



Ikbal Hussain
Interconnectors
Networks
9 Millbank
London
SW1P 3GE

Uniper UK Limited
Compton House
2300 The Crescent
Birmingham Business Park
Birmingham B37 7YE
www.uniper.energy

Paul Jones
Senior Regulation Manager
T 44 (0)7771-97 57 82
paul.jones@uniper.energy

Registered in
England and Wales
Company No 2796628

Registered Office:
Compton House
2300 The Crescent
Birmingham Business Park
Birmingham B37 7YE

Cap and floor regime: Initial Project Assessment of the GridLink, NeuConnect and NorthConnect Interconnectors

14 August, 2017

Dear Ikbal,

Thank you for the opportunity to respond to the above consultation. This response is made on behalf of Uniper. Uniper is an experienced international energy company focused on power generation, energy trading, transportation, and storage, as well as a provider of specialist power engineering services. In the UK we own seven power stations comprising over 6GW of flexible installed capacity, as well as a fast churn gas storage site. As such, Uniper is the fifth largest generator in GB and is making a major contribution to ensuring security of supply and providing a bridge to the energy market of the future.

We have not been able to consider fully the economic analysis that has underpinned Ofgem's minded to decision and so are not in a position to answer the detailed questions posed in the consultation. However, we would like to offer the following general comments:

- We recognise the contribution that interconnectors can make to supporting the market in Great Britain and wider within the EU. Interconnection can support liquidity in the provision of energy and balancing services across interconnected markets and contribute to security of supply, by increasing the diversity of sources of supply. However, there are clearly limits to the benefits that can be provided which would be expected to decrease with subsequent interconnection, or following changes in policy, particularly carbon pricing. Therefore, it is important that each new interconnector investment decision is carefully assessed to ensure that cost of the new interconnector is at least fully offset by the benefits provided.
- This is of particular importance for an islanded system such as Great Britain, where interconnection to the rest of Europe entails building large and expensive, subsea, HVDC links. Network assets cannot simply be removed should there be a mistake in assessing the benefits of a project or projects. With a cap and floor price control settlement the risk of such a miscalculation would sit with GB customers, who will be required to pay for any over-investment for a long time. For purely merchant interconnectors of course, the risk would sit with the shareholders of the relevant project. Therefore, we

support Ofgem's approach in being cautious when assessing whether projects should be underwritten by customers through a cap and floor settlement. Of course, uncertainty around ongoing market arrangements once the UK has left the EU is another reason to ensure a cautious approach is adopted.

- We believe that interconnectors should be treated in a manner which is consistent with their status as transmission network assets as defined in European regulations. This legal definition means that interconnectors no longer pay network charges such as Transmission Network Use of System charges and Balancing Services Use of System charges in GB. Unfortunately, we have already seen an inconsistent application of this principle, in that interconnectors are effectively treated as generation assets and are allowed to compete directly in the capacity market. Interconnectors do not provide capacity as such, but are actually transmission assets which enable providers of capacity overseas to deliver that to the GB market. There is also a lower incentive on cap and floor interconnectors to deliver under the capacity market as, while they are potentially exposed to penalties for non-delivery, this would be underwritten by GB customers were the floor to be reached as a consequence. Therefore, it is those overseas capacity providers who should be rewarded through the capacity market instead.
- This competitive distortion is exacerbated by levying of BSUoS charges on domestic generation but not on flows into GB over interconnectors. As the amount of interconnection increases, the amount of GB generation output will reduce. As generation is exposed to 50% of BSUoS charges, the unit cost will rise, further increasing the cost disparity between GB generation and interconnector flows, and worsening the distortion to competition.
- It appears that the minded to position is based on the predicted impact on GB customers alone. We would have expected the decision to be based on the total UK social welfare impact of a new project, taking into account the impact on customers, market participants and the UK economy as a whole. This would be consistent with other decisions that regulatory authorities are required to take in a wider European context, such as whether or not to set up different pricing zones. We note that the GB total welfare for the three interconnector projects is actually relatively small in the base scenario (GridLink £62m, NeuConnect £-254m, NorthConnect £-410m).
- Additionally, it is not clear that the analysis takes into account any security of supply issues associated with capacity closures within GB as a result of increased interconnection. Under the present arrangements, it would be reasonable to expect that new cap and floor funded interconnector projects would be successful in securing UK CM agreements, given that the developer is protected from revenue cost risks. They would therefore be expected to displace other indigenous sources of capacity such as storage and generation technologies. It is unclear from the analysis on what basis that it has been established that sufficient overseas capacity will remain available to fulfill this demand, so it is not possible for us to comment on whether this seems a safe assumption. However, were insufficient overseas capacity to be retained, the growth in dependence on interconnectors could have adverse consequences on UK welfare that go beyond the modelled scenarios.
- Similarly to our comments on the capacity market, we are concerned that National Grid's analysis on ancillary services refers to interconnectors' ability to



provide balancing services such as frequency response and black start. Whilst we agree that such ancillary services can be facilitated by interconnection, any commercial arrangements around this should reward the true providers of these services in the interconnected markets concerned rather than the interconnector owners directly, who should continue to be rewarded through congestion revenue. Where the service stems from the interconnector technology, provision of the service should be on a consistent and competitive basis as other types of provider.

I hope the above comments prove helpful. Please do contact me in the first instance should you wish to discuss any of these issues further.

Yours sincerely

Paul Jones
Senior Regulation Manager
Uniper