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Dear Sirs,

### **Arrangements concerning more than one NEMO in one bidding zone**

On 11 April 2016, we received proposals developed by Transmission System Operators (TSOs) for arrangements concerning more than one Nominated Electricity Market Operator (NEMO) in a bidding zone.<sup>1</sup> These proposals were submitted in accordance with the guideline on Capacity Allocation and Congestion Management (CACM)<sup>2</sup> and consider the day-ahead and intraday timeframes.

This letter sets out our decision that the proposal should be amended in order to clarify what is being proposed and to demonstrate the impacts of the proposals. The comments within this letter do not fetter the Authority's discretion with regards to any final decision on the proposals.

### **Background**

CACM is a central component of the internal electricity market, as set in the EU Third Energy Package.<sup>3</sup> CACM, which came into force on 14 August 2015, aims to maximise the efficient use of interconnection and facilitate greater cross-border electricity trade, through market coupling in the day-ahead and intraday timeframes. Market coupling should make sure power is produced where it is most efficient and used where it is most valued. This should lower prices for consumers and support secure and sustainable supply.

In order to achieve this, CACM establishes new entities, NEMOs, to operate single day-ahead and intraday market coupling. CACM requires NEMOs and TSOs to work together to develop the terms, conditions and methodologies needed to implement CACM. These are approved by National Regulatory Authorities (NRAs) within fixed timescales that are set out in CACM.

CACM Articles 45 and 57 require methodologies to be developed for the day-ahead and intraday timeframes respectively. Articles 45 and 57 of CACM require TSOs, in cooperation

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<sup>1</sup> The terms "we", "us", "our", "Ofgem" and "the Authority" are used interchangeably in this document and refer to the Gas and Electricity Markets Authority. Ofgem is the office of the Authority. The TSOs concerned with these proposals are National Grid Interconnectors Ltd, BritNed Development Ltd, EirGrid Interconnector Ltd and Moyle Interconnector Ltd.

<sup>2</sup> [Commission Regulation \(EU\) 2015/1222 establishing a guideline on capacity allocation and congestion management](#).

<sup>3</sup> The EU Third Energy Package is a suite of legislation that includes Directive 2009/72/EC of 13 July 2009 concerning common rules for the internal energy market in electricity and repealing Directive 2003/54/EC and Regulation (EC) 714/2009 of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003.

with NEMOs, to develop proposals for cross-zonal capacity allocation and other necessary arrangements for such bidding zones. The proposals should describe the expected impact on the objectives of CACM and include proposed timescales for their implementation (CACM Article 9(9)).

TSOs are required to submit these proposals within four months of more than one NEMO being designated in a bidding zone. On 10 December 2015, we designated APX Commodities Limited (APX) and Nord Pool Spot (NPS) as NEMOs to perform day-ahead and intraday coupling in Great Britain (GB).<sup>4</sup> This triggered CACM Articles 45 and 57.

## **The proposals**

The day-ahead and intraday proposals submitted follow a similar format. They cover:

- cross-zonal capacity arrangements,
- intra-GB arrangements,
- implementation and timescales,
- additional NEMOs and interconnectors, and
- costs.

The cross-zonal capacity arrangements propose that each interconnector TSO shall nominate a NEMO for the purposes of submitting day-ahead cross-zonal capacity and allocation constraints to the price coupling algorithm, delivering day-ahead results to the TSO, undertaking the role of financial and physical shipping agent in respect of the coupling process, and collecting incomes arising from the process. The proposal states that NEMOs shall offer reasonable terms to the TSO for undertaking these activities.

The proposals also state that relevant NEMOs shall ensure that the price coupling algorithm reflects all intra-GB borders and (except where the data for the GB bidding zone is not included for the relevant day or the coupling process does not operate) sufficient volumes of capacity for any intra-GB orders are submitted to the algorithm to avoid any constraint when matching relevant NEMOs' order books.

The day-ahead proposals shall be implemented within six months of approval by us. The intraday proposals shall be implemented prior to the scheduled date of implementation of single intraday coupling within the GB bidding zone.

The proposals state that NEMOs and TSOs shall, where relevant, cooperate with each other to facilitate the accommodation of new NEMOs and/or interconnectors.

Finally, the proposals state that costs shall be shared and recovered in accordance with Articles 75 to 80 (inclusive) of CACM. They also state that the TSOs shall not levy charges on NEMOs in connection with performing activities for which they are stated within CACM as being responsible for (and vice versa).

## **Our decision**

We have reviewed the proposals submitted to us in line with the requirements of CACM and our wider statutory duties and obligations.

We do not consider that either of the proposals are sufficiently detailed for us to approve the proposals at this time. It is unclear what is actually being proposed in terms of process, roles and responsibilities. It is also unclear how the proposals meet the objectives of CACM. The proposals therefore need to be amended to clarify what is being proposed and to demonstrate their impacts. This should be set out in the proposals themselves or provided in a supporting document. Stakeholders should have the opportunity to comment upon the

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<sup>4</sup> <https://www.ofgem.gov.uk/publications-and-updates/final-decisions-applications-apx-and-nps-be-designated-nominated-electricity-market-operators-great-britain>

proposals and expected impacts. This is important in allowing us to understand that the proposals are the best solution for GB.

#### Areas where an amendment and/or further clarity is required

##### *Expected impact on CACM objectives*

CACM Article 9(9) states that the methodologies should include a description of their expected impact on the objectives of CACM (which are set out in CACM Article 3). The introduction to the day-ahead proposal generally states that it does not hamper the achievement of these objectives. Furthermore, it states that it contributes to the achievement of the objectives set out in CACM Article 3(b), (d) and (h) but it gives no explanation of why/how this is the case. The introduction to the intraday proposal also states that they do not hamper the achievement of these objectives. In particular, the intraday proposal states that it furthers the objectives in CACM Article 3(b) and (h). Both proposals are silent on the other objectives.

The description provided in each of the proposals is insufficient for us to make a proper assessment on the expected impact on the objectives of CACM.

##### *Cross-zonal capacity arrangements*

We consider that the language is not sufficiently detailed for us, and other parties, to fully understand the process TSOs and NEMOs will undertake to achieve optimal market coupling. For example, the proposal states that TSO “*shall nominate*” a relevant NEMO in respect of an interconnector to carry out specific named functions related to market coupling.

We do not understand from the proposals what “*nominate*” means in this context, including what criteria will be used to select a NEMO. We consider this information is necessary to ensure the fair, non-discriminatory treatments of TSOs and NEMOs as well as ensuring the transparency and reliability of information (CACM Article 3).

It is also unclear how, in the case of day-ahead, this is different from the arrangements today and, if it is different, how any transition to the proposed arrangements will be managed.

##### *Intra-GB arrangements*

CACM Article 39(2) states that the price coupling algorithm shall deliver a single day-ahead clearing price for each bidding zone. The intra-GB arrangements must therefore allow for the delivery a single day-ahead price, and more generally make sure that there is optimal use of and efficient flows across the network in both the day-ahead and intraday timeframe. We consider that the arrangements must therefore make sure that all orders submitted to any NEMOs can be matched, cleared and settled with all orders submitted to market coupling operator taking into account there is no network constraint between NEMOs operating within the GB bidding zone.

We understand that arrangements already exist between APX, NPS, IFA and BritNed to facilitate the early implementation of single day-ahead coupling. It is not clear from the proposals whether this is what is being proposed as the enduring solution, how any necessary changes will be achieved or the roles, responsibilities and timelines for the parties involved. It is also not clear whether any alternatives exist and whether the relative merits of each has been assessed.

Finally, the process for intra-GB arrangements in the event of decoupling is unclear. We consider that this needs to be set out within the proposals or indicate where this will be resolved.

### *Additional NEMOs and interconnectors*

CACM Articles 45 and 57 state that the arrangements must allow additional TSOs and NEMOs to join the arrangements. The proposals do consider this but we consider that further clarity on roles, responsibilities and timelines is needed to allow a new entity to reasonably foresee what they need to do in order to participate in GB arrangements. Furthermore, there are references within the day-ahead proposal to other documents such as the GB Agreed Procedures and GB Framework Agreement, which is the existing contractual framework governing early implementation of day-ahead arrangements on BritNed and IFA. It is not clear whether the intention is to open up this contract to potential new entities therefore the current proposal does not sufficiently set out how additional TSOs and NEMOs would join.

### *Implementation and timescales*

The day-ahead proposals state that within six months of approval, the TSO shall submit to the NEMOs details of any amendments to the GB Agreements needed to implement CACM. The TSOs and NEMOs shall then cooperate to implement the proposals "*as soon as is reasonably practicable*."

The intraday proposals state that TSOs shall submit to the NEMOs details of any amendments to the GB Agreements needed to implement CACM prior to the date scheduled for implementation of single intra-day coupling. The TSOs and NEMOs shall then cooperate to agree these changes prior to the date scheduled for implementation of single intra-day coupling.

We do not think that either of these proposals provides us with a reasonable expectation of exactly what will be delivered and when. We acknowledge the dependencies on other aspects of CACM but encourage the TSOs to consider setting out what can be expected and a timeline for implementing the solution(s) with milestones as appropriate.

### *Costs*

Title III of CACM (Articles 73 to 80, inclusive)) describe the principles of cost recovery. Both proposals refer to CACM Articles 75 to 80 and state that costs shall be shared and recovered in accordance with CACM. Furthermore, the proposals state that TSOs shall not levy charges on NEMOs in connection with performing activities for which they are stated within CACM as being responsible for (and vice versa).

We are unclear why costs are included as part of this proposal. Our view is that duplication of arrangements already set out in CACM is unnecessary. Furthermore, the issue of cost recovery extends beyond the scope of this proposal and we cannot approve anything that may fetter our discretion for future decisions.

### Wider consultation and cooperation

CACM Articles 45 and 57 do not require the TSOs to carry out a consultation as part of developing their proposals. However we think stakeholders would value the opportunity to consider and comment on the proposals. We also believe stakeholders should understand the merits of any alternative options and be able to comment on the analysis. The results of such a consultation would also help inform our final decision.

In the GB day-ahead timeframe NEMOs and TSOs have already established a decentralised approach:

- National Grid ran a tender which NPS won to facilitate the design, development and implementation of a "GB Virtual Hub" (GB VH), which will be operated by the successful bidder under the terms of an operational agreement with NGIC and

- NPS and APX have bilaterally contracted to hold required collateral for intra-GB transactions.

CACM Article 36(4) says that “Where possible, NEMOs shall use already agreed solutions to efficiently implement the objectives” of CACM. It could be that setting up a single hub to operate these two elements could deliver a more appropriate solution. There could also be other options that have not yet been considered. It is not clear from the proposals whether maintaining the current arrangements for day-ahead is in fact the most efficient solution. In the case of intra-day, there are no existing arrangements. This places greater importance on understanding the merits of different approaches.

Without this information we are unable to determine the associated impact on NEMOs, TSOs, market participants and ultimately consumers.

We could carry out our own consultation on the proposals to inform our decision. In this case however, given the lack of detail in the proposals, we think that it would be difficult for stakeholders to engage constructively and for us to effectively assess the impacts of the proposals. We also consider that TSOs and NEMOs are better placed to assess the potential costs and merits of alternative approaches and impacts of the proposals themselves. Furthermore, we consider there is a risk that any consultation carried out by us may highlight a new material issue that the TSOs are then unable to address, having already submitted the proposals. This could result in further delay to approving any proposals, which could otherwise be avoided if discovered prior to resubmission.

CACM requires the proposals to be developed in cooperation with NEMOs. The proposals do not contain any evidence of this cooperation having taken place and how comments received from other parties have been factored into the proposals (or the justification for not doing so). We ask the TSOs to set out in their response how they have taken into account the views of other parties when amending the proposals. This, in addition to a report on the outcome of any stakeholder consultation and other relevant context, should be provided as part of a supporting document alongside the proposals.

### **Next steps**

Please make the amendments necessary to address the points set out above and resubmit the proposals to us by **10 December 2016**.

In parallel to engaging with GB interconnector TSOs and NEMOs in order to inform our assessment of the proposals, we will continue to discuss our current views with NRAs making similar decisions within their respective Bidding Zones.

If you have any queries on the matters referred to in this letter please contact [david.mccrone@ofgem.gov.uk](mailto:david.mccrone@ofgem.gov.uk) in the first instance.

Yours faithfully,

**Mark Copley**

Associate Partner, Wholesale Markets