

ITPR team
Ofgem
9 Millbank
London
SW1P 3GE

21st November 2014

Dear Sir/Madam,

ITPR Draft Conclusions

Transmission Investment manages one of the largest offshore electricity transmission portfolios in terms of the capacity of offshore wind connected. Our portfolio of assets includes the connections to the Robin Rigg, Gunfleet Sands, Barrow, Ormonde and Lincs offshore wind farms - a portfolio of over 800MW (circa £600m in capital employed). We are also developing, or advising on the development of, several electricity interconnector projects between Britain and the rest of Europe.

In particular, in partnership with the French national grid company RTE, we are leading on the development of an up to 1400MW electricity interconnector between France and Britain via Alderney (the “FAB” project). This is one of the five projects qualified for cap & floor regulation through Ofgem’s first application window.

For more than five years we have been advocating a greater role for third parties in investing in transmission onshore and offshore, and in interconnection.

We are therefore pleased with the direction of travel of the ITPR project and we largely support the measures it is proposing to take. We believe that these initial conclusions on ITPR should be viewed as a staging post along the way and not the ultimate destination – and in fact the consultation document recognises that this may indeed be the case in several areas.

Interconnection

We continue to support the pre-ITPR decision to allow near term interconnector projects access to the cap & floor regulatory model. This model should unlock several more GW of interconnection capacity between GB and the continent, including our FAB project, which should not only earn their promoters a reasonable (but capped) return on investment but should also provide significantly more value to GB consumers.

However, this decision was long overdue and in our view policy makers and regulators have not hitherto struck the correct balance in protecting consumers' interests between:

- i) on the one hand the need to avoid inefficient investment; and
- ii) on the other ensuring that the benefits of interconnection are captured by consumers.

and we believe that this has resulted in consumers missing out on £bns per annum in lost benefits.

It should also be noted however that there is still considerable work to be done on the cap & floor model to:

- i) make it acceptable for non- or limited recourse financed projects (for example annual application of floor);
- ii) and for low cost equity providers (in particular no true up after five years as this severely limits yield, and the level of the floor) rather than just large balance sheet players.

ITPR essentially recommends an extension of the cap & floor model.

In our view this risks a continuation of under investment in interconnection capacity once the initial group of cap & floor projects have progressed to completion. However, we note that Ofgem is going to keep this decision under review as more interconnection is developed and therefore as projects become less profitable. In that light we support it but policy makers should not be allowed let the situation drift if the cap & floor model ceases to be effective in bringing forward interconnection that has a net consumer benefit.

In our view the cap & floor model is a compromise between market and regulated models that will ultimately fail to provide the benefits of each but will have the drawbacks of both. Eventually interconnection must be treated as an asset that facilitates the market (i.e. is treated as transmission as it is in the rest of Europe) and is not a market player (say akin to generation). For too long it has been neither one nor the other, for example it has to earn its revenues from the energy market (like generation), but:

- i) It will have its returns capped either through the cap & floor model (if regulated) or by Europe if merchant (not like generation);
- ii) It may not be able to access long-term capacity contracts (even if new build, unlike generation) but it may be able to access short-term capacity contracts;
- iii) It has to apply for a connection like generation but it doesn't have access to connect & manage and it does not pay TNUoS charges.
- iv) Despite being exposed to market conditions the owners are expected to be unbundled, which makes it impossible for the companies that best understand the risks associated with energy trading to invest in cap-and-floor interconnector projects.

Treating interconnection like transmission, fully regulated, centrally planned, but competitively delivered, seems the only sensible end game.

Competition in Onshore

We have been a long standing advocate of bringing to onshore transmission the benefits of competition and the opportunities for third parties to invest.

Ofgem first suggested the idea of bringing competition into the delivery of onshore transmission in January 2010. So it has taken a long time to reach this point; but it is very positive that there is now a timetable within which a first tender could be run (2016 or 17).

It is not possible to comment too much on the detail of the proposed process as these have not yet been published for consultation. The detail we have seen we broadly support in terms of asset size and separability and we hope to be an active contributor in the process Ofgem undertakes to define this regime in detail.

We do believe that, as other countries have seen, there will be an enormous appetite for tendered projects, and that if run fairly and openly it could change the landscape of onshore transmission quite radically.

We also support continuity in regulatory treatment as being very important for the confidence of all investors.

Our one big area of concern though is with whether the roles that the SO and the incumbent TOs will play in this process will make for a fair and transparent process.

Conflicts of Interest

We believe that the consultation document correctly summarises the main conflicts of interest that could arise and we note the processes and obligations that will be put into place in order to try and mitigate these conflicts of interest. Our main concern is the conflicts of interest that could arise within the SO given its affiliation with an onshore TO, an interconnector developer, and potentially a competitive TO. We are still of the view that the measures proposed by the consultation document will not be sufficient to either deal with the conflicts of interest, or almost as importantly, deal with the perception of conflicts of interest. In our view removing the conflict itself is the only certain way of dealing with this which in practice would mean complete (ownership) separation of the SO and therefore an ISO model. Again we recognise that Ofgem will keep this under review.

There is an outstanding question of whether the incumbent TOs will be allowed to bid for competitively delivered projects within their geographic areas. Our default position is that they should not but we understand that this is the subject of further assessment by Ofgem.

We provide specific responses to Ofgem's consultation responses in the attached annex.



Sixth Floor · 135 Cannon Street · London · EC4N 5BP
T +44 20 3668 6680 www.transmissioninvestment.com

We strongly support all the steps proposed by the draft conclusions document but we also believe that it will be in consumers' interests if this work is continued to its logical conclusion.

Yours sincerely,

A handwritten signature in blue ink, appearing to read "Chris Veal".

Chris Veal
Managing Partner

Annex 1 – Responses to specific questions in the Consultation Document

CHAPTER: Two	
Question 1: What are your views on our proposed enhancements to the SO role in system planning, including the specific roles we have proposed the SO would undertake for onshore, offshore and interconnection planning?	<p>In general we support the enhanced role but continue to have concerns with regards to business separation.</p> <p>In our view the long term solution should be to have a totally ownership unbundled ISO with a more directive role.</p>
Question 2: Are there other roles that you think an enhanced SO could or should undertake in order to better support the development of an efficient transmission and interconnector network?	As stated in response to question 1 above, we consider that the SO (as an ownership unbundled ISO) should be in a position to determine what transmission system reinforcements, including interconnection, best meet the needs of consumers.
Question 3: What are your views on the specific obligations for TOs that might be needed to support our proposed enhanced SO role?	[No response]
Question 4: What are your views on our proposal that, as part of its enhanced role, the SO should lead gateway assessments for offshore projects that include investment to provide wider network benefit?	We agree with this proposal but note that it gives rise to conflicts of interest issues which need to be addressed.
CHAPTER: Three	
Question 5: What are your views on our proposal to extend competitive tendering to new, high value, separable onshore assets?	<p>We completely support this proposal and believe that it should:</p> <ul style="list-style-type: none"> i) reduce costs to consumers; and ii) make more certain the delivery of these assets.
Question 6: What are your views on our proposals to maintain a developer-led approach to interconnection and to extend the cap and floor regime?	We understand the reasoning behind the proposal (cap & floor must be given a chance to work) but our view is that it is only a matter of time before a more centrally planned approach will be required in order to ensure the level of interconnection gets built that is optimal for consumers. We therefore consider that Ofgem should keep this under review and be prepared to move towards a centrally planned approach in due course.

<p>Question 7: What are your views on our proposal that non-GB generators pay for their connections, without consumer underwriting?</p>	<p>[No response]</p>
<p>Question 8: What are your views on our proposal to provide regulatory continuity when the purpose of a transmission asset changes?</p>	<p>We agree that regulatory continuity is very important if investor confidence is to be maintained and therefore if the lowest possible cost of capital is to be available.</p>
<p>CHAPTER: Four</p>	
<p>Question 9: What are your views on our assessment of conflicts of interest?</p>	<p>We agree with Ofgem’s assessment that conflicts of interest can arise (or be exacerbated) given the NETSO’s enhanced role, along with the introduction of competition to National Grid Electricity Transmission’s core business of transmission ownership.</p> <p>We note your statement that many stakeholders have called for “sufficiently stringent business separation arrangements to ensure the SO is shielded from commercial influence, e.g. managerial, physical and information separation”. We are also strongly of the view that such separation is necessary.</p>
<p>Question 10: What are your views on our proposals for mitigating conflicts of interest?</p>	<p>We note that the proposals for managing the NETSO’s conflicts of interest are based on increased transparency, increased Ofgem scrutiny of NETSO activities, setting out overarching principles and stronger ring-fencing requirements.</p> <p>While the first three measures represent desirable changes we are doubtful as to whether they will significantly mitigate the conflicts. In particular the level of information asymmetry between NETSO and other industry participants (including Ofgem) is such that it is very difficult to hold NETSO to account.</p> <p>Increased transparency is valuable. We note for instance that had unredacted information on the Caithness Moray project been available to all transmission companies we could have provided Ofgem with a much more detailed critique of the extraordinarily high costs of this project. However the level of detail in any such analysis by other transmission companies will ultimately be limited by the fact that, unlike NETSO, they do not receive funding from consumers for such analysis work.</p> <p>Because of this, the forth mitigation measure proposed by Ofgem – ring fencing of information and decision making – becomes particularly important. Whilst we appreciate that the details of these measures remain to be finalised, we are very concerned by the statement that “in practice this</p>

	<p>separation has largely already been achieved”. In our view the current situation where separation seems to be limited to NETSO being a separate department with NGET’s management structure is inadequate. We have previously put forward our view that a degree of ring fencing equivalent to the provided by the European ITO model is the minimum required and we cannot understand why the measures needed to ensure ring fencing should be any less in this case,</p>
<p>Question 11: Do you think independent scrutiny of the SO’s activities (eg through an expert panel or auditors) would provide value for money?</p>	<p>We think it would be very difficult and costly to try to shadow National Grid’s SO role and a better solution would be to remove any conflicts of interest it would have.</p>

{End}