

Joint Opinion of the Commission de regulation de l'énergie (France) and the Gas and Electricity Markets Authority (Great Britain) on ElecLink's exemption request under article 17 of Regulation EC no 714/2009 for an electricity interconnector between France and Great Britain

1.1. This document sets out the Joint Opinion (the "Joint Opinion") of the National Regulatory Authorities ("NRAs") in France and Great Britain ("GB") on ElecLink Limited's request for an exemption under Article 17 of Regulation (EC) No 714/2009¹ ("Article 17", "the Regulation") for an interconnector between France and GB. This follows an assessment by both NRAs of ElecLink's exemption request against the conditions that must be met for an exemption to be granted under Article 17. The NRAs have concluded that ElecLink has met those conditions and should be granted an exemption, subject to the terms and conditions set out in this Joint Opinion, including its Schedules.

1.2. Pursuant to the provisions of the Directive 2009/72/EC² (the "Directive")- in particular Article 9 relating to ownership unbundling, 32 relating to third party access conditions and 37(6) and 37(10) relating to the ability for NRAs to fix and control these conditions - and Article 16(6) of the Regulation, relating to the use of revenues resulting from the allocation of interconnection capacity, applicable to transmission network, management of cross-border electricity interconnections, to the extent that they constitute electricity transmission networks or parts of an electricity transmission network, is in principle a regulated activity.

1.3. However, paragraph 1 of Article 17 of the Regulation provides that new cross border electricity interconnectors may, upon request, be exempted, for a limited period of time, from certain rules of the Directive and the Regulation. In particular, this exemption may concern the use of revenues resulting from capacity allocation, the principle of ownership unbundling and third party access conditions.

1.4. In accordance with paragraph 4 of Article 17, the decision is made on a case by case basis by the NRAs of the concerned Member States.

1.5. ElecLink Limited ("ElecLink"), a joint venture between Star Capital Partners Limited ("Star Capital") and Groupe Eurotunnel has sought an exemption under Article 17 of the Regulation for its proposed interconnector ("the ElecLink Interconnector") between the

¹ Regulation (EC) No 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003

² Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC.

transmission systems in GB and France. ElecLink's exemption request was submitted in September 2013 to the concerned NRAs.

1.6. The concerned NRA in GB is the Gas and Electricity Markets Authority ("the Authority"), whose administrative functions are carried out by the Office of Gas and Electricity Markets ("Ofgem"). The concerned NRA in France is the Commission de régulation de l'énergie ("CRE") (together "the NRAs").

1.7. In accordance with paragraph 7 of Article 17, the NRAs have provided, for information, a copy of ElecLink's exemption request to the European Commission (EC) and to Agency for the Cooperation of Energy Regulators (ACER).

1.8. This document is divided into two chapters and three schedules:

- Chapter 1: Provides a description of the general context of ElecLink's exemption application. This description includes an overview of the legal contexts (1.1.), in which ElecLink's exemption application (1.2.) must be determined and the procedure that was followed (1.3.).
- Chapter 2: Contains the analysis of the NRAs, on whether the conditions of Article 17 of the Regulation, and of relevant national requirements, are fulfilled or not.
- Schedules: Schedules A, B (confidential) and C (confidential) which set out the decision of the NRAs to grant ElecLink an exemption and the conditions on which that exemption is granted.

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Chapter 1: General Context

1.1. Legal context

1.1.1. European legal context

1.9. Article 17 of the Regulation provides that new electricity interconnectors may, upon request, be exempted, for a limited period of time, from the following legal provisions of the Regulation and of the Directive:

- **Article 16(6) of the Regulation** which governs how revenue resulting from the allocation of interconnector capacity may be used;
- **Article 9 of the Directive**, which provides that the same person cannot exercise direct or indirect 'control' over a transmission system operator ("TSO") or transmission system and at the same time exercise direct or indirect 'control' over or have any right over an undertaking performing the functions of generation or supply³;and
- **Articles 32, 37(6) and 37(10) of the Directive**, which concern requirements to offer terms for third party access ("TPA") and regulatory approval of charging methodologies.

1.10. In accordance with paragraph 4 of Article 17 of the Regulation, the concerned NRAs should reach an agreement on whether the exemption should be granted, within six months⁴ of the date of receipt of the exemption request by the last of the two concerned NRAs.

1.11. In accordance with paragraph 5 of Article 17, where all the concerned NRAs have not been able to reach an agreement within this time, the exemption decision is taken by ACER, after consultation with the NRAs concerned and the applicant.

1.12. In accordance with paragraph 7 of Article 17 of the Regulation, the concerned NRAs (or ACER where the regulators have not been able to reach an agreement within the six-month period) should notify, without delay, the exemption decision to the EC. The EC may, within a period of two months⁵ from the day following receipt of notification, take a decision requesting the NRAs concerned to amend or withdraw the decision to grant an exemption.

³ And conversely, Article 9 forbids the same person to exercise direct or indirect 'control' over an undertaking performing the functions of generation or supply and at the same time exercise direct or indirect 'control' or exercise any right over a TSO or transmission system. These requirements are known as "ownership unbundling" requirements.

⁴ Article 17, paragraph 4 of Regulation (EC) No 714/2009.

⁵ This two-month period may be extended by an additional period of two months where further information is sought by the EC (paragraph 8 of Article 17 of Regulation).

1.13. Paragraph 1 of Article 17 specifies the cumulative conditions that must be met for an exemption to be granted. These are:

- (a) the investment must enhance competition in electricity supply;
- (b) the level of risk attached to the investment is such that the investment would not take place unless the exemption is granted;
- (c) the interconnector must be owned by a natural or legal person which is separate at least in terms of its legal form from the system operators in whose systems that interconnector will be built;
- (d) charges will be levied on users of the interconnector;
- (e) since the partial market opening referred to in Article 19 of Directive 96/92/EC, no part of the capital or operating costs of the interconnector has been recovered from any component of charges made for the use of the transmission or distribution systems linked by the interconnector; and
- (f) the exemption is not detrimental to competition or the effective functioning of the internal electricity market, or the efficient functioning of the regulated system to which the interconnector is connected.

1.14. In accordance with paragraph 4 of Article 17, the NRAs decide upon the rules and mechanisms for management and allocation of capacity prior to issuing an exemption. It also provides that in the NRAs' assessment of conditions (a), (b) and (f) above, the results of the capacity allocation procedure shall be taken into account by NRAs when assessing conditions (a), (b) and (f) above.

1.1.2. National context: Great Britain

1.15. The Authority has the power to grant licences to electricity interconnector operators under the Electricity Act 1989 ("the Act"). The Authority granted an interconnector licence to ElecLink on 19 November 2013.⁶

1.16. The interconnector licence reflects European regulation and permits the Authority as the concerned NRA for Great Britain to, in agreement with the relevant concerned NRA, exempt new interconnector operators from relevant licence conditions, as provided for by Article 17 of the Regulation.⁷

⁶ Notice of licence grant can be found here:

<https://www.ofgem.gov.uk/ofgem-publications/84513/eleclinklimitedelecinterconnectorlicencewebnotice.pdf>

⁷ Article 17, paragraph 4 of Regulation (EC) No 714/2009.

1.1.3. National context: France

1.17. Articles L.111-40, L.321-1 and L.321-6 of the French Energy Code entrust RTE with the operation of the electricity transmission system and, as such, the development, construction and operation of regulated interconnectors. Private investors can thus only construct and operate an interconnector within the context of an exemption, as provided for in Article 17.

1.18. The Regulation permits CRE, as the concerned NRA for France to, in agreement with the relevant concerned NRA, exempt new interconnectors from relevant legal provisions as provided for by the Article 17 of the Regulation.

1.2. ElecLink's application for exemption: main elements

1.19. ElecLink is a joint venture project between Star Capital and Groupe Eurotunnel. ElecLink proposes to build, own and operate a new 1000MW electricity interconnector between GB and France which is to be sited inside the Channel Tunnel.

Table 1: ElecLink Interconnector overview

| | |
|-------------------------|---|
| Developer | ElecLink Limited |
| Shareholders | Star Capital Partners Limited (51%) & Groupe Eurotunnel (49%) |
| Capacity | 1GW (1000MW) |
| Length | 70 km (via the Channel Tunnel) |
| Connection points | GB (Sellindge substation) – France (Les Mandarins substation) |
| Planned commission date | Q4 2016 |
| Project Cost | ca €400m |

1.20. Furthermore, the request for a connection to the French public electricity transmission network includes an additional 50 MW electricity withdrawal in order to conduct the energy supposed to cover the electric loss of the facility and the power supply of the converter station auxiliary systems.

1.21. ElecLink states that, subject to the exemption being obtained, it is due to start construction works in 2014.

1.2.1. Information provided by ElecLink in its exemption request

1.22. ElecLink's exemption request consists of a main exemption submission document and a number of supporting exhibits.

1.23. The main submission document sets out ElecLink's rationale for the requested exemption and summarises how it considers the relevant exemption conditions have been met.

1.24. The other submitted documents are the following:

- Technical study;
- Consents and licences;
- Market scenarios and revenue study (Redpoint Energy);
- Economic analysis and evidence (Redpoint Energy);
- Project financial information;
- References and supporting data;
- Capacity Allocation and Congestion Management;
- Impact of ElecLink, a new 1000 MW DC link between France and Great Britain, on the continental European transmission system (Consentec);
- Financial and technical proposal from RTE for connection to the French transmission grid;
- Connection agreement with National Grid Electricity Transmission plc (“NGET”) for connection to the GB transmission grid.

1.25. These supporting documents contain further evidence and analysis provided by ElecLink in support of the main exemption submission document.

1.2.2. Scope and duration of requested exemption

1.26. ElecLink has requested an exemption from the following provisions of European legislation for a period of 25 years:

- **Article 16(6) of the Regulation**, which governs how revenue from interconnection may be used;
- **Article 9 of the Directive**, which provides that the same person cannot exercise direct or indirect ‘control’ over a transmission system operator (“TSO”) or transmission system and at the same time exercise direct or indirect ‘control’ over or have any right over an undertaking performing the functions of generation or supply ; and ⁸
- **Articles 32, 37(6) and 37(10) of the Directive**, relating to requirements to offer terms for TPA and the need for regulatory approval of charging methodologies.

⁸ Or exercise direct or indirect ‘control’ over an undertaking performing the functions of generation or supply and at the same time exercise direct or indirect ‘control’ over or have any right over a transmission system operator (“TSO”) or transmission system.

1.2.3. Proposed arrangements for capacity allocation

1.27. ElecLink proposes the following arrangements for allocation of its interconnector capacity:

- 80% reserved for multi-year products (up to 20 years); and
- 20% reserved for short term market (day ahead and intra-day) in line with prevailing short term allocation arrangements.

1.28. ElecLink also proposes to mitigate possible competition issues by limiting the capacity rights from GB to France that may be owned by any one party⁹ to 50% of total capacity.

1.29. ElecLink states that it will facilitate a secondary market for capacity trading that will allow holders of long-term capacity rights to sell on such rights to other market participants. ElecLink indicates that this would occur through some form of bulletin board/exchange operated by a third party.

1.30. ElecLink also states that, in order to ensure the efficient use of the interconnector and to prevent capacity hoarding, any physical transmission rights will be subject to 'Use it or Sell It' ("UIOSI") provisions (where un-nominated periodic rights will be compensated based on the day-ahead market spread when positive).

1.2.4. Rationale for exemption presented by ElecLink

1.31. In ElecLink's view, "unique challenges [of the project] demonstrates the **"specific nature"** of [its] Project and constitutes a compelling case for ElecLink being treated as an exceptional case and being granted an exemption as provided in the regulations".

1.32. ElecLink puts forward the following rationale for requesting an exemption (see also part 3.3 of ElecLink's exemption request):

- **No recourse to regulated revenues or assets:** Application of Article 16(6) of the Regulation would compromise the required level of comfort that periods of low returns can be offset by periods of higher returns;
- **Need to use project finance:** Application of Articles 32, 37(6) and 37(10) of the Directive would compromise arrangements for project finance to be underpinned by long-term contracts and stable revenue returns;
- **Risks of unpredictable interruptions to network access in the initial years** until such time as the national Transmission System Operators (TSOs), NGET and

⁹ This limitation would only apply to undertakings with a greater than 25% share of the generation or supply market in either Great Britain or France.

RTE, reinforce their respective networks. Risks arising from such unpredictable interruptions cannot be mitigated or managed if the provisions of Article 16(6) of the Regulation and Articles 32, 37(6) and 37(10) of the Directive are applied;

- **Unique construction and operating risks:** There would be inherent risks specific to the Channel Tunnel that could not be mitigated or managed if the provisions of Article 16(6) the Regulation and Articles 32, 37(6) and 37(10) of the Directive are applied;
- **Exceptional market and policy risks:** The timing of its proposed interconnector project would make potential returns highly uncertain. The application of Article 16(6) of the Regulation and Articles 32, 37(6) and 37(10) of the Directive would potentially limit ElecLink's ability to mitigate and manage such risks;
- **Independent and unique project shareholders:** An exemption from Article 16(6) of the Regulation and Articles 9, 32, 37(6) and 37(10) of the Directive would be necessary to accommodate the financing requirements of the project and potential future investment activities of the shareholders;

Need for an exemption from the management monopoly over the transmission grid owned by RTE under French regulation: French legislation entrusts the electricity transmission system operator (RTE) with the development, construction and operation of regulated interconnectors. Private investors can thus only construct and operate an interconnector within the context of an exemption. *"The project can only proceed if CRE provides ElecLink an exemption as foreseen in its Délibération of 30 September 2010¹⁰."*

1.3. Processing of the exemption request by the NRAs

1.33. CRE and Ofgem acknowledged receipt of ElecLink's exemption request respectively on 11 and 18 September 2013.

1.34. Both Ofgem and CRE sent a copy of ElecLink's exemption request to both ACER and the EC on the 18 September 2013 in accordance with paragraph 7 of Article 17 of the Regulation.

1.35. To facilitate the NRAs' assessment of whether conditions (a) and (f) have been met and also assess the appropriateness of ElecLink's proposed capacity allocation arrangements and market remedies, Ofgem and CRE commissioned external consultants to carry out a critical review of ElecLink's application.

1.36. Following an open tender exercise, London Economics was selected to conduct a critical assessment of ElecLink's analysis and evidence of the impact on competition and on its revenues, (of the impact on the revenues of regulated interconnectors and "social

¹⁰ Deliberation of the French Energy Regulatory Commission dated 30 September 2010 on the application of Article 7 of Regulation (EC) No. 1228/2003 dated 26 June 2003 and on conditions for access to the French electricity transmission grid for new exempt interconnectors (30 September 2010).

welfare” of the proposed interconnector¹¹. In particular, the study provided an assessment of the analysis provided by Redpoint Energy for ElecLink which included evidence of the impact on competition, revenues and social welfare, as well as a review of ElecLink’s proposed capacity allocation arrangements and measures for market protection.

1.37. In addition, CRE asked RTE, the French Transmission System Operator (TSO), to provide information on the impact of the connection of ElecLink on the French transmission grid.

1.38. A joint consultation (“the Joint Consultation”) was undertaken by Ofgem and CRE on ElecLink’s request for exemption. The Joint Consultation was held between 28 November 2013 and 3 January 2014.

1.39. Non-confidential responses to the Joint Consultation were published on CRE’s website on 20th February 2014 and on Ofgem’s website on the date of publication of this Joint Opinion.¹²

1.40. Pursuant to sub-paragraph 5 of paragraph 4 or Article 17, the NRAs have six months to come to an agreement on the exemption decision and will inform ACER. The exemption decision will be notified without delay to the European commission, pursuant to paragraph 7 of Article 17.

¹¹ The study carried out by London Economics can be found here :

<http://www.cre.fr/documents/consultations-publiques/demande-de-derogation-d-eleclink-au-titre-de-l-article-17-du-reglement-ce-714-2009-concernant-une-interconnexion-entre-la-france-et-la-grande-bretagne>

¹² The Joint Consultation and non-confidential responses on the NRAs’ websites can be found here :

<http://www.cre.fr/documents/consultations-publiques/demande-de-derogation-d-eleclink-au-titre-de-l-article-17-du-reglement-ce-714-2009-concernant-une-interconnexion-entre-la-france-et-la-grande-bretagne>

<http://www.cre.fr/en/documents/public-consultations/request-from-eleclink-for-an-exemption-under-article-17-of-regulation-ec-714-2009-for-a-gb-france-interconnector>

<https://www.ofgem.gov.uk/publications-and-updates/request-eleclink-exemption-under-article-17-regulation-ec-7142009-gb-france-interconnector>

Chapter 2: NRAs analysis of whether ElecLink fulfils the exemption conditions in paragraph 1 of Article 17 of the Regulation

2.1. Analysis of the fulfilment of conditions a) and f) by ElecLink's investment project

1.41. According to condition (a): "the investment must enhance competition in electricity supply".

1.42. According to 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".

1.43. In its guidance on the application of the exemption conditions¹³, the EC outlines that condition (f) has similarities with condition (a) but that, "the exemption itself should not be to the detriment of the competitive functioning of the market".

1.44. CRE, in a communication of 29 March 2012¹⁴, states that the analysis of condition (a) is "completed by analysis of [condition] f".

1.45. Indeed, if adding a new interconnection capacity has an effect of itself on these conditions, ElecLink's requested exemption may undermine the overall positive effects of the interconnector. The NRAs have investigated ElecLink's proposed conditions and whether they may 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 connected.

¹³ Commission staff working document on Article 22 of Directive 2003/55/EC concerning common rules for the internal market in natural gas and Article 7 of Regulation (EC) No 1228/2003 on conditions for access to the network for cross-border exchanges in electricity:

http://ec.europa.eu/energy/infrastructure/infrastructure/gas/doc/sec_2009-642.pdf

¹⁴ Communication of the French Energy Regulatory Commission of 29 March 2012 on the application of Article 17 of Regulation (EC) No 714/2009 of 13 July 2009:

<http://www.cre.fr/en/documents/deliberations/communication/interconnections>

1.46. **Condition (f) consists in checking that :**

- the exemption is not detrimental to competition: Test 1;
- the exemption is not detrimental to the effective functioning of the internal electricity market: Test 2; and
- the exemption is not detrimental to the efficient functioning of the regulated system to which the interconnector is linked: Test 3.

1.47. This chapter considers **the fulfilment of conditions (a) and (f) in two parts:**

- Part 1: Impact on competition and the internal market, and
Part 2: Impact on the efficient functioning of the regulated systems to which the interconnector is linked.

Chapter 2, Part 1: Impact on competition and the internal market

1.48. In general, additional interconnector capacity is likely to increase competition in the internal market. Additional interconnector promotes cross-border trades and increases the supply sources to connected markets. Competitive pressure is likely to increase with market size as market participants have access to a larger number of bids and offers.

1.49. NRAs have undertaken a quantitative assessment of the competition benefits of ElecLink. Generally, the NRAs would expect additional interconnector capacity to lead to a decrease in market concentration (as measured by the HHI¹⁵) which is particularly high in the French market, still dominated by the historical incumbent. This quantitative assessment, undertaken by NRAs and further tested by London Economics, is explored further in the subsection "Limiting the capacity share of a single market player" (section 2.1.1.2.) hereafter.

1.50. The current price convergence rate between France and GB (number of hours where French and GB wholesale spread price is lower than €1/MWh) is quite low (only 11% in 2013, to be compared with a 71%¹⁶ convergence rate between French and Belgian prices). This indicates that the IFA interconnector between GB and France is often congested.

1.51. Furthermore, ACER's Annual Report on the Results of Monitoring the Internal Electricity and Natural Gas Markets in 2012¹⁷ states that the incremental welfare that would result from an incremental increase of the capacity (+100MW) between France and GB is one of the highest in Europe. This highlights the fact that such additional interconnection capacity is expected to increase competition. This effect decreases with the development of new interconnectors.

1.52. The NRAs note that investment in new interconnector capacity with the appropriate markets rules for interconnector trading – for example through market coupling and other aspects of the efficient use and management of interconnection – help to bring together French and GB electricity prices, ensure the effective functioning of French and GB markets and thus, the Internal Electricity Market.

1.53. The NRAs note that ElecLink would increase the interconnector capacity between GB and France by 50%.¹⁸ Generally, the NRAs therefore expect ElecLink to have a positive impact on competition through an increase in cross-border capacity and liquidity.

¹⁵ The Herfindahl-Hirschman Index (HHI) is a measure of market concentration.

¹⁶ This figure being calculated on the basis of spreads lower than 0,01€/MWh

¹⁷ http://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/ACER%20Market%20Monitoring%20Report%202013.pdf (see in particular 3.3 Gross welfare benefits of interconnectors, p74).

¹⁸ There is 2GW of existing interconnection capacity between GB and France (IFA interconnector)

1.54. Although, an increase in cross-border capacity would, in general, have a positive impact on competition and on the internal market and therefore can suggest that conditions (a) and (f) of Article 1 is met, NRAs have considered how the specific proposals put forward by ElecLink could adversely impact these benefits.

1.55. NRAs have considered the two following measures proposed by ElecLink:

- Capacity allocation for a volume up to 800 MW through multi-year products ; and
- the 50% limitation of capacity amount that can detain any undertaking in the GB-to-France direction.

1.56. In the following paragraph, the NRAs investigate the appropriateness of the limits suggested by ElecLink, and review these limits where necessary in order to avoid any detriment of the Interconnector to competition or to the functioning of the internal market.

2.1.1. Third Party Access and sale of multi-year products

1.57. ElecLink asks to be able to sell up to 80% of its capacity through contracts up to 20 years in length. ElecLink states that being permitted to secure such multi-year contracts is essential in order to guarantee the revenues needed to underpin the debt finance required for the project.

1.58. The NRAs note that the requested exemption from the general principles of interconnector access is important considering the amount and length of multi-year products along with the allocation process proposed by ElecLink.

1.59. The NRAs note that :

- Such an allocation process is not explicitly defined in the draft Network Codes on Capacity Allocation and Congestion Management, (CACM) and on Forward Capacity Allocation (FCA);
- Very long-term products could potentially give an advantage to those players in position to secure such multi-year products at a better price, for a longer term and for larger volume. Furthermore, there is concern that only significant players have such an ability and that multi-year products restrict capacity access for new players;
- Allocating such long-term products, on an interconnector, where typically the maximum product length on interconnectors is one year, raises competition concerns.

1.60. The NRAs consider that a sufficient part of the capacity should be reserved for day-ahead allocation (through market coupling) and shorter-term hedging products (e.g. annual, monthly), which are typically more accessible to any market player.

1.61. Nonetheless, the NRAs acknowledge that ElecLink's business model requires a proportion of its capacity to be sold through multi-year products.

1.62. The NRAs consider that there are several efficient ways, developed in this chapter, to manage the concerns listed above.

1.63. ElecLink proposed mitigation measures to answer these concerns.

- Limit on the amount of capacity that can be sold through multi-year products;
- Limiting the capacity share of a single market player;
- Limiting the impact of multiyear products on competition and internal market, especially on shorter-term allocations;
- Rules relating to the nature and the allocation of shorter-term products; and
- Exemption from regulatory approval of Access Rules.

1.64. NRAs have considered these measures and established, in the following sections (parts 2.1.1.1. to 2.1.1.5.), the appropriate measures.

2.1.1.1. Limit on capacity that can be sold through multi-year products

1.65. The *Open Season* for the sale of these multi-year products has not been run yet and such capacity price and volume are not yet known. The amount of multi-year capacity that ElecLink will need in order to finance the project will only be known when the contracts will have been signed -.

1.66. Given this uncertainty, NRAs consider it appropriate to define the limit to the amount of capacity that ElecLink can sell through multi-year products both in terms of revenue earned and volume of capacity (MW). This ensures that the amount of capacity allocated through multi-year products is limited to the necessary volume for the project to raise finance.

1.67. Moreover, this gives the opportunity to maximize the capacity reserved for yearly, monthly or day-ahead timeframes from the beginning of the interconnector operation. The analysis of the 800MW cap proposed by ElecLink and the finetuning of the limitation of the amount of multi-year products to what is strictly necessary to ElecLink's financing are presented in more detail in section 2.2.1.

2.1.1.2. Limiting the multi-year capacity allocated to a single market player

1.68. NRAs consider that the decided multi-year capacity limitation must be completed by a limitation on the amount allocated to a single market player.

1.69. ElecLink has provided a study of the impact of the allocation of multi-year products on the French and GB markets, based on the HHI indicator¹⁹. From this study, ElecLink concludes that an exemption would not have a negative impact on competition as long as

¹⁹ The Herfindahl-Hirschman Index is a market concentration index

no dominant²⁰ market participant holds more than 50 % of the total capacity of the interconnection from GB to France.

1.70. NRAs jointly sought external advice from London Economics, through a study. In particular, this study focused on the impact on market concentration of interconnection capacity being held by the largest generation company in each market. Currently, EDF is the largest generation company in both countries²¹.

1.71. In addition to the HHI analysis used by ElecLink, London Economics also considered the RSI²² indicator (on selected hours of the study period). The choice of this second criterion is consistent with that adopted in 2007 by the Directorate General for Competition of the EC to analyze the structure and performance of six European wholesale markets for electricity between 2003 and 2005.

1.72. This analysis showed that a lower limit than that proposed by ElecLink would be necessary to limit the market power of interconnection users on the French and GB markets. In addition, London Economics found that the problems of competition and market power may arise on both sides of the border and, therefore, proposed to limit the amount of capacity held in both directions, and not only in the direction from GB to France, as proposed by ElecLink.

1.73. In summary, London Economics therefore proposed to limit multi-year capacity allocated to the same player as shown below:

| Summary of RSI results | | | | | |
|------------------------|-----------------------|------------------------|------------------------|---|--|
| Flow direction | Prices | EdF Market Power in FR | EdF Market Power in GB | Ability and incentive to raise price in either country in significant ~ hours | % Share Interconnector for EdF indicated |
| FR→GB | $P_{gb} - P_{fr} > 0$ | Yes | Yes | Yes | ~40% |
| GB→FR | $P_{fr} - P_{gb} > 0$ | Yes | No | Yes | ~20% |
| Both ways | NA | Yes | Yes | Yes | ~20% - 40% |

1.74. The NRAs broadly accept the methodology and results of the study by London Economics. Nevertheless, they observe that a player with a minority market share may also exercise market power in certain situations. Therefore, when considering the limit on interconnector capacity that can be held by any one party, this should not be limited to

²⁰ Defined by ElecLink as a player holding 25% or more of the market share for generation or supply in France or GB

²¹ According to London Economics : “No other player has a market share greater than 25% in either market”

²² Residual Supply Index is an indicator of market structure representing the narrowness of the market, the market share of the most important actors, their essential role and evolution of demand in relation to share of capacity owned in the market. In that sense, the RSI is an indicator of market power.

only the largest generation company of each market but should also consider a broader set of market participants.

1.75. However, insofar as the number of hours during which a player is likely to exercise market power is greater if its market share is high, the NRAs consider it is appropriate to apply a different limit depending on the market share of the considered market participant.

1.76. Therefore, in order not to undermine competition and minimize potential adverse effects on the GB and French markets, NRAs consider it necessary to introduce a limit on multi-year products that would depend on the market share of the concerned market player, as specified in paragraph (G) of Schedule A.

2.1.1.3. Limiting the impact of multi-year products on shorter-term markets and allocations

1.77. As set out above, allocating capacity through multi-year products raises concerns, particularly where this capacity is allocated for a long period of time (up to 20 years as proposed by ElecLink). Therefore, additional arrangements should be put in place to prevent market foreclosure and any negative impact on the shorter term markets.

1.78. ElecLink proposes to reserve a proportion of its capacity (at least 20%) for shorter-term allocation, i.e. of a duration similar to that of regulated products.

1.79. ElecLink also proposes to put in place Use-it-or-sell-it (UIOSI)²³ arrangements that will automatically provide additional capacity for day-ahead allocation when long term capacities are not nominated.

1.80. NRAs consider that these measures are important to ensure appropriate functioning of the market and to minimise the possible negative impact of selling capacity through multi-year products. NRAs further consider that additional measures around netting provisions for capacity and the split of short-term capacity across different product lengths should also be introduced.

1.81. The NRAs agree that the UIOSI provision is necessary (compulsory for physical transmission rights (PTR) in the framework guidelines for Capacity Allocation and Congestion Management (CACM FG)) to ensure that multi-year products to have no detrimental impact on short-term markets.

1.82. Nevertheless, this condition should also be completed by netting provisions, so that ElecLink maximises the capacity it makes available to the day-ahead allocation. Thus, all

²³ Use it or sell it (UIOSI) means the principle according to which any capacity that has been allocated in the long term and it has not been nominated, is then made available (resold) automatically in the day-ahead capacity allocation with the proceeds going to the previous capacity holder.

long-term capacity nominated at the long-term nomination deadline in one direction shall induce an equivalent increase of the proposed capacity at day-ahead timeframe in the opposite direction.

1.83. It is only if ElecLink is obliged to always maximise the capacity it gives to the market at each timeframe, in particular in the day-ahead timeframe, and in particular through UIOSI and netting provisions, that allocating a significant volume of multi-year products will be acceptable.

1.84. These two conditions ensure that “congestion management rules [...] include the obligation to offer unused capacity on the market”, as provided by Article 17(4).

1.85. In addition, ElecLink has made no clear proposal about the split between the different timeframes of the capacity reserved for shorter-term products.

1.86. In order to guarantee that a sufficient level of hedging products (yearly or monthly for example) is allocated periodically and is thus available for market players that would not be in a position to acquire multi-year products, it is necessary that the NRAs approve the capacity split between the different timeframes.

1.87. In addition, ElecLink’s proposal to develop secondary trading for the multi-year capacity is likely to contribute to making shorter hedging products available at a sufficient amount. This would indeed allow capacity which has been previously allocated, in particular through the Open Season, to be resold.

1.88. To ensure optimal efficiency, such a secondary market should be organized in a coordinated way with regulated interconnector capacity between France and GB and according to the Access rules approved by the NRAs. A secondary market should be organized through a common allocation/resale platform and fungible products. The NRAs consider that it is important to ensure a level of consistency in the features of products allocated during the Open Season and the yearly products after the relevant yearly auction for the same delivery period, and the harmonisation of products (physical or financial transmission rights).

1.89. The NRAs consider that the measures presented above, including secondary trading and UIOSI provisions, reduce the potential anti-competitive impact of selling capacity on a multi-year basis and prevent significant market participants from restricting capacity access to new market participants, by holding multi-year products.

2.1.1.4. Rules relating to the nature and the allocation of shorter-term products

1.90. As part of the exemption application, ElecLink did provide some detail about the proposed interaction with European Network Codes, and specifically provided an indication of the extent to which it may comply with requirements under the draft Capacity Allocation and Congestion Management (CACM) network code.

1.91. For allocation timeframes that exist or will exist on regulated interconnectors on the same border (particularly for yearly to balancing timeframes), NRAs see the harmonization of the capacity allocation as key, as it is partly linked to the efficiency of the European target models. NRAs therefore consider that:

- Having a common firmness and allocation platform for hedging products on regulated interconnector capacities and ElecLink is important to ensure a liquid and efficient secondary market;
- The day-ahead and intraday optimization mechanisms on ElecLink should be aligned, in procedures and rules, with those on regulated interconnectors between France and GB;
- The remaining capacity on ElecLink after the intraday timeframe should be made available to RTE and NGET so that it is dealt with in the same way as such remaining capacity on regulated interconnectors of the same border for balancing purposes.

1.92. NRAs consider essential:

- that the exemption from Article 32 is strictly limited to the capacity sold through Open Season; and
- to ensure that all remaining capacity on ElecLink is, and will be, subject to the same (current and future) conditions and requirements regarding capacity allocation that are in place for regulated interconnectors on the same border.

2.1.1.5. Exemption from regulatory approval of Access Rules and Charging Methodologies/Tariffs

1.93. ElecLink has applied for an exemption from Article 37(6) and 37(10) of the Directive, relating to NRAs' power of approval of the third party access conditions to the infrastructure and to the network along with their authority to require the modification of these conditions.

1.94. If such an exemption was granted the NRAs would not be in a position to control, *ex ante*, the application by ElecLink of the principles set out in this decision and of the legislation relating to the Access Rules. NRAs consider that the ability to approve and amend Access Rules is an important aspect of the allocation process and therefore consider a level of oversight to be necessary.

1.95. NRAs therefore decide not to grant any exemption from article 37.6 and 37.10, concerning NRAs' approval power of Access Rules and Charging Methodologies/Tariffs.

1.96. Moreover ElecLink will be subject to the following conditions:

- Conditions of access for ElecLink's capacity should be presented in Access Rules which will include Access Rules for the shorter term timeframes, and Open Season Access Rules.
- The Access Rules will be submitted for approval to the NRAs. Thus, the NRAs will make sure all the conditions imposed in this Joint Opinion (in particular for the Open Season: type of products, maximum allocation to a given undertaking...) and in all relevant national and European legislations are respected.

Furthermore, NRAs consider it important to check that the procedures for ElecLink's capacity allocation are transparently defined to ensure a level playing field for all market participants. Therefore, ElecLink must consult publically on their Access Rules

before submitting these, together with the contributions to the public consultation, to the NRAs for regulatory approval of the Access Rules. After regulatory approval, the Access Rules shall be duly published by ElecLink.

2.1.2. Ownership unbundling provisions

1.97. In the assessment of whether the exemption is detrimental to competition and the effective functioning of the internal market, the NRAs have also considered the possible impact of an exemption from ownership unbundling.

2.1.2.1. ElecLink's rationale for exemption from the ownership unbundling requirements

1.98. ElecLink has requested an exemption from the ownership unbundling requirements set out in Article 9(1) of the Directive. In particular, ElecLink refers to provisions contained in Article 9(1) (b), (c) and (d) relating to restrictions on board member appointments and exercising of voting rights. In its view, restrictions of this kind would *"prove problematic and unnecessarily limiting"* to ElecLink's shareholders.

1.99. ElecLink further states that energy infrastructure projects do not comprise the core business of its shareholders and that its shareholders require an exemption from unbundling requirements *"in order to retain the flexibility to invest in future independent projects and to ensure that the obligations imposed on [them] in respect of [their] operation of the ElecLink interconnector are appropriate and proportionate"*.

1.100. ElecLink states that as of 30 June 2013, ElecLink's shareholders do not have *"any direct or indirect links to energy producers or suppliers except in their capacity of consumers of electricity and gas"*. However, ElecLink indicates that Star Capital, the 51% shareholder, is currently considering an initiative to invest in the generation of electricity from renewable sources.

1.101. ElecLink considers any future energy related investments that its shareholders may make would provide minimal scope for discrimination or a conflict of interest *"given the likely value and nature of the participation in such activities and the likely size and market share of any such generation and/or supply activities"*.

1.102. According to ElecLink, Article 9(1)(a) of the Directive is drafted such that ElecLink would be *"categorised as a TSO with associated obligations"*. The TSO obligations are set out in Article 12 of the Directive. ElecLink considers the requirements under Article 12 of the Directive to be *"inappropriate and potentially onerous for an operator with a single transmission asset"* such as itself.

2.1.2.2. Consideration of ElecLink's ownership unbundling exemption request

1.103. Article 17 allows exemption for a new interconnector from Article 9 of the Directive. This article firstly provides that *"each undertaking which owns a transmission system acts as a transmission system operator"*. Secondly, it obliges Member States to ensure that *"the same person or persons are not entitled to directly or indirectly exercise control over a production or supply undertaking and directly or indirectly to exercise control or exercise any right over a transmission system operator or over a transmission system"*. Conversely, directly or indirectly exercised control over a transmission system

operator should preclude the possibility of directly or indirectly exercising control or any right over a production or supply undertaking.

1.104. The proposed ElecLink interconnector is a single 'point-to-point' interconnector, which will be owned and operated as such, and in this respect it differs from a national TSO. NRAs wish to highlight that ElecLink will still be required to comply with the tasks defined under Article 12 to the extent that they apply to a TSO only operating an interconnector. The NRAs consider that an exemption from Article 9 does not exempt ElecLink from the requirement to be certified as a TSO.

1.105. The exercising of certain functions relating to the management of an interconnector by entities associated with a company exercising electricity supply or generation activities, may be to the detriment of competition. In particular this could occur as a result of access to information that is privileged and/or commercially sensitive within the meaning of Article 16 of the Directive, through the possibility of influencing strategic decisions, and the risk of discrimination of third parties for network access. NRAs therefore consider that there are potential negative impacts of awarding a total exemption from ownership unbundling requirements, particularly in view of condition f.

1.106. Conversely, the NRAs also recognise that an obligation to comply with the full ownership unbundling requirements could be considered as a limitation for financial investors like STAR Capital or for Goldman Sachs, reference shareholder of Groupe Eurotunnel. ElecLink has stated that an exemption from ownership unbundling would be required especially in order not to compromise STAR Capital's strategy to invest in the utilities sector.

1.107. The NRAs therefore consider that it is appropriate to grant ElecLink a limited exemption from Article 9 as defined by the specific terms and conditions detailed in part I of the NRAs exemption decision at Schedule A

1.108. Under this approach, ElecLink will be subject to measures, based on an amended ownership unbundling model ("amended OU model"). Such rules are designed not to compromise Star Capital's strategy to invest in some undertakings performing generation or supply activities. As such ownership unbundling model will permit investment under certain conditions, in generation or supply activities by some direct or indirect shareholders of ElecLink, the NRAs will require ElecLink to comply with all conditions set out in Chapter V of the Directive (ITO model) with the exception of Article 22.

1.109. NRAs consider that these measures will alleviate any competition concerns that could arise from a total exemption from Article 9. In particular, these provisions will ensure non-discriminatory third party access, the independence of the operator of the interconnector and the protection of commercially sensitive information.

Conclusion on the impact on competition and the internal market

1.110. In summary, the NRAs consider whilst the ElecLink project presents benefits to competition and the internal market, it is critical to ensure that appropriate conditions are imposed on ElecLink to ensure that the condition (a) of Article 17 is met. These conditions ensure that the potential competitive benefits of the project are not eroded. These conditions are defined in more detail in the Exemption Decision at Schedule A.

Chapter 2, Part 2: Impact on the efficient functioning of the regulated systems to which the interconnector is linked.

1.111. Test 3 of condition (f) requires confirmation that “the exemption is not detrimental to the efficient functioning of the regulated system to which the interconnector is linked”.

1.112. Assessing if test 3 of condition (f) is fulfilled requires analysis of the impact of the exemption itself on the effective functioning of the regulated system to which the interconnector is linked. However, the fulfilment of condition (b) implies that the investment would not take place unless an exemption is granted. As a result, the counterfactual scenario used to assess the impact of the exemption on the regulated system is the scenario where the investment does not take place taking into account that no regulated interconnection on the France-GB border are foreseen by 2016. Thus, analysing the impact of the exemption on the effective functioning of the regulated system implies analysing the impact of the investment itself.

1.113. Provided it is used efficiently, and all other things being equal, new interconnection would result in generation costs savings as resources are allocated more efficiently across the border, and an increase in security of supply. The NRAs would expect grid users, in both GB and France would benefit from a portion of these generation costs savings and from increased security of supply.

1.114. These benefits may however come at a cost to consumers. For example, new interconnection may generate costs resulting from the integration of the interconnector in the regulated system through network reinforcements and balancing costs. New interconnection may result in transfers between grid users (consumers and generators) and other interconnectors in the interconnected markets as a result of wholesale electricity price changes resulting from increased interconnector flows. Finally, the new interconnection could have an impact on the expected profitability of future interconnectors between GB and continental Europe.

1.115. To analyse these different effects of the project on the regulated system in both France and GB, the NRAs have used information provided by ElecLink, London Economics, RTE, NGET and ACER. Informations provided by the documents listed below have been used by the NRAs to reach a conclusion whether ElecLink is detrimental to the efficient functioning of the regulated systems in GB and France (Test 3 on condition (f)):

- ElecLink studied (i) the projected impacts on consumers and generators in France and in GB, (ii) the projected generation costs saving in France and in GB, (iii) the projected congestion rent on the new interconnector, and submitted its analysis as part of its exemption request.
- The NRAs requested London Economics to test this analysis; London Economics delivered its own projections, on the same scope.

- RTE has provided its projections regarding the generation costs savings in Europe that new interconnection capacity between France and GB would allow. ACER has published a similar analysis, carried out on all relevant borders²⁴.
- Finally, ElecLink submitted its analysis regarding the costs of the integration of the new interconnector on the regulated transmission systems in France and in GB. The NRAs asked RTE and NGET respectively to provide information on grid congestion and reinforcement costs caused by the integration of the new interconnector on the regulated grids in France and in GB.

1.116. The NRAs' analysis of the information provided in the documents listed above is set out below.

The new interconnector will allow generation costs savings in Europe and will increase security of supply

1.117. Provided the ElecLink interconnector is used efficiently, it will result in generation costs savings, as it will increase the utilisation of the most efficient plants across the connected markets and, to a certain extent, flatten peak demand and mutualise storage facilities.

1.118. For France and GB alone, ElecLink estimates generation costs savings of ██████████. London Economics estimates the same figure as €4,135 million (2017-2054²⁵, discounted at a 3.5 % rate, expressed in 2013 prices). The magnitude of these two projections differ, as the underlying assumptions and the methodologies used in the respective modelling are different. Thus, these projections do not allow drawing precise quantitative conclusions.

1.119. At the European level, RTE estimates that a 1,000 MW increase in interconnector capacity between France and GB, from a starting level of 3 GW, will allow, in 2020, €76 million in annual generation costs savings all over Europe. Similarly, RTE estimates that a 1,000 MW increase in interconnector capacity between France and GB, from a starting level of 4 GW, will allow, in 2020, €64 million in annual generation costs savings all over Europe. ACER estimates that a 100 MW increase of available commercial interconnection capacity between France and GB would have resulted, for the year 2012, in a €9 million increase in "social welfare" (corresponding to the sum of consumers' and producers' welfare and congestion rent).

1.120. Part of these generation costs savings (at the European level) will benefit grid users directly. The rest will be earned as a new congestion rent for the interconnector

²⁴ http://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/ACER%20Market%20Monitoring%20Report%202013.pdf (see in particular 3.3 Gross welfare benefits of interconnectors, p74).

²⁵ The analysis is carried over the entire lifespan of the interconnector, beyond the exemption period, as the assessment of Test 3 implies analysing the impact of the investment itself on the effective functioning of the regulated system to which the interconnector is linked, and not only the impact of the exemption.

operator, defined as the product of energy transited through the interconnector and the wholesale electricity prices differentials between French and GB markets.

1.122. Although the quantitative results of the various studies differ, they all indicate that ElecLink's proposed 1000 MW interconnector would contribute to decreased generation costs, and that part of this decrease would benefit European grid users.

1.123. Furthermore, the new interconnector will increase security of supply in France and GB, through the pooling of energy, reserve and other balancing services between the two interconnected markets (subject to the terms of the exemption from Article 32 of the Directive, under which ElecLink would need to ensure the optimal use of the interconnector as discussed earlier in this document). The benefits in terms of security of supply were confirmed by London Economics.

The integration of the new interconnection on the regulated transmission systems will result in moderate congestion and reinforcement costs for grid users

1.124. ElecLink has commissioned Consentec to study the costs imposed by the new interconnector on the continental European transmission systems. This study concluded that the realisation of the new interconnector has no severe negative impact concerning voltage, stability and thermal constraints.

1.125. However, information provided by the national TSOs (RTE and NGET), following the NRAs' request, set out that the integration of the new interconnector may generate costs for grid users. Indeed, it may generate congestions on the regulated networks, which may require reinforcement of the regulated networks, or other measures such as re-dispatching. The costs of these measures will be borne by the network users through increased network tariffs.

1.126. The possible impact of ElecLink on the regulated systems in France and GB would be:

- As concerns the French grid, RTE's report to the NRAs suggests that congestion generated by ElecLink would be largely diminished by reinforcements already planned in the North of France. Other reinforcements necessary for the ElecLink connection are estimated at €8 million. The remaining congestions could lead to residual redispatching costs thereafter, estimated at €3 million per year, associated with an automatic curtailment system allowing RTE to disconnect ElecLink in the event of a network fault (the cost of this solution will be mutualised through the network tariff and borne by grid users), which could lead to an expected curtailment volume of 7 GWh/year. The study conducted by RTE on this matter is consistent with the methodology it usually uses to evaluate investment decisions and to establish annual investment plans and the Ten Year Network Development Plan (TYNDP).

- In GB, ElecLink is subject to a non-firm connection to the GB transmission system from 2018 to 2023. This reflects the significant reinforcement costs across the South of England that would be required to accommodate ElecLink at its full capacity. The connection agreement includes provisions that allow NGET, as the Transmission System Operator, to limit ElecLink's access to the GB transmission system in order to preserve system security.

1.127. In addition, it is to be noted that ElecLink will be subject to the national arrangements applicable to interconnectors in GB and France. Specifically, in GB, ElecLink will be required by its interconnector licence to comply with relevant industry codes²⁶ which will ensure that the exemption itself is not detrimental to the efficient functioning of the system to which the interconnector will be connected. In France, the new interconnector will be subjected to a set of technical requirements, aimed at ensuring that its operation will not jeopardize the stability and the safety of the transmission grid.

The new interconnector will result in financial transfers between consumers, generators and other congestion rents of other interconnectors

1.128. New interconnection capacity between France and GB will, as a general rule, impact wholesale electricity prices in France, in GB and in other markets. As a result, financial transfers will occur between generators, consumers and other interconnectors' operators through congestion rents.

1.129. In markets where wholesale electricity prices will rise, on average, financial transfers will occur from consumers to generators, whereas in markets where wholesale electricity prices will decrease, on average, financial transfers will occur from generators to consumers. When several countries form a single market (in the absence of congestions between interconnected countries), transfers can occur between generators and consumers in different countries.

1.130. Furthermore, congestion rents are likely to decrease on other regulated interconnectors between France and GB, compared to a situation without ElecLink. Modelling presented by ElecLink and London Economics clearly demonstrated this impact; the magnitude is however subject to uncertainty due to the different assumptions and methods used in the respective modelling. The congestion rents may also vary on interconnectors on other borders, as rents are transferred from or to other market participants. The characteristics of these transfers will then depend on the beneficiaries of congestion rents in the base case scenario.

1.131. ElecLink provided an analysis of the net welfare of generators and consumers in France and in GB resulting from the new interconnector. This analysis accounts for the net variation of wholesale revenues for generators (increase / decrease in price and

²⁶ Including Grid, Connection and Use of System and Balancing and Settlement Codes as required by SLC 3 (Compliance with codes) of ElecLink's interconnector licence.

increase / decrease in volume), the variation of generation costs (increase / decrease in volume) for generators and the variation of wholesale electricity price for consumers.

1.132. ElecLink also provided its projections regarding congestion rent losses on present and future regulated interconnectors between France and GB. The effect of the new interconnector on the congestion rents on other borders, as well as the social welfare impact in others countries, have not been studied. The detailed results are as follows:

| € million, 2016-2054, Net Present Value (2011 prices) | France | GB | Total |
|--|--------|------|-------|
| Grid users' welfare | 871 | -232 | 640 |
| Congestion rent variation on regulated interconnections (IFA and IFA2) | - | - | -81 |

| € million, 2016-2041, Net Present Value (2013 prices ²⁷) | France | GB | Total |
|---|--------|------|-------|
| Grid users' welfare | 746 | -148 | 598 |
| Congestion rent variation on regulated interconnections (IFA and IFA2) | - | - | -54 |

London Economics challenged this study and provided its own analysis. The detailed results are as follows:

| € million, 2017-2041, Net Present Value (2013 prices ²⁸) | France | GB | Total |
|--|--------|------|-------|
| Grid users' welfare | 6707 | -841 | 5866 |
| Congestion rent variation on regulated interconnections (France-GB border) | - | - | -498 |

1.133. The analysis by ElecLink and London Economics provide estimations of different magnitude for the welfare impacts on consumers and generators in France and GB. Different underlying assumptions (generation mix, production costs, etc.) account for some of these differences, but ElecLink and London Economics also used different pricing methodologies in their respective modelling, which appear to have a significant influence

²⁷ CRE's calculation from data provided by ElecLink.

²⁸ CRE's calculation from data provided by London Economics.

on the outcome of the modelling²⁹. In spite of very different quantitative results, both conclude that losses of congestion rents on regulated interconnectors between France and GB are limited compared to the benefits to users of the French and GB networks.

The ElecLink project will not impact on the feasibility of future regulated interconnectors.

1.134. Finally, NRAs do not consider that ElecLink will hinder the realisation of future regulated interconnectors, as all studies converge on the fact that the socially optimal interconnection capacity between France and GB is around 5 GW.

The NRAs consider that Test 3 of condition (f) is satisfied

1.135. Overall, the NRAs consider Test 3 of condition (f) to be satisfied and therefore that the exemption is not detrimental to the effective functioning of the regulated system to which the interconnector will be connected. Indeed, the interconnector is likely to generate more benefits for grids users (part of the generation costs savings, and increased security of supply) than the costs they will incur for its integration into the regulated transmission grid.

Conclusion on whether ElecLink satisfies conditions (a) and (f)

1.136. The NRAs consider that, subject to ElecLink complying with the additional conditions described in part 2.1., conditions (a) and (f) are satisfied.

²⁹ London Economics' model predicts price changes of much larger magnitudes than ElecLink. This is due to differences in modelling the margin of producers over the marginal costs. For further details see appendix 2 of the public consultation which has been run by the NRAs on the 28 November 2013 (<https://www.ofgem.gov.uk/publications-and-updates/request-eleclink-exemption-under-article-17-regulation-ec-7142009-gb-france-interconnector> ; <http://www.cre.fr/documents/consultations-publiques/demande-de-derogation-d-eleclink-au-titre-de-l-article-17-du-reglement-ce-714-2009-concernant-une-interconnexion-entre-la-france-et-la-grande-bretagne>)

2.2 Analysis of the fulfillment of condition b) – level of risk

1.138. Condition b) of Article 17(1) (“condition b”) of the Regulation sets out that the exemption can only be granted to the extent that “the level of risk attached to the investment is such that the investment would not take place unless an exemption is granted”.

1.139. The analysis of the satisfaction of this condition is twofold. First, ElecLink needs to prove that it takes risks in order to propose a project which is more attractive for the community than what is proposed by regulated TSOs. Second, the exemption scope and duration need to be proportionate to the risk taken by ElecLink.

1.140. ElecLink requests an exemption from the rules relating to the use of congestion revenues as defined in article 16(6) of Regulation. ElecLink is seeking an exemption to manage risks associated with the specific nature of the project and to ensure the ElecLink project can be financed. ElecLink states that it faces construction and operating risks specific to the Channel Tunnel. Furthermore, its grid connections are subject to unplanned interruptions in the initial years of operation of the interconnector and it faces market and energy policy risks. Finally, the project holders intend to fund the project partly through non-recourse project finance debt.

1.141. The assessment of condition b) is clearly linked to the exemption from the use of revenues. NRAs have also considered in the analysis below whether ElecLink’s requested exemption from third party access, ownership unbundling and regulatory approval of charging methodologies are proportionate to the risk taken by ElecLink.

2.2.1. Allocation of multiyear contracts through Open Season

ElecLink wants to be able to sell up to 80% of the interconnector’s capacity through multi-year products in order to ensure the funding for the project

1.142. ElecLink is requesting an exemption from Third Party Access under Article 32 of the Directive in order to sell up to 80% of its capacity through multi-year products, up to 20-year duration.

1.143. As described in part 1 (analysis of the impact of ElecLink on competition and the internal market) of paragraph 2.1. aiming at assessing the respect of conditions a) and f), the allocation of multi-year contracts through an Open Season constitutes an exemption from European target models. NRAs consider that the conditions discussed in part 1 mitigate any impact to competition. As a reminder, these conditions are intended, in particular, to ensure that:

- market power and market shares of dominant market participants are not increased by limiting the multi-year capacity volume that a single market participant can hold;
- multi-year capacities contribute to maximize volume of shorter term hedging products (for instance annual or monthly) by organising an effective secondary market;
- multi-year capacities do not interfere with the daily market efficiency and contribute to maximise short term capacity through netting and UIOSI, the latter also preventing capacity hoarding.

1.144. Multi-year products should only be permitted to the extent that they are necessary to the funding of the project. This will ensure that short-term capacity, such as daily/monthly/annual capacity, is maximised.

1.145. In its application, ElecLink explains that multi-year contracts could generate a stream of predictable cashflows because they are guaranteed by contracts signed with legitimate counterparties at a fixed price for the whole duration of these contracts.

1.146. In its application, ElecLink indicates that:

“We estimate total project costs of c.€400m to be financed through a non-recourse project finance structure. The management of Groupe Eurotunnel and STAR Capital consider ElecLink to be outside of the scope and risk profile of their existing core businesses and are seeking a financing structure commensurate with such risk. Equity capital will be provided by the Shareholders and debt financing will be underpinned by the sale of long-term capacity rights through an open season process in advance of interconnector operations. Long-term contracts will provide ElecLink with stable cashflow to underpin the required debt service.”

As well as: “We need to raise non-recourse project finance debt. We can only proceed if we are able to project finance ElecLink. We will sell long-term interconnector capacity contracts to generate a stream of predictable cashflows on which lenders will issue a finite amount of debt on inception. An exemption will allow us to demonstrate to lenders the stability of such cashflows despite a changing regulatory environment over the course of the exemption period. As a single asset, we would not be able to demonstrate such predictability under a regulated tariff regime.”

And finally: “Without this source of finance, the Project will not be viable”.

London Economics notes that project finance, which is used because of project promoters identity, requires regular cashflows

1.147. According to London Economics:

“project finance for large infrastructure projects is common. The main reason is that the projects themselves will be large and lumpy, but have real fixed assets. The balance sheets of the companies involved could be small relative to the total capital investment.”

1.148. Without access to Star Capital’s balance sheet, London Economics assumes that its size is such that a project finance structure would be necessary. Concerning Groupe

Eurotunnel, London Economics analysed its financial information as stated in its database³⁰.

1.149. The study conducted by London Economics confirms that, considering the project promoters identity, project finance is necessary for the project financial viability:

"Our analysis (in the Annexes) indicated we confirm the need for project finance"

1.150. London Economics thus considers that:

"If the cash flows can be regularized, then project finance can be achieved."

NRAs consider that without multi-year products, ElecLink would be exposed to a high volatility of revenue

1.151. The need for ElecLink to sell multi-year products should be assessed in the light of the downside risks faced by the project and the perception of that risk that creditors can have. Indeed, the creditor loan decisions are taken on that basis. Furthermore, as an exempted interconnector, ElecLink doesn't present the same financial guarantee as a regulated asset can offer.

1.152. The risks and uncertainties surrounding the ElecLink project vary, for example:

- In the absence of multi-year products, the project profitability would depend on the short-term capacity value, namely the price spread between French and GB spot markets³¹. As such, the profitability is fully exposed to the risks of the interconnected market. The evolution of the level, the volatility and the correlation of the electricity prices in France and GB, for the 25 coming years, are the main determinants; however these elements are complex to analyse and impossible to predict with a sufficient level of certainty after the very early years.
- Other interconnector investment:
 - the total additional capacity provided in the coming years by new interconnectors between the British Isles and mainland Europe is uncertain.
 - the exact impact that future additional interconnectors between the British Isles and the continent will have on the price spread between France and GB is uncertain. However, the increase in the interconnection capacity will automatically result in a decrease in the interconnector capacity price as increased interconnector flows reduce the price spread that generates these assets revenue. It is difficult to anticipate the extent of price convergence after projects Nemo, IFA 2, FabLink and CelticLink, as well as new interconnectors linking, directly or indirectly the same markets, are achieved.

³⁰ As extracted from London Economics's Bloomberg Professional Terminal and Database service subscription

³¹ The same day or the day projected by ElecLink's costumers when purchasing shorter-term products (one year ahead maximum).

1.153. Furthermore, ElecLink has few comparable projects. Creditors cannot easily observe an equivalent project from which they could draw useful lessons in terms of risk analysis on revenues.

NRAs consider that multi-year products allow ElecLink to decrease revenue volatility and facilitate project finance...

1.154. Allocating multi-year products would allow ElecLink to:

- Guarantee a revenue share with counterparties whose credit would be sufficient to serve as collateral to creditors; and
- Provide financial visibility over a very long period (up to 20 years) to the benefit of creditors.

1.155. NRAs therefore agree that if all capacity were to be sold through yearly or shorter-term products, the degree of risk associated with changes in electricity markets is of such magnitude that it would be likely to prevent long-term financing for significant amounts on acceptable terms for project promoters.

1.156. NRAs understand from the analysis from London Economics that the funding structure sought by ElecLink is frequently used for similar projects. Like London Economics, NRAs consider that contracting debt for ElecLink will be facilitated by the ability to allocate multi-year products. Therefore, without these kinds of products, the project may not be realised. NRAs therefore consider that ElecLink should be able to allocate capacity in this way.

...but consider that the share of these products shall be limited to the necessary minimum

1.157. However, the NRAs consider that the volume of multi-year products should be proportionate to the risks borne by ElecLink – i.e. this volume should not exceed its need for funding. ElecLink wishes to sell up to 80% of capacity through multi-year products. [REDACTED]. However, London Economics' analyses show that multi-year capacity prices could be above ElecLink's expectations. In such a situation, the 80% of the capacity allocated through multi-year products would generate regular cashflows above ElecLink financing requirement.

1.158. Thus, in addition to ElecLink's proposed limit of 80% of total capacity, the NRAs also consider it appropriate to limit multi-year capacity allocation by a cap corresponding to the generated revenues. The maximum value for multi-year contracts sold by ElecLink is based on project funding needs.

1.159. London Economics' analysis is consistent with this position:

“Given the uncertainty around the revenues the market will actually allow ElecLink to raise, a way forward would be to base the derogation on the revenues required to achieve project financing, rather than the % of capacity allowed to sell long-term contracts.”

2.2.2. Revenue and profit risk

1.160. It is up to the regulators to decide the relevance of exemption from Article 16 (6) of the Regulations and to determine its extent.

ElecLink requests to keep all the revenues

1.161. ElecLink requests a total exemption from article 16(6) of the Regulation in order to keep all revenues resulting from interconnection capacity allocation. ElecLink suggests that this will allow it to recover construction, operation and maintenance costs, and provide a return that it considers adequate.

1.162. ElecLink provided NRAs with a business plan based on a number of assumptions and costs projections, including expected construction costs, and revenues projections. This business plan has a rate of return in line with the usual estimates of return expected by investors in projects significantly riskier than regulated activities.

1.163. ElecLink’s revenue comes from the selling of capacity between the French and GB electricity markets. It is therefore mainly dependent on the spread between French and GB prices. ElecLink has provided financial projections based on a reference scenario and financial sensitivity analysis based on a number of different scenarios.

1.164. ElecLink also cites various project risks that it will bear. In its exemption request, it points in particular to:

1.165. The market risks:

“The owners of ElecLink face a number of risks that could have a negative impact on congestion revenues arising from price differences between GB and France. We categorise these as market risks. All of them would drive changes in ElecLink revenue through changes in either the level or volatility of electricity prices in France and GB. “

1.166. The risks of unplanned interruptions:

“Our grid connections are subject to unplanned interruptions in the initial years until such time National Grid and RTE reinforce their respective networks.”

1.167. The unique risks of construction and operation:

“Unique construction and operating risks specific to the Tunnel which make our Project challenging to develop and operate”

1.168. The risks of competing projects:

“Additional interconnector capacity is expected to have a negative impact on ElecLink revenues since it would likely supply electricity to GB when the electricity price in GB is high and export electricity from GB when the electricity price in GB is low. The resulting price convergence will reduce the benefit of arbitrage opportunities available to the capacity holders of ElecLink.

A large number of new interconnector projects are due to be built within the next ten years in response to the need for more interconnection and a concerted policy drive at EU level to increase the level of interconnection between member states. In this respect, the Project is expected to be developed during a unique period in terms of changes to the competitive landscape in interconnection.”

1.169. The risks pertaining to energy policy:

“The Project is being developed against a background of a generation mix in Europe which is forecast to profoundly change over the next decade as policies designed to achieve renewables and decarbonisation targets progressively impact electricity supply (generation plant retirements and new build) and demand (energy efficiency and demand response). In addition, the policies of individual member states with regard to the role of nuclear power are subject to sudden and fundamental change.

The economics of the Project would be highly sensitive to the changes in the generation mix and capacity margins that would result from policy-driven changes. These risks are not under our control and we are investing in a market and policy landscape which is characterised by an unprecedented level of uncertainty.”

The regulators consider that revenues could be higher than expected by ElecLink ...

1.170. Estimates from ElecLink suggest that the interconnection capacity available thanks to IFA 2000, IFA2, BritNed and NEMO is lower than the optimal interconnector capacity between GB and France (and Belgium) from around 5000 MW. This estimation is consistent with the analysis provided by RTE in the ten year development plan³².

1.171. The NRAs requested London Economics to conduct additional analysis on the expected return and risk of the project.

³² In the 2013 Ten Year Development Plan, RTE considers that : “During the next ten years, ENTSO-E (the association of European national transmission system operators) foresees particularly high flows between the British islands and the continent, as a result of an important development of wind generation in Ireland, Scotland and off the English shores, requiring a total interconnection capacity between 5 and 10 GW with the continent.” (Translation of CRE’s services) »

1.172. The analysis undertaken by London Economics suggests that prices, and therefore revenues, may be higher than predicted by ElecLink. For multi-year capacity, London Economics suggests that, based on the observed auction prices of IFA capacity, revenue could be higher than projected by ElecLink.

1.173. In addition, for prices of annual and shorter term products, London Economics considers that:

“The upside risks of the assumptions of ElecLink appear to outweigh the downside risks, although there are risks on both sides.

- *Higher peak demand in France, if a more plausible assumption that peak demand grew in line with total demand would lead to higher prices.*
- *An increase in the gas share of electricity production in the reference scenario might be considered as too high. There is a significant upside risk with this assumption.*
- *ElecLink’s reference case supposes much higher competition from other interconnectors than what is currently expected. This has potentially a significant positive impact on the interconnector’s revenues.*

Downsides

- *A significant change in the capacity mix could lower the congestion rents and lower the revenues of ElecLink.*
- *The downside low gas price scenario seems plausible, and this would lower ElecLink’s expected congestion rents.”*

1.174. Taking into account these uncertainties on capacity price, the NRAs consider that:

- There is an inherent incentive to undersize the project capacity in order to maximize profits, leading to suboptimal capacity and potential adverse effects for the electricity market;
- Whilst ElecLink provides some justification in its application, it is not possible to determine whether ElecLink’s proposed capacity (1000 MW) is the maximum capacity that is technically feasible in the Channel Tunnel, or if higher capacity could be built;
- A high congestion rent would be a sign that the optimal total capacity is significantly higher than the proposed project.

... and that the downside risks to the project are not such as to justify a total exemption

1.175. NRAs consider that multi-year products act as a floor to market risks taken on by ElecLink. Indeed, revenues from multi-year products are significantly more predictable than revenues from annual or shorter term products. The degree of risk is however higher than that attached to regulated revenues because of counterpart and OPEX risks (which are taken into account at their projected values by the mechanism).

1.176. In addition, the NRAs consider that the distribution of instances of high and low revenue from interconnector capacity products is not equal. Indeed, revenue can hardly be below a certain threshold, whereas very high revenue are possible:

- Short term volatility of electricity price may provide a natural lower bound to the price of interconnector capacity. While the differential between GB and French forward prices has fluctuated strongly from 2009 to 2013, including periods of positive, negative and even zero spread, the bidirectional capacity prices for yearly products for IFA's auctions has never been less than 5,6 €/MW.
- Very high revenue may happen if special market conditions prevail (such as extreme weather or generation scarcity for example).

Therefore, the NRAs believe that only a partial exemption from Article 16 (6) is proportionate to the risks of the project

1.177. Overall, NRAs are required to consider all of the risks and uncertainties set out in this section in our decision as to whether an exemption from Article 16 (6) should be granted. Whilst NRAs recognize that the project presents risks that are not common across all interconnectors, they also consider that the project revenue and return expectations may be underestimated and that, based on evidence of optimal capacity across the GB-France border, the size of the project may be sub-optimal. NRAs therefore consider that the degree of risk carried by the project holders does not justify a full exemption from the use of revenue requirement of Article 16(6). Thus, only a partial exemption from Article 16(6) may be granted.

1.178. Unlike regulated activities, investors in ElecLink bear the risk of the project. In the case of regulated transmission system activities, operators benefit from a guarantee to recover their costs prescribed by law. In particular, all investments and a share of operating expenses are taken into account through the pass through mechanism which covers operators if expenditure is different from projected. In this case, the holders of ElecLink do not benefit from a similar guarantee. They are exposed to risks specific to the asset and therefore should bear the operational and financial risks associated with that asset while having to meet certain regulatory requirements (as grid codes). A business plan with a profit exceeding that of a regulated activities, and consistent with the usual levels of projects with a degree of risk higher than that associated to the regulated activities, is therefore justified.

1.179. This business plan has been reviewed by the NRAs and London Economics and sensitivity tests were performed. The ability to significantly exceed the expected return in this business plan exists, for example if prices are higher than expected, which could result in ElecLink earning a disproportionate share of the congestion rents. NRAs therefore consider it essential that the exemption is accompanied by a mechanism to share the excess profit in case the return actually generated by the project exceeds a certain threshold. The chosen mechanism is to give network users [REDACTED] of the profits exceeding a [REDACTED] IRR.

2.2.3. Summary and conclusion on the fulfilment of condition b)

1.180. If the profit exceeds a certain level consistent with a reasonable internal rate of return (taken into account all the risks carried on by the investors), part of the revenues exceeding this level will be distributed, at equal parts, to regulated TSOs in France and GB and will be used as indicated in article 16(6) of the Regulation.

1.181. NRAs consider that this will ensure that the project can make a return that is commensurate with the risks faced by the project developers whilst ensuring that excessive returns cannot be exploited at the expense of French and GB grid users or consumers. The specific details of the mechanism for rent sharing is set out in the Exemption Decision in Schedule A and Schedule B – “Operating the profit sharing mechanism”.

2.3. Analysis of whether ElecLink has met condition c)

1.182. According to condition c):

“the interconnector must be owned by a natural or legal person which is separate at least in terms of its legal form from the system operators in whose systems that interconnector will be built”.

1.183. The system operators concerned by this article are Réseau de Transport d’Electricité (in France) and NGET (in GB).

1.184. In its exemption request, ElecLink confirms that it is owned by Star Capital (51%) and Groupe Eurotunnel (49%) and that at 30 June 2013, neither shareholder was related to the System Operators in GB or France.

1.185. In the absence of elements that could call into question the respect of condition c), the NRAs consider that this condition is met.

2.4. Analysis of whether ElecLink has met condition d)

1.186. According to condition d):

“charges are levied on users of that interconnector”.

1.187. In its exemption request, ElecLink confirms that its costs will be recovered through the sale of the interconnector capacity to market players. Furthermore, ElecLink’s description of capacity allocation clearly indicates that charges will be levied on all users.

1.188. Therefore, the NRAs consider that this condition is met.

2.5. Analysis of whether ElecLink has met condition e)

1.189. According to condition e):

“since the partial market opening referred to in Article 19 of Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity³³, no part of the capital or operating costs of the interconnector has been recovered from any component of charges made for the use of transmission or distribution systems linked by the interconnector”.

1.190. In its exemption request, ElecLink confirms that its proposed interconnector is a ‘new’ interconnector and that no part of the costs of the project has yet been recovered. Indeed, ElecLink specifies that it intends to recourse to project financing and equity to recover costs, and that these will be paid back by the sale of interconnection capacities. As a consequence, none of ElecLink’s costs will be underwritten through regulated transmission charges.

1.191. Therefore, the NRAs consider that this condition is met.

2.6. Requested exemption duration

ElecLink requested an exemption duration of 25 years.

1.192. According to ElecLink:

“A 25 year exemption is required to provide lenders confidence that they will be repaid with some margin for downside scenarios i.e. where forecast cashflows are lower than expected due to unplanned outages, lower than expected arbitrage at borders, materially higher operating and financing costs or higher construction costs.”

The NRAs consider that the exemption scope should be proportionate to the risks taken by ElecLink

1.193. ElecLink’s financial projections show that an exemption duration shorter than 25 years reduces the project’s expected return [REDACTED]. As noted above however, using London Economics price projections leads to a higher return.

1.194. The profit sharing mechanism set out in the previous paragraph is based on an exemption duration of 25 years. Given the uncertainty over revenue projections (see in particular the two previous sub-sections 2.2.1 and 2.2.2), the NRAs consider that it is not appropriate to limit the exemption to a duration substantially lower than ElecLink’s request given that such a limit could adversely impact on the feasibility of the project.

³³ OJ. 27, 30.1.1997, p.20

1.195. Thus, the NRAs grant a partial exemption from Article 16(6) of the Regulation and Article 9 of the Directive for 25 years, while adjusting the scope of the exemption to the risks of the project by setting conditional limitations to the exemption.

1.196. However, granting a partial exemption from Article 32 of the Directive enabling the allocation of multiyear products for the whole exemption period is not justified by ElecLink's financing needs. Indeed, ElecLink indicates in its business plan that it will repay the project finance funding in 20 years. Therefore, multi-year products, which are justified by the need for project finance funding, can only be allocated for the first 20 years of ElecLink's exemption.

2.7. Conclusion on the fulfilment of exemption conditions a) to f)

1.197. Following the analysis undertaken by the NRAs and set out in this Joint Opinion, the NRAs consider that additional conditions must be added to ensure fulfilment of the exemption conditions. Provided that the conditions mentioned above and described in the Exemption Decision at Schedule A are fulfilled, the exemption conditions (a) to (f) set out in Article 17 are considered satisfied.