



Making a positive difference
for energy consumers

Greenlink Interconnector Limited,
NeuConnect Britain Limited,
electricity interconnector
licensees, cap and floor
applicants and other interested
parties

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Date: 25 February 2021

Dear stakeholders,

Statutory consultation on our proposal to insert new special conditions into the electricity interconnector licences held by Greenlink Interconnector Limited and NeuConnect Britain Limited to implement the cap and floor regime

We are proposing changes to the electricity interconnector licence held by Greenlink Interconnector Limited (GIL) and the electricity interconnector license held by NeuConnect Britain Limited (NBL). These changes are required in order to implement the cap and floor regime for the Greenlink and NeuConnect interconnector projects, and in particular to implement changes to the default regime that we approved for these projects in May 2020 to better enable project finance solutions.¹ We are seeking views on these proposed licence changes from interested parties during this consultation.

We are proposing to introduce 11 new special conditions into GIL's licence and NBL's licence. These special conditions set out the cap and floor regime that will apply to GIL and NBL. The special conditions are specified in Schedule 1A of our notice to GIL, NBL and interested parties. This consultation is our statutory consultation under section 11A(2) of the Electricity Act 1989 with respect to these proposed licence modifications.

We are also publishing an informal guidance document that explains these licence conditions. It may help GIL, NBL and interested stakeholders to better understand the proposed new conditions. We welcome comments on this guidance document as part of this consultation.

Alongside this statutory consultation, we have also published updated cap and floor financial models (CFFM1) and handbook to the model which implement our May 2020 regime variations decision for GIL and NBL. We welcome views from interested parties on how we have implemented our May 2020 decision in the CFFM1 for the Greenlink interconnector and the CFFM1 for the NeuConnect interconnector. We have provided further detail on the CFFM1 in Appendix 2 to this letter.

¹ Decision on proposed changes to our electricity interconnector cap and floor regime to enable project finance solutions (May 2020): <https://www.ofgem.gov.uk/publications-and-updates/decision-proposed-changes-our-electricity-interconnector-cap-and-floor-regime-enable-project-finance-solutions>

Background

The cap and floor regime is the regulated route for new electricity interconnector investment in Great Britain (GB). This developer-led approach balances incentivising investment through a market-based approach, with appropriate risks and rewards for the project developers.

Ofgem created the cap and floor regime in order to encourage investment in electricity interconnectors. This means that, if developers meet certain requirements, they will receive a top-up from consumers if revenue falls below a predefined level (the floor). Consumers underwrite the risk that interconnector developers are unable to generate sufficient revenues to pay for their investment.

Alternatively, developers can obtain regulatory approval by requesting an exemption from certain aspects of the regulatory framework, including obligations around ownership unbundling and use of revenues. Under this route, developers do not benefit from any consumer underwriting as they would under our regulated regime.

Each project that is granted a cap and floor regime will have special conditions inserted into its electricity interconnector licence which place specific obligations and incentives upon the licensee with respect to its cap and floor regime. As part of this consultation we have published the draft special conditions for the Greenlink interconnector and the NeuConnect interconnector, discussed below.

Greenlink was granted a cap and floor regime in our first application window (Window 1). It is a planned 500MW electricity interconnector between the Republic of Ireland and GB. The project developer is Greenlink Interconnector Limited ("GIL").

NeuConnect was granted a cap and floor regime in our second application window (Window 2). It is a planned 1400MW electricity interconnector between Germany and GB. The project developer is NeuConnect Britain Limited ("NBL").

GIL's and NBL's cap and floor regimes are both a split-regulation model. Project costs and revenues will be split equally between GB and Ireland (in the case of Greenlink) and between GB and Germany (in the case of NeuConnect).

The licence stipulates that the cap and floor regime for the Greenlink and NeuConnect interconnectors is set for 25 years and governs the GB share of any payments that may be required between either GIL or NBL and the GB Electricity System Operator on behalf of consumers.

We regulate 50% of GIL's interconnector and NBL's interconnector based on costs and revenues, except where costs are specific to GB or Ireland or Germany (as applicable), as agreed by a licensee and the regulators.

The cap and floor levels are determined based on a 'building block' approach. These building blocks include our assessment of efficient construction costs; a notional return on capital or allowance to enable competitive and transparent lending terms agreed between a licensee and its lender; and our assessment of operating expenditure.

We will set the preliminary cap and floor levels for GIL and NBL after our Final Project Assessment (FPA) decision for the projects and as soon as the licensees have secured the necessary financing to construct and operate their projects. We will update the CFFM1 for Greenlink project and the CFFM1 for NeuConnect project (which we have published alongside this letter) based on our costs determination as set out in our FPA decision for each project and the financial parameters both licensees are able to secure from lenders (subject to Ofgem oversight and approval).

Special licence conditions

Our May 2020 decision noted that we would implement the decision by setting out the necessary changes in the special licence conditions issued to GIL and NBL. We indicated our plan to develop and consult on these licence conditions with the aim of amending the relevant licences in advance of Financial Close² for the respective projects.

The proposed special conditions being consulted upon use the IFA2 interconnector project cap and floor special conditions³ that we implemented in June 2020 as a starting point. Variations to the text from this starting point for the GIL special conditions and the NBL special conditions are reflected in Schedule 1A to this consultation. The key variations include:

- Amendment to the Regime Start Date (RSD) definition to reflect the target completion date for each project and the Authority's discretion to specify the RSD as a later date in a direction issued pursuant to a new Standard Licence Condition on "Delay to Regime Start Date caused by Pre-Operational Force Majeure".⁴ The target completion date for our cap and floor Window 1 projects is 1st January 2021 (this applies to the Greenlink interconnector) and for Window 2 projects is 1st January 2024 (this applies to the NeuConnect interconnector).
- Amendments to the descriptions of regulatory periods to accommodate a scenario where a project's regime start date is different from April 1 financial year start. These include the first and last Relevant Years; the Regime End Date; the 25 year regime duration; and 26 assessment periods (26 Relevant Years).⁵
- Amendments to implement our May 2020 regime variations decision which aims to broaden the sources of finance available to GIL and NBL to progress their projects.
- The addition of several definitions and the amendment of some existing definitions to provide further clarity.

² Financial Close date approximates to the Final Investment Decision (FID). A detailed definition of Financial Close is set out in special licence condition 1 of a licensee's licence.

³ Decision on changes to the electricity interconnector licence held by National Grid IFA2 Limited (NGIFA2) (10 June 2020): <https://www.ofgem.gov.uk/publications-and-updates/statutory-consultation-decision-changes-electricity-interconnector-licence-held-national-grid-ifa2-limited-ngifa2>

⁴ We expect to publish this new Standard Licence Condition on "Delay to Regime Start Date caused by Pre-Operational Force Majeure" shortly following the publication of this statutory consultation.

⁵ To align the Regime Start Date to a financial year start date of 1st April, we divide the 25 year regime duration into 26 assessment periods (26 Relevant Years). More detail on this is provided in paragraph 3.26 of our licence guidance.

Please note that variations from the IFA2 special conditions to reflect specific GIL or NBL regime parameters, such as the Irish or German regulatory authority (as applicable) and project-specific availability targets, are not highlighted in Schedule 1A.

Statutory consultation

We are seeking views on:

- 1) the proposed new special conditions to be inserted into the electricity interconnector licence held by GIL and the electricity interconnector licence held by NBL as required under section 11A(2) of the Electricity Act 1989; and
- 2) the guidance document for the new special conditions and the CFFM1 for the Greenlink and NeuConnect projects. The licence guidance and the CFFM1 are not subject to statutory consultation, but we welcome your views on the documents as part of this consultation.

Our proposed licence changes, together with the reasons and effect of those proposed changes, can be found in Schedules 1A and 1B published alongside this consultation.

Our proposed CFFM1 (in workbook in Microsoft Excel format) and model handbook (in Microsoft Word format) for the Greenlink (GCFFM1) and NeuConnect (NCFFM1) projects are published alongside this consultation.

For ease of reference, please use the response template (in Microsoft Word format, published as a subsidiary document alongside this consultation) to provide your specific comments on the proposed licence text and to suggest any alternative wording.

Please send responses by 12 April 2021 to:

Cap.Floor@ofgem.gov.uk

We would prefer to receive responses by email. If this option is not convenient, please send responses to:

Okon Enyenihi
Systems and Networks
10 South Colonnade
Canary Wharf
London
E14 4PU

Unless marked confidential, all responses will be put in Ofgem's library and on our website, www.ofgem.gov.uk. You can ask for your response to be kept confidential and we will respect this, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004. If you would like your responses to be kept confidential, clearly mark the document/s to that effect and include the reasons for confidentiality.

If you have any questions in relation to this letter, please contact Okon Enyenihi by email (okon.enyenihi@ofgem.gov.uk) or on +44 207 901 7017.

Yours sincerely,



Stuart Borland
Head of Interconnectors

Appendix 1: List of subsidiary documents published alongside this consultation

- 1) Notice of proposed insertion of new special conditions into the electricity interconnector licence held by GIL
- 2) Notice of proposed insertion of new special conditions into the electricity interconnector licence held by NBL
- 3) Schedule 1A – Proposed new special conditions for the electricity interconnector licence held by GIL
- 4) Schedule 1A – Proposed new special conditions for the electricity interconnector licence held by NBL
- 5) Schedule 1B - Reasons and effects of proposed insertion of new special conditions into the electricity interconnector licence held by GIL
- 6) Schedule 1B - Reasons and effects of proposed insertion of new special conditions into the electricity interconnector licence held by NBL
- 7) Guidance on the cap and floor conditions in electricity interconnector licence
- 8) GCFFM1 - Proposed cap and floor financial model 1 implementing aspects of our May 2020 regime variations decision for GIL
- 9) NCFFM1 - Proposed cap and floor financial model 1 implementing aspects of our May 2020 regime variations decision for NBL
- 10) CFFM1H – proposed cap and floor financial model 1 handbook for GCFFM1 and NCFFM1
- 11) Licence consultation response template.

Appendix 2: Overview of our draft Greenlink CFFM1 (GCFFM1) and NeuConnect CFFM1 (NCFFM1)

GCFFM1 and NCFFM1

Our draft GCFFM1 and NCFFM1 are workbooks in Microsoft Excel ® format published alongside this consultation. We will use the GCFFM1 and NCFFM1 to determine our preliminary cap and floor levels for the Greenlink and NeuConnect interconnectors (as applicable) following Financial Close by GIL and NBL.

At the end of project construction or start of operation, we will use the GCFFM1 and NCFFM1 again to facilitate any updates we may have to make to the preliminary cap and floor levels to reflect our final views on a project's delivery costs as recognised under the regime following our Post Construction Review (PCR) stage. We expect to maintain the final GCFFM1 and NCFFM1 under that name on our website.

Aspects of our May 2020 decision relevant to GCFFM1 and NCFFM1

Our May 2020 regime variations decision enables us to set the floor level in two ways:

1. Developers can opt to keep the default notional approach but replace the default benchmark with Non-financial iBoxx BBB 10+ years, with everything else remaining the same as in the default regime. **The floor resulting from this approach is the Notional Floor Level (NFL).** Under this approach, notional cost of debt is paid on 100% of the Regulatory Asset Value (RAV) and developers are allowed full recovery of equity and debt investments at the floor.
2. Developers may also choose a competitive market approach (based on actual debt achieved, its cost and actual gearing,⁶ including provision for a reasonable debt service cover ratio and/or reserve and tail requirements) to inform how we set the floor, with Ofgem to oversee the process. **The floor resulting from this approach is the Actual Floor Level (AFL).** Under this approach, we set the AFL to allow developers to recover only what is necessary to meet their contractual yearly debt financing obligations to lenders. We expect developers to use future revenues above the floor to ensure that the overall cost to consumers under this approach (over the regime duration and including any extension where necessary) is broadly the same as the notional approach or better from GB consumer point of view.

We indicated in our May 2020 decision our intention to work with the developers to update the structure of our default cap and floor financial model (CFFM1) to ensure it is fit for purpose. To be able to accommodate the NFL and AFL approaches in one single model, we have updated our default cap and floor financial model (CFFM1) published with our Nemo Link PCR decision.⁷ This updated model is GCFFM1 and NCFFM1.

We note that the structure and the mechanics of both models are the same. The model inputs will be project-specific and determined at the FPA stage for each project and following GIL's and NBL's Financial Close.

⁶ Gearing is a ratio measuring the extent to which a company is financed through borrowing.

⁷ Decision on the Post Construction Review of the Nemo Link interconnector to Belgium (December 2020): <https://www.ofgem.gov.uk/publications-and-updates/decision-post-construction-review-nemo-link-interconnector-belgium>

If developers opt to use actual financing parameters, we will oversee and approve the AFL financial inputs achieved by GIL and NBL through a competitive and transparent debt financing process before we use these inputs in the GCFFM1 and NCFFM1. More detail on the AFL approach and the requirements that apply under it are set out in our May 2020 regime variations decision and the special licence conditions for GIL and NBL.

Key updates to our default CFFM1 that underpins GCFFM1 and NCFFM1

We expect to use the GCFFM1 and NCFFM1 to determine Cap Level (CL), NFL and/or AFL (as applicable). Project developers have the flexibility to choose between the NFL and AFL approaches depending on their chosen financing strategy.

We have kept the mechanics of the GCFFM1 and NCFFM1 that underpins the NFL the same as the mechanics of our default CFFM1. The GCFFM1 and NCFFM1 will both take in notional inputs, as the default CFFM1, to calculate the cap and floor levels.

We are proposing an approach to calculating the AFL that will ensure that the AFL (Sterling £) value equals the yearly debt financing obligations due to lenders. This will include, in addition, a provision for a reasonable debt service cover ratio and/or reserve and/or tail (if required) that is determined through a competitive and transparent process plus the yearly operational costs incurred during those years in which debt is serviced.

The AFL will be calculated from GIL's and NFL's project finance model based on financial parameters set at Financial Close. Ofgem will have oversight of the Financial Close process (from initial engagements with lenders until when all financial parameters are determined) and approve all the relevant financial parameters. This is to ensure that the process is transparent, competitive and well documented.

AFL and other relevant financial parameters from the GIL and NBL project finance models will then be used as inputs into the GCFFM1 and NCFFM1 and certain parameters will be 'back solved' to ensure the AFL generated in the GCFFM1 and NCFFM1 match the AFL in the GIL and NBL project finance models. We have introduced new variables across the different worksheets in the Excel workbook to capture all expected financial parameters that will be set at Financial Close and will underpin the AFL.

GIL and NBL will be required to produce a reconciliation and narrative document explaining any variance between the financial variables underpinning the AFL in the GIL and NFL project finance models and those underpinning the AFL in the GCFFM1 and NCFFM1.

We have set out more detail on the workings of the GCFFM1 and NCFFM1 in our proposed cap and floor financial model 1 handbook for GCFFM1 and NCFFM1 (CFFM1H).

We welcome stakeholder views on our proposed approach to calculating AFL and more generally on how we have implemented the relevant aspects of our May 2020 decision in the GCFFM1 and NCFFM1.