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Stuart Borland
Future Networks, EU Electricity Transmission
Ofgem
9 Millbank
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3 February 2015

Dear Stuart,

PUBLIC NGIH Response to “Cap and Floor Regime: Initial Project Assessment for the NSN interconnector to Norway” [consultation published 17 December 2014]

Thank you for the opportunity to respond to the above consultation.

Following NSN Link’s submission in September 2014, Ofgem have reviewed the information we provided for this project. This included complete Initial Project Assessment (IPA) information as well as some details relating to the Final Project Assessment (FPA).

In December 2014 Ofgem published a consultation on their minded-to position for the IPA, as well as the first steps of the FPA. This consultation also sets out the next steps for the cost-assessment process, including for the FPA and Post Construction Review (PCR). Following the consultation period, in March 2015 Ofgem will publish its final decision on the IPA as well as the aspects of FPA consulted on.

Shortly after Ofgem finalises its March 2015 decision, National Grid intends to take its Final Investment Decision (FID) on NSN Link. Ofgem’s December 2014 consultation provided a useful indication of the likely conclusions in the March 2015 decision and thus the regulatory framework for NSN Link at FID.

We have had positive engagement with Ofgem thus far and are encouraged that Ofgem recognise that a delay in the decision on awarding NSN Link a cap and floor regime will result in a subsequent delay in investment. Providing our Board with certainty regarding a guaranteed award of a regulatory regime for NSN Link is our utmost priority from the Ofgem decision in March 2015.

We believe that Ofgem and National Grid are broadly aligned in terms of what is needed from the March 2015 decision on NSN Link regarding firm regulatory approvals and clear processes, but ultimate assurance of this alignment is only confirmed in the precise wording of the March 2015 decision.

Given this, we have used this consultation response to highlight the areas where greater clarity is needed on the specific wording/ meaning of Ofgem's publication(s) in March to confirm that we have alignment around the intent behind the decision. We provide specific examples relating to this in our detailed response in Appendix A to this letter.

We are happy to discuss our views contained within this letter further should that be helpful. For further details, please contact Hannah Kruimer [Hannah.kruimer@nationalgrid.com]. This response is not considered confidential. We are therefore happy for it to be published on the Ofgem website and shared for the purpose of the consultation.

Please note that we have also submitted a confidential supplementary response for issues that are commercially sensitive.

Yours sincerely,

A handwritten signature in blue ink that reads "Alan Foster". The signature is written in a cursive style with a large initial 'A'.

Alan Foster

Director
National Grid Interconnector Holdings Limited

Appendix A: Consultation Questions

This Appendix sets out our detailed answers to Ofgem's consultation questions.

Questions 1-5

We are aligned with Ofgem's conclusions on Modelling, GB System Impacts and Qualitative Assessment. In summary, Ofgem's assessment of NSN Link reinforces our own modelling and analysis that NSN Link is likely to deliver significant benefits to consumers.

Question 6: Are there any additional impacts of NSN link that we should consider qualitatively?

We reviewed Ofgem's table 5.2 on the hard to monetise benefit assessment of NSN Link. An additional factor to include is the fact that the capacity of NSN Link would provide valuable hedging benefit to GB security of supply in the event that the significant new generation capacity forecast to be needed (for example in Scenario Outlook and Adequacy Forecasting) is either delayed or not forthcoming.

Question 7: Do you have any comments on our assessment of NSN's chosen connection locations or cable routes?

Ofgem provides a view on NSN Link's justification for, and their own assessment of, the chosen connection point, shore and landing locations and landfall site, onshore and offshore cable route for NSN Link (sections 6.8 - 6.17).

Ofgem state that they agree with the chosen connection point, shore and landing locations and landfall site, onshore and offshore cable route. However, they also note that they may re-examine NSN Link's connection location or cable route at the post-FID FPA stage if there have been significant changes to the information provided at IPA stage. We agree that it would make sense to revisit these choices if changes occur to aspects directly relating to these areas i.e. change of location, connection point or route.

Question 8: Do you have any comments on our assessment of NSN's project plan?

We are aligned with Ofgem's conclusions on the Project Plan.

Question 9: Do you agree with our conclusions for IPA?

The consultation notes (section 8.8) Ofgem's minded-to position on awarding NSN Link a cap and floor regime in principle, which is subject to no material escalation in costs. We agree with this position assuming that it means that NSN Link is awarded a cap and floor regime, provided that there is no significant deviation from high-confidence cost estimates already provided by NSN Link.

We do not agree with consultation sections 1.15 and 9.15 as these statements do not take into account the cost estimates already provided by NSN Link and instead state they are subject to the next steps of the FPA.

Question 10: Do you have any comments on our application of the regime to NSN?

We believe that we are both aligned in terms of what we need from the March 2015 decision on NSN Link regarding cost assessment principles and processes, but would need to see this confirmed in the wording of the March 2015 decision.

Assessment of risk sharing arrangements

Ofgem note that the proposed multiple lot procurement process could be justified, but that it introduces interface risks between the contracts that NSN Link must manage. Ofgem will review the risk sharing arrangements between NSN Link and its contractors, and ensure they reflect a positive outcome for consumers. We agree with this statement if it means that Ofgem will be reviewing the efficiency of risk sharing arrangements; that is whether or not risks are placed in the most efficient place for them to reside based upon a balance between the risk costs and the party best placed to manage and mitigate the risks. Further detail is needed on exactly how this assessment will be made by Ofgem as part of the post-FID FPA (and PCR).

Use of benchmarking

Ofgem will assess capital costs, replacements costs, decommissioning costs and project management costs as part of the as part of the post-FID FPA. Ofgem will use benchmark figures to help inform their assessment. We agree with Ofgem that it should compare comparable projects to help inform their assessment of NSN Link and the usefulness of benchmarks. We furthermore agree that Ofgem should consider the specifics of a project of this scale and nature to determine if costs are efficient and whether they should feed through the cap and floor.

To help inform developers about the approach that Ofgem will take in this aspect of the cost assessment, it would be helpful to have further information on how Ofgem propose to use benchmarks to help inform their decision making. We note that the recent ED1 activities included more detailed discussion on the limitations of benchmarking in some instances, and also identified how different types of benchmarks could be used to inform different analysis. This level of detail and transparency on Ofgem's decision making with reference to interconnection would be useful in helping developers to provide the right information into the cost assessment process.

Re-Assessment of costs as part of the PCR, incl. reporting and accounting structures

We hope that we are aligned that the scale and complexity of a project like NSN Link means that estimated capital costs (including EPC contracts) and project management costs may change during the construction phase. However, Ofgem's consultation seems to provide contradictory information on the scope of the PCR, especially if and when capital costs and project management are subject to re-assessment as part of the PCR. For example, see section numbers 9.22 compared to 9.3 and 9.26.

In 9.22 Ofgem states that it does not plan to reopen capital costs (including EPC) contracts as part of the PCR. However, in section 9.3 Ofgem notes that they will monitor spending during construction and take into account efficient expenditure needed to address risks arising. Following this, the final cap and floor levels will be set. In section 9.26 Ofgem notes that it will look at changes to the final "HVDC contract" costs as part of PCR.

To avoid misinterpretation, clarity on exactly how the PCR process will work is needed. Ideally, this is a process that recognises that deviations from initial capital cost and project management

cost allowances are subject to re-assessment as part of PCR by Ofgem. It is also important that it is clear that deviations from initial cost allowances that meet Ofgem's justification criteria and are related to controlling and mitigating (construction) risks will feed through the setting of final cap and floor levels.

We agree with Ofgem that this ask appropriate monitoring and reporting throughout the construction phase to ensure that they are kept up to date on the project costs and any deviation from initial cost allowances.

Implementation of the cap and floor regime

We would expect Ofgem to recognise that the mechanics of the cap and floor regime will be implemented in an interconnector license for NSN Link as well as in other regulatory documents, for example Regulatory Instructions and Guidance (RIGs), financial and tax model. We would also expect Ofgem to confirm that they are committed to bilateral engagement with the NSN Link (over and above that which is needed for monitoring and reporting) regarding the development of any cap and floor implementation documents (for example, license, tax model, financial model) and also to producing an implementation and engagement timeline which would further confirm this.

Overcoming challenges around split regulation

Guidance from Ofgem is sought that sets out how split regulation will support projects, such as NSN Link, which are working in close partnership with another TSO that has already received regulatory approval, for example of organisation structures and treatment of costs. There is a risk that joint working and decision making of the NSN Link project will be disrupted if there is not sufficient cooperation and coordination between the regulators.

We are looking for recognition of this issue by Ofgem and further discussion on the specific challenges of split regulation on the NSN Link asset and explore options to resolve them.

Application of the availability incentive

Ofgem propose to set the availability target at the same time as setting the initial cap and floor. We urge Ofgem to not lock down the availability incentive and its parameters and target in the March 2015 decision. Instead we believe it is appropriate for Ofgem to consider our concerns about the availability incentive, explain how the availability incentive provides an effective control, and consult on a further refined availability incentive proposal for NSN Link as part of the post-FID FPA.

Please note that we have highlighted in both formal consultation responses and most recently in informal communications on the NSN Link project, that we do not believe the availability incentive is an effective tool to meet the problem identified by Ofgem (and CREG). See, for example, our responses to the January Impact Assessment on Nemo Link and the consultation on the cap and floor design consultation released in March 2013.

We have yet to have any response from Ofgem on our concerns that the incentive actually reintroduces the perverse incentive it is designed to mitigate and currently do not feel that our concerns are appropriately considered.

Question 11: Do you have any comments on our assessment of the development costs?

We are in line with Ofgem's conclusions on development costs.

Question 12: Do you have any comments on our initial assessment of technology choice or tendering strategy for the NSN interconnector?

We are in line with Ofgem's conclusions on procurement actions and practice.

Ofgem furthermore provides a view on NSN's justification for, and own assessment of, the chosen transmission capacity, voltage and converter and cable technology (sections 9.13- 9.15) for NSN Link. Ofgem note that the choice of transmission capacity and voltage are justified. Cable technology is also deemed as broadly justified. However, Ofgem may revisit these areas as part of the post-FID FPA. We accept this point if it means that Ofgem reserves the right to revisit the technology choices if the final design deviates from that presented by NSN Link in their submission.

Ofgem asked some specific questions about the use of alternative cable types. We have considered alternative cable types for the project; however, a number of factors rendered them unsuitable for the NSN Link. We have provided further detail on our technology choices in our confidential response.