

# BritNed interconnector competition assessment

## A REPORT PREPARED FOR BRITNED

BritNed Development Ltd (BritNed), a joint venture between National Grid and TenneT, is potentially planning to build an HVDC subsea link between the UK and the Netherlands.

BritNed wishes to obtain an exemption from Article 6(6) of EC Regulation 1228/2003 (the Regulation) and the respective national transpositions of Articles 20 and 23 of the Electricity Directive 2003/54/EC. The Regulation sets out the criteria which must be met for a new DC interconnector to be granted exemption from these Articles. The Regulation states that, *inter alia*:

‘(a) the investment must enhance competition in electricity supply

.....

(f) the exemption is not to the detriment of competition or the effective functioning of the internal electricity market...’

BritNed has requested Frontier Economics to conduct a competitive assessment of the BritNed line and its proposed exemption in order to ascertain whether the competition tests embodied within these two criteria are in fact met.

## MOTIVATION FOR APPLYING FOR EXEMPTION

Typically, requests for energy infrastructure to obtain exemption from the requirement to offer rTPA are motivated at least in part by the fact that they need access arrangements that would **not** meet the criteria for rTPA. For example, users of an LNG terminal will want long term contracts, because they in turn will make major investments that can only be justified with assured access to an import terminal.

BritNed’s motivation for seeking rTPA is rather different. It does not seek the ability to enter into long term contracts with users, as the economic rationale for the BritNed line does not depend on potential users making major investments for which access to the line is critical. In contrast, BritNed’s need for exemption is related to the commercial risk of the project.

The value of the BritNed line will be derived from the difference between the price of electricity in the UK and the price in the Netherlands. Such price differences are very uncertain and therefore the commercial returns to the project are uncertain. Given these risks, investors in BritNed need the assurance that they will not just face the downside risks to project returns, but will also benefit fully from the potential upside. If the line were not exempt from Article 6(6) of the Regulation and the respective national transpositions of Articles 20 and 23 of the Electricity Directive 2003/54/EC, there would be a danger that, if it is commercially successful, the returns to investors would be capped. However, if it is unsuccessful there is no mechanism for compensating investors. From a UK perspective, National Grid Electricity Transmission plc’s licence prohibits its

participation in interconnectors. Furthermore, it would seem at odds with Ofgem's approach, and practically very difficult, to enable an independent owner of an interconnector to receive compensation from socialised charges. The potential to cap upside but not downside would create an asymmetry which would reduce expected returns to below the level that would be acceptable to the investors.

To have the greatest assurance possible of keeping the upside revenue potential, BritNed is seeking exemption from both Article 6.6 of the Regulation and the rTPA provisions contained in Articles 20 and 23 of the Electricity Directive 2003/54/EC.

Article 6.6 of the Regulation, if applied, would require that

Any revenues resulting from the allocation of interconnection shall be used for one or more of the following purposes:

- (a) guaranteeing the actual availability of the allocated capacity;
- (b) network investments maintaining or increasing interconnection capacities;
- (c) as an income to be taken into account by regulatory authorities when approving the methodology for calculating network tariffs, and/or in assessing whether tariffs should be modified.

It is difficult to interpret how this Article might be applied when the parties making the investments are not TSOs acting *que* TSOs. The least favourable interpretation from the project sponsors' perspective would be that they would be required to surrender **all** revenue (not just any return on capital) in order that such revenue be applied to one or more of these purposes listed above. Less extreme interpretations would still introduce a risk of material loss of value in the event that the project turns out *ex post* to be successful. We are informed that any interpretation that risks the revenue not accruing to the project sponsors would be unacceptable to the sponsors.

Articles 20 and 23 of the Electricity Directive 2003/34/EC deal with the role of regulatory authorities in setting or approving *inter alia* tariffs or tariff methodologies for rTPA and do not distinguish between arrangements for interconnectors and networks more generally. While the requirement for market based congestion management on interconnectors leaves the concept of tariffs for interconnectors potentially redundant, exemption from these Articles would assure the sponsors that there could be no attempt to impose tariffs that would reduce their remuneration below that which would be the result of the normal implementation of market based congestion management.

In summary, BritNed is seeking exemption from rTPA solely to protect expected returns. It is not seeking to institute an access regime that would differ from the auction based access under rTPA, it only seeking to avoid the imposition of tariffs or the requirement to apply interconnector revenue to specified uses.. Indeed, we are informed that BritNed is prepared to have imposed as a condition

of exemption that it offers a regime for **access** that meets all the current relevant rTPA congestion management requirements and guidelines.

## IMPLICATIONS FOR THE COMPETITIVE ASSESSMENT

This position changes the nature of the analysis needed to establish whether the relevant exemption criteria are met. In short, we will establish:

- The investment *per se* (absent access and ownership issues) would enhance competition.
- The intended ownership and a regime of congestion management access in accordance with rTPA would not jeopardise the competitive benefits that the investment would bring.
- The exemption cannot have a detrimental effect on competition because the access arrangements are such that that the competitive conditions in all relevant affected markets, under exemption, will be identical to those that would have prevailed with the investment under rTPA.
- While the investment under rTPA is **not** the relevant counterfactual (because without exemption the investment would not take place), we will have established that competitive conditions with the investment under rTPA would be better than those with no investment. Hence, competitive conditions under the investment with exemption must be better than with no investment.
- Hence, the exemption cannot be detrimental to competition

Expressed in more formal logic:

Let  $\mathbf{C}(A)$  be the state of competition in under state  $A$ ; and

let  $Access(rTPA)$  be the access arrangements - as opposed to the revenue disposition arrangements - under rTPA .

$\mathbf{C}(Investment + Access(rTPA))$  is preferable to  $\mathbf{C}(No Investment)$

$\mathbf{C}(Investment + exemption)$  is identical to  $\mathbf{C}(Investment + Access(rTPA))$

It therefore follows that:

$\mathbf{C}(Investment + exemption)$  is preferable to  $\mathbf{C}(No investment)$

This logic is generic in the sense that it can be applied to any affected market in electricity supply (cf Regulation, Art. 7.1 (a)) and can equally be applied to any affected market germane to the internal electricity market (cf Regulation Art. 7.1(f))<sup>1</sup>. To the extent that it applies to all affected markets, it must also apply to an holistic judgement encompassing all relevant affected markets.

---

<sup>1</sup> We are unclear as to whether there is an intentional difference between the scope of 'electricity supply' in Art 7.1(a) and the 'internal electricity market' in Art 7.1(f). However, given the nature of the

There is therefore no need for this competition assessment formally to identify relevant affected markets because, regardless of the definition of affected markets, the investment *per se* enhances competition and the exemption (which makes the investment feasible) cannot have a detrimental effect on competition in any market.

The rest of this paper elaborates on this argument and is organised as follows:

- First, we explain why the investment *per se* enhances competition
- Next we explain why the proposed ownership of the investment and operation under rTPA would not jeopardise the competition benefits that the investment would create;
- We then describe BritNed's approach to access;
- We go on to identify the requirements stipulated for rTPA and show that BritNed's approach to auction based congestion management is compatible with both existing and draft new requirements. We complement this by identifying examples of existing access regimes for regulated interconnectors in the EU and EEA, demonstrating that the extremes of the range of auction arrangements proposed by BritNed are in fact currently in place within the EU; and
- Finally, we discuss the issues of Use It or Lose It provisions, intraday and balancing trade.

## **INVESTMENT *PER SE* IS PRO COMPETITIVE**

In this section we describe why the investment is pro competitive and then go on to assess the impact that the line will have in relation to the key concerns raised by the European Commission's recent sector enquiry.

### **Impact of the investment on competition**

Given suitable access arrangements and absent any issues of ownership, the investment *per se* must enhance competition.

The BritNed line will provide infrastructure that would enable British generators to compete more effectively in the Dutch wholesale market. Use of the BritNed line will be easier than (and in any event an option that is additional to) British generators' (notional) ability to use the IFA connection, followed by transmission across France and Belgium. Likewise, it will enable Dutch generators to compete more effectively in the British wholesale market.

The obverse of the same point applies to retailers. The BritNed line will enable British retailers potentially to procure generation from The Netherlands and Dutch retailers to procure generation from the UK.

---

argument we are putting forward, we believe that it is robust with respect to any potential scope difference

In addition to facilitating static competition, the BritNed line will also help to improve dynamic competition by facilitating new entry. Generation only comes as substantial, indivisible investment. A generator would ideally like to build up a customer base to match the output of a prospective station. With the BritNed line, for example, a UK generator wishing to enter the generation market in the Netherlands would be able to build up a customer base served, initially, primarily by its UK generation portfolio before making an investment in a generating plant in the Netherlands.

Analogous arguments apply to retail entry. The key point for both retail and generation entry is that the BritNed line provides a further option by which participants can match supply and demand in each jurisdiction in the start up period when indivisibilities and load uncertainties would normally make this matching more challenging and therefore tend to create an entry barrier.

With suitable institutional arrangements, the BritNed line will also facilitate more competition in the provision of balancing services and ancillary services to the respective transmission system operators (TSOs). Even if it proves impractical to achieve full integration of the two balancing markets, the availability of TSO to TSO exchanges (for example in the manner in which the IFA interconnector presently operates) will still increase the options open to each TSO.

Furthermore, given that the Netherlands is interconnected to other European countries, the increased competition in the Netherlands wholesale market will *ceteris paribus* also create competitive benefits in neighbouring countries<sup>2</sup>.

We may therefore conclude that the investment *per se* is pro competitive.

### Assessment of impact in relation to EC sector enquiry concerns

Our general assessment of the competition impact of the BritNed line was set out above. However, in order to assist regulators in their assessment, it may be helpful to set what we believe are the key impacts as they relate to the specific electricity sector concerns identified by the EC in its recent enquiry. These concerns were related to:

- market concentration (in generation);
- vertical foreclosure;
- market integration;
- transparency; and
- price formation.

**Market concentration:** It is unlikely that the capacity of the BritNed line will be such as to unify the generation markets which currently exist at either end of its planned route, although this may happen in a few hours of the year. Nevertheless, to the extent of its capacity, the BritNed line will enable Dutch

---

<sup>2</sup> In a formal sense this is also true for Eire which is electrically connected to the UK, although prior to any East – West interconnector the linkage is weak.

generators to compete in the UK and UK generators to compete in the Netherlands. This will reduce the concentration that generators presently have in their respective markets which are in effect currently unconnected.

**Vertical foreclosure:** The EC has expressed concern about two aspects of vertical foreclosure:

- Vertical integration between generation and retail, reducing wholesale market liquidity; and
- Integration of supply and network companies, reducing the incentive of network companies to offer non discriminatory third party access.

The BritNed line will help to address the former of these by increasing the options that retailers have to buy from generators and by increasing the number of retailers to whom generators may sell.

With respect to the latter, the BritNed line will have no direct impact on any existing bundling, although we note that neither the UK nor the Netherlands are likely to be the focus of these concerns. It will, however, represent new transport infrastructure which is consistent with the preferred model of ownership independence from generation and supply.

**Market integration:** The EC's concerns here relate to lack of interconnector capacity (and the associated problem of long term capacity reservation), together with poor congestion management and inadequate incentives to add to interconnection capacity. The BritNed line will help to address these concerns as it will:

- Add to interconnection capacity;
- Not be subject to long term capacity reservation; and
- Be subject to congestion management complying with all relevant EC guidelines (see subsequent sections).

**Transparency and price formation:** While, as an interconnector investment, the BritNed line will not have any direct impact on these issues, it will through its contribution to addressing the first three areas of concern make an indirect contribution to addressing these latter concerns. In particular, the BritNed line can be expected to help transparency and reliable price formation by increasing wholesale market liquidity and as an element of infrastructure owned independently from generation and supply, there are incentives for transparency in relation to available capacity

In summary, the BritNed line will make a contribution to addressing most of the key concerns identified by the EC sector inquiry and will have no adverse impact with respect to the remainder. This is consistent with our conclusion that the line *per se* is pro competitive.

## INVESTMENT + PROPOSED OWNERSHIP + RTPA IS COMPETITIVE

Having established that the physical addition of the investment enhances competition, the next step in our argument requires that the investment, with its proposed ownership would be pro competitive if the access regime is rTPA<sup>3</sup> compliant.

As noted, the rationale for an interconnector is founded in there being, a difference between the price of electricity in the markets at either end. The returns to the interconnector investment depend on the prices in the two adjoining wholesale markets. A consequence of this is, even if BritNed offers rTPA, ownership of the line could introduce a competition concern. Were a player that is dominant in either or both of these markets to own the interconnector, then such a player could have an incentive (or increased incentive) to manipulate one or both of the adjoining market prices.

The BritNed line will be owned by a joint venture between National Grid and TenneT. Neither party owns a material share of generation in either market and so we can safely infer that neither of the owners of the interconnector has any market power whatsoever in either relevant wholesale market. Therefore, the ownership of the interconnector does not jeopardise the pro competitive benefits that the investment would provide.

With regard to the access regime, it should be uncontroversial to make the next step and conclude that, if the investment - with its proposed ownership - is offered under an rTPA compliant access regime, it will be pro competitive. rTPA arrangements are designed generally to ensure that the competitive benefits that can potentially be made available are in fact made available. However, for completeness we explain why rTPA avoids giving any additional advantage to dominant players and hence ensures that the pro competitive characteristics of the investment are not negated.

The requirements of rTPA ensure two key outcomes:

- The capacity of the interconnector will be made available and cannot be withheld (see our subsequent discussion on UIOLI arrangements).
- Where there is congestion, the price paid for the use of the interconnector will be the result of a market based allocation mechanism.

As we discuss in more detail below, the two market based allocation mechanisms are in essence implicit or explicit auctions.

If **implicit auctions** alone are employed then there is no way in which a dominant or potentially dominant participant can gain control of even a part of the interconnector. The full capacity of the link, made available by the link operator and the TSOs, will always be used if there is any economic value to its

---

<sup>3</sup> Here and in the rest of this report, unless otherwise stated rTPA refers to the access conditions (congestion management) imposed through rTPA and not to the associated conditions concerning possible tariff regulation or the disposition of interconnector revenues.

use<sup>4</sup>. A dominant player cannot gain control of the link and influence the extent to which it is used. Nor can such a player benefit more from the exercise of market power than it would have done in the absence of the link. Suppose a dominant generator in the higher price region also owns generation in the lower price region. It cannot increase further the price in the higher price region and gain an extra benefit from flows over the link. The value it would receive for generation in the low price region would remain at the low price region's clearing price. Any flow over the link will tend to reduce any dominance that it might have had in the higher price region.

In summary, under an implicit auction, a dominant party can neither withhold capacity by controlling the link nor increase the pay off from exercising market power. The link can only add a source of supply tending to reduce the dominant player's dominance.

If **explicit auctions** are used, the conclusions are essentially the same, but the reasoning is slightly more complex.

Although a dominant player can in principle acquire control of a share of the interconnector for a relatively short period, use it or lose it (UIOLI) provisions under rTPA will prevent the dominant party from withholding capacity on the interconnector.

In addition, any (hypothetically) dominant player will not be in a position where acquisition of short term interconnector capacity rights gives it a greater incentive to exercise market power. Any sustained attempt by a dominant party to exercise incrementally more market power will increase the value of the interconnector usage rights and the dominant party will simply end up paying a higher price to acquire interconnector capacity in each subsequent auction. The increase in the price paid for interconnector capacity rights in essence negates the increased revenue from interconnector flows earning a higher wholesale price (ie the benefit is competed away in the interconnector auctions<sup>5</sup>). The competition for interconnector rights prevents continual acquisition of short term interconnector capacity rights from materially increasing the incentives for the exercise of market power.

If there were a dominant party in the low price region, it would have no incentive to acquire and withhold interconnector capacity, as this would decrease its profits from selling into the higher priced market and reduce effective demand in its

---

<sup>4</sup> The interconnector may not be fully used if the prices at each end are equal, but this does not create a competition issue.

<sup>5</sup> If there were a dominant player controlling the wholesale price to an average level that avoids regulator intervention, it is possible with explicit auctions for that dominant player to depress returns to other parties buying interconnector capacity by choosing to correlate wholesale price market outcomes with the outcome of the explicit auctions. (see 'Analysis of cross-border congestion management methods for the EU internal electricity market' Consentec and Frontier Economics Ltd, June 2004, published by the EC) However, this would not increase the price paid by consumers on either side of the link. The principle effect would be a slight decrease in the revenue which investors in the link gained from explicit auctions. However, this should in our view be seen as a limitation in what rTPA is able to achieve and not something which could possibly cancel out the competitive benefits that the interconnector could bring.



home market. Furthermore, in this case, owning interconnector rights would actually decrease the incentive for the dominant player to exercise market power in the market in which it is dominant.

Hence, even if one of the markets adjoining the interconnector contained a dominant (or potentially dominant) player, rTPA prevents access to the interconnector creating adverse competition effects.

## Conclusion

We may therefore conclude that the BritNed line, with its proposed ownership and operating under rTPA, would be pro competitive.

## BRITNED'S PROPOSED ACCESS ARRANGEMENTS

The detail of BritNed's access arrangements are at an early stage of development. However, several crucial decisions have been taken:

- BritNed intends that its access arrangements will meet the criteria laid down for rTPA.
- BritNed intends that access should be by means of an implicit auction, one or more explicit auctions or a mixture of implicit and explicit auctions. The contract periods for explicit auctions shall not exceed 1 year.
- BritNed will implement agreed Use It or Lose It (UIOLI) or Use It or Sell It (UIOSI) provisions.
- BritNed will, consistent with whatever UIOLI or UIOSI arrangements are agreed, use all reasonable endeavours to facilitate economic intraday and balancing trades.

The first decision is, by definition, compatible with rTPA.

We now examine the remainder of these decisions to confirm that they are compatible with rTPA. In the next section we address the auction arrangements. In a subsequent section we address the intertwined issues of UIOLI/UIOSI arrangements and intra-day/balancing trade.

## rTPA REQUIREMENTS FOR AUCTION ARRANGEMENTS

### rTPA requirements

Access to regulated cross border interconnectors within the EU is governed by Annex 1 to EC Regulation 1228/2003. ERGEG subsequently held a public consultation process and published more detailed guidelines in 2005. In the light of ERGEG's work, the EC has published a revised draft of Annex 1 to the Directive. This was put out to consultation in January 2006. While the former

Annex is still binding<sup>6</sup>, we also analyse the position were the latter to apply. We refer to the Annex and draft Annex as Annex 03 and Annex D06 respectively.

In the context of this competition assessment, the key rTPA requirements in respect of auctions relate to congestion management.

Annex 03 specifies ‘Principles governing methods for congestion management’:

1. Network congestion problems shall preferentially be solved with non-transaction based methods, i.e. methods that do not involve a selection between the contracts of individual market participants.
2. Cross-border coordinated redispatching or counter trading may be used jointly by the TSOs concerned. The costs that TSOs incur in counter-trading and redispatching must, however, be at an efficient level.
3. The possible merits of a combination of market splitting, or other market based mechanisms, for solving ‘permanent’ congestion and counter-trading for solving temporary congestion shall be immediately explored as a more enduring approach to congestion management.

We interpret Principle 1 as requiring a market based allocation mechanism. Explicit and implicit auctions are both recognized as meeting this criterion and are arguably the only practical ways in which this criterion can be met.

While Principle 3 does not mandate a practice, it may reasonably be regarded as endorsing a mixture of implicit (market splitting) and explicit auctions. Counter trade may also play a part.

Annex 03 goes on to specify guidelines for explicit auctions. In the context of this report and the early stage of the BritNed project’s preparation, the key guidelines are:

1. The auction system must be designed in such a way that all available capacity is being offered to the market. This may be done by organising a composite auction in which capacities are auctioned for differing durations and with different characteristics (e.g. with respect to the expected reliability of the available capacity in question).
2. Total interconnection capacity shall be offered in a series of auctions, which, for instance, might be held on a yearly, monthly, weekly, daily or intra-daily basis, according to the needs of the markets involved. Each of these auctions shall allocate a prescribed fraction of the available transfer capacity plus any remaining capacity that was not allocated in previous auctions.

Annex D06 specifies similar congestion management methods:

---

<sup>6</sup>The old Annex 1 is binding in the sense that a revised version has not been formally adopted. However, as the new draft Annex is generally an elaboration rather than a contradiction of the old, we assume that regulators could well be within their rights to have close regard to the new guidelines even if formally they are acting under the old.

- 2.1. Congestion management methods shall be market-based in order to facilitate efficient cross-border trade. For this purpose, capacity shall be allocated only by means of explicit (capacity) or implicit (capacity and energy) auctions. Both methods may coexist on the same interconnection.
- 2.2. Depending on competition conditions, the congestion management mechanisms may need to allow for both long- and short-term transmission capacity allocation. They may then be implemented on e.g. an annual, monthly, weekly, daily and intra-day basis.

Annex D06 therefore explicitly dictates that allocation must be by explicit or implicit auctions or a mixture of both. Both Annex 03 and Annex D06 exemplify the pattern for explicit auctions being a mixture of timeframes from annual downwards.

## Compatibility with existing market coupling developments

### *Implicit auctions*

Implicit auctions require the coordination of energy market auctions on either side of the interconnector. At present Britain does not have a power exchange offering a day ahead auction as opposed to continuous trading. BritNed understands that APX expects to have established an auction at a British exchange in the next few years. .

Assuming such a day ahead auction in the UK , the next issue is whether implicit auctions between the UK and the Netherlands could in any way interfere with the current move towards market coupling between the Netherlands, Belgium, France and the Nordic area. Nordpool already caters for up to 11 pricing areas (although several of these coalesce from time to time). The addition of The Netherlands, Belgium and France will involve coordination of 14 areas. We do not see that coordination of 15 pricing areas creates any materially greater problems than coordination of 14<sup>7</sup>. Therefore, we do not perceive that the BritNed line and the introduction of market coupling between the UK and the Netherlands would in anyway undermine the benefits of existing market coupling developments.

### *Explicit auctions*

Explicit auctions will have no effect on market coupling developments already in hand. Explicit auctions will not affect APX directly (except in so far as APX may be a company to whom explicit auctions might be outsourced). All that will happen is that those with rights to use the BritNed line will potentially add to the liquidity of APX if they offer to buy or sell power through that exchange. This

---

<sup>7</sup> We note that coupling with UK would introduce the issue of the 1 hour time difference that exists between the UK and Continental Europe. Clearly effective coordination would require any UK power exchange auction to happen 1 hour earlier in local time than that on the continent. It would be for any power exchange to decide whether the advantages of an earlier auction offering coordination with the Netherlands would be more valuable than a later auction optimised for decisions of participants in the UK market.

will not create a problem for coupling of APX with neighbouring exchanges, but may create a marginal benefit for buyers and sellers both on APX and on connected exchanges.

## **Examples of auction arrangements under rTPA in the EU and EEA**

As noted, BritNed wishes to offer access on the basis of:

- Implicit auctions;
- Explicit auctions; or
- A mixture of implicit and explicit auctions.

The purpose of this section of our report is to show that there are examples of implicit and explicit auction approaches operating currently in respect of regulated interconnectors within the EU and the EEA.

### ***Implicit Auctions***

The Nordpool area (Norway, Sweden, Finland and Denmark) provides examples of regulated cross border interconnectors where access is via implicit auctions (otherwise known as market splitting or market coupling) in the Elspot market. Market participants make their bids to the Elspot market and the Nordic TSOs inform Nordpool of the transfer capacities between the various potential price zones<sup>8</sup>. Nordpool then optimises the acceptance of bids in the Elspot market, subject to the constraint of not causing any transfer between price zones to exceed the capacity of the relevant interconnector.

The clearance of the energy market(s) in this way has the effect of implicitly auctioning the interconnection capacity. While there are no market participants identified directly as users of the interconnector, participants as a whole make efficient use of the interconnector. Furthermore, any participant that sells generation in one price zone and buys an equivalent quantity in another price zone will in effect pay the difference in the prices between zones (positive or negative). This is the implicit market clearing price for use of the interconnector.

### ***Explicit auctions***

In response to Regulation 1228/2003, France has adopted explicit auctions for all of its interconnectors. For example, since 1<sup>st</sup> January 2006, the France - Belgium interconnector has operated under a regime of annual, monthly and daily auctions<sup>9</sup>. The time frames for these auctions match the time frames which BritNed expects to follow if it chooses explicit rather than implicit auctions.

---

<sup>8</sup> See, for example, [www.nordpool.com](http://www.nordpool.com) and 'An Overview of Current Cross-border Congestion Management Methods in Europe', ETSO, September 2004.

<sup>9</sup> See CREG Decision (B)0051201-CDC-494, and 'Access Rules for Imports and Exports on the French Public Power Transmission System, Version 2' RTE (2005) available from [www.rte-france.com](http://www.rte-france.com)

### *Mixed explicit and implicit auctions*

While there are currently no mixed access models operating, APX, BelPex and Powernext have been actively engaged in developing market coupling arrangements among The Netherlands, Belgium and France. It seems quite possible that a mixed explicit/implicit auctions model will emerge in this area.

Although there is no specific example of a mixed regime operating currently we note that the existing Regulation (1228/2003) does not preclude such regimes and the draft amendment to the Regulation explicitly states that both methods may coexist on the same interconnection (para 2.1).

### **Conclusions on BritNed's proposed auction arrangements**

BritNed's decision to manage congestion on the link by means of implicit or explicit auctions or a mixture of the two is compatible with current rTPA guidelines and, subject to detailed UIOLI arrangements etc discussed below, will ensure that competitive benefits made feasible by the line are not lost by an inappropriate method of capacity allocation. We do not believe that either implicit auctions or explicit auctions would interfere with the benefits which may flow from existing market coupling arrangements. On the contrary, the existence of the BritNed line would be likely to increase the depth and liquidity of, and therefore enhance, the coupled markets.

### **UIOLI/UIOSI INTRADAY TRADE AND BALANCING**

These issues have significant interdependencies and we therefore deal with these in together.

To the extent that **rights** to use the line - as opposed to **rights and matching obligations** - are sold in auctions, it is necessary to consider whether UIOLI or UIOSI<sup>10</sup> provisions are needed to prevent interconnector capacity being withheld for strategic reasons. While, as we have explained earlier in this report, we do not believe that any (hypothetically) dominant player could persistently gain from acquiring and withholding link capacity, there may nonetheless be merit in ensuring that such a strategy is seen to be infeasible.

Again, as previously explained, the issue does not arise with the use of implicit auctions. No market participant acquires explicit rights to the interconnector capacity. The issue is most pertinent with explicit auctions, and in particular with auctions significantly in advance of real time.

The simplest UIOLI arrangement ( but also the most ambitious actually implemented) is that rights acquired in advance of the day ahead must either be nominated day ahead or surrendered to the day ahead auction. This deals with advance rights are not hoarded and then unused but it does not ensure that

---

<sup>10</sup> In the remainder of this section references to UIOLI may be read as UIOLI/UIOSI. Both have the same implications for competition

rights sold in a day ahead auction are exercised. However, it does mean a (hypothetically) dominant player would in effect have to pursue an ‘acquire and withdraw’ strategy solely through the day ahead auctions and therefore any gains could be expected to be competed away in daily auctions very quickly indeed.

BritNed will as a minimum use this mechanism to ensure that any rights held prior to the day ahead are not withheld from use.

The problem with extending UIOLI provisions to shorter timescales is that it is inefficient to impose an obligation to use such rights because they are generally allocated before the relevant energy markets are cleared. Given this, enforcing use of those rights on every occasion may turn out to be inefficient.

This problem is compounded if intraday and balancing trade are to be encouraged. Given uncertainties inherent in real time power system conditions, if trade in intraday and balancing time frames is to be made feasible, market participants (or possibly TSOs) must hold on to interconnector capacity rights which they may not be used at all.

At this time there is no established best practice on how to achieve the competing aims of generally full use of an interconnector with preservation of the option for valuable trades very close to real time. However, we are of the view that BritNed’s interests would be exactly the same as those of the relevant regulators, ie BritNed would like to see the most valuable use of the line and this will generally maximise the return on their investment. In line with this, we understand BritNed is prepared to comply with any agreed guidelines as to how this should best be achieved. Obviously, this has to be subject to the proviso that the relevant regulatory authorities, Ofgem and DTf, themselves agree.

However, as best practice in this area is likely to evolve over time, it would seem inappropriate to be very prescriptive at this stage as to exactly what arrangements should be put in place.

We note that, operationally, use of the interconnector for intraday and balancing trade will require BritNed to maintain through some means or other the capability to reprogramme the transfer on a 24/7 basis. We understand that BritNed will commit to making such arrangements so long as they are economic and practicable.

### **Conclusions regarding UIOLI, intraday and balancing trade**

BritNed is prepared to commit to following best practice as stipulated in evolving regulatory guidelines in this area and to match this with the operational capability to reprogramme the transfer. Given the alignment of BritNed’s interests and those of regulators encouraging competition, we see no cause for concern that arrangements would be likely to undermine the achievement of the competitive benefits which the interconnector will make available.

## **CONCLUSIONS**

We conclude that:

- The BritNed line as a physical investment would enhance competition. In doing so, it would help to address a number of the competition concerns identified by the European Commission in its recent sector enquiry;
- Neither BritNed's proposed ownership nor operation under access terms compliant with rTPA would materially jeopardise the competition benefits that the interconnector could bring;
- BritNed's commitment to institute auction access arrangements compatible with rTPA means that exemption from rTPA would not change the competitive outcomes from those that would have ensued if the line were to be operated under rTPA;
- BritNed will comply with evolving guidelines on UIOLI, and intraday/balancing trade; and
- The exemption therefore makes feasible an investment which is pro competitive and the exemption itself introduces no detriment to competition.

**On the basis of this, we conclude that the BritNed line, with its proposed access arrangements, meets the two competition tests embodied in Article 7, 1(a) and 1(f), of EC Regulation 1228/2003.**