

Nemo Link Limited, National Grid Interconnectors Limited, National Grid Electricity Transmission Plc, electricity interconnector licensees, future cap and floor applicants and other interested parties

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Date: 4 February 2016

Dear stakeholders

**Consultation on proposed changes to the standard conditions of the electricity interconnector licence, the electricity interconnector licences held by Nemo Link and NGIL and the electricity transmission licence held by NGET to implement the cap and floor regime and use of revenues compliance**

We are proposing to make changes to the standard conditions of the electricity interconnector licence and the electricity interconnector licences held by Nemo Link Limited (Nemo Link) and National Grid Interconnectors Limited (NGIL). We are also proposing changes to the electricity transmission licence held by National Grid Electricity Transmission Plc (NGET). These changes are required in order to implement the cap and floor regime and NGIL's use of revenues compliance. We are interested in your views on these proposed changes.

Specifically, we are proposing to:

- 1. introduce new standard conditions into the electricity interconnector licence to implement the cap and floor regime.** These conditions will be switched off by default and will be switched on (via a direction from the Authority) for licensees that are granted a cap and floor regime.<sup>1</sup> These new cap and floor standard conditions give effect to, amongst other things:
  - a condition that establishes the Cap and Floor Regulatory Instructions and Guidance (Cap and Floor RIGs). We have published a draft set of Cap and Floor RIGs as part of this consultation; and
  - a requirement for cap and floor licensees to notify the GB System Operator (SO) of best estimates of revenue against their cap and floor levels (to inform the SO's estimates of transmission charges).
- 2. introduce new special conditions into the electricity interconnector licence held by Nemo Link that will give effect to Nemo Link's specific cap and floor regime.** These special conditions set out the cap and floor levels and assessment processes that apply specifically to Nemo Link.

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<sup>1</sup> We envisage that, following the final decision to award a licensee a cap and floor regime (ie. following the Final Project Assessment stage); we would consult on the special conditions to implement each licensee's particular regime and direct that these standard conditions are switched on.

3. **introduce new special conditions into the electricity interconnector licence held by NGIL with respect to the Interconnexion France Angleterre (IFA) interconnector.** These special conditions put in place a mechanism for NGIL to make payments, where surplus funds cannot be used in accordance with one of the allowed uses in accordance with Use of Revenues requirements under its licence, and so it elects to return monies back to consumers by reducing network charges from the SO.
4. **amend the special conditions of the electricity transmission licence held by NGET to give effect to its role in processing payments to/from interconnector licensees.**<sup>2</sup> This will require NGET to amend its transmission charges to reflect payments to/from interconnector licensees granted a cap and floor regime and also reflect payments from NGIL in accordance with its Use of Revenues requirements. We anticipate using similar arrangements to that proposed here for NGIL, to provide for NGET to receive payments from interconnector licensees which have a cap on revenues imposed in any exemption order.<sup>3</sup>

Alongside this consultation, we are also publishing an informal guidance document for Nemo Link's licence conditions. It may assist Nemo Link and readers with an interest to understand the proposed new conditions. We welcome comments on this guidance document as part of this consultation.

## **Background and further information**

### The cap and floor regime

The cap and floor regime is the regulated route for new interconnector investment in GB, which sits alongside the exemption route (whereby project developers apply for exemptions from certain aspects of European legislation).

The cap and floor regulatory regime sets a framework for GB interconnector investment. This developer-led approach balances incentivising investment through a market-based approach, with appropriate risks and rewards for the project developers.

Our proposed licence changes for the cap and floor regime fall into two categories. Firstly, the insertion of new cap and floor standard conditions that will be applicable to all electricity interconnector licensees granted a cap and floor regime.<sup>4</sup> Secondly, the amendment of the special conditions of the electricity transmission licence held by NGET to reflect its role as SO in processing cap/floor payments.

Each project that is granted a cap and floor regime will also have special conditions inserted in to its electricity interconnector licence. As part of this consultation we have published the draft special conditions for the interconnector Nemo Link, discussed below.

### Nemo Link interconnector

Nemo Link is the first interconnector to be granted a cap and floor regime and is developing a 1,000 MW electricity interconnector between Zeebrugge in Belgium and Richborough, Kent in Great Britain (GB). The project developers are Nemo Link (a subsidiary of National Grid and Elia). Together they will jointly own and operate the interconnector.

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<sup>2</sup> We will also propose associated updates to the onshore transmission owner regulatory reporting packs as part of the RIGs development process.

<sup>3</sup> Issued under standard condition 12 (Application of Conditions 9, 10 and 11: Exemption Orders) of the electricity interconnector licence.

<sup>4</sup> Following a direction issued by the Authority under proposed standard condition 1A: Application of Section G.

We published our final decision to award the cap and floor regime to Nemo Link in December 2014.<sup>5</sup> The basis of the licence changes is the need to reflect the Nemo Link specific elements of the cap and floor regime that are contained within the final December 2014 policy decision. Nemo Link is the first of its kind and the pilot project for the cap and floor regime. It differs in some aspects from other projects which have subsequently been granted a cap and floor regime in principle.

Nemo Link is also 100% regulated under the cap and floor model but with consumers in the UK and Belgium sharing the benefits/liabilities on a 50/50 basis. A number of conditions that apply to Nemo Link would not be expected to apply to other projects being granted a cap and floor, hence the reason that changes to implement the cap and floor are made through amendments to the special conditions. The licence of each future cap and floor project will be amended to include a similar set of special conditions, specific to its final policy decision and Final Project Assessment (FPA).

The draft special conditions for Nemo Link specify the preliminary cap level and the preliminary floor level (£83.8m and £48.8m respectively, in 2013/14 prices). These levels are the values we specified in the December 2014 decision document, with updates to the relevant indices at financial close. As Nemo Link was the pilot cap and floor project, it did not have the FPA stage that we subsequently developed for the launch of the first and second application windows.<sup>6,7</sup> Therefore, over the course of 2016 we may determine a further interim adjustment of Nemo Link's cap and floor levels in order to bring it up to date with the new process.

#### NGIL (with respect to the IFA interconnector)

NGIL holds an electricity interconnector licence with respect to the IFA interconnector. These proposed licence changes are required to put in place a mechanism that allows for NGIL to, in accordance with its Use of Revenues requirements, make payments to the GB System Operator which are then passed through to consumers via a corresponding decrease in network charges.

We are also proposing to make corresponding changes to the electricity transmission licence held by NGET to reflect its role as SO in processing such payments.

#### **Consultation**

We are seeking views on:

- (1) the proposed insertion of new cap and floor standard conditions into the standard conditions of the electricity interconnector licence;
- (2) the proposed insertion of new special conditions into the electricity interconnector licences held by Nemo Link and NGIL;
- (3) the proposed amendments to NGET's electricity transmission licence;
- (4) the draft Cap and Floor RIGs published alongside this letter; and
- (5) the draft guidance on the cap and floor conditions in Nemo Link's electricity interconnector licence published alongside this letter.

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<sup>5</sup> Our 2014 decision:

[https://www.ofgem.gov.uk/sites/default/files/docs/2014/12/final\\_cap\\_and\\_floor\\_regime\\_design\\_for\\_nemo\\_master\\_-\\_for\\_publication\\_1.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2014/12/final_cap_and_floor_regime_design_for_nemo_master_-_for_publication_1.pdf)

<sup>6</sup> Our decision to launch the first window:

[https://www.ofgem.gov.uk/sites/default/files/docs/2014/08/decision\\_cap\\_and\\_floor\\_near\\_term\\_electricity\\_interconnectors.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2014/08/decision_cap_and_floor_near_term_electricity_interconnectors.pdf)

<sup>7</sup> Our decision to launch the second window:

[https://www.ofgem.gov.uk/sites/default/files/docs/decision\\_to\\_open\\_a\\_second\\_cap\\_and\\_floor\\_application\\_window\\_for\\_electricity\\_interconnectors\\_in\\_2016.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/decision_to_open_a_second_cap_and_floor_application_window_for_electricity_interconnectors_in_2016.pdf)

A list of our proposed licence changes, together with the reasons and effect of those proposed changes can be found in appendix 1. For ease of reference, please use the response template (appendix 2 and online in MS Word format) to provide your specific comments on the proposed drafting and to propose alternative wording.

Please send responses by 6 April 2016 to:

Laura Edwards  
Networks  
9 Millbank  
London  
SW1P 3GE

Or to [Cap.Floor@ofgem.gov.uk](mailto:Cap.Floor@ofgem.gov.uk)

Unless marked confidential, all responses will be put in Ofgem's library and on our website, [www.ofgem.gov.uk](http://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.

When we have considered the responses to this consultation, we will publish a statutory consultation on proposed licence modifications ahead of any decision.

If you have any questions in relation to this letter please contact Laura Edwards ([laura.edwards@ofgem.gov.uk](mailto:laura.edwards@ofgem.gov.uk)) or on 0207 901 7249.

Yours sincerely,

A handwritten signature in black ink that reads "S3 Beel". The signature is written in a cursive style with a large, stylized "S3" followed by the name "Beel".

**Stephen Beel**  
**Partner, Competitive Networks**

## Appendix 1

This appendix is structured as follows:

- Part A: Sets out the reasons and effect of our proposed insertion of new standard licence conditions (SLCs) to the electricity interconnector licence;
- Part B: Sets out the reasons and effect of our proposed insertion of new special conditions into the electricity interconnector licence held by Nemo Link;
- Part C: Sets out the reasons and effect of proposed insertion on new special conditions into the electricity interconnector licence held by NGIL with respect to the IFA interconnector; and
- Part D: Sets out the reasons and effect of our proposed changes to the existing special conditions of the electricity transmission licence held by NGET.

### **Part A: Reasons and effect of proposed modifications to the SLCs of the electricity interconnector licence**

#### SLC 1A: Application of Section G

The reason for this new standard condition is to provide for the standard conditions in proposed new section G (Cap and Floor Conditions) to be switched on via a direction issued by the Authority. Section G is switched off by default for all licensees.

The effect of this proposed new condition is to provide for the cap and floor standard conditions in section G to only be made applicable to licensees that have been granted a cap and floor regime.

#### SLC 24: Definitions

This new standard condition sets out the defined words and expressions that are used in proposed new section G:(Cap and Floor Conditions) and gives their meaning.

The reasons and effect of making this change is to improve the clarity of section G by housing all common definitions used in section G within a single licence condition.

#### SLC 25: Cap and Floor Regulatory Instructions and Guidance

The reason for this new standard condition is to establish the group of documents collectively referred to as the Cap and Floor Regulatory Instructions and Guidance (Cap and Floor RIGs). These documents include instructions and guidance on what data interconnector licensees must report and how, and the templates they must complete.

The Cap and Floor RIGs will be the primary means by which we ensure that interconnector licensees collect and provide us with the information we require to monitor their performance and, where appropriate, make adjustments to the revenue the licensee is allowed to earn under the cap and floor regime. A single set of Cap and Floor RIGs documents will apply to all interconnector licensees.

The effect of this proposed modification is to ensure that we have the information necessary to carry out our functions effectively and also ensure that a consistent approach to reporting requirements is applied to all interconnector licensees granted a cap and floor regime.

#### SLC 26: Provision of information to the GB System Operator

The reason for this new standard condition is to require interconnector licensees granted a cap and floor regime to liaise with the GB System Operator to inform the Transmission Network Use of System (TNUoS) charge setting process.

The condition stipulates that the licensee must provide best estimates of its revenue relative to its cap and floor level and continue to review these estimates and inform the GB System Operator of significant changes. The condition also requires the interconnector licensees to inform the Authority of its estimates and any revisions to these estimates.

The effect of this condition is to ensure the GB System Operator has available the necessary information required to facilitate its forecasting and setting of TNUoS charges.

## **Part B: Reasons and effect of proposed insertion of new special conditions into the electricity interconnector licence held by Nemo Link**

### Special Condition 1: Definitions and Interpretation

This condition sets out particular defined words and expressions that are used in the special conditions and gives their meaning. This condition also sets out the general rules of interpretation of provisions within the licence.

The reasons and effect of making this change is to improve the clarity of the special conditions by housing all common definitions that are used in multiple special conditions within a single licence condition.

### Special Condition 2: Cap Level and Floor Level

This condition sets out how Nemo Link's cap and floor levels are calculated. It also sets out the calculation of the values of the different adjustment components that feed into the calculation of the cap and floor levels.

The reasons and effect of this condition is to specify how the cap and floor levels are derived and how the values of the different adjustment components are calculated. It also, where appropriate, sets out the relevant processes to be followed.

### Special Condition 3: Cap and Floor Assessment

This special condition sets out the process for:

- (a) assessing Nemo Link's revenue against the cap and floor level (calculated in accordance with its licence) for each assessment period; and
- (b) determining the value of any revenue adjustment component that may be required at the end of each assessment period as a consequence of a breach of the cap or floor levels.

This condition also sets out how the various component used in the calculations to determine the value of any revenue adjustment component, due at the end of an assessment period, are calculated.

The reasons and effect of this condition is to specify the process by which Nemo Link's revenue is assessed against the cap and floor level in each assessment period. It also provides clarity on how the value of any end of period payment is determined and how the values of the various adjustment components that feed into it, are calculated.

### Special Condition 4: Interconnector Availability Incentive

This licence condition provides for adjustments to the cap and floor levels depending on performance of the interconnector. The condition also places obligations on Nemo Link in the event of an interconnector outage.

The reasons and effect of this condition is to ensure the Authority is sufficiently informed of any outage events occurring on the interconnector, provide for an up to 2% increase or reduction in the cap level where performance exceeds or falls short of the specified availability target, and make eligibility for floor payments conditional on achieving a minimum level of availability.

#### Special Condition 5: Assessed Revenue

This condition calculates Nemo Link's assessed revenue for the purposes of assessing the amount of revenue it has earned in a relevant assessment period compared against the cap and floor levels calculated in accordance with its licence.

The reason for this condition is to set out the calculations for the assessed revenue term. The effect of this condition is to derive the value of Nemo Link's assessed revenue for the purpose of comparing it against the cap and floor levels.

#### Special Condition 6: Within Period Adjustment

The condition sets out the grounds on which Nemo Link may submit a request for a revenue adjustment within a relevant assessment period. It also sets out the process that Nemo Link must follow if and when it requests a within period adjustment. This condition includes the process for determining the value of any within period adjustments.

The reasons and effect of this condition is to provide for adjustments to Nemo Link's interconnector revenue outside of the five-yearly assessment periods where the requested adjustment meets the requirements specified in this condition.

#### Special Condition 7: Non-Controllable Costs

The reasons for this condition are to set out relevant calculations for adjustments to Nemo Link's interconnector revenue as a result of changes in its Non-Controllable Operational Costs. It also sets out calculations and relevant processes for the determination of costs relating to decommissioning and income adjusting events.

The effect of this condition is to provide for certain non-controllable operational costs to be passed through to consumers. It also provides for adjustments, where determined by the Authority, to Nemo Link's assessed revenue in the event of an income adjusting event and the cap and floor levels in the event of changes in legislative requirements related to decommissioning.

#### Special Condition 8: Process for determining the value of the Post Construction Adjustment terms

The reason for this condition is to establish the process for determining the value of the Post Construction Adjustment terms. That is, any adjustment (whether upwards or downwards) to Nemo Link's cap and floor levels as a consequence of the difference between the Authority's:

- (a) estimate, assumed in the preliminary cap floor levels, of the economic and efficient costs associated with developing, constructing, operating, maintaining and decommissioning of the interconnector; and
- (b) assessment, at the Post Construction Review stage, of the economic and efficient costs associated with developing, constructing, operating, maintaining and decommissioning of the interconnector.

The effect of this condition is to account for the difference between the preliminary cap and floor levels set by the Authority and the actual cap and floor levels, following the Authority's assessment at the Post Construction Review stage.

### Special Condition 9: Process for determining the value of the Opex Reassessment Adjustment term

The reason for this condition is to establish the process for determining the value of the Opex Reassessment Adjustment terms. These terms provide for a one-off adjustment (whether upwards or downwards) to the cap and floor levels not less than 10 years after the start of Nemo Link's cap and floor regime.

The effect of this condition is to account for the difference between the Authority's:

- (a) assessment at the post construction review stage of costs associated with operating the licensee's interconnector; and
- (b) reassessment, at the Opex Reassessment stage, of the economic and efficient costs associated with operating the interconnector.

### Special Condition 10: Calculation of adjustments to the licensee's Interconnector Revenue (GB share)

This condition calculates the value of the Interconnector Cap and Floor Revenue Adjustment terms for each assessment period and partial assessment period. These terms provide for an adjustment (whether upwards or downwards) of Nemo Link's interconnector revenue as a consequence of the factors specified in the licence, including the:

- assessment of Nemo Link's assessed revenue against the cap and floor levels;
- determination by the Authority of any Within Period Adjustment or Pass Through Adjustment;
- 50/50 sharing factor between GB and Belgium.

This condition also provides for Nemo Link to submit a proposed value for a true up term, for Authority approval, calculated so to reconcile any forecasting or reporting errors from previous years.

The overall effect of this condition is to derive the total value of any upwards or downwards adjustment of Nemo Link's revenue (ie payment from/to consumers via TNUoS charges).

### Special Condition 11: Cap and Floor Financial Model Protocol

The reason for this condition is to require Nemo Link to establish and maintain the Cap and Floor Financial Model Protocol (the CFFMP) in a form approved by the Authority. It stipulates that the CFFMP should, as a minimum, set out the processes and/or timescales by which Nemo Link effects adjustments to the cap and floor levels or interconnector revenue.

The effect of this condition is to ensure that any such adjustments are in accordance with a protocol approved by the Authority.

## **Part C: Reasons and effect of proposed insertion of new special conditions into the electricity interconnector licence held by NGIL with respect to the IFA interconnector**

### Special Condition 1: Determination of the Interconnector Payment term

This reason for this condition is to require NGIL to submit a proposed value for the Interconnector Payment (ICP) term in accordance with and by the date specified in this condition. The value of the ICP represents revenue earned by NGIL from the allocation of interconnector capacity that is to be returned to consumers in accordance with the Use of



Revenues requirements under its licence. The condition also sets out the process for determining the value of the ICP term.

The effect of this condition is to put in place a mechanism for an amount equal to the value of the ICP term to be returned to consumers via a corresponding decrease to network charges.

#### Special Condition 2: Provision of information to the GB System Operator

The reason for this new special condition is to require NGIL to liaise with the GB System Operator to inform the TNUoS charge setting process.

The condition stipulates that NGIL must provide best estimates of its revenue relative to its agreed return and continue to review these estimates and inform the GB System Operator of significant changes. The condition also requires NGIL to inform the Authority of its estimates and any revisions to these estimates.

The effect of this condition is to ensure the GB System Operator has available the necessary information to facilitate its forecasting and setting of TNUoS charges.

### **Part D: Reasons and effect of proposed modification to the special conditions of the electricity transmission licence held by NGET**

#### Existing Special Condition 1A: Definitions and Interpretation

The reason for our proposed amendment to this condition is to introduce a new defined term for 'Interconnector Owner' which does not currently exist in the special conditions of this licence.

The effect of this amendment is to define a term that is introduced into NGET's special conditions by our proposed changes to existing special condition 3B of that licence.

#### Existing Special Condition 3B: Calculation of allowed pass through items

The reason for our proposed amendments to this condition is to include two new pass through items (with associated definition) in the formula for calculating the Transmission Network Revenue allowed pass-through items.

The effect of these changes is to provide for any payments made to or received by NGET from interconnector licensees granted a cap and floor regime to be passed through to consumers via a corresponding increase or decrease in TNUoS charges.

It also provides for any payments received by NGET from NGIL, where NGIL cannot use surplus funds in accordance with one of the allowed uses specified in the Use of Revenues requirements under its electricity interconnector licence, to be passed through to consumers by reducing network charges from the SO.<sup>8</sup>

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<sup>8</sup> We anticipate using similar arrangements to this proposed here for NGIL, to provide for NGET to receive payments from interconnector licensees which have a cap on revenues imposed in any exemption order issued under standard condition 12 of the electricity interconnector licence.

