

# Guidance

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## Schedule 5A: Cap and Floor Regulatory Instructions and Guidance (Cap and Floor RIGs)

**Publication date:** 12 September 2019

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This document provides instructions and guidance to the interconnector owners (IOs) operating under the cap and floor regime to enable them to complete the reporting requirements associated with the cap and floor regime.

This is an update on the previous version of the document, which we published in February 2016.

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## 1. Introduction

### Context and related publications

1.1. This document is the Cap and Floor Regulatory Instructions Guidance (“Cap and Floor RIGs”) established under Standard Licence Condition (SLC) 25: Cap and Floor Regulatory Instructions and Guidance of the Interconnector Owner’s (“IOs”) electricity interconnector licence. It covers provision of information by the IO to the Gas and Electricity Markets Authority (the “Authority”) in respect of the IO’s construction and operation phases, including construction costs, operating costs and financial information.

1.2. The information described in this document is required for a number of reasons:

- **Post Construction Review** – this information will be used by the Authority to inform the Post Construction Review of costs ahead of operation.
- **Building knowledge** – acquiring experience and knowledge of the actual costs involved in constructing and operating an electricity interconnector licence will enable the Authority to evaluate subsequent projects more effectively.
- **Financial health** – monitoring the IO’s costs enables the Authority to secure that the IO is financially stable and able to finance its activities and obligations or to be prepared to respond in the event that the IO’s financial health deteriorates.
- **Licence compliance** – SLC 25 of the IO’s licence requires that this information be collected.

1.3. The Cap and Floor RIGs provide a framework that enables the Authority to collect data from the IO in a consistent format. The Cap and Floor RIGs describe the information required to be provided to the Authority, guide the IO on how to provide this information and enable the IO to put the systems in place to collect the data to the level of detail required.

1.4. These Cap and Floor RIGs may be modified in accordance with the change control procedures detailed in SLC 25 of the electricity interconnector licence. For the avoidance of doubt, the IO must not change the structure of the Cap and Floor RIGs – this includes adding or removing rows or columns, even if they do not contain data. If the IO identifies a need for a change, it should raise the matter with Ofgem and the Authority may make the change to the master version of the reporting template as required.

1.5. The Authority welcomes the opportunity to engage with IOs to further improve the reporting pack. In addition, if any of the guidance contained in this document is not sufficiently clear then the IO should contact Ofgem for further guidance and/or to discuss potential changes to the reporting template. In the first instance queries should be directed to: [Cap.Floor@Ofgem.gov.uk](mailto:Cap.Floor@Ofgem.gov.uk)

1.6. This document, as well as the associated template, is an update on the previous version, which we published in February 2016.<sup>1</sup>

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<sup>1</sup> These documents can be found at:

<https://www.ofgem.gov.uk/publications-and-updates/proposed-changes-standard-conditions-electricity-interconnector-licence-licences-held-nemo-link-and-ngil-and-ngets-electricity-transmission-licence-implement-cap-and-floor-regime-and-use-revenues-compliance>

## Legal framework

1.7. The reporting requirements relating to the Cap and Floor regime are contained in single licence condition:

- Standard Condition 25: Cap and Floor Regulatory Instructions and Guidance.

1.8. SLC 25 sets out the scope and governance arrangements for the Cap and Floor RIGs.

1.9. For the avoidance of doubt, this document is subordinate to the licence conditions. This document will not change, alter, or amend any definition or obligation contained within the licence. In the event of any inconsistency between any licence condition(s) and this document, the licence condition(s) will take precedence.

1.10. This document should be read in conjunction with SLC 25. Where definitions are provided within the licence conditions, they are not duplicated in this document.

## 2. Guidance on completing the template and commentary

### Section summary

The purpose of this chapter is to provide general instructions for completing the template and commentary document. This will enable Ofgem to effectively monitor expenditure (and revenue) during development, construction and operation of the assets and provide information about the performance of IOs under the cap and floor regime.

## Reporting under the Cap and Floor RIGs

### Timescales for reporting

2.1. The completed Cap and Floor RIGs will be submitted on an annual basis.

2.2. The reporting year for the provision of information under the Cap and Floor RIGs is defined under SLC 25 of the electricity interconnector licence. Different interconnectors may have different reporting years (e.g. 1 April to 31 March or 1 January to 31 December). Each IO should report in accordance with the timescales set out in its licence.

2.3. The template should include actual values up to, and including, the most recent relevant year, and forecasts for each of the remaining years.

2.4. Except where otherwise stated, the IOs must provide the information required under the Cap and Floor RIGs as soon as reasonably practicable and in any event not later than the submission deadline established under SLC 25 of its licence (three months from the end of the reporting year to which such information relates). This is the latest date that IOs can submit information unless Ofgem has previously consented to an extension in writing.

2.5. Where it is not possible for any reason to provide the data in the level of detail required, this should be explained in a commentary submitted alongside the reporting pack. As far as is practical, IOs should notify Ofgem of any failure to report in advance of the submission to allow Ofgem to consider either an exemption or alternative reporting arrangements.

### Form of submission

2.6. Instructions for the electronic submission of the workbooks will be circulated to the IO's regulation manager in advance of each submission deadline. However, if there is any doubt about the method of submission, the licensee must contact Ofgem.

### Resubmissions

2.7. IOs are required to seek the agreement of Ofgem or person(s) nominated by Ofgem before resubmitting any information provided in accordance with these Cap and Floor RIGs.

2.8. In any such instance, the report concerned must be resubmitted in full. The volume of supporting information the licensee will be required to submit to support any resubmission will be dependent on the nature of any required resubmission.

2.9. For each resubmission, a detailed explanation must be provided in the changes log in the Cap and Floor RIGs, listing every cell that has been amended. The explanation must include sufficient commentary to explain the reasons for the resubmission.

2.10. In relation to the detailed return required as part of revenue reporting, this must only be resubmitted where a restatement is necessary in the opinion of the appropriate auditor (where appointed).

### **Review**

2.11. Once the IOs have submitted the information to Ofgem, Ofgem or person(s) nominated by it ('a reviewer') will undertake a detailed review of the information. A review may include a visit to the IO for discussion of the information submitted. Such visits will be agreed with the IO in advance.

### **Appointing an examiner**

2.12. In accordance with SLC 25, the IO must permit a person(s) nominated by Ofgem to examine:

- the systems, processes and procedures for measuring the specified information,
- the specified information collected by the licensee, and
- the extent to which the systems, processes and procedures and the specified information complies with the Cap and Floor RIGs.

### **Audit requirements in relation to cost and revenue reporting**

2.13. SLC 25(7)(h) provides for Specified Information to be subject to audit, the terms on which an auditor is to be appointed by the licensee for that purpose and the nature of the audit to be carried out by that person. The current issue of the Cap and Floor RIGs does not require an audit report to be submitted pursuant to this condition, although in future the Authority may modify the Cap and Floor RIGs. Such changes may extend to introducing an audit requirement for some or all of the cost and revenue reporting where this is considered necessary by the Authority. If so, Ofgem will issue an Agreed Upon Audit Procedures (AUP) for use by an appropriate auditor by the end of the year to be reported on.

### **Accounting policies**

2.14. All costs and revenues should be reported on a cash basis. Cash means exclusive of provisions and accruals and prepayments that are not incurred as part of the ordinary level of

business. IOs should use the same accounting policies as in the preparation of the regulatory financial statements, in accordance with UK GAAP<sup>2</sup> or IFRS<sup>3</sup> unless otherwise stated.

2.15. In the event that the accounting policies applied to prepare the template differ from those used in the regulatory financial statements (for some or all years), the IO must include appropriate details including quantification of the difference.

2.16. The template is designed to capture the data across the construction phase and the operational phase. All previous reporting periods are to be completed with the outturn figures in nominal prices and all future periods are to be completed with nominal forecasts. To be clear, costs and revenues must not be price re-based to the reporting year, nor should forecasts include any inflation estimates.

### **Data entry**

2.17. As the template includes a series of tables in *Microsoft Excel* worksheets, links and formulae have been included to limit, where possible, the amount of manual data entry required. The workbooks have not been “locked”, but IOs must not make changes to any formulae or formats (including insertion or deletion of rows or columns, moving any cells, or altering any text, figures, or formulae in any cells not shaded yellow) unless specifically instructed to do so. If a change is necessary (to correct an error, for example), Ofgem will make the correction and notify the IOs.

### **Use of Estimates and Allocations**

2.18. Apportionments should be avoided wherever possible. However, where an IO (and any affiliate or related undertaking of the licensee) has to do this to complete the template, the basis of apportionment must be provided. Changes in apportionments should also be highlighted.

### **Additional information**

2.19. If IOs consider additional information beyond that requested is necessary to develop a complete understanding of the information presented in the template, then such information should be included in an appendix to the submission.

## **Components of the Cap and Floor RIGs**

### **Overall structure**

2.20. The Cap and Floor RIGs comprise two main elements:

- These instructions and guidance on how to report the data commentary; and
- Associated cost template (“the template”) for reporting data, including costs, revenues and availability data (in *Microsoft Excel* format).

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<sup>2</sup> United Kingdom Generally Accepted Accounting Practice (UK GAAP)

<sup>3</sup> International Financial Reporting Standards (IFRS)



## Cap and Floor RIGs template

2.21. The template includes a series of *Excel* worksheets. The purpose of the template is to facilitate the submission of uniform and comparable information from IOs. This will enable Ofgem to monitor expenditure during development and construction of the assets and assess spend against the provisional cap and floor allowances during the project's operation. It provides an information basis for the Post Construction Review (PCR) to help determine final cap and floor levels.

2.22. The template has been designed to ensure that we are able to conduct our role of assessing each project's submitted information in a consistent and fair manner. If you have any comments or questions on the template, please contact us in the first instance (as set out in paragraph 1.5 of this document).

2.23. The template has been designed to be consistent with the Cap and Floor Financial Model and ex-ante allowances.

2.24. The key points to note in completing the template are:

- The licensee must take all reasonable steps to ensure the quality of its Cap and Floor RIGs data. The data must in all material respects be accurate, complete and fairly presented. Director-level sign-off and accountability is required for the submission of the template.
- The licensee must notify Ofgem of the possibility of any significant revisions to improve data quality. This notification must be issued to Ofgem as soon as it becomes evident to the licensee that a reasonable likelihood exists of significant inaccuracies in any of its previously submitted data.
- The template is colour coded to reflect the action required. The significance of these colours are specified within the template. Please adhere to these colour codes at all times.
- All financial values should be input in the price of the year to which the Cap and Floor RIGs relate, i.e. actuals are in the costs of the year, and forecasts should not include future inflation. Previous years' data should be reported in nominal terms (Ofgem will convert to real terms if necessary).
- Unless otherwise indicated in the guidance document or template, actual financial values should be provided in (nominal) Euro million or (nominal) GBP million (as appropriate) to the maximum accuracy available, with financial values reconcilable with statutory accounts. The actual financial data should be reported commensurate with the purpose for which such data is intended, taking into consideration the appropriate allocations that are necessary to complete the template.

### *Provision of forecast data*

2.25. There will be a requirement to forecast costs for any remaining years of the construction period, and at least part of the operating period. The IO must take all reasonable measures to ensure that its forecasts are as robust as possible. Ofgem may seek to reconcile or verify these forecasts with an IO's internally-used forecasts.

### *Provision of Indirect Allocation Methodology*

2.26. The IO must provide its methodology for allocating indirect costs as part of its reporting, and subsequently request approval from Ofgem of any changes to this methodology. As part of this process:

- An explanation must be given on why the IO is seeking to change its allocations.
- For the current reporting year, relevant costs (and the project total) using the current allocation methodology must be compared with the same costs (and the project total) following application of the proposed allocation methodology.
- Likewise, a comparison must be made between the subsequent reporting year – and any other future year where a relevant change in costs is known by the IO – between costs derived with the current methodology and costs using the proposed methodology.

2.27. In order for us to be able to conduct an efficient review of the IO's costs and information, the template has been split into the following tabs:

- Cover tabs
- Technical tab
- Cost summary tab
- Cost variations tab
- Risks tab
- Devex/Capex cost reporting tabs
- Tabs for costs in relation to the project's operational period
- Outages tabs
- Income tabs

2.28. The following section provides details on the purpose of these tabs and the information that we require. In addition, the template itself contains further information on how the template should be completed.

2.29. As detailed below, IOs should only fill in relevant sections within the template. For instance, the income and outages tabs should only be filled in when the interconnector is operational.

#### *Cover tabs*

2.30. These tabs provide the IO with further guidance on how to fill in the template. There are also numerous cells to be filled in by the IO within these tabs to provide us with key project information, as well as the assurance that the information has been signed off by the relevant person(s).

#### *Technical tab*

2.31. The main purpose of this tab is for the IO to provide us with the key technical information for the project. We expect the IO to provide extensive details on the project's technical characteristics within the commentary document that will accompany each

submission. However, this technical tab provides us with a clear overview of the project's key technical details.

#### *Cost summary tab*

2.32. This tab provides an overview of the project's costs, with the majority of the values within the tab being drawn from the other cost tabs. The tables within this tab enables us to view the project's costs at a glance and allows us to compare project costs.

#### *Cost variations tab*

2.33. This tab should be used to indicate and describe any cost changes between the IOs current and previous submission within the construction phase of the Cap and Floor RIGs. This enables us to identify key areas for the review which we conduct following each submission.

#### *Risks tab*

2.34. This tab should be completed to represent the IO's most recent view on the project's risks and associated contingency budget. The tab should be filled in as instructed within the template, ensuring that each risk is described in detail and that the associated cost has been calculated in a robust and transparent manner.

#### *Devex/Capex cost reporting tabs*

2.35. This tab enables the IO to provide a more detailed breakdown of the project's development expenditure (devex) and capital expenditure (capex). There are specific tabs for the project's different assets e.g. subsea cables. Each of these tabs includes a list of cost items that have been common to most interconnector projects. If the IO believes that any of these rows are not relevant for their project, then these should be left empty. Likewise, if the IO believes that certain cost items cannot be captured within the existing rows, then this should be communicated to us as soon as possible. We will then look to add additional rows to the template, if we believe this is appropriate. The values included within these tabs will feed into the costs summary tab.

#### *Tabs for costs in relation to the project's operational period*

2.36. These tabs provide us with an overview of the project's costs for the duration of its operational period. We expect the level of detail and maturity of these costs to increase as the project progresses through the reporting stages of the Cap and Floor regime. We acknowledge that the majority of these costs would be estimates as the IO begins to report its costs to us. However, we anticipate that the IO should be in a position to provide us with a robust rationale for these costs as part of their PCR submission. The information provided within these tabs will also be used to monitor actual operating expenditure over the regime period.

#### *Outages tabs*

2.37. Once the project is operational, we expect the IO to complete these tabs with the relevant details for outages that it has experienced within the reporting period. The

information will be used to establish the level of incentive, if any, that should be applied to the cap and floor, for comparison with assessed revenue.

#### *Income tabs*

2.38. Once the project is operational, we expect the IO to complete these tabs with the relevant details for the income from the project. The information will be used to establish the level of income that should be compared to the cap and floor.

#### **Commentary document**

2.39. Alongside the submission of the template, each IO must complete a commentary. The guidance for this is set out below. This commentary is required in order to:

- Give Ofgem an understanding of the project's progress in terms of expenditure and milestones (for both construction and operational Cap and Floor RIGs);
- Provide an explanation for the methodology behind forecasts, including key evidence, assumptions, sensitivities and confidence (for both construction and operational Cap and Floor RIGs);
- Provide an understanding of material variances against previous year's actuals, forecasts and the ex-ante provisional cap and floor levels (for both construction and operational Cap and Floor RIGs);
- Inform Ofgem of any organisational changes/performance improvements, including modification/enhancements to allocation methodology and/or data capture e.g. systems (for both construction and operational Cap and Floor RIGs); and
- Provide an overview of the project's actual performance, including outages and income (during the project's operational Cap and Floor RIGs).

2.40. This commentary should explain the materiality of cost variations, reasons for these, efficiencies used (e.g. in the case of lower spend) or mitigations applied (e.g. in the case of higher spend).

2.41. The commentary should, where relevant in that reporting year, provide separate focus on costs, revenues and availability performance.

2.42. At an aggregate level as well as for each table (e.g. subsea cable), the commentary should:

- Provide an overview of performance, including material cost overruns or underspends relative to the previous year's forecast. Where this does not qualify as risk or contingency (e.g. if it is an efficiency that has lowered costs), this should be made explicit;
- Outline and explain any contract variations, covering reasons for the variation and evidence demonstrating the need for the variation (e.g. unknown obstacle), its value, and how forecasted costs are affected. In addition, any cost reductions should similarly be explained. These variations should be treated individually rather than on a net basis, although the overall net position should be clearly given;
- Where there are any variations to the base provisional allowances (and cap and floor levels), this must also be made clear if not already through the above requirement;

- Highlight any other variations that might qualify as risk costs or use of contingency, including whether the scope of works has changed;
- Explain changes in the forecasts (up to decommissioning) provided in this reporting year compared with the forecasts made in the previous year; and
- Explain any changes in the scope of works in a well-justified manner.

2.43. Where costs have changed, the commentary should provide a clear comparison between the most recent cost and the equivalent cost from the previous submission.

## **Conclusion and next steps**

2.44. This guidance document, alongside the associated template, form the Cap and Floor RIGs. These Cap and Floor RIGs supersede the Cap and Floor RIGs that we published in 2016.

2.45. All IOs should complete this updated template as part of their annual construction and operational submissions.

2.46. If the IO has any comments or questions on these Cap and Floor RIGs, they should contact Ofgem to discuss these.

2.47. It should be noted that these Cap and Floor RIGs can be updated and superseded in line with SLC 25 of the IO's licence.