

OFGEM

Att: Ms. Emmanouela Angelidaki
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Handled by:
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Our date:
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Dear Ms. Angelidaki

We refer to the joint Ofgem and CREG consultation "Cap and floor regime for regulation of project NEMO and future subsea interconnectors".

Please find enclosed Statnett's answer to this consultation.

Yours faithfully,



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ELECTRICITY INTERCONNECTOR POLICY

As the Transmission System Operator in Norway and as a partner of National Grid in interconnector projects between Norway and the UK, Statnett welcomes the opportunity to participate in Ofgem's consultation process on a "cap and floor regime" for regulation of project NEMO and future subsea interconnectors.

Statnett believes that it is in the interest of both Norway and the UK that the regulatory regime in the UK allows for interconnectors that do not require exemptions from European legislation.

Before addressing the questions most relevant for Statnett as a partner in interconnector projects between UK and Norway, it is appropriate to provide some information on Statnett's interconnector experience and our current interconnector project portfolio.

Statnett operates three subsea DC interconnectors to Denmark (Skagerrak 1 – 3) with a combined capacity of 1,000 MW and one 700 MW subsea DC interconnector to the Netherlands (NorNed). Additionally, there are strong AC interconnectors with Sweden and minor AC interconnectors with Finland (100 MW) and Russia (50 MW).

Statnett is currently involved in several new projects for additional subsea DC interconnection capacity, including:

- a fourth interconnector to Denmark (Skagerak 4)
- a new interconnector to Sweden
- a new interconnector to England
- a new interconnector to Germany.

A previous cooperation project with National Grid for an interconnector between Norway and the UK (NSI = North Sea Interconnector) had progressed quite far, but was stopped in 2003 when the Norwegian Ministry for Petroleum and Energy refused to grant the license for exporting and importing power. The Ministry stated that the welfare economic benefits to Norway were not certain enough. There may also have been concerns over complexity and non-symmetrical risk/reward mechanisms. Previous projects for interconnectors to Germany such as Euro Cable and Viking Cable have also failed to be completed.

For every existing interconnector the Norwegian parts are included in the Norwegian central grid tariffing system, and are hence fully regulated on the Norwegian side. This is independent on how the regulation is on our partners' sides. It is our opinion that the regulation of existing interconnectors is functioning well. We further believe that any deviation from a regulated model, which allows the interconnector's economic benefits to be channeled to our grid customers, will greatly increase the challenges of being awarded the necessary licenses and concessions.

One question that often arises is the matching of incentives between partners. Please be aware that Statnett does have incentives to be efficient in development and operations of interconnectors. This is due to the incentive mechanisms in the Norwegian regulatory regime for grid companies, in which results from benchmarking studies are incorporated when the income caps are defined. Furthermore, the income regulation is complemented with governance signals from the Ministry of Petroleum and Energy, which is the sole owner of Statnett.

Question 4.1: Is the cap and floor model the right approach to meet the principles of the new regulated investment regime for subsea interconnections? Are there alternative approaches that we should be considering?

Statnett's view is that a cap and floor model can be a viable solution to bridge the need for incentives to ensure efficient development and operations of interconnectors with the need to avoid exemptions to EU regulation.

Our key opinion and experience is that the regulation of an interconnector does not need to be identical for both/all partners in the project. We believe that TSO partners in interconnector projects to UK should be able to keep their part of the interconnector as part of their TSO grid if so preferred. This implies similarly that the regulation for National Grid could be extended to cover their part of the interconnectors. As long as the regulation of the different partners is similar enough to avoid too deviating incentives, the efficiency of the project should not be hampered. The "cap and floor" regime is a welcomed model in this sense, as it should bring the regulation of UK interconnectors significantly closer to that of the EU and Norway.

Question 5.2 Question 5.2: Do you have a preference for the options presented under each parameter? Do you have a preferred combination or straw man proposal for a cap and floor design?

Narrow vs wide range?

We see it as crucial that the model with cap and floor is officially accepted by the EU as a regulation that does not require exemption. This should be verified with the EU to avoid an iterative process that risks delaying interconnector projects beyond connection time windows offered by National Grid Electricity Transmission.

We do believe that there are limits to how wide the range can be for EU to accept the model as a regulated approach.

Our opinion is that the levels of cap and floor need not be the same on all interconnectors connecting the UK to adjacent countries. In the cases where the partner outside the UK is fully regulated, the range between cap and floor should not be too wide in order for incentives to be adequately compatible.

How often is performance assessed against the cap and floor?

Reaching the cap and floor may influence the incentives for an optimal operation of the interconnector.

Historic analysis reveal significant volatility in annual interconnector revenues. Hence a combination of narrow performance range and a short assessment period implies a project will likely hit its cap or floor very quickly.

Statnett's view is that the assessment period should be relatively long.