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23 September 2016

Dear Ikbal,

**National Grid Interconnector Holdings Limited Response to Statutory Consultation on NEMO Link Licence Conditions**

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 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, in conjunction with a number of partners, is developing several interconnector projects that will be subject to cap and floor regulatory arrangements, and this response is being made on behalf of these interconnectors, namely National Grid IFA2 Limited, National Grid NSN Limited and National Grid Viking Limited. Despite the uncertainty caused by the Brexit vote, NGIHL remains committed to its ongoing investments in interconnectors.

Nemo Link will be the first interconnector to be regulated under the new cap and floor regulatory arrangements. As indicated above NGIHL is developing other interconnectors which will also be regulated under cap and floor. We understand the desire to use the Nemo Link licence drafting as the starting point for the licence drafting for these other interconnectors but it should be recognised that each interconnector must be dealt with separately in order to arrive at an appropriate set of licence conditions that properly balance risks between consumers and investors.

The representations we set out in our response to this consultation represent real risks to interconnector developers should these licence conditions be applied to them. Whilst the likelihood of these risks materialising may be low, over a 25 year period, and given the increase in number of interconnectors, the probability increases.

We would also note that the licence conditions require a number of subsidiary documents, models and associated governance to be developed to ensure that the end to end regulatory process functions and consumer payments are calculated as intended. We will not be able to comment fully on whether appropriate regulatory incentives and balance of risk between consumers and investors exists until the full end-to-end process through to the calculation of consumer payments is established.

We have set out our comments, and proposed changes, where applicable, in the attachment, and provide additional detail on our representations below.

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**Definition of Force Majeure: Income Adjusting Events and Actual Availability**

As per our representations in relation to the previous informal consultations we propose that the force majeure definition is changed so that interconnectors subject to the cap and floor regime are protected against the impact of future legislative or regulatory changes that may impact on their operability or availability.

We have set out in our previous representations our concerns that the definition of force majeure does not include events arising from legislative or regulatory changes. These concerns remain.

By way of context, the licensee's assessed revenues can be reduced by costs incurred by it as a result of an income adjusting event and its actual availability can be adjusted to discount outages caused by an exceptional event. This is important because the licensee's assessed revenues determine whether it is obliged to make a cap payment or receive a floor payment, while its actual availability determines whether it has met its minimum availability target and is therefore eligible in principle to receive a floor payment.

In order to establish the occurrence of an income adjusting event or an exceptional event and therefore an adjustment to the assessed revenues or to its actual availability, there must be force majeure. The current definition of force majeure does not include legislative or regulatory change as one of the specified events that are to be treated as beyond the reasonable control of the licensee and there can therefore be no adjustment to assessed revenues or actual availability to deal with the consequences of these types of events.

The effect of this is that if the licensee incurs costs as a result of a legislative or regulatory change beyond its control, such costs will not be deducted from its assessed revenues when comparing them to the cap and floor levels and therefore the licensee may still have to make a payment to consumers in circumstances when its real net revenues have not reached the cap or the licensee may not receive a floor payment in circumstances when its real net revenues are below the floor. Additionally, if the availability of the link falls below the minimum availability target as a result of a legislative or regulatory change beyond the licensee's control, no adjustment will be made to the actual availability target term and therefore the licensee will not be eligible for any floor payment that would otherwise be due.

We believe that over the 25 year period of the cap and floor regime, there is a genuine risk that there will be legislative or regulatory changes that impact the licensee's assessed revenues and its actual availability. The Brexit referendum has taken place since our previous representations on this issue, and we believe that this outcome increases the likelihood of this type of change impacting on interconnectors.

Given the nature of these risks it is very difficult to identify specific examples but we believe the following are events that have a realistic prospect of materialising and will not seemingly constitute an income adjusting event or an exceptional event:

- changes at a European level, perhaps through Network Codes, which could would affect the licensee's ability to make its capacity available for use;
- changes at a UK level in the context of the implementation of Brexit, which could affect when interconnector capacity is available for use; or
- changes to environmental or health and safety legislation and regulations, which could require an upgrade to the licensee's equipment and therefore involve de-energisation of the interconnector.

For example, the ongoing developments to the Flow Based Methodology through the Capacity Allocation and Congestion Management (CACM) Code may dictate the amount of capacity the interconnector can flow, so at any moment in time this could result in the interconnector having to reduce its availability when it is not (for the individual interconnector) economically efficient to do so. While the interconnector is actually available we believe the proposed definition of force majeure

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would not provide developers with the appropriate level of protection from such third party events, which are totally outwith its control.

Additionally. figures or caps embedded in legislation (for example, health, safety and environmental legislation) could change which could result in significant changes to interconnector systems or equipment, for example noise levels within environmental legislation or design specifications. This could result in the requirement for periods of low or zero availability whilst outages are carried out to undertake the necessary changes. Equally, there is a risk over a 25 year period that new health, safety and environmental legislation (and other legislation) is introduced which has a similar impact on the availability of the interconnector.

Going forwards, the uncertainty associated with the United Kingdom's withdrawal from the European Union is likely to manifest risks that cannot be identified at this stage. Further market coupling is likely to deliver changes to the way the market operates, which is also likely to impact the licensee's assessed revenues and actual availability.

The absence of legislative or regulatory events from the definition of force majeure means the licensee carries the sole risk of such events, both in terms of availability and cost.

Practically, in terms of the impact on availability, the absence of legislative or regulatory changes from the definition of force majeure prevents the licensee from submitting a request to the Authority for consideration of an exceptional event. Such a request will ordinarily be made in circumstances where the licensee's actual availability falls below the minimum availability target and, subject to the Authority's approval, is designed to adjust actual availability upwards to take account of the impact of the exceptional event. This supports the underlying principle that the licensee should be able to access the floor payment in circumstances where it fails to meet the minimum availability target for reasons beyond its control.

The events described above could lead to actual availability falling below the minimum availability target and there is currently no recourse to submit a request to the Authority for consideration of an exceptional event. In these circumstances the licensee is exposed to the costs of such events and is also prevented from recovering the floor payment.

Contrary, therefore, to the Authority's position that the minimum availability threshold affords protection, this protection does not extend to the events described above. It is correct that they afford protection in respect of the level of funding in respect of any capacity mechanism or changes to the GB carbon price floor, as noted in paragraph 1.65 of the Ofgem's decision paper dated 2 December 2016 and confirmed, in part, in its decision paper issued August 2016, but this is because those stated events affect revenues without affecting actual availability. The floor is available in circumstances where such events erode the licensee's revenue and where those events fall within the definition of exceptional events. It is not, however, available for the aforementioned events (because they will not constitute exceptional events) where they result in the actual availability of the interconnector falling below the minimum availability target.

The floor does not therefore provide the protection claimed by the Authority in the consultation documents. Broadening the definition of force majeure as we have suggested will afford protection to the licensee and future developers thereby properly balancing risks with consumers.

Practically, in terms of costs, the mechanism which permits the developer to submit a request for an income adjusting event is similarly not available to the licensee for the aforementioned events because this does not fall within the definition of force majeure. These events could have significant costs consequences for the licensee yet there is no mechanism for the Authority to consider these as income adjusting events. The effects of this are three-fold. Unless such costs are deducted from its assessed revenues the licensee:

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- could be in a position where its assessed revenues are above the cap and it is therefore required to make a payment to consumers in circumstances where its real net revenues have not reached the cap; or
- could be in a position where its assessed revenues are above the floor in circumstances where its real net revenues are below the floor and it is due a floor payment.

We are not aware that any other regulated regime places these risks solely with the developer and believe that this approach will 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 in the UK. Indeed, investor confidence and protection from changes in law have been an important issue in relation to the introduction of CfDs as per the Electricity Market Reform undertaken by the last Government, which includes a sophisticated force majeure clause that includes protection for classes of changes in law. Similarly, the definition of force majeure under the GB offshore transmission licence includes for legislative and regulatory changes.

Finally, we do not believe that the aforementioned examples or those that are likely to materialise in the future constitute "government restraint" for the purpose of the force majeure clause.

We consider that it is appropriate that interconnector developers should be afforded protection against these types of issues arising. Encouraging investment in future interconnectors is in the interests of consumers. We believe the current position on force majeure may place inappropriate risk on developers and, particularly because it is out of step with other regulatory regimes, may discourage developers.

**Definition of Force Majeure: Force Majeure: Strike, Lockout or other Industrial Action**

Ofgem is proposing to remove 'strike, lockout or other industrial disturbance' from the definition of Force Majeure. We do not understand the rationale for this proposal, as these words were included in the definition in the informal consultation and no respondents commented upon their inclusion.

We believe that the implementation of this proposal would be inappropriate and would result in a situation where interconnector licences are inconsistent with OFTO licences. (The generic Round 3 OFTO licence refers to the definition of Force Majeure in the SO-TO code, which does include 'strike, lockout or other industrial disturbance'.) There doesn't appear to be a reason for drawing a distinction between the force majeure position under the OFTO regime and that under the interconnector regime.

**Calculation of Actual Availability**

As per our representations to the informal consultation we propose that the formula that calculates Actual Availability is amended to include adjustment for force majeure related outages. We do not believe that the availability incentive will function as intended if the availability of the cap is not in the control of the licensee due to exceptional events not being taken into account.

**Service development costs – costs of sale**

We welcome the addition that is proposed to the definition of the Additional Revenue Term to allow for the deduction of 'and relevant costs of sale'. We would like to seek clarification as to what can be included in the costs of sale, for instance, can it include any capex and opex associated with the development of new services?

**Other Matters – calculation of Actual Availability**

It is unclear exactly what Interconnector Capacity means in this context. The term is taken from the Interconnector Licence Standard Conditions, where it is used principally in relation to the requirements on the licensee in respect of the allocation of capacity. However, it seems to be a test of actual

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available capacity over the interconnector. It is therefore unclear how there can be a reduction in such actual capacity to result in an Interconnector Outage.

**Interconnector Licence and Transmission Licence**

NGIHL confirms that it has no representations to make on the changes proposed to the electricity interconnector licence held by NGIL or the electricity transmission licence held by NGET to give effect to the processing of payments to/from interconnector licensees.

If you require any further information about any aspect of this consultation response, then please contact John Greasley (john.greasley@nationalgrid.com, 07836 357137).

Yours sincerely

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| Respondent details | John Greasley, john.greasley@nationalgrid.com | | | | |
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| **Licence/Document name** | **Condition/Section number** | **Condition/Section name** | **Page/Paragraph Ref** | **Comments** | **Suggested alternative drafting (please use tracked changes wherever possible)** |
| Special Conditions | SpC 1 | n/a | Page 3, paragraph 5 | Definition of Force Majeure. Definition should include legislative and regulatory changes | Definition of Force Majeure should be changed to:<br>means an event or circumstance which is beyond the reasonable control of the licensee, including (without limitation) an act of God, strike, lockout or oher industrial disturbance, act of the public enemy, war declared or undeclared, threat of war, terrorist act (or threat of), blockade, revolution, riot, insurrection, civil commotion, public demonstration, sabotage, act of vandalism, fire, flood, governmental restraint, Act of Parliament, other legislation, bye law or directive or decision of a court of competent authority or the European Commission or any other body having jurisdiction over the activities of the licensee provided that lack of funds of the licensee or performance or non-performance by an electricity transmission licensee or equivalent entity shall not be interpreted as a cause beyond the reasonable control of the licensee and provided that weather and ground conditions which are reasonably to be expected at the location of the event or circumstance are also excluded as not being beyond the reasonable control of the licensee |
| Special Conditions | SpC 1 | n/a | Page 3 paragraph 5 | Definition of Force Majeure. 'Strike, lockout or other industrial disturbance' should be re-instated | |
| Special Conditions | SpC 4 | Part D | Page 24, paragraph 18 | Calculation of Actual Availability should include Force Majeure related outages | Formula in paragraph 18 should be amended to read:<br>$AAt = MPA - \sum IO_t + \sum FO_t$<br>Where:<br>$\sum FO_t$ means the total Force Majeure related Outage (in MWh) in Relevant Year t reported by the licensee in its Annual Cap and Floor RIGs Submission for Relevant Year t |
| Special Conditions | SpC 5 | Part D | Page 33, paragraph 12 | We seek clarification from Ofgem what can be included as 'costs of sale' in the definition of $\sum(ADRS)_t$ | n/a |