

## **Contribution of 50Hertz Transmission GmbH to Ofgem-CREG consultation on Cap and floor regime for regulation of project NEMO and future subsea interconnectors (Ref 86/11)**

### **I. Introduction**

As transmission system operator in the centre of Europe, 50Hertz Transmission GmbH (50Hertz) stands for the secure integration of renewable energies, for the development of the European electricity market and for maintaining a high level of security of supply.

50Hertz provides the operation, maintenance, planning and expansion of the 380 / 220 kilovolt transmission grid in eastern and northern Germany. Our grid covers an area of 109,000 square kilometres and has a length of approximately 9,750 kilometres.

More than 40 % of all wind power generation in Germany is located in the control area of 50Hertz. The infeed from renewable energy sources are integrated into the grid and transmitted to the consumption centres. 50Hertz is responsible for reliably supplying electricity to more than 18 million people.

Since 19th March 2010, our shareholders are the Belgian transmission system operator Elia System Operator (Elia which holds 60 % of the shares and the infrastructure fund Industry Funds Management (IFM) which holds 40 % of the shares. IFM is one of the world's largest investment companies in the infrastructure sector. 50Hertz is thus at the same time a fully independent transmission system operator and part of the international Elia Group.

As European transmission system operator, 50Hertz is a member of the 'European Network of Transmission System Operators for Electricity' (ENTSO-E).

### **II. High Level principles**

50Hertz agrees with the principles of the proposed regime in the consultation documents.

The Regulatory treatment of such projects with participation of regulated grid companies should be coordinated between involved NRAs. Besides that, the returns should be corresponding with the several levels of risk the participant' exposure. A symmetric approach for risk sharing, where consumers benefit from a cap and developers from a floor will allow investors to take a longer term view. This reduces costs of capital and ultimately deliver a more economically efficient resource.

The nature of a cross-border interconnector leads to much uncertainty on the revenues because the revenues depend strongly on the willingness of market parties to use the interconnector and pay for its usage. Though, the supposed system seems to be a reasonable approach to deal with the risks of such investment.

There is a big need to find the appropriate balance between the protection of the consumers and incentives to realize new interconnectors. Therefore the developers should be exposed to the market's valuation of interconnector capacity and the consumers should be protected from the cost implications of excessive returns or market power that might accrue to interconnector owners.

The proposed regime is the right approach to meet the underlines principles of the new regulated investment regime listed on page 14 of the consultation.

### **III. The Cap and Floor Approach**

Profits-sharing regimes can minimize some risks associated with lack of incentives when caps are reached. The profit sharing within the cap and floor will not create such an incentive. Such an arrangement will lead to a higher cap when allowing proportionate risk-sharing between the developers and the consumers. Profit sharing arrangements above the Cap will provide an incentive to the interconnector operator to ensure maximum availability and maximize the overall project returns. Such arrangements should therefore be assessed by regulators with the view of consumers' protection.

In order to keep the interconnector availability at high level the lack of incentives can be solved by a profit sharing arrangement above the cap.

In cases when interconnector developer (asset owner) is not an interconnector operator (asset operator), the issue should be taken into account that the asset owner needs enough incentives in order to increase the revenues above the cap generated by auctioning and return these to consumers.

### **IV. Design of the cap and floor**

50HzT agrees with proposed design parameters of the cap and floor regime on page 23 of the consultation.

The reference to the interconnector lifetime concerning the question of duration seems to be a good approach. Besides being compliant with the EU Electricity regulation requirements, it offers the same advantages to consumers and developers after the financing period. It also allows for a continuous evaluation of returns over the interconnector lifetime, while providing certainty on returns within the cap and floor range.

An IRR approach is the better option to be levied on. It offers a measure of return which is consistent with the original investment decision.

There are a number of options relating to when to evaluate project progress and performance, and when to make or take payments to or from the interconnector owners. A multi-year (the assessment is made on a multi-year basis, similar to a price control process) evaluation seems to be the best option. The length of the period should be not too long and not too short, so the interests of developers and consumers are not out of sight. 50HzT thinks a periodic assessment (4 to 6 years) could be an appropriate way. However, there may be a different reporting cycle due to the future European Electricity Regulation.

If resetting the cap and floor it will generate more uncertainty both for developers and consumers. The cap and floor should be fixed before the investment decision. A variable setting of the cap and floor would increase risks and therefore the costs of capital considerably.

For the distance between the cap and floor a risk-sharing between the interconnector developer and consumer should be taken in account.

The suggested cap and floor design deserves deeper analysis if it comes to other interconnector projects. But at first glance, it seems to be a realistic approach for the given situation of the NEMO project.