Address:
Calon Energy Limited
Severn Power Station
West Nash Road
Newport
NP18 2BZ

T: +44 (0) 1633 530 130

Registered Office:
Severn Power Station
West Nash Road
Newport
NP18 2BZ

Registered in England & Wales
No: 09020390

CALON energy
passionate about power

Okon Enyenihi
OFGEM
10 South Colonnade
Canary Wharf
LONDON
SE14 4PU

27 November 2019

By email only: cap.floor@ofgem.gov.uk

Dear Okon,

Company Background

Calon Energy was founded in October 2012 and, following a series of acquisitions, are the owner of 2.3 Gigawatts (GWs) of flexible and efficient Combined Cycle gas-fired generation. We have three operational, transmission connected generation sites at the following locations:

- Baglan Bay (Port Talbot)
- Sutton Bridge (Lincolnshire)
- Severn (Newport)

Calon Energy has also acquired the Willington site in Derbyshire with a view to building a 1.6GW Combined Cycle Gas Turbine (CCGT) power plant subject to acquiring a Capacity Market contract at a price which renders the project economically viable.

Capital is deployed into Calon Energy from a range of major international investors. Calon Energy remains keen to participate in the continued development of a sustainable, secure and economically-efficient electricity generation sector in the UK.

Calon's position in response to the consultation

Calon Energy appreciates that interconnectors play their part in the security of supply for Great Britain (GB) and provide a short term fix to create downward pressure on energy bills through sourcing electricity from the continent when prices are low.

This is partly achieved through Interconnectors having exemptions in the GB market from tariffs and charges that onshore generators don't, such as network and balancing costs. This issue is exacerbated by most continental generators not paying transmission charges, CPS and other charges GB generators face. By defining Interconnectors as transmission assets they fall outside of the usual charging regimes that GB generators have to bear, the power flowing in is not competing on a level playing field with GB operators. This is creating a distortion to competition and may result in the UK importing high carbon power at certain times.

Furthermore, the interconnectors are currently in the Capacity Market, with both a lower cost base and guaranteed rate of return. So generators face unfair competition in the energy market and in the Capacity Market. In the long term these distortions will have a detrimental effect on customers as these markets will not will be acting efficiently.

In Europe, Interconnectors which cross borders are caught by the same or similar charging methodologies as generators, i.e. none pay the costs GB generators do, which creates a differential between the two countries where there is an interconnection from GB. This uneven playing field creates risk and uncertainty for GB generators as there is no Cap & Floor mechanism to guarantee profits or returns, unlike Interconnector investors who have this certainty.

Whilst the GB energy market needs a diverse and flexible demand based portfolio of generation, supporting and encouraging more interconnection with mainland Europe may cause onshore flexible generation to decrease as investors focus their interests on less risk and guaranteed profits. This would therefore have the opposite effect of the security of supply in GB if this displaces economically efficient, firm generators in the UK. Whilst the demand & supply of energy could be met through renewable technologies with interconnection supporting, ancillary services, such as frequency & voltage support for the Electricity System Operator (ESO) would reduce, impacting the safe & stable operation of the National Grid in GB. What customers appear to save in using cheaper off-shore generation they may pay instead for ancillary services.

An energy mix that is primarily from renewable sources, battery and demand side response with interconnection to and from neighbouring countries gives a positive story from GB's reliance of using fossil fuels, meeting ambitious carbon reduction targets and sourcing the cheapest energy for consumers. However, this would tip the balance resulting in the transmission system being vulnerable to inertia and frequency drops that cannot be corrected causing severe impacts to the public and potentially wider UK economy. The security of supply offered by interconnectors diminishes with increasing interconnection, this concern is echoed in a report made by Aurora Energy Research[1].

Whilst GB generation can be specifically traced to the actual generation & fuel mix used, that cannot be said for power that is being received from the continent and therefore may discourage or stifle the reduction and reliance of fossil fuels on the continent. The two countries (Republic of Ireland & Germany) that will be connected as a result of these latest developments have a combined fuel mix generation of 59.5% fossil fuel, therefore it's highly unlikely that the power received by GB will be coming from renewable sources. Carbon leakage is not just about where we import steel from, but where power comes from as well.

Consultation Questions - Response

Question 1: Do you have any views on the project finance variations requested by developers?

Our comments in relation to each of the requested variations are:

Variation 1: (To reduce the default five-year revenue assessment period to one year)

> An annual review as to whether the variation made to allow an annual revenue assessment is necessary to continue. Industry should have sight of the assessment when conducted and the level of payments being accessed/assessed.

Variation 2: (To consider changes to the principle underpinning our Minimum Availability Threshold (MAT) of 80% (below which the floor is not paid)

> Consumers are having to pay for far too many 'added extras' within their energy bills (Mutualised Supplier of Last Resort payments, unrecovered payments from green taxes and potentially

[1] https://www.auroraer.com/wp-content/uploads/2018/05/Aurora-Energy-Research-Energy-security-in-an-interconnected-Europe.pdf

Capacity Market payments). GB energy consumers shouldn't have to prop up the revenues of privately owned development companies. This doesn't create an even playing field for all types of generation in GB as no other generation asset connected to the transmission network has their revenues de-risked through consumer underwriting. Where a party has an asset that is not available to benefit customers it should receive no benefit. We consider 80% to be low given the availability most generators achieve, as demonstrated in the ESO's calculations of de-rating factors for competitive assets in the Capacity Market.

Variation 3: To broaden our definition of force majeure events under the default regime to cover more events

In legal definition force majeure is unforeseeable circumstances that prevents someone from fulfilling a contract. Straying too far from a legal definition by being overly prescriptive may have negative effects on the regime and payments which is likely to result in poor outcomes for consumers.

Should the variation be made to include events such as changes in regulatory frameworks, or the introduction of new or amended legislation, this would create a divided regulatory environment for the GB energy industry. Force Majeure should be used as an exception for a limited time period during unforeseen and uncontrollable events rather than a 'wild card' to be exempt when others are held to account. We note that generators in the Capacity Market have no force majeure clause to protect them from not receiving the income that the Government identified as necessary "missing money".

Variation 4: To use project-specific actual cost of debt and gearing to set the cap and floor levels and to calculate Interest During Construction (IDC) rather than the default notional cost of debt and gearing.

Where high gearing and beneficial accounting treatments are used which provides a lucrative return beyond the notional debt and gearing, this should be returned to consumers as a benefit. Any change proposed to the baselined methodology must be through a competitive and independent tendering process to ensure the process is transparent to achieve any alternative methods of setting the cap & floor levels. Ofgem needs to operate the regulatory regime on the basis of actual data wherever possible, unless it believes that a company has a demonstrable "out of the market" financing structure which they need to account for to fulfil their duty to protect the interests of customers.

Variation 5: To maintain the default 25-year regime length where projects are late to start operation rather than reducing the regime length to reflect project delays.

Where the delay is within the developers' control, the regime length of 25 years should not be amended.

We believe that a limit on the delay timescales (that influence when the default regime starts) should be imposed. We'd suggest a year's grace as the developers would benefit from any delay whereas consumers wouldn't.

Question 2: Do you agree with our categorisation of key and additional variations? Are there any additional factors we should consider?

We agree with the categorisation of key and additional variations made by OFGEM.

Question 3: Is there additional evidence that we should take into account when considering the implications for consumers and developers of either granting or rejecting the key variation requests?

All of the variation requests made, including those which have been discounted for consultation, are themed towards the desire for developers to reduce any financial risk where possible by diverting financial losses to consumers. Whilst there is an incentive for consumers in the event revenues exceed the cap there is no guarantee that this will occur and whilst price capping has been introduced by OFGEM to regulate the cost of energy, we believe it would be irresponsible and unreasonable to push this burden onto consumers.

The impact of price capping has seen UK suppliers and generators lose profits without any safety net, most of which are investor backed. The UK has fuel poor and financially vulnerable citizens and any cost increase, or 'human insurance' for a private developer, must be the last possible resort.

Question 3: Is there additional evidence that we should take into account when considering the implications for consumers and developers of either granting or rejecting the key variation requests?

Where costs need to be recovered from consumers the calculation and modelling of the energy price cap should be considered to ensure the cap reflects additional charges to be recovered.

Question 4: Is our approach to assessing the costs, risks and benefits of project finance variations suitable? Are there any additional factors that we should build into our assessment?

Where GB generators fail to deliver agreed capacity under the CM penalties are imposed, there doesn't seem to be any similar measure for Interconnectors using the cap & floor where their availability fails to meet 80%. Such a measure being placed within the cap & floor regime could incentivise interconnectors to meet and maintain 80% availability.

Question 5: Do you have any views on the specific qualitative or quantitative analysis published in our Impact Assessment?

Based on the information and data available, taking into account the current medium term and longer terms objectives as known today, the analysis made is suitable. Should the wider policy objectives change in light of the enormous political uncertainty, the analysis should be revisited.

Question 6: Do you agree with our proposed approval of the requests to reduce the default revenue assessment period, to make changes to the minimum availability threshold at the floor, and to broaden our definition of force majeure?

Our position and response to the three part question is reflected in our thoughts described against variations 1, 2 & 3. In summary, we agree with your minded to position in respect of variation 1 taking into consideration our points around an annual decision as to whether an annual review is necessary or required. We disagree with your minded to approval for variation 2, as per our comments and we also disagree with the minded to position of approving variation 3 on the definition of force majeure.

Question 7: Do you agree with our proposal to reject the requests to use a project-specific actual cost of debt and gearing, and to maintain a 25-year regime duration?

We do agree with your proposal to reject this request as per our comments noted against Variation 4 & 5.

Question 8: Do you have any views on the conclusions from our draft IA, or our early thinking on risk mitigation?

The Impact Assessment states that additional evidence may become available after the consultation has concluded. This additional evidence may identify additional risks that weren't known which may have an impact or effect on the cap & floor regime variations agreed. Any developments that need to be considered post consultation closure or implementation of the variations to the cap & floor regime should be taken into account and acted upon, accordingly, ideally after further consultation.

I hope that our response provides you with sufficient information to inform your final decision on this matter. If you would like to discuss our response further, please do feel free to contact me.

Best wishes,

Peter Berry
Senior Compliance Officer

On behalf of Andrew Mackintosh,
Director of Government & Regulatory affairs.