

Memo



Subject The regulation of future electricity interconnection - proposal to roll out near term regime

To Jon Parker
Future Networks, Electricity Transmission,
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Copy

From Ulrik Stridbæk

Regarding Consultation document

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Our ref. lasss

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Thank you for the opportunity to respond to this consultation. DONG Energy is an utility company and not an interconnector developer. Thus, our comments in this consultation response are from the viewpoint of an international energy company focused on efficient market operation, European integration and the transitions to low carbon technologies.

Besides being necessary to integrate electricity markets, interconnectors are highly cost effective facilitators of the transition of the European electricity system and to maintain or increase system security. Therefore, we welcome Ofgem's consulting on a near term interconnector regime and the intention to open up an application window in August/September this year. The initiative seems timely in light of the deteriorating GB capacity margins. New interconnectors can contribute to the margin if timely and appropriate regulatory actions are taken.

The near term regime should encourage the most mature and profitable projects to come forward. It must, however, be stressed that "the right level of interconnection" seen from a social welfare perspective is unlikely to be delivered by projects driven solely by arbitrage value (congestion rents).¹ To reach a right level of interconnection, we expect that projects will need a mechanism that allow for an appropriate level of risk sharing with GB consumers putting a value on the contribution to system security. This is particularly so, since the decarbonisation is a politically driven project that makes it difficult for transmission investors to predict the future generation portfolio and price patterns. At the same time we know, that timely investments in interconnectors will be a prerequisite for successful build-out of new low-carbon technologies. We welcome Ofgem's recognition of this in the consultation document.

¹ Referring to the consultation document where it is concluded that the current regime does not deliver "the right level of interconnection."

To bring forward additional projects, other opportunities (developer led or centrally identified) must be established. We await the conclusions of the Integrated Transmission Planning and Regulation (ITPR) project, and remain hopeful that a mechanism for achieving a social welfare optimal build-out of interconnectors will be identified and secured.

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With the proposed methods to calculate the floor in the near term regime we believe there is a risk that projects with significant benefits for GB consumers will not be developed and eventually built. In particular we note that consumer benefits from increased security of supply are not directly valued in the proposed mechanism. We propose that Ofgem considers a project specific up-lift of the floor, if significant additional consumer benefits can be demonstrated.

Since the GB capacity market is likely to have a downward effect on GB wholesale prices, the arbitrage value that can be realised from interconnectors decreases. Hence, the capacity value and contribution to security of supply that interconnectors bring to the GB market must be incorporated in the business case by other means, directly or indirectly. Interconnectors can get a revenue from the market by allowing them to participate *directly* in the market. If de-rated interconnector capacity is deducted from the demand for capacity in the capacity market, the interconnector participate *indirectly* in the market. Both methods should increase the revenue obtained by the interconnector and make more projects viable.

Our answers to the specific questions:

Question 1: Do you agree that making the developer-led cap and floor regime available to near term projects would be in GB consumers' interests?

Yes, but we see a risk of the proposed mechanism only attracting the most profitable stand-alone projects in the market and not bringing forward other interconnectors that would also clearly benefit GB consumers. The ITPR design is likely to be crucial in providing further incentives for meeting that objective. For GB consumers to benefit from the contribution of interconnectors to the capacity margin, the ITPR regime or a possible uplift of the floor must be in place before irreversible capacity investment are done driven by the capacity market.

Question 2: What are your views on the cap and floor regime design?

Since DONG Energy is not an investor in interconnectors, we will refrain from putting in detailed comments on the specific cap/floor design. In order to unlock the GB consumer benefits related to system security it could be considered to grant an up-lift to the floor if significant GB system security benefits can be demonstrated.

Question 3: What are your views on our proposed approach to the cost assessment process?

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No comments.

Question 4: Where do you think we may need to be flexible to accommodate the specifics of different projects and other national approaches?

We support the flexibility proposed recognising that the GB interconnector regulation differs from regulation in connecting markets.

Question 5: What are your views on the framework and processes set out in this document?

No comments.

Question 6: What are your views on the timing and the information that we would require developers to submit?

No comments.

Question 7: What are your views on our proposed eligibility test and the specific provisions that we are minded to include in such a test?

No comments.

Question 8: What are your views on how we intend to assess projects at the initial and final project assessment stages?

No comments.

Question 9: What are your views on the need for and timing of future windows?

As mentioned above the August/September window is likely to only bring forward the most attractive stand-alone projects leaving behind other projects with significant GB consumer benefits. Other opportunities will be needed to develop and build these remaining projects. The new ITPR model might be such an opportunity.

Question 10: What are your views on the options to protect consumers from the risk of a needs case changing between our decision to award a cap and floor and a project's final investment decisions?

No comments.

Question 11: What are your views regarding the next steps?

The proposed next steps seem appropriate.

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Again we thank you for being consulted and are very happy to answer any questions you might have in this regard.

Best regards

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Director
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