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Dear Okon,

National Grid Interconnector Holdings Ltd response to the Ofgem consultation on the proposal to insert new special conditions into the electricity interconnector licences held by Greenlink Interconnector Limited and NeuConnect Britain Limited to implement the cap and floor regime.

National Grid Interconnector Holdings Ltd (NGIH) welcomes the opportunity to respond to this consultation. NGIH is the legal entity within the National Grid group responsible for interconnector development and the management of existing operational interconnector businesses (comprising a 50% stake in the operational IFA interconnector, a 100% investment in National Grid NSN Limited (NSL), National Grid Viking Link Limited and National Grid IFA2 Limited together with a 50% interest in BritNed Development Limited and Nemo Link Limited). NGIH, in conjunction with its partners, is investing several billions of pounds in interconnector projects that will be subject to cap and floor regulatory arrangements. A single response is being submitted reflecting our interest in all these interconnectors, regardless of their stage of development/operation or whether they are subject to cap and floor.

This response is not confidential, and we are happy for Ofgem to publish it.

We have worked closely with Ofgem on the development and implementation of the cap and floor regime and provided a detailed response to the project finance variations (PFV) consultation¹. This special condition consultation represents the implementation of the PFV decision and is our first opportunity to comment on that decision. This response therefore considers both the PFV decision and its implementation within the proposed licence conditions.

¹ [Project Finance decision including NGIH response](#)

Specific areas that we would like to comment upon are:

1. Regime Principles

The NGIH PFV response revisited Ofgem's founding five principles that underpinned the development of the cap and floor regime and considered the extent to which the two most relevant ones were being adhered to i.e. the risk-reward balance and level playing field.

- **Risk-Reward Balance (RRB):** (Ofgem and CREG): Developers should be able to earn returns that are commensurate with the levels of risk they are exposed to under the regulatory framework
- **Level Playing Field (LPF):** (For GB only and new interconnector developments) Regulatory treatment should allow third party developers and should be impartial and unbiased between TSOs and non-TSO developers, existing and future developers

These principles, as set out within the 2011 consultation², offered us assurance that either all competitors would have the same arrangements; or that any subsequent adjustments to allow bankability must be:

- NPV neutral from a consumer and investor perspective (RRB); and
- made available to all interconnectors on a non-discriminatory basis (LPF).

NGIH welcomes Ofgem's confirmation that they remain committed to the above principles in theory and have used the above to test adherence in practice.

2. PFV decision's adherence to the principles

The PFV consultation's impact assessment showed a nearly £2bn (in NPV terms) cost to consumers (across five non-NGIH interconnectors) implying an average c.£0.4bn advantage per non-NGIH interconnector.

NGIH welcomes the consumer safeguards introduced within the final decision such as capping the consumer underwritten debt and the need for repayment of temporary support values. Ofgem's updated impact assessment cost of nearly £900m though shows that the RRB principle has not been implemented.

3. Safeguarding of Consumers

Ofgem's impact assessment shows a considerable consumer cost of nearly £800m for variation 2 (floor payments below 80% availability) alone necessitating a proactive regulatory role to protect consumers and the regime principles. This considerable cost should be mitigated through steps such as those suggested in our response to the PFV consultation (which overlap with the Citizens Advice requirement that Ofgem "ensure sufficient safeguards are in place for consumers") such as:

- **Difficult years following bumper ones:** ensuring that consumers don't provide financing for low revenue years that follow high-revenue years. This would avoid monies potentially being paid to equity investors before consumers are then required to provide support (even temporarily).

This could be achieved by requiring that a reserve/buffer be established in above floor years or that any previous equity distributions must be repaid before consumers are called upon.

² [28.06.2011 C&F principles](#) (pages 14-17) with principles 3 and 5 being the RRB and LPF ones respectively.

- **Recovery likelihood assessment:** Ofgem should directly assess a licensee's future capability to repay any loans prior to them being awarded. i.e. consumers should not underwrite unreliable assets for up to 25-years on an unsecured basis.

4. Transparency and Appeal Rights

The impact assessment's £900m cost of the PFV illustrates the extent to which the regime principles have been stretched to deliver project finance bankability. NGIH is concerned that even further stretching may occur through additional specific variation requests, implementation detail within specific licence conditions, financial models, methodology statements or policy decisions.

All decisions that impact NGIH's competitive position should continue to be consulted upon with appropriate appeal rights for all licensees regardless of where they are within their project cycle. This would ensure that NGIH is not disadvantaged for having been the first to reach final investment decision and the first to start to deliver considerable benefits to GB consumers. Illustrative examples where it would be inappropriate for different developers to have varying arrangements are:

- **Network Costs:** Interconnectors do not currently incur network costs (such as TNUoS and BSUoS) and the regime as currently implemented would provide no allowances for such costs should that position change post-PCR.

The extent of these costs (millions of pounds per annum) would leave floor revenues unable to fund this shortfall.

- **Protection from external events (PFEE):** NGIH welcomes the adherence to the LPF principle within the force majeure element of the PFV decision and looks forward to the relevant changes being made to all NGIH licences. We also note the development of a future standard licence condition covering PFEE in relation to receiving the full 25-year regime length and support this being implemented on a LPF basis.

NGIH notes however that the force majeure definition changes still fall short of the protections within other Ofgem regulated regimes, Ofgem's original policy intent and the changes requested within the PFV consultation.

Any core regime changes for items such as network costs and PFEE and should be provided on a LPF basis. This would alleviate our concern that project-finance bankability driven arguments will continue to provide a competitive advantage for non-NGIH interconnectors.

5. Use of standard rather than special conditions and regime elements outside of the licence

Ofgem has implemented many core regime elements through special (rather than standard) conditions and much of the end-to-end regime remains outside of the licence including:

- establishing cap and floor levels (model 1) where only the high-level process is licence enshrined; and
- moving from measured to settled consumer payments e.g. the ICft licence term

This non-standardised implementation approach will generate inconsistency between licences, undermine the LPF principle and increase the administrative burden on licensees and Ofgem alike. Any changes coming from the broader cap and floor regime review will inevitably create further differences in addition to those within the PVF decision, individual licensee variation requests and any policy evolution that occurs between each published licence.

NGIH therefore continues to encourage Ofgem to move towards a standardised approach, ideally within standard licence conditions, that promotes consistency and provides appropriate appeal rights to existing as well as future licensees.

As a result of this approach to developing the regime, NGIH notes that:

- Window 2 interconnectors appear to have been granted an additional 12-month grace period in relation to the operational start date³;
- This cap and floor licence consultation is taking place prior to Ofgem's FPA consultation and/or decision, which might be viewed as pre-judging the outcome of Ofgem's FPA assessment, where a cap and floor regime in principle is either confirmed or removed; and
- A favourable default notional regime has been made available to all non-NGIH interconnectors through the application of BBB debt to the floor (as opposed to an ABB/BBB blend). Whilst the assessed magnitude is small, this is a clear breach of the LPF principle.

6. Licence wording, CFFM1 and its associated handbook

NGIH has restricted its consideration of the draft licence conditions to areas that differ from existing cap and floor licences and could therefore impact the RRB and LPF principles.

We have also raised some specific technical points regarding the published CFFM1 with your colleague Martin Namor. These points are mainly surrounding the calculation of the actual cost of debt and associated actual floor level. We believe these issues should be addressed so that the model can function in all possible scenarios and adhere to best practice and we are happy to continue to liaise with Martin in this area.

We are unable however to comment on the licence aspects that relate to the operational period model (CFFM2) as part of this response as neither that model nor the associated handbook has yet been made available.

Thank you again for the opportunity to comment on this consultation. Please contact me if you would like to discuss any of it any further.

Yours sincerely

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National Grid Interconnector Holdings Ltd

³ NeuConnect draft licence Regime Start Date definition