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Dear Stuart,

Cap and floor regime: Initial Project Assessment for the NSN interconnector to Norway

This response is on behalf of National Grid Electricity Transmission plc. This response is not confidential and we are happy for it to be placed on the Ofgem website and for it to be shared more widely.

We support Ofgem's minded to position to award NSN a cap and floor regime in principle subject to no material escalation in costs. We believe that greater regulatory certainty will aid the delivery of future interconnection. This in turn will ensure GB consumers are well placed to enjoy the benefits interconnection can provide consumers and aid the development of a single European energy market.

In our submission to Ofgem, we highlighted that NSN has the potential to bring significant benefits to system operation by increasing competition in the provision of ancillary services. The benefits to consumers are further demonstrated in Ofgem's analysis. We would, however, like to highlight that the analysis undertaken by Poyry does not align with the modelling undertaken by ENTSO-e which is explained in more detail in the Appendix. Despite the differences in modelling approaches, we believe that NSN will deliver notable benefits to GB consumers.

The timely delivery of investments is essential to ensure that consumers gain the benefits of increased interconnection. We therefore share Ofgem's concern that a delay in decision-making could have a detrimental impact on consumers.

As raised in our response to the NEMO cap and floor impact assessment, we believe it is important to ensure that our transmission charges provide a level of certainty for customers and future movements in them are predicable. There is a potential risk that without a suitable mechanism in place, that payments to / from interconnectors under a cap and floor regime may provide uncertainty into transmission charges. This could result in an increased cost to the consumer, as suppliers hedge against the potential price fluctuations.

Our answers to the specific questions raised in the consultation are contained in the attached appendix. We are happy to discuss our views contained within this letter and appendix further should that be helpful. For further details, please contact Ben Graff ben.graff@nationalgrid.com.

Yours sincerely

[By email]

Richard Smith
Head of Network Strategy

Appendix 1: Questions raised in Cap and floor regime: Initial Project Assessment for the NSN interconnector to Norway

1. What are your views on the approach Poyry has taken to modelling the impact of cross-border interconnection flows?

The modelling of cross border interconnection flows requires multiple variables to be taken into consideration. We support the modelling of a diverse range of scenarios not least to establish the possible range of outcomes in the future. Such an approach is consistent with pan-European market modelling undertaken by ENSTO-E for development of the Regional Group Investment Plans (RGIPs) and the Ten Year Network Development Plan (TYNDP).

We support the two approaches, namely 'first-in approach' (FA) or 'marginal approach', adopted to assess the impact of cross border flows and subsequent welfare benefits. These approaches are similar to ENSTO-E recommended methods of PINT (put one in at a time) and TOOT (take one out at a time) for assessing the impacts of interconnectors.

The development and choice of scenarios for market modelling is a vital element of the process to ensure appropriate forecasts are produced. We believe the outcomes of the Low Scenario used in Poyry's analysis are somewhat unrealistic. We are unable to source reasonable evidence or qualitative arguments to support the assumptions adopted for the Low Scenario. The projections for GB wholesale energy prices, and those forecast for various other European member states appear to be very low. Subsequently, the forecast flows for both NSN and the other interconnectors assessed through this round of Cap and Floor assessment, may be inappropriate for the Low Scenario and could somewhat distort the decision making process.

2. Do you agree with the modelling results for NSN and our conclusion that NSN is likely to provide benefits to GB consumers?

We support that the total surplus approach has been adopted to appraise the impacts of NSN to GB consumers. However, the components have been modelled in a notably different way to the approach adopted by ENSTO-E. It is worth noting that ENSTO-E's recommended approach for modelling welfare benefit stated in its CBA Methodology Guidance has been reviewed and subsequently approved by ACER and the European Commission.

A similar analysis has been performed to determine the value of NSN for GB consumers; however it is unclear whether the welfare benefits have been modelled for a 25 year period. This is highly desirable not least to evaluate the changing nature of impacts over the appraisal period.

We also note that we believe Value of Lost Load (VOLL) is a recognised indicator for monetising the Security of Supply indicator and as such its use should be avoided in the assessment of welfare benefits. Furthermore, the inclusion of interconnector revenues should be treated with care or else it could lead to unnecessary double counting of benefits.

Despite the above mentioned issues, as well as the issues associated with the modelling results for the Low Scenario mentioned in response to Question 1, we agree NSN will deliver notable welfare benefits for GB consumers.

3. Do you have any comments of the system operation impacts of NSN?

We would like to further clarify our analysis on constraint management costs. The analysis demonstrates that constraint management costs will increase if the current arrangement for

constraining interconnectors continues in the future. That being said, changes to the current arrangements may be delivered through the implementation of the European Codes which may reduce constraint management costs.

4. Do you have any views on the onshore connection information?

We support the connection information and believe this is the most efficient connection onshore following our optioneering process, where we considered the impacts of a variety of onshore connection locations.

5. Have we appropriately assessed the qualitative impacts of NSN link?

We agree that it is difficult to quantify all aspects of interconnectors and that a suitable range of qualitative impacts have been considered. Diversity of supply and security of supply are particularly important benefits which interconnectors can provide the UK Electricity System.

Our only concern in this assessment is regarding the indicative monetised carbon impacts. We recognise that the volume of carbon saving should be noted, however the monetised value of the carbon savings (£14.76m in 2020) should be used with care as there is potential for these savings to be double counted.

6. Are there any additional impacts of NSN link that we should consider qualitatively?

No, we agree that a suitable range of qualitative impacts have been considered.

7. Do you have any comments on our assessment of NSN's chosen connection locations or cable routes?

We support the connection location as noted in question 4.

8. Do you have any comments on our assessment of NSN's project plan?

The project plan seems reasonable based on the high level information provided in the consultation. All of the important areas which need to be taken into consideration appear to be covered.

9. Do you agree with our conclusions on the IPA for NSN?

We agree with your overall conclusions on the IPA for NSN and support your decision to award a cap and floor subject to no significant escalation in costs. We note our queries above on the modelling of flows and assessment of welfare benefits however believe this project is in the best interests of consumers.

10. Do you have any comments on our application of the regime to NSN?

As noted in our response to NEMO's cap and floor impact assessment, our customers place considerable value on the level of certainty over transmission charges and future movements in them. As a result we will be keen to ensure that there is appropriate notice and visibility built in to the necessary process for adjustment to Transmission Network Use of System (TNUoS) charges so that customers fully understand its implications for them.

Suppliers typically make decisions on their tariffs in the autumn based on the latest TNUoS forecast (July or October). The MOD and NICF Directions from Ofgem currently come out in Nov/Dec - in time for us to factor them into our tariffs for the following April (but too late for suppliers to factor into their tariffs). Adding the financial flows from interconnectors under the

cap and floor regime is another variable for suppliers to carry on top of MOD and NICF. The numbers involved could start to get large particularly if there are multiple interconnectors operating under the cap and floor regime. There is a danger this will result in suppliers adding a risk margin to their tariffs to reflect the uncertainty over TNUoS levels and this will feed through as increased costs for consumers. Our recommendation would therefore be to have a mechanism that ensures any Ofgem Direction in respect of this issue is made in the first financial quarter, e.g. around June.

11. Do you have any comments on our assessment of the development costs?

The development costs being shared between GB and Norway seems reasonable as consumers in both countries equally support the costs.

12. Do you have any comments on our initial assessment of technology choice or tendering strategy for the NSN interconnector?

n/a