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3 January 2014

## **Response to Request from ElecLink for an exemption under Article 17 of Regulation (EC) 714/2009 for a GB-France interconnector**

Dear Guro and Ikbal,

ElecLink welcomes the opportunity to respond to the public consultation document. We believe that greater clarity of some points would be helpful in obtaining a fuller understanding of the benefits of additional GB - France electricity interconnection.

Our comments are set out as responses to some of the questions raised by the national regulators; CRE and Ofgem (together the NRAs).

### **Part I: Impact on competition and the internal market**

Question 1: Do you consider ElecLink's proposed investment enhances competition in electricity supply and therefore meets condition (a)?

Question 2: Do you consider the exemption requested by ElecLink would not be to the detriment of competition and that it therefore meets test 1 of condition (f)?

Question 3: Do you consider the exemption requested by ElecLink would not be to the detriment of the effective functioning of the internal market in electricity and that it therefore meets test 2 of condition (f)?

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Analysis carried out by the NRAs and London Economics on competition focusses on the impact of the allocation of new interconnector capacity to EDF, and is consequent ability to strengthen its dominant position in both connected markets. London Economics concludes that EDF's capacity holding on ElecLink could be restricted to 20-40% of the 1000MW capacity, compared to ElecLink's proposed limit of 50% of the capacity to any single user.

London Economics' analysis confirms EDF's dominant position both with and without ElecLink. Its analysis demonstrates that the impact of allocating all or none of ElecLink's capacity to EDF shows a very small difference of the RSI index (within the error range of the analysis), i.e. constraining EDF's capacity on ElecLink will have no material impact on EDF's position before and after the construction of ElecLink. Other measures would need to be undertaken by the NRAs to reduce EDF's dominant position.

In the spirit of developing market competition, ElecLink is proposing a 50% limit for any single user, based on our initial HHI analysis. While the RSI may be useful as an additional measure of concentration in this context, we note that the HHI measure is still widely adopted in merger and competition studies (e.g. Ofgem, Ofwat, OFT), and thus should not be discarded. We do not consider a unilateral constraint below 50% appropriate unless such a limit is imposed on all interconnectors on the same frontier to create a level playing field. A review by the NRAs in May 2013 of IFA's access rules<sup>1</sup> did not consider any such constraint on any user was required for medium-term capacity products.

### Third Party Access

Question 6: Analysis conducted by London Economics shows that the price of capacity for long-term contracts may be significantly higher than those assessed by ElecLink. Do you think any limit of capacity sold on multi-year products should be based on the actually contracted revenues or on a maximum volume or on any other basis?

Question 9: In your view, how should the capacity be allocated:

- a) the Open Season (one long-term allocation before the interconnector becomes operational); or
- b) periodical allocations of standard long-term products as defined by the European target model for electricity)?

What should in your view be the split of the foreseen capacity between these two mechanisms?

ElecLink intends to allocate long-term capacity (>1 year) through an open season tender process, designed to ensure maximum competition and transparency. All capacity holders will be subject to a 'Use-It-Or-Sell-It' (UIOSI) obligation at the day-ahead stage, consistent with the European Target Model.

ElecLink's returns are highly dependent on the long-term differential of wholesale electricity prices between the UK and North West Europe – ElecLink is a price-taker and cannot

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<sup>1</sup> <https://www.ofgem.gov.uk/publications-and-updates/national-grid-interconnectors-limited-ngic-and-r%C3%A9seau-de-transport-delectricit%C3%A9-joint-consultation-revised-access-rules-england-france-interconnector-ifa>

influence wholesale generation prices in large liquid markets. ElecLink, together with its advisors Redpoint, have made an assessment of the long-term price differential between the GB and French markets. London Economics' performed the same analysis and we note that on a fundamental forward-looking basis, Redpoint and London Economics' long-term prices are within approximately €1MWh of each other.

As a sensitivity, London Economics considered the impact of 2014 IFA prices (which are at historic highs) and applied such prices to ElecLink, with a discount, over the life of the project. This sensitivity, unsurprisingly, produced a return above ElecLink's base case return, and the results were used to suggest that a reduction in long-term contract cover from our proposed 80% could be achieved.

Clearly prices in the future may be lower than the recent highs and below our base case assumptions. Our analysis indicates that interconnector capacity pricing is cyclical, with periods of high prices being followed by periods of low prices (as seen over the last decade). It would be wholly inappropriate to take a single year of auction results, extrapolate forward 20 years, and then impose a constraint based on the results.

ElecLink, its shareholders and banks have taken a symmetrical approach in analysing upside and downside price sensitivities. With this in mind, ElecLink is seeking the flexibility to allocate up to 80% of its capacity to long-term contracts to raise an adequate level of debt, protect the returns of debt investors and, to a lesser extent, returns to equity investors in the project. Alternative suggestions to limit capacity allocated on a long-term basis to the revenues required to service debt at the outset of the project may significantly curtail ElecLink's ability to refinance the project during periods of low capacity prices. This would increase the risk to shareholders thus making the project unfinanceable.

## **Part 2: Impact of exemption on the regulated system**

Question 24: Do you consider the exemption requested by ElecLink would not be to the detriment of the efficient functioning of the regulated systems to which the interconnector is connected and that it therefore meets test 3 of condition (f)?

ElecLink has calculated the net social benefit (welfare) of the project to be €640m over the period of the exemption based on prudent assumptions. In comparison we note that London Economics (page 5 of appendix 2) estimates that ElecLink will generate over €3.2bn of welfare based on its economic model (and using a number of different assumptions). We note that the direction and overall conclusions from the welfare analysis is similar in the two models. Both estimates of the high level of welfare validate ElecLink's selection by the European Commission as a Project of Common Interest and the urgent need for further interconnection on the congested GB - French border to reduce renewable curtailment in both markets.

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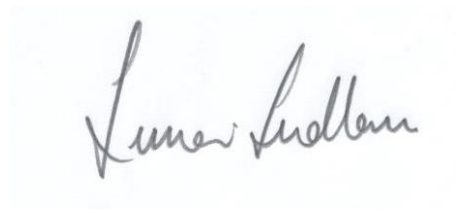
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We trust this note has provided some clarification on some of the key issues raised in the consultation document. We look forward to our continued constructive engagement.

Yours sincerely



Simon Ludlam

cc Angus Norman, CEO ElecLink

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