



Consultation response on the Post Construction Review of the Nemo Link interconnector

About National Grid Ventures and National Grid Interconnectors

National Grid Ventures (NGV) is the organisation within National Grid plc that owns and operates energy businesses in competitive markets in the UK and US. NGV's UK portfolio includes National Grid Interconnectors, Grain LNG, and National Grid Metering.

National Grid Interconnectors is the leading UK developer and operator of subsea electricity interconnectors. Our portfolio includes 4,000MW of operational interconnection capacity, comprising IFA and the joint ventures BritNed and Nemo Link. We have another 3,800MW of interconnection capacity under construction through our IFA2, North Sea Link and Viking Link projects.

Our interconnectors benefit GB consumers through lower electricity prices and enhanced security of supply. In addition, they provide a vital tool to decarbonise the energy system, by allowing renewable energy to move from where it is produced to where it is most needed. Imports across the NGV interconnectors are expected to be 65% from zero carbon sources in 2020, rising to 90% by 2030.

Summary of our consultation response

Nemo Link is the first interconnector to reach the Post Construction Review of the cap and floor regime. NGV has followed this process with special interest, as in addition to Nemo Link our portfolio includes 3 other interconnectors that are regulated under the cap and floor regime (IFA2, North Sea Link and Viking Link).

From our perspective, Nemo Link has delivered the project to time and well within the provisional FPA allowance and we are encouraged to see that in most cost categories Ofgem proposes no or minimal cost disallowances. We are however concerned about the approach that has been followed towards replacement costs, which has resulted in a placeholder 25-year repex allowance that represents only 1% of the construction cost. Our operational experience shows that proactive asset replacement is essential to guaranteeing high levels of interconnector availability, with the associated consumer benefits. We therefore hope that Ofgem will continue to engage with Nemo Link on Nemo Link's planned replacement plan to reach an allowance which is both reasonable and efficient.

As for the other aspects of the consultation, we continue to support Ofgem's refinement and standardisation of the cap and floor regime to deliver the level playing field principle which Ofgem correctly placed at the heart of the cap and floor regime and which NGV relied upon in undertaking its investment decisions¹. We therefore welcome the increased standardisation and publication of

¹ Ofgem 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, [Ofgem consultation on cap and floor principles](#)

the cap and floor financial models (CFFMs), updated cost reporting templates and the changes to both the standard interconnector licence conditions and Nemo Link special licence conditions.

In the next few pages we provide more detail behind our views and address the specific questions in the consultation.

The Nemo Link PCR cost assessment

Consultation Question 1: Do you agree with our proposed cost allowances?

Ofgem proposes to make cost disallowances of €58.8m on repex and opex (combined) and €4.1m on capex. Our main comments to this proposal are as follows:

Repex:

Replacement expenditure (repex) is essential to maintain a high level of interconnection availability, to the benefit of consumers. Repex includes fundamental operational areas such as the interconnector control and protection system and the building service systems that support the operation of the interconnector. There is a high level of sophisticated IS technology in these assets, which over time becomes obsolete and requires replacement.

We note that Ofgem does not consider the information provided by Nemo Link on replacement costs to be sufficient to determine an economic and efficient allowance. We trust that Ofgem will continue engaging with Nemo Link on the information it requires. We would also urge Ofgem to engage with other interconnector developers to agree what repex information is reasonably available at their PCR stage, in order to avoid unnecessary regulatory uncertainty.

We also expect that the Nemo Link repex 'placeholder value' of €5.9m is only a provisional figure, as a repex value of only 1% of the Nemo Link capex value for all replacement activities over 25 years would be an unreasonably low allowance.

More broadly, we note that the cap and floor regime seeks to create incentives for interconnector owners to deliver high levels of interconnection availability, to the benefit of licensees and consumers, and we are concerned that an insufficient repex allowance would act as a disincentive for investment in maintaining asset availability and future interconnectors.

Opex:

Ofgem has proposed to set the real wage growth at 1% against the proposed Nemo Link value of 1.5%. In the consultation, Ofgem makes reference to 'current wage trends'. Whilst real wage growth has been slower in the years following the financial crisis, we encourage Ofgem to consider a wider historical series. Setting an appropriate real wage growth allowance is particularly pertinent given the inherent interconnector owner risk associated with an ex ante assessment that would apply for at least 10 years.²

² By contrast, the onshore regimes are returning from 8-year to 5-year assessments, partly because of the risks generated by longer ex-ante assessments.

Capex:

Ofgem proposes to disallow €3.1m of Delay in start-up (DSU) insurance, which provides developers with a payment if construction issues affect the interconnector go-live date. If both costs and revenues were included within the cap and floor calculations, both licensees and consumers would benefit in the event of a successful claim.

As an interconnector developer, we consider DSU insurance to be an important commercial tool to mitigate construction risks. To avoid any perception of retrospective and asymmetric regulatory risk, we would appreciate Ofgem making a clear policy statement that any DSU insurance proceeds, as well as costs, will not count towards cap and floor revenue assessments for future interconnector projects.

Broader cap and floor considerations

Consultation Question 2: Do you agree with our proposed changes to the CFFM?

We welcome Ofgem's proposed changes to the cap and floor financial model (CFFM) and agree that there should be a standardised CFFM (and indeed licence) in support of Ofgem's clearly stated regime principle to ensure unbiased and non-discriminatory treatment between developers.

For the same reason, we also agree that the responsibility for the development, maintenance and operation of the standardised CFFM should sit with Ofgem and would encourage Ofgem to also consider promoting standardisation over the final consumer payment calculation.³

Consultation Question 3: Do you agree with our proposed modifications to Nemo Link's licence?

The proposed modifications to the Nemo Link licence resemble text in the North Sea Link (NSL) licence and we welcome Ofgem making cap and floor licences more comparable. Comparing the two licences in detail, we have the following comments:

- The definition of 'Allowed Outage' in the NSL licence condition 1 is broader than in the Nemo Link licence condition 3, as the NSL definition includes 'reductions in capacity' by the System Operators in the connecting countries. We think this broader definition should apply to Nemo Link and to all other interconnectors regulated under the cap and floor regime. Interconnector owners have no control over reductions in capacity required by System Operators and hence they should not be penalised in the cap and floor calculation of Actual Availability.
- The NSL licence condition 2 includes a definition of Trial Operation Exceptional Events, which does not appear in the Nemo Link licence. This definition is no longer relevant to Nemo Link as it has successfully completed its trial operations, but we would expect this definition to appear in future cap and floor licences.
- The NSL licence condition 11 includes a provision for the cap and floor values resulting from the PCR and the Opex Reassessment to be written into to the licence. By contrast, for Nemo Link there is no provision for writing these values in the licence. This is peculiar given that the provisional cap and floor values are already part of the Nemo Link licence. Whilst we understand the final cap and floor values are intended to be written in a direction to the

³ The licence algebra currently ends in the final year of the period being assessed, leaving each interconnector to fill in the gap to the consumer payment based on limited guidance.

licensee, our preference would however be that the licence is a self-contained document that includes the final cap and floor values.

Consultation Question 4: Do you agree with our proposed modifications to SLC 25?

The changes to the interconnector standard licence condition 25 appear non-controversial to us. We would like to offer our comments on the wider changes to the Regulatory Instructions and Guidance (RIGs) that are associated with this licence condition.

We consider the updated RIGs to be a significant improvement over the previous version, with a much clearer and more streamlined document to support interconnector owners when preparing their annual cost submissions. There are however a few areas that we think need further consideration:

- Accounting policies: We support the intent of clarifying the accounting basis for costs and revenues within the cap and floor calculations however suggest that the following would more accurately reflect that intent

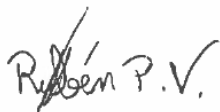
*All costs and revenues should be reported on an **accruals basis** which means exclusive of provisions and accruals and prepayments that are not incurred as part of the ordinary level of business. IOs should use the same accounting policies as in the preparation of the **audited statutory financial statements**, in accordance with UK GAAP or IFRS unless otherwise stated.*

- Audit requirements: the term 'audit' has specific technical meaning within an accounting context and we suggest the document should instead use the 'Agreed Upon Audit Procedures (AUP)' term already used elsewhere in the document.

We also note there is a new RIGs reporting template. Once we gain experience in using this template, we will provide our feedback to Ofgem.

If you would like to discuss the contents in this letter, please do not hesitate to contact Ruben Pastor- Vicedo (ruben.pastor-vicedo@nationalgrid.com).

Kind regards,



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