

Decision on the Post Construction Review of the IFA2 interconnector to France

Subject	Details
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This decision document confirms our final position on the Post Construction Review of the IFA2 interconnector project. It sets out our final determination of the values for the Post Construction Adjustment terms submitted by NGIFA2 and the final cap and floor levels for the project.

Alongside this decision, we have also published licence modification notices making changes to the special conditions of NGIFA2's licence. We have also published the IFA2 Cap and Floor Financial Models and associated handbooks.

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Executive summary

Interconnexion France-Angleterre 2 (IFA2) is a 1 GW electricity interconnector between Lee-on-Solent, Hampshire in Great Britain (GB) and Merville-Francville-Plage, Normandy in France. The project was jointly developed by National Grid IFA2 Limited (NGIFA2) and Réseau de Transport d'Électricité (RTE), the French transmission system operator (TSO). The IFA2 interconnector entered commercial operations on 22 January 2021. Our cap and floor regime applies to National Grid's 50% share in the project.

We granted NGIFA2 a cap and floor regime in principle in July 2015. NGIFA2's electricity interconnector licence sets out the preliminary cap and floor levels for the project. The licence also includes the process for setting the final cap and floor levels following our determination, at the Post Construction Review (PCR) stage, of the values of the Post Construction Adjustment (PCA) terms. These terms adjust the provisional cap and floor levels to take into account our final assessment of the project's costs.

In March 2022, we consulted on our minded-to position on IFA2's PCR, in particular our views on the proposed values for the PCA terms submitted by NGIFA2 and the final cap and floor levels for the project. Alongside this, we also conducted a statutory consultation on related changes to the special conditions in NGIFA2's licence.

The consultation closed on 24 April 2022. We received two consultation responses, which have been published alongside this decision. We have taken these responses into account in reaching our decision.

Scope of our decision

This decision provides our final view on IFA2's PCR, in particular our determination of the values of the PCA terms and the final cap and floor levels for the project. Alongside this decision, we have also published:

- A direction determining the values of the PCA terms and final cap and floor levels for IFA2,
- Licence modification notices modifying the special conditions in NGIFA2's licence, and
- Final versions of the NGIFA2 Cap and Floor Financial Models and associated handbooks.

Overview of our decision

The cap and floor levels are set using a building blocks approach, based on the project's development costs, capital costs, operating and maintenance costs, replacement costs, decommissioning costs, tax and allowed return. The preliminary cap and floor levels for IFA2, as specified in its licence, are £50.7m and £27.6m each year (2016/17 prices).

In February 2021, NGIFA2 submitted its proposed values for the PCA terms for determination, together with supporting project cost and narrative information (the PCR Submission). NGIFA2 submitted further cost information in June 2021 as part of their annual reporting requirements in the Cap and Floor Regulatory Instructions and Guidance (Cap and Floor RIGs). Following this, we received a second cost update in October 2021. NGIFA2 proposed upward adjustments to the preliminary cap and floor levels of £10.2m and £10.5m (in 2016/17 prices), respectively.

In our March 2022 consultation, we indicated that our minded-to position was that the proposed PCA values submitted by NGIFA2 should be adjusted downwards and determined as £9.7m and £10.2m, respectively. We noted that this would generate a final cap level of £60.4m and a final floor level of £37.8m in 2016/17 prices.

We have now confirmed our final view on cost allowances and the financial parameters for the project. Based on our analysis, we have decided to set the:

- combined capital expenditure (capex) and development expenditure (devex) value at £335.7m,¹ a decrease of £2.9m from NGIFA2's PCR submission; and
- the operating expenditure (opex) value at £536.3m, a reduction of £2.9m from NGIFA2's PCR submission.

Accordingly, we have determined the final PCA values to be:

- **Post Construction Adjustment At Cap (PCAC) as £9.7m;** and
- **Post Construction Adjustment At Floor (PCAF) as £10.2m.**

These PCA values generate a **final cap level of £60.4m and final floor level of £37.8m** in 2016/17 prices.

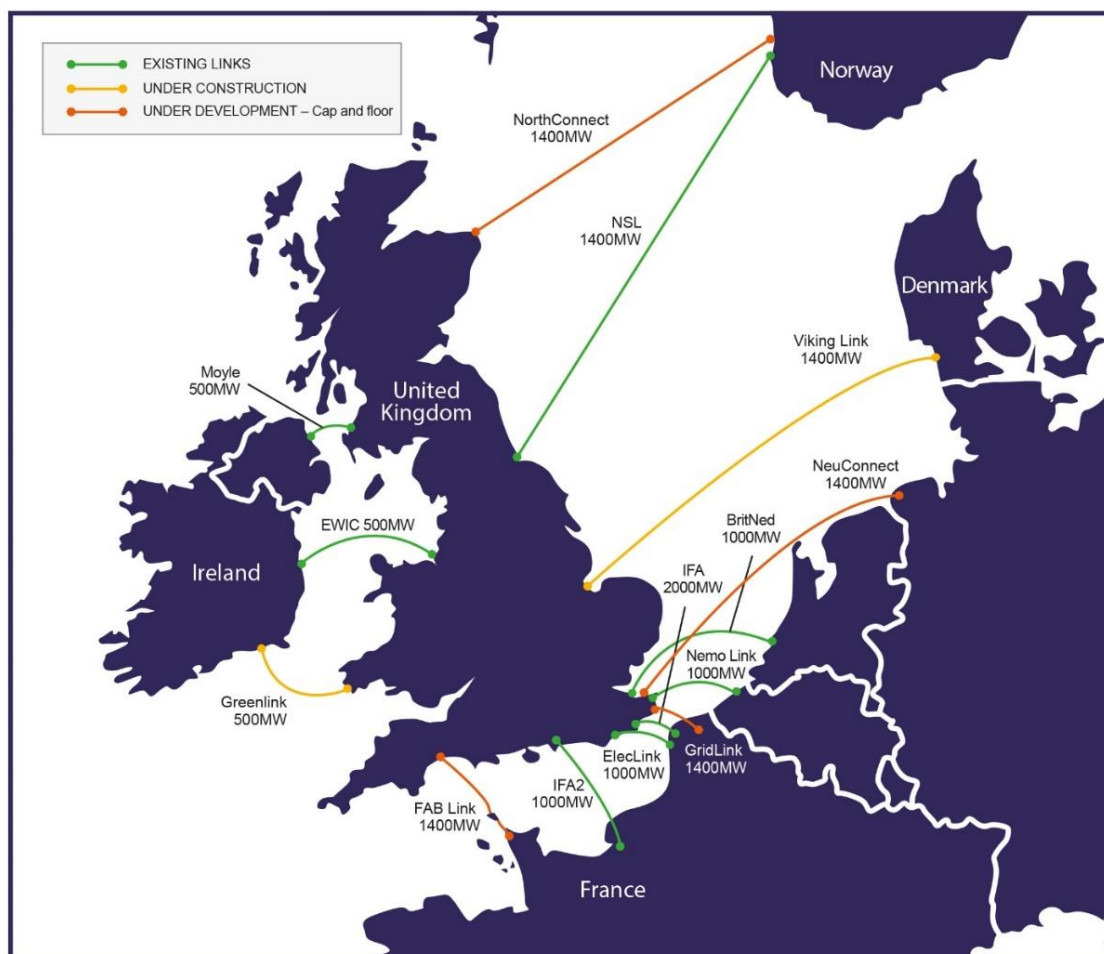
¹ Unless otherwise stated, all costs reported within this document are in real 2016/17 prices.

1. Introduction

IFA2 project overview

- 1.1. The IFA2 project is a 1 GW electricity interconnector between GB and France. On the GB side the cable landfall is at Lee-on-Solent, followed by approximately 2 km of onshore cable to a converter station located in Daedalus. This is followed by approximately 10 km of double circuit AC cable, including 5 km of offshore cable, which connects to the grid at Chilling substation. The French end of the cable lands at Merville-Franceville-Plage, followed by 23 km of onshore cable to a converter and substation at Tourbe.
- 1.2. The project developers are NGIFA2 and RTE, the French TSO. Our cap and floor regime applies to NGIFA2’s 50% share in the project. Figure 1 below shows the IFA2 interconnector alongside other operational and proposed electricity interconnector projects. IFA2 started commercial operations on 22 January 2021.

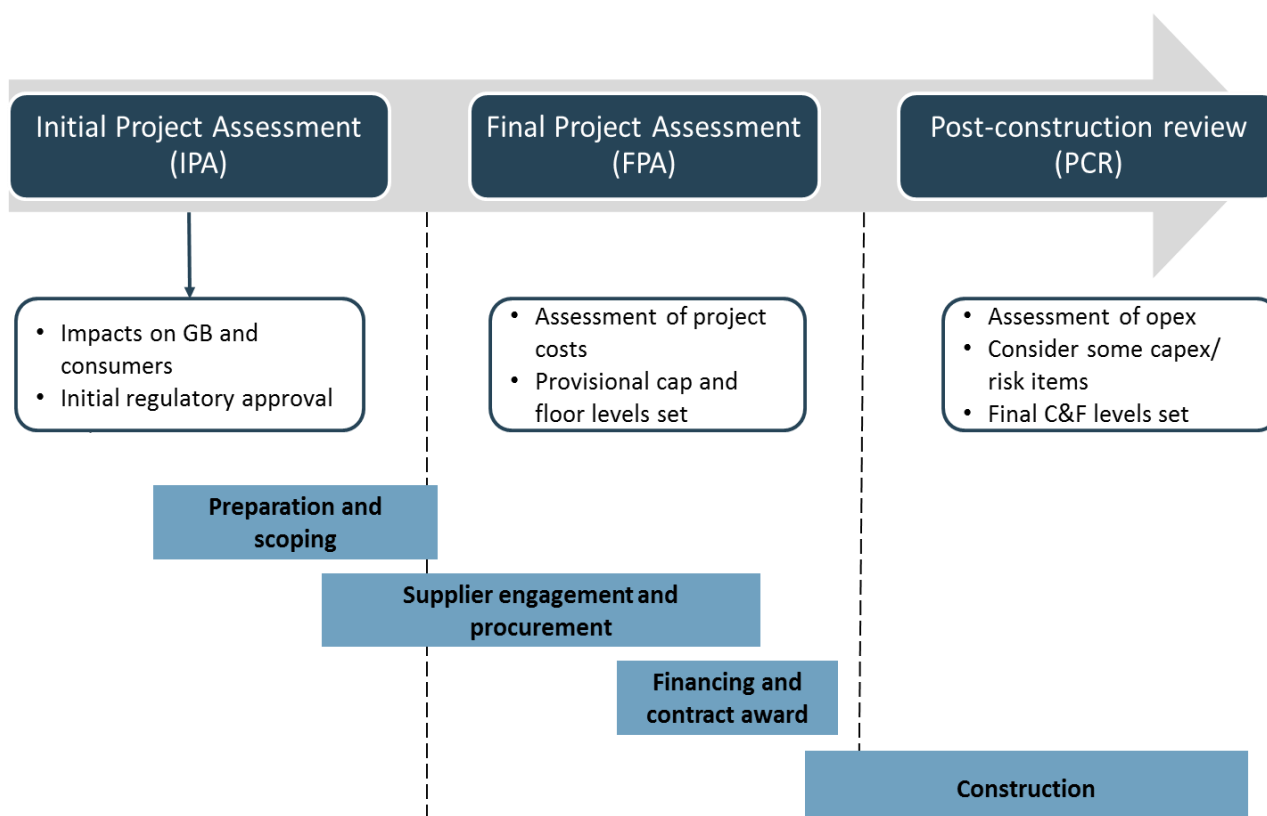
Figure 1: Map of existing and proposed GB electricity interconnectors



Our cap and floor regime

1.3. The cap and floor regime is the regulated route for interconnector development in GB. It sets a minimum and maximum return that interconnector developers can earn. There are three main stages to our cap and floor assessment framework, shown in Figure 2 below.

Figure 2: Cap and floor assessment framework



- The **Initial Project Assessment** (IPA) stage is when we assess the needs case for new interconnector projects. This is predominately an economic assessment, taking into account the total costs and benefits of new interconnectors and assessing the likely impacts on consumers.
- At the **Final Project Assessment** (FPA) stage, we confirm the grant of a cap and floor regime and set the provisional cap and floor levels. We assess the economic and efficient costs associated with developing, constructing, operating, maintaining, and decommissioning of the licensee’s interconnector. We also set the project’s financial parameters, develop a project-specific financial model, and set the values for incentives.
- The cap and floor levels are then confirmed at the **Post Construction Review** (PCR) stage, when we revisit aspects of our cost assessment that were not fixed at

the FPA stage and assess the efficiency of costs incurred during construction. We conduct a review of the final capital costs (capex) and consider the efficiency of the interconnector's operational costs (opex). We also re-examine any information or aspects of the initial submission that have changed significantly.

- 1.4. In July 2015, we granted NGIFA2 a cap and floor regime in principle at our IPA stage, which we then confirmed at our FPA stage in July 2018. In June 2020, we made licence changes to give practical effect to that decision. The licence specified preliminary cap and floor levels of £50.7m and £27.6m (in 2016/17 prices), which applies to NGIFA2's 50% share of the project. The licence provides for the final cap and floor levels for IFA2 to be set following our determination of the PCA terms at the PCR stage.²
- 1.5. The determined PCA terms adjust the preliminary cap and floor levels (whether upwards or downwards) to account for the difference between:
 - Our estimate, assumed in the preliminary cap and floor levels for IFA2, of the costs associated with developing, constructing, operating, maintaining, and decommissioning IFA2; and
 - our assessment of these costs at the PCR stage (when the majority of the development and construction costs have been incurred).
- 1.6. The determined PCA values are used to calculate the final cap and floor levels for IFA2. The final cap and floor levels then remain fixed for the duration of IFA2's cap and floor regime, subject to any specific adjustments.³
- 1.7. In February 2021, we received NGIFA2's PCR submission, which included NGIFA2's proposed values for the PCA terms. NGIFA2 submitted further cost updates in June 2021 and October 2021. Our March 2022 PCR consultation took into consideration these further cost updates and set out our minded-to position on the proposed PCA values and proposed final cap and floor levels.

² Relevant provisions are included in Special Condition 8: Process for determining the value of the Post Construction Adjustment terms and Special Condition 2: Cap Level and Floor Level. The PCA terms consist of two terms – the Post Construction Adjustment At Cap term (PCAC) and the Post Construction Adjustment At Floor term (PCAF).

³ The regime allows for a discretionary revision of the final cap and floor levels after no less than 10 years from the start of the regime to re-assess and benchmark the opex forecast submitted at the PCR stage and, if required, for multiple revisions to re-assess the decommissioning costs forecast submitted at the PCR stage.

What are we making a decision on?

1.8. This decision sets out:

- Our final view on IFA2's PCR, in particular our determination of the values for the PCA terms and the final cap and floor levels for the project. The determined PCA values and final cap and floor levels are specified in the direction attached at Appendix 2;
- Related changes made to the special conditions in NGIFA2's licence to reflect the changes in the governance arrangements and updates made to the IFA2 Cap and Floor Financial Models (IFA2CFFMs) as well as update references to the IFA2CFFMs in the licence.

The relevant licence modification notice is attached at Appendix 3; and the IFA2 CFFM1 & CFFM2 and associated handbooks are attached at Appendices 4-5.

Structure of this document

1.9. The rest of this document is structured as follows:

Section 2 – Summary of our PCR decision

1.10. This section provides a summary of our final review of IFA2's costs and our determination of the values of the PCA terms and final cap and floor levels, including an overview of the relevant cost variations.

Section 3 – Main points raised during consultation

1.11. This section addresses the key issues raised by respondents to the March 2022 PCR consultation concerning the following areas:

- our proposed cost allowances at consultation stage; and
- proposed changes to NGIFA2's special licence conditions.

Related publications

[Final Project Assessment of the IFA2 interconnector to France](#)

Published: July 2018

[Post Construction Review of the IFA2 interconnector to France Consultation](#)

Published: March 2022

[Cap and Floor Regime Handbook](#)

Published: September 2021

[Statutory consultation: Decision on changes to the electricity interconnector licence held by National Grid IFA2 Limited \(NGIFA2\)](#)

Published: June 2020

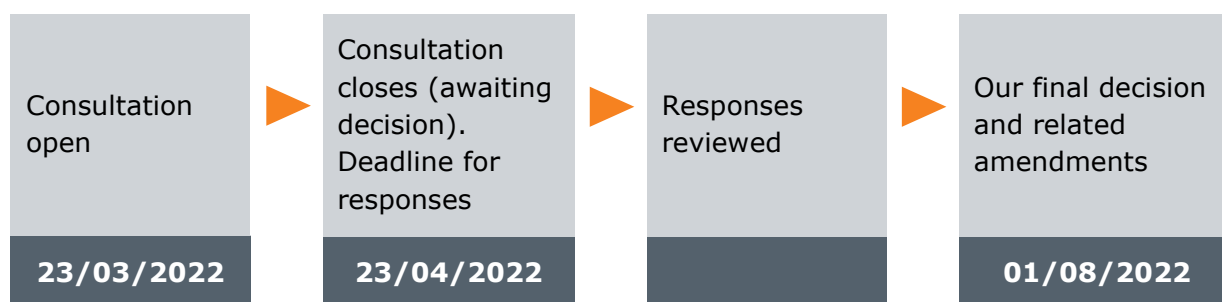
[Cap and Floor regime: Initial Project Assessment for the FAB Link, IFA2, Viking Link and Greenlink interconnectors](#)

Published: March 2015

Our decision making process

1.12. The consultation on IFA2’s PCR and related documents closed on 24 April 2022. We have reviewed the responses received, which can be found published alongside this decision.

Figure 3: Decision-making stages



Your feedback

1.13. We value the feedback of our stakeholders on the quality of our work, and we encourage them to provide some using the template provided below.

General feedback

1.14. 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. Summary of our Post Construction Review (PCR) decision

Section summary

This section outlines any changes between our minded-to position (in our March 2022 Consultation) and our final decision, following consideration of responses.

It also provides a summary of our cost assessment process and final position on project costs, the determined values for the PCA terms and final cap and floor levels for IFA2.

Key changes between our minded-to position and final decision

- 2.1. We have considered the issues raised by consultation respondents and our minded-to position has not changed.
- 2.2. Below we provide more detail on the factors that we have considered in reaching a final view; an overview of the cost assessment process; and final position on the project costs, the determined values for the PCA terms and final cap and floor levels for IFA2.

Cost assessment summary

- 2.3. In its PCR submission, NGIFA2 proposed upward adjustments to the preliminary cap and floor levels of £10.2m and £10.5m (in 2016/17 prices), respectively.
- 2.4. In our March 2022 Consultation, we proposed to:
 - set the combined capital expenditure (capex) and development expenditure (devex) value at £335.7m, a decrease of £2.9m from NGIFA2's PCR submission;
 - set the opex at £536.3m, a reduction of £2.9m from NGIFA2's PCR submission; and;
 - consequently to revise and adjust the PCA values submitted by NGIFA2 downwards by £0.5m and £0.3m respectively.
- 2.5. Following consideration of Consultation responses, we have decided to confirm our provisional PCR position to:
 - maintain our allowance for IFA2 devex at £10.3m;
 - maintain our allowance for IFA2 capex at £325.3m;
 - maintain our allowance for IFA2 opex to £470.3m; and

- adjust the NGIFA2 proposed PCR values down and determine the PCA values as follows:
 - Post Construction Adjustment at Cap (PCAC) as £9.7m, and
 - Post Construction Adjustment at Floor (PCAF) as £10.2m.

2.6. Table 1 below shows a summary of these costs:

Table 1: Summary of project costs⁴

£m, 2016/17 prices

Item		IFA2 FPA submission	Ofgem FPA position	IFA2 PCR submission	Ofgem minded-to position	Ofgem final position
Devex		10.3	10.3	10.3	10.3	10.3
Capex	<i>Firm costs</i>	290.4	284.9	328.2	325.3	325.3
	<i>Risks</i>	42.8	29.0	0.0	0.0	0.0
Opex⁵		462.3	462.3	471.2	470.3	470.3

2.7. Table 2 below sets out the preliminary cap and floor levels, the adjustments to these levels proposed by NGIFA2, our provisional and final determination of these adjustments and the corresponding impacts on the final cap and floor levels.

Table 2: Summary of proposed cap and floor levels

£m, 2016/17 prices

	Cap	Floor
IFA2's preliminary cap and floor levels	50.7	27.6
NGIFA2's proposed PCA values	+10.2	+10.5
Cap and floor levels using NGIFA2's proposed PCA values	60.9	38.0
Ofgem provisional determination of the PCA values	+9.7	+10.2
Cap and floor levels using our provisionally determined PCA values	60.4	37.8
Ofgem final determination of the PCA values	+9.7	+10.2
Final cap and floor levels	60.4	37.8

⁴ For all tables in this document, due to rounding the figures in the table may not add up precisely to the totals indicated.

⁵ Includes market related costs with a value of £23.3m (2016/17 Prices)

Final capex cost adjustments

- 2.8. The capex submitted by NGIFA2 at the 2018 FPA was £333.2m whereas the value submitted at PCR was £328.2m, a decrease of £4.9m. In our March 2022 Consultation, we proposed to make reductions totalling £2.9m to the submitted PCR value.
- 2.9. After consideration of consultation responses, we are confirming our minded-to position, setting the final capex allowance at £325.3m.

Final opex and post-construction cost adjustments

- 2.10. Our March 2022 Consultation proposed to reduce NGIFA2’s combined opex (excluding market related costs), repex and decommissioning cost submission of £516.0m by £2.9m, resulting in a provisional opex allowance for the regime period of £513.1m.
- 2.11. We proposed a reduction of £0.9m to the submitted controllable opex and a reduction of £2.0m to the submitted repex costs. Table 3 below provides a summary of the adjustments and section 3 of this document provides further information on this decision.

Table 3: Final proposed operational cost adjustments

£m, 2016/17 prices

Category	Description	PCR submitted cost	Proposed adjustment	Final adjustment ⁶	Final adjusted cost
Controllable opex ⁷	All of the main operating costs	424.2	-0.9	-0.9	423.3
Non-controllable opex	Costs for leases and statutory fees	23.7	0.0	0.0	23.7
Repex	Costs for periodic asset replacement	41.9	-2.0	-2.0	39.9
Decommissioning (decommex)	Funds provisioned for decommex	26.0	0.0	0.0	26.2
	Total	516.0	-2.9	-2.9	513.1

⁶ These final adjustments take into account all Ofgem disallowances made at FPA and PCR.

⁷ Excludes market related costs with a value of £23.3m (2016/17 Prices)

3. Key issues raised in consultation responses

Section summary

This section addresses the key points raised by respondents to the March 2022 Consultation.

- 3.1. This chapter sets out views on the key issues raised in response to the March 2022 Consultation, specifically:
 - the treatment of repex;
 - the disallowance of the Delay in Start-Up (DSU) insurance;
 - the treatment of costs related to IFA2'S Marketing and Website costs;
 - Commissioning Power costs;
 - Covid-19 – Converter Station Mitigation; and
 - A suggestion that the final Cap and Floor levels be included in the licence conditions of every cap and floor interconnector for clarity and transparency reasons
- 3.2. We received two responses to the IFA2 consultation. The respondents were National Grid Interconnector Holdings Limited (NGIH) – the parent company of the concerned licensee – and National Grid IFA2 Limited (NGIFA2) – the concerned licensee. Both consultation responses have been published alongside this decision document.
- 3.3. A summary of consultation responses providing our views on other issues raised in response to the March 2022 Consultation, including those not listed above, can be found in Appendix 1.

PCR cost allowances

- 3.4. We consider below the key issues raised in the March 2022 consultation and provide our views.

Repex

- 3.5. A downward adjustment £2.0m to the repex value was proposed in the consultation, this related to an adjustment made to the Control and Protection component of the repex costs.
- 3.6. Both NGIH and NGIFA2 state that the estimates provided for the repex costs were the result of detailed engagement with the IFA2 equipment manufacturers and that NGIFA2 took a balanced view by using the middle point of the provided range of costs as part of their PCR submission and that they would expect the general approach of allowing the middle of the range cost to be adopted instead of the lower part of the range.
- 3.7. We accept the general merits of the approach described by NGIH and NGIFA2 in paragraph 3.6 above. However, as part of the PCR assessment we further assessed all repex costs and queried values that were higher than expected or where we required further information as part of the Supplementary Questions (SQ) process. We identified the Control and Protection costs to fall into this category and determined through our assessment that the developer has the potential to reduce costs through efficiency savings with co-ordination between converter stations. As a result, we remain of the view that a reduction of £2m to these costs is appropriate.

DSU insurance

- 3.8. Both respondents consider DSU insurance to be an important risk-mitigation tool that provides significant benefits to the consumer. We have previously noted in both the PCR for Nemo Link⁸ and the FPA for IFA2⁹ that we do not consider DSU insurance to provide any tangible additional benefit to consumers.
- 3.9. After reviewing both consultation responses and information provided during the PCR, we remain of that view.

⁸ [Decision on the Post Construction Review of the Nemo Link interconnector to Belgium](#)

⁹ [Final Project Assessment of the IFA2 interconnector to France](#)

Marketing and Website Costs

- 3.10. In our March 2022 Consultation, we proposed to disallow £0.9m of marketing and website costs that were specifically for marketing IFA2 individually. We noted that there are allowances for the purpose of marketing IFA2 as part of the broader National Grid portfolio of interconnectors.
- 3.11. Both responses stated that they disagreed with the treatment of the project-specific marketing costs and felt that not having IFA2-specific marketing would put IFA2 at a disadvantage compared to other interconnectors.
- 3.12. We maintain the view that the allowed marketing costs for IFA2 included within the broader National Grid portfolio of interconnectors represent economic and efficient expenditure in this area and that this offers the best value to consumers. We have therefore decided to confirm our consultation position and disallow £0.9m of marketing costs.

Commissioning Power

- 3.13. IFA2 submitted costs of £8k for power during their commissioning phase. Both respondents state that IFA2 had conducted the commissioning efficiently, resulting in a minimal cost being incurred. It is noted that the commissioning process can have potential risks but there is also the possibility for the commissioning test to result in a positive value.
- 3.14. We maintain our minded-to position to disallow the cost of commissioning power on the basis that we consider this to be a commercial cost that IFA2 can trade as part of the commissioning process and that any positive revenue earned would be excluded from the cap and floor regime.

Covid 19 – Mitigation Costs

- 3.15. NGIFA2 requested £4.17m (GB share) worth of Covid-19 mitigation costs related to:
- extension of time for contractors and IFA2 teams (£3.77m), and convertor station mitigation measures (£0.41m) including Sanitation and cleaning, Food services and accommodation units.
- 3.16. Of the £4.17m costs submitted we have allowed £3.98m covering all the above items with the exception of food services. We have disallowed the remaining £0.2m of food services costs. This cost relates to the provision of free meals to all converter station staff.

- 3.17. Meals were provided to all staff between March and July at a cost of £0.2m. Both respondents believe that the actions of NGIFA2 were correct and that the measure was efficient at minimising contact with the wider population.
- 3.18. While we understand the desire to minimise staff mixing with people locally and therefore minimising the risk of exposure to Covid-19, we remain of the view that the provision of free meals to the staff exceeded the threshold of what we consider to be economic and efficient project expenditure and have disallowed the £0.2m of costs relating to meals.

Related changes to NGIFA2's special licence conditions

- 3.19. In 2019, we split the CFFM into two separate models: Cap and Floor Financial Model 1 (CFFM1) and Cap and Floor Financial Model 2 (CFFM2). For the IFA2 project:
- IFA2CFFM1 – to be used to determine the final cap and floor levels at PCR stage, following the final assessment of costs for:
 - developing;
 - building;
 - maintaining;
 - operating;
 - decommissioning the interconnector project; and
 - IFA2CFFM2 – to be used during the operational period to:
 - adjust cap and floor levels (where required following revision of the baseline allowance for controllable operating costs or decommissioning costs);
 - inflate cap and floor levels annually;
 - reflect performance relative to NGIFA2's availability targets;
 - assess, at the end of each default 5-year assessment period, actual revenue earned by NGIFA2 against the adjusted cap and floor levels;
 - actual non-controllable operating costs against the baseline level; and
 - determine whether NGIFA2's revenues should be 'topped up' to the floor level or whether excess revenue (above the cap level) should be returned to consumers.
- 3.20. As a result of the changes described, we proposed to modify the special licence conditions of NGIFA2's licence in the manner described in Schedule 1 to reflect this change in governance arrangements.
- 3.21. We note that no substantive concerns were raised with respect to these proposed licence modifications. We further note a suggestion with respect to including the

final, determined cap and floor levels in the relevant licence for clarity. We have set out our views on this point in attached Appendix 1. Accordingly, we are now making these licence changes and have published the licence modification notice at Appendix 3. The actual licence modifications can be found in attached Schedule 1.

Appendices

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Documents published alongside this decision

Appendix	Description
Appendix 2	Direction to determine Post Construction Adjustment (PCA) terms for the IFA2 interconnector
Appendix 3	Direction to modify special conditions of the electricity interconnector licence held by National Grid IFA2 Limited Schedule 1 - Modifications to the special conditions of the electricity interconnector licence held by National Grid IFA2 Limited
Appendix 4	IFA2CFFM1 Schedule 2 - Cap and Floor Financial Model 1 Handbook (CFFM1H)
Appendix 5	IFA2CFFM2 Schedule 3 - Cap and Floor Financial Model 2 Handbook (CFFM2H)

Appendix 1 – Summary of responses to our NGIFA2 PCR consultation

Table 4: List of key themes from responses

Respondent	Item ref	Comments	Our view	Change
NGIFA2/NGIH	DSU Insurance	Respondents note that DSU Insurance provides significant benefit to consumers.	We do not consider DSU insurance to provide any additional benefit to the consumer. We provided our reasoning in our Nemo Link PCR and IFA2 FPA decisions.	No change
NGIFA2/NGIH	Licence	Respondents request that the final cap and floor levels are included in the licence for transparency reasons.	Our current approach aligns with what we did for Nemo Link at the PCR stage. The final IFA2 cap and floor levels are included in the updated IFA2CFFM1 published alongside this decision. The values will be specified in writing via a direction issued under IFA2’s licence.	No change.
NGIFA2/NGIH	Covid-19- Converter Station Mitigation	Respondents feel that in providing meals to converter personnel, NGIFA2 provided a fair mitigation to the Covid-19 pandemic.	While we understand the desire to minimise staff mixing with people locally and therefore minimising the risk of exposure to Covid-19, we remain of the view that the provision of free meals to the staff exceeded the threshold of what we consider to be an economic and efficient project expenditure and have disallowed the £0.2m of costs relating to meals.	No change
NGIFA2/NGIH	Commissioning Power	Respondents feel that the costs of commissioning tests should be included in the cap and floor level.	We maintain our position to disallow the cost of commissioning power. We consider this cost to be a commercial cost that IFA2 can trade as part of the commissioning process and that any	No change

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			revenue would be excluded from the Cap and Floor regime.	
NGIFA2/NGIH	Marketing	Respondents feel that the NGIFA2 should have its own marketing strategy and website.	We maintain the view that the allowed marketing costs for IFA2 included within the broader National Grid portfolio of interconnectors represent economic and efficient expenditure in this area and that this offers the best value to consumers. We have therefore decided to confirm our consultation position and disallow the marketing costs.	No change
NGIFA2/NGIH	Repex	Respondents note for the most part OFGEM has approved Repex estimates that were middle of the range. Specifically for Control and protection however, Ofgem has adjusted costs to a value that would represent a value closer to the lower range. Respondents feel it would be better if the middle of the range approach was consistently applied throughout the Repex category.	Ofgem still considers that the reduction of £2m to the Control and Protection value is justified based the reasoning's stated within document sections 3.5 to 3.7	No change