

Analysis of the access to the French-Spanish interconnection

Executive Summary

EFET appreciates the recent progress made on the French-Spanish border with the implementation of market-based allocation mechanisms since mid-2006. We encourage the Regulators to take further up the Roadmap they published in the Order ITC/4112/2005, and where further developments such as the Use-it-or-sell-it mechanism are described.

EFET Task Force France and EFET Task Force Iberia made a common analysis of different issues related to the allocation and the use of cross border capacity at the French-Spanish border. The current paper enumerates and describes the result of this work. We give a detailed overview of regulatory aspects, necessary improvements of the applicable rules, lack of harmonisation, etc. Due to these barriers, the efficient use of the border is hardly achieved. We suggest improvements and/or recommendations for each problem identified.

We are aware that some of these proposals will require substantial changes in either the IFE rules or current (rather domestically oriented) regulations and processes.

The allocation mechanism should avoid any ex-ante discrimination against the market players, both in the regulatory framework put in place on both sides of the interconnection, and in the actual procedures, such as the requirement to have a bilateral contract to use periodic capacity with the obligation to sell power only through these contracts (instead of selling it directly at OMEL), as well as the ban on imports for the main Spanish players, instead of ex-post regulatory monitoring supported by EFET.

It is also important to guarantee the firmness of periodic, daily and intra-daily capacity rights at the outcome of the allocation (auction). Additionally, it is necessary to consider the creation of a model based on balancing perimeters in the Spanish market as it exists nearly everywhere in the European markets. And the last but not the least, it is essential to achieve a harmonisation of several different operational rules, such as nomination procedures, bank guarantees, complaints procedures, and single point of contact for market participants.

Although the analysis might give the impression that essentially we target the Spanish market, we would like to mention that EFET Task Force France recently suggested similar improvements needed for the French system. We find necessary to consider that analysis as an annex to this paper¹.

¹ EFET TF France « Harmonisation des pratiques d'enchère à l'échelle européenne », letter to RTE, December 2006, available on www.efet.org

Content

R: Regulatory issues and market rules

H: Harmonisation issues

O: Operational and organisation issues

I: Further improvements to be considered

R1: Discrimination in the imports France to Spain

Due to Spanish Regulation RDL 5/2005², three market players (Iberdrola, Endesa and Union Fenosa) are not allowed to purchase energy outside Iberian Peninsula and to import it to Spain.³ We observe that TSOs' implemented rules accordingly, having as consequences:

- Not allowing the participation in the capacity auctions from France to Spain;
- Not allowing the holding of the capacity rights (even with the secondary market in place);
- Not allowing the flowing of the energy they produce abroad.

EFET considers that this prohibition reduces competition in the allocation mechanism, is discriminatory and arbitrary, and is against the following regulations:

- Article 3.1.c and 28 of the EU Treaty: "Quantitative restrictions on imports and all measures having equivalent effect shall be prohibited between Member States";
- Article 6 of the Regulation EC/1228/2003: "Network congestion problems shall be addressed with **non-discriminatory** market based solutions."
- Article 1.2 of the Congestion Management Guidelines⁴: "When **there is no congestion** there shall be no restriction of access to the interconnection" while, for instance, between the 1st of June 2006 until the 14th of February 2007, the interconnector was not congested in 47% of the hours where exporting energy from France to Spain had an economical sense⁵;
- Article 2.10⁶ of the Congestion Management Guidelines: "All potential market participants shall be permitted to participate in the allocation process without restriction". We acknowledge that the latter Article 2.10 contemplates further restrictions in general or on an individual company on account of market dominance in the case of **potential** abuse of dominant position of any market player".

For the time being, such an abuse of dominant position on behalf of the mentioned market players in relation to the use of the interconnectors has not been proved in the Spanish market. Moreover, the restriction is only based on the ex-ante criteria: "holding more than 10% of the generation and power supply" (see footnote 2), which is an arbitrary choice of the Spanish regulatory authorities.

For the avoidance of any doubt, EFET recognizes that the anti-trust authorities can impose anti-hoarding measures until the market is more developed. We are aware that some restrictions exist on other European borders, for instance the 400 MW import restriction to the Netherlands or the 325 MW cap on yearly and monthly capacity rights from France to Belgium. However, EFET believes that all these caps have been determined rather arbitrary, **without a clear impact analysis** and **without real proves of abusive behaviour** of (the involved) market players. The

² The Regulation RDL 5/2005 states that "power purchases in countries outside Mercado Ibérico de la Electricidad (Spain and Portugal) are not allowed to Operadores Dominantes del Sector Eléctrico (Dominant Players)". The definition of Operador Dominantes can be found in the same law: "having a higher share of 10% of generation and power supply in (Spain & Portugal)". However, CNE (Spanish regulator) is applying this share only for Spain without counting Portugal.

³ For the avoidance of doubt, such constraints have not been imposed in the direction Spain to France.

⁴ Commission Decision of 9 November 2006 updating the Annex to the Regulation EC/1228/2003

⁵ Data based on RTE and REE data.

⁶ Commission Decision of 9 November 2006 updating the Annex to the Regulation EC/1228/2003

example in the French-Spanish border is even more disproportioned compared with the Dutch and Belgian borders, as the reduction of the entitlement to have import access rights is **non-objectively set at zero** for the three companies, as mentioned above.

R2: Discrimination in the use of annual and monthly (periodic) capacity between Spanish generators and other market participants

According to the Ministerial Order ITC/4112/2005 (article 8.1) and to the REE operational procedure issued by the Spanish Industry Minister (PO 4.1, article 5.2.1), capacity rights acquired in **annual and monthly** auctions (in both directions) can only be used **for bilateral physical contracts** (CBF) with market participants registered in Spain. Periodic capacity rights cannot be used for direct selling or purchasing on the Spanish power exchange (OMEL).

Technically speaking, this means that any cross border nomination of periodic capacity rights (i.e. international exchange of energy) has to be associated with a physical bilateral contract (CBF) in Spain. OMEL (article 28.5 of the OMEL "Electricity Market Activity Rules of the Daily and Intraday Markets") and REE (article 7.5 of the IFE rules) have put in place validation processes that check the validity of such association:

- **To import energy** in Spain, the bilateral contract can be either with a "retailer" or a Spanish generator, as the operators can only check the "existence" of a bilateral contract but not the origin of the energy (RTE is not performing such check on the French side);
- **To export energy** from Spain, the operators check the "existence" of a bilateral contract and the availability of the energy⁷ which is nominated through this contract. Hence, one leg of this bilateral contract has to be an available and producing (i.e. having nominated that the generator produces at least the amount needed for export) generation unit belonging to a Spanish generator.

Agents cannot sell or purchase the energy nominated through the periodic capacities in Spain directly on the Spanish power exchange OMEL.

EFET considers that these measures (that do not exist anywhere in Europe) impede the access to cross-border capacity.

This also prevents a "retailer" (and an external agent) to have the choice to sell the energy via a bilateral contract or via OMEL. This may not be consistent with article 21 of RDL 6/2000.

Moreover, there is discrimination when a market participant (external agent and "retailer") with no generation in Spain would like to export from Spain via periodic capacity rights. He would have no choice but to negotiate a bilateral contract with a Spanish generator.

A Spanish generator has the choice to export to France via periodic capacity rights and to purchase the energy on OMEL or through a bilateral contract with other

⁷ See REE P.O.4.1 and Omel "Reglas de funcionamiento del Mercado diario et intradiario de produccion de energia electrica"

market participants with no other commercial expenses. An external agent would need to pay a negotiated commercial fee for the execution of the bilateral contract with the generator he negotiated.

We understood that one of the reasons for implementing such regulation in Spain was to make sure that the overall Spanish electrical system could cope with international export of energy. EFET believes that the market can provide this guarantee in Spain like it does in other Western European countries (like France, Germany, Belgium, and Switzerland). As long as the nomination on the border is binding and that there is no incentive to stay out of balance, the market participant has no choice but to bid at the instrumental price⁸ which should give enough guarantee to REE that the energy will flow.

EFET recommends the removal of any discrimination in the use of interconnection capacity and advocates that any market participant should be able to use its capacity on either OMEL or via a bilateral contract like on any other Western European borders. Such flexibility existed before the implementation of a coordinated allocation mechanism between RTE and REE. EFET fails to understand the benefit of more coordination when it removes flexibility for market participants.

EFET urges REE to implement a balancing responsible scheme in order to avoid all these problems.

R3: one counterpart rule

The article 6.07 of the IFE auction rules states under the paragraph “Nomination” that “in order to be able to send nominations to the TSOs, the Participant must send to the TSOs [...] a duly signed copy of the Nomination Counterparty Designation Form [...]. The Participant will ensure that the Nomination Counterparty in each system has not been previously designated by another Participant”.

Although the IFE rules do not mention it explicitly, this rule actually only applies in practice for long-term capacity rights (yearly and monthly); indeed, for daily and intraday capacity rights, the Nomination Counterpart on the Spanish system can be OMEL.

The understanding of this rule is, that if A, an external agent, having a periodic export capacity right from Spain, wants to export from Spain, he needs to have a bilateral contract with a generator B and no other player C can then have such an export contract with this generator), and vice versa, if X, (external agent) wants to use a periodic import right to Spain, he needs to have a bilateral contract with a retailer or a generator Y whereby Y cannot be appointed again by another external agent Z for the use of his import rights; this leads to a **limited flexibility** in the bilateral market and it could be that some external agents do not find a generator.

Although EFET does understand that a one-to-one rule for cross-border nominations can facilitate and speed up the matching of the nomination process, it is still not understandable why then it is not possible to **create balancing perimeters in the Spanish system** as an intermediate hub location where external agents at their own discretion can nominate energy they want to export/import. From this balancing perimeter, the (external) agents have then the freedom to exchange energy with

⁸ Either the minimum (0€/MWh) or the maximum bid price (180.3€/MWh) depending if we are selling or buying on OMEL

whomever counterpart (via bilateral nominations) they opt for, including OMEL. Such a model respects the one-to-one concept for the matching process on the border.

H1: Bank Guarantee

The article 3.02 (a) of the auction rules provides that “a bank guarantee has to be provided covering all outstanding debts resulting from the Auctions of Physical Transmission Rights for exports from Spain to France and [...]”.

The rules further precise that “all debts resulting from the Auction of Physical Transmission Rights from France to Spain are covered by the Bank Guarantee provided according to the French Import Export Rules”. This means thus that no additional French Bank Guarantee is required.

When we have a closer look at the bank guarantee required under the French Import/Export Rules, we see that here a fix amount of 500.000 € is required in order to participate on several auctions organised by RTE, i.e. export from France to Spain, Belgium, Germany, and Italy, while for the Spanish border a variable amount is necessary.

We urge to review the modalities towards those of the French side that are more balanced⁹; it would be even more advisable to integrate the Spanish credit requirements under the French requirements, which looks more feasible once the whole operational process (auction, invoice, nomination) of both sides of the border are delegated to a single dedicated entity acting on behalf of both RTE and REE (or even on behalf of all coordinated TSOs) as stated in our comments under point H2.

H2: Auctioneer harmonisation

EFET observes that for the time being, the auction operations are in the hands of two operators. For the monthly and the daily allocations, Ariba is appointed as the auctioneer, while for the intraday auctions and the yearly auction (2007) eSICA is the platform.

EFET believes that in the interest of the evolution towards one harmonised and integrated market, it is more suitable to put all auction operations in the hands of one entity. EFET does not take a position in favour of any of both mentioned platforms, and we also refer to the two letters prepared by EFET Task Force France in 2006 in which the problems with the Ariba platform have been criticised and where general improvements to the different systems have been suggested, based on best practices at different borders in Europe. Many of these suggestions have been implemented or are taken up.

It is clear that further market integration needs harmonisation, and not at the least in the communication protocols with the different TSOs. Such harmonisation will reduce the operational risk of market participants and also the operational costs which cover similar operations they have to perform on different platforms, the IT investments and the update of the costs they have.

EFET urges RTE and REE to opt for a single auction operator, which should be commonly appointed for regional (CWE, SWE) borders as well.

⁹ Participants having only transactions on 1 border are even exempted and only need credit coverage of 100.000 €.

Our harmonisation concern even goes further: all operational activities, including the auction process, but also the nomination and the invoice process should ideally be in hands of one appointed entity that acts on behalf of the TSOs and is the unique counterpart for the market players active on this and other borders.

O1. Transparency: Curtailments in the grid (due to maintenance, etc.); to inform as soon as possible and to justify the reasons for such curtailments

EFET observes that at several occasions, there have been curtailments on the French-Spanish border, with each time a lack of information on:

- Information on reducing programs and allocated capacity;
- The origin of the problem and the estimated duration until it is solved.

For this, we advocate the necessity for a “SPOC” in case curtailments happen.

A unique department, **Single Point of Contact (SPOC)**, is needed, as a common voice or interface on behalf of both TSOs rather than different and several sources from both TSOs. When problems occur, there seems to be a lack of communication and of organization for solving and communicating the problems. Market players never know who is responsible for the problems happening and never know to whom they should address claims. SPOC should be responsible to contact agents by reasonable (email, phone call or fax) ways.

We urge both TSOs to co-operate and deal jointly with any complaints from agents.

O2. One single nomination of the periodic and daily capacities, valid for both TSOs, in the same way as the intraday capacity nominations

The IFE Rules, v.1.0, Article 6.07, establish that “Following Auctions and irrespective of the energy trades in the bilateral and/or organised markets, Nomination Agents must nominate **to both TSOs** their Exchange Programmes ...]”.

Even though it is not precisely specified, since the coordinated auction system was put in place, the norm has been that “periodic and daily” capacity rights should be effectively nominated to both TSOs, whereas “intraday” capacities are to be nominated solely to REE.

Our opinion is that this “double nomination” system for periodic and daily capacity rights is a source of mistakes, arising from the fact that there are two different procedures in the nomination process, one per each TSO.

A single nomination should allow TSOs to display in real time the position of market participant at the border as there will be no need to wait for the matching process. This should reduce a large volume of current physical imbalances that market players encounter currently due to the lack of information provided by eSIOS platform (see also different problems with this platform under O5).

It has already been shown, through the achieved experience that intraday nominations work as well as the periodic and daily ones with regard to effectiveness in actual network programming by TSOs, and the process for all users is strongly simplified.

Also, in the presentation to the users of this first version of the IFE rules, both TSOs agreed that it would be a natural evolution to have only one nomination to either of the two TSOs.

Therefore, we propose that in the new version of the IFE rules a single nomination should be extended to ALL capacity rights, in the same way as it is now done for the intraday.

This single nomination has to be binding and may not be reviewed by REE following OMEL's schedules as it is normally the case of other European interconnections.

O3. Reliability and lack of user friendly eSIOS platform

- The eSIOS/eSICA system is using a Java application not compatible with other (Java) applications.
- The connection requires permanent activity because three minutes of inactivity disables the application and “re-logging in” is necessary, which at stress moments can cause operational risks.
- An Internet based system with password would be a lot more user friendly instead of the current application that requires a card reader.
- The files to be uploaded in the system are a special “ome” file type (which is a kind of text file). In the scope of harmonisation of nomination systems as xml files could be a better option as this is already used in other nomination systems in Germany, Austria, Switzerland and France.

EFET urges to harmonise platforms used by TSOs, it will not only reduce their development costs, but also the risks that are incurred by their customers.

O4. Firmness of capacity rights

Between the allocation process (auction) and the use of the obtained capacity rights (nomination), there is still an intermediate step that is called the “authorisation procedure” as specified in the IFE rules version 1.0 under paragraph 6.06.

The reason for this intermediate step is actually the fact that capacity rights (periodic, daily and intradaily) are not yet “firm” rights. Indeed, if TSOs would offer firm capacity rights, the nomination authorisation would be already given at the outcome of the auction.

The degree of firmness of Physical Transmission Rights (PTR) on the French-Spanish border is less than on any other RTE borders. While periodic capacity rights become firm upon reception of “Capacity usage authorisation” on the FR/DE, FR/BE and FR/IT borders, periodic capacity rights on the French-Spanish border become firm only once the nomination has been accepted following the matching process between REE and RTE. This means that instead of being firm usually at 16.00 CET on D-2, periodic PTRs on the French – Spanish border become firm around 8.35 AM CET on D-1.

The same lack of firmness applies for daily and even intradaily capacities. On the FR/IT or FR/BE borders, daily capacity rights are firm as soon as they have been

auctioned to market participants. Again, on the French-Spanish border, these daily PTRs become firm only once the nomination has been accepted following the matching process between TSOs.

According to the draft version 2.0 of IFE rules, market participants are compensated less in the case of reduction of PTRs at the French – Spanish border than on other RTE borders. From the first hour of reduction up to the time limit set in the auction rules (“total reduction days”), market participants are compensated at 100% of the auction price. Any reduction after that is compensated at 110%. On all the other RTE borders, market participants are compensated at 110% of the auction price from the first hour of reduction, without any limitations.

As a first step towards full firmness of PTRs, EFET advocates the harmonisation of the degree of firmness of PTRs at the French-Spanish border with other RTE borders (i.e. to Germany, Italy and Belgium).

EFET has recently published a paper that describes the maximisation and firmness of capacity rights¹⁰. This is an issue in nearly all interconnections in Europe. One of its main ideas is that curtailments, if any, should be compensated at the market spread at the moment of the curtailment except for the real force majeure (narrowly defined), in which case we need at least to recuperate the auction value.

The EU Regulation 1228/2003, under article 6.6¹¹, and the Spanish regulation (Ministerial Order ITC/4112/2005, articles 5&6 of Annex 1) give actually TSOs the resources to guarantee the firmness of capacity rights.

We also refer to our point W1 (secondary markets) where we explain how the secondary markets could be used as a tool for buying back capacity rights TSOs sold too much in advance.

I1. Secondary market

- **The deadline of notification acceptance for a transfer of capacity rights, as proposed by RTE, is not appropriate** with market requirements. Transfers should ideally be possible for yearly and monthly capacity rights until the last minute of the nomination gate closure and not the proposed D-2 or D-4 for Monday deliveries.
- EFET believes that the time needed for the acceptance of such a capacity trade by RTE should be as short as possible; therefore it is very important that **RTE commits to minimize the confirmation delay** towards the traders once a capacity transfer has been notified.
- The RTE rules only propose a voluntary resell of capacity. However, unused capacity after the nomination deadline should be automatically reallocated through a **Use-It-Or-Sell-It (UIOSI)** mechanism, which will reimburse the (primary or secondary) owner of non-nominated yearly and monthly capacity rights automatically at the daily auction value of the capacity right.
- The draft version IFE rules 2.0 provide the possibility to resell Y and M capacity rights on the daily auctions, which is already a step in the right

¹⁰ EFET Position Paper “More transmission capacity for European cross-border transmission: Firmness and Maximisation”, May 2006, available on www.efet.org

¹¹ Regulation 1228/2003, Article 6, point 6 : “Any revenues resulting from the allocation of interconnection shall be used for one or more of the following purposes:

(a) guaranteeing the actual availability of the allocated capacity;”

direction. However, this still requires manual intervention and operational risks, while at the moment of the nomination of the Y and M rights, the unused capacity rights could be “automatically” sold in the daily auction, which is the UIOSI mechanism as advocated in the previous bullet. Also the lead time (on D-2 “weekdays” 14h30) in the resale model is too high.

- Reselling capacity to the auction is a complementary service to being able to trade capacity rights. TSO’s proposition is however far too restrictive to encourage market players to resell capacity. We believe that annual capacity holders should be able to split and **resell their capacity rights in monthly auctions, using products similar to what is currently auctioned** by RTE (Base, peak , off-peak), thus not only limited to the proposed base product.
- TSOs should disclose the capacity available and the names of the companies with capacity holdings (without disclosing individual positions).

As a general remark, EFET would like to stress that the non-firm capacity rights currently auctioned by RTE and REE will only undermine and complicate the secondary market. TSOs should take this opportunity to offer firm capacity, as required in the article 6.2 of the EU Regulation 1228/2003. TSOs would then be able to intervene on the secondary capacity market and buy capacity rights back when curtailments are deemed necessary. Alternatively, when a buy-back is not possible and curtailments are necessary, TSOs should compensate curtailed capacity holders (primary and secondary) at the full market spread. EFET paper on maximization and firmness of capacity rights describes the benefits in more detail. We discuss this further also under the item O4.

12. Cross border intraday allocations

EFET welcomes the fact that on the French Spanish border in both directions cross-border intraday facilities have been installed.

In July 2006, an intraday allocation based on explicit auctions has been put in place.

The auction model enables the participant for acquiring capacity he really needs (because he can put a bid corresponding to the value such a right has for his own position). However, it has a limited flexibility because there are only two intraday capacity auctions (first intraday auction takes place on day ahead at 16h45, the second auction closes on the day D at 11h45)

- a) EFET would like to urge RTE and REE to put in place a continuous intraday platform allocating capacity on an hourly basis implicitly via the “take it and use it” principle. EFET describes the features of such model in its recent position paper “Intra-day markets”¹².
- b) Until a continuous platform is in place, EFET believes that the current intraday auction model could be improved:
 - Implementing a Use it or Sell it regime instead of a Use it or Lose it one between two intraday auctions;
 - Increasing the number of intraday auctions from two to more (at least three – one more at the beginning of the day to cope with overnight changes in the market);

¹² EFET Position Paper “Intra-day markets”, December 2006, published on www.efet.org

- Making sure that any capacity bought at the intraday auction can be used. We observe on the Spanish border that the capacity is managed by two entities: REE and OMEL. We strongly urge to implement the necessary changes in OMEL rules in order to ensure a binding nomination and firmness of the capacity allocated. It is not currently the case:

According to the current OMEL rules, a market participant has the possibility to decrease his cross border nomination after the day-ahead deadline without having to buy back any capacity in the other direction at the next capacity auction. This will prevent another market participant which has bought some capacity at the intraday auction to be able to use it as OMEL gives priority to the agent who wants to reduce his cross border flow by buying back its position on OMEL.

13. Transparency on methodology of the process to establish the partition of capacity that will be auctioned yearly, monthly and daily

We urge TSOs to publish the methodology of how ATC and NTC volumes are calculated and how capacity is shared between different products. The monthly offered capacities are very variable month by month as shown in the table below, at least in the direction France to Spain. Therefore, TSOs should inform with at least one year advance, their best forecast of capacity and volumes to be auctioned (Congestion Guidelines CE/1288/2003 Art. 5.5). EFET would welcome a consultation form TSOs to participate in defining the share between different products.

Monthly Auctioned Capacities (MW)		SP→FR	FR→SP
June	2006	250	700
July	2006	250	700
August	2006	200	500
September	2006	250	599
October	2006	250	400
November	2006	200	700
December	2006	200	399
January	2007	100	199
February	2007	100	300
March	2007	99	500

14. Possibility of using the interconnection for balancing mechanisms in both France and Spain

We invite both TSOs to agree on a mechanism to allow market players to participate in balancing mechanism through the interconnector if there is spare capacity after the latest commercial allocation (and/or use i.e. the nomination process). There are some experiences of this use in Europe on the Switzerland-France interconnections. For the avoidance of doubt, EFET considers that no capacity should be reserved for balancing mechanism.