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Laura Edwards
Competitive Networks, Ofgem
9 Millbank
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SW1P 3GE
6 April 2016

Dear Laura,

National Grid Interconnector Holdings Limited Response to Nemo Licence Consultation

National Grid Interconnector Holdings Limited (NGIHL) welcomes the opportunity to respond to the above consultation. NGIHL is the legal entity within the National Grid group responsible for interconnector development and the management of existing operational interconnector businesses (comprising of a 100% investment in National Grid NSN Limited, National Grid Viking Link Limited and National Grid IFA2 Limited together with a 50% interest in BritNed Development Limited and Nemo Link Limited). NGIHL is developing several interconnector projects that aim to deliver substantial consumer benefits and assist the United Kingdom in reaching the European Commission's proposal for a European Union interconnection target of 15% by 2030 (as outlined in its Communication on European Energy Security Strategy dated 28th May 2014).

This response from NGIHL represents our views as both a developer and future operator of a portfolio of interconnectors but does not include our views in relation to the Nemo Link Joint Venture which is responding separately to this consultation.

Nemo Link is the first interconnector to be regulated under the cap and floor regime. We recognise that this consultation represents a big step towards establishing the requirements of this new form of regulation. We note that there is further work to do to establish the full end to end regulatory regime, for example the development and agreement of financial models and associated governance.

The roll out of the cap and floor regime to near-term interconnection projects, its design and regulatory framework was welcomed by NGIHL. It enables the realisation of near-term interconnection investment and promotes the importance of interconnectors in the future electricity market in Great Britain and Europe. The proposed cap and floor approach incentivises developers to identify and progress commercially viable projects, delivering economic, environmental and security of supply benefits to consumers with low project underwriting risks. Under the operation of the regime, sales and costs are fully driven by market conditions, however resulting revenues are capped and subject to a

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floor; this means that a fine balance of risk exposure is required to ensure investors are fairly and appropriately compensated.

We would, however like to highlight the need for the market-led principles of the cap and floor regime to be upheld throughout the development and duration of the regime and we provide specific examples below of where we feel this principle is at risk as a result of the licence drafting that has been consulted on:

- **Force Majeure** (SPC1 definitions)

  As drafted, the definition of force majeure does not provide any detail on what would constitute government restraint, nor does it include a change in law or regulation as an event of force majeure. Whilst the definition does not exclude 'change in law' as a force majeure event, it is likely that the list of events referred to in the definition would be interpreted in an exclusive manner particularly given the content of the draft guidance document in this context.

  As changes in law and regulation are not specified in the definition of force majeure, the interconnector licensee will be left with the risk that such changes would not be considered by the Authority, in consultation with the Belgian National Regulatory Authority, to be a force majeure event. This could result in the interconnector project being penalised for not meeting the Minimum Availability Target in a situation that is outside of its control.

  Neither the licence nor the decision to award the cap-and-floor regime to the NEMO project by Ofgem contains any change in law provisions or protection from any changes to the overall legal and regulatory regime applicable at the time of granting the licence. As a consequence, the NEMO project will be exposed to political risk arising from government restraint, change in law or simply a change to the licence conditions by the Authority.

  Given that the cap and floor regime granted to the NEMO project will essentially (i) be implemented by a 'switching on' of the standard conditions in the proposed new section G (Cap and Floor Conditions) following a direction issued by Ofgem; and therefore (ii) be dependent on Ofgem's decisions to maintain or change the regime over time (e.g., through amendments to the licence, in particular to the switching 'off' of SLC 1A or an amendment to the Cap and Floor RIGs), it is appropriate to consider the protections the proposed amendments to the SLC would offer to the NEMO project in case of changes made as a result of government restraint or Change in Law.

  If the licence drafting were to be implemented in its current form, the NEMO project (and future interconnector projects that are subject to the cap and floor regime) will be exposed to political risk arising from government restraint, change in law or simply a change to the licence conditions by Ofgem. In addition, implementation of the licence drafting in its current form would lead to change in law protection being available in Belgium but not in the UK which in turn would not only challenge the concept of a 'single regulatory regime' for the NEMO project but would also increase legal uncertainty. It may therefore be difficult for lenders and other investors to get comfortable with the relevant provisions in the drafting approach.

  The proposed approach to the definition of force majeure means that the protection for the NEMO project and its investors under the cap and floor regime in relation to government restraint or change in law events is materially weaker than that available to projects under the CfD regime. A refusal to make available to the NEMO project and other cap and floor interconnector projects at least the same level of change in law protection as is available to other investors in the UK energy market under the CfD regime could be seen as a regressive step and out-of-step with what has now been established as market standard for comfort in relation to protection against change in law and government restraint in the UK.

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The proposed approach also offers a lesser standard of protection than is available to the NEMO project pursuant to the CREG decision. Arguably, stronger protection is also available to projects which benefit from an exemption under Article 36 of the Third Gas Directive or Article 17 of Regulation 714/2009 on the basis that changes to the relevant exemption decisions require the consent of the European Commission and possibly ACER in addition to that of the two relevant national regulatory authorities.

We believe that interconnectors subject to the cap and floor regime should be protected against the impact of future significant legislative changes that may impact on operability and this should be appropriately reflected in the licence definition of force majeure. We do not think that the floor itself provides sufficient protection for the investor against such changes. Such legislative changes may prevent the floor payment being triggered in the first instance since they may prevent operation at the minimum availability target level.

- **Income Adjusting Events** (SPC 7.17) - The current drafting proposals do not provide protection for investors in relation to events that are force majeure type events which do not result in the failure to perform obligations but which do result in significant cost increase. We propose a mechanism should be developed in order that the efficient costs imposed by these types of events can be approved as income adjusting events at the discretion of Ofgem (following consultation).

- **Actual Availability** (SPC 4.18) - We propose Actual Availability should be adjusted for Allowed Outages and Force Majeure events because the interconnectors do not, by definition, have control over Allowed Outages and Force Majeure events. This amendment is required for the availability incentive at the cap to be effective and equitable.

- **Market Related Costs and New services** (SPC 5 Part C) - It is intended by Ofgem to incentivise developers to identify and develop projects in a way that maximises benefits to both consumers and investors *(Reference: DRAFT: Guidance on the cap and floor conditions in Nemo Link Limited's electricity interconnector licence. 1.3, page 7)*. However there are at least two asymmetries in the current drafting proposals that would dis-incentivise the development of new services even if these services would benefit consumers and the wider economy:
  - No allowance or adjustment is provided in the regime for Capacity Provider Penalty charges or for other new market related costs that may arise in the future but the associated revenues such as capacity market revenues are included for cap and floor revenue assessment.
  - Similar to above no allowance or adjustment is provided in the regime for additional revenue related additional costs but there is an adjustment for additional revenues meaning that the licensee is not incentivised to develop and offer additional new services because the business risk (investment and opex) may be significant but its upside potential is limited by the cap.

We acknowledge that a number of licence provisions that apply to Nemo Link would not necessarily be expected to apply to other projects being granted a cap and floor. Accordingly changes to the Nemo special conditions are not necessarily precedents for other cap and floor interconnectors. We expect that the cap and floor specific provisions of each future cap and floor project will be discussed bi-laterally with Ofgem and will be amended to include a set of special conditions, specific to its final policy decision and Final Project Assessment.

We recognise that the joint regulation approach for Nemo Link's incorporated joint venture encouraged a bi-lateral agreement covering the bespoke UK and Belgian dual jurisdictions. For other interconnectors with cap and floor being on a split regulation basis, then it should be possible to explore the possibility of incorporating more of the regulatory pricing calculations directly into the licence (e.g. the cap and floor protocol, ICF methodology and a supporting revenue model and

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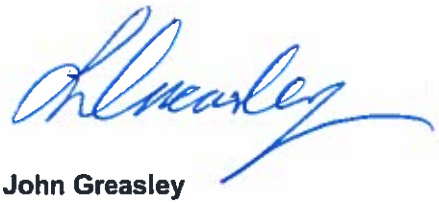
handbook). This approach could generate greater regulatory consistency and certainty for future UK interconnectors.

We are happy to discuss our views contained within this letter further should that be helpful. For further details, please contact John Greasley (John.Greasley@nationalgrid.com). Our response is not considered confidential. We are therefore happy for it to be placed on the Ofgem's website and shared for the purpose of the consultation.

Yours sincerely,



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For and on behalf of National Grid Interconnector Holdings Limited