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Dear Stuart,

### **Project TransmiT – InterGen response to call for evidence**

#### **Overview**

InterGen welcomes Ofgem's review of transmission charging at this time of anticipated substantial change in the electricity sector.

InterGen is the UK's largest and most successful new entrant independent generator, having invested £1.4 billion in the UK since 1995. InterGen owns and operates three highly efficient gas fired power stations in the UK totalling 2,490MW and actively trades in the prompt and forward wholesale power and gas markets. InterGen is currently pursuing a number of development opportunities in the UK including the construction of two further 900MW gas fired power stations, representing a further £1 billion investment.

#### **Project TransmiT: why change the current arrangements when they are already working?**

Project TransmiT states its objective as "The aim of the review is to ensure that we have in place arrangements that facilitate the timely move to a low carbon energy sector whilst continuing to provide safe, secure, high quality network services at value for money to existing and future consumers". InterGen would urge Ofgem to consider first and foremost whether there is any evidence to suggest that the existing regime will not support the above stated objective.

The present gas and electricity charging regime has been very successful in encouraging the siting of new thermal generation near to the centres of load, reducing the total investment in gas and electricity grid expansion. Hence InterGen believes that the present charging regime is effective in achieving the value for money objective.

Considering the low carbon objective, the National Grid Quarterly Report states that there is over 7GW of renewable projects currently in the connections queue in Scotland alone. Although InterGen is aware that not all projects with connection dates will be constructed, Ofgem should still review whether there is any compelling need to further facilitate the timely move to a low carbon energy sector given that the number of existing and planned low carbon projects are already close to meeting the installed capacity needed for the UK to reach its 2020 target.

The majority of low carbon generation in the UK receives direct support from schemes such as ROCs, LECs and avoiding the cost of purchasing EUETS allowances and, if implemented, would also benefit from a carbon price floor. If the call for evidence demonstrates that the UK is in danger of falling short of its 2020 targets, then the first solution that should be considered is to change the levels of support from the existing mechanisms, not to adjust transmission charging to obtain a similar effect with other undesirable side-effects (for example location of new generation further from the centres of load with increased cost to customers).

InterGen would remind Ofgem that we are shortly expecting to receive from the Department of Energy and Climate Change (DECC) a consultation on market reform, potentially changing the market beyond all recognition. Some of the principles of the market reform consultation are very similar to the objectives of Project TransmiT; namely to ensure investment in low carbon generation, security of supply and a fair price for consumers. The architects of Project TransmiT should be mindful that this could lead to further double counting of support measures for low carbon if market reforms deliver against those objectives.

InterGen does not consider that the case is proven that the existing grid charging arrangements are broken: quite the reverse as it appears to us that the regime is effective in encouraging new generation to be sited near to load centres (minimising costs to consumers) while enabling high volumes of low carbon generation build in combination with the relevant subsidies.

**Key issues for consideration:**

Regulatory certainty is necessary to attract the necessary investment in the industry:

InterGen fully supported DECC's work on 'Improving Grid Access', where a Connect and Manage approach was adopted to ensure timely connection to the transmission system for new low carbon and flexible thermal plant. In concluding that work DECC stated in their Annual Energy Statement that grid access reforms "will provide greater certainty for all new generators about the rules for access to the grid over the long term". InterGen would stress that the key point here is certainty; there is an estimated £200 billion investment requirement for new generation and networks in the UK in the coming decade to allow the UK to meet its binding climate change targets. Any uncertainty in the investment landscape will reduce the probability that the necessary investment will be made.

InterGen believes that whilst regulatory changes are necessary to deal with changing circumstances, such regulatory changes should be the minimum necessary adaptation – otherwise investors will move to other markets with greater stability. In the case of GB transmission charging, investors have already invested many billions on the basis of the present regime and InterGen would urge Ofgem to proceed with caution, fully considering whether the present regime is broken before trying to fix it. InterGen's view is that the current regime is not broken.

Securing Project Finance funding requires minimisation of regulatory change:

InterGen develops projects on the basis of Project Finance which is likely to be a major and necessary source of capital to support the required investment in UK electricity infrastructure over the next decade. In Project Finance, a highly structured project is developed where the project company has a controlled amount of risk and banks are therefore able to lend to the project without any recourse to the creditworthiness of the parent company. Project finance arrangements for power plants typically require long term offtake contracts which may not extend to insulating the project from all regulatory risks.

As an independent generator, InterGen relies on Project Financing to bring generation projects to fruition. Continued regulatory uncertainty such as TransmiT makes it more difficult to attract Project Finance investment to the UK, and any further regulatory change will diminish further investment and hence the independent generators share of the market. InterGen believes that independent players bring important cost and operational efficiency competition to the UK market, ultimately delivering a better price for consumers. InterGen also has two 900MW flexible clean gas-fired generation projects in development in the UK, projects which are likely to look less attractive to foreign investors if the charging regime in the UK is uncertain.

It is necessary to ensure that regulatory changes do not undermine existing investments as this will undermine confidence and prevent sponsors from advancing essential new projects.

Locational Signals:

InterGen has historically followed the locational charging signal in the UK and sited its projects near to centres of demand while also taking into account the cost of gas supply pipelines. InterGen believes that this incentive should not be diluted or the efficiency of the market will be compromised and customers will unnecessarily end up paying more as electricity and gas grid costs increase. As stated above, low carbon generation already receives direct support from schemes such as ROC's, which is a cost to the consumer. Flattening transmission charges across the UK will not only support low carbon generation to connect in areas of low demand but also other thermal plant, in total adding hugely and unnecessarily to the costs of electricity to consumers. Hence InterGen believes that flattened transmission pricing would result in increased consumer costs and also

clearly discriminates against those generators who have constructed projects on the basis of a favourable zonal transmission charge.

InterGen has experience of The Netherlands (NL) electricity market and charging regime, as it has operated gas fired project in the country since 2004. The Netherlands has flat electricity transmission charges but the approach would not work in GB. The present GB transmission charging regime features zonal gas and electricity transmission charging and flat electricity grid congestion charging via BSUoS. This provides developers with appropriate incentives on site selection since NGET resolution of congestion issues will result in increased TNUoS as the local grid is extended to overcome constraints. Hence overall there are reasonable but not excessive locational incentives which are reasonably predictable.

The NL arrangements are very different. NL being a small country, TenneT operational electricity grid charges are flat across the country. Gas charges were fixed a number of years ago to be approximately cost reflective for the then-prevalent gas flows from Southwest to Northeast. Sites for power stations are pre-selected under the SEV3 legislation.

The NL arrangements have some benefits (predictability of charges, clarity of siting) but have recently led to two significant issues:

1. Congestion management: as with the UK, electricity transmission constraints are restricting new build and operation. In the UK, it is reasonable to smear the system operator's constraint management costs across the market because new build in congested areas is still strongly disincentivised through likely rises in zonal TNUoS. However, the NL flat transmission charges do not allow this. Hence it is likely that congestion management charging will be shared among all generators behind the constraint boundary, with consequent barriers to new developments and unpredictable effects for incumbents if they are near to new developments.
2. Gas flows are now reversed and GTS proposed a revision to the gas charging regime to be reasonably cost reflective of the new flows (higher charges in the South). However, much fixed infrastructure (industry and power stations) has now been built in the South based on the previous fixed costs and the location of the industrial zones of the NL. Revising the GTS charges would have undermined the economics of many industries and power stations, especially given the lack of compensating effect from electricity transport charges for proximity to load centres. The GTS charges are now under regulatory review by NMa/Energiekamer.

The NL example illustrates the importance of a consistent set of charging and siting incentives and in particular the limitations of a fixed charging regime with postage-stamp grid charges. The present GB charging regime gives significantly clearer and more predictable geographic incentives.

## **Conclusions on gas and electricity charging**

InterGen concludes that the present UK charging arrangements provide a good compromise between stability and adaptability and give sufficiently strong signals to ensure electricity and grid economics are taken into account in plant siting decisions.

InterGen urges Ofgem to let the new Connect and Manage regime deliver accelerated dates for low carbon generation before layering on another regulatory uncertainty through revising transmission charges. Uncertainty will reduce the attractiveness of UK infrastructure investment and through this will exacerbate security of supply concerns in the short term. It may even hamper rather than assist the UK in meeting its climate change targets in the long term.

In conclusion, InterGen believes strongly that the existing charging arrangements for gas and electricity should remain unchanged.

Yours sincerely,

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