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Commission for Regulation of Utilities  
The Exchange  
Belgard Square North  
Tallaght  
Dublin 24

Utility Regulator  
Queens House  
14 Queens Street  
Belfast  
BT1 6ED

**Greenlink Interconnector Ltd**  
Unit 3, 4075 Kingswood Road  
Citywest Business Campus  
Saggart, Co. Dublin  
D24 KF85, Ireland

[www.greenlink.ie](http://www.greenlink.ie)

Dear Emer and Simon,

Greenlink Interconnector Limited welcomes the opportunity to provide a response to SEM Consultation Paper entitled 'Compensation Arrangements for Net Transfer Capacity Reductions' SEM-23-024 dated 15th March 2023 (the "**Consultation Paper**").

Greenlink Interconnector Limited ("**Greenlink**") is of the view that appropriate compensation for net transfer capacity ("**NTC**") reductions is critically important to ensuring that decisions made by Transmission System Operators ("**TSOs**") are economically efficient and thereby minimise costs to consumers.

While it may be the case that obligations under EU law no longer apply to interconnectors between EU countries and a post Brexit UK, it nevertheless remains the case that there are compelling economic and policy reasons for those obligations being implemented. The fact that there may now be uncertainty in relation to the application of compensation arrangements for NTC reductions as a consequence of Brexit does not in any way diminish the rationale for such arrangements, or their need to be reflected in enduring arrangements between Ireland and the UK. Greenlink urges the SEM Committee to approach this question from the same perspective as the EU, namely to implement the most economically efficient arrangements that allocate risk to the person best able to manage it, minimise costs for consumers and promote energy security and decarbonisation by eliminating barriers to investment in interconnection.

**Consultation Question 1. Please set out your view on the appropriate arrangements for NTC reduction compensation going forward in the SEM, given the current arrangements for cross-border trading. Would this be impacted if cross-border forward**

Registered in Ireland  
Company Number 536954

**Registered Office:**  
Unit 3, 4075 Kingswood Road  
Citywest Business Campus  
Saggart, Co. Dublin  
D24 KF85, Ireland

**Directors:**  
Carsten Koenig – German  
Padraig McManus – Irish  
Dermot Nolan – Irish  
Adrianus Schampers - Dutch  
Johnny Shine – Irish  
Indu Vaidya – British

## **hedging instruments were introduced in advance of MRLVC and, if so, in what way?**

At the outset, we do not understand why a failure to introduce FTRs is relevant to the question of whether compensation should be paid for a reduction in NTC.

The statement “The provisions outlined in Article 3 were conceived in the context of Financial Transmission Rights (FTRs) being sold on the SEM-GB interconnectors.” in the consultation does not appear to be supported by the text of the ICZA. Article 3 (19 and 20) make no reference to FTRs and Article 3 (21) only clarifies the position for FTRs holders in relation to financial impact and compensation caps.

The compensation principles ought to be the same whether FTRs are sold or not.

If an interconnector sells FTRs, it will receive revenues for the sale of FTRs, but then be required to compensate FTR holders with the Loss Adjusted Market Spread for their contracted volume irrespective of reductions in NTC. When these reductions in NTC occur due to actions of the TSOs, it is entirely appropriate that the TSOs should compensate the interconnector owners to the level that they have to compensate FTR holders. This mechanism ensures that (i) FTR holders are kept whole for the reduction in NTC that is beyond their control; (ii) the interconnector owner does not bear the risk of NTC reductions instructed by the TSOs as this is beyond their control; and (iii) TSOs see the full cost of a reduction in NTC allowing them to make an economically rational decision in relation to their actions (for example whether to reduce NTC prior to the DA / IDA firmness deadline or implement a SO-SO trade at a later timeframe).

If an interconnector does not sell FTRs, it obtains its revenue from congestion rent. If the interconnector is instructed by a TSO to reduce NTC in these circumstances, exactly the same principles should apply. The interconnector owner should be compensated by the TSO(s) that instructed the NTC reduction to a level that is equal to the forgone congestion rent. In this way (i) the interconnector owner does not bear the risk of NTC reductions instructed by the TSOs as this is beyond their control; and (ii) TSOs see the full cost of a reduction in NTC allowing them to make an economically rational decision in relation to their actions (for example whether to reduce NTC prior to the DA / IDA firmness deadline or implement a SO-SO trade at a later timeframe).

Greenlink is therefore of the view that it is clear that the arrangements for cross border trading are irrelevant to the question of whether or not an interconnector owner should be compensated for a TSO instructed NTC reduction. The arrangements for cross border trading are only relevant to the question of how the level of compensation is calculated. In each case, the compensation must be set at the level at which the interconnector owner is indifferent to whether or not the NTC reduction occurs, thereby sending an economically efficient price signal to the TSO of the cost of the NTC reduction. This calculation may be different depending on the trading arrangements, but not the principle. This principle does not change whether or not cross-border forward hedging instruments are introduced in advance of MRLVC.



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**Consultation Question 2. This paper references various principles that underpin different approaches to compensation arrangements for NTC reduction (i.e. ‘causer pays’, ‘cost neutrality’, ‘different compensation arrangements for allocated and unallocated capacity’). In your view, what principles should underpin compensation arrangements for NTC reduction going forward in the SEM?**

As noted in response to question 1, the principles that should underpin compensation for NTC reductions are:

**Causer pays** – If the TSO(s) reduce NTC it is critical that the TSO(s) bear the cost of making that decision. This ensures that risk is allocated to the only person able to manage it and that the TSO(s) are able to make an economically informed decision about whether to instruct the NTC reduction or take some other action. If the interconnector owner is responsible for the NTC reduction, then it should bear the risk.

**Cost Neutrality** – The principle of cost neutrality means that the interconnector owner must be compensated to a level at which it is indifferent to whether the TSO(s) instruct an NTC reduction or not. It is critical to ensure that the compensation mechanism achieves cost neutrality to ensure economically efficient decisions are made that result in least cost to consumers in the long run.

The compensation principles should not differ whether capacity is allocated or unallocated. When the ‘cost neutrality’ principle is applied to the interconnector owner, the compensation it receives will be determined by the loss that it suffers as a result of the TSO instructed NTC reduction. This loss may be different depending on whether capacity is allocated or unallocated and, as such, the quantum of compensation may be different, but the principles should remain the same.

**Consultation Question 3. Are there any other factors, not covered in this paper, which should be considered by the RAs ahead of a decision? If providing, please explain relevance.**

Factors which should be taken into account by the RAs in making this decision include:

**Interconnector Financing** – The Cap and Floor arrangements and specifically the floor are key to prospective Interconnectors getting bank financing, but the ability to harness revenues above the floor are vital to Equity investment in projects. Any changes to potential revenues and ongoing regulatory uncertainty in this area will jeopardise future private Interconnector investment / development. This is inconsistent with EU and Irish Government Policy to incentivise further investment in interconnection.

**Economic efficiency** – It is critical that risk be allocated to the person best able to manage it. The only person able to manage the risk of TSO instructed NTC reductions is the TSO. The TSO must therefore bear the cost of this to ensure that NTC reductions only occur when this represent the least cost solution to solving the system problem that they are designed to address. The alternative, in which the TSOs bear costs of certain actions (such as SO-SO trades) but not NTC reductions, means that it is always cheaper for the TSO to reduce NTC rather than taking another action that is economically more efficient.



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In summary Greenlink are of the opinion, for the reasons outlined above, that Interconnector Owners must be compensated on a cost neutrality basis for any TSO initiated NTC reduction, irrespective of market arrangements.

Yours sincerely,

*Colin D'Arcy*

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**Greenlink Commercial Director**



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