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Dear Bert,

Nemo Link – ICF_t methodology approval

This document sets out our decision to approve Nemo Link's methodology for the calculation of the value of the Interconnector Cap and Floor Revenue Adjustment term (ICF_t) under Part C of Special Condition 10 of Nemo Link's electricity interconnector licence.

Background

Nemo Link is a 1GW electricity interconnector between Zeebrugge in Belgium and Richborough, Kent in Great Britain (GB). The interconnector is the first project to be developed under our cap and floor regime, which was developed jointly for Nemo Link by Ofgem and the Belgian energy regulator, the Commission de Regulation de l'Electricite et du Gaz (CREG). The cap and floor regime is the regulated route for interconnector development in GB. It sets a minimum and maximum return that interconnector developers can earn.

The Nemo Link interconnector started operating commercially on 31 January 2019 and the project developers are National Grid Interconnector Holdings Limited and Elia Transmission Belgium NV/SA (Elia), the Belgian transmission system operator. Each owns 50% of the shares in Nemo Link.

Special Condition (SC) 10 requires Nemo Link to, as soon as practicable, establish and maintain a methodology for the calculation of the value of the ICF_t term. The form of this methodology must then be submitted to, and approved by, the Authority.

Methodology requirements

Assessment framework

For the duration of the 25-year cap and floor regime, Nemo Link is required annually to submit revenue information, through the Cap and Floor Regulatory Instructions and Guidance (“Cap and Floor RIGs”). For each Relevant Assessment Period (every five years for Nemo Link), the value of the ICF_t term is then calculated.

Methodology essentials

The main purpose of the methodology is to account for the time value of money, from the point that a cap or floor payment is determined as due, to the time that it is paid through the Transmission Network Use of System (TNUoS) charging cycle. If a cap or floor payment is not determined as due, then the methodology is not required to be applied for that Relevant Assessment Period.

The ICF_t Methodology is required, as a minimum, to set out the licensee’s methodology for calculating the proposed value of the ICF_t term taking into account:

- (a) the relevant payment timescales prescribed in the CUSC; and
- (b) the Operation Discount Rate specified in Part I of Special Condition 3 (Cap and Floor Assessment) of the licence as applied to the relevant payment timescales.

Methodology

A copy of the approved ICF_t methodology is provided as the Appendix to this document; this section provides a brief description of the methodology. The methodology was developed by Nemo Link and then iterated through bilateral discussions with Ofgem. Consideration was also given to other interconnector projects, and these references have been included in the Appendix, to illustrate the transferability of the methodology to other cap and floor projects.

Provisional ICF_t calculation and payment

The provisional payment due to or from the interconnector licensee (ICF_t) is determined using the formula:

$$ICF_t = (1 + ODR)^x \times (1 + Inf) \times ICF_{ap}$$

Where the determined cap and floor payment for the Relevant Assessment Period (ICF_{ap}) is multiplied by $1 +$ the Operational Discount Rate (ODR) term (3.88% for Nemo Link) raised to the power of x , which is the time gap, expressed in years, between the median settlement period and median measurement period. This is then multiplied by $1 +$ the time value of money, as expressed in the Inf term, calculated in accordance with Special

Condition 2 and incorporates the Purchasing Power Parity Indices (PPPI) for the measurement and settlement periods.

The provisional payment is paid to or from National Grid ESO, the GB System Operator, in the earliest available settlement (CUSC) year through the TNUoS cycle, as indicated in the summary timeline provided in the Appendix.¹

Final ICF_t calculation and reconciliation payment

The PPPIs used above are, in part, determined using forecast inflationary figures and therefore a reconciliation process is included in the methodology to perform this calculation with actual figures and the total payment is adjusted, accordingly, using the formula:

$$\text{Reconciliation} = (1 + \text{ODR})^y \times (1 + \text{InfRec}) \times (\text{Final ICF}_t - \text{Provisional ICF}_t)$$

The forecast monthly inflation index and exchange rate values required to calculate the reconciliation payment are determined in the same way as those required to calculate the provisional ICF_t payment, as described above.

The reconciliation payment is paid to or from National Grid ESO, the GB System Operator, as described above. No further reconciliations are performed after this reconciliation payment (i.e. the inflation index and exchange rate forecasts used in the calculation of the reconciliation payment are not subsequently replaced with actual observed inflation index and exchange rate values).

Decision

We are satisfied that Nemo Link's ICF_t methodology meets all the requirements detailed in SC 10 of its electricity interconnector licence. We therefore approve the methodology as detailed in the Appendix.

If you have any questions on the content of this letter, please contact Alexander Graham (alexander.graham@ofgem.gov.uk)

Yours sincerely,



Stuart Borland
Deputy Director, Offshore Network Regulation

¹ The deadline for notifying National Grid ESO of any payments due is the 25th January, immediately predating the 1st April start date of the relevant CUSC year.