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MARKET PARTIES PLATFORM Linking the CWE Market

ACM consultation on the Core TSOs proposal of a methodology for splitting long-term cross-zonal capacity (ACM/19/035455)

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EFET and MPP response – 17 September 2019

The European Federation of Energy Traders (EFET) and the Market Parties Platform (MPP) welcome the opportunity to provide comments on the ACM consultation on the CORE TSOs proposal of a methodology for splitting rules for forward capacity allocation. Forward capacity allocation is critical to allow market participants to hedge their long-term positions across borders and make sure that they are not exposed to short-term price volatility and imbalance costs.

EFET and the MPP responded to the CORE TSOs consultation back in July 2019[1]. We welcome some of the progress that have already been made in the final version of the TSOs proposal compared to the initial draft methodology, in particular:

- the deletion of the concept of 'initial long-term capacity', which embedded the reservation of cross-zonal capacity for the day-ahead timeframe;
- the lower capacity reservation percentage for the monthly auctions, from 50% to 20% - nonetheless we still propose an alternative solution in the present response that would allow the market itself to decide on the split between yearly and monthly products, in order to stick as close as possible to the FCA Regulation objective of meeting market participants' hedging needs.

Comments on individual articles

- ***Article 3.1:*** *In case of AC interconnectors, eighty percent of the long-term capacity available of the year ahead timeframe will be offered to the subsequent yearly capacity allocation session at the Single Allocation Platform*

We welcome the fact that the TSOs seem to have heard market participants' call to release as much capacity as possible in the yearly auction, which led them to raise the proposed split of capacity between yearly and monthly capacity from 50%-50% to 80%-20%. However, we call on ACM and the other regulators of the CORE region to go even further.

[1] EFET and MPP response to the CORE TSOs consultation on a methodology for splitting long-term cross-zonal capacity, dated 10 July 2019 and available at: https://efet.org/Files/Documents/Downloads/EFET-MPP_CORE_CCR%20splitting%20LT%20CZC_10072019.pdf.

Indeed, we believe that **all the capacity calculated by the capacity calculation process year ahead should be made available to the market (*i.e.* 100% of the calculated capacity year-ahead), not just 80%**[2]. Further release of capacity at shorter time horizons in the forward timeframe (monthly) should be the result of capacity recalculations, or gradual release of the margins and constraints initially applied by the TSOs for year-ahead allocations as uncertainties reduce with real time getting nearer.

For avoidance of doubt, and bearing in mind that certain market participants may only wish to purchase capacity for specific months and may be reluctant to re-trade purchased yearly forward transmission rights on the secondary market, the TSOs may choose to allocate the 100% of calculated capacity year-ahead not only via yearly products but also via monthly products (but a year in advance). For example, **the TSOs could make sole use of monthly products in the year-ahead and monthly auctions, which could be bundled into multi-month or annual blocks in the yearly auction**. This distinction between the timing of the auctions and the granularity of the products offered by the TSOs allows the market itself, at the time of the yearly auction, to perform the splitting of capacity between yearly and monthly capacity in the most economically efficient manner.

To recall, for market participants hedging is about assessing and covering their positions against a variety of risks: price risk, volume risk, regulatory risk, etc. The further away from real time, the greater the uncertainty and therefore the greater the interest and importance for market participants to cover those risks, including across borders. It is therefore vital that TSOs make available to the market the maximum capacity they can as far in advance of real time as possible. We believe that the solution mentioned in the paragraph above is the best solution to reach the objective of the FCA Regulation in general, and its article 16 in particular, i.e. **meeting the hedging needs of market participants**. In the manner described above, it will be the market itself adjusting the split of capacity to the hedging needs of its participants at each auction.

We also believe that **this approach is in line with article 9 and 16 of the FCA Regulation**. Indeed:

- Article 9 states that "*All TSOs in each capacity calculation region shall ensure that long-term cross-zonal capacity is calculated for each forward capacity allocation and at least on annual and monthly time frames*" – Our proposal still foresees a calculation of capacity year-ahead and each month.
- Article 16 states that "*The TSOs of each capacity calculation region shall jointly develop a proposal for a methodology for splitting long-term cross-zonal capacity in a coordinated manner between different long-term time frames within the respective region*" – The article does not mandate TSOs to decide on a split, but to design a methodology for splitting capacity; with our proposal, the

[2] EFET defended this position in responses to the TSOs consultation on the Channel, SWE and Hansa CCRs Splitting Rules for forward capacity allocation, dated respectively 15 April, 30 April and 27 May 2019, and available at: https://efet.org/Files/Documents/Downloads/EFET_ENTSO-E%20consult%20Channel%20Splitting%20Rules_15042019.pdf, https://efet.org/Files/Documents/Downloads/EFET_SWE%20Splitting%20Rules_16042019.pdf and https://efet.org/Files/Documents/Downloads/EFET_Hansa%20Splitting%20Rules_27052019.pdf

market would decide on the split, based on rules and auction design agreed between the TSOs and NRAs.

The TSOs should not hide behind a supposed obligation hidden somewhere in article 16 to issue capacity at the yearly and monthly auctions:

- First, there is no such obligation in the FCA Regulation. **The obligation is to calculate and offer capacity for the yearly and monthly timeframes (i.e. the products), but not necessarily at each auction**. With our proposal, there may indeed be occurrences of monthly auctions without capacity available – though with monthly recalculation and relaxation of TSO constraints, this should happen rather rarely. However there will not be occurrences of market participants not being proposed monthly or yearly products – and those will be subscribed exactly in the amount and proportion that is most economically efficient.
- Second, the proposal of the **TSOs does not guarantee that the 20% of available long-term capacity withheld for monthly auctions will actually be allocated at the monthly auctions**. Indeed, there may be occurrences were the monthly recalculation of capacity will result in an assessment by the TSOs that they cannot release the 20% of initial capacity that they withheld. So with the TSO proposal, there is actually no guarantee that market participants will always have access to either yearly or monthly hedging products in the proportion they need.

Having a look at the TSOs post-consultation report annexed to their proposal, we'd like to point **a number of weaknesses in the analysis of the TSOs with regard to market participants' hedging needs** (point 2.1 of the report):

- First, we were surprised of the assertion of the TSOs that "from [a] market perspective allocating all available LT-capacity as soon as possible it is not per se the optimum of hedging, as it was requested by the majority of traders". Indeed, we believe that market participants know best what their hedging needs are, and when "a majority of traders" request this capacity maximisation as early as possible in all consultations on the subject since the drafting of the FCA Regulation, that should probably be a fairly good indication of what these hedging needs are.
- Second, when TSOs say that "a split of available LT capacity could be more effective to consider the hedging needs of all MPs with their very different needs (e.g. for long term portfolio trading as well as for the need to hedge against price risks e.g. for contractual short term physical delivery of energy)", we would like to point out that EFET and MPP members, who supported the maximisation of capacity allocation in the yearly auction, comprise large and small trading companies, pure traders and trading entities linked to utilities with a generation and/or supply portfolio, renewable electricity producers or offtakers, etc. In short, our memberships represent a wide diversity of market

participants, and established together our position of calling for a market-based split of monthly and yearly capacity.

- Third, the conclusion of the TSOs that "the provision of sufficient LT-capacity by monthly products has to be assured by any proposed splitting methodology" is somewhat right: indeed, if market participants need them, there should be monthly products available. But our proposal of letting the market decide on the split between yearly and monthly capacity does not say anything else: it will be up to the market to decide the proportion of monthly vs. yearly capacity that is needed. Our only call is to make sure that this happens as soon as the capacity is calculated (i.e. for the auction in Y-1), and that the choice is given to market participants to choose how to divide capacity at that moment. As mentioned before, auctioning monthly products that can also be bundled into multi-month or annual products in the Y-1 auction would make sure that the exact right amount of monthly capacity is provided to the market. Additional monthly capacity would then be released at each monthly recalculation of capacity.

To conclude, while we appreciate the efforts made by the TSOs in trying to find a compromise solution, we still have fundamental objections with their overall approach to capacity splitting. We believe that TSOs go beyond their mandate in trying to impose to the market what they consider market participants' hedging needs are. The practical solution we propose has the added value of maximising capacity allocation as far away from real time as possible while securing capacity for the yearly and monthly timeframes, with a split decided by the market itself. It is also in line with the FCA Regulation's spirit and letter.

- ***Article 4.1:*** *In case of new high voltage direct current Interconnectors for the first three years of operation, sixty five percent of long-term capacity available at the year ahead time frame will be offered to the subsequent yearly capacity allocation session at the Single Allocation Platform.*
- ***Article 4.2****: In case of high voltage direct current Interconnectors with more than three years of operation, eighty percent of long-term capacity available at the year ahead time frame will be offered to the subsequent yearly capacity allocation session at the Single Allocation Platform.*

Our comments to article 3.1 apply equally to articles 4.1 and 4.2 (see above).

In addition, we see the introduction of a differentiation between new DC interconnectors (up to three years of operation) and older ones: for the former, only 65% of the capacity calculated year ahead should be made available in the yearly auction, while for the latter, the same provision as for AC interconnectors applies (80% of the capacity in the yearly auction). This derogation for new DC links is justified by the "temporary potential issues linked to the operation of new assets" in the TSOs post-consultation report. We believe that derogations of this sort, especially when introduced at the last minute, should be thoroughly backed by data showing the lower reliability rates of DC links in the first years of operation, in the same order of magnitude as the derogation allows. Otherwise the derogation should be amended to reflect the reality of this data, or deleted if not properly justified.

Additional comments

There is no provision on the publication of capacity allocation data by the TSOs, as it is the case in certain LTSR methodologies for other CCRs. For instance the Hansa and Baltic LTSR proposal foresees the publication of the marginal auction price and the demand curve for LTTRs for each time frame.

Last but not least, we call on the TSOs to support the development of secondary markets for the exchange of forward transmission rights at all bidding zones borders in Europe. Such markets are part of market participants' hedging needs and will further improve the economic efficiency of hedging practices in the market, allowing easier access to transmission rights even after the initial auctions.