

Energy UK Response to the Ofgem Interconnector Review Working Papers

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About Energy UK

Energy UK is the trade association for the energy industry with over 100 members spanning every aspect of the energy sector – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

We represent the diverse nature of the UK's energy industry with our members delivering nearly 80% of the UK's power generation and over 90% of the energy supply for the 28 million UK homes as well as businesses.

The energy industry invests £13bn annually, delivers £31bn in gross value added on top of the £95bn in economic activity through its supply chain and interaction with other sectors, and supports 738,000 jobs in every corner of the country.

Introduction

Energy UK welcomes the opportunity to respond to the Ofgem Interconnector policy review. We have focused our response on Working Papers 3 and 4 although many of the principles are applicable to more than one paper.

Please note that this response reflects the views of Energy UK generator members. National Grid Ventures does not support this response and we refer Ofgem to see National Grid Ventures' individual response for further reasoning.

Energy UK are concerned that Ofgem's conclusions in the Working Papers have discounted the analysis in the Afry report¹. Particularly as the draft Afry report shows that there is negative or minimal positive impact on GB as a result of the four modelled connections. We are unclear as to how Ofgem has reached the opposite view that there are consumer benefits from future interconnectors being built with cap and floor support. There is a lack of analysis on cross-border competition impacts on the GB market, particularly given the different treatment of interconnectors and generation across interconnected countries.

In short, the Afry CBA finds additional interconnection has no substantive benefits for the GB consumer. Further, Energy UK would welcome analysis from Ofgem regarding cross-border competition.

Working Paper 3

We remain concerned that the Ofgem assessment does not distinguish between efficient and economic transfer of power and the import of cheap power as a result of differing policy frameworks. For example, there is a significant difference between the network costs GB generators face compared to their EU counterparts. The price differential across interconnectors is contributed to, in part, due to generators in GB facing amongst the highest network costs in Europe. In contrast, generators in markets connected to GB via interconnectors are exposed to much smaller or zero network charges. Whilst this differential could be offset by EU generators facing deeper connection charges, the problem

¹ An AFRY report for Ofgem: Ofgem interconnector policy review – independent report (December 2020)

is complex and no analysis has been properly conducted in this area. We would welcome additional analysis from Ofgem regarding cross-border competition. Addressing this issue could allow for more efficient (not just cheap) power to flow across interconnectors. Additionally, it is difficult to assess how green the power imported over interconnectors is. Ofgem should give due thought to this and GB carbon targets.

The Working Papers have not properly considered the inconsistent treatment of interconnectors compared with other parties with whom they are allowed to compete. They are effectively treated as market participants for the purposes of the Capacity Markets and for Balancing and Ancillary Services, but conversely are able to avoid network charges such as TNUoS, BSUoS and BSC costs, that other market participants are exposed to, as in that context they are regarded as network assets. This misalignment in treatment effectively distorts markets in which interconnectors are allowed to compete, which could result in inefficient investment. Without fully taking account for such potential market distortions, any cost benefit analysis of interconnectors' value for GB participants would be invalid.

Energy UK supports the Ofgem statement that interconnectors can often be one of the largest loss on the system and, as such, can cause large deviations in frequency. This is a Security of Supply (SoS) issue which requires the ESO to ensure adequate response is available or, in certain network situations, reduce flows over interconnectors altogether. As Working Paper 3 states, interconnectors could therefore be seen to create a need for additional cost to the network and agree that this should be a part of any assessments of future interconnectors.

Energy UK shares the Ofgem concern regarding the CION process. Developers should not have basis for preferred connection points based on price signals, but should rather give more weight to system impacts. The benefit to GB consumers of a prospective interconnector under the CION process can therefore be vastly overstated should a new connection create a new constraint on the GB system. As Working Paper 3 highlights, much more focus needs to be given to the whole-system impact of interconnectors in the planning process. The recently established Holistic Network Design ("HND") process² is a step towards better system impacts considerations of offshore transmission activity. This is untested, though, with first results not expected until early 2022. Ofgem should ensure that system costs are a component of the HND process.

Interconnectors are able to directly compete in GB markets. With the ESO managing these markets and the TO building around constraints on the network, there could therefore be a perception of a conflict of interest between National Grid's Venture business (NGV) which owns the majority of interconnectors connected to GB and National Grid's regulated businesses TO and ESO. This conflict arises both in terms of planning and the operation of new interconnectors.

We also note that further perceptions of conflicts of interest could arise from the regulated National Grid Group business awarding Black Start contracts to its non-regulated NGV arm. The procurement of Black Start contracts is an untransparent process which is where this perceived conflict arises. Energy UK notes that both Ofgem and BEIS have commented on the potential for a conflict of interest in the Independent/Future System Operator workstream and would welcome further proposals to ensure that any conflicts of interest are addressed.

² Appendix 2: [Consultation on changes intended to bring about greater coordination in the development of offshore energy networks | Ofgem](#)

Working Paper 4

A more coordinated approach to offshore network asset build is necessary and is likely to save costs for consumers and reduce the number of landfall points from offshore energy infrastructure compared to conventional radial connections of offshore wind farms and interconnectors³. Such coordination and/or integration of offshore and onshore transmission could include multi-purpose interconnectors (“MPIs”). However, as outlined in our response above, increased interconnection may result in further distortions to markets unless these are rectified. It is our view that market distortions introduced through current status and treatment of interconnectors need to be identified and removed ahead of progressing with MPIs.

In setting up the regulatory backdrop of MPIs, there are a number of principles Energy UK recommends:

- Any parts of the MPI that is a transmission asset must be unbundled from generation (same unbundling rules must apply as onshore)
- Monopolies have regulated assets and regulated incomes
- Distortions between interconnected markets need to be removed (i.e. network charging) before increased interconnection, including MPIs, amplify market distortions further
- Generators connected onshore, to an OFTO, or to an MPI should not benefit from different charging or commercial arrangements without proper justification and appropriate regulatory approval

An appropriate network charging regime for offshore generation connected to shared offshore transmission networks need to be developed. This could be undertaken as part of Ofgem’s wider review of TNUoS charges as indicated in the recent Access and Forward-looking Charges SCR minded-to decision. However, the timescales upon which certainty is required to deliver the government’s targets (e.g. 40GW by 2030) and the objectives of BEIS’ Offshore Transmission Network Review (“OTNR”) are short. In order for offshore coordination to be realised before 2030 regulatory changes, including regarding network charging, will be needed during 2022 to allow time for coordinating developers of generation and transmission infrastructure on and offshore to consent the coordinated designs. The OTNR is aiming to deliver coordination between offshore infrastructure on these timescales, and this includes MPIs where possible. The wider review of TNUoS charges by Ofgem has no timescale yet set out.

Energy UK notes that in addition to the market distortion challenges already outlined, there is not yet any agreed stable regulatory or market framework for MPIs across borders⁴. A market framework that is attractive for investors needs to be established before Energy UK can develop an informed opinion on MPIs and comment further.

There are a number of questions that Energy UK would welcome clarity on:

- Could a generator sell power and flexibility services to both sides of the interconnector at the same time, and to what extent would this be distortive? How would a CfD work in this context?
- Is the expectation that MPIs are a new type of network asset (i.e. Different to interconnectors)? What licencing regime would apply to these?
- For a generator connecting to an MPI, how is its connection managed and which network company manages said connection? Further, how will this interact with a MPIs Cap & Floor regime?

³ [Offshore Coordination Project | National Grid ESO](#)

⁴ [Market arrangements for offshore hybrid projects in the North Sea - Publications Office of the EU \(europa.eu\)](#)

- What initial and ongoing charges will a generator face when connecting to an MPI?
- Could Ofgem confirm if the EU fit for 55 Carbon Border Adjustment Mechanism (CBAM) has been considered in the assessment? How will this be considered in interconnectors/MPIs future needs case going forwards?

Should you have any questions regarding our response, please do get in touch.

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