Public consultation

Paris, 4 June 2015

CRE's public consultation on the evolution of the characteristics of long-term electricity transmission rights allocated in long-term timeframes at the France-Italy interconnection

Introduction

The creation of an internal market for electricity in Europe is based in particular on the harmonisation of the rules for the use of cross-border electricity interconnections. Several European network codes are currently being adopted, among which the code related to forward capacity allocation, i.e. for monthly and annual timeframes. All French borders are concerned (with the exception of the Swiss border which is not a part of the European Union). With regard to the Italian border, long-term capacity products are still subject to specific firmness rules. The purpose of this public consultation, and of the one carried out at the same time in Italy, is to request stakeholders to express their opinion on the possible evolutions of the firmness rules that would apply within the framework of the early implementation, as from January 2016, of the network code on forward capacity allocation. This evolution in the firmness regime could go together with a redefinition of the capacity levels allocated in long-term timeframes. Responses are expected for 19 June 2015 at the latest.

1. Process for harmonizing the rules for allocation of interconnection capacity in long-term timeframes

1.1. European network code on forward capacity allocation

Electricity transmission rights at interconnections are allocated according to several complementary mechanisms, including long-term, day-ahead, intraday timeframes and balancing. While capacity is allocated implicitly through market coupling for day-ahead capacity, and such a solution will be progressively deployed for intraday capacity, the allocation of long-term rights is carried out through explicit auctions. Also called physical transmission rights (PTRs), long-term products complete the day-ahead timeframe by offering to players the possibility of taking a position at the interconnection over a long period (one year, one month, etc.) enabling them for example, to implement an over-the-counter cross-border delivery contract. Moreover, such a product enables players to hedge against price fluctuations in cross-border exchanges. These rights therefore help to ensure the proper functioning of the electricity market, by reducing the financial risks to which market players are exposed, and therefore the related costs. The benefits brought by these products increases when the guarantees provided by transmission system operators to honour their cross-border transmission service (also called firmness) does.

In order to improve and harmonise the quality of capacity products allocated to market participants in these timeframes, a European network code on long-term product allocation (Forward Capacity Allocation

Network Code, FCA code) is being prepared and is expected to specify the arrangements for calculating and allocating capacity for this timeframe. The current text, prepared by ENTSO-E based on the framework guidelines drafted by ACER, was recommended[1] for adoption by ACER to the European Commission subject to certain amendments. ACER essentially wished to make the text more ambitious, in particular in terms of firmness and harmonisation.

The provisions of the FCA Code specify that ENTSO-E shall propose harmonised allocation rules reflecting the technical guidelines in the code (Harmonised Allocation Rules, referred as HAR rules). These rules, gathered in a single text, will specify the allocation arrangements and characteristics of long-term products for all of the European borders. They will be formally adopted by national regulatory authorities and will be able to be revised.

Wishing to enable market participants to benefit from the advantages of the firmness rules contained in the network code as soon as possible, ACER made in 2014 a request to ENTSO-E for the early development of the harmonised allocation rules, applicable to all products whose delivery is to begin after 1 January 2016. The French energy regulatory authority (CRE) particularly encouraged this approach, because of the importance it attaches to the application of a satisfactory level of firmness for all of the French interconnections. ENTSO-E therefore submitted these HAR rules for public consultation in February 2015. This first set of rules includes a certain number of annexes that should enable local specificities to be addressed temporarily. The rules will be submitted to regulatory authorities early July 2015, for approval scheduled for September or October according to the different national approval procedures.

1.2. Evolutions envisaged for long-term products at the border with Italy

The firmness of a product reflects the level of commitment of the system operators to honour the right sold in the event of an unforeseen event affecting the network.

A distinction is generally made between physical firmness, through which system operators commit to honouring the transmission right sold to users regardless of operational difficulties, and financial firmness where system operators commit to providing to a right holder an equivalent service. Since the main goal of long-term transmission rights is to cover players against the spread between the prices of the origin and destination spot markets, there is equivalence if, in the event of a curtailment in its long-term right, a market participant obtains payment by the system operators of this spread applied to capacity not being honoured. Indeed, in the event of curtailment, a player that intended to transit energy from one market to another will have to sell on the origin market the surplus energy it holds, and find the missing energy in the destination country.

With regard to the interconnection between France and Italy, the financial compensation rules in the event of capacity reduction are currently very far from the financial firmness principles that constitute the target established in ACER's framework guidelines and in the Network Code proposed by ENTSO-E. If there is a curtailment, the right holder only receives compensation equal to 110% of the auction price at which the right had been sold[2]. It is therefore a reimbursement of the capacity subscribed, which does not correspond to the loss of value for the right holder.

[1] ACER's recommendation for adoption was published on 22 May 2014 and is available at the following link: www.acer.europa.eu

[2] It should be noted that beyond 35 days of curtailment of all capacity sold, it is no longer possible for system operators to curtail capacity.

The discussions on the evolution of firmness began between French and Italian regulatory authorities and system operators several months ago, in particular within the framework of the revision of the explicit auction allocation rules of the CASC platform[3] which was necessary for enabling extension of day-ahead market coupling to the France-Italy border[4].

For a long time now, the Italian regulator, AEEGSI, has expressed its concern regarding the risk of a cost increase for the Italian system operator that could be caused by a change in the firmness regime[5], highlighting that in order to maintain firmness costs, such an evolution might require a downward revision of the volume of products allocated in long-term timeframes. This concern is due in particular to the fact that the volumes allocated for long-term products are particularly high (almost all annual capacity is allocated in long-term timeframes). At the other French borders, generally 80%[6] of the capacity calculated one-year ahead is allocated in long-term timeframes) and to the fact that the price spread in the France to Italy direction is very high (an average €20/MWh in 2014).

In order to quantify the financial risk for system operators related to the evolution of firmness and to enable market participants to express their opinion on firmness as well as on the volume of long-term products, CRE, not only with its Italian counterpart, but also with the Austrian and Slovene regulators, requested system operators:

- to produce a study stating the impact on the average volume allocated for long-term products if firmness costs were to be strictly maintained;
- and to publish this study at the same time as the public consultation carried out in February 2015 on the HAR rules.

The system operators submitted their conclusions to regulators at the end of April, which was too late however for those conclusions to be included in the public consultation organised by ENTSO-E in February. Their proposal consisted in not improving firmness at the France-Italy border earlier than set out by the Network Code[7] and to keep the characteristics of long-term products as they are.

However, AEEGSI and CRE, considering to propose changes to improve firmness, decided to organise two parallel consultations in order to:

- bring to the attention of market participants the fact that the change in firmness regime could result in a drop in the volume of products allocated in long-term timeframes;
- present the different envisaged options based on the scenarios studied by the system operators.

AEEGSI's consultation covers the three coupled north-Italian borders (France-Italy, Italy-Austria and Italy-Slovenia). CRE's consultation only covers the France-Italy interconnection.

[3] CASC is the platform that allocates long-term rights in particular, for all of the French interconnections (with the exception of the France-England border).

[4] In its deliberation of 23 October 2014, in addition to the modifications strictly necessary for market coupling, CRE had extended the application of the 110% coefficient to both directions, whereas it was previously applied only to the France to Italy direction.

[5] The improvement in firmness can in fact present a risk of higher firmness costs for system operators if the curtailments occur during times at which the price spread is higher than the price of the auction where the right was acquired.

[6] The France-Spain interconnection is an exception.

[7] This firmness regime was thus addressed in a specific annex to the HAR rules proposal.

On the basis of the responses obtained at their two consultations, CRE and AEEGSI intend to define a common approach for both the firmness and the volume of capacity allocated in long-term timeframes. For this second point, while the present consultation should enable the broad lines to be set, a subsequent consultation by RTE (in September) on the rules for splitting capacity between timeframes (split rules), shall enable players to express their opinions on the exact definition of long-term products.

2. System operators' study and options proposed by AEEGSI in its public consultation

2.1. Summary of the system operators' study

The study carried out by the system operators consists in assessing the volume of long-term products allocated in the France to Italy direction according to three scenarios as an alternative to the current practice. This practice, validated by CRE in the rules for splitting capacity between the different timeframes, involves maximising the long-term capacity sold in view of the yearly capacity calculated by the system operators (yearly NTC – Net Transfer Capacity).

The first two scenarios consist in seeking strict maintenance of the costs generated for the system operators according to whether the firmness considered is a reimbursement of the positive price spread as envisaged by the "target firmness" or a reimbursement at 110% of the price of the initial auction (current firmness regime). It should be noted that this approach only concerns the gross costs of an increase in firmness, and focuses on the consequences only from the system operators' point of view. For CRE, other elements should be taken into account such as the value of firmness for the market, which could result in greater appreciation for long-term products by market participants and therefore, higher allocation prices.

The first scenario (scenario A) compares these costs and proposes a redefinition of the total average capacity sold as long-term products based on the curtailments observed over the last four years, as well as on the past spot prices and auction prices.

The second scenario (scenario B) compares the costs and proposes a redefinition of the total average capacity sold as long-term products based on the same spot prices and the same auction prices, but by considering that the system operators are required to reduce all of the capacity sold, for all hours of the year.

A third scenario (scenario C) involves a definition of long-term products, not as in current practice based on a yearly capacity calculated in a relatively precise and coordinated manner by all of the system operators of the north Italian border, but based on a more conservative calculation. The France-Italy border is indeed the only French interconnection for which yearly capacity is calculated with such a degree of coordination (this however, is not the case for day-ahead capacity). The calculation proposed in the third scenario would adopt an approach no longer based on an optimised calculation, but on a conservative calculation based on an N-2 rule (i.e. capacity that can be met in the event of the failure of two elements in the network) instead of the N-1 rule generally applied.

The results in terms of the redefinition of long-term capacity are summarised below:

Table 1: Total average volume of long-term products in the France to Italy direction

(in MW)	Current volumes	Scenario A: Maintenance of firmness costs, historic reductions	Scenario B: Maintenance of firmness costs, total reductions	Scenario C: approach based on an *ad hoc* capacity calculation
2011	1,742	1,516	1,109	875
2012	1,522	1,461	1,208	883
2013	1,721	1,342	1,591	917
2014	1,853	1,853	1,748	1,070
Average for the four years	1,710	1,543	1,414	936
reduction compared to current volumes	-	-10%	-17%	-45%

2.2. Options proposed by AEEGSI and CRE's preliminary analysis

On the basis of this study, AEEGSI proposed three options in its consultation launched on 21 May.

The first one consists in a status quo for the two issues:

- maintenance of current firmness[8];
- maintenance of the current rule for defining long-term products based on yearly capacity (and maintenance of the methodology for calculating yearly capacity).

For CRE, this option defers the improvement of firmness to the application of the FCA network code, while the early evolution of firmness at this border would definitely be beneficial.

The second option consists in:

- an evolution of firmness towards target firmness. The rule would then be a reimbursement of the price differential with the application of a cap on income as provided for in the network code: firmness costs could not exceed the income generated at this interconnection for all timeframes. However, the cap envisaged is a monthly one, an in that regard, deviates from the target solution recommended by ACER, which defines an annual cap;
- a measured reduction of the total average volume allocated in long-term timeframes based on scenario B proposed by the system operators.

CRE considers that given the current state of reductions at the France-Italy interconnection, the definition of a monthly cap instead of an annual cap is not likely to affect the actual compensation of transmission rights holders since it is highly unlikely that a monthly or yearly cap would be reached. In addition, CRE considers that, while the reduction of the volume allocated in long-term timeframes is not in itself justified by the

[8] This firmness derogation regime was addressed in a specific annex to the HAR rules proposal drafted by ENTSO-E.

improvement in firmness, strictly maintaining the level of financial risk related to firmness costs for system operators can lead to the redefinition of volume. CRE notes however, that in this context, the system operators' scenario A is more relevant than scenario B given the reduction hypotheses that it considers.

Nevertheless, CRE observes that this scenario would lead to selling in long-term timeframes 80% of yearly capacity (yearly NTC), which corresponds to the levels applied at the other French borders, although the NTC is not calculated in such a precise manner. From a more general perspective, this approach is part of an overall strategy which consists in the allocation by system operators of more and more capacity as real time approaches, enabling them to offset the risk taken by better knowledge of the system.

The third option consists in:

- a complete alignment of firmness with the target model;
- a considerable reduction of the total average volume allocated in long-term timeframes based on scenario C proposed by the system operators.

For CRE, this option aligns perfectly with the target firmness defined in the FCA code, but at the price of a reduction of volumes allocated in long-term timeframes deemed disproportionate. The system operators' scenario B (on which option 2 proposed above is based) is already a borderline case in which the risk of an increase in the firmness cost is largely ruled out. In addition, this option involves not taking advantage of the continuous efforts system operators have made for some years now to optimise their yearly capacity calculation.

More generally, concerning options 2 and 3, which envisage a reduction of the volume allocated in long-term timeframes, CRE considers:

- that any volume not sold for any of the long-term timeframes shall be made available to the market for the day-ahead timeframe at the latest;
- that such a volume deferred from a long-term timeframe to another timeframe must be justified by a real and significant risk for the system operator and that the volume that would be set following this consultation could be reviewed at a later time;
- that if such a risk related to the distance from real time can lead to the acceptance of a prudent approach for volumes allocated for long-term products, the volumes allocated for the day-ahead timeframe and intraday timeframe must be maximised, by taking advantage of the more precise knowledge of system operators concerning the electricity system in these timeframes. Therefore, the volumes allocated in these short-term timeframes could not be based on the capacity calculated at yearly timeframe. The implementation of a coordinated capacity calculation complying with or tending to comply with the specifications of the regulation for capacity allocation and congestion management (CACM regulation) is, in that regard, essential. CRE is therefore paying particular attention to the project currently being developed at the north-Italian interconnections in order to implement a coordinated capacity calculation. CRE invites RTE and its partners to complete the project as soon as possible and expects an increase in the capacity available between France and Italy and a more secure operation of the electricity system.

3. Questions to market participants

CRE invites interested parties to answer the following questions in the light of the elements presented above. CRE recalls that this consultation is organised in parallel to the consultation launched by AEEGSI on the same topic on 21 May 2015 (http://www.autorita.energia.it/allegati/docs/15/239-15.pdf).

Contributions must be addressed to CRE by Friday, 19 June 2015 at the latest:

- either by email to the following address: dr.cp1@cre.fr
- or by post: 15, rue Pasquier - F-75379 Paris Cedex 08

CRE will release a synthesis of the answers, taking into account elements protected by law. Contributors are invited to make clear for which elements they wish to preserve anonymity and/or confidentiality. Otherwise, your whole contribution will be considered to be non-confidential and non-anonymous.

Question 1: Do you wish for the firmness of long-term rights at the France-Italy border to evolve significantly as from 1 January 2016 towards the target model, given that it is likely that such an increase would result in a reduction of the total average volume allocated in these timeframes?

Question 2: Which of the three options described above appears to be the most relevant in your opinion? In particular, does option 2 appear to be an acceptable compromise given that it is based on an approach that consists in the allocation by the system operator of more and more capacity as real time approaches?

Question 3: Following this consultation, CRE and AEEGSI may request system operators to work on a new definition of products based on the total average volume allocated in long-term timeframes which will result from the option adopted. These questions will be addressed in a consultation to be carried out by RTE in autumn 2015. Do you already have elements that might be taken into account by RTE in its preparation of these rules and, in particular, in terms of the split between annual and monthly products?

Question 4: To what extent would an improved firmness lead you to better price interconnection capacity? Would that have an impact on your strategy for bidding at explicit auctions? If so, can you quantify the impact according to the different options proposed in terms of firmness?

Question 5: Do you have any other remarks?