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3 January 2013

Request from ElecLink for an exemption under Article 17 of Regulation (EC) 714/2009 for a GB-France interconnector

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users.

In general, we support the development of interconnection if the investment is economic in its own right, based on market price differentials. The merchant-led approach, given the GB regulatory framework, is our preferred approach because it removes the risk of consumers facing the cost of stranded assets, as that risk is taken by the developers. So in principle, we are supportive of ElecLink's application for an exemption under Article 17 of Regulation (EC) 714/2009, albeit with some conditions and changes to their proposals.

Our detailed responses are set out in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries, please contact Nigel Edwards on 020 3126 2506, or me.

I confirm that this letter and its attachment may be published on Ofgem's and CRE's website.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Angela Pearce".

Angela Pearce
Corporate Policy and Regulation Director

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Attachment

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EDF Energy's response to your questions

Chapter 3: Impact on competition, the effective functioning of the internal market and on the efficient functioning of the regulated system

Part 1: Impact on competition and the internal market

Question 1: Do you consider ElecLink's proposed investment enhances competition in electricity supply and therefore meets condition (a)?

Yes, as the proposed investment should enhance competition in electricity supply by allowing GB suppliers and traders (and hence end consumers) further access to European generation and conversely European customers to GB generation.

Question 2: Do you consider the exemption requested by ElecLink would not be to the detriment of competition and that it therefore meets test 1 of condition (f)?

We believe the exemption requested would not be to the detriment of competition because:

- (i) other interconnectors are/will be available between GB and France and the presence of ElecLink should apply further competitive pressure and drive down costs;
- (ii) a merchant approach is likely to have strong performance incentives; and
- (iii) there will be no capital risk to end consumers

Question 3: Do you consider the exemption requested by ElecLink would not be to the detriment of the effective functioning of the internal market in electricity and that it therefore meets test 2 of condition (f)?

- (iv) The exemption would not be to the detriment of the effective functioning of the internal market because the development of further interconnection is an enabler of both, cross-border integration and the development of a single market. Furthermore, ElecLink would not be a pivotal asset in the interests of an efficient and economic market as there are and will be other UK-Continental Europe interconnectors available.

Question 4: Do you consider ElecLink has provided sufficient information on demand for its interconnector capacity between France and GB?

We are not clear to what "sufficient" relates in this question. Nevertheless, it should be noted that, with a merchant line, the commercial risk of inadequate demand would be borne by the developers and their financiers, rather than by consumers.

Third Party Access

Question 5: Do you consider such long-term products would be necessary to raise financing for the project?

Although we do not have an individual view on this matter, it is logical to assume lenders would want the comfort of firm long-term revenues to service their long-term loans.

Question 6: Analysis conducted by London Economics shows that the price of capacity for long-term contracts may be significantly higher than those assessed by ElecLink. Do you think any limit of capacity sold on multi-year products should be based on the actually contracted revenues or on a maximum volume or on any other basis?

Maximum volume would seem the most straightforward and transparent basis. Ex-post bases to limit capacity, such as using contracted revenues, could lead to market uncertainty.

Question 7: Would you be interested in having capacity reserved for shorter-term timeframes (either yearly, monthly, or day-ahead) and allocated through regulated rules based on the European target model for electricity?

We would be interested in ElecLink providing capacity across the whole spectrum of timeframes, from day-ahead to multi-year long-term, with market appetite determining the relative volumes.

Question 8: Would you be interested in multi-year products allocated through an Open Season? If so please provide detail if possible on how much, for which duration, contacts initiated with ElecLink, on which price basis per MWh? Answers to this question would be considered as confidential.

Multi-year products allocated through an Open Season might be of interest, as part of a wider portfolio. However, even confidential comments on appetite are not appropriate without detailed analysis, requiring detailed assumptions of capacity price, terms and market conditions.

Question 9: In your view, how should the capacity be allocated:

- a) **the Open Season (one long-term allocation before the interconnector becomes operational); or**
- b) **periodical allocations of standard long-term products as defined by the European target model for electricity)?**

What should in your view be the split of the foreseen capacity between these two mechanisms?

It would be difficult to secure the required long-term finance for construction without a substantial part of the link's revenues being supported by long-term capacity contracts.

Question 10: What would in your view be the most appropriate split of capacity (please answer in MW among the following: day-ahead, monthly, yearly, less than 5 years products, 5 to 20 years products).

This split should be a financial decision (rather than a policy one) based upon what was necessary to achieve adequate financing, requiring access to the confidential business case.

Question 11: Do you think it appropriate to consider different types of products (PTRs or FTRs) for the same delivery hour?

We understand that merchant developers are considered as Transmission System Operators (TSOs) under the EU Network Codes and would have the same obligations as national TSOs. Under the draft Forward Capacity Allocation Network Code (FCA NC), it would not be possible to consider different types of products for the same delivery hour, so we do not believe this is a viable option (while we note that the FCA NC is still a draft and so could still be changed).

Question 12: Do you consider it appropriate for there to be a lower degree of firmness for multi-year products?

Given that merchant developers will be classified as TSOs under the EU Network Codes, we expect that the firmness requirements would be mandated via those codes. However, in principle, we see no reason why a lower degree of firmness should apply to multi-year products.

Question 13: Do you consider it important (especially, but not only, for the secondary market), that the firmness of multi-year products would improve when coming closer to delivery time?

No.

Question 14: In your view, would such provisions allow for a sufficient level of competition?

No comment

Question 15: In your view, what criteria should be looked at to authorise a market player to participate in the Open Season?

Conventional commercial criteria should be considered, particularly credit rating and robust governance.

Question 16: What information should be publicly available concerning the selection criteria and results of the Open Season (name of the holder of the long-term capacity, amount, and price paid for it)? Would publication of aggregated information be appropriate?

We would expect the developers and bidders to want this data to be kept confidential. Consequently, to guard against any concerns of market manipulation, this data should still

be made available to Ofgem and the CRE, as well as to other bodies with a statutory duty to ensure fair competition.

Question 17: Do you consider it important that remaining capacity after intraday allocation could be used for balancing exchanges? If so, how could this be managed most efficiently?

Based on our understanding of the EU Network Codes, this will be a requirement. An efficient approach would be to have the national TSOs coordinate this activity.

Ownership unbundling

ElecLink considers that an exemption from the unbundling obligations in Article 9 is necessary to allow STAR Capital to retain the flexibility to invest in future energy projects.

Question 18: Do you consider that such exemption is necessary? Please take into account the two Commission staff working papers on how the rules on OU are to be applied, and where applicable, the GB relevant supplier test.

The rules on ownership unbundling are laid down in Article 9 Electricity and Gas Directives. Article 9(1)(b)(i) Electricity and Gas Directives requires that the same person cannot 'control' generation, production and/or supply activities, and at the same time 'control' or exercise 'any right' over a TSO or a transmission system. Furthermore, according to Article 9(1)(b)(ii) Electricity and Gas Directives, the same person cannot 'control' a TSO or a transmission system, and at the same time 'control' or exercise 'any right' over generation, production and/or supply activities.

From ElecLink's application for exemption, we understand that neither STAR Capital nor Groupe Eurotunnel has any direct or indirect links to energy producers or suppliers or transporters of Energy.

In GB, Ofgem is required to apply five tests in order to determine whether the Applicant meets the ownership unbundling requirement for exemption:

The first test is that, the applicant:

- (a) does not control a relevant producer or supplier;
- (b) does not have a majority shareholding in a relevant producer or supplier; and
- (c) will not, on or after the relevant date, exercise shareholder rights in relation to a relevant producer or supplier.

This test appears to be met by the applicant.

The second test is that, where the applicant is a company, partnership or other business, none of its senior officers has been, or may be, appointed by a person who:

- (a) controls an electricity undertaking which is a relevant producer or supplier; or
- (b) has a majority shareholding in an electricity undertaking which is a relevant producer or supplier.

This test appears to be met by the applicant.

The third test is that, where the applicant is a company, partnership or other business, none of its senior officers is also a senior officer of an electricity undertaking which is a relevant producer or supplier.

This test appears to be met by the applicant.

The fourth test is that, the applicant is not controlled by a person who controls a relevant producer or supplier.

This test appears to be met by the applicant.

The fifth test is that, the applicant is not controlled by a person who has a majority shareholding in a relevant producer or supplier.

This test appears to be met by the applicant.

In summary, on the basis of the information provided in the consultation and application, we believe the requirements of the five tests are met by ElecLink.

Question 19: If you consider an exemption from Article 9 to be appropriate, should such an exemption be:

- a) **granted in full with no conditions imposed by the NRAs?**
- b) **granted subject to additional conditions imposed by the NRAs?**

We think that if an exemption is granted, it should be (b) "granted subject to additional conditions imposed by the NRA".

Question 20: Should an exemption subject to additional conditions be deemed appropriate what conditions do you consider it would be appropriate for the NRAs to impose?

In the case of a such an exemption, the NRAs may, if they deem it appropriate, include relevant provisions from, or similar to, those contained in the two main separation models described in the Directive, which constitute alternatives to the main unbundling regime:

- ***the Independent Transmission Operator, set out in Chapter V of the Directive; and***
- ***the Transmission Owner / Independent System Operator, set out in Articles 13 and 14 of the Directive.***

If STAR Capital decides to divulge its part of ElecLink, at that stage, the tests should be conducted again and the status of the exemption reviewed, and changed if appropriate.

Question 21: Do you consider inclusion of such provisions necessary to ensure the exemption is not detrimental to the efficient functioning of the internal market?

Yes, in the circumstance described in the previous answer.

Question 22: Do you consider inclusion of such provisions would be enough to ensure the exemption is not detrimental to the efficient functioning of the internal market?

Yes.

Question 23: Do you consider inclusion of any such provisions may be harmful for ElecLink's interconnector project?

Not materially.

Part 2: Impact of exemption on the regulated system

Question 24: Do you consider the exemption requested by ElecLink would not be to the detriment of the efficient functioning of the regulated systems to which the interconnector is connected and that it therefore meets test 3 of condition (f)?

We do not believe the exemption would be to the detriment of the efficient functioning of the regulated system and so it meets test 3 of condition (f).

Chapter 4: Level of risk attached to investment

Question 25: Taking into consideration existing and planned regulated interconnectors between France and GB, do you consider that the risk attached to ElecLink's project is such that the investment would not take place unless an exemption is granted and that it therefore meets condition (b) of Article 17?

It is not appropriate to comment upon this without the full economic analysis available to ElecLink and the regulators.

Question 26: What is your assessment of the hypotheses taken by ElecLink in its exemption request? For instance, are the congestion rent provisions and optimal interconnection capacity appropriate?

It is not appropriate to comment upon this without the full economic analysis available to ElecLink and the regulators.

Question 27: Do you consider the scope of the exemption, as requested by ElecLink, is necessary to realise the investment?

Yes, as far as can be judged without the full economic analysis available to ElecLink and the regulators

If not, which of the following would you consider to be the most appropriate and effective means to reduce the exemption in order for it to be proportionate to the risks born by ElecLink?

- reduction of the scope of the exemption on Third Party Access
- reduction of the scope of the exemption on use of revenues?
- reduction of the scope of the exemption on ownership unbundling
- other (please explain)

Not applicable

Question 28: Do you think it would be appropriate to impose a revenue sharing mechanism? If so, does the criteria for a possible revenue sharing mechanism listed in paragraph 4.22 seem relevant to you? Are there any other criteria that you consider would be important?

We do not have a strong view regarding this issue.

Question 29: In the reference scenario, ElecLink estimates the project's Internal Rate of Return (IRR) at a level that appears to be significantly higher than allowed regulated returns. Taking into account the project's and ElecLink's specificities, what are your views on the reasonable rate of return for such a project?

We do not have a strong view regarding this issue. However, it would be reasonable to expect a forecast higher rate of return than that allowed for regulated assets, to allow for the lack of external financial support if revenue levels are lower or cost levels higher than forecast.

Chapter 5: General questions and other relevant exemption conditions

Question 30: In your overall assessment, do you consider ElecLink has met all of the exemption conditions and so should be granted an exemption?

If so,

Question 31: Should an exemption be given for the duration requested by ElecLink (25 years), or should it be shortened (If so, by how much)?

We do not have all of the relevant data to answer this question

Question 32: Should this exemption cover all of the provisions for which ElecLink has sought exemption, or should it be an exemption from only some of/parts of the concerned provisions? For this question, you may refer, in particular, to question 27

We do not have all of the relevant data to answer this question

Question 33: Do you have any other remarks on ElecLink's exemption request?

No.

Question 34: In your opinion, is there any reason to consider that conditions (c), (d) and (e) are not fulfilled? If so, which condition(s) and why?

No.

EDF Energy
January 2014