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**Private and Confidential**

Office of Gas and Electricity Markets (Ofgem)  
9 Millbank  
London  
SW1P 3GE  
Attention: Andrew Stone/Scott Laczay

25 April 2016

Our ref: KM/ABH

Dear Sirs

**Audit of Ofgem's Standardised Cap and Floor Financial Model (CFFM)**

In accordance with the terms of engagement per our agreed contracts CON/SPEC/2011-108L of 18 March 2015 and CON/SPEC/2016-108L of 22 March 2016 (together the "Contract") we have carried out an independent review of the standardised cap and floor financial model (the "Model") which has been developed by Ofgem (the "Model Author").

The Model has been developed as a template to aide potential developers seeking to apply in the second window for future electricity interconnector projects within the cap and floor regime. The Model is designed to calculate the cap and floor levels and associated operational period adjustments for individual interconnectors.

Subject to the assumptions and comments which we have summarised in Appendix A and subject to the representations and responses from Ofgem in respect of our Base Case Findings Reports upon which we have relied. As a result of our review, we confirm that in our opinion, the Model version "standard interconnector model 20160401\_BDO Audit FINAL\_250416 ammendment.xlsx" (as received on 25 April 2016):

- is logically constructed, internally consistent and, in all material respects, is arithmetically accurate in terms of its formulae, algorithms and calculations
- is consistent, in all material respects, with our understanding of Ofgem's summary of Licence Conditions as reflected in the document 'cap and floor regime summary for the second window.xlsx' as received on 18 March 2016

Our work was limited to the matters set out above and accordingly did not include, for the avoidance of doubt, any form of review of the commercial merits, technical feasibility, or the factual accuracy of the input data. Further, for the avoidance of doubt, in accordance with our agreed scope of review we have not conducted a review of the Model's consistency with UK Generally Accepted Accounting Principles or International Financial Reporting Standards, or a review of the Model's consistency with current corporate UK tax standards and legislation and offer no further opinion thereon.

All comments and opinions above are given solely in respect of the Model and cease to be valid if there are subsequent changes to the Model.

This letter has been prepared solely for the information and benefit of the addressee subject to their agreement to the terms and conditions of our engagement and the aggregate limitation of liability set out therein and no other party may place reliance on any matters contained herein.

Yours faithfully

BDO LLP

Appendices: A

**Assumptions and Comments on the Model**

## APPENDIX A

### ASSUMPTIONS AND COMMENTS ON THE MODEL

#### Assumptions and Comments on the Model

- 1.1 The outputs from the Model will be used to form part of the interconnector licence and revenue calculations. We understand that the Model is a template that will be used for future interconnector projects and currently contains 'dummy' input assumptions for illustrative purposes. On this basis, when updating for future interconnectors the Model may not automatically update in all respects, for example manual updates will be required to the calculation of the average annual RPI if there are changes to the timing of year ends.
- 1.2 The Model is designed as a tool to calculate the cap and floor levels and associated operational period adjustments on the basis of the assumptions and input data contained on the input worksheets. In accordance with our agreed scope of work we have accepted the hardcoded input assumptions reflected on these sheets as given and offer no further comment thereon.
- 1.3 The Model assumes construction expenditure has been incurred from the year ending 31 March 2012. Construction is assumed to end on 31 March 2022 and operations are assumed to commence on 1 April 2022. The cap and floor will remain fixed for the 25 year operational period and the Model reflects time periods ending 31 March each year.
- 1.4 The Model assumes that once the interconnector is operational, interconnector revenues will be assessed every five years to determine if the cap or floor has been triggered. These end of period assessments assumes that any revenue above the cap would be returned to the National Electricity Transmission System Operator which would ultimately reduce network charges for network users. If revenues fall below the floor then the interconnector owners would be compensated through higher network charges. The Model also has the functionality to calculate within period adjustments and pass through revenue adjustments.
- 1.5 The Model is denominated in millions of GBP except for some cost inputs which are stated in millions of EUR and converted to GBP using the average annual exchange rate for the applicable period. In accordance with our agreed scope of work we have accepted the hardcoded exchange rate assumptions reflected in the Model as given and offer no further comment thereon. The Model does not provide for any other foreign currency translation.
- 1.6 The Model is designed as a practical forecasting tool and, as is typical for models of this nature, does not attempt to include all matters referred to in the Project Documentation. Although not intended as an exhaustive list items not explicitly modelled include the reinstatement of floor for an 'exceptional event' (Annex 1 - Table 2: Availability incentive) which we understand from the Model Author would require a change to the Model. In addition we note the Model does not reflect Financial Assistance (Annex 1 - Table 2(c)) and Force Majeure. We understand however that, were these to be required, calculations will be performed externally to the Model and adjustments made to the inputs entered into the Model.