

Deliberation of the French Energy Regulatory Commission (CRE) dated 2 October 2013 approving the implicit Day-Ahead allocation method for interconnection capacity within the North-West Europe region and approving changes to the access rules for the France-England interconnector.

Present: Philippe de LADOUCKETTE, Chairman, Olivier CHALLAN BELVAL, H  l  ne GASSIN, Jean-Pierre SOTURA and Michel THIOILLIERE, Commissioners.

In application of Article 30 of the specifications appended to the public service concession agreement dated 27 November 1958, providing for the concession to RTE R  seau de Transport d'  lectricit   (RTE) of operation of the French power system and referring to the text of French Order No. 2006-1731 dated 23 December 2006 approving the standard specifications for the concession of the public electricity transmission system, RTE wrote to the French Energy Regulatory Commission (CRE) on 13 September 2013 to request approval of the following:

- A proposal of Day-Ahead allocation mechanism for interconnection capacity for the England-France, France-Germany and France-Belgium borders,
- A proposal of access rules for the England-France interconnector.

1. Background

Explicit auction mechanisms for the allocation of Day-Ahead interconnection capacity result in inefficient use of the interconnectors as they do not include information on organised market energy prices. The Report on the Use and Management of Interconnections in 2012, published in July 2013 by CRE, highlighted this.

This is why CRE recommends the implementation of implicit auctions through market coupling. Price coupling is the target mechanism for Day-Ahead capacity exchanges. It was defined as such in the Framework Guidelines on Capacity Allocation and Congestion Management published by ACER on 29 July 2011, following consultations with the stakeholders on a European level. Market coupling is a major step forward in the integration of European electricity markets and its implementation leads to more efficient border exchanges and optimal use of Day-Ahead capacity.

On 9 November 2010, the trilateral coupling (France-Belgium-The Netherlands) was extended to Germany and the Central-West Europe region (CWE)¹ has since been coupled in terms of volume with the North region². The plan for market coupling in the North-West Europe region (NWE)³ aims to change volume coupling with the Nordic market into more efficient price coupling, and to further market coupling between France and Great Britain. Significant gains

¹ Germany, Belgium, France, Luxemburg, the Netherlands

² Germany, Denmark, Finland, Norway, Sweden

³ Germany, Belgium, Denmark, Finland, France, Great Britain, Luxemburg, Norway, the Netherlands, Sweden

are expected through the coupling with Great Britain: the supply costs on Day-Ahead markets would have been cut, on average, by almost €50 million per year over the last four years if market coupling had been in place between France and Great Britain.

As part of the launch of market coupling between France and Great Britain, it is necessary to modify the access rules applicable to the England-France interconnector (IFA). These rules must reflect the Day-Ahead capacity allocation method. The implementation of coupling implies the modification of the rules with regard to the firmness of capacity, the fall-back procedure and the resale of long-term products (Use-It-Or-Sell-It). Moreover, IFA interconnector is a Direct Current (DC) cable and energy flows are subject to physical losses. The issue of loss and the impact (in particular with regard to the Use-It-Or-Sell-It) must also be addressed.

The Transmission System Operators (TSOs) in charge of managing the interconnector (RTE for France and NGIC for Great Britain) consulted market players from 7 May to 15 June 2013 with regard to the new price-based market coupling mechanisms in the NWE region and the new version of IFA access rules.

2. The main characteristics of price coupling in the North-West region

The NWE price coupling solution must replace price coupling in the CWE region and volume coupling with the Nordic region as well as extending coupling between France and Great Britain. The implementation of this solution will go hand in hand with the implementation of the future European price coupling algorithm.

This project has required the standardisation of practices by Power Exchanges (PXs) and TSOs. The algorithm must also take into consideration the requirements of stakeholders in the NWE region, and in Europe as a whole. The market coupling design has raised issues such as the inclusion of losses into the algorithm, the implementation of robust coupling procedures and the harmonisation of price caps.

A study of the losses on Direct Current cable conducted by the project team of the PXs and TSOs of the NWE region shows that including losses in the algorithm results in an increased overall gain and the consequences on French prices and flows are minor.

With regard to coupling procedures, a consultation was conducted during the first quarter of 2013 by the project team in order to request market players' requirements. The proposed procedures on the Day-Ahead market, including fall-back procedures, are a compromise obtained from the consultation, as demonstrated in particular by keeping the auction gate closure at 12pm and introducing flexibility with regard to the nomination time.

Up to now, price caps applied by the NWE PXs are not harmonised. During the consultation conducted by the project team, a large majority of market players (65 contributors to the consultation out of 72, i.e. 90%) are in favour of harmonised price caps, putting forward the advantages in terms of coupling efficiency, competition, price convergence and market integration. The project's Joint Steering Committee, made up of PXs and TSOs of the NWE market coupling project, approved the level of harmonised price limits (+3000 €/MWh and -500 €/MWh).

3. The main amendments proposed by RTE to IFA access rules

The IFA access rules, proposed jointly by RTE and NGIC, include the modifications required for the launch of market coupling between France and Great Britain. The main changes concern the discontinuation of the explicit Day-Ahead auctions, to be replaced by implicit auctions except in the event of market coupling unavailability (fallback procedure), the implementation of financial firmness after the nomination of long-term rights and changes of compensation conditions resulting from the Use-It-Or-Sell-It.

As part of market coupling, a physical firmness of implicit allocations must apply. For products sold through explicit auctions in the long-term timeframe, the TSOs have proposed a reimbursement at the auction price before sending of authorisation programs and followed by financial firmness. This financial firmness is based on compensation at the price difference between the French and British Day-Ahead markets. RTE and NGIC propose that compensation at the price spread does not take into account the cost of losses and should be capped to the monthly income received by the TSOs and by Day-Ahead market spread cap. The Day-Ahead market spread cap proposed is calculated by taking the 80th percentile of price spread over the twelve months preceding the month concerned.

The proposed valuation of non-nominated long-term capacity (Use-It-or-Sell-It) is based on the price spread resulting from market coupling. In the case of implicit allocation, the payment of the Use-It-or-Sell-It is made by paying all income from the implicit auction obtained from the resale of rights and is equal to the price spread adjusted by losses in the event of congestion and nil if there is no congestion.

4. CRE's observations

Concerning NWE market coupling:

In its analysis of the NWE price coupling solution and based on the joint report of NWE regulators assessing the coupling algorithm, CRE believes that the conditions of the solution enable efficient coupling in the region.

Firstly, according to the study conducted by the PXs and TSOs, the inclusion of losses in the algorithm optimises market coupling and the impact on flows and prices remains limited. However, CRE believes that there are potential gains related to the optimised management of losses between the different timeframes, resulting in a better acknowledgement of actual losses.

Secondly, the coupling procedures proposed may help to reduce the risks of total decoupling by authorising partial decoupling. However, partial coupling procedures may no longer be launched 40 minutes after the gate closure time (12:40pm for D-1). CRE believes that this restriction is harmful as it increases the risks of total decoupling. The procedures in the event of coupling unavailability (fallback procedures) seem solid, and the information provided to market participants and the time left to adapt offers are satisfactory.

Lastly, with regard to the harmonisation of price caps, CRE supports the position of the majority of market participants. Within a coupled area, this harmonisation ensures that exchanges are not limited due to a lack of standardisation, while the interconnector is not congested and there is a price difference. The harmonisation of price caps is therefore essential for the proper functioning of the markets. The levels of the caps fixed and approved by the project's Joint Steering Committee seem to be an acceptable and coherent compromise in view of their objectives and price history.

Concerning to the IFA access rules:

In its analysis of the changes to the IFA access rules, CRE believes that the proposed changes enable the implementation of market coupling between France and Great Britain. However, some amendments to the rules appear necessary in order to ensure an efficient and non-discriminatory functioning of the markets.

To improve quality of coverage and avoid differences in treatment among capacity holders according to the auction through which they obtained it and how they will use it, it is necessary to strengthen the firmness of products proposed via explicit auctions, by shifting from a reimbursement of auction price to financial firmness before and after the sending of authorisation programs. This strengthening of firmness is supported by CRE and it is based on the Framework Guidelines on Capacity Allocation and Congestion Management. A compensation cap may be considered. However, the criterion proposed by RTE and NGIC (80th percentile) seems too low. The cap must apply

only in cases of price peaks. A criterion around the 95th percentile would result in compensation of the price differences, except in the event of particularly high price differences, when the cap would be activated.

Moreover, CRE recommends the consideration of losses in the compensation, failing which treatment would be more favourable in the event of reduction than for resale via Use-It-Or-Sell-It.

Lastly, RTE and NGIC have decided, based on the opinions of market participants received during the consultation, not to implement a pro-rata reduction method that takes into account rights allocated for all timeframes without distinction. CRE would like the TSOs to analyse the reasons why market participants were not in favour of the pro-rata method, which seems to be suitable at many borders and enables a non-discriminatory treatment regardless of timeframes.

The rules submitted by RTE and NGIC include the possibility of reserving capacity for intraday, while this was not an option in the rules for the splitting of capacity at the different allocation timeframes. If reserving capacity for intraday are to be considered, it must be provided for in the capacity splitting rules and subject to regulatory approval.

5. CRE's decision

Pending approval from the other regulators concerned, CRE approves the launch of NWE market coupling. In particular, CRE approves the inclusion of a loss factor in the algorithm concerning the DC cable between France and England. Furthermore, CRE recommends the harmonisation of price caps within the NWE region.

CRE approves the IFA access rules submitted by RTE on 13 September 2013, pending their approval by Ofgem and provided that the following amendments are made prior to the launch of coupling between France and Great Britain:

- The Day-Ahead market spread cap must be set at the 95th percentile.
- The option of reserving capacity for intraday must be removed.
- Compensation in the event of reduction must take into account the cost of losses. This modification must be made as soon as possible.

The proposed changes are a step forward and are essential for the implementation of market coupling. CRE notes, however, that additional improvements remain necessary for more efficient management of the interconnector and to operate in line with target models on a European level, in particular with ACER's recommendations and with the Framework Guidelines on Capacity Allocation and Congestion Management.

As a result, CRE requests that RTE:

- Study improvements with regard to the management of losses and the interactions between the various timeframes in order to bring about a better acknowledgement of actual losses, for long-term products in particular,
- Analyse the possibility of shifting the prioritization of reductions towards a pro-rata based method for all timeframes, in particular by considering the reasons why market participants were not in favour of this pro-rata method,
- Study the feasibility of extending the maximum duration of partial decoupling launches in order to avoid total decoupling,
- Introduce, during the next changes made to the rules, financial firmness before the sending of authorisation programs, to reduce the impact of compensation caps and withdraw the application of these caps after market coupling (12pm D-1).

Executed in Paris, 2 October 2013,

On behalf of the French Energy Regulatory Commission (CRE),

The Chairman,

Philippe de Ladoucette