Responses to the comments in relation to the consultation titled “GB Commercial Arrangements relating to Interconnector Capacity Calculation”

January 2020

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Introduction

Introduction

From 6 November 2019 to 3 December 2019, National Grid Electricity System Operator (NGESO) published an informal consultation on GB commercial arrangements relating to interconnector capacity calculation as required for Capacity Calculation Methodologies (CCMs).

We would like to thank all those who took the time to respond to the consultation. We appreciate your input and have given careful consideration to the feedback provided as summarised in the following section. This has been fundamental in developing the final proposals.

The purpose of the informal consultation step was to seek initial industry feedback on commercial arrangements where Commission Regulation (EU) 2015/1222 guideline on Capacity Allocation and Congestion Management (CACM) and the Commission Regulation (EU) 2016/1719 guideline of Forward Capacity Allocation (FCA) codes have a provision for reduction of allocated capacity and gather feedback on situations not detailed in these codes for unallocated capacity. The next stage includes embedding any necessary revised proposals into the formal 2019-2020 C16 consultation ahead of its submission to Ofgem in February 2020.

During the informal consultation, we received one joint response from 7 GB interconnectors owners/ developers namely BritNed Development Limited, ElecLink Limited, EirGrid Interconnector Designated Activity Company, Moyle Interconnector Limited, FAB Link Limited, Nemo Link Limited and National Grid Interconnector Holdings Limited. A further 6 separate responses were received from individual Interconnector Companies. A response to the broader 2019-2020 C16 informal consultation was received from Drax Group, which included comments specifically on the proposals relating to the interconnector capacity calculation.

Section 2 of this document contains a summary of the feedback received and NGESO has aimed to provide a reply to all the points that were raised. The responses have been collated into six main areas of discussion:

1. Legacy Arrangements: Intraday Transfer Limits (ITLs)
2. Legacy Arrangements: Ireland United Kingdom (IU) Region
3. Commercial principles
4. Requirement for payment
5. Vehicle of payment
6. Brexit

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Feedback and Responses

Feedback and Responses

1. Legacy Arrangements: Intraday Transfer Limits (ITLs)

Industry Comments

- We do not believe that legacy arrangements, Network Transfer Capacity (NTC) and ITL, are consistent with the latest EU regulation, which requires a coordinated calculation to take place prior to capacity being removed from the market, and therefore welcome future proof arrangements where financial arrangements are in place.
- No Transmission System Operator (TSO) should be compelled to implement an interim process. Without the Common Grid Model (CGM) being operational, it is not possible for NGESO to take an informed view of the level of restrictions expected when the CGM becomes available. Any interim arrangement must therefore be sub optimal and possibly detrimental.
- NGESO should bring forward arrangements that enable efficient and cost reflective actions as soon as possible, using the principles adopted from the conclusion of this consultation process and the principles in the formally agreed Day Ahead (DA) / Intraday (ID) CCM, as opposed to developing something altogether new. Waiting another 2 years for implementation would neither be appropriate nor acceptable as there is currently no visibility or transparency of the actions taken by NGESO.
- Restriction of unallocated day-ahead or intraday capacity imposed under bilateral arrangements were limited to exceptional circumstances until October 2018. There has been an increase which market participants and stakeholders are questioning the fairness, economic, reasonable and efficient basis relative to other options. ID capacity limitations are no longer exceptional but part of daily operation for NGESO.
- We note that NGESO highlights that the implementation of one of these new services, Trans European Replacement Reserves Exchange (TERRE), will “reduce the functionality of some of the existing System Operator tools”. We note that due to differing market designs, TERRE will only be implemented on the GB – France bidding zone border initially.
- Although a bilateral commercial arrangement has been in place since April 5th, with the introduction of the explicit intraday product which enables NGESO to manage the ROCOF issues and general congestion; it is the view of Nemo Link that once NGESO are satisfied that this product meets their requirements, day ahead capacity restrictions should cease. Whilst we recognise the need for a transition period, Day Ahead capacity should be fully utilised to maximise social welfare from the interconnector.

NGESO Response

There has been a fundamental change to the nature of users connecting to, and using the GB transmission system, for example, a dramatic increase in the volume of non-synchronous generation. Consequently, many aspects of current day to day system operation would have been previously thought of as exceptional. An example of this is a regular requirement to manage the real time maximum flow on an interconnector to manage Rate of Change of Frequency (RoCoF). NGESO has recognised the need to update our approach for interconnector capacity management, hence, this consultation process. Both the number of interconnectors and the frequency of the need for NGESO to issue Intraday Trading Limits (ITLs), increase the requirement to introduce a standard policy for interconnector capacity management. This will increase industry transparency which in turns demonstrates that fair and equal treatment is being applied.

As ITLs are the current precursor to NTCs, NGESO is consulting on the appropriate commercial arrangements that are equally applicable to both the current GB legacy arrangements and future capacity management under the EU Guidelines. NGESO's proposal is that the commercial principles should apply before the delayed Common Grid Model (CGM) becomes available to ensure that economic and efficient decisions are maintained. As laid out in the CCMs, a capacity calculator is required to calculate the cross-zonal capacity for each interconnector using a coordinated NTC approach. In the absence of the CGM the processes will be coordinated and agreed between relevant parties. By engaging and working with the interconnectors and the wider industry, this will allow an early adoption of a process that is in line with the CCMs whilst ensuring the maintenance of system security. Cost reflective commercial arrangements are the best way to avoid any sub optimum decisions prior to the implementation of the CGM.

NGESO agrees that the coordination provided by the Regional Security Centres (i.e. Coreso) under the CCMS does provide transparency and therefore would support the involvement of Coreso in the application of interconnector management both prior and after the implementation of the CCMs. In lieu of this, any process in the short term (i.e. ITLs) should ensure that all parties involved have confidence that decisions by each System Operator is made in isolation and not impacted by the status of the other SO's network.

We agree that TERRE is currently only being developed on the GB and France bidding zone border so any changes resulting from TERRE will only apply to relevant interconnector services on this border.

2. Legacy Arrangements: Ireland United Kingdom (IU) Region

Industry Comments

- Consultation states that NGESO is in favour of a single solution for all GB interconnectors, this falls significantly short of the existing capacity calculation compensation arrangements which exist in the IU region. Proposals which differ from existing arrangements could pose significant legal and regulatory issues. We do not believe that different principles can guide compensatory arrangements for interconnectors operators between connecting regions as this is contradictory to the principles of transparency and non-discriminatory access.
- Existing IU arrangements should be excluded from the proposed terms of any future consultation. IU CCM makes clear reference to compensation for interconnector capacity restrictions.
- Whilst the Single Electricity Market (SEM)-GB compensation arrangements are in place, NGESO has since resisted codifying them in Interconnector Operating Protocols. This history and some of the language used in the consultation give rise to concerns that NGESO may wish to conclude that not compensating interconnector capacity restrictions is a valid approach, potentially supported by what we anticipate will be a negative reception from some vested interests within the industry.
- Agency for the Cooperation of Energy Regulators (ACER's) guiding principles provide legal context and set out fundamental prerequisites to ensure efficient, transparent and non-discriminatory methodologies. Polluter pays principle is clearly implemented in the existing IU Interim Cross Zonal TSO Arrangements approved by all IU parties including NGESO in August 2017.

NGESO Comments

NGESO believes there are clear benefits of equality and transparency from applying consistent commercial principles to all GB interconnectors. That said NGESO notes that the specific requirements of the remote end market may require some flexibility for the specific implementation of each border / project.

NGESO agrees that in August 2017[1], interim cross zonal arrangements were developed in order to allow the go-live of ISEM prior to the implementation of the enduring CACM and FCA arrangements.

[1] As laid out in the "Interim Cross Zonal TSO Arrangements for GB-ISEM go-live" document

These arrangements cover a range of subjects including interim operational and procedural principles associated with interconnector capacity reductions. NGESO believes that the enduring arrangements should now be established for all GB borders to ensure a consistent GB enduring approach. Consequently, NGESO is proposing the final arrangements would equally apply to both IU and Channel interconnectors.

NGESO believes that the principles of the enduring proposed arrangements are consistent with those in the IU Interim Cross Zonal TSO Arrangements document, as well as the 'causer pays' concept within the EU Target Model.

3. Commercial principles

Industry Comments

- Broadly agree with proposed payment principles and single GB framework. Any agreed commercial arrangements should be administered by NGESO across all GB interconnectors, negating the need for duplication of administrative effort across all relevant parties.
- For the avoidance of doubt, we understand and support the principle that the payments would consider the price differences between the relevant bidding zones, rather than a single price for all interconnectors.
- Market-based solutions (ancillary services) should be used in preference to capacity reductions compensated via the GB Commercial Arrangements under this consultation.
- Where a payment is due, each GB interconnector owner should be kept whole (i.e. each interconnector owner should not bear any financial loss nor gains) for compensation of market parties, shipping agents or loss of congestion income.
- The table presented on page 7 of the consultation document is incorrect and is missing the rules regarding the curtailment of capacity allocated via implicit allocation. In this case the interconnector owner is subject to the imbalance prices in both connecting markets.
- The Harmonised Allocation Rules (HAR) and Border Specific Annex (BSA) rules are the most appropriate basis for compensation towards capacity holders for allocated capacity. NGESO should reference these rules.
- NGESO should consider engaging within ENTSO-E to develop suitable mechanisms to recover costs associated with hosting cross border flows directly from the connecting TSO. The Inter-Transmission System Operator Compensation ("ITC") mechanism defined by the Commission Regulation (EU) 838/2010 may be suitable in this respect.
- We are not aware of the referenced sharing methodology and we are concerned that the development of an additional methodology would delay the implementation of these GB Commercial Arrangements. We suggest that a simple alternative whereby a payment from NGESO is only due when the constraint in the GB National Electricity Transmission System (NETS) is the most limiting element restricting the interconnector capacity.
- Agree that capacity restriction should only be paid by a single limiting party as we would expect the regional security coordinator to provide appropriate transparency of the party responsible
- In cooperation with NGESO we have considered whether to re-run the day ahead algorithm to see what the clearing price would have been if the capacity had been made available to the market. This may be more cost reflective, however introduces considerable complexity.

- NGESO should clarify responsibilities under the “polluter-pays” principle as the consultation is silent on this and does not address ownership of balancing charges arising from interconnector capacity reductions.
- ACER’s guiding principles provide legal context and set out fundamental prerequisites to ensure efficient, transparent and non-discriminatory methodologies. Polluter pays principle is clearly implemented in the existing IU Interim Cross Zonal TSO Arrangements approved by all IU parties including NGESO in August 2017.
- In relation to the stated second principle clarification and evidence is sort on implied revenue benefits resulting from the restriction of capacity. We question undertaking a pseudo-calculation of the outturn of affected day-ahead and intraday allocation process with the original restriction being reversed solely for determining a revised compensation position. If intraday allocations are subject to frequent and significant restrictions in available capacity this could actually reduce the value of capacity over time as market participants, no longer participate due to lack of liquidity. If capacity is reduced to zero, this will obviously result in reduced interconnector incomes.
- There are specific considerations which should be considered separately for the long-term timescale. Reducing the NTC could increase the marginal price between countries. However, the increase in marginal price is very unlikely to offset the reduced congestion rent as a result of the restriction (if it did, existing interconnectors would have no financial incentive to return to full service after faults).
- Detailed commercial solution for long term CCMs may need to be different reflecting the timeframes. We encourage the opportunity to commence initial discussions on long term CCMs. In the Day-Ahead / Intraday timeframes rights purchased are physical, whereas while those in the long-term timeframe may become physical, they can also be resold and so treated somewhat similarly to a non-physical right. This degree of optionality makes compensation more complex to determine payments associated with LT CCMs.
- Separately, it is not clear why interconnectors should be compensated for unallocated capacity. The arrangements for compensation are clearly set out in Commission Regulation (EU) 2015/1222 and Commission Regulation (EU) 2016/1719 and the relevant methodologies. These two Regulations do not include compensation arrangements for unallocated capacity because there is not meant to be any compensation.

NGESO Comments

NGESO will continually compare the cost of all available actions and adhere to EU Regulations that supports addressing congestion problems with non-discriminatory market-based solutions. If other market-based solutions have been exhausted, or are ineffective, then interconnectors may be constrained; this avoids the material risk of entering an emergency scenario. NGESO supports the establishment of a single, non-discriminatory, consistent set of arrangements, whereby constrained interconnectors under this process are held whole, which will typically require payments based upon the market price differentials. The final proposed commercial mechanism is consistent with the HAR and BSA rules.

Payments will only be made for capacity restrictions resulting from constraints on the GB NETS and not restrictions only initiated by other neighbouring TSOs to ensure consistency with ‘polluter pays’ principles. In the instance when both System Operators (SOs) require capacity restriction, until a formal ENTSOE sharing methodology is agreed, the responsibility for joint restriction will be apportioned between the SOs.

NGESO agrees that implementing and re-running the day ahead algorithm is not the right approach for GB as it would introduce a requirement for a complex IT solution. However, in order to ensure close cost reflectivity, the proposal is to use historic order book data to allow the impact of capacity restrictions on market prices to be better understood. An annual calculation will be performed to calculate a dynamic discount factor such that an NTC reduction of X% will equate to a discount of Y% on an appropriate sliding scale. To determine this relationship, 20 market periods (with no active restriction) will be chosen at random from the previous year and historic interconnector data will provide the resulting clearing price for a range of different capacities in order to model the relationship.

NGESO agrees that a reduction of capacity after the Firmness Deadline would both increase the value of the remaining capacity in the Intraday Market as well as introducing a lost opportunity cost from reduced volumes and that the impact of these will not always be equal and opposite therefore the final proposal is to determine the net financial impact by determining the unrestricted clearing price from the Intraday bid curve which would form the basis of the compensation.

NGESO notes the differences between physical and non-physical access rights and the fact that long term access has the option to be resold and that this introduces an additional complexity to determining appropriate compensation. That said, NGESO believes that the final proposals are consistent and compatible with the Long Term CCMs once they are approved by the Regulators.

Representation from the consulted parties proposed that compensation from unallocated capacity was important, therefore this has been included within the commercial arrangement. The proposed commercial arrangement seeks to value the unallocated capacity fairly. Cost reflective compensation, based on market spread, mitigates the risk that compensation is provided for unallocated capacity that would not have been sold; this would occur under the scenario where the market prices converge. Under such a scenario, the payment will be negligible.

The Inter TSO Compensation Agreement (ITC) aims to compensate parties for costs associated with losses resulting from hosting transit flows on networks and for the costs of hosting those flows. The scope of the ITC does not extend to commercial arrangements relating to CCMs. The CCMs are developed for each capacity region and have varying regional approaches to commercial arrangements.

4. Requirement for payment

Industry Comments

- By using un-costed interconnector action, NGESO may not be dispatching more efficient generator or demand side actions, either via TERRE or balancing service contracts.
- Un-costed restrictions can lead to inefficient signals and drive up overall costs to the GB consumer who loses out on the socio-economic welfare of the curtailed interconnector capacity.
- Restricting the ability to sell the interconnector capacity without fair compensation undermines the investment case for existing and future interconnectors, damaging still further the delivery of socio-economic benefits of interconnection to GB consumers.
- All reasonable market actions should be examined before curtailment of interconnectors capacity. CCM should only be used where market related actions are not feasible.
- Despite the implementation of the intraday product, Nemo Link is now also subject to intraday capacity reductions, and currently these restrictions are not compensated. During discussions, the view from NGESO has been that these restrictions are only applied to unallocated capacity and as a result, there are minimal financial or commercial implications for interconnectors. We believe that such actions can have serious consequences for market participant confidence and long-term liquidity of the intraday market. In order for NGESO to make efficient balancing and congestion management decisions, these actions should be costed and not remain as a free option which would otherwise distort the market.
- While the consultation characterises the capacity calculation process as a tool to manage interconnector flows, the intention of CACM and FCA is to maximise interconnector capacity. The objectives of ACER recommendation 02/2016 to ensure transparency, non-discriminatory, market-based solutions have not been satisfied by NGESO in the case of Moyle where NGESO continues to restrict flows specifically for the purpose of limiting internal congestion. It is clear that 1) restricting interconnector flows should not be a primary option and 2) restrictions need to be properly priced to provide correct economic signals. Clean Energy Package reinforces the message that interconnector flows should not rank behind internal flows and if it proves essential to restrict capacity, this should not be a free option.
- Interconnector owners have firm access to the GB NETS under bilateral connection agreements so it is essential that financial arrangements are implemented alongside any CCM that may restrict this capacity. Compensation arrangements are an integral part of the IU CCM, it cannot be implemented without them and if NGESO sought to freely restrict interconnector capacity the result would be the polar opposite of the regulatory objectives and open to challenge.

- We note that currently the ESO typically assumes more interconnector capacity as available for allocation than that which can be safely delivered. Consequently, closer to real time it reduces interconnector flows, via countertrading, to address system requirements (e.g. RoCoF) and allow for secure system operation. We do not believe that this approach is efficient nor sustainable, and we note that the relevant costs will only increase as interconnection capacity in GB grows in the coming years. It is our view that more emphasis should be placed on making better use of the Coordinated Capacity Calculation process so that only cross zonal capacity that can be safely delivered is allocated to the market.
- In CACM there are no compensation arrangements for capacity reduction after the ‘day ahead deadline’, because that capacity is meant to be ‘firm’ and not curtailed (except for force majeure and emergency situations). Should the ESO need to reduce allocated interconnector capacity, for example, due to an emergency, then it could use tools such as TERRE (2020) or MARI (2021) to countertrade. We consider this could be a transparent, market-driven way of reducing interconnector flows, where required.
- More clarity on the legal basis of the proposed arrangements will enable a more informed discussion on this topic. Directive 2009/72/EC, Regulation (EC) No 714/2009 and the standard terms of the Interconnector License provide that interconnectors should be treated as transmission networks. We would welcome more information from the ESO on how this interacts with interconnectors being eligible for financially firm access rights.

NGESO Comments

NGESO agrees that the wider socio-economic welfare cost must be considered to ensure that the impact is assessed for all industry participants. To avoid passing additional costs onto consumers, whilst the financial impact to the whole industry should be considered with costed actions.

Economic and efficient actions should support NGESO’s priority to maintain a secure system. NGESO agrees that reasonable market actions should be considered before interconnector capacity reductions, however it may be the only operationally or economically feasible option available. As is consistent with CACM and FCA, it is not NGESO’s policy to manage internal GB congestions issues with interconnector capacity management unless the alternative consequence is to risk entering an emergency scenario. It is acknowledged that capacity restrictions will have some impact on markets, however system conditions will sometimes require such actions and should involve cost reflective payments.

The EU target model seeks to maximise cross border capacity whilst maintaining system security. The CCMs seek to optimise capacity, whilst taking into account inter market constraints. NGESO agrees that control of interconnector flow should be transparent and market driven and where this is not feasible, it should be via a fully costed action.

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5. Vehicle of payment

Industry Comments

- We believe that if framework changes are required to the C16 statements they are unlikely to capture the full complexity of the arrangements described. We note that NGESO is yet to share any wording changes regarding the C16 statements. We request NGESO publish the full details of the final arrangements in a separate policy document, to avoid any unfair commercial advantage including, in particular, any such advantage from preferential or discriminatory arrangements. Bilateral arrangements would then need to be established in line with this published policy.
- C16 statements do not set out the detailed commercial arrangements for such services which are normally set out in a form of agreement struck between NGESO and the counterparty. The Procurement Guidelines already give a degree of leeway to NGESO to procure Balancing Services from any party, the sole exception being services procured under the SO-TO Code. Some minor clarificatory changes to the Procurement Guidelines sections on Constraint Management might be required to state that such services can be procured from generators and HVDC system operators.
- Expect Ofgem to hold a public consultation before issuing a decision on this matter. Clarification on whether Ofgem's decision on the ESO proposals as part of the 2020-2021 C16 Statements review would be sufficient from a regulatory perspective to enable the relevant payment flows from the ESO to interconnectors and vice versa would also be useful.

NGESO Comments

The first consultation was intended to capture initial views on suitable commercial principles prior to the consequential development of detail. NGESO agrees that the detailed methodology for any commercial arrangements associated with capacity restrictions should be available to the industry. Consequently, in parallel with the formal C16 consultation, a GB methodology has been published and consulted upon as part of the 2019-2020 C16 consultation. NGESO also agrees that implementation of the final methodology will require amendment to each counter party's individual bilateral agreement however this will be on the basis that the same standard and transparent GB Methodology is applied in all cases.

The formal consultation on C16 will run from the 13 January 2020 till the 10th February 2020. After this closes, NGESO will make formal proposals for Ofgem consideration.

6. Brexit

Industry Comments

- We believe that the regulatory mandate for any capacity reductions would need to be re-examined in the case of a no deal Brexit, given that the current DA/ID CCM is mandated under European Law (Regulation 2019/943, and the CACM regulation).

NGESO Comments

NGESO would like to confirm that the proposed early adoption would mean both the commercial arrangements and process are implemented outside the CCMs being available and so discussions with interconnectors would be necessary to ensure that the early adopted arrangements are maintained in the case of a no deal Brexit.

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