

Consultation of Ofgem and the Department of Energy Security and Net Zero on Market Arrangements for Multi-Purpose Interconnectors

21 July 2023

Offshore hybrid assets (OHAs) are expected to make a considerable contribution to the decarbonisation efforts of both the UK and its continental neighbours. They could also bring significant benefits to consumers in terms of lower costs and improved security of supply. However, a key precondition for realising these benefits remains the development of efficient connection and trading arrangements that would ensure the effective integration of these new volumes of renewable energy into electricity markets.

Key messages

- The choice of a connection model needs to be made on a case-by-case basis
- Price coupling is the most efficient way of allocating cross-zonal capacity
- Close cooperation between all relevant authorities and stakeholders is essential

Detailed comments

Offshore renewable energy assets and related infrastructure are expected to grow considerably from 2025 onwards. They are likely to evolve into a complex meshed grid connecting multiple countries and various assets (e.g., generation, storage, transmission infrastructure), where competition and efficient cross-zonal trading will be essential. A high degree of transparency and coordination as well as sophisticated governance will key to ensure that. In particular:

1. The choice of connection model should be based on a case-by-case market efficiency assessment

We do not think that one or the other model – Home Market (HM) vs Offshore Bidding Zone (OBZ) – for connecting an offshore renewable asset to cross-border interconnectors should necessarily be implemented as a general rule. A case-by-case assessment should be carried out to determine the most appropriate connection model depending on the circumstances. For each offshore project and each interconnector, this decision should be taken in full transparency and considering the network specificities in order to guarantee efficient price signals for optimal overall market efficiency. The choice of market model should also take account of possible technological evolutions in the more distant future and ensure compatibility for the connection of various types of technologies to OHAs, aside from offshore wind farms.

2. Price coupling should be reinstated, as the most efficient way of allocating cross-zonal capacity

From a commercial and grid development and operation perspective, there is an undisputable benefit to having the same trading arrangements applied to all relevant interconnectors. Electricity markets neighbouring the UK - EU markets and Norway - are all connected through price coupling in the day ahead and intraday timeframes, which creates favourable conditions for the efficient integration of offshore renewable energy into electricity markets.

We understand that the UK Exit from the EU brings complexity to the discussion of the most efficient way forward in relation to capacity allocation. However, we object to the assertion in the consultation document equating in terms of efficiency price coupling and volume coupling (the so-called multi-region loose volume coupling (MRLVC) proposed under the Trade and Cooperation Agreement (TCA)). The options for implementing MRLVC come with considerable risks and implementation uncertainty attached to them. Price coupling is certainly the more efficient solution, and the one we wish to see implemented in the nearest possible future to ensure an efficient integration of OHAs.

3. Close cooperation between all relevant authorities and stakeholders is necessary

Even if the most appropriate trading arrangements are correctly identified, they cannot be implemented without close cooperation between all relevant authorities and stakeholders. In such a complex set-up, the governance and cooperation arrangements around OHAs would be of paramount importance. As offshore hybrid assets by definition would be connected to more than one market, and as some of them may be built beyond territorial waters, close coordination and consultation among the relevant TSOs and authorities will be paramount.

The UK is no longer part of the EU, nor is it an EEA signatory. At the same time, it remains one of the most important parties in relation to North Sea offshore renewable energy development. Close cooperation within the framework of the North Seas Energy Cooperation (NSEC) and in the context of the Specialised Committee on Energy, and implementing the cooperation commitments of the Ostend Declaration would be essential.

From a governance perspective, there are a number of moving pieces, which create considerable uncertainty about the prospects for efficient integration of OHAs in electricity markets. Those include:

- ***Implementation of EU-UK Trade and Cooperation Agreement (TCA)***
The TCA foresees the implementation of new arrangements for cross-border trading between the UK and the EU following the Exit of the UK from the EU. A number of open questions remain regarding the options for implementing the proposed multi-region loose volume coupling (MRLVC). Moreover, even if those significant risks are somehow addressed, MRLVC cannot deliver the same level of efficiency as price coupling where a single algorithm determines simultaneously

flows across interconnectors between connected markets and prices for those markets.

We acknowledge that the OHAs market arrangements and the TCA implementation are separate processes, but the two cannot be discussed in isolation due to the strong impact that trading arrangements would have on the efficient integration of offshore renewable energy into cross-border electricity markets. Inefficiencies will also result from the adoption of different trading arrangements at different borders due to the expected highly complex meshed character of the offshore generation, storage and transmission infrastructure.

- **Review of Electricity Market Arrangements (REMA)**
The same comment relates to the ongoing REMA process. We understand that this is a separate process, but some of the discussions taking place in the REMA context – e.g., the prospects for implementing nodal pricing – are of high relevance for OHAs and potential issues need to be considered already today.

We are particularly concerned about the potential effect of nodal pricing on cross-border trading with neighbouring zonal markets over standard, MPIs and non-standard interconnectors (NSIs). We hope that the consultation feedback will include how the relevant REMA and MPI policy teams will be exploring the links between the two processes.

- **EU (and potential future UK) Carbon Border Adjustment Mechanism (CBAM)**
The EU CBAM is already a reality and the UK Government is also considering implementing such a regime. We are concerned that unless the UK (and EEA neighbours in the case of a UK CBAM) is exempted from the application of such a mechanism for electricity imports (e.g., through linking the EU and the UK Emissions Trading Schemes (ETSs), or through market coupling), cross-border trading may be seriously impacted. With the expected growth of OHAs and the market arrangements for those under development, the potential impact of CBAM on these assets (e.g., the congestion rule for using actual emissions) needs to be examined closely.

The interdependencies and relevance of these processes with that of OHA trading arrangements are so strong that they cannot be discussed in isolation. In the same way that discussions around OHAs need to take those processes into account, it is essential that the future of OHAs features prominently in discussions on the TCA implementation, REMA, and CBAM implementation.

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