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Ørsted Response to Ofgem's Interconnector Policy Review: Working Paper 4 Consultation

10 August 2021

Our ref. Interconnector Policy Review:
WS4 Consultation Response

Dear Ricardo,

The Ørsted vision is a world that runs entirely on green energy. In the UK, we develop, construct, and operate offshore wind farms as well as battery storage and innovative waste-to-energy solutions. We also offer flexibility solutions to our industrial and commercial customers as well as supplying them with electricity and gas. Headquartered in Denmark, Ørsted employs 6,000 people, including over 1,000 in the UK.

We welcome the opportunity to respond to Ofgem's Interconnector Policy Review. In June, Ofgem issued working papers relating to four different workstreams under this review, with the fourth being a consultation on Multiple-Purpose Interconnectors (MPIs). The consultation follows Ofgem's initial analysis, findings, and provisional recommendations within workstream 4, and this letter is our response.

Ørsted acknowledges that MPIs are likely to have a key role to play, within a coordinated offshore transmission regime, in delivering the UK's ambition of 40GW of offshore wind by 2030 and net zero by 2050. It is therefore vital that Ofgem continues to analyse the benefits that MPIs can offer to the UK energy system and uses this to inform future policy decisions. This will need to be balanced with careful regulation, to ensure that the assets are funded, supported, and utilised appropriately.

Our more detailed responses to the consultation questions outlined in the response proforma can be found in the Annex.

Please do not hesitate to reach out (07768 288836, jamjc@orsted.co.uk) should you have further questions about our response.

Yours sincerely,

James Jackson
Regulatory Affairs Advisor

Annex

Question 1: Do you agree with the approach we have taken to workstream 4?

Broadly yes. However, we note some confusion with regards to the Call for Evidence (CfE) that was conducted to inform the consultation. Despite formally submitting an expression of interest in WS4, we did not receive any communication on the CfE and were not approached for comment. It would be helpful to understand if a targeted engagement approach was taken, and if so, why.

It would also be appropriate to align this review with the work being carried out via the Offshore Transmission Network Review (OTNR), given the considerable overlap between the two. Ørsted is conscious that a more coordinated approach to offshore network asset build is the direction of travel with regards to development. This approach is likely to bring financial savings, as well as reduce the disruption to communities, when compared to conventional radial connections of both offshore wind farms and interconnectors. It is therefore vital that a coordinated approach to policy development is taken, with all related consultations and reviews being progressed in parallel.

Question 2: Do you think we have missed any important benefit that MPIs could deliver?

We feel that the benefits have been adequately described. In Ørsted's view, the key benefits of MPIs can be condensed into the following:

1. Enhanced robustness of both offshore wind and transmission projects.
2. CAPEX savings.
3. Reduced need for new connection points.
4. Improved alignment of supply and demand.
5. Mobilisation of the investments needed.

We would encourage Ofgem to take an approach that continues to explore the benefits of MPIs, as more detail on actual projects emerges.

Question 3: Do you agree with our views on the conclusions of the ITPR?

Yes. The ITPR provides a useful starting point for analysis, however the conclusions will need to be revisited to ensure that they are up to date and remain relevant. Both this review and the OTNR should be used to consider fully how MPIs fit into the offshore landscape, as well as how they should be regulated.

Question 4: Do you agree with our proposal to further explore the applicability of the cap and floor regime for the MPI projects currently under consideration?

Yes. We expect that MPIs will require some form of regulatory support to provide developers with the confidence to make investments. It is therefore sensible to continue to explore the applicability of the cap and floor regime to MPIs.

Question 5: Do you agree with our proposal to also consider alternative regulatory models for MPI projects in the long term? What models should we consider?

Yes. It is important to design a regulatory model which provides the right incentives to project developers to design the assets in a way that creates the greatest societal benefit. In particular, it is important that the model facilitates efficient cross border trading, both to encourage investment at lower CAPEX and provide flexibility that enables lower carbon systems to operate. This should be kept under review as the development of actual MPI projects continues.

Our expectation is that MPI development will continue to be developer-led (as per point to point interconnectors) to a large extent during this decade. However, we agree that a more system-wide and coordinated approach makes sense in the long run, with the relevant design options outlined in the OTNR consultation having a role to play.

When developing and implementing a regulatory model, it is also important to be mindful that – regardless of the model used – suitable commercial arrangements will need to be in place for wind farm developers to consider utilising an MPI connection. If a developer were to be worse off operationally and financially, when compared to the status quo of a radial connection (or indeed another coordinated solution), then there would be no incentive to use the MPI assets.

The overall market income for an MPI – assuming that an offshore wind asset is connecting in – is made up of two income streams: a) the sale, by the offshore wind developer, of electricity generated; and b) the congestion rent earned by the grid owner through allowing trade of electricity between high and low price areas. The overall potential earnings are well defined, but the allocation of those earnings between offshore wind developer and grid owner is highly dependent on the regulatory regime in place.

A fundamental novelty for MPIs is that transmission lines serve as both feeder lines for offshore wind to shore and as interconnectors. This affects the business case – and thus the willingness to invest – of both offshore wind developers and grid owners. If transmission lines are treated as a transmission asset only, lower power prices undermine incentives for the offshore wind developer. If treated as feeder lines only, it reduces congestion rents for the grid owner, thereby undermining the incentives for build-out. Careful regulation will therefore be necessary to ensure that the assets are viable for all parties, and this warrants further consideration of a range of regulatory models.

Finally, we note that development of an MPI takes a number of years, and therefore any decisions around regulatory models need to be communicated well ahead of delivery to ensure that investments can be made on the basis of having the fullest information available, and further model changes are minimised to maintain investor confidence. There is therefore a need to balance spending time

in analysing regulatory models with making a pragmatic decision that allows more time for projects to be developed.

Question 6: What other wider policy issues or aspects related to MPIs should we be aware of?

To realise the development of hybrids, regulation must support regional approaches with private and public partners from multiple countries. As a result, Ørsted considers that efficient cross border trading arrangements are key to the development of MPIs. We recommend that further detailed work is undertaken in this area to assess the different models available and to consider how the GB arrangements interface with the EU arrangements, and how the requirements of the Trade and Cooperation Agreement facilitate this.

In terms of market model, we can see opportunities for both a home market and offshore bidding model. Ørsted views that the two options are not mutually exclusive and will most likely co-exist in Europe. It is therefore worth taking the time to identify properly the benefits and potential drawbacks of each market arrangement.

In addition, Ørsted can see a role for the embedding of net-zero targets to stimulate anticipatory investments. Though we note that Ofgem's remit includes elements relating to Net Zero, the principal duty of the regulator – under the current remit – is to act in the interest of the consumer by minimising costs. We view that the remit could go further and include a duty to facilitate decarbonisation. Without this, we would be concerned that the planning and design of transmission assets and offshore wind projects would not allow for the anticipatory investments needed to facilitate the development of MPIs.

Question 7: Do you agree with our initial conclusions? If not, please concisely explain why and provide supporting information if available.

Yes.

We agree with Ofgem that a definition for MPIs needs to be introduced. This is important for development certainty, as well as to establish the applicability of policy support schemes. More specifically, there will need to be consideration for whether MPIs are considered to be a new type of network asset (i.e. different to interconnectors), as well as which licencing regime would be applicable to the assets.

Question 8: Do you agree with our initial proposals? If not, please concisely explain why and provide supporting information if available.

Broadly yes. We agree that Ofgem should explore ways to provide regulatory certainty to developers of MPI projects. However, certainty also needs to be provided to those generators or developers who may be looking to use the MPI

infrastructure. Without this, there will be a substantial challenge in attracting investment.

Question 9: Do you have any further feedback on our analysis, conclusions or proposals presented in this consultation document?

Ofgem should consider whether there would need to be changes to other regimes to facilitate the proposals within this working paper. One such change, for instance, is whether an adjustment would be required to the Contracts for Difference (CfD) arrangements to allow the generator to connect to a party other than a Transmission Licensee.

We note that traded markets across GB interconnectors have decoupled this year as explicit auctions have returned while the post-Brexit FTA arrangements are still being worked out and put in place. This has led to a lack of pricing transparency and efficiency in the traded markets as interconnectors are not always flowing in the directions expected. This could become a significant risk cost, but also introduce further security of supply risks. We encourage Ofgem to use this consultation and other workstreams in this review as an opportunity to work with European agencies and regulators to ensure alignment and coordination that reinstates market coupling, for existing interconnectors as well as future MPIs.