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Stuart Boland  
Ofgem  
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Dear Stuart,

**Re: Cap and floor regime: Initial Project Assessment of the FAB Link, IFA2, Viking Link and Greenlink interconnectors**

We welcome the opportunity to comment on the initial project assessment for four interconnectors considered in the consultation.

Interconnection may play an important role in supporting the operation of the system and security of supply. We agree that increased interconnection may provide benefits to GB consumers. However, we would like to highlight some issues that we believe were not sufficiently addressed in the analysis. We believe that these issues could have significant impact on the assessment of the benefit of additional interconnection.

We have taken the opportunity to briefly explain SSE's point of view regarding interconnection but not answered the specific questions posed by the consultation as our submissions mostly fall outside the scope of these questions.

**Net Welfare Case - HM Treasury receipts**

We support the view that current interconnection of the GB market to other markets is limited and further interconnection could benefit GB consumers. However, we do not believe that the net welfare case for the three interconnector projects considered for

approval is robust. The current impact assessment of the GB welfare does not include the potential for a reduction in HM Treasury carbon price support receipts (CPS receipts), which were projected by HM Treasury to be worth over £3 billion between 2013- 2016. If, as Ofgem suggest, new interconnection resulted in displacing expensive GB generation from the Capacity Mechanism, then this is likely to have a corresponding impact on the value of CPS receipts.

If the impact of reduced CPS receipts is factored into the base case scenario, the GB welfare assessment would be negatively affected. This demonstrates that the net welfare to GB provided by the Ofgem analysis is over-estimated and that the case for providing cap and floor mechanisms for Viking, FAB and IFA2 is not as clear as the Ofgem consultation document suggests.

### **Our high level analysis**

Our assessment is based on the CPS rate trajectories outlined in the Poyry Cost Benefit Analysis, coupled to some assumptions about the average carbon intensity of the generation displaced.

Our assessment for Viking, IFA2 and FAB of the loss of CPS receipts for the base cases is as follows:

- Viking, NPV from 2020 to 2035 at 3.5% discount rate = £400m
- IFA 2 NPV of lost CPS receipts from 2020 to 2035 at 3.5% discount rate = £350m
- FAB NPV of lost CPS receipts from 2020 to 2035 at 3.5% discount rate = £475m.

We believe that there is a strong case for considering a lower number of interconnectors than Ofgem is currently minded to be approved. It is clear that the GB welfare analysis is almost entirely based on a carbon price differential between the GB and other markets for two of the proposed ICs. This is clear from the CPS scenarios where the net GB welfare benefit reduces significantly (the net benefit reduces to Viking £1m, IFA2 -£19m, FAB £513m).

We would suggest that Ofgem asks Poyry to factor CPS receipts into its analysis before a final decision is made, in order to properly assess the true welfare benefit.

### **Competition between GB Generation and imports over ICs**

We also consider that the current review of ICs provides a good opportunity to compare the competitive framework between generators in GB and generation being imported into the UK by interconnection.

Different rules are applied for generators and ICs in relation to the costs of balancing services and transmission losses. ICs are not currently subject to the same network charges as generation, which has had a distortive effect on competition. Fair competition between GB generators and ICs could be ensured if BSUoS and TNUoS charges and transmission losses were charged on the same basis (preferably removed for both or, otherwise, imposed on both based on the same methodology). This would allow generators and ICs to compete on an equal footing.

### **Revenue Cap**

Furthermore, we believe that a reduced cap on interconnectors' revenue should be considered to reflect the reduced market and operational risks faced by interconnectors under the cap and floor regime.

### **Electricity Storage**

Finally, we would like to highlight that in order to advance competition between competing approaches to provision of market solutions, a cap and floor-like regime should be made available for electricity storage projects in GB. Additional storage projects can provide many of the benefits that can be provided by additional interconnectors. They can also provide additional benefits in terms of security of supply and contribution of positive GB net welfare by better allowing the benefit of low priced electricity to be accessed by GB producers and consumers.

However such projects face similar risks to ICs and, given this, are subject to the same market considerations that may prevent optimal investment levels. Additionally, at present, due to their status as generators, electricity storage projects in GB do not have access to some of the current advantages enjoyed by interconnectors such as: (1) an exemption from BSUoS, and TNUoS charges and transmission loss costs; and (2) a limited downside risk granted by the current regulatory regime which is designed to incentivise interconnection.



We appreciate that Ofgem has indicated that its minded-to decision is to grant cap and floor support to three interconnectors referred to in the consultation, however we hope that the points outlined in this response will provide grounds for Ofgem to broaden out its assessment of the benefit of additional interconnection, taking into consideration factors not previously addressed in the assessment to date, as well as exploring the alternatives.

Kind regards,

(by email)

Lesley Gray  
**Interim Head of Regulation (Markets)**