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Dear Jon,

**Consultation on ‘The regulation of future electricity interconnection: Proposal to roll out a cap and floor regime to near-term projects’**

Greater interconnection of the GB electricity transmission system with Europe further links markets and provides trading opportunities that ultimately benefit the end consumer. Increased interconnection also aids the development of a single European energy market and so helps fulfil the objectives of the EU third package. As such, we welcome the timing of this consultation and believe providing greater regulatory certainty for developers will aid the delivery of such projects in the near term. (That is before 2020). This will ensure that GB is well placed to enjoy the benefits interconnection can provide to consumers and we are determined to play our part in helping to bring this about.

The main focus of our comments are on the role of the SO, both in the context of the roll out of the proposed process, and potentially beyond (given the potential ‘enhanced SO’ role that is being discussed under ITPR). We also cover the management of perceived conflicts of interest and the cost benefit analysis criteria.

We begin by discussing the process underpinning the proposed roll out.

***Proposed roll out process***

We have previously highlighted that we are open minded as to the best way to get interconnector projects moving and believe that pragmatism is important, to ensure that the benefits that greater levels of interconnection could bring are realised. The proposed roll out of a cap and floor regime to near term projects as developed and piloted by the Nemo project seems to be a sensible and pragmatic approach that will provide an alternative regulatory route to the EU Exemption process for interconnector projects within GB, ahead of any final conclusions of Integrated Transmission Planning and Regulation (ITPR) project.

We support Ofgem’s decision to only include the roll out of this process to market-to-market interconnector projects. As previously stated in our response to the Ofgem consultation on the regulation of transmission connecting non-GB generation to the GB Electricity transmission system, it is not clear a cap and floor regime would provide benefits to projects which are connecting non GB generation to the GB network, as there is no, or only limited, market risk. This is because such projects are likely to be underpinned by a Contract for Difference (CfD) under EMR.

We understand the need for the process to be undertaken in an expedient manner as there is limited time to ensure delivery ahead of 2020. However, we do have some concerns regarding the short timescales in which the process is planned to be undertaken and the impact this will have upon all parties to provide evidence to support and resource the process. The impact will depend upon the number of applicants, the amount of evidence Ofgem require and the amount of support Ofgem seeks from both us as SO and also from the Transmission Owners (TO), who may need to undertake significant studies to support the cap and floor licence application process. To meet the challenges of

the proposed process and deliver, it would be beneficial for all parties to explore both the practical and resourcing implications together.

In addition, we consider that the option of more “application windows,” in the future for projects aiming to connect in the early 2020’s may be appropriate to ensure that the process does not drive the wrong behaviours (e.g. projects push their planned timescale to meet what they perceive is a single window, or drive projects to push connection dates forward ahead of 2020). It may be appropriate for Ofgem to provide confidence to developers that there will be other opportunities for interconnectors to apply for a cap and floor regime in the future so as to avoid developers applying before their project is at a sufficient stage of development.

The proposed process suggests that developers will provide a Strategic Wider Works (SWW) style submission. Given our experience of SWW and knowledge of the projects we have concerns regarding how developers would be able to undertake a ‘least worst regret investment’ decision<sup>1</sup>. We suggest it may be beneficial for Ofgem to clarify the requirements for developers and we are happy to discuss how we can support the process and share our experience.

The projects likely to apply in this application window will have received a connection agreement ahead of the introduction of the interim connection process and CION (Connections Infrastructure Options Note). We have worked closely with our customers and where possible we have applied a retrospective CION process to capture key information to aid the regulatory decision making process. Given our current position we are able to support the process in the following manner:

- confirm evidence associated with the connection process submitted by the developer and sharing the retrospective CION documentation, if completed;
- confirm efficiency of delivery for the connection site and associated onshore works.

In addition, it may be possible to provide information regarding the potential range of operational benefits the interconnector may be able to provide such as balancing services etc. The analysis to assess any potential operational benefits will need to be based upon a number of assumptions and possibly the development of scenarios due to the level of uncertainty in terms of the position of the SO at the remote end and technology impacts. It should be noted that this type of analysis has not been undertaken previously during the connection application process and therefore has a resource and timing implication.

### ***Role of the System Operator***

As the SO, we are determined to play a full part in helping the UK to benefit from a greater degree of interconnection. We worked closely with Ofgem and others to help develop the interim process. We recognise that the opportunity exists to do more, and this closely links with the developments being considered as part of the ITPR project.

We would note that it is unclear from the consultation as to the full implications in terms of what the System Operator would be required to do under these proposals. The relevant passage (paragraph 4.35) reads: “Input from NETSO on the efficiency of the timing and location of the connection point, and potentially also including the value of interconnector project for system operation (e.g. balancing)”. Clarity over the outputs Ofgem requires is vital to support the proposed process and deliver projects ahead of 2020. We make no presumptions but look forward to working with Ofgem to understand in detail, so that we can plan and resource in a way that is consistent with ensuring that these projects are appropriately developed. Some of the outputs which Ofgem would find it useful for us to provide may be more consistent with an ‘enhanced SO’ role as discussed below.

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<sup>1</sup> Please refer to section 4.5.3 on page 155 of 2013 ETYS for a detailed definition of least worst regret investment process  
<http://www2.nationalgrid.com/UK/Industry-information/Future-of-Energy/Electricity-Ten-Year-Statement/>

At present the interconnector regime is driven by the developer with limited obligations on them to fully coordinate and share information with the SO. In practice, in the past each developer has acted in a different manner with different degrees of coordination and information sharing. Furthermore at present, no one party has access to all the data to be able to determine the optimal timing and connection location of an interconnector from both a European and GB perspective. In our current role it is difficult for us to challenge the overall efficiency of timing or location of the entire project including the broader social welfare benefits and if we disagree with the developer we would need to refer the contractual connection offer to Ofgem for determination. Consequently, this led us to develop and introduce the interim connection process for interconnector applications in January this year, which includes the adoption of the CION process. Going forward the adoption of the CION will aid coordination and information sharing that will help support regulatory decisions in the future.

In the future if an Enhanced SO model was introduced as a result of the ITPR project (as per Ofgem minded too position summer 2013), there is scope to provide additional support and information, if this is deemed to be service Ofgem finds it helpful for us to provide. It is possible to expand our role within Europe building on the ENTSO-E Ten Year Network Development Plan (TYNDP) and the GB Electricity Ten Year Statement (ETYS) to provide the market with greater information regarding interconnector opportunities in terms of levels of capacity and connection areas within GB. To do this would require the development of a European modelling and resource capability. We could also provide specific need case information to Ofgem on the GB transmission system impact of an interconnection project. In addition, we could establish processes and scenarios that could consider the value interconnectors provided to the system and balancing services, such as reserve, response, black start, reactive power etc.

### ***Conflicts of interest***

Previously, industry responses to the ITPR project consultations have raised concerns regarding our role and the potential for conflicts of interest. Although not raised within this consultation we feel it is worth restating our previous position. Conflicts of interest is an area which we take very seriously and keep continually under review. We consider that we are in good shape to manage these risks and significant safeguards are already in place to manage the potential conflict between National Grid Electricity Transmission NGET and National Grid's unlicensed business development function. In addition, further steps are being introduced to reduce / eliminate / manage such risk by the targeted business separation rules that will be introduced into NGET's transmission licence as part of EMR.

We continue to believe that transparency is the key to mitigating against perceived conflicts of interest in relation to our role within this process and additional measures could be facilitated through consulted methodologies, process, stakeholder engagement and greater information publication. We welcome the opportunity to discuss and develop options, if required, to provide confidence to stakeholders that any support we provide to the roll out of the cap and floor regime for near term projects (and in a broader ITPR project context).

### ***Consumer benefit test***

The consultation refers to projects needing to be in "consumers' interests". Going forward it is important to understand how this test will be applied and in particular the breadth of this test, as this will impact upon the evidence provided by NGET and others (e.g. TOs) to support the applications, and the ability of the SO to support the process. The Third Package and its associated legislation including Network Codes refer more usually to enhancing, optimising or maximising social welfare. Interconnectors provide benefits to both consumers and producers and at different times and in different proportions in the markets that they interconnect. We fully recognise Ofgem's position is driven by its statutory duties (and other NRA's may have similar constraints). However, we consider that greater clarity is required regarding how those duties are applied in the case of interconnector developments

Answers to the specific questions raised within the consultation document can be found in Appendix 1 of this document.

We are happy to discuss our views contained within this letter further should that be helpful. For further details, please contact Emma Carr (emma.j.carr@nationalgrid.com). Our response is not considered confidential and is provided on behalf of National Grid Electricity Transmission (NGET). We are therefore happy for it to be placed on the Ofgem website and shared wider for the purposes of this project and the ITPR project.

Yours sincerely,



**Mike Calviou**  
**Director, Transmission Network Service**

**Appendix 1 – Questions raised within the consultation on the regulation of future electricity interconnection: Proposal to roll out a cap and floor regime to near-term projects**

*Question 1 – Do you agree that making the developer led cap and floor regime available to the near term projects would be in the GB consumer's interests?*

As noted above we consider the timing of this consultation important to deliver the potential benefits of greater interconnection in the near term to provide the opportunity for GB consumers. We are pragmatic as to the best way to get interconnector projects moving and “cap and floor” offers an alternative regulated route to the EU Exemption process for interconnector projects. However, we have requested clarification regarding the “consumer interest” test and how this will be applied in practice because it will have a bearing on how we support of Ofgem in this process.

Interconnectors provide benefits to both consumers and producers at different times and in different proportions in the markets that they interconnect. These benefits span those that are inherent in any trading arrangement that links different markets, providing a range of opportunities for consumers that did not previously exist. Hence, interconnectors play a powerful role in society in enabling consumers to make meaningful choices and to seek real value in an extended market place. A narrow domestic consumer interest test of the value of an interconnector development therefore risks being a barrier to regulatory approval, a barrier to the delivery of a more efficient internal market, and a barrier to delivering greater social welfare for all European stakeholders. It also risks understating some of the broader benefits that could accrue to consumers on a European level (including those in the GB) of these projects.

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

The proposed design, framework and process are a pragmatic approach and consistent with Ofgem's other assessment processes. We agree that greater interconnection can offer significant benefits to existing and future consumers. We support a design that sits within the existing legal framework within GB and the EU that enables the possibility of new interconnector projects prior to 2020 without significant changes being required. However, we have raised some clarifications regarding the process in our response and are happy to discuss further, if required.

*Question 3 – What are your views on our proposed approach to the cost assessment?*

Ofgem has proposed that applications from interconnector developers include a needs case akin to those provided for Strategic Wider Works (SWW) projects. In our experience of working on SWW projects, and given the particular complexities of interconnectors, this raises some concerns. A SWW is generally based on determining “least worst regret decisions” against a range of scenarios that considers all costs and benefits. It is not clear to us that an individual developer will have all the necessary information to support such a process.

In our experience, Ofgem seeks to identify unit cost figures for key project elements and uses these to assess the efficiency of a project. Transmission unit costs are more readily available than for unique interconnector projects. It is therefore important for Ofgem to also consider market conditions prevailing at the time that relevant investments are scheduled to take place as part of the assessment.

Ofgem's approach to SWW has been very rigorous with many requests to the relevant TO for additional data and clarifications. Consultations with stakeholders are undertaken at regular intervals regarding the cost and benefits that accrue from the projects. Given the additional complexity of interconnector projects it is likely that there will be greater uncertainty regarding information and assumptions used. It will therefore be important that Ofgem pragmatically considers the appropriateness of SWW assessment. Also materiality of any data that may be incomplete or not to the same level of detail. Going forward it may be more appropriate to obtain costs via a procurement process that takes into account the state of the HVDC supply chain market.

In addition, the proposed process does not explain how projects that may be competing will be assessed and how decisions will be made. It should also be noted that projects may not only be competing at a GB level but also a European level.

We are happy to discuss these issues further and provide assistance in developing the regime, where possible. Also it may be beneficial for a workshop to be held, ahead of the application window opening, to clarify the evidence and information required for all interested parties.

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

Each interconnector project is different due to its nature, connecting country, location and technical design. The aim of the cap and floor process is to provide greater certainty as an alternative regulatory route for EU Exemptions for near term projects. As a consequence there needs to be a balance between flexibility and certainty. The process and high level principles can be applicable to all projects but it is likely there will need to be flexibility to take into account the requirements of the connecting country and any specific or unique aspects of each project.

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

The proposed design, framework and process are a pragmatic approach and consistent with Ofgem's other assessment processes. As detailed above we have raised some concerns regarding:

- the need to clarify our role in supporting Ofgem in the process and any additional resources/capabilities that may be required to deliver the require input and analysis, and how this relates to a potential 'enhanced SO' role under ITPR.
- the need to clarify the consumer welfare test and ensuring all the value of interconnection is captured.
- the timing, the potential for only one application window and the likely impact this will have on all parties.
- the need to clarify the SWW evidence developers are required to provide (please refer to our response to question 3 above).

We would like to highlight that trained resource in these areas would take time either to source or train. We are happy to work with Ofgem to ensure we can deliver the support required within the timescales taking into account the resource market and time required to develop appropriate tools/models.

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

Please also refer to our response to question 3 above.

*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?*

The proposed eligibility test is a practical approach to ensure resources of all parties are focused on those projects most likely to deliver prior to 2020. Ofgem has made clear that they will consider consumers' interests<sup>2</sup> and that they will also consider social welfare (4.35 and Appendix 3). The developers are seeking to develop network infrastructure that will be underwritten and possibly funded by consumers. Developers will be certified as TSO (in GB). It is therefore essential that projects are developed in a manner that is coordinated and that is economic and efficient when viewed holistically (rather than on the narrow basis of the developer's assets alone). Given the above we consider that the

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<sup>2</sup> As noted elsewhere in this response we look forward to clarification of what this means in practice



Interconnector Licence that developers must possess in order to fulfil the eligibility criteria should include a condition consistent with Section 9, 2 (a) of the Electricity Act requiring the developer to develop (and maintain) the interconnector in an efficient, coordinated and economical manner.

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

Please refer to our response to questions above.

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

The need and timing of future windows will depend upon the number of projects with a post 2020 connection aspiration and the outcome and implementation of the ITPR project. It may be necessary for an additional window to be opened within 2015/16 to support projects that wish to connect in the early 20's, in order that the timetable for implementation of ITPR does not act as a barrier to such projects.

*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?*

The options summarised below to protect consumers from risk within the proposed process are sensible measures to ensure risk is managed and with the party best placed to manage such risks, the developer.

- Developers require to submit credible plans for reaching Financial Investment Decision
- Time limits for developers to submit information
- Reducing the duration of the cap and floor from 25 years due to delays
- Allowing reopener of the cap and floor decision if the date or project functionality subsequently changes.

The time limit approach for developers to provide information to Ofgem provides comfort to ensure decisions are based upon the most up to date and relevant information. The ability to re-open the assessment process, if significant changes occur provides a clear process for developer's whilst protecting the needs of the consumer.

*Question 11- What are your views regarding next steps?*

Given the proposed timescales for delivery of the process at this stage is it unlikely code changes could be delivered ahead of the proposed process to facilitate the introduction of the cap and floor regime.

To deliver the benefits of greater interconnection greater coordination is required. The interim connection process for interconnectors is a step in the right direction to encourage greater coordination. However, it may be appropriate for coordination obligations to form part of the developers interconnector licence similar section 9 (2) (a) of the Electricity Act and detailed within our response to question 7 above.

Currently, interconnectors apply and fall under the Connection Use of System Code CUSC. Going forward with the development of the proposed cap and floor regime this may no longer be the most appropriate code. The SO–TO Code (STC) provides a framework for us and licensed TSO engagement and coordination but focuses on ensuring that the NETSO is able to offer a connection to an applicant seeking to connect to or use the National Electricity Transmission System (NETS). The STC process allows for the recovery of revenues from SO to the TO's. The CUSC and charging methodologies provide the mechanism for any revenues to be recovered or repaid via Transmission Use of System charges TNUoS. As noted in our response to the NEMO consultation (12 February 2014), code changes to CUSC, charging methodologies, our licence and interconnectors and possibly STC will be

required ahead of any project connection to facilitate the funding mechanism of the cap and floor process.

Our principle concern in this area is to ensure that our customers obtain as much predictability regarding future changes in charges resulting from financial flows between NGET and interconnector owners subject to revenues below the floor or above the cap. We will continue to work with Ofgem to develop the appropriate Licence conditions to give effect to a cap and floor regime.

It is for wider consideration under ITPR, as to whether the STC should be extended to include interconnector licensees, (although not all procedures within the STC will be applicable and hence a review of the current framework will be required). We are holding discussions with Ofgem regarding this and will continue to work on detailed proposals ahead of any project connecting.