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NorthConnect response to Ofgem consultation

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

The NorthConnect project is a joint venture planning to build and operate an HVDC interconnector between Norway and the UK. The company is owned by: Vattenfall (SWE), Agder Energi (N), Lyse (N) and E-CO (N). They are reputable energy market players with the necessary skills and capacity for execution of such large infrastructure projects.

NorthConnect agrees with the statement of Ofgem that interconnectors can offer significant benefits to existing and future consumers, and welcomes the effort of Ofgem to facilitate interconnector investments.

NorthConnect believes that to facilitate 3rd party interconnectors it is important to solve the following key issues related to the current regulatory framework for development of much needed cross-border capacity in Europe:

- Getting acceptance in Norway, Sweden and the EU that market coupled 3rd party Interconnector projects are important supplements to TSO projects;
- Reduce risk to attract new types of investors, as well as a new type of owners with the skills and execution capacity for development and construction of interconnectors; and

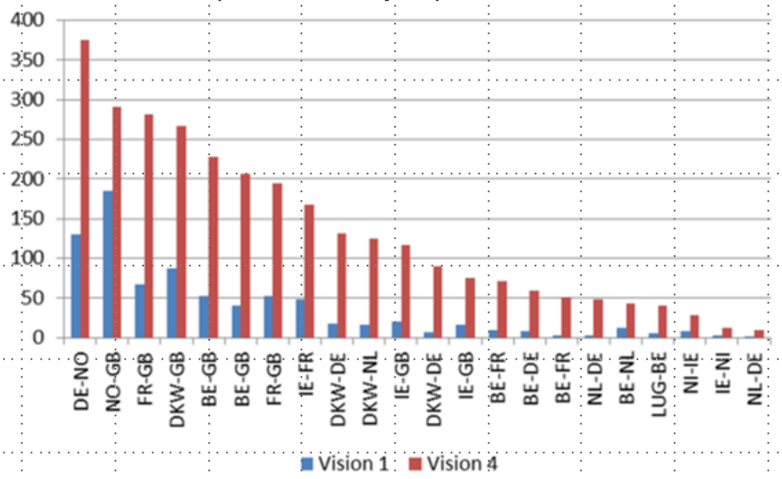
NorthConnect considers the proposed Cap and Floor regime as a reasonable alternative to the current regulation of merchant interconnectors to stimulate 3rd party investment. However, it is crucial that the current merchant interconnector model with revenue exemption will continue as an alternative regulatory route for 3rd party interconnectors, and that applications for exemptions are reviewed on equal grounds to projects applying for Cap and Floor.

NorthConnect responded to the previous consultation (May 2013) relating to the Cap and Floor regime. Whilst NorthConnect supported the need for an availability incentive, the need for a distinct definition of target availability was underlined. NorthConnect are still concerned about implications for interconnector availability arising from current development of the Entso-E Draft Network code on Capacity Allocation and Congestion Management (CACM), and keep the view that any curtailment in capacity arising from market design or other market related factors should not have consequences for the Cap through availability incentives. The same applies for any country internal bottlenecks reducing interconnector capacities. All in all, NorthConnect see a need for a definition of reasons for capacity reductions that are outside of the interconnector Developer’s control, and not viable for revenue adjustment at the Cap. This also applies to the proposed minimum availability threshold (80%) required for floor payments.

NorthConnect support the proposed introduction of within-period annual adjustment of floor payment, and believe that further specification of the terms for receiving floor payment between the 5 year assessment periods is important for financing of projects.

In the Context (page 2) Ofgem writes: *"Only a limited number of interconnectors have been built under the current regulatory framework. Therefore we have been evaluating and consulting on alternative regulatory options that would facilitate investment in interconnection where that is in consumers' interests"*. NorthConnect would like to point out that the limited investments in interconnectors could be explained by regulations in the GB energy market, giving subsidies to capacity and renewable energy, which do not reveal the true value of interconnectors. The figures from the (draft) ENTSO-E TYNDP 2014 provided in the chart below below shows how highly economically profitable an interconnector between Norway and GB is regarded in an EU perspective. Based on this, it is important to ensure that interconnectors (or energy transmitted through interconnectors) receive the true value of its potential contribution to GB society and consumers. This could be achieved by structuring interconnector participation in energy-only markets without any distorting regulations vis-à-vis subsidies for capacity or renewable energy, and putting interconnection on equal terms with domestic projects so that interconnectors actually get built.

Economic benefit (million Euro / year)



Ofgem proposes that any interconnector revenue arising from capacity remuneration mechanism (CRM) should be included in the Cap and Floor regulatory mechanism. NorthConnect would like to point out that a CRM in itself is likely to constitute a cap on wholesale market revenues through its impact on price formation, and such pose a significant threat to interconnector revenues and investments, hence we believe that any mechanism should also take account of the risk for the cable owner following a CRM. Furthermore, in order to serve for a cost efficient realization of the targeted capacity level in the best interest of UK end-users, it is of utmost importance that the regulator takes into account whether or not the cable capacity is sufficiently incentivized to optimize its contribution to a secure supply when fixing that cap and floor

With regards to the application process, NorthConnect understand and agree with the need for application windows for assessing different projects in relation to each other. The proposed timelines, however, seem tight and should be evaluated in relation to regulatory processes in connected countries / jurisdictions.

In the Executive Summary Ofgem writes: *"Projects will be eligible for this window if they have a connection date before the end of 2020 and meet other proposed criteria. Our focus is on providing a framework for projects looking to make significant investment decisions in 2015"*. This seems to indicate that the proposed cap-and-floor model will only be available for projects already well ahead in the planning process and ready to make investment decision in 2015. Ofgem should make it clearer if this cap-and-floor mechanism will be an opportunity also for projects beyond those who make investment decision in 2015. The development of these projects requires certainty and stability in the Regulatory framework.

Please find answers to specific questions in the attached Appendix.

Kristiansand, 2014.07.15

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Appendix – Specific Questions

1: Do you agree that making the developer-led cap and floor regime available to near term projects would be in GB consumer's interest?
Yes, but alternative regulations routes for merchant interconnectors should be kept open.

Question 2: What are your views on the cap and floor regime design?
NorthConnect agrees that the proposed design could contribute to attracting necessary interconnector investments, however, we see a need for further specifications on *i*) availability incentives*, ii)* within period payments of Floor and *iii)* Cap and Floor in relation to regulation in other countries / jurisdictions. NorthConnect would also like to underline the importance of setting the cap high enough to still make it attractive and give the necessary incentives to invest in interconnectors.

Question 3: What are your views on our proposed approach to the cost assessment process?
NorthConnect agrees that the proposed hybrid solution for cost assessment is preferable.

Question 5: What are your views on the framework and processes set out in this document?
NorthConnect agrees with the use of application windows to assess the relative benefits of projects and combination of projects, and understand the need for a pre-defined application period.

Question 6: What are your views on the timing and the information that we would require developers to submit?
While NorthConnect understand that time limits are needed to keep Cap and Floor decisions relevant, the time limits need to take account of financing and regulatory issues, such as regulation in connected countries / jurisdictions.

Question 9: What are your views on the need for and timing of future windows?
NorthConnect believes that early announcement of future windows is necessary for Developers to be able to prepare all required information and documentation.

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?
NorthConnect finds this question unclear with regards to timelines and in relation to a hybrid cost assessment. Under the hybrid solution, an eligible Capex cost is awarded ahead of FID. NorthConnect does not understand why the evaluation of a needs case should change during this

period, and do not believe that the Developer should be expected to cover the risk of a needs case changing.