# Response to consultation on proposal to grant an electricity transmission licence to TI LIRIC LIMITED

Dear Utility Regulator,

We welcome the opportunity to comment on your proposal to grant an electricity transmission licence to TI LIRIC LIMITED in respect of a proposed interconnector between Scotland and Northern Ireland.

This response is on behalf of Mutual Energy Ltd. (MEL). MEL owns and operates three of the four licenced gas transmission networks in Northern Ireland via subsidiary companies which are licenced gas TSOs as well as the Moyle Interconnector, a 500MW HVDC link between the NI and Scottish electricity transmission networks. All of these assets are financed through mutualisation.

The mutualisation model has worked well to date with c£200m being returned to NI consumers so far. Whilst we recognise that potential support schemes are not the primary focus of this consultation, if it is determined that there is a need for further interconnection in the future in Northern Ireland, there is a strong case to carefully consider the potential role for mutualisation, or hybrid models in order to deliver the optimal level of interconnection at least cost to NI consumers. For example, this could include consideration of full mutualisation or a hybrid model involving a cap and floor regime in GB and mutualisation in NI. Mutualisation can be attractive from the developer's point of view as it could offer an early (appropriate) return on investment if a developer premium is paid post-construction at the time of mutualisation of the assets. We would therefore welcome and recommend future consideration of these options. Our answers to the specific consultation questions are as follows:

## 1. Do respondents have any objections to the UR's proposal to grant a transmission licence (which includes the terms and conditions set out in a draft of the proposed licence) to TI? If so, please set out the basis and reasons for any such objection

We believe that granting a transmission licence in this case may be premature and that it is important that the need for new electricity interconnection is assessed before progressing new regulatory requirements to facilitate it. Regardless of whether this project is ultimately supported by a cap and floor regime or not, it may not be without risk to Northern Ireland consumers.

GB followed this approach in 2020 with an Interconnection Policy Review to establish if there was further need for GB interconnection capacity. This review concluded that further interconnection would be in the consumer's best interests and that the cap and floor mechanism was suitable for development of further interconnection[1]. Having informed decisions regarding the need for interconnection will help in determining what is required to facilitate its development.

[1] https://www.ofgem.gov.uk/sites/default/files/2021-12/ICPR%20Decision%20Paper.pdf

## 2. Do respondents agree with the UR's proposed two-step approach? Please provide any supporting information

As per the answer above, while we can see the appeal of the two-step approach as a pragmatic option to avoid regulatory delay to a project, we have concerns with issuing a licence before any assessment of whether further interconnection, or this project in particular, is in the interests of NI consumers. We would suggest that if the needs case assessment for further interconnection demonstrates that this project would be beneficial, then that would be the appropriate point to consider issuing a licence. This would still allow for a pragmatic two-step approach as it would allow the relevant project(s) to hold a licence, with the associated benefits, in parallel to details of a cap and floor regime (or other regulated underpinning) being developed.

## 3. What are respondents' views pertaining to consumer impact, or any other impact, in granting a licence without specified operational revenue regime licence conditions? Please provide further information which lends support to the views expressed.

As noted in the consultation document, granting a licence will allow the promoters to advance their project, particularly through the potential availability of compulsory purchase powers. There is therefore a risk that the project could proceed on a commercial basis if the promoter's determine that it is in their interest, even if is ultimately determined to not be in the best interests of NI consumers. Additionally, there is the possibility that the project progresses without a cap and floor regime and is commercially highly lucrative to the developers – in this case NI consumers would not benefit from the return of excess profits above any cap (and, for balance, would obviously not be exposed to funding floor payments). Consumers would be further impacted by the cannibalisation effect that this interconnector would have on the profitability of the Moyle Interconnector, reducing the availability of surplus revenues to be returned to NI consumers from Moyle[2].

There is a risk that this project gains a first-mover advantage so displaces other potential projects and becomes baked in as a part of NI's energy system, ahead of other options which may be more beneficial to Northern Ireland (such as development of local storage solutions which could provide more flexibility than extensive further interconnection). There is also the risk, particularly with grant of compulsory purchase powers for a project which has not been determined to be an optimal solution for NI, that land may be acquired that has the effect of preventing other projects progressing. It would be expected that landing an interconnector cable or an offshore windfarm connection would be in

[2] We recognise that this cannibalisation effect will materialise regardless of any regulatory underpinning. The issue to be grappled with is how to optimise the benefit delivered for consumers from further interconnection.

competition for the same landing sites on the east coast of NI. Granting this licence could therefore lead to higher costs or indeed a failed project for future offshore windfarms.

Whilst not directly within the scope of this consultation there will need to be a whole system approach to assessing the need for further interconnection, looking not just at interconnection but other technologies which may be more optimal but for which policy and the regulatory framework lags that of interconnection, meaning projects have not yet come forward.

## 4. What are respondents' views on the risks and benefits of the proposed approach?

The benefits of the proposed approach are that it may allow the project to be delivered slightly earlier than if the licence was granted at a later stage. Of course, earlier delivery is only beneficial if the project itself is beneficial overall and especially in the initial phase of operation. Whilst additional interconnection may deliver benefits in a world where Northern Ireland has significant levels of offshore wind generation and widespread electrification, care is needed to ensure delivery timings are aligned to avoid unintended adverse consequences. For example, if there is insufficient excess generation capacity or demand (and onshore transmission capacity) to serve a new 700MW interconnector, the interconnector is likely to drive constraints, be underutilised and result in the existing interconnection also being underutilised. We have seen in recent years that relatively modest increases in market scheduled interconnector flows (both import and export) have troubled the transmission system operator in NI (resulting in regressive restrictions on flows) so there is risk from large scale new interconnection being delivered ahead of anticipated increases to electricity supply and demand as the energy transition progresses in the NI energy system.

As referred to in the previous answers, the risk is that this project may proceed regardless of whether or not it is ultimately the best option for Northern Ireland. Development of a major project such as this should be driven by government policy where a clear need has been established, rather than by a reactive approach to developer proposals.

## 5. Are there any additional risks or benefits regarding further interconnection? If so, please provide supporting evidence.

The key benefits of interconnection in delivering price convergence and as a potential source of flexibility are well understood. Additional risks or obstacles to achieving these benefits are outlined below:

- It is critical to ensure that interconnection connects at a desirable location in the other jurisdiction. Northern Ireland obviously already has 500MW of interconnection to Scotland, which has high levels of wind generation and similar weather patterns to Northern Ireland. There are also long-standing north-south network constraints between Scotland and England. These factors mean that the market may not schedule excess power to flow from NI to Scotland and, even if it does, the network in GB may not be able to facilitate the increased level of NI to GB flows, so there may be challenges to delivering potential benefits from

exporting excess power from NI across the proposed interconnector. We would therefore expect the needs case for further interconnection to consider the economic and technical merits of different connection points (particularly in the other jurisdiction) and even the case for multi-purpose interconnection[3]. National Grid ESO's recent 'Beyond 2030' report[4] is a useful reference point for GB ambitions.

- A further issue that could be a risk or benefit is that the UK government is currently considering introducing locational electricity pricing in GB. It is anticipated that this would result in lower wholesale prices in Scotland than the south of England for example, which ceteris paribus would result in a strong price signal to flow power into NI. This should put downward pressure on prices in NI, which is a clear benefit, although knock on impacts of such flow patterns will need to be considered as there may be impacts on the viability of local projects – whilst wind curtailment is the obvious example, the viability of storage projects could also be impacted.
- Locational pricing in GB could also lead to increased internal network congestion on the island of Ireland, with Ireland being used as a route to 'offshore' constraints between Scotland and England – i.e. using the existing interconnectors, power could flow into NI from Scotland and out of Ireland to Wales/England simultaneously. These aspects must be carefully considered.
- It is essential that electricity interconnection is not considered as a panacea to renewable oversupply and system flexibility. As mentioned above, market conditions and arrangements in jurisdictions change and the willingness and ability of neighbouring TSOs to provide the desired flexibility will fluctuate over time. It is important to bear in mind that the utility of additional interconnection to the system can be curtailed by these exogenous factors and this should be considered against local solutions.
- It is important to note that increased interconnection has diminishing returns, in that the more interconnectors there are, the more likely the price spread between the markets will plateau and utilisation will reduce. This will be particularly prevalent as both interconnected jurisdictions decarbonise through renewable generation. Subject to the rules governing market bidding behaviours of renewables under renewable support mechanisms this could result in price convergence, or conversely perverse outcomes – e.g. if GB allowed negative pricing of renewables but NI did not, this would result in the imports of excess renewables from GB at times of excess wind in both jurisdictions. These types of scenarios and the ongoing Review of Electricity Market Arrangements in GB need to be very carefully considered.
- As noted in paragraph 4.5 of the consultation paper, Ireland has determined to add significant new interconnection capacity. With strong north-south interconnection and a continued SEM this may well provide sufficient cross border interconnection for the island without the need for NI customers to underpin new infrastructure. The risk of developing sub optimal levels of interconnection would be reduced by a joined-up approach with the authorities in Ireland (and potential connecting jurisdictions, primarily GB) to assessing interconnection needs.

[3] https://www.nationalgrid.com/national-grid-ventures/interconnectors-connecting-cleaner-future/multi-purpose-interconnectors

[4] https://www.nationalgrideso.com/future-energy/beyond-2030

## 6. Do respondents have any views regarding the anticipated timelines outlined?

We note the proposed process envisages UR making a decision on whether or not to grant a transmission licence and then (assuming a decision to grant a licence) undertaking work with DfE to establish the needs case assessment for interconnection. If such a sequential approach is taken (licence decision in Q4 and needs case by March 2025), this seems like a very short window for developing the needs case. As will be clear from our earlier answers, we believe that establishing the needs case for interconnection on a whole energy system basis should be the first step in this process and will require industry engagement and consultation. We would also see that work as being essential, regardless of whether this consultation process results in the award of a licence, in order to provide clear signals to the market as to what projects government views as needed and would be prepared to commit customers to underpin.

We would suggest that Step 2(ii) should first consider the potential generic design and merits of a cap and floor regime in NI before then considering what that design (and counterfactuals) would mean for the NI consumer in the context of LIRIC. Lastly, with reference to Step 2(iii) we would see it as essential that the outcome of the assessment of the appropriateness of a Cap and Floor regime in NI be consulted upon.

## 7. Are there other provisions that stakeholders consider should be included in the licence conditions and/or the revocation schedule? Please provide details and supporting rationale.

We note that the proposed transmission licence is mostly consistent with that held by Moyle Interconnector Limited in NI under the Electricity (Northern Ireland) Order 1992. That licence is very much bespoke to the circumstances of the mutualised Moyle Interconnector business, and we would expect a similar case-by-case approach to be taken for future interconnectors, given there are likely to be a limited number of interconnector projects brought forward. For example, we observe that Conditions 2 (Maximisation of Capacity Receipts etc) and 4 (Economic Purchasing of Interconnector Services) of the proposed licence are suitable for a mutualised entity's licence to ensure that the entity operates to minimise the requirement for funding from consumers (in Moyle's case via the Collection Agent Income Requirement), but they do not seem appropriate or required in a merchant operator licence, as such a party should seek to maximise revenue and minimise costs to deliver shareholder value. Whilst we understand the rationale for proposing a licence similar to Moyle's but excluding any conditions around a regulated revenue entitlement, we would expect that the proposed licence would require significant change if a cap and floor regime were to be introduced and potentially different forms of regulatory oversight if the project proceeds on a merchant basis.

Whilst our view is that a licence should not be issued until need is established, if a licence is granted we would suggest that the UR consider whether revocation of the licence could or should be linked to the future needs case. We would also suggest that similar consideration is given to limiting compulsory purchase powers to avoid blocking other desirable projects.

## 8. What are the specific issues of further interconnection that are most likely to need specific regulation? Please provide your reasons.

There are significant gaps in the regulation of SEM-GB interconnection as a result of Brexit, since relevant EU regulation no longer applies on the border and implementation of the Trade and Cooperation Agreement has been slow at best. For the avoidance of doubt, we do not comment further on these issues because they exist regardless of further interconnection and are not solely within the UR's gift to solve but do note that issues with sub-optimal arrangements for cross border capacity calculation and allocation will obviously be amplified with further interconnection.

They key issues requiring specific regulation will differ depending on what regulatory underpinning any new interconnection receives. A cap and floor regime will be the most involved, while a merchant or mutualised model can likely be regulated under existing frameworks.

## 9. Do respondents have any views on the proposed approach in relation to a potential regulated Cap and Floor operating revenue regime?

As we have commented above, our view is that a whole energy system needs assessment is required before decisions are taken on the appropriate regulatory regime to deliver the required investment. In this case the process is following a non-linear path.

Whilst details of how it would operate in NI are not yet known, cap and floor is a reasonably well established and successful mechanism for supporting interconnection investment in GB. It has delivered investment and seen significant revenues exceeding the cap being returned to consumers following the recent energy crisis. It is therefore reasonable for this to be considered as an option for delivering further interconnection in NI.

The cap and floor levels are crucial parameters which allocate risk between consumers and developers and mutualisation can be thought of as a special case of cap and floor where the cap and floor are set at the same level. The existing mutualisation model in NI has proven to be successful for ownership and operation of NI's cross border infrastructure with GB.

If further interconnection results in the desirable scenario of price convergence between GB and NI, then consumers will be required to make top-up payments to the interconnector operator under a cap and floor regime. Over the long term this is likely to be the case (unless developers do not develop enough interconnection) and raises the question of what is the appropriate choice of regulatory underpinning to develop the optimum level of interconnection? Assuming the floor does not include a return on investment, when receiving floor payments there would be no incentive on an equity-based investor to operate or develop more interconnection. A mutual or RAB based regulatory model may well be more appropriate in that circumstance i.e. where diminishing returns reduce commercial incentives from cross border arbitrage and increase the customer support required by both existing and new interconnectors.

If significant price differences between GB and NI endure and further interconnection is not built to capture the arbitrage, then the interconnector operator will be required to hand back excess revenues above the cap to consumers. We would highlight that these transactions between consumers and interconnector operators, in both directions, happen today under the Moyle Interconnector's mutualised operation. The difference is that all of the interconnector's profits are reinvested or returned to consumers and profits below any cap cannot be extracted from the business. A mutual entity benefits from similar protections as that provided by the floor under a cap and floor regime. However, given that a key benefit of mutualisation is that it provides for raising lower cost debt finance than other funding models, the applicable 'floor' for a mutual will be lower than that of a non-mutual operator.

It is therefore difficult to see, from a policy perspective, why offering a cap and floor regime to a developer would be preferable to further roll out of the established mutual ownership model in NI. We would suggest that this question should be considered as part of the proposed 'Step 2' work between DfE and the UR and we look forward to supporting the required work in this area.