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## **Interconnector policy review: Working Paper 3 – Wider impacts**

Dear IC Policy Review Team,

Thank you for giving us the opportunity to provide comments on the WP3 consultation.

Etchea Energy Partners is an independent firm providing management and consulting services to clients operating in the energy sector including interconnector projects.

### **Question 1: Do you agree with the approach we have taken to workstream 3?**

We note the three core areas identified by Ofgem on which it will focus on the non-market-modelling aspects in conjunction with its work on WS2:

1. Interconnectors' potential to provide flexibility in the energy system.
2. System operability benefits through the provision of services, as well as system costs.
3. Interconnectors' contribution towards decarbonisation.

We agree these areas cover the majority of the wider areas of impact of interconnection.

### **Question 2: Do you agree with the potential wider impact categories we have focussed on? Are there any other areas we should consider?**

We agree the categories covered in the consultation are the primary areas of investigation.

In our response of December 2020, we discussed the impact of new interconnector capacity on the liquidity of GB's wholesale electricity market.

The current structure of GB's wholesale electricity market is built primarily on physical bilateral trades between generator and consumer at a fixed price. These bilateral trades have little transparency and low liquidity. In comparison with the financial markets, the electricity wholesale market is relatively unsophisticated but has the potential to develop through the greater use of financial products, transparency of carbon content and granularity of intraday pricing.

Notwithstanding Brexit, recent developments in the trading of interconnector capacity have demonstrated the value of implementing some of these changes. The introduction of market coupling and the development of CfDs on neighbouring power exchanges has led to improvements in the use of interconnector capacity by ~5%. Importantly, this has also led to improved price signalling to the whole GB market and in turn to consumers.

Castagneto Gisseey and others noted in their 2019 paper<sup>1</sup>; *“With liquidity in new markets increasing, the establishment of additional markets at more fragmented timescales could maintain or even improve the profitability of interconnectors, which could help create a more secure, cheaper and sustainable electricity system”*.

Ofgem recognises that the low levels of liquidity in the GB wholesale market is an impediment to achieving efficient trading. Ofgem commissioned NERA to prepare a report on the same in December 2019<sup>2</sup>. NERA noted that GB's market churn was half that of France and less than one sixth of Germany. One explanation advanced by NERA to explain this market failure was that continental European countries benefit from high degrees of interconnection whereas GB does not.

Looking forward, the amount of GB interconnector capacity will more than triple from the current 5GW in operation, which in turn will materially increase liquidity in the wholesale markets. Further work is required to determine the value this liquidity can bring to the functioning of the GB market and to consumers, particularly as power flows will markedly increase in both volume and price volatility over the next decade.

Following the UK's exit from the EU, GB is no longer part of the Single Day Ahead Coupling. Therefore, there are no arrangements in place for the implicit day-ahead allocation of transmission capacity between GB and neighbouring bidding zones. Ofgem is currently consulting on the proposed approach to costs for the multi-region loose volume coupling trading arrangements under the EU-UK Trade and Cooperation Agreement<sup>3</sup> that will replace Single Day Ahead Coupling. This appears to be a timely opportunity to consider more broadly the impact of interconnection to the GB wholesale electricity market and its contribution to improving liquidity and value.

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<sup>1</sup> The Value of international electricity trading G. Castagneto Gisseey, B. Guo, D. Newbery, G. Lipman, L. Montoya, P. Dodds, M. Grubb, P. Ekins May 2019

<sup>2</sup> GB Wholesale Power Market Liquidity: Options Assessment, NERA December 2019

<sup>3</sup> Consultation on the proposed approach to costs for the multi-region loose volume coupling trading arrangements under the EU-UK Trade and Cooperation Agreement, Ofgem 26 May 2021

**Question 3: Do you think the discussion presented in this document adequately represents the potential impact of interconnection within each category? If not, please explain and provide supporting evidence if possible.**

We broadly agree with the discussion on each category in section 3 of the consultation document.

We note that Ofgem makes increasing mention of the ESO as part of the decision-making process for many aspects of an interconnector's products and services. As part of its remit, the ESO is well placed to determine and procure ancillary services from interconnectors and provide input to Ofgem's analysis on system operability. We also note Ofgem's comment "*the determination of location points for interconnectors is considered as part of the ESO's Connection Infrastructure Options Note (CION) process*". To date Ofgem has encouraged a developer-led approach for determining project locations. We consider it important that any change in policy avoids the risk that the developer-led approach is diluted to make way for a centralised decision process and snuffs out an entrepreneurial approach that has defined interconnector policy success to date.

**Question 4: Do agree with our initial views with respect to each potential wider impact category? If not, please explain why.**

We broadly agree with Ofgem's initial views on categories in section 3 of the consultation document.

Many of the wider benefits were well known before this consultation and have been modelled and quantified by ENTSO-E for more than a few years. Ofgem should avoid a lengthy analysis of these impacts if this results in a delay in analysing and advancing near-term projects.

**Question 5: Do you agree with our view on how wider impacts have been captured in past needs case assessments?**

As Ofgem notes, interconnector projects have previously been analysed by ENTSO-E, the EC and the connecting NRA as part of the TYNDP, PCI and project final approval decision respectively. The PCI approach has ensured a project's wider impacts have been identified and subject to analysis even if not directly appraised by Ofgem.

**Question 6: How do you think we should approach future needs case assessments within the framework presented in this working paper? Are there any other options we should consider?**

We consider Ofgem has identified the three main approaches to a needs case assessment. We agree the solution may lie somewhere between these approaches. Our preference is for a Developer led approach to maximise the population of projects presented to Ofgem. Such an approach provides flexibility to the developer to find solutions that best responds to the connecting country regulatory environment and overall financing solutions. Equally we are

less favourable on a centralised approach to assess projects where the choice of project is constrained to a smaller group of organisations.

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

We agree with the key wider impact categories identified by Ofgem; decarbonisation, flexibility, security of supply and system operability. As mentioned in our response to question 3, we consider a developer-led approach remains the optimal strategy to identifying projects for Ofgem's assessment.

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

We broadly agree with Ofgem's initial proposals subject to the following comments from our responses above:

- Ofgem's assessment of methodologies for assessing the wider impacts of interconnectors should not cause a delay in the advancement of near-term projects where there is already a clearly established needs case.
- Ofgem's assessment of the role proactive network planning could play in potential future needs case assessments should not constrain the developer-led approach to identify future projects.

We are available to discuss further any of the points made above.

Sincerely