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Stuart Borland
Interconnectors Team
Ofgem
10 South Colonnade
Canary Wharf
London, E14 4PU

Dear Stuart Borland,

Ofgem consultation on proposed changes to our electricity interconnector cap and floor regime to enable project finance solutions¹

Citizens Advice has statutory responsibilities for representing the interests of energy consumers in Great Britain. This response is completely non-confidential and may be published on your website. We also appreciate the time that Ofgem staff took to discuss this consultation with us ahead of our submission.

We are responding to this consultation which covers requested changes to Ofgem's cap and floor regime by the developers (companies) of two projects: Greenlink and NeuConnect. The requested changes are for the purpose of enabling them to raise the finance required to move from development to construction and operation stages. We are broadly supportive of efforts to ensure that these interconnectors become operational on time, function well and deliver benefits for consumers.

¹ See the following link for full consultation details:
<https://www.ofgem.gov.uk/publications-and-updates/consultation-proposed-changes-our-electricity-interconnector-cap-and-floor-regime-enable-project-finance-solutions>.

Variation 1²

We support this variation request.

Our view is that the needs case for this request rests largely on the companies' debt portfolios and the regularity of raising funds and associated repayments. Whilst it would have been helpful for these to have been evidenced in the Consultation Document (CD), we accept that five-yearly assessments could result in requirements for alternative forms of financial liquidity (Impact Assessment (IA) para 2.7) and given interest payments are normally made annually, deviating from this could incur additional and avoidable costs.

We do recognise the risk that this change would introduce for consumers, who may suffer if revenues are often below the floor as they would no longer be provided protection through smoothing of significant revenue variations over a five-year assessment period (IA para 3.8). However the overall payments would remain equal (adjusting for the time value of money), and an annual process would reduce incentives for operators to conceal compounded payments at the ceiling (for example through the use of service charges to related parties). Further, it is our view that if Ofgem committed to an annual assessment of interconnector caps and floors then this would enable them to build and maintain an experienced team for such regular assessments. This in turn should bring benefits to the regulation of interconnectors and enable further savings for consumers.

Finally, we would welcome clarity from Ofgem regarding the future of the discretionary 'within-period adjustments' function and whether it would still be needed (and under what circumstances) if this variation request is granted.

² Currently, the revenue assessment period for interconnectors operating under the cap and floor regime is five years. Companies have requested an annual assessment process to ensure that they are able to access any payments due from consumers annually. This would align Ofgem's assessment process with annual debt repayment obligations that companies expect.

Variation 2³

We give qualified support for this variation request.

We recognise some of the merits of this request, however there is an underlying risk to consumers that Ofgem must more fully consider before we could support such a change. As it stands, this change would not protect against a scenario whereby 80% of the availability target is continuously not met. This would lock consumers into effectively servicing an un-capped level of debt in perpetuity, based on a risk that they can not influence, whilst simultaneously enabling a below-expectations level of service delivery. Whilst we note Ofgem's intention to incorporate a repayment mechanism when revenues are above the floor, that does not necessarily mitigate the risk outlined above. As such, we encourage Ofgem to revisit the conditions around the revenue floor, to ensure sufficient safeguards are in place for consumers (outlined in our response to Variation 4 below).

We would also welcome analysis from Ofgem which assesses the potential impact of varying the availability threshold currently set at 80%.

Variation 3⁴

We give qualified support for this variation request.

There appears to be no detail regarding the specific proposed additional definitions of force majeure, without which we cannot support any specific changes to the previously agreed arrangements. However we are open to amendments, providing any new additions to the definition are assessed thoroughly and on a case by case basis.

We look forward to reviewing the proposals around this aspect of the regime change and expect to see detailed information regarding the types of events that are being considered for inclusion in the definition and a justification for each. Ofgem must (see IA

³ Companies have requested that consumers should top up revenues to the floor if the 80% minimum availability target is not met to enable debt servicing. They have proposed to repay consumers (from future revenues) on an NPV-neutral basis for payments received in years where availability is below 80%.

⁴ Companies have requested that Ofgem should broaden its definition of force majeure under the regime to cover more events.

para 4.16) fully consider any negative impact on consumers if an altered or wider force majeure definition shifts the risk balance in favour of companies.

We would welcome commentary from Ofgem regarding the existing definition which excludes strike action, where this is typically included in other licences granted by Ofgem. Further, whilst we would need to see the evidence base for such a proposal before coming to a firm position, we do see some potential consumer benefits of strike action being covered by an updated definition. In any case, where a risk can be covered by insurance, then that should be the preferred route of protection before widening of the force majeure definition is considered.

Finally, we fail to see why any proposed variations could not have been considered prior to the existing arrangements being agreed, and consequently we have concerns regarding the precedent that this proposed change sets for the predictability and reliability of regulatory decisions in the future.

Variation 4⁵

We neither oppose nor support this variation request.

If good evidence can be produced by companies to show that their debt was competitively raised, and that the iBoxx bond market indices are not a good reflection, then we would consider this change request. That evidence has not been presented in the CD so we cannot reach an informed position at this stage. If this change does go ahead, then Ofgem must ensure that:

- it is reflected in continual assessments of the net present value of these projects (which we consider to be particularly relevant for the Greenlink interconnector); and
- the risks associated with gaming this mechanism are properly understood and mitigated.

⁵ Companies have requested that the cap and floor levels should be calculated based on the actual funding arrangements (cost of debt and gearing), rather than on a notional cost of debt benchmark (corporate iBoxx indices) and gearing calculated based on comparator firms.

In any case, we encourage Ofgem to revisit and consider tightening the conditions around the revenue floor to ensure sufficient safeguards are in place for consumers (a point that also relates to Variation 2 above). We strongly encourage Ofgem to provide comments on this issue, particularly to get a view on whether the existing arrangements provide a sufficient safeguard.

Variation 5⁶

We give qualified support for this variation request.

We would consider this request where it can be demonstrated that it would benefit consumers, and would be willing to provide a position should such evidence be presented. As such, we would welcome further discussions with Ofgem and interconnector companies should this request be explored again in the future.

Greenlink - additional regime change requests

Actual vs notional cost of debt

It is not clear why Greenlink are requesting a regime change that would see their actual cost of debt only applied to the actual debt geared portion of the Regulated Asset Value (RAV), with no explanation as to why they effectively seek to retain the default regime (the notional cost of debt) for the remainder of the RAV (CD para 3.13). We would welcome further explanation on this issue from Ofgem.

Additional noncontrollable costs

We would need to see significantly more information and persuasive evidence before we could support this change.

⁶ Companies have requested that Ofgem should maintain the default 25-year regime length where projects are late for reasons beyond their control or where a delay is demonstrated to be in the interest of GB consumers.

Exchange rate changes between FPA and Financial Close

This proposal implies that consumers should bear all the risk associated with exchange rate variations. On those grounds we oppose this proposal, as companies have access to tools that can mitigate these risks, which are outside of consumers' control.

Threshold for Income Adjusting Events (IAEs)

We support Ofgem's minded to position to reject this proposal.

Incentives when revenues are above the cap

We accept the view of Greenlink that incentives are reduced once the cap is reached, however we would welcome further commentary on why companies need incentives beyond the cap.

NeuConnect - additional regime change requests

NETSO payments

We would need to see significantly more information before being able to provide an informed view on this proposal.

Please contact me if you wish to discuss anything in this response in more detail.

Yours sincerely

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Energy Networks & Systems