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All interested parties

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Dear Colleagues

Update on the regulation of transmission connecting non-GB generation to the GB transmission system

In this letter, we provide an update on the regulation of transmission connecting non-GB generation to the GB transmission system ("non-GB connections") following our consultation in November 2013. We summarise the responses to this consultation and explain why our work on non-GB connections is now part of the Integrated Transmission Planning and Regulation (ITPR) project and timelines. We are publishing this letter alongside our consultation 'The regulation of future electricity interconnection: proposal to roll out a cap and floor regime to near-term projects'¹.

Background and work to date

The UK government has been considering the options for trading renewable energy² with other EU Member States as set out in the EU Renewable Energy Directive. A Memorandum of Understanding (MoU)³ was signed between the UK and Irish governments in 2013 to explore the possibility of renewables trading between the two countries. Both governments have outlined their support, while acknowledging the complexities involved in taking forward these types of projects. There are also potential projects with other non-GB states⁴.

The connection of generation projects outside GB jurisdiction directly to the GB transmission system is unprecedented. Ofgem's role is to establish how the GB elements of non-GB connections should be regulated. We must ensure that the regulatory approach is in the interest of existing and future GB consumers.

In our November 2013 consultation we suggested the key principles for the regulation of transmission assets and presented potential regulatory options for non-GB connections. This included consideration of the type of licence that these projects might be granted, potential transmission asset configurations and options for the regulatory regime.

Responses to the consultation

The consultation closed on 17 January 2014. We received over 100 responses, of which 4 were confidential. We have published the non-confidential responses on our website⁵. About a

¹<https://www.ofgem.gov.uk/publications-and-updates/regulation-future-electricity-interconnection-proposal-roll-out-cap-and-floor-regime-near-term-projects>

²https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/251889/130627_Response_to_Call_for_Evidence_on_Renewable_Energy_Trading_Final.pdf

³ Signed on 24th January 2013, <http://www.dcenr.gov.ie/Press+Releases/2013/Irish+and+UK+Energy+MOU.htm>

⁴ 'State' refers to any country, EU Member State or territory.

⁵ <https://www.ofgem.gov.uk/publications-and-updates/regulation-transmission-connecting-non-gb-generation-gb-transmission-system>

third of the non-confidential responses were from industry stakeholders and the balance from Irish residents.

The responses received were from a variety of stakeholders with views broadly aligned within groups. Irish residents opposed the development of large wind farms in their local community and expressed concern over possible environmental, visual and health impacts.

Developers expressed a desire for an early and clear decision on the regulatory and licensing frameworks to progress projects and make investment. GB generators expressed concern that different regimes for GB generation and non-GB generation might lead to unequal treatment. Non-GB generation developers expressed some concern that they would face unequal treatment compared to GB generators if the transmission asset was not offered fixed regulated returns.

Many respondents agreed that the transmission link would be an interconnector under GB law and should be licenced as such. However, they were less certain whether it would meet the EU definition of an interconnector particularly in configurations without market-to-market integration. Some felt that an Offshore Transmission Owner (OFTO) type regime would be more appropriate.

The responses have provided useful insight and input into the issues and questions raised in the consultation. We continue to consider these as we develop our proposals. The appendix provides a summary of respondents' views.

Next steps

Our ITPR project aims to determine whether the system planning and delivery arrangements are appropriate for achieving a long-term efficient integrated transmission network - onshore, offshore and cross-border. Responses to the November 2013 consultation have supported our view that regulation of non-GB connections has a number of interactions and interdependencies with the ITPR project. We need to establish the regime for non-GB connections which best reflects the use of the assets, coordinated system planning and the arrangements for revenue regulation. Therefore we think it is appropriate to continue our work on non-GB connections as part of the ITPR project. The alignment of non-GB connections with our ITPR work also takes into account inter-governmental progress and timing on renewables trading. We expect to publish the draft conclusions on ITPR in September this year.

We are today consulting on proposals for the regulatory regime for near-term investment in electricity interconnectors. This regime is applicable to interconnectors which exclusively connect the GB market with another market. We are proposing that non-GB connections will not be eligible for this regime⁶ while we consider the most appropriate framework as part of ITPR.

As our work progresses, we very much welcome discussions with stakeholders on the issues regarding a potential regulatory framework for non-GB connections raised in the November 2013 consultation. If you would like to talk to us, please email ITPRMailbox@ofgem.gov.uk

Yours faithfully,

Kersti Berge
Partner, Electricity Transmission

⁶ More detail on the scope of the cap and floor regime for near-term interconnectors can be found in chapter 1 of our consultation published alongside this letter. <https://www.ofgem.gov.uk/publications-and-updates/regulation-future-electricity-interconnection-proposal-roll-out-cap-and-floor-regime-near-term-projects>

Appendix: Stakeholders' responses to our consultation on the regulation of non-GB generation connections

The consultation closed on 17 January 2014. We received over 100 responses to the consultation, of which 4 were confidential. We have published the non-confidential responses on our website. 32 of the non-confidential responses were from industry stakeholders and the balance from Irish residents. These are published in full on our website and are also summarised below.

The majority of responses (approximately 70) were from Irish residents who objected to the construction of large wind farm projects in their local communities. Many of these responses did not specifically address the questions posed in the consultation. A summary of the main concerns identified by Irish residents is presented at the end of this appendix. Below is a summary of the industry responses.

General factors driving non-GB connections (Chapter 1)

The majority of respondents sought early clarity on the regulatory and licensing arrangements. They indicated that this would need to be provided before significant progress could be made with project development. Many respondents stated that decisions would need to be made on the regulatory and licensing regime by mid-2014; planning applications would need to commence in early 2015 and final investment decisions made by 2016 for projects to deliver by 2020.

Some respondents considered decisions on the regulatory framework and decisions on the support mechanism, ie Contracts for Difference (CfDs), to be closely linked. Others believed that clarity on the regulatory arrangements was necessary to make progress on the support mechanism.

Respondents also flagged that it was important to also take into account:

- lead times for technical components of the assets
- the development and implementation of European network codes
- the availability of long-term power purchase agreements
- the fact that a more coordinated approach to developing projects would help satisfy the Irish planning authorities
- the regulatory framework for non GB connections would need to be applied to projects beyond Irish Wind, eg for the export for Icelandic power to GB, Isle of Man projects or Channel Island renewable energy.

Principles of transmission regulation (Chapter 2)

This consultation set out the principles we consider relevant for decisions on the regulatory treatment of non-GB connections. We will take these principles into account when assessing the merits of the regulatory options. We outlined 4 principles.

- i. Protecting consumers from exposure to undue costs or risks.
- ii. Promoting efficient capital and operational network costs.
- iii. Promoting efficient and coordinated development of the network.
- iv. Supporting investment in low carbon electricity generation.

The majority of industry respondents agreed these were the correct principles, in particular the need to protect consumers from undue costs and risks.

A significant number of respondents suggested additional principles to consider, including:

- the need to ensure generation and transmission opportunities were future-proofed
- consideration of the Government's objectives for further interconnection
- the creation of the single energy market
- the principle of non-discrimination between GB and non GB generators

- the need for the creation of an attractive investment environment
- consideration of the wider benefits to GB (e.g. creation of jobs, security of supply)
- consideration of how these projects could help in achieving renewable objectives and low carbon infrastructure development.

Legal classification and licensing (Chapter 3)

The consultation sought views on licensing non-GB connections as interconnectors and the impact of alternative classification of projects.

Many respondents broadly agreed with the interpretation that a subsea transmission link would be an interconnector under GB law. They were less certain about whether it would meet the EU definition of an interconnector. Some questioned whether the asset was an EU interconnector if it was a direct and exclusive connection as there would be no market-to-market integration. Some respondents stated they were less concerned with the licensing model chosen as long as it provided investment certainty.

Some stakeholders suggested that the application of an approach similar to the OFTO (offshore transmission owner) regime was appropriate. Some mentioned that GB and non-GB generation connecting to GB should be licensed in the same way. Others noted that there was no need for two licences, and that the regulators should come to an agreement on generation licensing.

Asset configuration (Chapter 4)

The consultation set out possible configurations for non-GB connections. This included configurations that could incorporate the transmission of electricity for other purposes, such as market integration, management of GB network flows and direct and exclusive connections.

The majority of respondents considered a direct and exclusive connection was deliverable by 2020 with clarity on the regulatory and licensing framework and support mechanism from the UK Government. The proposed infrastructure for non-GB connections would not be inherently different in risk to other existing HVDC (high voltage, direct current) projects.

Respondents highlighted limited transmission capacity within the network in north and south Wales, the need for grid reinforcements and the time involved in achieving full planning consent as challenges to the delivery of Irish projects. Additionally some felt the technology required would be more challenging if a coordinated connection approach were to be pursued.

Many respondents also recognised the benefits of configurations that included market-to-market trading and network reinforcements. Benefits included:

- the potential for reduced capital costs and enhanced consumer benefits of an integrated solution
- the increased capacity for cross border trade
- the increased utilisation of transmission assets
- the potential for better operational flexibility and reduced costs, eg reduced reserve requirements
- increased likelihood of accessing EU funding.

Some respondents expressed concern that more regulatory risk could be introduced by market-to-market integration. Others recognised the benefits of configurations incorporating other purposes but felt that this could risk delays to projects.

Regulatory options for non-GB connections (Chapter 5)

The consultation set out the regulatory options for non-GB generation connections. The options range from an interconnector licence with exemption(s) to options that would provide consumer underwriting including Cap and Floor and a fixed revenue model.

Some respondents thought the interconnector licence with exemptions, as currently available, was a feasible option for non-GB connections. Respondents mentioned that if the interconnector licence approach was adopted, then the exemptions would have to be pursued where appropriate. Some respondents highlight the potential difficulty in achieving exemptions.

Many respondents felt that an exemption from use of revenue would be needed to allow investment decisions to be made and for retention of the revenue to fund the transmission investment. A number of stakeholders saw Third Party Access exemptions as important as renewable generation would need guaranteed access to the network in order to secure CfDs. There were mixed views on whether an unbundling exemption was appropriate and should be sought. Many felt that it would depend on the project proposal but some respondents thought it would be inappropriate if unbundling was not required as this could lead to unfair competition with GB generators. Others also felt that it would be inappropriate if the project was also a market to market interconnector.

A number of parties felt a regulated approach, such as the offshore transmission regime for non-GB connections, should be pursued as it could help reduce cost of capital. Some respondents argued that it was important to ensure non-GB generators faced the same treatment as GB generators.

Some parties considered that neither a Cap and Floor nor a regulated approach should be considered. Others thought a fixed revenue, but not Cap and Floor, would be appropriate for a direct and exclusive connection. These respondents believed that a fixed revenue would make the projects more attractive to investors, while others mentioned that a fixed revenue approach may be more attractive to the European Commission, and remove the need for exemptions.

Other regulatory issues (Chapter 6)

The consultation set out other regulatory challenges we have identified for connecting non-GB generation projects to the GB network. These include the areas of capacity allocation on an interconnector, interactions with the GB network and cost allocation.

There were a variety of views provided in relation to capacity access:

- Some respondents felt long-term access for the non-GB generator for use of the interconnector capacity would be necessary, especially to secure CfDs.
- Other respondents mentioned the need to comply with European rules, for instance the need for non-discriminatory access to the interconnector to be offered to all users.
- Some parties stressed the need for equal treatment of GB and non-GB generators in the context of access to the GB transmission system.

A few stakeholders noted that a different connections approach may be required for non-GB generators, due to the different risks, costs, timescales and revenues faced by non-GB generators and interconnectors as compared with GB generators. There were concerns that if multiple individual offers for connection were made, this might not allow an approach that would contribute to market integration and wider network benefit.

Stakeholder views varied on charging and cost allocation issues. Some thought tariffs should be set through contractual negotiations between the non-GB generation asset owner and the transmission asset owner while others thought the connection of non-GB generation to an interconnector required a new charging mechanism. Some respondents thought the charging and cost allocation provisions should be the same for GB and non-GB generation but another thought that if the transmission connection is considered to be an interconnector then it should be exempt from GB costs such as transmission charges and use of system charges.

Irish Resident Responses

Irish resident and local campaign groups' responses were aligned in opposing non-GB projects, with a number focusing on the impact of potential projects in the Midlands of Ireland. 56 of the responses were standardised.

A number of reasons were given in the responses for these objections. The role of Ofgem in the process is to ensure there is a regulatory framework in place to support such projects, in the event that the two Governments come to an agreement about their development and support, and developers are in a position to develop them. Therefore many of the objections raised by Irish residents relate to issues outside of Ofgem's control.

The Irish residents who responded recognised that that these projects are complex already but were concerned that if the UK was no longer part of the EU then the complexity would increase further.

Residents stated that there is a constitutional right in Ireland that all means of power production be used for the benefit of the Irish and therefore clarification would be required before projects could proceed to export to the UK.

Some residents raised concerns about the impact on UK consumer bills as the projects would be funded by subsidies from the UK. Some felt that there would be a requirement for Irish citizens to pay for the transmission links to support these projects, increasing electricity bills. Residents also raised concerns that the project could strain UK / Irish relations.

The vast majority of responses outlined concerns of the various environmental and visual impacts these projects could have on the landscape in the Irish Midlands and the health impacts on its residents.

For the full list of non-confidential responses, please see:

<https://www.ofgem.gov.uk/publications-and-updates/regulation-transmission-connecting-non-gb-generation-gb-transmission-system>