are available at: <https://www.ofgem.gov.uk/publications-and-updates/decision-changes-standard-conditions-electricity-interconnector-licence-electricity-interconnector-licences-held-nemo-link-and-ngil-and-electricity-transmission-licence-held-nget>

regime duration is reduced but the cap and floor levels are the same as they would be otherwise.

Proposed extension to connection date

In our Window 1 IPA decisions, we noted that we would deem any delay to projects of more than 2 years (ie connection beyond the end of 2022) as material, and may revisit our IPA analysis. There are a number of external pressures on the delivery of interconnector projects, including supply chain constraints and the confirmation of regulatory and legal arrangements in GB and in connecting countries.

As a result, we are extending the deadline that we would deem material from the end of 2022 to the end of 2023. We do not expect this to have a detrimental impact on other projects or on consumers. Developers should continue to be incentivised by the condition noted above to reduce any delays as far as possible.

Proposed changes to project design

We recognise projects can change as they move through the development phase, and we would not want the timing of our IPA decision to deter developers from making changes where these may be in consumers' interests. We also recognise that developers may make changes for commercial reasons – the cap and floor regime maintains a strong incentive on developers to maximise the commercial case for projects.

Viking Link has increased its capacity from 1.0GW to 1.4GW since our IPA decision. The rationale for this change is to increase the market offering (following Danish system changes) and to maximise the benefit of the link for both GB and Denmark.

We were notified of Viking Link's proposed change and have considered whether or not this is deemed efficient, and also whether or not it is likely to have a material impact on the market. We understand that the cost increase is not material. Initial information provided by NGIH suggests the 40% increase in capacity will increase anticipated capex by roughly 12%, and that operational costs are expected to stay largely the same as those we considered at our IPA stage.

We have revisited our economic welfare analysis for the Base case. This suggests that the increase in capacity would provide the results shown in Table 2. We have considered the increased capacity against the baseline of our IPA scenarios for both Window 1 and Window 2, and have included a third test assuming some additional future interconnector capacity.⁴

⁴ Our IPA scenarios for Window 2 are referenced in Table 2 as 'updated market conditions'. We also added some additional interconnector capacity to test the sensitivity of our analysis to further interconnection.

Table 2: Updated economic welfare analysis for Viking Link (£m, 2013)

Test	Scenario	Viking Link - 1000MW		Viking Link – 1400MW		Change resulting from additional capacity	
		GB consumer welfare (CW)	Total GB welfare (GBW)	CW	GBW	CW	GBW
Original analysis used in our Window 1 IPA	Base case	2148	152	2894	392	746	240
	Low case	87	-614	236	-611	149	3
Updated analysis (1): • W1 projects only • Updated market conditions	Base case	3183	82	4452	328	1268	246
	Base case	2093	-48	3012	162	920	210

This updated analysis suggests that the proposed increase in capacity increases the positive benefit that is expected to accrue to GB and to GB consumers. As a result, we are approving this increase in capacity and our IPA decision for Viking Link remains in place.

The project developers have also suggested that the project has been delayed by two years, from late 2020 to late 2022, as a result of delivery constraints in the supply chain. We are aware of these constraints and we are working with interconnector developers, supply chain participants and government to help alleviate these where possible.

Next steps

We now expect the projects approved as part of Window 1 to progress towards final investment decision (FID), contract award and submission for our FPA stage.

Developers are welcome to submit information for FPA either before or after taking FID. However, this information must be sufficiently detailed for us to complete our FPA stage. We are happy to work with developers prior to submission to ensure that the right information is included for the FPA stage, including factoring in any final contract prices as developers move through the procurement process.

Project developers must continue to provide regular quarterly updates, including formal notice of any material changes to cost or design. As part of our consultation and decisions on the IPA stage for Window 2 projects, we will set out similar conditions to manage the progression of those projects.

If you have any views on the content of this letter, please contact Stuart Borland at cap.floor@ofgem.gov.uk or on 020 7901 7134.

Kind regards,

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