

Email to:

Cap.Floor@ofgem.gov.uk

14 July 2023

Dear Nick Pittarello, Joshua Coomber, Richard Harrap, and Bartosz Slota,

Consultation on the Regulatory Framework, including Market Arrangements, for Offshore Hybrid Assets: Multi-Purpose Interconnectors and Non-Standard Interconnectors

About Scottish Renewables

Scottish Renewables is the voice of Scotland's renewable energy industry. The sectors we represent deliver investment, jobs, and social benefits and reduce the carbon emissions which cause climate change. Our 330-plus members work across all renewable energy technologies, in Scotland, the UK, Europe, and around the world. In representing them, we aim to lead and inform the debate on how the growth of renewable energy can help sustainably heat and power Scotland's homes and businesses.

About RenewableUK

RenewableUK members are building our future energy system, powered by clean electricity. We bring them together to deliver that future faster; a future which is better for industry, billpayers, and the environment. We support over 400 member companies to ensure increasing amounts of renewable electricity are deployed across the UK and access markets to export all over the world. Our members are business leaders, technology innovators, and expert thinkers from right across industry.

Overview

Scottish Renewables and RenewableUK (RUK) welcome the opportunity to respond to Ofgem's consultation on the Regulatory Framework, including Market Arrangements, for Offshore Hybrid Assets: Multi-Purpose Interconnectors and Non-Standard Interconnectors.

Please note that this response refers to multipurpose Interconnectors (MPIs), which have Offshore Wind Farms (OWFs) connected in GB waters, we have not covered Non-Standard interconnectors (NSI) which have OWFs connected outside GB waters.

Scottish Renewables and RUK welcome both consultations and believe they represent an important step forward to developing Multi-Purpose Interconnectors (MPIs) in Great Britain (GB). We continue to believe that MPIs will have an important role in delivering net-zero at least cost to the consumer and meeting the Government ambitions of 50GW of offshore wind and 18GW of interconnection by 2030. An Enduring Regime will need to coordinate changes to legislation, codes and methodologies in order to enable MPIs on the electricity grid.

The current legislation for interconnectors (Electricity Act 1989) was not developed with MPIs in mind and instead defines interconnectors as point-to-point connections with other countries. MPIs also do not fit into the definition for offshore transmission, which only considers a radial link connecting a single generator back to the shore. The current regulations do not provide an easy mechanism for these elements to interact through licensing, connection policy, charging or ownership.

Current legal and regulatory frameworks focus only on existing onshore transmission with 'bolt-on' regulatory arrangements for offshore transmission. Therefore, we welcome any changes wherein the compartmentalisation of the transmission system between offshore and onshore is reduced or removed. The development of an integrated offshore and onshore transmission system is needed to support the overall delivery of net-zero.

The proposals presented in this consultation represent an important step forward for developing the regulatory framework and market arrangements for MPIs. However, we are concerned that the proposals provide an attractive investment case for MPI owners but do not incentivise enough Offshore Wind Farm (OWF) developers to consider an MPI connection as opposed to a radial connection. In fact, under an Offshore Bidding Zones (OBZ) arrangement, a lot of changes need to be made to compensate for OWF to consider connecting to an MPI.

We recognise the potential system benefits of MPIS, but these will only be realised to the extent that offshore wind developers are incentivised to invest in connecting to an MPI rather than continuing with the status quo of radial connections.

Threshold returns

As set out in the consultations, offshore wind farm developers are expected to engage in significant new risks by connecting to an MPI. There also appears to be limited symmetry of the risk profile between OWFs and MPIs. MPIs appear to benefit from a narrow band Cap & Floor and RAB-based offshore platforms, whereas OWFs can expect to see lower prices and uncertain volume offtake. The consultations do not highlight advantages for existing OWFs and those in development to connect to MPIs. Creating an environment that will stimulate further investment in offshore wind is important. **Clear upsides to offshore wind developers connecting to MPIs need to be identified to compensate for the risks articulated in the Consultations.**

We have not responded to your questions in detail, but we would like to draw your attention to the following key points:

- We think that the benefits MPIs will bring to consumers go beyond the market design adopted. By combining interconnection with direct connections to OWFs, MPIs have the potential benefit of reducing disruption to coastal communities and reducing capacity costs due to decreased landing sites and associated infrastructure required.
- We support Ofgem's decision to classify MPIs as a new and separate asset class within the regulatory framework, with a new and dedicated licence to be introduced through primary legislation. It is in our interests that primary legislation for licences progress as quickly as possible. It may be the case that the details of the licence could set up new operational issues, such as changes to the 98% availability target, but that is still unclear. To ensure that OWFs connecting into an MPI are not worse off than under the radial counterfactual, availability targets (as well as any other relevant licence requirements) will need to be aligned between MPIs and OFTOs to the extent possible.
- It is our belief that the Home Market model is at present the model preferred by Offshore Wind Farms (OWF) for its similarity with the radial connection approach, but we understand the benefits of an Offshore bidding zone model. An OBZ market model will maximise the utilisation of the MPI and will better support market efficiency.
- In this context, we support the preferred option from Ofgem and DESNZ – an OBZ model with implicit trading arrangements. However, this is conditional on the OWFs being compensated fairly for the loss of revenue that they will have under this market setup.
- At present, our preferred compensation mechanism for OWFs under the OBZ model is an amended Contracts for Difference (CfD). However, we are open to the discussion of other options. Overall, the introduction of compensation mechanisms needs to be simple and transparent for all parties involved in the development of the asset.
- An amended CfD should reflect the reference price set in the OBZ market when the MPI is importing electricity to GB. This is because the OWF would receive the lowest price of the two bidding zones. Therefore, without an amendment of the CfDs, there will be an explicit loss of revenue when the OWF is importing electricity as the OWF will be paid the strike price over the GB wholesale price which will be higher than the EU price.
- The CfDs should also be extended to 25 years duration to align with the regulatory regime and reflect the life duration of the assets. Also, given that OWFs operating in an OBZ model will face higher balancing costs compared to the counterfactual radial connection, a new administrative strike price must be calculated to reflect this new risk for OWF developers.

- It is important that this regime is not overly restrictive to mandate the use of CfDs. We see a future for alternative revenue models such as Power Purchase Agreements (PPAs) or even merchant projects, which should be taken into account in any enduring regime. We would encourage DEZLN and Ofgem to look further to understand how OWF connected to an MPI could work on a merchant basis or under a PPA.
- In our understanding an OBZ model with implicit trading arrangements will provide market efficiency for all parties, but if this is not the case, and the OWF cannot trade electricity at the maximum capacity, we believe that a new compensation mechanism must be introduced. Otherwise, OWFs will have no incentive to connect to an MPI. We welcome clarification from DESNZ and Ofgem on this particular point.
- We support the preferred regulatory regime proposed by Ofgem. A narrow cap and floor model for the cables and a RAB model for the offshore platform. This regime will ensure that the MPI owner recovers the costs of investments. Overall, other regulatory mechanisms could impose an excessive risk on the MPI owner which could push back investments.
- We think that if the OBZ model is adopted, onshore TNUoS charges should be removed, as the OWF will lose priority access to the grid. Local charges should also be removed because the MPI owner will recover the costs of cables and offshore platform through the narrow cap and floor, and RAB model.
- We also believe that there needs to be consideration of the anticipated life of these assets and how the asset life relates to the regulatory regime. It is highly likely that if more than one offshore wind farm is connected, the use of the connections will vary in duration. Some owners may wish to extend the life of their assets or may design their offshore windfarms with a different design life. The current OFTO regime did not include provisions for extended Tender Revenue Periods. It would be good to see this considered upfront as this is likely to be more complex with the proposed schemes.
- It is vitally important that DESNZ and Ofgem ensure that there is a level playing field between offshore wind developers in whatever the final regulatory arrangements are.

Other considerations that need to be taken into account in an Offshore Bidding Zone model (OBZ)

- The calculation of imbalance prices and costs for a separate bidding zone created for OWFs connected to a single MPI needs clarification. For example, would this require switching the reference on an hourly basis based on the flow direction? And which TSO would be appointed to this separate bidding zone?
- If a separate bidding zone is created and included in the Single Intraday Coupling (SIDC), we must consider how market parties can trade out short-term imbalances given the one-

hour gate closure time of XBID. In addition, during periods when there is no cable capacity left, insufficient liquidity within the bidding zone renders the ability to organize a continuous local market impossible.

- The OBZ model poses financing insecurity for developers as their revenues converge to the lower-priced area. In addition, OWF with CfDs are affected by the market price of the connecting country, which implies that the funding required from GB consumers is determined by the price difference between the two markets, rather than GB's own market conditions. This raises questions about the financing of CfDs, the risk exposure of GB consumers and the involvement of the state.
- It may be worth mentioning that the European Parliament's ITRE group has recently agreed to grant a TAG (transmission access guarantee) for OWF connected to MPIs as part of the ongoing power market reform discussions. If this provision finds its way into the final regulation it may affect market arrangements in GB as well.
- The risk appetite of OWFs undertaking the project needs to be considered. This in turn will be informed by the method of financing that project and the threshold level of returns required by the developer. Moreover, further information would be required in relation to the expected rate of return under each of the regulatory options for a developer to investigate which of the options would be commercially viable.

Finally, with the assumption that, in some cases, the existing CfD scheme would be amended to address the issue identified with the reference price for the CfD in an OBZ arrangement. It is **essential that offshore wind developers are involved throughout the stakeholder engagement process**; we have set out some of our key concerns with the current direction of travel in the development of UK MPI regulation, but it is still **too early in the regulatory development to respond definitively**.

We are therefore keen to support and engage with Ofgem and DESNZ as the regulatory process develops to ensure the regulatory arrangements will incentivise offshore wind developers to connect OWFs to MPIs, and ultimately deliver on the Government and Ofgem's objectives.

Scottish Renewables and RUK would be keen to engage further with this agenda and would be happy to discuss our response in more detail.

Yours sincerely,

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