

Decision

Decision on assessment of IFA, BritNed and Nemo Link’s pilot project and interim period cost recovery submissions under the Capacity Allocation and Congestion Management (CACM) Regulation

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This document sets out our decision on the amount for recovery through Transmission Network Use of System (“TNUoS”) charges following our assessment of IFA, BritNed and Nemo Link’s submissions of pilot project and interim period costs, under the CACM Regulation.

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Executive summary

Summary of this decision

This document sets out our decision on the assessment of IFA, BritNed and Nemo Link’s pilot project and interim period cost recovery submissions. These submissions relate to costs that were incurred in connection with historic obligations set out under the European Commission Regulation (EU) 2015/1222 on Capacity Allocation and Congestion Management (the “CACM Regulation”).¹ The amounts determined as efficiently incurred, reasonable and proportionate will be recovered through the 2021 cycle of Transmission Network Use of System (“TNUoS”) payments, these are summarised in Table 1.

Table 1 – Overview of final allowances²

Interconnector	Submitted cost (£m)	Ofgem adjustment (£m)	Ofgem allowance (£m)
IFA	19.75	-3.21	16.54
BritNed	4.97	-0.89	4.08
Nemo Link	0.32	0.02	0.34

Background

In August 2019, we decided on the approach to cost sharing and cost recovery under the CACM Regulation, hereafter referred to as the “August Decision”.³ Our August Decision allowed for the recovery of efficiently incurred, reasonable and proportionate development and operational costs through TNUoS payments, for both the pilot project period and interim period.

Following the submissions of pilot project and interim period costs from IFA, BritNed and Nemo Link, we have carried out a cost assessment and consulted upon our minded-to position in our December 2020 consultation, hereafter referred to as the “December 2020

¹ [Link](#) to Commission Regulation (EU) 2015/1222 on capacity allocation and congestion management.

² The details of the full final amounts for recovery through TNUoS by IFA, BritNed and Nemo Link can be found in Appendix 2.

³ [Link](#) to Ofgem’s decision on the approach to cost sharing and cost recovery under the Capacity Allocation and Congestion Management (CACM) Regulation.

Consultation.⁴ The December 2020 Consultation detailed our assessment of the submissions, as well as the amounts we were minded-to accept for recovery. It also sets out our position on two main issues highlighted through the supplementary questions process undertaken with IFA, BritNed and Nemo Link during our assessment. These include,

- i. our position on the treatment of the Time Value of Money (TVM) in relation to the claims; and
- ii. our position on adjustments to account for currency exchange rates.

All respondents agreed with how we had carried out our assessment for costs as being efficient, proportionate, and reasonably incurred. The majority of respondents did not agree with our position on the TVM rate and provided us with a number of detailed responses on this topic. Two respondents also disagreed with our minded-to position on the treatment of currency exchange rates, and provided responses outlining the rationale for their respective positions.

Having considered all consultation responses, and on the basis of our internal assessment and analysis, we maintain our minded-to position on the costs to be recovered through the 2021 cycle of TNUoS charges.

Next steps

Following publication of our decision, IFA, BritNed and Nemo Link must inform National Grid Electricity System Operator (NGESO), before 25 January 2021, of the final amounts to be recovered through the 2021 cycle of TNUoS charges.⁵

⁴ [Link](#) to the 1 December 2020 Consultation: Consultation on our assessment of IFA, BritNed and Nemo Link’s pilot project and interim period cost recovery submissions under the Capacity Allocation and Congestion Management (CACM) Regulation

⁵ The details of the full amounts for recovery through TNUoS by IFA, BritNed and Nemo Link can be found in Appendix 2.

1. Introduction and background

Context and overview

1.1. On 30 August 2019, we published our August Decision on the approach to cost sharing and cost recovery under the CACM Regulation. The August Decision sets out how costs in relation to the CACM Regulation should be shared between Transmission System Operators (TSOs) and Nominated Electricity Market Operators (NEMOs), and the appropriate mechanism for their recovery in GB. Our decision separated the costs into three different time periods; the pilot project, interim period and enduring arrangements as presented in Figure 1.

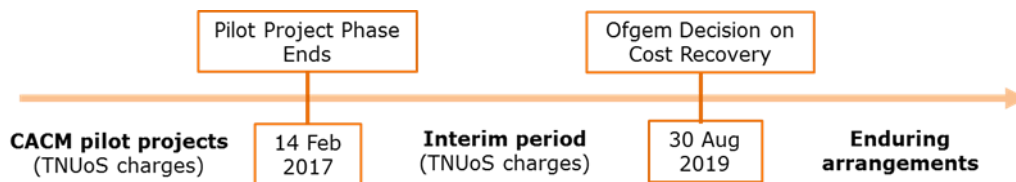


Figure 1 - Timeline of the three different time periods for cost recovery

1.2. As stated in our August Decision, we decided to allow the recovery of costs for the interim period between 14 February 2017 and our decision dated 30 August 2019. This allows efficiently incurred, reasonable and proportionate development and operational costs incurred during that period to be recovered through the TNUoS charges.

1.3. The interim period was introduced to recognise the time that had passed between the pilot project phase ending on 14 February 2017 and our August Decision. We were mindful of the uncertainty that the absence of an approved approach to cost sharing and cost recovery under the CACM Regulation during this interim period may have caused, particularly with respect to arrangements for enduring costs. After considering these concerns, we chose to permit the recovery of efficiently incurred, reasonable and proportionate costs during this interim period through TNUoS charges.⁶

1.4. This document sets out our decision on the assessment of IFA, BritNed and Nemo Link’s pilot project and interim period cost recovery submissions under the CACM Regulation.

⁶ We note that a proportion of the interim period costs will be in relation to costs that, under the enduring arrangements, would be borne by NEMOs.

The amounts determined as efficiently incurred, reasonable and proportionate will be recovered through the 2021 cycle of TNUoS payments.

This document

1.5. We consulted on our minded-to position setting out the amounts of efficiently incurred, reasonable and proportionate CACM pilot project and interim period costs that IFA, BritNed and Nemo Link can recover from the TNUoS charges.

1.6. This document includes a summary of the responses to our December 2020 Consultation and sets out our decision on efficient, reasonable and proportionate pilot and interim period costs.

1.7. The final determination of these costs will allow IFA, BritNed and Nemo Link to inform National Grid Electricity System Operator (NGESO) of the costs to be recovered through the 2021 cycle of TNUoS.

1.8. For avoidance of doubt, this decision does not cover the enduring arrangements for cost sharing and cost recovery as historically incurred in connection with legal obligations under the CACM Regulation.

1.9. Figure 2 provides an overview of the decision making stages that have been followed.

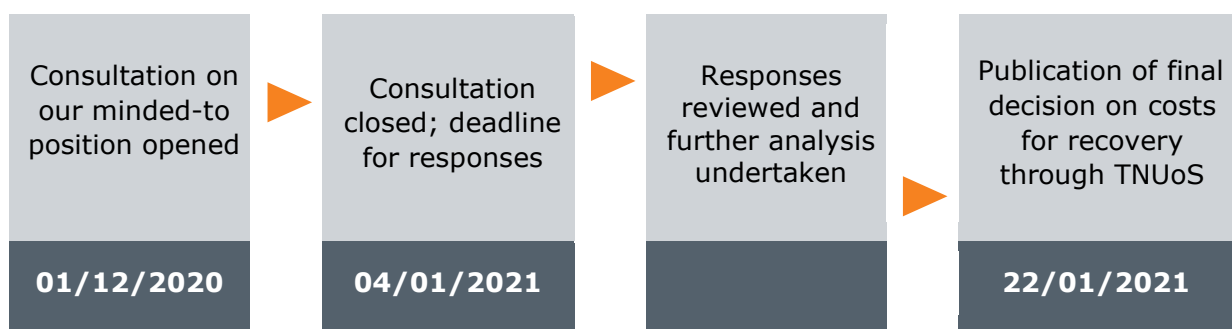


Figure 2 – Overview of the decision making stages for cost recovery

Related publications

[Decision on the cap and floor regime for the GB-Belgium interconnector project Nemo](#)

(Published: December 2014)

[Decision on approach to cost sharing and cost recovery under the Capacity Allocation and Congestion Management \(CACM\) Regulation](#) (Published: August 2019)

[Decision on proposed modifications to the standard conditions of the electricity interconnector licence, the special conditions of the electricity interconnector licence held by NGIL and the electricity transmission licence held by NGESO](#) (Published: October 2020)

[Consultation on our assessment of IFA, BritNed and Nemo Link’s pilot project and interim period cost recovery submissions under the Capacity Allocation and Congestion Management \(CACM\) Regulation](#) (Published: December 2020)

Your feedback

1.10. We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this report. We’d also like to get your answers to these questions:

1. Do you have any comments about the overall quality of this document?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Are its conclusions balanced?
5. Did it make reasoned recommendations?
6. Any further comments?

Please send any general feedback comments to stakeholders@ofgem.gov.uk.

2. Overview of our December 2020 Consultation

Section summary

This section outlines the key considerations that we set out in our December 2020 Consultation, as well as an overview of the responses that we received to that consultation.

Our consultation position

2.1. Our December 2020 Consultation set out our minded-to position on the amounts of efficiently incurred, reasonable and proportionate CACM pilot project and interim period costs that IFA, BritNed and Nemo Link can recover from TNUoS following our assessment. This position is summarised in Table 2.

Table 2 – Overview of final allowances⁷

Interconnector	Submitted cost (£m)	Provisional adjustment (£m)	Provisional allowance (£m)
IFA	19.75	-3.21	16.54
BritNed	4.97	-0.89	4.08
Nemo Link	0.32	0.02	0.34

2.2. As Table 2 demonstrates, our minded-to position in our consultation included adjustments to each of the interconnectors’ submitted costs.

2.3. We adjusted all three submissions to reflect our assessment of an efficient, reasonable, and proportionate representation of time value of money (TVM). We also adjusted BritNed’s submission based on our assessment of an efficient conversion of the submitted costs from EUR to GBP.

⁷ The details of the full amounts for recovery through TNUoS by IFA, BritNed and Nemo Link can be found in Appendix 2.

Consultation responses

2.4. We received responses from IFA, BritNed, Nemo Link and Nord Pool.

2.5. All respondents agreed with our minded-to position on assessment of costs as efficient, reasonable and proportionate.

2.6. IFA, BritNed and Nemo Link disagreed with our assessment of TVM, whereas Nord Pool agreed with our assessment on this matter.

2.7. IFA and BritNed disagreed with our minded-to position on currency exchange rates. Nemo Link and Nord Pool agreed with our minded-to position on this topic.

2.8. We have included a summary of all consultation responses in Appendix 1⁸ and set out our views on the areas covered in the consultation responses in Chapter 3 of this document.

⁸ These responses are also published on our website as an annex to our decision.

3. Our decision

Section summary

This section sets out our cost decision, following consideration of consultation responses. It also provides a summary of our cost assessment process.

Overview of our decision

3.1. Following our December 2020 Consultation, we have considered all the consultation responses whilst coming to our decision. Where necessary, we have undertaken further assessment and analysis to ensure that the final position as set out in this decision is robust and gives due consideration to Ofgem’s principal objective to protect the interests of existing and future consumers.

Overview of allowances

3.2. Following careful consideration of the responses to our consultation, as well as undertaking further assessment and analysis, we have decided to maintain the cost positions that we presented as provisional allowances within the December 2020 Consultation. The costs submitted by the interconnectors and the allowances that we have determined for each of these are shown in Table 1 of this document.

Our assessment of the CACM cost recovery claims

Overview

3.3. IFA, BritNed and Nemo Link made their cost submissions on 16 December 2019, 6 March 2020, and 30 September 2020, respectively. Following our request, each interconnector also provided a report, which gave an overview of the costs in the submissions, and further details of the activities, projects and parties related to the costs. Each cost submission has been assessed as to whether they are efficient, reasonable, and proportionate.

Our consultation position and consultation responses

3.4. During our cost assessment, we ensured that each interconnector had explained and justified the costs that it had submitted in relation to establishing, amending and operating SDAC and SIDC.

3.5. We ensured that costs submitted to us by each interconnector and assessed by us were auditable through invoices, with a clear justification and description on costs in relation to establishing, amending and operating SDAC and SDIC. As part of our supplementary questions (SQs) process, we requested explanations as to how interconnectors ensured processes, including tenders and decisions on market design, were administrated in such a way to ensure efficient, reasonable and proportionate outcome on costs. If costs could not be clearly described and explained or could not be associated with any invoice, we asked the interconnector to remove these from its cost submission and provide us with an updated submission.⁹

3.6. As part of our December 2020 Consultation, in regards to cross-clearing fees¹⁰, we noted that around the go-live of XBID¹¹, during a meeting in April 2018, the European Commission guidance was given that NEMOs and Central Counter Parties Shipping Agents should not charge each other cross-clearing fees and should bear their own clearing and settlement costs. We are mindful of this guidance, however, as this guidance was discussed at a meeting towards the end of the relevant time period for this decision, we have decided to allow for the recovery of these costs until the date of our decision on 30 August 2019. We will consider this issue separately for enduring costs.

3.7. All respondents to our December 2020 Consultation were satisfied with how we have assessed costs as being efficient, proportionate, and reasonably incurred. In particular, one respondent welcomed our position on cross-clearing fees up to the period of 30 August 2019 which form a part of the cost base to be recovered.

⁹ The amounts referred to in this decision are from the updated submissions, which did not include costs which could not be clearly evidenced via invoices.

¹⁰ Cross-clearing fees come about when trades have to be executed between two different Central Counter Parties (CCPs), which can be a NEMO, clearing house or a Shipping Agent. There are fees associated with needing to clear and settle trades between the two different CCPs

¹¹ Cross-border continuous intraday trading project to create a single pan-European cross-zonal intraday market in Europe

Our decision

3.8. As part of our decision, we are maintaining our position on the pilot phase and interim period costs, following our assessment of IFA, BritNed and Nemo Link’s submissions to us.

3.9. We are also maintaining our position to allow the recovery of cross-clearing fees until the date of our decision on 30 August 2019 and note that the matter on cross-clearing fees will be considered separately for enduring costs.

Time value of money and inflation rates

Overview

3.10. To allow fair and reasonable cost recovery, we consider it appropriate to adjust historical costs incurred by the relevant interconnectors to reflect both inflation and time value of money (TVM).

3.11. The first adjustment is to ensure purchasing power parity between the time when costs were incurred and the time when the same costs are recovered, protecting the value of the claim in real terms. To do this, the historical value of costs incurred needs to be uplifted in line with inflation, as measured by the relevant price index. For the purpose of this decision, we consider this index to be the Retail Price Index (RPI), in line with other regulatory regimes during the time in which these costs were incurred (e.g. RIIO price controls for regulated networks, Cap and Floor interconnector regime, offshore transmission regime).

3.12. The second adjustment is to reflect the concept of TVM, i.e. the principle that one-pound today is worth more than one-pound tomorrow, because one-pound today can be profitably employed to return a value higher than one-pound tomorrow. To reflect this principle, the historical value of the costs incurred needs to be uplifted using an appropriate TVM rate.

3.13. In their original cost claims, IFA and BritNed included adjustments reflecting both inflation and TVM. For the first, they used RPI; for the latter, they used the average Operational Discount Rate (ODR) across the three interconnectors regulated under the Cap

and Floor regime that were subject to Ofgem’s Final Project Assessment (FPA) during the time period over which IFA and BritNed incurred their CACM-related costs.¹²

3.14. The ODR is a weighted average cost of capital (WACC) rate calculated as the average of the cap return rate (a cost of equity rate) and floor return rate (a cost of debt rate) that are determined, for each individual interconnector, on a project-specific basis and with reference to the project’s specific Final Investment Decisions (FID) date. The ODR is intended to be used only under the Cap and Floor regime and only for specific pre-determined purposes.

3.15. In its original submission, Nemo Link did not include an RPI adjustment or a TVM adjustment.

Our consultation position

3.16. In our consultation document, we noted that neither the comfort letters dated 22 June 2012 and 16 January 2014, provided by Ofgem in relation to pilot project costs, or the CACM Regulation set out a specific approach to calculating an appropriate TVM adjustment.

3.17. We said that we considered RPI to be an appropriate price index to use to reflect inflation; and a cost of debt (CoD) rate, rather than a WACC rate, as proposed by IFA and BritNed in their respective cost submissions, to be an appropriate discount rate to reflect TVM.

3.18. This was because we considered that, in the context of the cost claims involved, a CoD rate reflected an efficient marginal cost of financing for a corporate entity.

3.19. More specifically, we considered a CoD rate appropriate in relation to the recovery of specific costs that were marginal relative to the overall size of the operations of the interconnectors involved.

3.20. Moreover, these costs had to be incurred to comply with specific regulatory requirements, rather than being associated with general and wider licensed activities, i.e. these costs were not linked to an optional investment, which the interconnectors could have

¹² Nemo Link, North Sea Link (NSL) and IFA2.

decided whether to undertake or not based on considerations in relation to the expected return of such an investment.

3.21. For these reasons, in determining an appropriate TVM rate to adjust the cost claims submitted by the interconnectors, we considered appropriate to use a CoD rate reflecting the efficient cost of financing marginal additional expenditure, rather than using a higher rate reflecting the overall return expected from the entire enterprise by its investors.

3.22. Therefore, the proposed TVM adjustment was not meant to provide investors with a specific remuneration in line with the return earned or expected by shareholders on their general licensed activities.

3.23. Finally, referring specifically to the ODR used by IFA and BritNed in their submissions, we noted that this is a rate used in a different context (the Cap and Floor regime for regulated interconnectors) and for different purposes (assessing the revenue earned by an interconnector over a pre-determine period of time against its cap and floor levels in an NPV-neutral way).

3.24. As a result of using a CoD rate instead of ODR (the WACC rate proposed by IFA and BritNed), in our consultation document we proposed reducing the amount of the claims originally submitted by the two interconnectors. Since Nemo Link had not included a TVM adjustment in their originally submission, using CoD resulted in an uplift to the amount they had originally claimed.

Consultation responses

3.25. All four respondents to the consultation provided their views on our minded-to position to use a CoD rate as the appropriate discount rate to reflect TVM; no objections were raised in relation to the use of RPI as the appropriate price index to reflect inflation.

3.26. In Appendix 1, we provide a detailed summary of all points raised by respondents and our response to each of these points.

3.27. Nord Pool supported our proposals, saying it considered the inflation and TVM adjustments applied to the cost claims to be adequate.

3.28. Nemo Link raised only one point relating to them being a regulated interconnector under the Cap and Floor regime rather than an interconnector fully exposed to merchant risk like IFA and BritNed. Our response to this point is provided in Appendix 1, in the table

summarising responses to question 2; the relevant response is identified with the number 12.

3.29. IFA and BritNed raised several objections to the use of a CoD rate as the relevant discount rate to reflect TVM, and stated that their original position, i.e. ODR, a WACC rate intended for Cap and Floor interconnectors, should be used. IFA and BritNed raised mostly the same points in response to Question 2 (number 1 to 10 in the table in Appendix 1), with one additional point raised only by BritNed (number 11).

3.30. A detailed overview of the points raised by IFA and BritNed, alongside our response to each of them, is available in Appendix 1, under Question 2 (points number 1 to 11). A summary of their key objections is provided in the following paragraphs.

3.31. IFA and BritNed raised the issue of regulatory precedent, referring to RIIO price controls for regulated energy networks, the Cap and Floor regime for regulated interconnectors, UK Regulators Network (UKRN) principles, and more general regulatory “good practice”.

3.32. In addition, they highlighted the uncertainty associated with the level and timing of cost recovery.

3.33. Finally, they expressed concern that this decision might itself represent a precedent for future regulatory decisions and potentially deter investment.

Our decision

3.34. We have decided to confirm our minded-to position to use a CoD rate as the appropriate discount rate to reflect TVM and RPI as the appropriate price index to reflect inflation. Therefore, we have uplifted the nominal amount of historical costs incurred by the interconnectors by applying an index calculated combining, for each year, the average RPI rate in that year and the relevant allowed CoD rate for that year.¹³

¹³ As explained in the consultation document, for each interconnector we have used the relevant annual cost of debt allowance for the associated transmission system operators (TSOs) in the years in which CACM costs were incurred (e.g. in the case of BritNed, the annual TVM rate was calculated as the simple average of the annual cost of debt allowances for National Grid Electricity Transmission and TenneT).

3.35. We consider that the rationale provided in our consultation document, summarised in this decision in paragraphs 3.15 to 3.23, remains valid; in particular, we consider CoD to be an appropriate measure of the efficient marginal cost of financing or opportunity cost, and therefore an appropriate discount rate for a marginal cost claim (relative to the overall size of the businesses involved), for the specific purpose of uplifting historical CACM Regulation related costs and under the specific circumstances of this decision.

3.36. We have considered all points submitted by respondents to the consultation, and particularly the objections raised by IFA and BritNed, to which we have provided detailed responses in Appendix 1; in addition to these, in the following paragraphs we provide a brief overview of some of the key reasons for our decision (complementing those already presented in the consultation document and summarised in paragraphs 3.15 to 3.23 of this decision).

3.37. In determining an appropriate TVM rate for the particular purpose of this decision, we aimed to strike the right risk/reward balance for all involved: on the one hand, commercial interconnectors fully or significantly exposed to merchant risk; on the other, GB consumers.

3.38. When considering regulatory precedent and the discount rates used in other regimes, we think it is important to compare the risk/reward balance built into those regimes with the risk/reward balance that is more appropriate for a commercial enterprise exposed to merchant risk. Network companies regulated through RIIO price controls have a set revenue allowance; in return, they benefit from a range of regulatory protections. Both their risks and rewards are capped, and therefore they are characterised by a lower-risk/lower-reward balance relative to the higher-risk/higher-reward merchant interconnectors.

3.39. Interconnectors subject to the Cap and Floor regime sit somewhere between fully regulated and fully merchant entities, as their merchant risk is limited both on the upside and the downside, but still significant. Therefore, they are higher risk/higher reward relative to a regulated network, but lower risk/lower reward relative to a fully merchant interconnector.

3.40. Due to these differences, we consider that regulatory decisions adopted in relation to RIIO price controls do not represent a binding precedent for the interconnectors subject to this decision in light of their very different risk/reward profile.

3.41. It should also be noted that the ODR rate used in the Cap and Floor regime is a rate specifically and exclusively intended for the interconnectors subject to that regime, and for

the specific purpose stated in the regime (assessing total revenue over a set period time against cap and floor levels in an NPV-neutral way). The ODR rate is also an ad-hoc rate determined specifically for each individual interconnector based on market data over a specific time horizon, which is set relative to the interconnector’s Final Investment Decision (FID) date. Therefore, it is not appropriate to average ODR rates determined for different Cap and Floor interconnectors, and to use this average in a decision involving interconnectors not subject to the regime, and for a different purpose from the one for which the ODR rate is intended.

3.42. Beside the distinction between different regimes, it is also important to make a distinction between setting an overall return allowance for the entirety of a regulated entity (such as a regulated network subject to RIIO price controls or, in a different way and to a different extent, a regulated interconnector under the Cap and Floor regime) and setting an appropriate TVM adjustment in relation to the recovery of marginal costs (relative to the overall size of a business), which had to be incurred by fully merchant as well as Cap and Floor regulated interconnectors to comply with the CACM Regulation.

3.43. In short, in this decision we are setting a very specific marginal cost adjustment rather than an overall return allowance for the entirety of a regulated business. For this purpose, we consider that CoD, as a measure of the efficient marginal cost of financing for a corporation, represent an appropriate TVM rate.

3.44. Finally, we note that if there are outstanding invoices to a service provider pending a decision on the cost recovery claims, these unpaid invoices should be paid applying the appropriate TVM and RPI adjustments determined in this decision.

Currency exchange rates

Overview

3.45. An interconnector is a transmission link between two different countries; such countries might use different currencies. In the case of the interconnectors affected by this decision (IFA, BritNed, and Nemo Link), the countries linked to Great Britain (respectively, France, the Netherlands, and Belgium) all use the Euro as their currency. Depending on where such interconnectors decided to establish their headquarters, their corporate reporting might be denominated in either GBP or EUR.

3.46. Moreover, the costs involved in the development, construction, maintenance, and operation of these interconnectors might be incurred in either GBP or EUR. For these two reasons, there is a degree of GBP/EUR exchange rate risk for these interconnectors.

3.47. In their cost submissions, IFA and Nemo Link converted EUR-denominated costs into GBP using the exchange rate at the time when these costs were incurred. BritNed used a recent exchange rate, explaining that, since it uses EUR for corporate reporting purposes, the same exchange rate should be used to convert costs and associated cost recovery payments, so that the amount recovered matches the amount of the costs that were incurred when both are denominated in EUR (rather than GBP).

Our consultation position

3.48. In our consultation document, we stated that our decision would determine the cost recovery allowances in GBP, irrespective of the currency in which these costs were incurred, due to the fact that these allowances would then be used by the interconnectors to inform NGESO of the amounts to be recovered through the 2021 cycle of TNUoS charges.

3.49. We stated that we aimed to ensure consistency between our reporting of efficiently incurred, reasonable and proportionate costs and of the payments that the interconnectors will receive through the 2021 cycle of TNUoS charges. Therefore, we considered it appropriate for any costs incurred to be converted between EUR and GBP using the relevant exchange rate at the date of the invoice or as close to it as reasonably practicable, as we did not consider it appropriate to pass any foreign exchange gains or losses onto GB consumers through TNUoS.

3.50. In relation to BritNed, our minded-to position was to convert their cost claim from EUR to GBP using average annual exchange rates for each year of the interconnector’s claim.

Consultation responses on this topic

3.51. All four respondents to the consultation provided their views on our minded-to position to use GBP as the relevant currency to set the cost recovery allowances for the three interconnectors.

3.52. In Appendix 1, we provide a detailed summary of all points raised by respondents and our response to each of these points.

3.53. Nord Pool fully supported our proposals with respect to currency adjustments; Nemo Link did not object to using GBP, noting it was aligned with its current Cap and Floor licence conditions.

3.54. IFA noted it had little foreign exchange exposure, since most of its costs were incurred in GBP, its functional currency. However, IFA argued that for interconnectors that have non-GBP functional currencies (such as BritNed), using GBP create foreign exchange risk, and therefore it would be appropriate for cost recovery to be considered in the original currency and converted at the date of the final decision.

3.55. BritNed, as the only interconnector using EUR rather than GBP for reporting purposes, objected to our minded-to position. It explained that, while incurring most costs in GBP, it reports in EUR, facing significant exposure to exchange rate movements.

3.56. A detailed overview of the points raised by BritNed, alongside our response to each of them, is available in Appendix 1, under Question 3.

Our decision

3.57. We have decided to confirm our minded-to position to use GBP as the relevant currency to determine the cost claim allowances for all interconnectors affected by this decision, including BritNed. Therefore, we have converted any EUR-denominated costs incurred by the interconnectors by applying the relevant GBP/EUR exchange rate at the date of the invoice of as close to it as reasonably practical.

3.58. We consider that the rationale provided in our consultation document, summarised in this decision in paragraphs 3.47 to 3.49, remains valid. We have considered all points submitted by respondents to the consultation, and particularly the objections raised by BritNed, to which we have provided detailed responses in Appendix 1; in addition to these, in the following paragraphs we provide a brief overview of some of the key reasons for our decision.

3.59. Similarly, to the considerations informing our decision on the appropriate TVM rate to use, in selecting the relevant currency for the particular purpose of this decision, we aimed to strike the right risk/reward balance for all involved: on the one hand, commercial interconnectors; on the other, GB consumers.

3.60. We acknowledge that when costs are mostly incurred in a currency that is different from the currency used for corporate reporting purposes, as is the case for BritNed, the

interconnector would face exposure to foreign exchange (FX) risk linked to movements in the relevant exchange rate (in this case, GBP/EUR).

3.61. We also acknowledge that uncertainty in relation to the level and timing of cost recovery would prevent the interconnector to put in place an effective hedge against this FX risk exposure.

3.62. However, this exposure arises when GBP-denominated costs and subsequent cost recovery payments are converted into EUR for the purpose of corporate reporting rather than for any regulatory purposes involving Ofgem.

3.63. Therefore, taking the specific circumstances of this decision into account, we consider dealing with this exposure to be outside of the scope of this decision, which determines the GBP-denominated amount to be paid to the interconnectors by NGEN. Our position is neutral in relation to any gains or losses that an interconnector might incur when converting a GBP-denominated amount into EUR for the purpose of its corporate reporting, as is the case in Ofgem’s other regulatory regimes.

3.64. Taking the specific circumstances of this decision into account, we do not consider that uplifting the GBP-denominated cost recovery allowance would represent fair and reasonable cost recovery, as it would transfer FX risk fully to GB consumers, who are unable to hedge against it, especially considering that, in this case, FX risk is the result of BritNed’s corporate decision to report in EUR rather than in GBP, a decision on which GB consumers had no say.

3.65. Therefore, we consider that allowing for a FX uplift such as the one proposed by BritNed would amount to a disproportionate burden for consumers.

Conclusion

3.66. Due to the unique characteristics of this assessment, in particular the period of time between costs being incurred and our final decision, we do not believe that this decision should set a regulatory precedent for future assessments in terms of our position on TVM and currency exchange.

3.67. We consider the regulatory approach adopted for the purposes of this decision as distinct from the approaches normally adopted under various regulatory regimes; such as Cap and Floor interconnectors, merchant interconnectors and RIIO T2 Final Determinations, where different approaches such as the use of a WACC rate have been applied.

3.68. Our decision confirms our approach regarding the socialisation of costs for the interim period to account for the time between the beginning of the pilot phase and the date of our August Decision.

3.69. We also note that any future regulatory decisions made in relation to cost recovery projects for matters such as TVM and currency exchange will be made based on their own merits and not on considerations relevant to this decision.

4. Next steps

Section summary

This section sets out the next steps associated with this decision.

4.1. Following publication of our decision, IFA, BritNed and Nemo Link must inform NGESO before, 25 January 2021, of the final amounts to be recovered through the 2021 cycle of TNUoS charges.

Appendices

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Appendix 1 - Summary of responses to our December 2020 Consultation

Question 1

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

The following table provides a summary of the responses received in relation to Question 1 and our comments in relation to each response:

Response	Respondent(s)	Ofgem’s comments
<i>1. Yes, we are pleased that Ofgem considers that 100% of the principal amount submitted by the three interconnectors is efficient, proportionate and reasonably incurred. All the costs associated with the claim of IFA are backed up by invoices, and we have also responded to a set of rigorous supplementary questions from Ofgem.</i>	BritNed, IFA	We note that BritNed and IFA fully supports our proposals in relation to how we have carried out our assessment for costs as being efficient, proportionate and reasonably incurred.
<i>2. Yes. Nemo Link has provided invoices to back all incurred expenditures and has also responded to follow-up questions from Ofgem.</i>	Nemo Link	We note that Nemo Link fully supports our proposals in relation to how we have carried out our assessment for costs as being efficient, proportionate and reasonably incurred.
<i>3. Nord Pool notes that the process described to</i>	Nord Pool	We note that Nord Pool fully supports our proposals in relation to how we

<p><i>assess costs incurred by interconnectors have been incurred efficiently, proportionately, and reasonably appears to follow a logical and coherent methodology.</i></p>		<p>have carried out our assessment for costs as being efficient, proportionate and reasonably incurred.</p>
<p>4. <i>Nord Pool welcomes Ofgem’s minded-to position outlined in paragraph 2.7 which suggests that cross-clearing fees levied up to 30 August 2019 should form part of the cost base recovered by interconnectors.</i></p>	<p>Nord Pool</p>	<p>We have made a decision to allow recovery of cross-clearing fees until the date of our decision on 30 August 2019. The cross-clearing fees will be considered separately for enduring arrangements.</p>

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)?

The following table provides a summary of the responses received in relation to Question 2 and our comments in relation to each response:

Response	Respondent(s)	Ofgem’s comments
<p>1. <i>Correspondence between Ofgem and National Grid in 2013 proposed that these costs should be dealt with through the RIIO-T1 mechanism. (...)</i></p>	<p>BritNed, IFA</p>	<p>The fact that the option of dealing with these costs through the RIIO-T1 mechanism was initially considered does not bind us to adopt such a mechanism, or a similar mechanism, in our final decision. We note that no</p>

<p><i>these statements from Ofgem informed our consideration so (...) we applied a TVM consistent with the WACC-based approach in RIIO-T1.</i></p>		<p>formal policy decision was published at the time regarding the specific issue of what TVM rate should be applied to these costs.</p> <p>We note the correspondence and the initial view that costs could be dealt with through the RIIO-T1 mechanism. However, since then we have consulted twice and published the August Decision which clearly outlines that costs would be recovered through TNUoS.</p>
<p><i>2. (...) we have assessed the draft decision against the relevant cost of capital principles and most recent annual publication issued by UK Regulators Network (UKRN).</i></p>	<p>BritNed, IFA</p>	<p>The UKRN is a network of UK economic regulators and a forum for these regulators to consider aligning, where possible and appropriate, regulatory principles across sectors.</p> <p>We do not consider that the cost of capital principles developed by UKRN are binding for the purpose of this decision or relevant to it, particularly considering that this decision concerns mostly merchant interconnectors rather than regulated entities.</p> <p>Nevertheless, the points raised in relation to each principle identified by the respondents are addressed below.</p>
<p><i>3. Consistency: This minded-to decision is not consistent with broader UK</i></p>	<p>BritNed, IFA</p>	<p>Ofgem’s onshore regime, as well as most other regulatory regimes considered in the development of the UKRN principles, relate to price</p>

<p><i>regulation including Ofgem’s onshore regime.</i></p>		<p>controls for regulated networks or other regulated entities, rather than merchant enterprises. The first are not exposed to merchant risk: they receive a pre-determined revenue allowance and benefit from a range of regulatory protections. The latter are exposed to merchant risk: they do not benefit from any or most of these regulatory protections but are fully or mostly unconstrained in terms of the revenue they are able to earn.</p> <p>In short, regulated networks and merchant interconnectors have very different risk/return profiles: the first are lower risk/lower return; the latter higher risk/higher return.</p> <p>Therefore, regulatory principles that apply to the first do not necessarily apply to the latter, and vice versa.</p>
<p><i>4. Risk reflective: Full recovery of CACM related costs and the associated timing were highly uncertain until the policy decision in August 2019.</i></p>	<p>BritNed, IFA</p>	<p>The August Decision addresses the uncertainty regarding the level and timing of cost recovery in the round; for example, we allowed interconnectors to recover not only the costs incurred during the pilot period but also the costs incurred during the interim period (between 14 February 2017 and 30 August 2019) in recognition of the uncertainty the interconnectors faced on the level and timing of cost recovery.</p> <p>We consider that providing a higher WACC-based TVM adjustment, rather</p>

		<p>than a lower CoD-based adjustments, to reflect this uncertainty would result in a risk/reward profile inconsistent with that of a commercial enterprise exposed to merchant risk, and transfer a disproportionate share of the risk to GB consumers.</p>
<p>5. <i>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 ex-ante agreed rules (...)</i></p>	<p>BritNed, IFA</p>	<p>As explained in relation to response number 3 in this table, this decision applies to costs incurred mainly by merchant interconnectors that have very different risk/reward profiles and are therefore subject to different regulatory settlements from regulated entities subject to price controls, for which a return allowance is determined as part of an overall revenue allowance.</p> <p>Even Nemo Link, which is a regulated interconnector under the Cap and Floor regime, retains significant exposure to merchant risk between its revenue cap and floor levels¹⁴.</p> <p>Moreover, as we explained in the “Conclusion” section of our decision, the regulatory approach, including the TVM adjustment, adopted by Ofgem for the purposes of this decision is not intended to serve as a general</p>

¹⁴ Nemo Link’s final cap and floor levels, as set in Ofgem’s Post Construction Review decision published in December 2019, are £77m and £44m a year, which leaves an annual merchant risk exposure of £33m before the regulatory protections designed to protect the interconnectors and GB consumer are triggered.

		precedent for costs assessment undertaken by Ofgem in the future.
<p>6. <i>Communication: communication from Ofgem strongly implied that a WACC rate would be applied as per ETO’s RIIO-T1 price controls.</i></p>	<p>BritNed, IFA</p>	<p>As explained in relation to response number 1 in this table, we do not think that having originally considered a different approach (such as dealing with these costs through RIIO-1 mechanisms), we should be bound to adopt such an approach, or a similar approach, in this decision.</p> <p>More importantly, the fact that we originally considered to deal with these costs through RIIO-1 should not be read as implying that a WACC rate would be chosen as the relevant TVM rate for this decision.</p> <p>In the communication referenced by respondents there was no reference to the TVM rate to be applied to uplift these costs or any indication as to whether this rate should or should not be a WACC rate.</p>
<p>7. <i>Good practice: WACC application is standard practice for establishing the marginal cost of finance for core and ad hoc financing decisions such as CACM (...) Ofgem has directly confirmed this within the recent RIIO-T2</i></p>	<p>BritNed, IFA</p>	<p>As explained in relation to response number 3 in this table, we consider that the context and circumstances of this decision are sufficiently different from those associated with the RIIO-2 Final Determinations for regulated networks to justify the adoption of a different TVM rate.</p>

<p><i>Final Determinations (...)</i> <i>The determination time value of money consideration rejects the use of COD as a WACC alternative (...)</i></p>		<p>The adoption of a CoD-based TVM rate in this decision is not inconsistent with the adoption of a WACC-based rate for RIIO-2, because driven by very different considerations and circumstances.</p> <p>Moreover, as explained in the “Conclusions” section of this decision, this decision is not intended to serve as a general precedent for any future regulatory decisions.</p>
<p><i>8. Evidence: No evidence has yet been shared as to why a COD is an appropriate marginal/opportunity cost of finance for CACM cost recovery (...)</i></p>	<p>BritNed, IFA</p>	<p>Our decision to use CoD as an appropriate marginal/opportunity cost of finance for CACM Regulation cost recovery is explained in detail in the main body of this decision document as well as in this Appendix.</p>
<p><i>9. 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.</i></p>	<p>BritNed, IFA</p>	<p>As explained in the “Conclusions” section of this decision, this decision is not intended to serve as a general precedent for any future regulatory decisions or for the development of regulatory principles by UKRN or others.</p>
<p><i>10. Our 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</i></p>	<p>BritNed, IFA</p>	<p>Comparisons against RIIO price controls are addressed in our comments to responses number 3 and 7 in this table.</p> <p>The Cap and Floor regime is a regulatory framework which sets a</p>

<p><i>cap and floor regulatory framework.</i></p>		<p>revenue cap and floor for eligible interconnectors, reducing but not eliminating exposure to merchant risk.</p> <p>Therefore, both network companies regulated under RIIO and interconnectors regulated under the Cap and Floor regime have a different risk/reward profile from that of a commercial interconnector fully exposed to merchant risk.</p> <p>Moreover, where a WACC approach is used in the Cap and Floor regime, this is for purposes that are very different from those involved in this decision (e.g. to assess revenue against cap and floor levels at periodic intervals in an NPV-neutral way).</p>
<p><i>11. 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 appropriate knowing that in reality all costs are financed through CoE.</i></p>	<p>BritNed</p>	<p>Our aim when choosing a TVM rate was to determine an appropriate rate for the purpose of uplifting the costs incurred by interconnectors to reflect the delay between the time when such costs were incurred and the time of cost recovery.</p> <p>The aim was not determining an appropriate return rate for the entirety of the businesses involved and their investors, as interconnectors do not earn a pre-determined regulated revenue and therefore do</p>

		<p>not require the determination of a return allowance¹⁵.</p> <p>Moreover, even in those regimes where return allowances needs to be determined (e.g. RIIO for regulated networks, Cap and Floor for regulated interconnectors), such allowances are determined on a notional basis rather than with reference to the specific financing structure of the regulated entities, which is irrelevant for the purpose of determining their return allowances.</p>
<p>12. (...) the expectation is that there would be consistency in approach for the cost of capital with the Cap and Floor regime. It is not entirely clear how the marginal cost of finance for Nemo Link can retrospectively be considered to be below the regulatory allowed return.</p>	<p>Nemo Link</p>	<p>As explained in relation to response number 11 in this table, this decision relates exclusively to the TVM rate to be used to uplift CACM related costs to determine the amount to be recovered by developers and should not be read as an attempt to determine (or re-determine retrospectively) a regulatory allowed return, which in the case of Nemo Link, as a regulated interconnector under the Cap and Floor regime, continues to be applied in relation to its intended purposes (e.g. assessing total revenue against cap and floor</p>

¹⁵ For Nemo Link, a regulated interconnector subject to the Cap and Floor regime, separate return allowances are determined as part of the process of setting revenue cap and floor levels intended to limit exposure to merchant risk, but the interconnector is still fully exposed to this risk within these two boundaries.

		levels at pre-determined intervals in an NPV-neutral way).
13. Nord Pool supports the proposals for cost allowances (...) including the provision for adequate adjustments for inflation and TVM applied to claim amounts.	Nord Pool	We note that Nord Pool supports our proposals on the TVM adjustment applied.

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 its claim?

The following table provides a summary of the responses received in relation to Question 3 and our comments in relation to each response:

Response	Respondent(s)	Ofgem’s comments
1. BritNed incurred most of the costs included in this claim in GBP and reports in EURO (...) Therefore, BritNed has a foreign GBP exposure due to exchange movements for CACM cost recovery.	BritNed	We note that BritNed incurred most of the costs in GBP whilst reporting in EUR and is therefore exposed to foreign exchange (FX) risk. However, this exposure arises when these GBP-denominated costs and the subsequent GBP-denominated payments reflecting cost recovery are converted into EUR for the purpose of BritNed’s corporate reporting rather than for any regulatory purposes involving Ofgem.

		<p>For the purposes of this decision, our position is neutral in relation to any gains or losses that an interconnector might incur when converting a GBP-denominated amount into a different currency for the purpose of their corporate reporting, as is the case in Ofgem’s other regulatory regimes.</p>
<p><i>2. Not allowing the use of currency today goes against the principle of fair and reasonable cost [recovery] (...)</i></p>	<p>BritNed</p>	<p>As further clarified with a worked example provided in their response, BritNed requested that an adjustment is applied to the incurred GBP-denominated costs when determining the GBP-denominated payments reflecting cost recovery, so that costs incurred and payments received are of the same value when expressed in EUR, rather than in GBP.</p> <p>Using BritNed’s example, they requested that £100 of costs incurred in 2015 (when the average exchange rate was 1.379) are uplifted to approximately £125 at the time of payment so that, assuming an exchange rate of 1.1 at the time of payment, both equal 138€.</p> <p>We do not consider such an uplift to represent fair and reasonable cost recovery, as it would transfer FX risk fully to GB consumers (asking them to pay, in the case of the example, an additional 25% on the top of the GBP-denominated costs actually incurred), when this risk is the result of BritNed’s</p>

		<p>corporate decision to report in EUR rather than in GBP.</p> <p>In addition, our August Decision introduced an interim period to recognise the time that had passed between the pilot phase ending on 14 February 2017 and our August Decision, as we were mindful of the uncertainty that the absence of an approved approach to cost sharing and cost recovery under the CACM Regulation may have caused. Consequently, more costs are being socialised through TNUoS to account for the uncertainty to interconnectors and NEMOs which otherwise would have been incurred by those parties as per the enduring cost arrangements outlined in our August Decision.</p>
<p>3. <i>Given the uncertainty as to the value and timing of cost recovery it would be impossible to hedge against foreign exchange movements.</i></p>	<p>BritNed, IFA</p>	<p>This point was raised both by BritNed in relation to their specific situation and by IFA in generic terms.</p> <p>We acknowledge that uncertainty on the level and timing of cost recovery would prevent the interconnector from entering effective FX hedging arrangements.</p> <p>However, as explained in relation to response 2 in this table, we consider that this FX risk, which depending on the direction of the FX movement might result in a gain or a loss at conversion, should sit with the interconnector rather than GB</p>

		<p>consumers, who are equally unable to hedge against this risk, but have no say on the currency selected by the interconnector for the purpose of their corporate reporting.</p> <p>In addition, our August Decision introduced an interim period to recognise the time that had passed between the pilot phase ending on 14 February 2017 and our August Decision, as we were mindful of the uncertainty that the absence of an approved approach to cost sharing and cost recovery under the CACM Regulation may have caused. Consequently, more costs are being socialised through TNUoS to account for the uncertainty to interconnectors and NEMOs, who otherwise would have incurred those costs as per the enduring cost arrangements outlined in our August Decision.</p>
<p><i>4. appropriate that cost recovery would be considered in the originating currency and converted to GBP at the date of the final decision (...)</i></p>	<p>BritNed, IFA</p>	<p>This point was raised both by BritNed in relation to their specific situation and by IFA in generic terms and has been addressed in our comments in relation to response 2 in this table.</p>
<p><i>5. The Ofgem decision follows from CACM regulation based on EU law in where the dominate currency is the Euro. (...)</i></p>	<p>BritNed</p>	<p>As outlined in the August Decision, the CACM Regulation allows Ofgem as the national regulatory authority to determine the appropriate mechanism for cost recovery in relation to both</p>

<p><i>The Ofgem decision itself does not state that reporting only GBP is acceptable, nor does it claim that foreign currency claims would be treated differently as compared to GBP claims.</i></p>		<p>TSO and NEMO costs. We also note that TNUoS charges are operated in GBP, and consequently the amounts need to be in GBP when reported to NGESO. Therefore, it is appropriate that the claim is submitted in GBP as opposed to EUR.</p>
<p><i>6. Nemo Link does not object to using GBP as this is aligned with the current cap and floor licence conditions of Nemo Link.</i></p>	<p>Nemo Link</p>	<p>We note that Nemo Link does not object to using GBP.</p>
<p><i>7. Nord Pool fully supports the proposals outlined with respect to currency adjustments in Ofgem’s consultation document.</i></p>	<p>Nord Pool</p>	<p>We note that Nord Pool fully supports our proposals in relation to currency adjustments.</p>

Appendix 2 – The full amounts for recovery from TNUoS for IFA, BritNed and Nemo Link

Interconnector	Submitted cost (£)	Ofgem allowance (£)
IFA	19,750,876.74	16,539,418.81
BritNed	4,967,622.17	4,080,973.63
Nemo Link	316,440.17	340,102.38