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### Vattenfall Response to the Ofgem Consultation

## **Cap and Floor Regime for Regulated Electricity Interconnector Investment for application to project NEMO**

Vattenfall commends the achievements reflected in the discussion on a cap and floor regime for the project NEMO. The overall impression is that the analysis reflects different stakeholders' interest in a fair way.

In general Vattenfall is supportive of the proposed regime as it allows for a project developer driven approach, where the pros and cons of respective cable are in focus rather than the organizational form of respective project developer. Vattenfall's view is that as long as use of interconnector capacity is subject to market valuation and with full third party access, the difference between TSO and non-TSO projects is primarily solutions on financing, as the principal socioeconomic merits are to a large extent identical. If this regime became the "EU standard design" for 3<sup>rd</sup> party interconnector (i.e. merchant links) it could potentially address some crucial shortcomings of the current regulatory framework for development of cross border capacities in the EU:

- Force countries like Norway (and Sweden) as well as the European Union to accept market coupled 3<sup>rd</sup> party projects as a relevant complement to TSO driven projects.
- Attract new type of investors in interconnectors (investment funds etc) since return is safer
- Protect investors against the consequences of TSOs moving internal bottlenecks to the border (if the Commission do not manage to stop this behaviour).

Vattenfall urge Ofgem to work for a European wide acceptance and recognition of the potential socioeconomic contribution from 3<sup>rd</sup> party projects as a complement to traditionally TSO regulated projects, a driving force identifying and realising interconnector capacity where socioeconomic potential is unexploited.

However, it is not clear to Vattenfall why this kind of regulation would not require an exemption from the current EU legislation and at the same time be neutral towards TSO and non-TSO projects. This warrants some clarification for a continuing discussion on this as a possible model for the development of the European grid.

The Cap and floor model may also tackle the issue of UK only allowing for merchant investments which can imply end too little investments being made from a socioeconomic perspective (the value of the interconnector may be far bigger than the congestion rents which is currently the only measure in the UK). This is an issue where Vattenfall finds the report somewhat lacking. The values of an interconnector and trade with electricity are more than can be measured by congestion rents. Thus the congestion rents may only at best serve as an indicator and the lower bound of the socioeconomic values created.

It is true that the move from a merchant approach (where underinvestment compared to the socioeconomic optimum occurs) to a regulated approach requires more insights on the optimum amount of investment in interconnectors. However, this seems a rather premature concern as there are no signs of too much infrastructure being planned in UK or the rest of Europe. Given the rather large changes that the UK electricity system faces it must be emphasized that the levelized cost of capital of a transmission interconnection is far below any alternatives (i.e. generation in gas, nuclear, etc.). Thus the value in using transmission as part of the capacity to keep “the lights on” seems vastly underestimated in the reasoning concerning the protection of consumer’s interest. If transmission can provide services at a lower cost than competing generation that also has long run consequences for the consumer budgets.

## **Answers to selected questions**

### **Chapter 2**

**Question 1:** *Do you agree with our proposed regime design outlined in this chapter and Appendices 1 and 2? Is the design consistent with the high level principles established for the cap and floor regime in December 2011?*

Given the regulatory assumptions on the actions of the EU, and current legislative changes in e.g. Norway, Vattenfall believes that the proposed principles should advance the possibilities for infrastructure investments.

**Question 3:** *Do you consider the proposed arrangements (for market related costs and the availability incentive) incentivise high link availability?*

Yes

**Question 4:** *Do you believe that there are opportunities for gaming by developers with our proposed regime design?*

There seems to be a good amount of checks and balances in the proposal to safeguard both the developer and the end consumer interest. Thus the risk of gaming should be similar to that facing OFGEM in its usual work with network and tariff regulation. Thus Vattenfall foresee no issue of gaming with respect to this proposal

### **Chapter 3**

**Question 1:** *Do you agree with our proposed approach on the key methodology considerations? Is our approach consistent with the high level principles established for the cap and floor regime in December 2011?*

Vattenfall agrees that the proposed approach is aligned with the key methodology considerations

**Question 2:** *Do you agree with our approach of using the cost of debt and equity to set returns at the floor and cap respectively, while acknowledging that that the appropriate level of the cap and floor returns are interrelated?*

Vattenfall agrees that in a cap and floor regulation, the floor must be based on the actual costs as these are foreseeable and thus fairly easy to use as a regulatory benchmark.

## Chapter 5

**Question 1:** *Do you agree with the proposed for considering the connection process in the regulatory decisions on electricity interconnector investment? Are there any other areas that need to be considered in the principles?*

Vattenfall considers a transparent and fair process for dealing with connections as vital. However, there seems to be a somewhat strong emphasis on guaranteeing as low as possible costs to the consumers. In Vattenfall's view the interconnector costs must be related to values created and values protected, rather than emphasising the lowest consumer cost. Thus environmental concerns, connection of wind power or extremely beneficial trade conditions can make more sense to consider than the overall cost of the connection. Thus we would like to emphasize the overall socioeconomic benefits, including non-pecuniary values as the key concern for connections.

**Question 2:** *Do you have any views on the regulatory decision making process for project NEMO and on any other areas of consideration for the cap and floor regime beyond NEMO?*

The process as described in this proposal seems fair and transparent. However, Vattenfall propose that in addition to this consultation that there are some public hearings as well as a follow-up stakeholder dialogue as this is legislation in continuous development.