Making a positive difference
for energy consumers

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Dear Rebecca,

NGIFA2 – ICF_t methodology approval

This document sets out our decision to approve National Grid IFA2 Limited's (NGIFA2'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 NGIFA2's electricity interconnector licence ("the Licence").

Background

Interconnexion France-Angleterre 2 (IFA2) is a 1 GW electricity interconnector between Lee-on-Solent in Hampshire, GB and Merville-Franceville-Plage in Normandy, France. The interconnector was developed under our cap and floor regime, which is the regulated route for interconnector development in GB. The regime sets a minimum and maximum return that interconnector developers can earn.

The IFA2 interconnector started operating commercially on 22 January 2021 and the project developers are National Grid Interconnector Holdings Limited (NGIH) and Réseau de Transport d'Électricité (RTE), the French electricity transmission system operator.

Special Condition (SC) 10 requires NGIFA2 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

NGIFA2's Assessed Revenue is compared against its Cap Level and Floor Level, in accordance with SC 3 (Cap and Floor Assessment) of its Licence, for each Relevant

Assessment Period of the 25-year Regime Duration, to determine whether a payment is due to or from consumers.

To enable the assessment, NGIFA2 is required annually to submit revenue information, through the Cap and Floor Regulatory Instructions and Guidance ("Cap and Floor RIGs").

Methodology essentials

The ICF_t term enables adjustments to the Interconnector Revenue as required in paragraph 2 of SC 10 (Calculation of adjustments to the Interconnector Revenue) of the Licence.

The purpose of the ICF_t methodology is to set out in detail how the value of the ICF_t term will be calculated by the licensee, taking into account 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.

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 Operational Discount Rate specified in Part I of Special Condition 3 (Cap and Floor Assessment) of the licence as applied to the relevant payment timescales.

The value of the ICF_t term is calculated for each Relevant Assessment Period (every five years for IFA2) or in the instance of a Within Period Adjustment (WPA) being requested by the licensee and approved by Ofgem.

Methodology

The approved ICF_t Methodology is provided as the Appendix to this document; this section provides a brief description of the methodology.

ICF_t calculation and payment

The payment due to or from the interconnector licensee (ICF_t) is determined using the formula:[1]

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

Where the determined cap and floor payment for the Relevant Assessment Period (ICF_{ap}) is multiplied by 1 + the Operational Discount Rate (ODR) term (3.95% for IFA2) raised to the power of *x*, which is the time gap, expressed in years, between the median settlement period and median measurement period.

[1] The payment is made to or from National Grid ESO, the GB System Operator, in the earliest available settlement (CUSC) year through the TNUoS cycle.

Possible reconciliation payment

There is provision within the Licence, in the event of forecasting or reporting errors with respect to the value of the ICF_t term for the Relevant Year *t-1,* to perform a true-up of the ICF_t terms for a Relevant Assessment Period and/or a Relevant Partial Assessment Period (ICF_{ap} and/or ICF_{pap}).

NGIFA2 have included a further potential reconciliation process to account for calculation errors or changes to settlement dates. Once all actual values, including the dates of the settlement period, are fully available (after the end of the settlement period), the calculation is updated and, should there be any difference between final and provisional ICF_t values this difference is uplifted to reflect the time lag, expressed in years, between the year of the reconciliation payment and the year of the settlement period:

$$Reconciliation = (1 + ODR)^{y} \times (Final\ ICF_t - Provisional\ ICF_t)$$

Where *y* represents the time gap, expressed in years, between the median reconciliation period (Relevant Year *t-1*) and the median settlement period. This potential reconciliation payment is paid to or from National Grid ESO, as described above.

Previously approved methodology for Nemo Link and current considerations

We have only approved one previous ICFt Methodology, submitted by Nemo Link Limited. This methodology was approved by Ofgem on 10 January 2022, with the accepted formula including an inflation uplift:

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

NLL's updated methodology proposes the removal of the *1 + Inf* inflation term. NLL argue that SC 10 paragraph 14 does not clearly require inflation uplift to be applied to the ICF_t value.

We have considered both formulae and accept that both fulfil the current licence requirements, taking the wording of the relevant provisions. We are also considering a wider consultation with stakeholders to determine whether the accepted formula for the ICF_t term should include an inflation uplift of *1 + Inf*.

NGIFA2 have submitted a proposed methodology that does not include this *1 + Inf* inflation term, as this reflects their view that the Licence. Specifically, SC 10, paragraph 14, does not clearly require inflation uplift to be applied to the ICF_t value.

Decision

We are satisfied that NGIFA2's ICF_t Methodology meets the requirements detailed in SC 10 of its Licence. We therefore approve the methodology as detailed in the Appendix.

In accordance with the requirements of SC 10, this methodology will be maintained by NGIFA2. NGIFA2 will make such modifications to the methodology, which must be approved by Ofgem, as may be needed to ensure that the methodology best achieves its objective.

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

Yours sincerely,

Okon Enyenihi
Head of Interconnector Delivery