National Grid Ventures
35 Homer Road
Solihull
B91 3QJ

John Greasley
Customer and Regulatory Manager
National Grid Ventures
john.greasley@nationalgrid.com
www.nationalgrid.com

For the attention of: Okon Enyenihi

Networks
Ofgem
9 Millbank
London, SW1P 3GE

1 March 2018

Dear Okon,

National Grid Interconnector Holding Ltd response to the statutory consultation on proposed changes to the electricity interconnector licence held by National Grid North Sea Link Limited to implement the cap & floor regime

National Grid Interconnector Holdings Ltd (NGIH) on behalf of the VikingLink and IFA2 interconnectors welcomes the opportunity to respond to Ofgem's consultation on the NSL Licence. 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 (NSL), National Grid VikingLink 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, and National Grid VikingLink Limited.

National Grid North Sea Link Limited is also responding to this consultation and the two responses have considerable overlap. Separate responses are being made:

- on the expectation that the enactment of cap and floor regime policy into the NSL licence will act as a precedent for how this will be done for IFA2, VikingLink and any other interconnectors that may ultimately come to fruition; and
- to reflect the different stages of these projects within the regulatory and investment approval process

The cap and floor parameters for IFA2 and Viking have not yet been determined and IFA2 notes that, more than a year following FID, little assurance is available over the parameter values that will ultimately be applied (there is no need for parameter determination to wait for the FPA cost assessment stage).

Additionally the extent to which the Financial Instruments (model, handbook, detailed parameter calculations) applicable to NSL will also apply to other cap and floor interconnectors, including IFA2 and Viking, remains unclear. There is therefore little certainty as to how the cap and floor regime will be implemented for IFA2 or Viking or over the level of consistency that will exist between Window 1 licensees.

To address this and ensure an unbiased and non-discriminatory treatment between licensees NGIH would encourage Ofgem to adopt a multilateral approach to regime implementation where policy is enacted in an open, transparent and consistent manner across all licensees.

The following points are aligned with the NSL response.

NGIHL believes that the cap and floor (C&F) regime design represents a significant and positive regulatory innovation. The mechanism seeks to promote efficient investment in interconnectors, places a reasonable balance of risk between investors and customers, and, most importantly, is likely to deliver in excess of £10bn of benefits to GB consumers[1]. In this context, the successful implementation of the C&F regime is critical to allowing those benefits to GB consumers to be realised.

The licence drafting being consulted upon here essentially represents the implementation of the policy determined during the regime design phase. It is NSL's observation that the proposed licence drafting does not facilitate the successful implementation of the regime in a number of areas, and we set these out in this response. From a consumer perspective, one of the main virtues of the C&F regime is that it seeks to encourage new infrastructure investors to enter the market and access new sources of finance to support such investments. In turn, this is likely to foster faster roll-out of a higher volume of interconnection – returning benefits to consumers more quickly as well as enhancing security of supply and sustainability.

For this to be effective in practice, however, current and future investors need to have sufficient certainty. In particular:

- There should be a "level playing field" between investors so that, in broad terms, the rules that apply to one interconnector investor might reasonably be expected to apply to other future interconnector developers[2].

- The C&F mechanism will need to provide sufficient regulatory protections and clarity to enable investors to raise finance to support projects on a stand-alone basis.

NGIHL considers that the current drafting does still not give the appropriate level of certainty or an appropriate appeal route to provide investors with sufficient confidence on the returns they can expect from interconnector projects. In particular, we note that:

- Special Conditions 8, 9 & 11: The financial model, its associated handbook and the key regulatory parameters are not linked to the licence, meaning that Ofgem has considerable discretion in deriving C&F values, without the licensee having the right of appeal on the merits to the CMA
- Definition of Force Majeure (FM): The drafting does not enact the stated policy[3] that the floor *would provide protection to investors against the risk that potential changes in the national or European legislation … could affect the business case of the project*

We attach our licence specific comments in the response template within appendix 1 where we believe that there should be changes made to the licence. We also attach within appendix 2 our broader observations on issues that are important to a successful regulatory regime implementation.

Yours sincerely

John Greasley
For and on behalf of National Grid Interconnector Holdings Limited

[1] Window 1 IPA consultation documents NSN, FAB Link, IFA2 & Viking,
[2] Indeed, we note that Ofgem has cited this as one of its core principles that should apply to interconnection "*The regime will be designed to ensure unbiased and non-discriminatory treatment between existing interconnector owners and future developers, so that there is no advantage for certain developers*" See Page 14, 28.06.2011 C&F principles
[3] June 2011 consultation, para 3.4.

Appendix 1: Licence consultation response template

Respondent details				NGIH		
Reference	**Licence/ Document name**	**Condition/ Section number**	**Condition/ Section name**	**Page/ Paragraph Ref**	**Comments**	**Suggested alternative drafting (please use tracked changes wherever possible)**
1.	Special Conditions	SPC1	Definitions and Interpretation	Page 2, paragraph 4	The availability incentive was introduced as there was acknowledgement that "For the wider benefits of interconnection to be realised, the developer needs to be incentivised to maintain high interconnector availability and repair any outages in a timely and efficient manner at all times. An availability incentive is necessary therefore for interconnectors if the operator does not face this incentive at all times. The partial exposure to market related costs and the foregone revenue from the interconnector being down provides a strong incentive in most but not all instances."[4] For the availability incentive at the cap to be fully effective, actual availability at all times should be amended for exceptional events, not just at the floor. The availability incentive at the cap was proposed, consulted on and implemented by Ofgem, as a necessary part of the licence to maintain high availability and in order for it to be fully effective, any impact on availability of exceptional events (which are by definition beyond the reasonable control of a licensee, and have to be approved by Ofgem), should be discounted from the calculation of actual availability in all circumstances, not just where an exceptional event reduces availability below 80%. The proposed change is also required to ensure that the definition of an exceptional event is consistent with what is intended in SpC2. para. 8b. During the period of 60 days of continuous operation which is required to meet the Full Commissioning Date, exceptional events should be discounted irrespective of the effect on the annual Actual Availability.	"Exceptional Event" means: (a) an event or circumstance that results in or causes the Actual Availability of licensee's Interconnector to fall ~~below the Minimum Availability Target in any Relevant Year~~; and (b) in the Authority's opinion, the event or circumstance: i. constitutes a Force Majeure event under the special conditions of this licence; ii. has been appropriately mitigated and managed by the licensee including responding to the event in line with Good Industry Practice; and iii. the Authority is satisfied that the licensee has met the requirements of Part A of special condition 4 of this licence

[4] Ofgem: Cap and Floor Regime for Regulated Electricity Interconnector Investment for application to project NEMO, 7 March 2013, para 2.61

2.	Special Conditions	SPC1	Definitions and Interpretation	Page 3, paragraph 2	We believe that the policy intent of income adjusting events is to cover interconnectors for events beyond its reasonable control, (subject to efficiency and materiality tests). The December 2014 NemoLink decision document[5] stated that one of the criteria for identifying the income adjusting event would be: "an event of circumstance constituting force majeure under the System Operator – Transmission Owner Code (STC)". However the current drafting of the definition of Force Majeure deviates from the STC definition and therefore does not achieve the stated effect of an income adjusting event. We understand that Ofgem's policy is that the floor provides protection to investors against the risk that potential changes in the national or European legislation (e.g. changes in the congestion management guidelines) could affect the business case of the project[6]. Further, in Ofgem's March 2013 document on the cap and floor regime[7], when considering the rate of return at the floor, the following was stated: "the risks faced by the interconnector developer are similar to those of a transmission company", and "The purpose of the floor is to ensure financeability for an efficient developer with a notional financing structure". In the December 2014 NemoLink decision document it stated that: "The floor provides for a guaranteed level of revenue, subject to meeting acceptable availability levels" and, "We will consider events that are beyond developers' control when assessing availability against this minimum threshold. Where we think that availability below this threshold was for reasons beyond the control of the developers, the top-up to the floor will be provided." Ofgem's May 2014 document reiterated this outside or the developer's control policy position [8] It is clear therefore that the floor should provide protection to developers which compensates for accepting a limit on returns (at the cap). Without the inclusion of legislative changes in the definition of force majeure, there is the risk that the floor is not available to the developer, if a force majeure event reduces availability below 80%. Additionally to ensure that floor provides effective protection and that the return at the floor aligns with the stated risk profile of the regime, income adjusting events need to also recognise legislative changes (through the definition of force majeure), so that notional assessed revenue can be appropriately adjusted for events outside the licensees control. Therefore, we recommend that the definition of Force Majeure is amended to be consistent with the definition in the STC	Definition of Force Majeure should be changed to: means an event or circumstance which is beyond the reasonable control of the licensee, including but not limited to act of God, strike, lockout or other 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 of the 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

[5] https://www.ofgem.gov.uk/sites/default/files/docs/2014/12/final_cap_and_floor_regime_design_for_nemo_master_-_for_publication_1.pdf

[6] Cap and floor regime for regulation of project NEMO and future subsea interconnectors, 28 June 2011, para 3.4

[7] https://www.ofgem.gov.uk/sites/default/files/docs/2013/03/cap-and-floor-regime-for-regulated-electricity-interconnector-investment--for-application-to-project-nemo_0.pdf

[8] Proposal to roll out a cap and floor regime to near-term projects 23 May 2014, pages 21 and 42

3.	Special Conditions	SPC4	Interconnector Availability Incentive, Part D Calculation of Actual Availability term (AA_t)	Page 24, paragraph 18	The calculation of availability incentive should include 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. The availability incentive is designed to ensure the licensee maintains a minimum availability to the consumer. If exceptional events are excluded this removes the benefit the availability incentive mechanism was designed to deliver.	Formula in paragraph 18 should be amended to read AA_t= MPA - ∑(I0t + FOt) Where FOt 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
4.	Special Conditions	SPC4	Interconnector Availability Incentive ,Part G:Interpretation	Page 27 paragraph 32	Allowed outage should also include Force Majeure event as per comment 3. Please note the interdependence between comments 1,3 and 4.	"Allowed Outage" means an Interconnector Outage (in MWh) that: (a) was caused by the de-energisation (whether partial or whole), disconnection or curtailment of the licensee's Interconnector by the GB System Operator or the Norwegian System Operator; ~~and~~ or (b) was caused by a Force Majeure Event: or (c) is specified in writing by the Authority as being an Allowed Outage
5.	Special Conditions	SPC4	Interconnector Availability Incentive, Part G:Interpretation	Page 28 paragraph 32	Maximum Possible Availability is calculated in 'one' direction so to calculate reductions of availability in 'either' direction effectively double counts reductions. I.e. a loss of 20% capacity in one direction, is only a 10% reduction in overall capacity, and should be recognised as such in the calculation of Actual Availability.	"Interconnector Outage" means any reduction in MWh of Maximum Possible Availability of the licensee's Interconnector ~~in either direction~~
6.	Special Conditions	SPC5	Assessed Revenue, Part B: Calculation of the Gross Revenue term (GR_t)	Page 30, paragraph 6	Further clarity could be provided for the terms: ASRN, CAR, CMR, to ensure it refers only to the licensee's revenue, not the total revenue, which is shared with its partner developer. i.e. similar to the terms: CPNt, CPGBt, RIt do refer to the income "receivable by the licensee".	E.g. ASRNt means the Ancillary Services Revenue (Norway) term for Relevant Year t and is: (a) equal to all revenue **received by the licensee** that is derived from providing a Norwegian Ancillary Service for Relevant Year t; and (b) reported by the licensee in its Annual Cap and Floor RIGs Submission for Relevant Year t Equivalent changes should be made to the definitions of CAR and CMR.

7.	Special Conditions	SPC5	Assessed Revenue, Part B: Calculation of the Gross Revenue term (GR_t)	Page 30, paragraph 6	High termination charges disincentives developing interconnectors from entering in the early years of CM auctions due to risk of late delivery which sometimes is outside of their control. We believe the cap and floor could be used to provide some protection from this risk thereby encouraging the participation of interconnectors. Interconnector participation reduces the clearing price and therefore reduces cost to end consumers. For example in the most recent t-4 auction the clearing price would have been an estimated £1.70 per kW higher if an equivalent of NSL's de-rated capacity had not participated. This equates to an estimated saving of circa £85m to consumers. We recommend an alternative treatment of CMR_t which allows capacity market costs, penalty charges or termination fees to be taken into account in some circumstance. See slides attached below which outline our alternative proposal. Additional detail is contained within appendix 2. CM_Alternative_Proposal_Mar18.pptx	We believe that licence drafting should be developed between Ofgem and NSL to deliver this intent.
8.	Special Conditions	SPC5	Assessed Revenue, Part C: Calculation of Market Related Costs term	Page 31, paragraph 8	NGIH believes that only the costs and revenues borne by the licensee should form part of the assessment. In most instances costs and revenues will be shared equally between the two project partners however there are occasions where this will not be the case. The MRC_t term should reflect the cost borne by the licensee and not 50% of the total cost of the interconnector.	Amend the definition of MRC_t to: *means the Market Related Costs term for Relevant Year t and is determined in accordance with paragraph 7 of this condition.* *determined in accordance with paragraph 8 of this condition*
9.	Special Conditions	SPC5	Assessed Revenue, Part D: Calculation of the Additional Revenue term	Page 32-33	NGIH welcomes Ofgem's partial movement on this issue and would encourage a further move to a mechanistic approach which would allow greater commerciality and innovation to occur without requesting up-front approval from Ofgem e.g. stating that all costs will be recovered to the extent to which they are covered by revenues. Additional detail is contained within appendix 2, point 2.b.	We would look to develop a mechanistic process with Ofgem such that Development and associated costs would be recoverable to the extent that they are covered by revenues on an NPV basis applying the applicable ODR rate over the lifetime of the regime.

10.	Special Conditions	SPC7	Non-Controllable Costs, Part C: Calculation of the Baseline Non-Controllable Operational Costs term ($BNCOC_t$)	Page 40, paragraph 13	The formula for Baseline Non-Controllable costs takes the BNCOA term and uplifts for UK RPI inflation. The BNCOA term appears to be a one-off value determined for the whole regime and an annual value. In the first and last relevant years this needs to be adjusted by a partial year factor.	The formula should be revised to: $$BNCOC_t = BNCOA \times RPI_t \times PYC_t$$
11.	Special Conditions	SPC7	Non-Controllable Costs, Part C: Calculation of the Baseline Non-Controllable Operational Costs term ($BNCOC_t$)	Page 40, paragraph 15	This term is used for costs that developers have no control over or are imposed on them by third parties. Over the 25 year cap and floor regime there is the potential for costs of these types to be imposed on developers therefore we think the definition of non-controllable costs should be expanded to allow for a future inclusion with the non-controllable cost category. One example could be costs imposed on interconnector TSOs as a recovery route for Nominated Electricity Market Operator costs under the European Network Codes. We recognise that there is potential for an Opex reopener within the regime; however this is intended for controllable costs.	The Non-Controllable Operational Cost Items are defined as the following: Crown Estate Lease Fees; GB Network And Property Rates; GB Licence Fees; and Other Non controllable costs as agreed by licensee and the Authority
12.	Special Conditions	SPC7	Non-Controllable Costs, Part D: Determination of the Income Adjusting Event term (IATt)	Pages 40-43, Part D	The original policy was that costs associated with IAEs should be fully passed through to consumers. The current licence drafting only permits IAE cost recovery when revenues are either above the cap or below the floor. Additional detail is contained within appendix 2, point 1.a.	The costs associated with IAEs should be adjusted to be on a fully pass through basis in line with stated policy.
13.	Special Conditions	SPC7	Non-Controllable Costs, Part F: interpretation	Pages 43-46, Part E	The licence drafting only covers developers for decommissioning costs as a result of changes in legislation when revenues are either above the cap or below the floor whereas stated policy was that all decommissioning costs changes were to be fully passed through regardless of how revenues compare to the cap and floor. NGIH does not believe that this policy has been enacted fully and additional detail is contained within appendix 2.	Decommissioning cost changes (not limited to legislative changes) should be adjusted to be on a fully pass through basis in line with stated policy. We believe that NSL should meet with Ofgem to develop suitable drafting in the relevant areas to meet the stated policy intent.
14.	Special Conditions	SPC8	Process for determining the value of the Post Construction Adjustment terms	Pages 48-49	Ofgem has considerable discretion in deriving C&F values, without the licensee having the right of appeal on the merits to the CMA. Additional detail is contained within appendix 2.	NGIH attaches revised drafting below  NSL SPC8 amendment.docx

15.	Special Conditions	SPC9	Process for determining the value of the Opex Reassessment Adjustment terms	Pages 50-51	Ofgem has considerable discretion in deriving C&F values, without the licensee having the right of appeal on the merits to the CMA. Additional detail is contained within appendix 2.	NGIH considers that the proposed changes to SPC8 should be replicated within SPC9.
16.	Special Conditions	SPC11	North Sea Link Cap and Floor Financial Model Governance	Pages 55-57	Ofgem has considerable discretion in deriving C&F values, without the licensee having the right of appeal on the merits to the CMA. Additional detail is contained within appendix 2.	NGIH attaches revised drafting below  NSL SPC11 amendment.docx

Appendix 2: C&F Framework Issues

This appendix sets out how NGIH believes that the proposed cap and floor arrangements should be amended to reflect established and best regulatory practice. It also sets out areas where we believe that finalised policy is not being enacted and builds upon comments that have already been made within Appendix 1.

Regulatory principles

To give investors a level of certainty allowing them to raise finance on a standalone basis we would reasonably expect a regulatory framework to follow established good practice. NGIH considers that the implementation of the C&F regime within the NSL Licence should be amended to reflect established regulatory practice. The primary regulatory framework elements which should apply to C&F are:

a. ***A consistent and transparent end-to-end process (see Appendix 1 comment 16):*** The end-to-end regulatory pricing process[9] impacts investor revenues and should be within the licence scope and delivered through the C&F Financial Model and associated Handbook being formally tied into the licence[10]. This consistent approach would allow licensees at different project stages to better understand the financial impact of any proposed changes to the C&F calculation.

b. ***Appropriate consultation and appeal rights (see Appendix 1 comment 16):*** Setting final C&F values within SPC8&9[11] is effectively a price control which happens to produce two allowed revenue values i.e. one for each of the cap and floor. Existing UK regulatory regimes provide public consultation and CMA appeal rights which recognise that broad price control elements such as financial parameters, models and methodologies impact multiple licensees and cannot be fully and effectively considered by Judicial Review. NSL believes the absence[12] of multilateral consultation and an ability to refer Ofgem's decisions to an independent expert body would be a regressive step which could be detrimental to consumers and competition.

The above elements of good practice are particularly important given that the C&F regime is new, incomplete, untested and includes an ex-post assessment. Investors will only find out, long after investment, how costs and allowances will be turned into the cap and floor levels. This means that a lower degree of regulatory assurance exists than within the established onshore regime until the final cap and floor levels are set.

We do not believe that the implementation of the regime has fully met the above requirements, and the adoption of our comments made in Appendix 1, and subsequently in this Appendix 2, will go some way to ensuring that the objectives of the cap and floor regime policy are met.

Specific Regime Comments

This section contains comments in the following areas:

1. Where policy has not been enacted
2. Other implementation decisions made
3. Future implementation decisions to be made

1. Where policy has not been enacted

To minimise the volume of text, only brief policy extracts from a non-exhaustive list are included below with links to the relevant policy documents.

[9] Regulatory pricing covers how costs and allowances are compared to revenues to calculate consumer payments

[10] For NGET this is covered by Special Condition 5A. Governance of ET1 Price Control Financial Instruments

[11] SPC8&9 covers the process which determines the final C&F value and any subsequent Opex Reassessment Adjustment which feed into Special condition 2

[12] The 'NSLCFFM is a stand-alone document and does not form part of this licence' SPC11 text probably removes the model from the CMA'

a. Adjustments within the collar (see appendix 1 comments 12 and 13): Income Adjusting Events (IAE) and decommissioning adjustments were clearly stated as being applicable both within and outside of the collar. Ofgem confirmed this policy intent within the NSL licence drafting discussions and it remains unclear as to why the NSL licence does not reflect this.

> *Ofgem policy*[13:]
> *Non-controllable costs: Differences from the baseline will be fully passed through, subject to supporting evidence and justification of need and efficiency provided by the developer, regardless of whether revenue is at the cap and floor.*
>
> *Income Adjusting Events: Costs relating to income adjusting events will be passed through regardless of whether revenue is at the cap or floor.*

b. IAE adjustment scope (see appendix 1 comment 2): The IAE process is a key element of mitigating the risk that licensees bear and has been consistently applied to the Offshore Transmission Owners (OFTO) licences regulated by the same Ofgem team that considers interconnectors. The reasons for the movement from policy to licence enactment remain unclear and leave C&F interconnectors with a materially higher risk level than OFTOs:

> *Income adjusting events shall be broadly defined as set out in the OFTO regime (with relevant amendments to reflect that interconnectors are not signatories to the STC).*[20]
>
> [20]*For OFTOs an income adjusting event must be:*
> *(i) an event of circumstance constituting force majeure under the System Operator – Transmission Owner Code (STC); or*
> *(ii) an event or circumstance resulting from an amendment to the STC not allowed for when allowed transmission owner revenues of the licensee were determined for the relevant year t; or*
> *(iii) an event or circumstance other than listed above which, in the opinion of the NRAs is an income adjusting event and is approved by them.*

Note: NSL's licence only permits force majeure i.e. criteria (ii) and (iii) above have been removed entirely. Furthermore the force majeure scope has been reduced to remove the following:

> *strike, lockout or other industrial disturbance, fire, flood, 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*

c. Decommissioning adjustment scope (see Appendix 1 comment 13): Stated policy made no direct reference to decommissioning adjustments being limited to legislative changes only and NGIH does not accept Ofgem's working level response that a footnote link to an illustrative 70-page OFTO licence made this policy intent clear.

2. Other implementation decisions made

At a conceptual level investors are paying the cost of capped returns and ensuring regulatory compliance for the value of the floor (when compared to a clean exemption). Policy changes and implementation asymmetry inevitably shift that balance and the basis on which the C&F regime has been sold to investors. A non-exhaustive list of examples is detailed below:

a. ***Capacity Mechanism revenue and penalties (zero annual limit) (see Appendix 1 comment 7 and supporting presentation):*** The C&F regime already provides strong commercial alignment between investor and GB consumer interests through the considerable collar width. This asymmetry is therefore unnecessary and will deter commercial decisions being made which would typically favour both parties (NGIH proposes a lower asymmetry option which it believes would enhance the regime's consumer benefits).

[13] Page 41 May 2014 consultation

b. ***Costs of developing new revenue streams (see Appendix 1 comment 9):*** NGIH welcomes Ofgem's partial movement on this issue and would encourage a further move to a mechanistic approach which would allow greater commerciality and innovation to occur without requesting up-front approval from Ofgem e.g. stating that all costs will be recovered to the extent to which they are covered by revenues.

c. ***Cap availability is not adjusted directly for allowed outages (see Appendix 1 comments 1, 3 and 4)*** The pre-investment decision documents did not state or infer that the cap incentive would leave investors exposed to events outside of their control. NGIH notes that other regimes have allowed IAEs (including force majeure) to be used for target adjustments (e.g. the 2011-13 'BSIS' scheme) and that the consistent application of established regulatory principles is congruous with stable, efficient regimes.

3. Future implementation decisions to be made

There are two specific areas where we consider that there is an opportunity for Ofgem to change the regime in the future with significant consequences:

a. ***Forex cost treatment:*** Bilateral working level forex cost discussions and the NSL Final Project Assessment decision[14] have provided assurance that a sensible hedging policy (simplified here as 'hedge where practical') will not be viewed asymmetrically with the benefit of hindsight. This however contradicts the formal RiGs guidance[15], (extracts of which are shown below) which infers the benefit of hindsight could be applied to the detriment of the licensee.

> *9.21 Ofgem will not allow foreign exchange losses as a cost category.*
>
> *9.26 A developer may choose not to hedge costs which are small, and/or unpredictable in timing. Ofgem will review such decisions on a case by case basis and, if it agrees that it was not appropriate to hedge these costs and finds that the developer acted in an efficient and economic manner otherwise, it will accept the costs at the sterling cost paid assessed at the spot rate prevailing at the time of payment.*
>
> *9.27 At no point will Ofgem accept 'exchange losses' as an efficient and economic cost.*

b. ***Fixed and unfixed items:*** NGIH's understanding is that for construction costs a full ex-post assessment will be undertaken which, unlike with the onshore ex-ante approach, the best possible outcome is allowed costs in line with those incurred. Whilst NGIH understands and accepts the principle of ex-post assessment a lack of a clear multilateral end-to-end process and working level references to allowances items being fixed infers that further surprises may occur (i.e. if costs go up allowances remain unchanged but if costs go down allowances will also do so).

With no interconnectors having reached the Post Construction Assessment stage (unlike OFTOs, C&F interconnectors cannot view disallowed costs in the context of a larger Contract For Difference backed generation investment) there is a high level of uncertainty over how the cost assessment process will work in practice. The OFTO regime is not fully visible to NGIH however NGIH notes the average 8% disallowance for the first four OFTOs from the independent National Audit Office report[16] and would welcome multilateral engagement to quantify the level of risk C&F investors are exposed to.

Summary and way forward

NSL considers that a fuller framework review and policy rationalisation is required to address points a and b above. This could remove any perception that Ofgem can selectively interpret various policy documents to justify whichever outcome is retrospectively preferred or provide a non-level playing field where each licensee receives a

[14] page 3, NSL FPA however NSL is unable to ignore the uncertainty created by the RiGs document,
[15] page 31, C&F RiGs
[16] NAO, 8% first 4 OFTOs

different regime implementation. NSL as part of NGIHL would be happy to support or even facilitate such workshops to aid Ofgem in moving the C&F regime forwards.