

## SEE TSOs consultation on a methodology for splitting long-term cross-zonal capacity



### EFET response – 2 September 2019

The European Federation of Energy Traders (EFET) welcomes the opportunity to provide comments on the ENTSO-E consultation on splitting rules for forward capacity allocation in the SEE capacity calculation region (CCR). 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.

#### Comments on individual articles

- **Article 4.2:** *For the yearly time frame, the offered capacity is the result of the application of the yearly percentage to the capacity, rounded up to the closest multiple of 10 MW. 40% of the Calculated Yearly Capacity will be offered to the yearly capacity allocation.*
- **Article 4.3:** *For the monthly time frame, the offered capacity is the result of the application of the monthly percentage to the capacity reduced by the already allocated capacity in the yearly time frame, rounded up to the closest multiple of 10 MW. 90% of the Calculated Monthly Capacity, reduced by the already allocated yearly capacity will be offered to the subsequent monthly capacity allocations.*

As a general rule, our target objective for forward capacity allocation is 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 only part of it. 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 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 yearly 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 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 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 part the capacity calculated year-ahead and withheld for monthly auctions and day-ahead allocation will actually be allocated at these moments. Indeed, there may be occurrences where the monthly recalculation of capacity will result in an assessment by the TSOs that they cannot release the 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.

This practical solution 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.

All this being said, we acknowledge **a number of specific circumstances on the markets of the SEE region that may require more time before the target solution we propose is implemented in a manner that benefits all market participants:**

- generally low liquidity of power markets in the region
- high seasonality of power generation patterns linked to hydrology
- important demand of monthly hedging products compared to yearly hedging products
- virtual non-existence of secondary markets for forward transmission rights in the region

Considering the above, maintaining a pre-determined split between yearly and monthly capacity for the time being may help ensure that all market participants access forward transmission rights according to their needs. However, this is not a *carte blanche* for TSOs to maintain the status quo, as they propose in this methodology. Indeed, we request the following:

- a clarification of the exact split they intend to apply (see our comments on article 5 regarding the confusing wording throughout the methodology document)
- the exclusion of any capacity reserved for the day-ahead timeframe
- a justification for the proposed split, based on historic demand curves, in order to set the pre-determined split as close as possible to the needs of market participants
- a roadmap for the evolution towards the target solution we propose, i.e. a split between yearly and month products set by the market itself

- **Article 5:** *The forward capacity allocation timeframes for Greece – Bulgaria and Romania – Bulgaria bidding zone borders are yearly and monthly. According to art. 16.2 of the FCA Regulation, the methodology for splitting long-term cross-zonal capacity shall comply with the following conditions:*
  - 1) *it shall meet the hedging needs of market participants; The risk of capacity reduction affects the hedging opportunity of Market Participants. The percentage of long term offered capacity with respect to the calculated long term capacity for Greece – Bulgaria and Romania-Bulgaria bidding zone borders is set at 90% from the calculated capacity. The level of firmness of the Yearly Capacity is based on a percentile of NTC. In order to guarantee an appropriate level of firmness of the yearly product, for capacity allocation purposes 40% from the yearly calculated NTC will be considered.*
  - 2) *it shall not lead to restriction in competition, in particular for access to long-term transmission rights. In order to allow market participants to cover their hedging needs on both yearly and monthly time frames, the Yearly Capacity shall not be offered for the entire volume in the yearly auction. Based on the above, 90% of the monthly calculated NTC has to be considered. The sharing of calculated long term capacity among the two different timeframes is established 40 % for yearly and 50 % for monthly. The rest 10% will be left for the daily allocation.*

The formulation of article 5 is not consistent with articles 4 and 6.

- In article 5, 1<sup>st</sup> principle, the allocation of both the yearly and monthly capacity is subject to an ex-ante reservation of capacity for the day-ahead timeframe of 10%. Consequently, the breakdown of capacity allocated according to the wording of this paragraph would be 36%-54%-10% (yearly, monthly, DA).
- In article 5, 2<sup>nd</sup> principle, the breakdown of capacity allocated would be 40%-50%-10% (yearly, monthly, DA)

In comparison, article 4 and 6 state that the breakdown of capacity would be 40%-54%-6% (provided that the capacity calculated month ahead is consistent with the capacity calculated year-ahead).

We request clarification from the TSOs as to which percentage breakdown of capacity they are actually proposing in this draft methodology.

### **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 proposals foresee the publication of the marginal auction price and the demand curve for LTTRs for each timeframe.

When deciding on the specification of transmission rights auctions, TSOs should make sure that the auctions are organised sufficiently in advance of the period covered by the transmission rights to fit the hedging needs of market participants.

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.