SENT BY EMAIL ONLY TO: Cap.Floor@ofgem.gov.uk

Correspondence address:
FAB Link Ltd
17th Floor, 88 Wood Street
London EC2V 7DA
United Kingdom

Stuart Borland
Interconnectors
10 S Colonnade
Canary Wharf
London
E14 4PU

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Dear Stuart

FAB Link Limited response to the "Consultation on proposed changes to our electricity interconnector cap and floor regime to enable project finance solutions".

The FAB project is a proposed 1,400MW electrical interconnector between France and Britain via the channel island of Alderney. The project has been under development by FAB Link Limited ("FAB Link") in the UK and Réseau de transport d'électricité (RTE) in France since 2013.

We welcome the opportunity to provide our views on regime variations necessary to support the introduction of non-recourse project finance solutions to interconnector projects. We support the claim made by the developers set out in the consultation document that variations to the default regime are necessary to avoid projects not going ahead or being delayed. Variations to the default regime will help to remove the current blockers for alternative forms of financing and support the benefits of future projects and increased competition to be realised.

Ofgem set out in the consultation that the primary aim is for a fair deal and state that developers should only be able to earn returns that reflect the risks they face in a stable regulatory environment. The current UK strategy for the origination of interconnector projects regulated under the Cap and Floor regime is "developer-led". This model relies on developers identifying opportunities and taking projects forward. The Cap and Floor Regulation should therefore set the enabling framework for developers to bring forward projects efficiently and in so doing, ensure that the benefits can be shared both by the promoter and the UK consumer. Regulation should be a strong enabler and ensure any barriers are avoided.

In the case of the default Cap and Floor regime there are key barriers that need to be addressed and we welcome that this consultation identifies that this is the case in situations such as those raised by Greenlink and NeuConnect. We address these specific points in the appendix attached to this letter.

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However, there are further and potentially critical concerns that we believe should be addressed within the regulation in order to align with the requirements of the finance, insurance and global supply and install contractors' markets, and in so doing not have the regulation be a barrier to these projects progressing. As part of this work we would support that Ofgem maintains flexibility so that it is able to address these crucial items as and when they may arise in the concluding stages of a project's development and as the fundraising processes are carried out. These critical items to address include:

- Removal of Ofgem's ability to retain discretion on all elements of the regulation and aligned to that the current lack of certainty on the Post Construction Review, Cap & Floor financial model & reporting;
- The detail of the proposed changes to the FM clause envisaged which should, as a minimum, allow for relief associated with:
    - Delays and costs in obtaining consents from public authorities;
    - Delays and costs due to insolvency of the Engineer, Procure, Construct (EPC) contractor;
    - Delays to the project due to uncontrollable and unexpected conditions such as severe weather and unexpected ground conditions;
    - Force Majeure exclusions under EPC Contracts available in the market;
- The treatment of project partner risk, potentially in the Force Majeure definition (noting that this is not applicable in the case of Greenlink and NeuConnect being interconnectors with a single entity project sponsor).

Further to the items set out above we would like to highlight our concerns regarding the Trial Operation period requirements. This currently requires a 60 days fault free period (aside from 1-hour de-minimis interruptions) and is more onerous than is offered by manufacturers. This presents a risk that a Taking Over Certificate is issued to the EPC contractors and the operational period would begin without the introduction of the floor. Without the EPC contractors' obligations being 'back-to-back' with those of the regulation, it is foreseeable that the link may never satisfy the requirements to be granted the floor and yet the developer would no longer have any recourse on the EPC contractors. Without a floor, required levels of cash-flow are not guaranteed creating a barrier to project financing and resulting in projects being unable to raise debt and therefore proceed.

Furthermore, under the current requirement and if finance is able to be raised (such as the case for a balance sheet financed project) perverse incentives exist. The requirement encourages owners to take a high-risk approach to achieving the 60-day requirement; potentially running the asset at risk and taking an outage shortly after the period has been achieved. We propose that the reliability run in period be aligned to that available from manufacturers so that this period can be managed in a more controlled way. This will allow the manufacturer to assess the asset risk against the potential financial impact of damages and take the adequate action.

Finally, confirmation that Ofgem will declare the successful completion of the Trial Operation period and introduction of the floor within the time afforded the owner (circa 24 hours) to issue the Taking Over Certificate to the contractors is equally key to managing this risk.

Answers to the questions set out in the consultation document can be found in the appendix attached to this letter.

If you would like to discuss any aspect of the response please don't hesitate to contact me directly.

Yours sincerely,

Richard Sidley
Commercial and Regulatory Manager – FAB Link

Appendix – Answers to the consultation questions

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

Key Variations	
Variation 1	We support this Variation as critical to the introduction of project finance to ensure cash-flow
Variation 2	We support this variation to ensure sufficient cash-flow and guarantee that debt can be serviced at all times in the regulatory period. However, further information would be helpful to understand the calculation inputs and mechanics (e.g. what interest/discount rate will be applied up to the pay-back point).
Variation 3	We welcome and agree with Ofgem's view that the current text is not compatible with project financing and it must be amended. However, without the proposed new definition it is not possible to take a view on the Variation. It is our view that the amended definition should as a minimum cover those items set out in the cover letter.
Variation 4	We support the principle of better alignment between the available funding arrangements at the time of FID and the Cap and Floor levels. Our experience from our discussions within the finance community is that the Ofgem benchmark, based upon an A or BBB credit rating, does not align with the credit level associated with the actual risk profile afforded under the Cap & Floor regulation. An alternative to moving towards an actual cost of debt approach may be to base the benchmark such that it is more accurately aligned to that realistically achievable for projects. However, there is insufficient information within the consultation to fully form a view on this variation and we would welcome further information and input to this Variation.
Variation 5	We support this variation. If a delay to the start of a regulatory period is in consumer interests then it makes sense to maintain the Cap and Floor levels for the 25-year period. The current discretion Ofgem have on this point until the end of the Trial Operation period creates uncertainty for investors and developers. We support this being better defined and if no detriment to consumers is evident then it seems fair for this Variation to be implemented.
Variations requested by Greenlink	
Additional non-controllable costs	We support this Variation. There is significant potential for changes to uncontrollable costs during the regime duration. This would include items such as the cost for Day-ahead market coupling, operational costs associated with auction platforms, corporation tax, changes in regulation requiring new procedures and therefore costs as well as changes in law such as the transition of the UK leaving the EU (or not). This can be perceived as a potential risk to the ability of the project to service debt and therefore a blocker to project finance. The regime should include consideration for costs to be reassessed and considered in the cap and floor levels.
Exchange rate changes between FPA and FC	This can only be controlled through currency hedging to the level of CAPEX at Financial Close (FC). This would not be possible for a developer seeking to introduce project finance at FC resulting in an uncontrollable risk to the levels of Cap and Floor. We therefore support this as required to support project finance however support Ofgem's view that this could be taken into account as part of a future decision-making process.

Threshold for IAE's	We support this variation as necessary to support project finance. The aggregated impact of multiple events in the same year is a credible risk to any project's cashflow and therefore is a risk to the project's ability to service debt in much the same way as uncontrollable costs. The proposed trigger levels should therefore be aligned to mitigate or at least minimise this risk.
Incentives when revenues are above the cap	We support this variation to incentivise interconnector owners to innovate and maximise the economic value of the interconnector beyond the Cap level. This would align the Cap and Floor regime with innovation incentives present in other Transmission regulatory regimes. A sharing mechanism above the cap seems to be the most appropriate way of ensuring an incentive exists whilst maintaining value to consumers. Interconnectors provide significant benefits to operational security through their inherent flexibility. The forecast increases in intermittent generation capacity will increase the requirement for more flexible services. By including financial incentives in the Cap and Floor regime which allow revenue streams beyond the cap will encourage IC owners to develop and provide products that add value to the operation of the power system. The benefits of this regime change would be applicable to all projects regardless of how they are financed. We therefore support this variation to be considered as an amendment to the default regime.
Variations requested by NeuConnect	
Modifications to PCR	We fully agree with the issue identified by NeuConnect and support the changes requested as critical to supporting project finance. From the consultation document Ofgem propose that this is not considered as a variation to the regime. If Ofgem consider that the issue identified is already covered by the regime a clarification should be published making clear the changes requested are included in the current regime.
NETSO Payments	We agree with the issue being identified by NeuConnect but understand that this may be very complex to implement. Considering Variation 1 however, we would request Ofgem and NETSO agree and inform the market of the anticipated calendar / timeframes for payments to be made as this will be a key input into any project finance process.

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

We agree that the five key variations are necessary to support project finance. However, any risk to cash flow and therefore the ability of the project to service debt at all times is critical to raising debt financing. We therefore support Greenlink's request for "Additional non-controllable costs" and "Threshold for IEA's" as key variations. We have also noted further considerations in our cover letter.

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?

The regime design takes feedback from the financial sector and from expert consultancies. We feel this should be supported with further inputs from manufacturers and a view of their markets to better inform the regime on requirements such as Trial Operations. This will help to identify gaps between the regulatory regime and EPC contractor obligations so that any blockers to project finance can be mitigated.

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?

Our view on the analysis is that it is fit for purpose and is a fair method to identify the potential benefit of variations.

We support the principle of grouping variations for analysis in order to consider the total impact of the package. However, there is little justification to the method of grouping. If Variation 1, 2 and 3 are clearly beneficial then Variations 4 and 5 should be grouped separately and quantitively assessed. i.e. A sixth option to be considered is to accept Variations 1, 2, 3 and 5.

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

With regards Variation 5, the consultation document appears to be contradictory. This Variation has been identified as key due to it being more likely to be required to raise debt financing (in paragraph 3.10). Whilst in the IA its states on page 4 that you found little evidence that Variation 5 was required to raise project finance and therefore it was dropped for the assessment.

In agreement with Ofgem, we support Variation 5 as a key variation to be considered and therefore its economic impact should be assessed and published alongside other Variations. If there is no consumer detriment to this Variation being taken forward it should be included through the same justification.

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?

Yes. We agree that these are necessary for developers to raise debt financing.

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?

No. Actual cost of debt and gearing will be confirmed at FC based on market costs and credit ratings available to the project at that time and in much the same way as the level of CAPEX required to purchase the assets. If a competitive and efficient process can be demonstrated and taking account that these are uncontrollable and market based costs, it doesn't seem reasonable for them to be set prior the actual levels being confirmed. Also, the 25-year regime duration, if no consumer detriment can be identified, should be extended to support the investment. We acknowledge this is not strictly required to enable project financing but with no consumer detriment the Variation will support the equally necessary equity investment.

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

We broadly agree with the conclusions from the draft IA with the exception of the points set out herein.

We do not currently have a view on the risk mitigation but acknowledge that variations will alter the balance of risk between consumers, developers and financial investors. However, we would like to point out that currently only projects financed on balance sheet have been successful in achieving Financial Close and that the Final Project Assessment and therefore Cap and Floor levels were confirmed after Financial Close on those projects. This presents a significant and potentially blocking risk for developers which don't have access to the required financial capacity to take this approach. The significant consumer benefit identified for Window 1 and Window 2 interconnectors may not be realised if these projects are not able to reach FC. This benefit loss should be considered as part of the assessment for an efficient balance of risk.

We would welcome further information and would be keen to input to Ofgem's thinking on this matter.