

Martin Crouch
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25th May 2012

Dear Martin

Planning for an integrated electricity transmission system

We welcome the opportunity to provide our views on what is needed to ensure that Britain's transmission system planning delivers an integrated transmission system onshore, offshore and cross border, and how the relevant institutions and incentives around them should evolve to support this activity.

As you are aware Transmission Capital is one of the few players that either is already involved in or has a desire to be closely involved in all of the overlapping regimes.

We are:

- i) Keen to play a part onshore when the opportunity arises for third party delivery under the RIIO framework;
- ii) The largest owner of grid connections to offshore wind farms in the UK (and the second largest in Europe) by MW connected;
- iii) A developer of several interconnector projects, one of which also involves the connection of offshore renewables.

Our thoughts in respect of the issues raised by the ITPR development are still developing, and we would hope to have more detailed discussions with you in due course, however our initial responses to the open letter questions are set out below.

1. Whether our objectives and scope of work for the ITPR project are appropriate?

We fully support the objectives set out in the open letter and are ourselves facing many of the issues driving this work. We agree with the scope of work with the clarifications that:

- i) The planning of new interconnectors between Britain and the rest of Europe should be part of the scope – whilst at present these projects are developer led, we can envisage an alternative arrangement whereby interconnectors would be planned by NETSO, with a separate mechanism to deliver them. This would align more closely with the rest of Europe and may become necessary as developer led projects dry up due to the reduction in expected congestion rents that would result from closer market integration, even though further interconnection could be justified on a socio-economic basis.

- ii) The business separation requirements between NETSO and the rest of National Grid should also be part of this scope.

2. Whether there are additional drivers for the project that should be considered?

In our view the open letter adequately summarises most of the drivers.

This consultation is one of several developments in the UK electricity industry that together make this a very opportune time to consider the future governance, incentivisation and ownership of NETSO. These other developments include:

- The proposals coming from the Electricity Market Reform exercise;
- The recent consultation on potential measures to support efficient network coordination of offshore transmission.
- The increasing need for interconnection between the UK and the rest of Europe and the move towards a more regulated model for interconnection;
- The growing number of TOs in the UK electricity market both through the OFTO process and owners of potential new interconnectors;
- The prospective introduction of competition in onshore transmission as part of the RIIO process.
- Technological developments that make the concept of connecting offshore renewables to HVDC interconnectors increasingly practical and economically desirable.

We also understand that DECC and Ofgem are conducting a review of the conflicts of interest NETSO might have in relation to its role in EMR. We understand that this work for EMR should also be cognisant of any potential conflicts of interest highlighted by the review of NETSO's role under ITPR and we fully support this. In addition we would expect additional potential conflicts of interest could arise from the increasing number of TOs with which NETSO will need to interface, many of which will be competing with NETSO affiliates, and from the need for NETSO to represent these TOs through ENTSO-E.

We would like to stress that as a new entrant into a market dominated by near-monopoly incumbents in many areas, the "incentives around relevant institutions" are very important to us. Moreover the offshore transmission regime has demonstrated the benefits that can be gained from competition in the provision of transmission financing and management. We would expect that these would be even more evident when new entrants also have the opportunity to procure and construct.

Therefore, a driver for us, and for UK plc, should be to ensure that there is the opportunity to bring competition into the delivery of as much transmission as possible, and that this competition should be on a level playing field. In our view competition should be extended to encompass all new transmission assets built offshore (including the associated onshore parts of these projects) and all large onshore transmission projects.

Incentives on monopolies (whether NETSO or onshore TOs) need to be carefully considered in this regard, as do business separation arrangements between these entities and affiliates (if any) allowed to take part in the competitive delivery of assets.

3. Whether there is additional evidence we could consider in understanding the current and future challenges?

The open letter covers the ground, and we note that this was explored further in the workshop held on 16th May 2012. The most important issue we think to come out of

the workshop is the need to consider that infrastructure may be constructed under one regime and then fall under another as further development occurs (e.g. a pure interconnector may become a generator connector as well if a generation development subsequently connects to it). This is important as there will be a need to consider the implications for investors of such a potential change in regulation, which could under some circumstances lead to a forced divestment (as has occurred under the OFTO transitional regime). We believe that the ITPR project should ensure that potential future developments could be accommodated without any need for forced divestment by transmission owners.

4. Whether the current interactions between the NETSO's role and the role of other TSOs in system planning are consistent and efficient?

Transmission Capital has direct experience of the planning interface between NETSO and other TOs through our interconnector development and other activities. We believe that the appropriate approach is for all transmission companies (including interconnector developers) to work together to determine the most economically efficient design. Where this results in a reduction in congestion rents, for instance because it is cheaper to restrict interconnector operation than to reinforce the onshore transmission system, the revenues allowed by the interconnector owner should not penalise the interconnector owner for adopting the optimum design.

NETSO have adopted a similar "joint planning by transmission companies" approach and to date our experience of working with NETSO has been positive. However this work is ongoing and we will update Ofgem of our experiences as it progresses.

We have concerns that National Grid faces a conflict of interest in representing Britain at ENTSO-E, as this will require it to play a role in deciding which projects are put forward in the Ten Year Network Development Plan, or as European priority projects. We believe it will be difficult for National Grid to be impartial in such processes where its own interconnector projects are in competition with independent projects.

We also have concerns with National Grid's request that Ofgem grant funds, from customers' tariffs, for National Grid to design and consent the bulk of the connections to Round 3 wind farms (Paul Whittaker letter to Ian Marlee, 18 April 2012). Whilst it may be appropriate for NETSO to do this under a "late-OFTO build model", it should not be possible for National Grid to use this either to gain monopoly rights over the delivery of this infrastructure or to gain an advantage in a competitive process for an OFTO delivery. We expect to be writing separately to Ofgem on this issue under the auspices of the Energy Networks Association OFTO forum.

5. Whether the arrangements for and relationship between the NETSO and other TSOs (for example, interconnector owners) appropriately incentivise system planning?

We do not think that the relationship between NETSO and National Grid's onshore TO business (between which there are currently no business separation arrangements) appropriately incentivises system planning. We consider that it is at best opaque as to whether NETSO's system planning is being carried out in an objective manner, and at worst it is being done in a manner designed to benefit National Grid's onshore TO business, potentially causing billions of pounds of additional cost to the consumer through the loss of the benefits of competition and delays to the build out of offshore renewables.

The open letter already notes that arrangements between interconnector owners (who do not pay TNUoS charges) and NETSO may not correctly incentivise system planning. This aspect needs to be considered as there appears to be no mechanism to reflect the costs of transmission reinforcement on merchant interconnectors (whilst

presumably these can be considered as part of the socio-economic analysis overseen by Ofgem for regulated interconnectors and reflected in caps and floors).

We are happy for this response to be made available on the Ofgem website.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Chris Veal', is positioned below the text 'Yours sincerely'.

Chris Veal
Managing Director