

Additional Explanatory note following Request for Amendment for:

Channel TSOs proposal for a methodology for splitting long-term cross-zonal capacity in accordance with Article 16 of the Commission Regulation (EU) 2016/1719 of 26 September 2016 establishing a Guideline on Forward Capacity Allocation

23 October 2020

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Introduction

This document provides the Channel National Regulatory Authorities (“Channel NRAs”) with analysis to support the amended Channel Splitting Rules Methodology proposal (“Amended Proposal”).

Section 1 sets out the Channel TSOs’ assessment of the necessity of the proposed reservation of 10% for daily allocation, in light of the long-term allocation inclusion mechanism and the low nomination rate for the physical transmission rights with the use-it-or-sell-it principle (“UIOSI”) , and an assessment of the costs and benefits associated with the reservation of day-ahead capacity in the long-term timeframe.

Section 2 outlines the Channel TSOs’ motivation behind the amended Splitting Ranges value(s) and presents the evidence supporting how these ranges can be considered as sufficiently addressing the hedging needs of market participants. This evidence includes a comparison between the amended values and the historical fluctuations of the proportion of long-term capacity allocated to certain timeframes.

Section 3 outlines the other changes introduced which aim to provide greater transparency and predictability with regards to the capacity split to the Channel NRAs and market participants.

Section 1 – Day-ahead reservation

1.1 Legal basis

Channel TSOs note that within the request for amendment the Channel NRAs acknowledge that the reservation of capacity for day-ahead allocation was explicitly foreseen in Article 2.6 of Annex I to Regulation (EU) 714/2009, and these provisions seem to be broadly transposed in Article 17(2) of Regulation 2019/943.

Channel NRAs also note that there is no longer an explicit provision for the reservation for day-ahead capacity retained in Article 17(2) of Regulation 2019/943.

Channel TSOs highlight that the recast provisions require that *“transmission system operators shall propose an appropriate structure for the allocation of cross-zonal capacity across timeframes, including day-ahead, intraday and balancing. That allocation structure shall be subject to review by the relevant regulatory authorities”*.

As such, in accordance with Article 17 of Regulation (EU) 2019/943 Channel TSOs shall define an appropriate structure for the allocation of capacity between different timeframes. Channel TSOs are of the view that the Amended Proposal defines the structure for the allocation of capacity in the long-term timeframe.

Channel TSOs propose a reservation of a minimum of 10% of the Nominal Capacity for the day-ahead timescale as an appropriate structure for the allocation of cross-zonal capacity across timeframes. For the avoidance of doubt, Channel TSOs will ensure that the capacity not made available through long-term allocation is made available at the day-ahead and/or intraday timescales in order to ensure that the market has the maximum opportunity to utilise interconnection capacity.

Currently the Channel TSOs do not reserve capacity for the intraday or balancing timescale, however it may be valuable to do so in the future as the proportion of renewable and intermittent generation increases. Such generation sources may find the intraday or balancing market a more valuable market compared to day-ahead, or long-term markets.

Pursuant to Regulation (EU) 2019/943 when drawing up this Amended Proposal, Channel TSOs have considered (a) the characteristics of the markets, (b) the operational conditions of the electricity system, such as the implications of netting firmly declared schedules and (c) the level of harmonisation of the percentages allocated to different timeframes and the timeframes adopted for the different cross-zonal capacity allocation mechanisms that are already in place.

Regarding (a) the characteristics of the markets, Channel TSOs note that in accordance with the regional design of long-term transmission rights pursuant to Article 31 of the FCA Regulation, all Channel bidding zone borders currently offer physical transmission rights. Therefore, to ensure the availability of cross border capacity for the day-ahead timeframe, Channel TSOs propose to reserve interconnection capacity for daily allocation.

Regarding (b) the operational conditions of the electricity system, such as the implications of netting firmly declared schedules, Channel TSOs consider that moving from physical transmission rights (“PTRs”) to financial transmission rights (“FTRs”) is inappropriate at this time. Channel TSOs consider that historic data alone is not sufficient to inform a decision, due to ongoing uncertainty in the connected markets and market arrangements. As such, it is believed that the ability to nominate capacity may become increasingly important to market participants and therefore a change in market arrangements should not be pursued and may be reassessed in the future.

Regarding (c) the level of harmonisation of the percentages allocated to different timeframes and the timeframes adopted for the different cross-zonal capacity allocation mechanisms that are already in place, Channel TSOs consider that the proposed structures harmonise the minimum and maximum percentages which are reserved for day-ahead allocation. The Amended Proposal also harmonises the Splitting Ranges for long-term allocation.

Channel TSOs note that Commission Regulation (EU) 2017/2195 of 23 November 2017 establishing a guideline on electricity balancing (“EBGL”) foresees reservation of capacity for the balancing timescale. Such reservation is achieved via i) a co-optimised allocation process (EBGL article 40), ii) a market-based allocation process (EBGL article 41), or iii) an allocation process based on economic efficiency analysis (EBGL article 42). The reservation of capacity for the day-ahead timescale is most comparable to the allocation process based on economic efficiency analysis (EBGL article 42).

1.2 Other capacity calculation regions (“CCR”)

The CACM Regulation aims at harmonisation of CCRs as a long-term target but allows that this is done in a progressively pragmatic way, acknowledging that specific market conditions and arrangements exist in different CCRs due to different technical, practical and market characteristics. The Channel TSOs have investigated other CCR arrangements regarding the reservation of day-ahead capacity and have found no definitive argument to include or exclude reservation which is consistently applied across all CCRs. As such, the Channel TSOs believe that the TSOs in each CCR should act in the best interests of the CCR in determining the appropriate structure for the allocation of capacity between different timeframes, as required by Article 17 of Regulation (EU) 2019/943.

IU

The two interconnectors within the IU CCR are both HVDC interconnectors connecting the GB and SEM markets. The IU methodology for splitting long-term cross-zonal capacity was approved by the NRAs of the IU CCR on 22nd July 2019. This methodology contains the ability for the TSOs to determine the optimal split, including the obligation to allocate at least 20% of cross-zonal capacity in the long-term market and the potential for reserving at most 80% of cross-zonal capacity for day-ahead allocation. For the avoidance of doubt, TSOs in the IU CCR are not required to reserve day-ahead cross-

zonal capacity. This CCR shares similarities to the Channel CCR, in that it is formed of DC interconnectors, and that by allocating FTRs in the long-term timeframe the use of the capacity is similar to the Channel CCR (PTRs with UIOSI, with typically low nomination rates).

Nordic

In general, capacity is allocated in the day-ahead timescale only within the Nordic CCR, apart from the DK1-DK2 border where long-term transmission rights are allocated (without day-ahead reservation). There is therefore no day-ahead reservation for DK1-DK2, and effectively 100% day-ahead reservation on the other Nordic bidding zone borders. It is acknowledged however that the Nordic market is not directly comparable to Channel, and that other mechanisms are used in the Nordic CCR to provide long term hedging opportunities to market parties, such as Electricity Area Price Differentials (EPADs).

Hansa

The Hansa methodology for splitting long-term cross-zonal capacity does not cater for the reservation of day-ahead capacity. Capacity can be split per interconnector, allowing the TSOs to react to conditions in the connected markets on a border by border basis. It is not possible to compare directly with the Channel situation, due to differing capacity calculation principles and market differences which have historically resulted in lower quantities of long-term capacity being allocated. For example, COBRA cable on the DK1-NL border allocated approximately 40% of capacity in long-term timeframes in 2019, compared to typical long-term allocations in Channel of 70-90%.

South East Europe ("SEE")

The recent public consultation on the South East Europe methodology for splitting long-term cross-zonal capacity has demonstrated the divergence of opinion on day-ahead reservation. The SEE TSOs proposed 100% of the long-term calculated to be split between the different long-term time frames, whereas some of the SEE NRAs supported 20% reservation. This is the direct opposite of the Channel discussion where TSOs proposed day-ahead reservation, and NRAs raised concerns. The ACER observations from the SEE public consultation are set out in section 1.3.

1.3 ACER's observations

The following observations are taken from the recent ACER public consultation on the South East Europe methodology for splitting long-term cross-zonal capacity.

ACER state;

"As a general principle, ACER acknowledges that adequate level of cross-zonal capacities is required for proper functioning of single day-ahead coupling ('SDAC') that promotes market liquidity and competition in the day-ahead market.

Following a proper design of capacity calculation in day-ahead and long-term timeframes, the day-ahead capacity calculation should by principle always produce significantly more capacities compared to the long-term capacity calculation because of uncertainties resulting in a reliability margin, outages considered in the long-term timeframes, etc. In such context, there should be no explicit need to set aside a percentage of the calculated long-term capacity for the SDAC.

In a context of scarcity cross-zonal capacity, in the event of improper design of the long-term and day-ahead capacity calculation methodologies which could result in little or no available capacity for SDAC, TSOs and NRAs should opt for the offer of Financial Transmission Rights (FTR) over Physical Transmission Rights. This would ensure that all physically available cross-zonal capacities are available for SDAC.

However, ACER acknowledges that there could be a time gap between the implementation of SDAC and the time when FTRs could be introduced, when scarcity of cross-zonal capacities for SDAC would have negative effect on SDAC. ACER therefore acknowledges as a measure of last resort that some of the calculated long-term capacity be set aside for daily allocation.

This measure must be justified and limited in time.”

Channel TSOs note that ACER highlight that a “*proper design of capacity calculation in day-ahead and long-term timeframes, the day-ahead capacity calculation should by principle always produce significantly more capacities compared to the long-term capacity calculation because of uncertainties resulting in a reliability margin, outages considered in the long-term timeframes, etc*”. The design of the Channel capacity calculation in the long-term and day-ahead timeframes considers the controllable nature of the HVDC cross border assets. As such, with the exception of planned outages, the full maximum permanent technical capacity of the interconnector is provided by the capacity calculator (both in the long-term and at the day-ahead stage).

Due to the design of the Channel capacity calculations, Channel TSOs do not anticipate a significant restriction of capacity in the long-term timeframe or the day-ahead timeframe, so it cannot be guaranteed that “*the day-ahead capacity calculation should by principle always produce significantly more capacities compared to the long-term capacity calculation*”. It cannot therefore be guaranteed that an adequate level of cross-zonal capacities will be allocated at the day-ahead stage; as required for the proper functioning of single day-ahead coupling.

As discussed in section 1.4, Channel TSOs do not believe it is appropriate to move to FTRs at this time. Therefore, day-ahead reservation is required to eliminate the risk of inadequate capacity for the single day-ahead coupling.

1.4 Nomination rates for the physical transmission rights with the use-it-or-sell-it principle

Historic nomination rates for long-term capacity on IFA, BritNed and Nemo Link are indeed low (in 2019 and 2020, typically lower than 9%). However, the current market uncertainty could see a change to market participant behaviour. As such, Channel TSOs consider it prudent to continue with the current practice, at least until the new trading arrangements have been agreed and implemented.

Channel TSOs consider that moving from PTRs to FTRs is inappropriate at this time. Channel TSOs consider that historic data alone is not sufficient to inform a decision, due to ongoing uncertainty in the connected markets and market arrangements. As such, it is believed that the ability to nominate capacity may become increasingly important to market participants and therefore a change in market arrangements should not be pursued and may be reassessed in the future.

1.5 An assessment of the costs and benefits associated with the reservation of day-ahead capacity

The following subsection outlines additional costs and benefits that Channel TSOs foresee related to the reservation of capacity for the day-ahead timeframe.

Ensures the availability of day-ahead capacity in case of high nomination rates.

Whilst the Channel NRAs, in their decision dated 29 July, point to the low nomination rates of long-term capacity rights which generally ensures that a proportion of capacity is allocated at the day-ahead timeframe, customer behaviour has the potential to change to reflect prevalent market

conditions at the time. At present, the market conditions are uncertain and a change to nomination behaviour cannot be ruled out.

The design of the Channel capacity calculation (long-term and day-ahead/intraday) considers the controllable nature of the HVDC cross border assets that make up the CCR. As such, with the exception of planned outages, the full maximum permanent technical capacity of the interconnector is provided by the capacity calculator (both in the long-term and at the day-ahead stage). It can therefore be expected that a high proportion of the capacity made available will be allocated in long term timeframes, compared to day-ahead. In a scenario where nomination rates are high, this will result in little to no capacity being allocated in the day-ahead timeframe, undermining the requirements to provide hedging opportunities and ensure a liquid day-ahead market.

The only way to provide sufficient hedging opportunities would be to allow an amount of day-ahead capacity to be reserved for allocation in the day-ahead process directly. In coordination with a minimum amount of capacity to be allocated in long term allocation processes, the Channel TSOs believe that the balance can be struck between giving market certainty and allowing the market to determine the optimal split between long and short term products.

Furthermore, the absence of an active day-ahead auction may undermine the UIOSI principle because the day-ahead auction could become a less reliable indicator of capacity value. This in turn could act as a disincentive to certain market participants, especially financial players and those without the ability to nominate positions.

Availability of long-term capacity.

Reservation of day-ahead capacity reduces the availability of capacity for long-term allocation. However, as set out in section 2, Channel TSOs consider that the amended Splitting Ranges provide sufficient hedging opportunities for market participants, especially when taking into account historical data.

Economic efficiency.

Channel interconnectors are (at least in part) financially incentivised to allocate capacity to the most valuable timeframe to maximise the congestion revenues, a key element of the regulatory frameworks within the countries that make up the CCR. As such, day-ahead reservation allows Channel TSOs to assess whether the capacity is more valuable in the long-term or whether it will be valued more highly at the day-ahead stage (within the limitations set out in the Amended Proposal). The incentive to maximise congestion revenues requires that Channel TSOs optimise the competing demands of market participants for i) long-term hedging opportunities, and ii) adequate capacities at the day-ahead stage. Since all Channel interconnectors' regulatory arrangements contain an element of revenue sharing with the consumer tariff arrangements in the connecting countries, undervalued capacity results in value transferring from consumers to larger market participants.

Ensures that smaller market participants are competing on a level playing field with larger market participants for a proportion of the cross-zonal capacity.

The purchase of capacity in longer-dated products requires a certain level of financial resources, with respect to both the purchase of that capacity, and the holding of positions with other market participants and/or exchanges that act as a complementary hedge against the value of that capacity (as is standard market practice). The reservation of day-ahead capacity provides an opportunity for smaller market participants who may hold fewer financial resources to obtain shorter term interconnector capacity (with less onerous collateral requirements). The Channel TSOs believe it is

important to minimise barriers to market entry and feel that removing the flexibility to reserve capacity for the day-ahead timescale would represent such a barrier. The promotion of competition also increases liquidity in cross border markets increasing market efficiency.

Reduces the market power of larger market participants to undervalue capacity.

Forward power markets are significantly less liquid, with less available price information, as many transactions take place over-the-counter. Offering too much capacity in the long-term timescale could result in an undervaluation of the capacity and hence a transfer of congestion revenues towards market participants while the TSOs require the congestion revenues to maintain the cross border transmission assets.

Provides certainty to interconnector owners, and market participants, of sufficient liquidity at the day-ahead stage (needed for efficient pricing to set UIOSI remuneration).

Despite the historically low nomination rates, a liquid day-ahead market (ensured by day-ahead reservation) provides certainty of availability of capacity for efficient operation of the single day-ahead coupling and therefore capacity value setting via the UIOSI remuneration process.

Section 2 – Splitting Ranges

The Channel NRAs requested that any new proposal for narrower Splitting Ranges or a more specific Capacity Split should be accompanied by a motivation of why the new value(s) can be considered as sufficiently addressing the hedging needs of market participants. For example, by providing evidence that those new values are in line with historical fluctuations of the proportion of long-term capacity allocated to certain timeframes.

The Amended Proposal has significantly reduced Splitting Ranges, compared to the previous proposal (Table 1). The use of Nominal Capacity rather than Long-Term Cross Zonal Capacity (defined as Nominal Capacity minus any capacity reserved for day-ahead allocation) means it has been possible to significantly reduce the percentage ranges.

Timeframe	Original Proposal		Amended Proposal	
	Min % of Long-Term Cross-Zonal Capacity	Max % of Long-Term Cross-Zonal Capacity	Min % of Nominal Capacity	Max % of Nominal Capacity
Annual	5%	95%	20%	70%
Seasonal	0%	90%	0%	20%
Quarterly	0%	90%	0%	30%
Monthly	5%	95%	7.5%	30%
Sum of all Long-Term timeframes shorter than monthly	0%	90%	0%	20%

Table 1 - Splitting Ranges from Original and Amended Proposals

2.1 Historic capacity splits

The amended ranges are in line with historic fluctuations of the proportion of long-term capacity allocated to certain timeframes. The figures below show the historic capacity splits for IFA, BritNed and Nemo Link during 2019 and 2020. A single data point for Jan 2021 is added for the capacity splits for IFA2 (already approved by CRE). The red (minimum) and green (maximum) lines show the extremes of the amended Splitting Ranges.

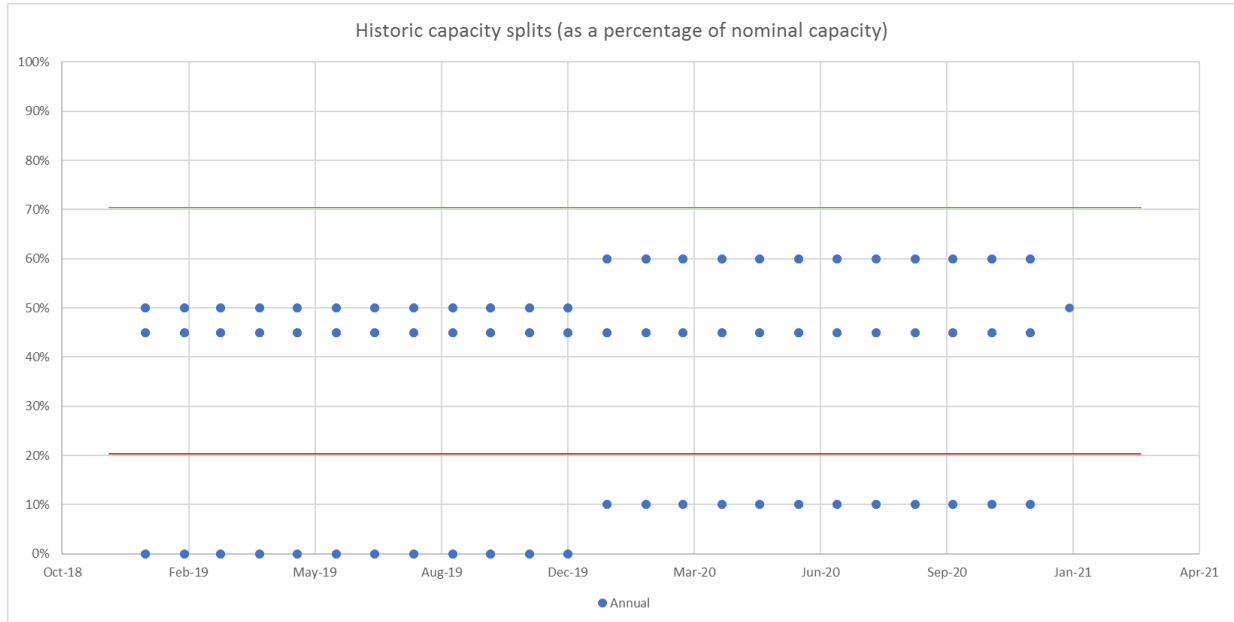


Figure 1 – historic annual capacity splits alongside the amended annual splitting ranges (min 20%, max 70%)

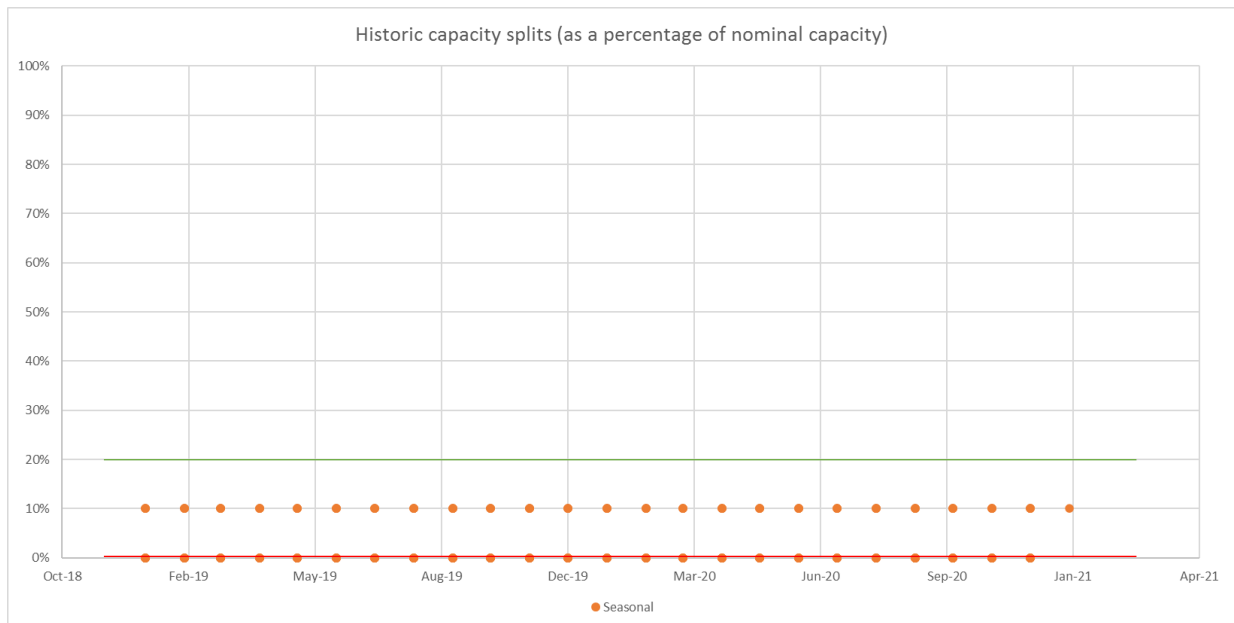


Figure 2 - historic seasonal capacity splits alongside the amended annual splitting ranges (min 0%, max 20%)

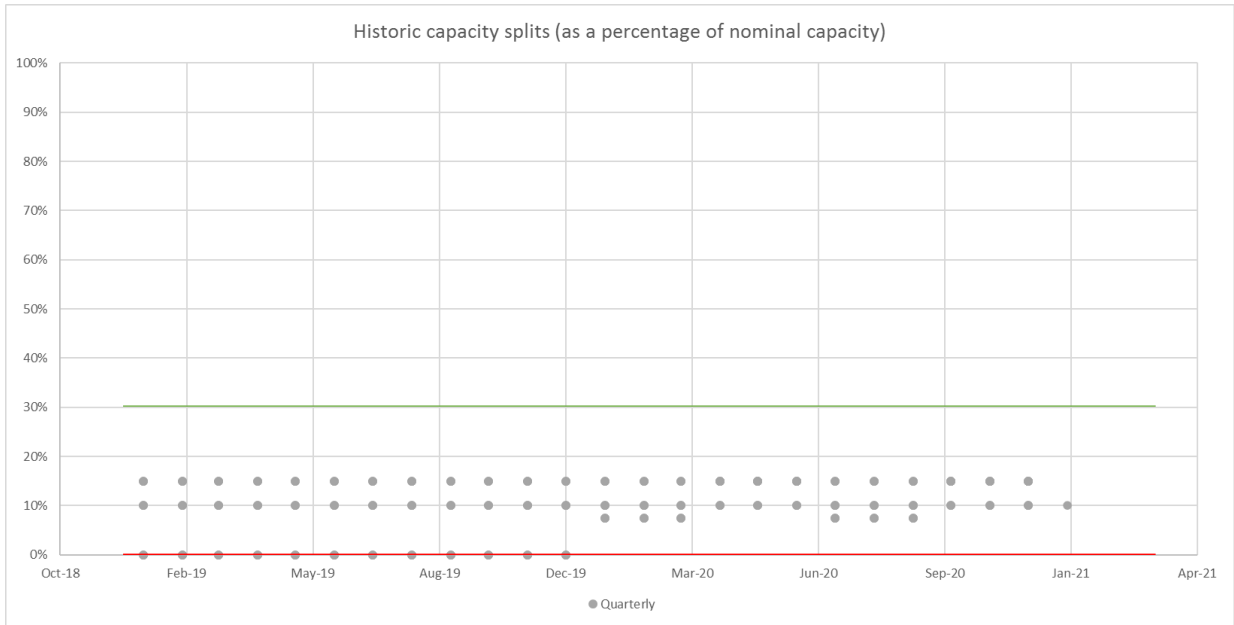


Figure 3 - historic quarterly capacity splits alongside the amended annual splitting ranges (min 0%, max 30%)

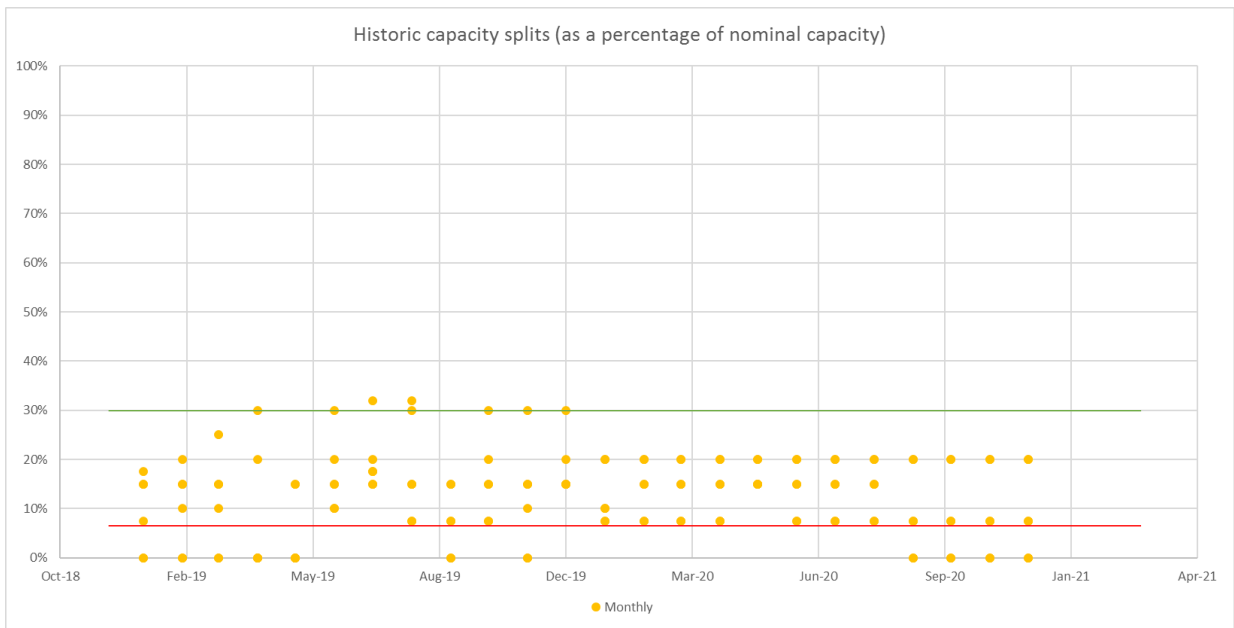


Figure 4 - historic monthly capacity splits alongside the amended annual splitting ranges (min 7.5%, max 30%)

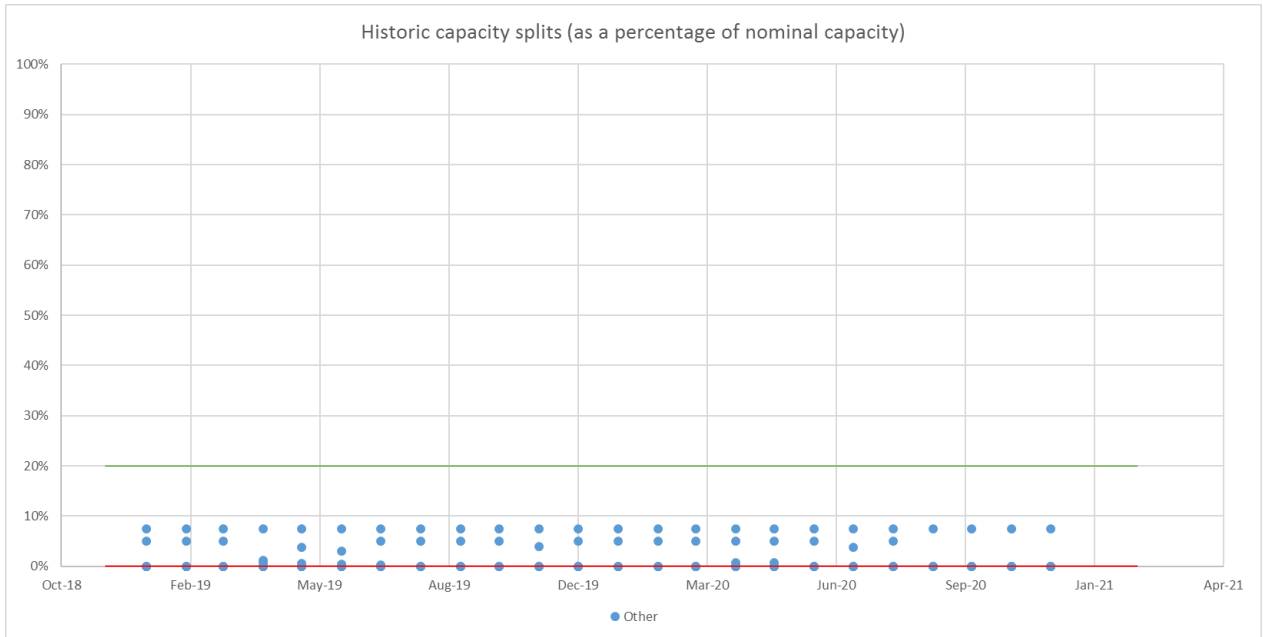


Figure 5 -historic other capacity splits alongside the amended annual splitting ranges (min 0%, max 20%)

2.2 Liquidity of long-term products

When considering the amended Splitting Ranges Channel TSOs considered the historic liquidity of the various long-term products.

Liquidity of annual and monthly products is higher than that of seasonal, quarterly, and other long-term timescales shorter than monthly. However, even annual and monthly product liquidity is drastically lower than that at the day-ahead timeframe.

For example, the figures below show the traded volumes of long-term energy products on the EEX French Power Futures for the French bidding zone for the first half of 2020.

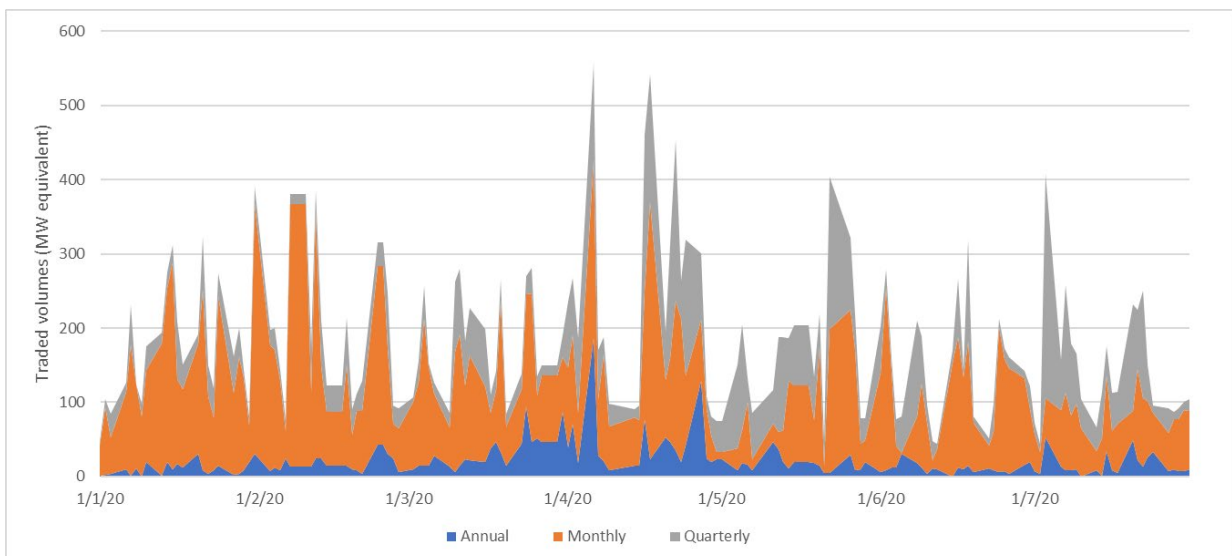


Figure 6 – MW equivalent volumes for energy products traded in the French bidding zone on the EEX French Power Futures

As can be seen from the figure above, the typical daily liquidity of long-term energy products is limited to a few hundred MW. Therefore, common practice on Channel interconnectors is to limit the capacity offered to any individual auction to a maximum of a few hundred MW.

Forward power markets are significantly less liquid, with less price information available, as a large proportion of transactions happen over-the-counter. Offering excessive capacity in the long-term timescale could result in an undervaluation of the capacity, leading to a transfer of congestion revenues towards market participants and hence away from the TSOs. In general, the TSOs require the congestion revenues to maintain the cross border transmission assets. In all cases in the Channel CCR, congestion revenues will benefit the consumer by reducing tariffs to some extent, depending on the regulatory arrangement that was put in place for each TSO. Any requirement to sell a large quantity of capacity at a timeframe where the supply would massively outweigh the demand would result in a significant undervaluation of the capacity.

2.3 [Link to the long-term capacity calculation methodology](#)

Article 3 of the Amended Proposal describes the coherence with the long-term capacity calculation. The overarching principle is that the long-term capacity calculation sets the maximum amount of capacity that can be offered to the market. The splitting rules are such that the Capacity Split will always respect the result of the long-term capacity calculation.

Article 5(2) of the Amended Proposal includes a provision requiring Channel TSOs to make at least 35% of the Nominal Capacity available for long-term allocation. This is consistent with the statistical methodology of the long-term capacity calculation.

As the long-term capacity calculation (based on a statistical approach) will (in most cases) guarantee 35% of Nominal Capacity at the end of February Y-1, the capacity made available for allocation must adhere to the Capacity Ranges detailed in the Amended Proposal as well as the 35% maximum. This will be the case until additional long-term capacity is granted in September (or in the worst case scenario, in December) through the long-term capacity calculation (scenario-based).

The minimum percentages of the annual (20%) and monthly (7.5%) long-term products sum to 27.5% (not 35%). As a result, the Responsible TSO(s) must offer an additional 7.5% from any long-term timescale (annual, monthly, quarterly, monthly, other long-term timescales shorter than monthly) to meet the 35% minimum.

Channel TSOs have also considered market participants' feedback that many parties prefer the same volume to be offered for allocation in both directions at the same time. This has been the standard practice on Channel interconnectors to date. However, the long-term capacity calculation could result in differences to the capacity for each direction (e.g. 500MW GB-FR but 750MW FR-GB). This difference requires some flexibility which has been taken into account in the amended Splitting Ranges.

2.4 [Competition concerns](#)

Channel TSOs confirm the detrimental impacts on competition that a restrictive methodology for splitting long-term cross-zonal capacity would introduce. As highlighted by Channel NRAs, the splitting ratios give interconnectors the possibility to use their product mix as a competitive advantage to differentiate from competitors and serve the market in a flexible way given the specific market conditions. Channel TSOs require this flexibility to offer the capacity products that are valuable to the market participants who participate in auctions on specific interconnectors. The capacity products that market participants value change over time. Market participants' valuation of capacity products is likely to change as the proportion of renewable generation sources increases. For example, the

capacity products that a solar generator values highly may be very different from the capacity products valued by a coal generator. Furthermore, these market participants may typically purchase capacity on different interconnectors. Fixed splitting percentages would not best meet market hedging requirements. Fixed percentages assume the requirements of market participants do not change, and that the requirements of all market participants are aligned. Flexibility is therefore needed to provide long-term cross-zonal hedging opportunities for all market participants, and so is aligned with the aims of the FCA regulation.

Section 3 – Other changes

Channel TSOs highlight that under the Amended Proposal, Channel TSOs cannot change the Capacity Split at any time, and certainly not at the very moment of allocation. In accordance with Article 6 of the Amended Proposal, Channel TSOs may only amend the Capacity Split following each long-term capacity calculation. An additional paragraph has been added to Article 6 to clarify this point. Furthermore, Channel TSOs have included a list of the specific circumstances which can lead to a change in the Capacity Split. This aims to provide comfort that Channel TSOs do not envisage regular changes to the Capacity Split following the publication of the provisional version of the Capacity Split, other than in specific scenarios, and only following a long-term capacity calculation.

Furthermore, the Harmonised Allocation Rules (“HAR”) already require TSOs to publish auction calendars reasonably in advance before the auctions take place. In accordance with HAR article 27(4) a provisional auction calendar for each calendar year shall be published no later than 1 December of the year preceding.

Regarding transparency, predictability and CCR level harmonisation, Article 7 of the Amended Proposal requires Channel TSOs to publish the provisional version of the Capacity Split as well as any changes following each capacity calculation alongside the auction calendar. In addition, the Channel TSOs recognise the need to provide information to the market on the reason for the changes. Any change will be accompanied by the relevant reason(s) from the newly added list in Article 6. All information regarding the Capacity Split is made publicly available. The Amended Proposal uses Nominal Capacity which Channel TSOs believe provide market participants with greater transparency (the use of Nominal Capacity delivers a more intuitive proposal and enables Channel TSOs to provide narrower Splitting Ranges).

On predictability, the auction calendar and Capacity Split publication covers the full calendar year of long-term capacity allocation. This gives market participants one full year of warning of future Capacity Split changes. The only exceptions to this are changes resulting from long-term capacity calculations. Where the capacity is reduced due a long-term capacity calculation, Channel TSOs consider it appropriate to (potentially) reconsider the Capacity Split given the updated availability of capacity. This is one of the scenarios envisioned in Article 6(4).

On CCR harmonisation, the Amended Proposal includes a harmonised minimum and maximum percentage for allocation at the day-ahead stage. The minimum and maximum percentages for each Splitting Range are also harmonised, and changes to the provisional version of the Capacity Split follow the harmonised long-term capacity calculation. The publication requirements are also harmonised.