

## **EFET observations on the ACER Position paper on the firmness of long term transmission rights**



**3 December 2013**

In this short paper we share EFET views with respect to the ACER position paper on the firmness of long term transmission rights circulated on 8 November 2013. We welcome the work of ACER on firmness and the willingness of the Agency to push TSOs and DC cable operators to ensure a higher degree of firmness in the forward timeframe than currently prevails in most parts of Europe. However, we find that the overall level of ACER ambition in this respect emerging from the paper is insufficient, given a lack of evidence that TSOs face real financial jeopardy from improving firmness. We offer therefore a number of comments on the observations, hypotheses and recommendations set out in the ACER position paper. We also remind ACER of the EFET comments on the Forward Capacity Allocation network code contained in our letter of 6 November 2013<sup>1</sup>.

### **1. The importance of forward transmission rights firmness for the wholesale and retail markets alike**

As the ACER rightly states, “*firmness of forward transmission rights addresses the problem of compensation to holders of transmission rights (i.e. market participants) in case such transmission rights are curtailed by Transmission System Operators and they cannot be used by market participants for their purpose, which is hedging long term price risks for the benefit of increased cross-border competition in the wholesale electricity market*” (p. 1).

We stress the importance of forward transmission rights for retail markets as well. Forward transmission rights also help retail competition, either directly (by lowering risk on cross-border retail) or indirectly through better liquidity of the wholesale market. The firmness of forward transmission rights is therefore a key element to keep power prices affordable for the end consumer.

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<sup>1</sup> EFET comments to ACER on the draft FCA NC submitted by ENTSO-E on 1 October 2013, available at: [http://www.efet.org/Cms\\_Data/Contents/EFET/Folders/Documents/EnergyMarkets/ElectPosPapers/~contents/4WXJLYWHREXEQ/EFET-comments-to-ACER\\_FCA-NC\\_06112013.pdf](http://www.efet.org/Cms_Data/Contents/EFET/Folders/Documents/EnergyMarkets/ElectPosPapers/~contents/4WXJLYWHREXEQ/EFET-comments-to-ACER_FCA-NC_06112013.pdf)

## **2. The necessity of forward transmission rights as hedging instruments at all bidding zone borders and their impact on system security**

In the introduction of the Paper (p. 1), the Agency mentions the variety of forward hedging options available to market participants in Europe. It also stresses that especially in markets with insufficient liquidity and competition, *“the transmission rights issued by Transmission System Operators play an important role”*. EFET believes that this statement is not only true for markets with limited competition and liquidity, but is valid for all bidding zone borders throughout Europe. Forward transmission rights are the best way for market participants to hedge basis risk and for TSOs to contribute more certainty to underpin cross-border forward transactions.

TSOs and HVDC cable owners bear special responsibilities as providers of transmission services. EU legislation recognises them as owners of essential facilities. In this capacity they must, under proper regulatory supervision, grant individual market participants the transmission access products which they legitimately request, including in forward timeframes. In this context, market participants do not expect to be greeted with a refusal of third party access to network infrastructures in the forward timeframe.

In addition, the discussion in the final part of introduction (p. 3) seems to imply that issuing forward transmission rights affects secure network operation. We would like to stress that this is not the case at all. Indeed the possibility for TSOs to take remedial actions (redispatch and countertrading) or to curtail (with appropriate compensation to market participants) shows that TSOs have many instruments at hand to ensure system security.

## **3. The reality of firmness costs**

In the context of cross zonal capacity allocation, the Agency rightly states that *“firmness costs may arise from the forecasting error between the (forecasted) level of long term capacity and the true (lower) level of capacity that can be accommodated by the transmission system in real time”*. Therefore, and contrary to the statement of paragraph 1.1 (p. 3), firmness costs constitute of the costs of financial firmness **or** the costs of physical firmness: TSOs either need to take remedial actions such are redispatching and countertrading (our preferred option) **or** compensate and reimburse market participants for curtailment of cross zonal capacity, not both.

We insist on the fact that curtailment is only one of the methods available to reduce the capacity in case it was oversold and manage TSOs’ financial risks arising from the compensation to market participants. Under a regulated and market-based buyback regime for instance, TSOs will always, by definition, be paying the market valuation of the capacity. This can then sensibly be assessed as an alternative to other firmness tools such as re-dispatch.

Additionally, if curtailment is the one method chosen at specific occasions, compensation costs can be covered from the proceeds of the auctioned forward transmission rights, as the value of the latter will be higher the firmer they are. As shown in the quantitative analysis section of the Paper (2.2, p. 12 to 14), firmness costs are proved insignificant compared to congestion revenues, except at very specific bidding zones borders. Specific caps, such as a rule establishing that payments for curtailment should not exceed annual auction revenues, could be put in place at such borders to ensure the financial viability of this essential TSO activity but making sure that they do not de-incentivise TSOs or DC cable operators to improve the reliability of their infrastructure.

#### **4. Firmness regimes**

EFET recalls certain basic principles concerning the firmness of forward transmission rights.

- The Framework Guidelines on Capacity Allocation and Congestion Management specify that TSOs may only curtail previously allocated transmission rights in cases of an emergency situation or force majeure [paragraph 3.3]. So does Regulation 2009/72 [Article 16]. Indeed curtailment may only be used where there is an emergency situation and other methods have been exhausted. This principle needs to be observed at all bidding zone borders, contrary to what the draft Forward Capacity Allocation (FCA) network code currently states, where an “entitlement” to curtail (unbounded) is granted to TSOs. A clear definition of the various types of situation encountered by TSOs (normal operation, emergency situation, Force Majeure) and a differentiation of what type of measure is allowed in which situation is needed for market participants to identify the type of firmness risk they are taking when purchasing a transmission right.
- In the event of curtailment, and in normal circumstances, the Framework Guidelines envisage compensation at market spread without any caps. And in order to implement a cap, TSOs require regulatory approval on a case-by-case basis [paragraph 6.4].
- The Framework Guidelines give preference to physical firmness after nomination and does not otherwise include a concept for different treatment before or after some arbitrarily defined deadline such as the “long term firmness deadline” developed by ENTSO-E in the proposed network code.
- The Framework Guidelines do not make any particular provisions for DC interconnectors other than the provisions on Force Majeure.

Therefore, here are our observations on the various options presented in the ACER paper:

- **Option A:** Initial price paid compensation is not a firmness regime. It does not endow market participants with an actual hedging tool, and in our view does not conform to a description as “market based”.
- **Option B1:** Capped market spread compensation (yearly cap), while not our preferred solution, may be an appropriate compromise to ensure that overall compensation does not exceed the revenues derived from the auction of forward transmission rights. In that sense, a yearly cap of total compensation corresponding to the total congestion income in all timeframes on a particular bidding zone border calculated ex-post (option B1) could be acceptable in specific cases when ex-post multi-year analysis has proven that the issuance of fully firm transmission rights are too costly compared to the revenue generated by their commercialisation. As mentioned in the Framework Guidelines, caps on compensation may be introduced before nomination deadline to cope with specific risks (e.g. DC cables) and shall be subject to NRAs’ approval. Hence, NRAs should only approve such caps when:
  - Specific risks have been identified
  - An ex-post multi-year analysis has been performed on the impact of these risks on the balance between congestion revenues and firmness costs

From the examples presented in the Agency’s paper, we have not identified any other potential case of such a need for a specific yearly compensation cap than DC cables with reliability problems.

- **Option B2:** In this sub-option ACER foresees capping the size of the market spread applicable over any period to compensation due for any curtailment. The aim seems to be to cap compensation in hours subject to extreme price spreads. **Such caps are in no case acceptable, as there is no demonstrable link between such a solution and the overall objective of ensuring financial balance (in the worst case) for TSOs.** Besides, as pointed out in 2.1.d (p. 9), overall firmness costs in the case of this option could still in theory exceed overall congestion income, which would presumably be an unsatisfactory outcome for TSOs.
- **Option C:** Full market spread compensation is the desired solution. It allows market participants to hedge price risks between bidding zones and the volume risks of their customer portfolio. They could otherwise not have an ability to manage such a risk and would only occasionally be able to offer market spread hedges off the back of other transactions. Appropriate and differentiated regimes for Force Majeure situations should be put in place, including the compensation of initial price paid.

## 5. The firmness regime of DC cables

The data presented in 2.2 (p. 12) shows higher durations of unavailability of interconnectors and higher amounts of curtailed capacity for DC cables. While we agree that unplanned outage on DC cables may result in the unavailability of the whole physical capacity of the interconnection in case of a single interconnector and that reparations take more time in the specific case of undersea cables, we think that using these elements as an argument for a looser overall firmness regime is specious. Moreover, we believe it is the duty of ACER to reflect whether the current firmness regime on DC interconnectors is not de-incentivising the good availability of DC interconnectors, and whether guaranteeing stricter firmness would not improve the reliability of such interconnectors.

## 6. Concrete suggestions for the FCA network code

As rightly stated in the Paper (p. 15), the Framework Guidelines requirements on firmness are supported by Article 16.6 of Regulation EC No 714/2009, which says that any revenues resulting from the allocation of interconnection shall be notably used for “guaranteeing the actual availability of the allocated capacity”. The network code can in no case be less demanding than the Regulation itself. As noted by ACER, EFET, alongside other market participants’ representatives, supports the firmness regime defined in the Framework Guidelines.

We welcome the Agency’s statement that Option C (firmness with full market spread compensation) *“should be provided in the Network Code on Forward Capacity Allocation (FCA) as the default compensation mechanism for transmission rights that have been curtailed”* (p. 16).

However, EFET is quite worried by the ACER statement that *“given the uncertainty of full implications of implementing Option C on the cash flows of TSO and on the impact on end-user tariffs, ACER advocates that relevant National Regulatory Authorities, which are competent in setting the tariffs and recovering the costs of regulated TSOs, should be able to introduce caps on the firmness costs. For this reason, the preferred policy Option C may be replaced with Option B to limit the risks and firmness costs borne by TSOs”*.

- The data presented earlier in the paper shows there is in actual fact a high degree of certainty concerning the implications of implementing full firmness.
- Any deviation from this principle should be granted on an exceptional basis, following an ex-post, multi-year comparison of firmness costs and congestion income. Only in the case of a structural imbalance between firmness costs and congestion income shall such an exception be considered and possibly approved.
- At least the two NRAs on each side of the concerned border shall be involved in the decision to introduce a cap on the market spread compensation, and in no case shall

such a decision be taken unilaterally by one NRA (unless the two concerned bidding zones are regulated by one single NRA).

The described methodology for NRAs to approve a yearly cap on market spread (Option B1) should be detailed in an article or an annex of the FCA network code, with the following amendments:

1. *The total congestion income (auctions revenues across all timeframes, including daily congestion income) is first reduced by **the amount of money used to guarantee the payout to holders of transmission rights which were not curtailed.***  
[EFET comment: This is a short way of describing a regulatory question, including not just spread pay-outs but also own methods and costs of ensuring firmness. ACER should strive to establish criteria to standardise such a calculation.]
2. *The remaining congestion income from 1) shall be used to guarantee firmness of transmission rights after long term firmness (nomination) deadline. No caps can be imposed for compensation in this timeframe.*
3. *The remaining congestion income from 2) **may be used (conditional to specific cases and subject to approval of relevant NRAs) to apply a cap on compensation before the long term firmness (nomination) deadline.** This implies that only a cap based on the (remaining) total congestion income may be applied.*  
[EFET comment: This permission is far too lax and open; the cap could be designed to permit an NRA to guarantee to a TSO retention of a percentage of congestion revenue after accounting for spread pay-outs and costs of remedial actions.]

Therefore, EFET proposes the following reformulation of the paragraphs quoted on p. 19 and 20 of the paper:

## FIRMNESS (C + B1)

### Article 73

#### GENERAL FIRMNESS PROVISIONS

1. Prior to the Day Ahead Firmness Deadline, all System Operators shall ~~be entitled to~~ **may, in the event of an emergency situation or Force Majeure and after considering alternatives,** curtail allocated Cross Zonal Capacities pursuant to article... . In such cases, System Operators on the Bidding Zone Border where allocated Cross Zonal Capacities have been curtailed shall compensate the Long Term Transmission Right holder whose underlying Cross Zonal Capacities have been curtailed.
2. The compensation for curtailments of Long Term Transmission Rights shall be equal to Market Spread. **In case of Force Majeure, the compensation for curtailments of Long Term Transmission Rights shall be equal to Initial Price paid.**

## **Article 74**

### **THE LONG TERM FIRMNESS DEADLINE**

1. ~~In specific cases,~~ **In the specific cases mentioned in article... and in line with the methodology described in annex/article...**, all System Operators on the same Bidding Zone Borders shall be entitled to implement a Long Term Firmness Deadline which separates the period before the Day Ahead Firmness Deadline into two sub-periods, the time before and the time after the Long Term Firmness Deadline.
2. The determination and the establishment of a Long Term Firmness Deadline shall be based on characteristics of the type of Long Term Transmission Rights and respect the objectives of this Network Code.
3. If a Long Term Firmness deadline pursuant to Paragraph 1 is introduced, all System Operators on the concerned Bidding Zone Borders shall be entitled to develop a proposal to include caps in the compensation payments for curtailments before the Long Term Firmness deadline. In such a case, compensation principles for curtailments before the Long Term Firmness Deadline shall be capped Market Spread pursuant to Paragraph 4.
4. Where System Operators apply a capped Market Spread compensation principle, a cap based on congestion income shall be used. The cap based on congestion income shall limit the compensation payments for curtailments before the Long Term Firmness Deadline to the total amount of congestion income collected by System Operators on the concerned Bidding Zone Border from Capacity Allocation in all timeframes over a specific period of time pursuant to Article 75, after having deduced the payment of Transmission Rights payout and compensation payments for curtailments after the Long Term Firmness Deadline. This period, proposed by the System Operators, shall be either the calendar year or calendar month.

## **Article 75**

### **COMPENSATION RULES**

1. All System Operators of a Capacity Calculation Region shall incorporate in the Allocation Rules according to Article 70 of this Network Code a set of Compensation Rules for the curtailments of allocated Cross Zonal Capacities.
2. The Compensation Rules shall include, at least:
  - a) the applied compensation principle(s) pursuant to Articles 73 and 74;
  - b) where applicable, according to Article 74(1) the determination of Long Term Firmness Deadline; and
  - c) where applicable, the applied cap based on congestion income according to Articles 74(3) and (4).