E.ON proposals

to amend the regulatory arrangements for East West Cable One Ltd.'s two proposed GB-Irish electricity interconnectors

The E.ON Group welcomes and appreciates the commercial initiative taken by Imera Ltd. to construct two electricity interconnectors between Great Britain and the All-Ireland market. We are of the opinion that these two projects contribute significantly to the Lisbon goal, aiming at a minimum interconnection capacity of 10 per cent, and are major steps towards the further integration of the British-Irish-French regional market.

Against the background of the progressive evolution of the European electricity market, E.ON would propose some amendments to the regulatory arrangements suggested by Ofgem. These changes reflect our desire to promote an efficient internal market for electricity by applying market-acknowledged best practice, particularly regarding congestion management and cross-border regulation.

In its application Imera Ltd. highlighted considerable benefits in terms of security of supply, competitiveness and sustainability, particularly by:

- promoting new market entry, through reduced barriers to entry in both connected markets;
- assisting in the development of a meaningful regional market, and enhancing security of supply.[1]

These criteria were also part of CER's considerations in 2007.[2] Although we fully support this view we favour some adjustments regarding the allocation of capacity which would more deeply contribute to the benefits mentioned above. Our considerations are primarily based on recent developments within the regional market framework and the target model for congestion management as developed in a study for the European Commission by Consentec.[3] The commercial impact of our proposal on EWC's return is low in our view, but would be beneficial for the overall market design and would strengthen competition.

I. Open season procedure for long-term capacity rights

E.ON is aware that the allocation of long-term capacity rights is an important element for the investor, in order to achieve a reasonable economic return against the background of certain payments over time by successful capacity bidders. Thus, the share of long-term capacity rights must be sufficiently large. However, after the allocation procedure, access to EW 1/2 is, then, only possible if primary capacity holders do not use capacities and either give them back to EWC (by the application of the use-it-or-lose-it principle) or sell them on a secondary capacity market. Although we welcome both opportunities and ask for immediate implementation, when EW 1/2 begins operation, we strongly doubt whether sufficiently high liquidity will exist. This would limit the access of market participants with short-term optimisation goals to EW 1/2 and could be detrimental to competition.

In order to promote new market entry through reduced barriers in all time frames, E.ON proposes that the allocation of long-term capacity rights should be capped to 70 per cent of

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[1] See IMERA's application, page 8.
[2] See Ofgem's initial view on the regulatory arrangements, page 6.
[3] Consentec: Towards a common coordinated regional congestion management method in Europe, Study commissioned by the European Commission, Directorate-General Energy and Transport, October 2007 (http://www.consentec.de/fileadmin/downloads/Rpt_EC_RCM_final_Oct-2007.pdf).

the entire capacity. The remaining capacity (30 per cent) should be offered in equal shares through explicit auctions with year-ahead, month-ahead and day-ahead time horizons.

The share of 70 per cent is derived from Imera's suggestion for the limitation of market power of a potential single buyer of EW 1/2 capacity. We think that not only should the power of a single buyer be limited but also the power of all long-term capacity holders compared to undertakings optimizing in the short-term.

Furthermore, our proposal fits with the congestion management target model mentioned above and would leave scope for further developments as set out under II.

Additionally, we are interested in a more detailed description of what the "open season type of auction process"[4] will look like and particularly, whether it will be in line with the typical explicit auction design with marginal pricing which we would prefer.

II. Contribution to market coupling or market splitting once available

The target model for European congestion management favours day-ahead implicit auctions of the market coupling or splitting type. Several projects in Europe have started to implement market coupling or splitting or are already running accordingly (Nord Pool, TLC, MIBEL, Denmark-Germany, Central Western market coupling).

Against the backdrop of these developments, E.ON strongly recommends that EWC should be obliged to contribute to market coupling or market splitting between Great Britain and the All-Ireland market, once available, with the available day-ahead capacity. The available capacity results from the initial reservation of 10 per cent of total capacity, plus unused capacity from the long-term capacity rights, year-ahead, and month-ahead explicit auctions by applying the use-it-or-lose-it principle.

Such an obligation is reasonable to avoid the widely known inefficiencies of day-ahead explicit auctions compared to implicit auctions and to focus on the equal treatment of cross-border capacities (Moyle and EW 1/2) once market coupling or splitting can be established. Otherwise it would be detrimental to competition if different capacity allocation mechanisms were to exist in parallel for day-ahead trading between GB and the All-Ireland market.

III. Reserve price

E.ON completely accepts the need to set a reserve price for capacity allocation which covers the operational costs. We also agree with Ofgem that it is in EWC's interest to undertake all necessary measures to keep the reserve price as low as possible in order to ensure the maximization of allocated capacities and, ceteris paribus, achievable profit. For the sake of clarification, E.ON is interested in learning whether such costs would also cover the physical losses for transmission on EW 1/2.

[4] See IMERA's application, page 12.