Mertcan Agir
European Markets, Ofgem
10 S Colonnade,
Canary Wharf,
London
E14 4PU

BritNed Development Limited

P.O. Box 718
NL-6800 AS Arnhem
Utrechtseweg 310, Building M01
NL-6812 AR Arnhem
The Netherlands

Telephone: +31 26 202 01 30
Fax: +31 26 202 01 39
Website: www.britned.com

Date	23 December 2020
Your reference	
Our reference	BN 20-027
Enclosure(s)	
Subject	Response to consultation on cost recovery submissions under CACM

Dear Mertcan,

Thank you for the opportunity to respond to this consultation. This response is made on behalf of BritNed Development Limited and relates to the cost recovery submission made for the BritNed interconnector. This response is not confidential.

Below we provide our answers to the three questions posed by Ofgem in the consultation document.

Question 1: Do you agree with how we have assessed costs as being efficient, proportionate and reasonably incurred*?*

Yes.

We are pleased that Ofgem considers that 100% of the cost submitted is efficient, proportionate and reasonably incurred. All the costs associated with the claim of BritNed are backed up by invoices, and we have also responded to a set of rigorous supplementary questions from Ofgem.

Question 2: Do you agree with our proposed cost allowances, including our approach to use Retail Price Index + Cost of Debt (RPI + CoD approach) to adjust the historical costs submitted by IFA, BritNed and Nemo Link to reflect inflation and time value of money (TVM)?

No.

This issue has been discussed at length with Ofgem during the supplementary question process, and we remain of the view that our original WACC based claim is more appropriate and robust than the RPI + CoD proposed by Ofgem.

BritNed pre-financed all the cost for the benefit of the market. Given that BritNed is fully financed through CoE, we believe that CoE should be part of the cost allowance. We don't consider CoD allowance proportionate knowing that in reality all cost are financed through CoE.
In considering whether the financing costs are efficient, reasonable and proportionate we have assessed the draft decision against the relevant cost of capital principles1 and most recent annual publication2 issued by UK Regulators Network (UKRN) whose members, including Ofgem, are responsible for the regulation of networks across the whole of the UK. Their principles together with how we believe they have been implemented here are considered below:

- Consistency: This minded-to decision is not consistent with broader UK regulation including Ofgem's onshore regime. For example, TPCR4 European costs, EMR and LNG Storage operating losses recovery all used a WACC approach to calculate financing costs;
- Risk reflective: Full recovery of CACM related costs and the associated timing were highly uncertain until the policy decision in August 2019 and IFA has neither a price control nor floor to reduce its financing costs to that of say ETO or a cap and floor interconnector;
- Investment: Based on this decision all UK regulated entities would need to consider the risk of their marginal cost of finance being retrospectively deemed to be below its WACC/allowed return. This could deter investment in the absence of specific ex-ante agreed rules and processes for each required investment. This may be particularly relevant in the context of development of post-Brexit cross-border trading arrangements;
- Communication: as stated above, communication from Ofgem strongly implied that a WACC rate would be applied as per ETO's RIIO-T1 price control;
- Good practice: WACC application is standard practice for establishing the marginal cost of finance for core and ad hoc financing decisions such as CACM (uncertain recovery on unknown timescales which eventually stretched to almost a decade). Coincidently Ofgem has directly confirmed this within the recent RIIO-T2 Final Determinations published on 8 December 2020. The determination's time value of money consideration (08.12.20 RIIO-T2 FD finance annex, page 126) rejects the use of CoD as a WACC alternative and notes that a change would require engagement with other GB regulators and industry.

11.50 Whilst we see advantages to applying one consistent TVOM approach to all corrections and revisions, we recognise that the proposal to apply CoD to Totex driven revisions moves away from Ofgem regulatory practice.

- Evidence: No evidence has yet been shared as to why a CoD is an appropriate marginal/opportunity cost of finance for CACM cost recovery and we note that the UKRN Cost of Capital reports make no mention of CoD being an appropriate TVM; and
- Review: If the CACM minded-to decision holds as good practice then we would reasonably expect to see this reflected within the future UKRN Cost of Capital annual updates and regulatory price control decisions

In summary, our December 2019 claim mirrored the WACC approach taken for the main RIIO price controls along with Ofgem's treatment of TVM for other comparable processes e.g. TVM in the cap and floor regulatory framework. We therefore still consider this a more appropriate approach than the RPI + CoD approach proposed by Ofgem.

[1] https://www.ukrn.org.uk/wp-content/uploads/2018/11/2016MarCoC-Principles.pdf
[2] https://www.ukrn.org.uk/wp-content/uploads/2019/09/2019-UKRN-Annual-Cost-of-Capital-Report-Final-1.pdf

Question 3: Do you agree with our proposed approach to use the value of GBP currency for the cost recovery claims, irrespective of the currency in which these costs were incurred, including our approach to adjust BritNed's costs based on the average annual currency exchange rates for each year of claim?

No.

BritNed incurred most of the costs included in this claim in GBP and reports in EURO comparable to most European TSOs. Therefore, BritNed has a foreign GBP exposure due to exchange movements for CACM cost recovery. BritNed's response maybe best explained by using an example to demonstrate that drop of the value in GBP currency impacts significantly. In this example an invoice of £ 100 is used.

Year		2015
Invoice received by BritNed in GBP (£)		£100
Exchange rate GBP to Euros in 2015		1.379
Invoice paid by BritNed in Euros in 2015	€	138
Cost recovery FX historic rate of 1.379	£	100
Cost Recovery FX current rate of 1.1	£	125

The example above demonstrates that BritNed is significantly exposed by GBP currency rate.

Based on the changes in currency valuation the claim in GBP is different today than it would have been in the past due to the changes. For example, ignoring the time value of money, if BritNed had made the claim in 2015 we would have claimed €138 using the example above and therefore £100 would be the value submitted in the claim. To get back to that same amount of €138 spent we need to claim £125 submitted to account for the fluctuation in currency based on an FX rate of 1.1 Euro to GBP.

Not allowing the use of currency today goes against the principle of fair and reasonable cost expenditure as the only proposed disallowance was the time value of money. This is simply a reflection of the expenditure at that time.
Given the uncertainty as to the value and timing of cost recovery it was impossible to hedge against foreign exchange movements historically. Therefore, BritNed considers it appropriate that cost recovery would be considered in the originating currency and converted to GBP at the date of the final decision so that any hedging policy could be effective from that point.

The Ofgem decision follows from CACM regulation based on EU law in where the dominate currency is the Euro. The CACM regulation sets out that costs can be recovered. The Ofgem decision itself does not state that reporting only GBP is acceptable, nor does it say that foreign currency claims would be treated differently as compared to GBP claims

We are pleased that Ofgem has stated its intent that these costs should be recovered through the 2021 TNUoS charges cycle, and we will do everything we can to support Ofgem in making sure this happens as planned.

Please contact me if you have any questions on any aspect of our response.

Yours faithfully,

BRITNED DEVELOPMENT LIMITED

By email

Jan Hoogstraaten
Regulatory & Legal Manager