

Ikbal Hussain
Manager, European Transmission Policy
Ofgem
9 Millbank
London
SW1P 3GE

Andrew McIntosh
Commercial Manager
European Business Development
National Grid
31 Homer Road
Solihull, B91 3LT

andrew.mcintosh@nationalgrid.com
Direct tel +44 (0)1926 655475

<http://www.nationalgrid.com/>

3rd December 2014

Dear Mr Hussain

Ofgem/CRE Joint Consultation – Request from ElecLink for an Exemption

Please find enclosed a response to the ElecLink exemption request from National Grid European Business Development (EBD). EBD is the division of National Grid which is responsible for the operation of existing interconnectors to France (IFA in partnership with RTE) and to the Netherlands (Britned in partnership with Tennet NL) and the development of proposed new interconnectors to Belgium (Nemo in partnership with Elia), Norway (NSN in partnership with Statnett) and France (IFA2 in partnership with RTE). These projects are generally being taken forward against the assumption that a regulatory regime can be determined for at least the GB part of each project recognising the lack of such a regime in GB prior to Ofgem's work on the Cap and Floor mechanism. We note that a joint decision by Ofgem and CREG is due on the Nemo Cap and Floor mechanism in March 2014. National Grid EBD is also in early discussions with prospective partners in Denmark and Iceland in relation to the development of interconnection to those countries.

As such National Grid EBD recognises the benefits to consumers of existing and future interconnection to/from GB and the contribution these projects bring – regardless of who the developer is - to completing the EU Internal Energy Market (IEM) and to overall GB security of supply by providing access to a broader range of generation sources within an enlarged pool of market liquidity. In the case of the ElecLink, this project is seeking what appears to be a very broad ranging exemption from the TPA principles which underpin the IEM and potentially from the EU Network Codes which provide the harmonised rules of the IEM. As one of the issues often leading to an exemption request is the absence of a regulatory regime to cover such investments, the timing of this exemption decision alongside the pending Nemo regulatory regime decision is interesting in the context of interconnector development in GB.

Aside from answering (where relevant) the various questions posed by the joint Ofgem/CRE consultation, our main point in responding to this consultation is to highlight the need for a level playing field principle to apply to all interconnectors current and future in respect of the IEM rules, whether the interconnector is regulated via an exemption or by more traditional forms of regulation such as the Cap and Floor regime being developed by Ofgem and CREG in relation to the Nemo project and which could be applied to other projects as well. We recognise the important role of the exemption procedure within the IEM regime and are therefore not against the granting of an exemption to any particular project. We would merely stress the equal importance of equality of treatment of all GB related interconnectors in terms of how the principles of the IEM and the network codes are implemented in the GB regime.

The attached Appendix 1 provides our specific answers to the individual consultation questions. If you have any queries on the points in this covering letter or in our answers themselves please direct them to me at the address above.

Yours Faithfully

A handwritten signature in black ink, appearing to read 'A. J. McIntosh', with a horizontal line drawn underneath the name.

Andrew McIntosh

National Grid - European Business Development

Appendix 1

Responses to Questions:

Part 1: 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)?

In our view a greater level of interconnection between GB and the rest of the EU offers significant benefits to consumers in terms of offering access to a wider range of generation sources and a greater pool of market liquidity in the IEM, hence supporting security of supply.

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)?

See answer to question 1.

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)?

We see the exemption process as an important option in the development of greater interconnection in the classic sense and also in the prospect of GB accessing long distance non-GB generation sources such as Ireland or Iceland. That said in terms of the efficient functioning of the IEM we see it as important that a level playing field principle applies to all forms of interconnection including links already in operation and those in the development stage. We will explore this further in future answers but in summary we would see comparable and proportionate implementation of the EU network codes in respect of all interconnectors to be an important aspect in ensuring the basic tenets of the IEM are respected.

Question 4: Do you consider ElecLink has provided sufficient information on demand for its interconnector capacity between France and GB?

No comment.

Third Party Access

Question 5: Do you consider such long-term products would be necessary to raise financing for the project?

In our view, long term contracts (or in target model terms, long term products) have a role to play in developing greater interconnection and in meeting the needs of the customers of those interconnectors. The ability to utilise long term products is clearly beneficial to supporting investment in any interconnector. It is not therefore surprising that ElecLink is looking to strike long term contractual arrangements to underpin their investment. Ultimately customers will determine the product mix which applies to interconnectors and we believe the Target Model recognises this even though most of the focus to date has been on shorter term products. In a system, such as GB, with a lot of renewable, intermittent energy sources in future, longer term products may well play a greater role alongside, and in parallel with, shorter term products (i.e. Day Ahead and Intraday) in providing a balanced range of products and opportunities for market participants.

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?

The key issue here for us is that equivalent rules and principles apply to all long term contractual arrangements and the mechanisms under which they are allocated whether these apply to operational links covered by an exemption (or not) or those which are developed under more regulated arrangements such as Cap and Floor. We would expect normal market principles to determine the proportion and value of long term capacity products.

Question 7: Would you be interested in having capacity reserved for shorter-term timeframes (either yearly, monthly, or day-ahead) and allocated through regulated rules based on the European target model for electricity?

Not applicable

Question 8: Would you be interested in multi-year products allocated through an Open Season? If so please provide detail if possible on how much, for which duration, contacts initiated with ElecLink, on which price basis per MWh? Answers to this question would be considered as confidential.

Not applicable

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?

We have no strong view one way or the other on this point other than to re-emphasise that long term products in whatever form are likely to play a greater role in interconnector commercial products in future. We would also expect the level playing field principle to apply to the allocation rules on all interconnectors offering such products.

Question 10: What would in your view be the most appropriate split of capacity (please answer in MW among the following: day-ahead, monthly, yearly, less than 5 years products, 5 to 20 years products).

This is largely a question for potential customers to opine on so we have no comment.

Question 11: Do you think it appropriate to consider different types of products (PTRs or FTRs) for the same delivery hour?

It is possible for PTR / FTR to coexist as separately defined and allocated products for the same delivery hour, but this should be driven by existing rules as set out in the network codes and/or in line with their use on other GB interconnectors.

Question 12: Do you consider it appropriate for there to be a lower degree of firmness for multiyear products?

The important question here will be to achieve an appropriate risk/reward balance across all parties namely the interconnector owner, those customers trading on the links and the end consumer. We would expect that rules concerning firmness of capacity are applied in a fair and non-discriminatory way across all GB Interconnectors, existing and future, as the network codes are implemented in respect of multi-year and other long term capacity products.

Question 13: Do you consider it important (especially, but not only, for the secondary market), that the firmness of multi-year products would improve when coming closer to delivery time?

No comment.

Question 14: In your view, would such provisions allow for a sufficient level of competition?

No comment.

Question 15: In your view, what criteria should be looked at to authorise a market player to participate in the Open Season?

No comment.

Questions 16: What information should be publicly available concerning the selection criteria and results of the Open Season (name of the holder of the long-term capacity, amount, and price paid for it)? Would publication of aggregated information be appropriate?

We would expect a commensurate level of transparency to that applying to other interconnectors operating in the environment of the IEM.

Question 17: Do you consider it important that remaining capacity after intraday allocation could be used for balancing exchanges? If so, how could this be managed most efficiently?

Again we would expect that exempt interconnectors should offer services for balancing on a commercial basis in a similar way to other more traditionally regulated interconnectors.

Ownership unbundling

ElecLink considers that an exemption from the unbundling obligations in Article 9 is necessary to allow STAR Capital to retain the flexibility to invest in future energy projects.

Question 18: Do you consider that such exemption is necessary? Please take into account the two Commission staff working papers on how the rules on OU are to be applied, and where applicable, the GB relevant supplier test.

We would expect the level playing field principle to apply again in relation to treatment under the unbundling obligations and with respect to ElecLink's certification status and obligations as a TSO.

Question 19: If you consider an exemption from Article 9 to be appropriate, should such an exemption be:

- (a) granted in full with no conditions imposed by the NRAs?
- (b) granted subject to additional conditions imposed by the NRAs?

See answer to question 18.

Question 20: Should an exemption subject to additional conditions be deemed appropriate what conditions do you consider it would be appropriate for the NRAs to impose?

No comment in addition to answer 18.

Question 21: Do you consider inclusion of such provisions necessary to ensure the exemption is not detrimental to the efficient functioning of the internal market?

Question 22: Do you consider inclusion of such provisions would be enough to ensure the exemption is not detrimental to the efficient functioning of the internal market?

Question 23: Do you consider inclusion of any such provisions may be harmful for ElecLink's interconnector project?

In relation to questions 21-23, we do not see how the overriding tenet of equality of treatment could adversely affect the project.

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)?

This is a matter for NGET and RTE to respond to.

Chapter 4: Level of risk attached to investment

Question 25: Taking into consideration existing and planned regulated interconnectors between France and GB, do you consider that the risk attached to ElecLink's project is such that the investment would not take place unless an exemption is granted and that it therefore meets condition (b) of Article 17?

On a generic basis, we do not see the risks attached to ElecLink's project to be any different to those applying to other interconnector projects, both existing and proposed, between GB and other Member States or Territories.

Question 26: What is your assessment of the hypotheses taken by ElecLink in its exemption request? For instance, are the congestion rent provisions and optimal interconnection capacity appropriate?

No comment.

Question 27: Do you consider the scope of the exemption, as requested by ElecLink, is necessary to realise the investment? If not, which of the following would you consider to be the most appropriate and effective means to:

- reduce the exemption in order for it to be proportionate to the risks born by ElecLink?
- reduction of the scope of the exemption on Third Party Access
- reduction of the scope of the exemption on use of revenues?
- reduction of the scope of the exemption on ownership unbundling
- other (please explain)

Question 28: Do you think it would be appropriate to impose a revenue sharing mechanism? If so, does the criteria for a possible revenue sharing mechanism listed in paragraph 4.22 seem relevant to you? Are there any other criteria that you consider would be important?

Question 29: In the reference scenario, ElecLink estimates the project's Internal Rate of Return (IRR) at a level that appears to be significantly higher than allowed regulated returns. Taking into account the project's and ElecLink's specificities, what are your views on the reasonable rate of return for such a project?

In general on questions 27-29, the level of return on HVDC Subsea Interconnector projects must relate to the risk that is being taken on by the developer in projects which can be technically challenging by their nature, over long distances often utilising cutting edge technology. As such one would expect returns on single HVDC sub-sea interconnector project, with limited inherent redundancy, to be higher than typical regulated returns which are applied across a much greater regulated asset base composed of numerous projects (e.g. to the regulated returns applied to an onshore EU TSO such as NGET). As the risks of such single projects are greater, so must be the likely return.

Chapter 5: General questions and other relevant exemption conditions

Question 30: In your overall assessment, do you consider ElecLink has met all of the exemption conditions and so should be granted an exemption?
If so,

Question 31: Should an exemption be given for the duration requested by ElecLink (25 years), or should it be shortened (If so, by how much)?

Question 32: Should this exemption cover all of the provisions for which ElecLink has sought exemption, or should it be an exemption from only some of/parts of the concerned provisions? For this question, you may refer, in particular, to question 27

Question 33: Do you have any other remarks on ElecLink's exemption request?

Question 34: In your opinion, is there any reason to consider that conditions (c), (d) and (e) are not fulfilled? If so, which condition(s) and why?

In respect of questions 30 – 34, and qualified by our responses to the preceding questions, we have no reason to expect that some form of exemption should not be granted. It is our view that some degree of qualification to an exemption granted to ElecLink appears to be necessary for the above stated conditions to be satisfied.

We believe that the scope of any exemption granted should be limited to the minimum necessary to permit the investment to proceed whilst respecting the level playing field principle across all interconnectors, and ensuring the aims of the IEM. This is of particular relevance concerning the common adherence to the market rules of the IEM and the requirement for coordination amongst TSOs set out in the Network Codes.