

Emmanouela Angelidaki  
Ofgem - London  
9 Millbank,  
London,  
SW1P 3GE  
*Via email: Cap.Floor@ofgem.gov.uk*

Handled by/Tel.:  
Håkon Halvorsen / +4723903281  
Your ref. /Your date:  
Consultation 28/13

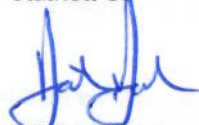
Our ref. / Doc. Id.:  
J/NSN/Kommersiell/Utenlandske  
interessenter/Ofgem  
Our date: 3<sup>rd</sup> May 2013

**Dear Madam**

We refer to the live consultation "Cap and Floor Regime for Regulated Electricity Interconnector Investment for Application to Project NEMO".

Please find enclosed Statnett's response to this consultation.

Yours faithfully  
Statnett SF



Håkon Halvorsen  
Commercial Manager, NSN Project  
Commercial Development Division

---

REF 28/13

## **CAP AND FLOOR REGIME FOR REGULATED ELECTRICITY INTERCONNECTOR INVESTMENT FOR APPLICATION TO PROJECT NEMO**

### **1. Background**

Statnett is the Transmission System Operator in Norway and a partner to National Grid in the interconnector project NSN. NSN is a 1,400MW HVDC link spanning 720 km between Kvilldal in Norway and Blyth in United Kingdom, and is on schedule for launch in 2019/2020.

Statnett currently 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).

Besides NSN, Statnett is currently involved in several new projects for additional subsea DC interconnection capacity, including a fourth interconnector to Denmark (Skagerak 4) and a new interconnector to Germany.

We have participated in previous Ofgem consultations, last on 2<sup>nd</sup> Sep 2011, and we welcome the opportunity to do so again now. Our interest to respond should be seen in light of our belief that the Nemo regulation will influence National Grid's regulation on NSN, which represents Statnett's largest interconnector project to date in terms of physical length, capacity rating and size of investment.

### **2. Main principles**

A key prerequisite to Statnett in a project the size of a North Sea interconnector is to find a motivated, industrially competent and financial strong partner which we believe has a long-term view on its participation in the project. As such Statnett supports Ofgem's intention to propose a regime which aims to facilitate economic and efficient developer led investments within a predictable and stable framework.

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. For this reason we have previously argued that the band between cap and floor returns should be set reasonably narrow. A wide band opens up for dissimilar incentives between the partnered developers of an interconnector, which creates a situation we aim to avoid.

### **3. Specific comments**

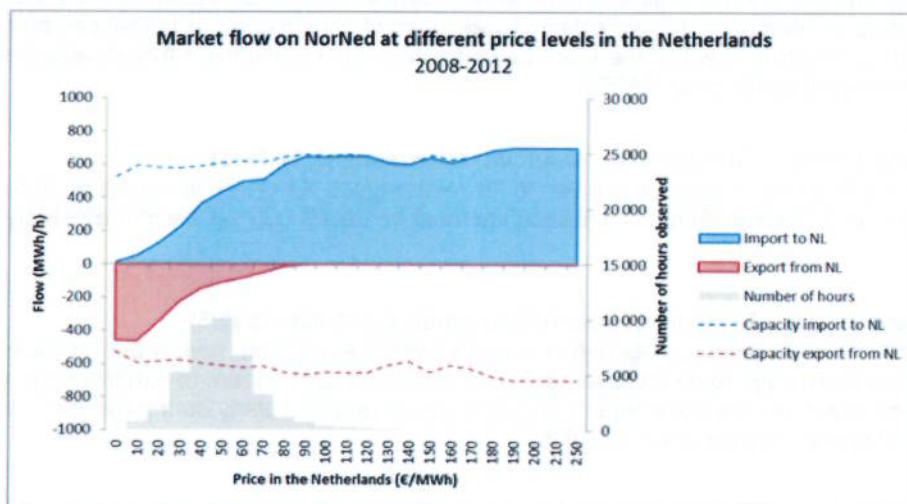
#### **CHAPTER 1 – INTRODUCTION (1.3)**

When listing benefits that electricity connection can bring to GB, we would like to emphasize that NSN will give GB access to the flexible Norwegian hydropower system and that this will represent a significant contribution to the GB security of supply.

This is illustrated in the figure below which shows flow on the Norwegian-Dutch interconnector, NorNed. All hours with operation on the interconnector since the start in May 2008 are sorted according to Dutch price. The shaded areas show the average import (blue) and export (red) for the different prices. The dashed lines show the average capacity on the interconnector for these different prices. We can see that



for high Dutch prices, there is maximum import to the Netherlands from Norway, which indicates that the Netherlands is importing from Norway when they are short of capacity. The key illustration is that the interconnector significantly contributes to Netherland's both in terms of security of supply and also in terms of valuable socioeconomic benefits to the consumer.



In Statnett's view the value of NSN with respect to GB security of supply is comparable to that of a power plant. Consequently, Statnett is basing its business case for NSN on a fair treatment of the project in the GB capacity market. We would suggest that access to another nation's production capacity be added as a benefit of connectivity in any upcoming consultation of the NSN project.

#### CHAPTER 2 – REGIME DESIGN – CHAPTER SUMMARY QUESTIONS 1-3

In general Statnett agrees with the proposed regime, and we believe the design represents a consistent and natural development based on the high level principles set in December 2011.

With regards to developer incentives, we believe it is critical that these incentives are based on factors the GB developer can control.

Whereas Ofgem sees financeability and availability purely from a regulation perspective, in a partnership the GB developer may be affected, limited or bound by a partner's views on one or more issues identified as critical in the other nation's context. The two areas immediately identifiable relate to availability incentives and the financeability approach in the Floor methodology.

#### CHAPTER 2 – REGIME DESIGN – CAPEX (2.14-2.28)

Our key message on CAPEX continues to be that we are sensitive to any process where the partners' business model is explicitly or implicitly verified with suppliers of cable and converter equipment and services.

While an ex-post approach to CAPEX would eliminate the above mentioned challenge an ex-ante approach would in our opinion be better suited to provide the GB developer with incentives to timeliness and efficiency in the construction phase.

If an ex-ante approach is used the CAPEX cost risk is on the hand of the developer. In such an instance we would suggest it becomes important that the range of returns from floor to cap is not skewed to the downside relative to some ideal target Ofgem may have, as this would represent a double negative risk.

---

On the contrary, Ofgem may consider compensating the downside CAPEX risk with other upside incentives, to encourage developer stability into the operations phase even if a project experiences some cost overrun.

In addition we would advise that the regime should avoid incentives for construction contract models that drive cost. The nature of interconnector projects includes types of construction risks that can be extremely costly to transfer to contractors. It would therefore be in the interest of consumers that developers accept such risk to achieve significantly lower CAPEX.

**CHAPTER 2 – REGIME DESIGN – TREATMENT OF FINANCIAL ASSISTANCE (2.29-2.32)**

Statnett believes any financial assistance is given to the joint project. So whilst we do not disagree with the statements, any such netting of financial assistance must be based only on the share kept by the GB developer.

**CHAPTER 2 – REGIME DESIGN – PERIODIC CONGESTION REVENUE ASSESSMENTS (2.5)**

Due to the volatility of annual revenue, Statnett is uncertain whether a 5-year review period allows for a representative revenue average to be discovered. We would encourage Ofgem to exhibit some restraint in making conclusions which impairs our partner's regulatory position particularly during the first review, when only 5 year of operational experience exists.

**CHAPTER 2 – REGIME DESIGN – AVAILABILITY INCENTIVE (2.60-2.70)**

Statnett has made it clear that any partner in an interconnector project to Norway must accept the Norwegian grid "as is", and Statnett would offer no financial compensation in cases of potential interconnector constraints due to grid issues.

It is imperative that Ofgem in any operational availability incentive recognizes this situation, so that our partner is not penalized based on actions beyond its control.

**CHAPTER 3 – 1<sup>ST</sup> CoC – FLOOR ON RETURNS (3.19-3.30)**

Statnett supports a flat floor in real terms and the notion that an efficient developer should be allowed to recover its costs and service its debt obligations (be "financeable").

However, in a project this size Statnett needs a strong a financial partner. Statnett will have views on minimum equity and/or liquidity and maximum allowable gearing. These views may or may not affect our partner's ability to structure its balance sheet in a manner assumed by Ofgem in setting the Floor methodology.

As in the previous section we ask that Ofgem recognizes the partnership's limitations to see whether these affect the GB developer's ability to act as assumed when the Floor approach is specified.

**CAP AND FLOOR REGIME BEYOND NEMO (5.12-5.15)**

Each interconnector project is unique, and we welcome Ofgem's approach to regulate each project separately, albeit in a common framework now being developed.

We support that the cap and floor regime is extended beyond Nemo, and in particular to our partner's share of the NSN revenue.

Statnett would be interested in learning more of the work of the ITPR project, and hence would welcome the opportunity to communicate with the project and assist in any way we can.