

OFGEM Consultation Ref:12/10

Electricity interconnector policy

RTE response

Réseau de Transport d'Electricité (RTE), the French Transmission System Operator, welcomes this opportunity to respond to the consultation on electricity interconnector policy launched by Ofgem. This consultation seems timely and useful, given the evolution of the broad regulatory scene with the third energy package adopted in July 2009, as well as the new impetus to facilitate the transition to a low carbon economy, to enhance security of supply, and to further develop the internal market for electricity. It is therefore of utmost importance to have a clear framework for developing, funding and regulating cross-border interconnection infrastructure, and to stress the need for convergence at the European scale between regulatory approaches applied to interconnection development.

CHAPTER: One

Question 1.1: Have we accurately captured the benefits of and demand for new interconnection? Are the projects under consideration all viable? Would they be sufficient? Are there other projects being developed?

As emphasized by OFGEM in Article 1.7 of its consultation document, during Autumn 2008, RTE, ELIA and National Grid held a consultation on future interconnections between England and the continent, in which market participants state a clear need for more interconnection capacity between GB and the continent. One of the main reasons is the projected growth in wind energy production in GB.

Respondents highlighted the potential for very high wind penetration levels in the GB market and the opportunity for interconnection to provide another means for the market to respond to intermittent renewable energy and to evacuate excess available power.

Nevertheless, the appetite for new interconnector capacity does not necessarily mean a need for exemptions. As OFGEM points out in articles 1.19 and 3.2: "*the regulated approach is the default approach*" and "*exemptions should be granted by exception*".

For its part, RTE is willing to engage itself in developing cross-border interconnection with GB under a regulated regime, and has engaged studies accordingly. This prospect, supported by its regulator, is nevertheless slowed down due to the regulatory regime applicable to GB, where it is prohibited by law for the same licensee to operate both the transmission network and an interconnector. We believe that the outcome of this regime has been to largely deter possible progress on regulated cross-border interconnection so far, and are of the opinion that it could usefully be reviewed, to be made more consistent with the dominant approach

in Europe. For RTE, any new merchant project shall come in addition to reinforcement of cross-border capacity between GB and continent that will take place under the regulated regime, that is, for the French part, funded, built and operated by RTE.

Question 1.2: Are there other key aspects of the legal or regulatory framework that we should consider, or should some features be given a different emphasis?

It is rightly pointed out in articles 1.19 and 3.2 of the consultation document that the regulated regime is the default approach within the framework provided for by article 7 of EC regulation n°1228/2003 (the same will apply for regulation 714/2009 when it enters into force). Accordingly, provisions of article 7 thereof shall be duly taken into account.

First of all, the six criteria of the European Regulation are cumulative, meaning that a private investor seeking an exemption must meet all of them.

Moreover, Condition b (*"the level of risk attached to the investment is such that the investment would not take place unless an exemption is granted"*) implies that, every time a regulated project is in place, about to be set up, or strongly foreseen, no exemption shall be granted. In other words EC regulation does not pave the way for competition between regulated and merchant interconnection projects. Accordingly, exemptions shall solely be granted when regulated initiatives are completely missing or have definitely failed, due to the level of risk associated to the investment to be supported under the regulated approach (which in turn supports the claim from merchant interconnector to keep all or part of revenues associated with cross-border capacity auctions).

Condition f (*"the exemption must not be to the detriment of competition or the effective functioning of the internal market in electricity, or the efficient functioning of the regulated system to which the interconnector is linked"*) also indicates that the grant of an exemption shall be subject to a thorough control, when considering on delivering a license for merchant operators, of its consequences on the market and on the efficient operation of the national grids on both sides.

It is our understanding that conditions b et f would not be met if the operation of the exempted interconnector creates constraints that would lead to limitations imposed on other users of the transmission system.

Question 1.3: How can the Regional Initiative best contribute to development or implementation of policy? Do you agree with the priorities and approach outlined?

The France-UK-Ireland (FUI) Regional Initiative has been very productive during the two last years, as outlined by Ofgem. It helped implementing new Rules and improved balancing arrangements on IFA interconnection.

However, new interconnectors may link the GB market with markets which are not part of the FUI ERI (Belgium, NL). In this context, inter-regional projects will develop, involving the FUI region. It is crucial that regulation of interconnectors is harmonised or, at least, consistent in the markets or regions linked by them, so that there is no barrier to develop new interconnectors and to harmonize access rules. This could be achieved by introducing some flexibility in the regional initiative process or by redefining them. Harmonization of access rules should be a prerequisite.

The priorities, as outlined in this paper, shall be supported by most stakeholders in the region, including RTE. Some emphasise, among other topics, should be given to firmness of capacity and market coupling.

CHAPTER: Two

Question 2.1: Are the target models explained in this chapter appropriate for GB? What are the issues that need to be considered? Are there alternative approaches that would be better? Will the target models effectively accommodate increased intermittency?

The target models presented in this chapter are consistent with the PCG model, which RTE is supportive of. RTE and the other TSOs of the CWE and Nordic regions have signed in October 2009 a joint Declaration, in which they commit to implement price coupling in the whole area, which would be expandable to other regions.

These models seem to be appropriate for GB, even if some specific issues need to be addressed to ensure their efficiency and harmonisation with other European interconnections. As outlined in this paper, some of those key issues worth being discussed at the regional level are the following:

- firmness of interconnector capacity, which is a critical condition to implement a day-ahead price coupling
- Triads, which is a barrier to the efficient use of the interconnection
- coordination with power exchanges in GB, which is crucial for price coupling implementation.

The issue of coordination between IFA and BritNed is crucial as well. It was suggested at the 4 Nov. 2009 meeting of the FUI ERI Stakeholder Group, that IFA and BritNed would implement a price coupling solution at the same time, potentially by early 2011.

RTE considers both harmonization of Access Rules and coordination between IFA and BritNed to be of high priority for the market. RTE, NGIL and BritNed are currently working to define the conditions under which a single price coupling can be implemented on both interconnections, including the extension of the future CWE-Nordic Price Coupling to the FUI region (by both IFA and BritNed).

RTE supports the implementation of this single price coupling on IFA and BritNed in early 2011 . Although we understand that the exemption on BritNed is binding, we would welcome any views on the ability to amend this exemption to give more time and opportunity to RTE, NGIL and BritNed to implement a single price coupling on IFA and BritNed at the same time, and coordinated with other pan-regional initiatives such as the CWE-Nordic price coupling project, which would be mostly welcomed by market parties. Keeping two different access model for IFA and BritNed can indeed lead to adverse flows, leading a general loss in social welfare.

Intra-day access to interconnections is crucial to accommodate intermittent generation, which is dependent of real-time conditions (such as weather, wind, etc). Harmonisation of rules remains important for this timescale, and there shall be advantage to take the time to discuss further with market players the appropriate solution in the light of the situation in the CWE Intraday project, which is more advanced, and of the options currently discussed in the AHAG project.

Question 2.2: What should be our approach to firmness of interconnector capacity? Should this vary between new and existing interconnectors, or between regulated and exempt? What are the categories of costs and benefits from changing approach, where should they fall and can they be quantified?

Market players generally consider that the level of firmness is not high enough to ensure an efficient use of the IFA interconnection. It is considered as well that an appropriate level of firmness is required to implement price coupling (firmness of day-ahead capacity).

On the other hand, RTE and NGIL may face huge financial exposure in case of outage on IFA. Both positions must be considered by interconnector policy, while taking into account the need for a balanced and sound policy framework, likely to direct the responsibility to face exposure to those having the incentive to best manage the associated risks. More importantly, regulators in both countries must coordinate so that a single firmness rule is applied on IFA, allowing both RTE and NGIL to face the risk of outage and the associated compensation to users.

Harmonization of firmness rules with other European interconnections should be sought, at the condition that interconnector operators (or TSOs) can cover the associated costs, should firmness be physical or financial.

We do not think that firmness rule should vary between existing and new interconnections, or between regulated and exempt.

RTE's position remains in line with ENTSO-E position, expressed in its position paper *[ETSO Paper Firmness on Cross-Border Capacities - 30.1.2009]*.

Question 2.3: Should we seek regional solutions rather than individual project solutions for access rules, such as through a broader North West European solution for market coupling? What are the priority areas for greater regional co-ordination?

RTE definitely considers that regional solutions are more appropriate. RTE is indeed part of the North West European initiative, whose objective is to implement a single price coupling solution on both CWE and Nordic regions and to open it to other neighbouring markets or regions. In this context, and consistently with the roadmap presented by the PCG group during the last Florence Forum, RTE would prefer to implement first the CWE-Nordic price coupling, and then (or potentially at the same time if feasible) expand it to the FUI region via both IFA and BritNed. However a further evolution of the perimeter of the Regional Initiatives may be required or useful to achieve a strong coordination between market coupling initiatives in the whole West Europe area.

The same goes for access rules more generally: regional or pan-regional harmonization of Rules must be sought, to ensure better efficiency and lower costs for market players.

Higher priority shall be given to day-ahead single price coupling and to the associated relevant firmness level. A high level of coordination should then be sought with the CWE and Nordic regions in this field.

Some focus can be given to explicit auctions rules as well. RTE considers that the implementation of intraday improvement, even if of crucial importance for the market,

should come later. A first phase of discussion with market parties, based on the solution being discussed in the CWE region and in the AHAG project, is required.

The need for a broad approach at regional level for all matters related to capacity calculation and allocation also stresses the advantages of having cross-border interconnections developed under the regulated regime by TSOs. The latter are already deeply involved, at the European level and in partnership with power exchanges, in the design of solutions in line with wishes expressed by the European Commission, Ministers for Energy, national regulatory authorities, and stakeholders for pan-European solutions.

CHAPTER: Three

Question 3.1: Does this chapter capture the key issues in regulation of new electricity interconnectors? Should we assume that all new interconnectors will seek exemptions?

This chapter captures most of the key issues in regulation of new electricity interconnectors.

However, one key aspect of new electricity interconnectors has not been addressed in the consultation document: the cost of upstream reinforcement on each side of the new interconnector. Whereas this issue is easily dealt with when new interconnections are regulated and belong to TSOs (all related costs are socialized), inserting exempted interconnectors into regulated power systems may generate costs that would not otherwise have been incurred. If those costs are borne by TSOs under their national regulation scheme, it basically means that they are passed on to final consumers whereas the relating grid developments mostly benefit the private operator whose merchant interconnector is to be integrated. Such system would prove adverse to sound economics principles that shall govern the decision to grant an exemption pursuant to article 7 of regulation 1228/2003. In the absence of any incentive scheme for investors seeking exemption for merchant projects to choose their location according to network capabilities, such costs could be important.

Accordingly, whereas OFGEM has captured the benefits of a "*merchant approach*" in article 3.3, those associated to the regulated approach have not been fully developed. First, TSOs will, on the contrary, seek to have new interconnectors located at the "right" places, in the view of minimizing upstream reinforcement costs. Second, under the 3rd energy package, new responsibilities for regulated grid operators have been provided for on European regulation. Those include the responsibility to publish every two years the Ten Year Network Development Plan, which is to become a key input for energy policy, and to participate in the new association for electricity grid operator, ENTSO-E, tasked with important roles as far as interconnection is concerned. Both ENTSO-E and the 10-year plan constitute central tools for TSOs to develop new interconnection capacity in a harmonious way throughout Europe. It appears difficult to see how merchant projects could fit in this picture.

Last, it may be pointed out that the issue of the future of merchant interconnector once the exemption period expired has not been developed. As provided for in article 17.1 of regulation 714/2009, "*new direct current interconnectors may, upon request, be exempted, for a limited period of time*". The conditions under which such a transfer could be concluded shall be examined prior to the exemption decision, and determined not to be detrimental in any way to the interests of the regulated grid operator, whose costs are socialized and ultimately passed on to final consumers.

Question 3.2: Of the options set out, which are preferable and why? What are the key considerations in taking forward any of the options?

See answers above. As the default approach provided for in European regulation 1228/2003 (and further 714/2009) is the regulated one and for the reasons laid down in the previous section, RTE is of the opinion that option 4 is preferable both legally and economically. To our mind, option 3 can be accommodated to be a variant of option 4, so that a preference for option 4 does not preclude any room for designing a regulation scheme including incentive mechanisms.

Question 3.3: Is it feasible to have a mixture of different approaches for different interconnectors – such as some exempt and others regulated? If not, why and how should this be resolved?

RTE believes that a mixture of different regime for different interconnectors between the same countries is likely to result in a less fluid coordination between operators on cross-border issues, but leaves it to national regulatory authority to decide whether to exempt or not merchant projects, when and where they exist, provided that the criteria laid down in section 2.1 of our answer are respected.

As a conclusion, it must be noted that coordination between regulatory authorities in neighbouring countries on this Electricity interconnector policy is essential. It would indeed be difficult to have two different regulatory regimes on each side of one border. In this field as in many other, coordination between European regulators appear of the utmost importance for the establishment of a clear regulatory framework.