EFET response to

ERGEG's benchmarking report on medium and long-term electricity transmission capacity allocation rules (E09-ERI-23-03)

We welcome the serious benchmarking work that has been carried out for this study and appreciate ERGEG's consultation which allows an interesting transverse discussion on the improvements that are still needed in order to facilitate cross border trading. EFET also shares the findings and conclusions of this study and is pleased to address its comments and highlights on specific general or regional topics.

Our comments aim to promote an efficient harmonised internal market for electricity and to contribute to identify:

- The best practises for an harmonised implementation of the target model,
- The step by step approach which is necessary to build a reliable market oriented allocation process and to facilitate and allow the maturation of markets,

1. Do you think that an important degree of convergence has been reached in terms of conditions for participation in the auctions, the characteristics of allocated products and the functioning of secondary markets?

Introduction

Yes, one of the main achievements is the definition of a common target model through PCG work, which will allow a progressive convergence of regional markets.

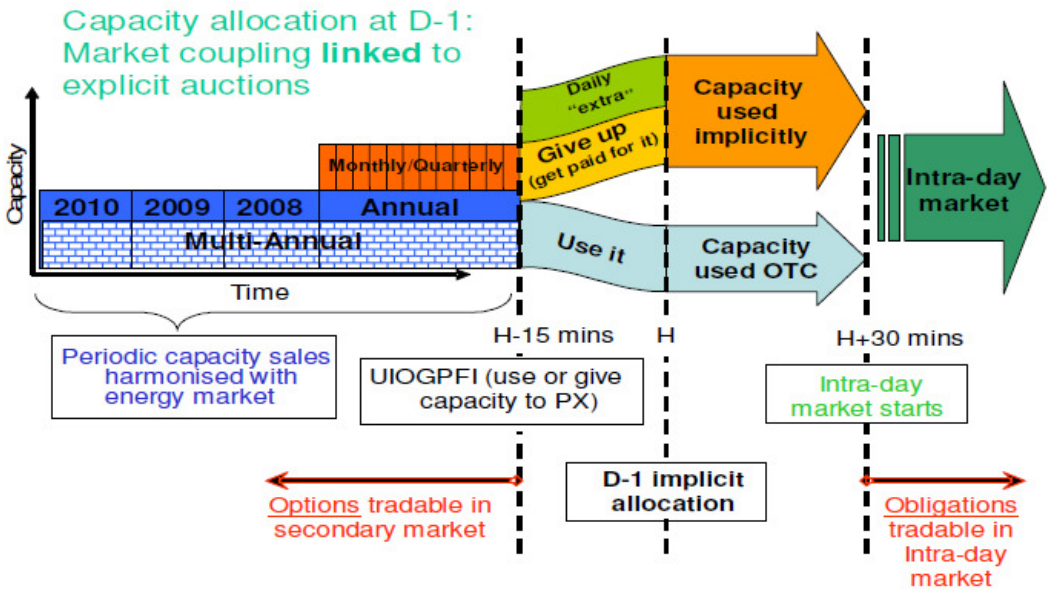
However, when it comes to the auction rules in force and to the operational procedures we experience true convergence only when several borders are administered by one common auction office and only one set of auction rules is applicable. Today some regional auction offices are operational such as CASC-CWE and CAO CEE (which does not include all the borders of this region). CAO CEE is so far a little more than a common registration and bidding platform; the auctions it run are not truly harmonised. Even in the case of CASC-CWE, auction rules still have different provisions for specific borders when it comes to firmness, compensation and nomination gate closures.

When estimating the degree of convergence from an operative perspective, except for CASC-CWE we unfortunately cannot confirm that any important degree of convergence has been reached: trading companies are forced to establish for each cross-border auction they take part in individual routines to reflect all diverging requirements (i.e. collaterals, invoicing, auction and nomination gate closures, scheduling requirements, IT platforms).

Major concerns: firmness and secondary market

On top of the operational inconsistencies which we deal with below, these are the two most important areas for improvement in nearly all auction rules. They must still be addressed by regulators.

We remind regulators of the scheme EFET has recommended since 2007 for linking the forward allocation of transmission capacity to the day ahead market coupling process:



Regarding firm allocation of capacity, all compensation for curtailment in the absence of force majeure should be made to a market-based standard. If firm capacity is curtailed for any other reason, including for a system emergency or security event, the TSO must reimburse the affected party (or parties) the market value of the transmission service for the entire duration of curtailment. Mechanisms used are quite diverse and generally not market-based. A good practice to highlight here (but unfortunately isolated) is certainly the day-ahead market spread compensation implemented on the French-Spanish border (where the caps established have been useless so far). (Please see further our answer to the question 2 below).

A secondary market allowing the sale and purchase of capacity rights at any moment in time, functioning in a complementary fashion to the regular forward (yearly/monthly) primary allocations is the missing link, which wholesale market players need to optimise their portfolio in capacity rights, according to their commodity portfolio on both sides of a particular border. And to aid that optimization further, they need also the possibility to sell or buy in such a secondary market whatever quantity and duration of rights (as "strips") will fit their portfolio need from time to time.

Other operational and harmonising improvements

As pointed out by ERGEG's benchmarking study a lot remains to be done in terms of evolution of the Rules, operational simplifications, operational and structural coordination between TSOs (for example through auction platforms), definition and firmness of the allocated products, maximisation of cross border potential.

Various regional experiences suggest that inter-regional project guidance is also necessary as well as a step by step approach in order to build on reliable operational process. For example, implementing a flow based allocation process will require as a preliminary

condition, a very tight TSO coordination and common TSO grid model as well as various market simulations before it can be guaranteed that this allocation methodology is mature to be implemented and can be proposed to the market. Its implementation requires additional steps in order to ensure that existing cross border activities can adapt to this evolution and that market players have all the information for this change.

EFET will continue to actively contribute in identifying the necessary adaptations and evolutions both at regional and inter-regional levels in order to facilitate the harmonisation process. Some of these include:

- Credit scheme: we have repeatedly encouraged CASC to develop a more efficient credit risk management scheme. The current one (covering 100% of our bidding) is a financial burden. Considering that the geographical scope of CASC might be broadened to the CSE region, this problem will become even more acute, in particular for smaller traders, with negative effects on investments. By contrast, in some regions more flexible and efficient credit schemes are used (bank guarantee, credit limit, coverage 1/12 of annual capacity obtained, company rating). This being said, multiple requirements unfortunately continue to coexist in the EU
- Non- harmonised additional requirements and national laws that hamper participation in auctions: any additional regulatory requirement, and notably if it limits participation, should have a clear impact analysis on how it affects competition and efficient allocation of capacity rights. An example can be found on IFE, where the participation of four market players in auctions from France to Spain is forbidden ex-ante without an impact analysis on the causes and the consequences of such measure
- We feel that some regional initiatives focus only on the ultimate goal instead of having a step by step approach. For example the CEE region is working since 2005 on the introduction of flow-based allocations. As CEE regulators do only focus on the flow-based the definitely realistic chance was repeatedly missed since end 2006 to harmonise the 5 existing LT auction procedures to one under one common set of auction rules operated by one platform and auction office
- Merchant interconnections should not benefit from any special treatment. IFA and BritNed rules are e.g. characterized by the use of very particular concepts and terminology (e.g.: ICE), a multiplicity of charges which calculation remains opaque, by the obligation for operators to cover the grid losses, and by cable access specificities hindering the development of trading with the continent

We give more details on some specific rule changes in our answer to question 4.

2. Do you think that a special attention should be paid by ERGEG on lack of harmonisation of auction rules, lack of firmness of both allocated and nominated capacities and long term financial capacity products not allocated by TSOs?

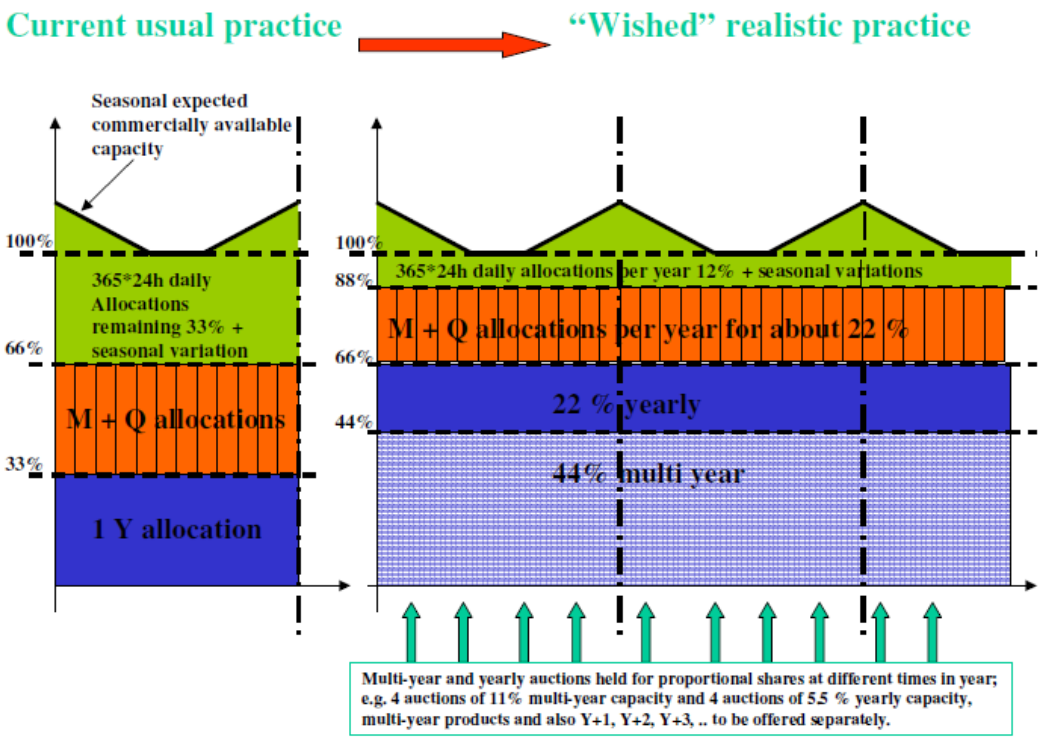
Yes, EFET, as indicated near the start of our answer to question 1, considers these issues as crucial and thinks that ERGEG has properly identified some of the major issues that have to be addressed. It is essential that ERGEG continues its transverse harmonisation stimulation in order to maintain a positive momentum in this field.

EFET insists that TSOs must guarantee firmness of both allocated and nominated capacities through their network management function. They benefit from the congestion revenues, whereas market participants are not in a position to manage the risk of non-availability of capacity. Significant efforts are still needed in that field so that maximum physical and financial firmness is granted.

TSOs should be offering the maximum practicably attainable amount of cross border capacity, separately estimated for each trading day and hour of the year on a fully firm basis. This capacity should then be tradable in secondary markets for cross border capacities. TSOs are natural sellers of transmission capacity rights and the quantitative analysis by

EFET suggests that offering firm capacity does not significantly increase TSO businesses risks, as has to date been commonly believed. TSOs only bear the residual risk of congestion being worse (or less severe) than what the market had expected.
There are wider benefits in TSOs taking on the responsibility of offering fully firm transmission capacity rights, including ensuring that TSOs face appropriate regulatory incentives, and that the present imbalance between risk and reward for TSOs should be reconsidered and that perverse incentives for TSOs to limit capacity should be abolished. To this end, EFET suggests a broad framework for additional regulatory incentives that might assist in achieving the goals of capacity maximisation, firmness and more competition in the European power markets.

As we stressed in various occasions, TSOs should auction maximum of available capacity over appropriate timeframes, as indicated in the illustrative graph below:



3. What share of the available transmission capacity should be allocated on long-term basis and what should be reserved for short-term allocations? Please, give your justification for the proposed shares.

The PCG model recognizes the importance of long-term hedging and therefore the need to propose longer-term products. This is a position already advocated many times by EFET. Closely related to this requirement is the maximization of available capacities over timeframes relevant for energy trading.

Example of repartition (until markets are liquid) - PCG Model:

- 10% of capacity has been sold for Y+3

- 20% of capacity has been sold for Y+2
- 40% of capacity has been sold for Y+1

With 100% of the capacity available offered at the auction.

On this topic we refer also to the EFET position paper Key principles in the treatment of electricity transmission capacity rights and their linkage to day ahead allocation mechanisms" (June 2007)[1].

As clearly explained in this paper (§2 of the Executive Summary), TSOs should auction the maximum of the available capacity at each timeframe, from yearly volumes to intraday hourly volumes.

4. What concrete improvement in long-term auction rules would you propose?

Various improvements are still needed depending on the region. The following comments illustrate the wide range of topics that still need to be addressed.

Rules improvements

Harmonisation and reinforcement of the firmness of capacities before and after nomination

We observe that limitations to firmness are the rule rather than the exception (market spread compensation is only offered on France-Spain interconnection and hopefully very soon on France-Belgium interconnection). Important steps are still needed on all other interconnections.

As we stressed at point 2, the TSOs should be offering the maximum available amount of cross border capacity.

In our opinion, "fully firm" for this purpose entails the provision of compensation at the full cross border market spread if a TSO has allocated capacity and subsequently curtails these rights for any reason (other than narrowly defined "acts of God").

We would also like to emphasise the importance of significantly improving the degree of firmness on the nominated capacity on IFA interconnection. This interconnection, with its frequent curtailments, could at least benefit from financial firmness since curtailments impose market players to rebalance their positions on both sides after unavailability is published. Full market spread compensation should apply in this case and not only 100% as in today's Rules. Even more, compensation at imbalance prices should be granted on each side should when it is not feasible to rebalance buy/sell energy as desired.

Timing

Very concrete improvements are common principles for consulting auction rules and a common time table. It lies in the nature of the yearly auctions that usually within two or three weeks changed rules and requirements are published and participants need to fulfil all kinds of individual requirements to register. For a company active all over Europe this means that during a very short period over 20 different auction rules need to checked and individual registration requirements to be fulfilled.

- If auction rules are consulted or changed, a version that highlights all the track changes should be always published.

[1] Available on http://www.efet.org/GetFile.aspx?File=2500

- For the yearly allocation final auction rules should be available two months prior to the auction date. With publication of the auction rules the crucial changes as well as the participation requirements should be clearly highlighted.
- The yearly capacity auction should take place end November Y-1 at the latest.

Network security and emergency

The Regulation requires a clear definition of "network security" and "emergency" situations, but unfortunately hardly any rules make this definition clear and adequate.

Nevertheless, there are few exceptions: France-Spain interconnection, and the rules applicable to the Eastern borders of Germany and Hungary.

Products

In terms of product offering, our priority is to find sufficient amount of capacity for each type of product proposed. As a consequence, we recommend offering a product range which is common in most explicit auctions, limited to daily, monthly and calendar yearly products, thus unless specific energy products are traded in a country for some structural energy market reasons (like for the UK market) no seasonal, quarterly, weekly or other annual (with particular starting date, discontinuous products…) or peculiar products (eg: monthly baseload only in one direction) should be allocated. With the common standard reference of daily, monthly and yearly products, traders could also build the position they need. No capacity reservation should be made for intraday.

Removal of trade barriers such as Triads on UK interconnections: this mechanism only prevents cross border trades without contributing to network charges (no export during Triad risky periods).

Secondary markets: Using a widespread on-screen platform tool would facilitate genuine secondary markets and makes their access very easy (in just one click) through traders screens.

Consistent intraday systems as well as uniform nomination schedules and trading windows for the whole European region are essential for well functioning secondary markets. The ultimate goal should be one single scheduling system.

Operational improvements

Overall goal should be to set up one single auction platform for the EU/EEA region. This may be achieved by the reduction of the number of auction platforms through a progressive concentration on the main regional platforms, such as CASC (also with integration of Swiss and Italian borders allocations) and CAO.

Other necessary improvements include:

- Automated process, simplification of operational and process reduction of redundancy, easy to use functionalities
- Operational firmness (fast confirmation message and associated guarantee on the transaction).
- Manifest errors controls (such as volume check / double confirmation for unusual values, etc), should be implemented in order to prevent auction cancellations and to increase global reliability
- Last minute cancellation of planned capacity auctions should be accompanied by an explanatory statement.

- Publication of offered capacities: three weeks in advance for yearly auctions and one week for monthly auctions. All TSOs should publish a provisional monthly schedule for the following year no later than 2 weeks before the first monthly auction takes place. This measure would avoid the uncertainty about the dates when specifications of a monthly auction are published later than expected

- Secondary markets: Using a widespread tool like GlobalVision would enable genuine secondary markets and makes their access very easy (in just one click) through traders screens

Coordination improvements

- Coordination between regional projects and market oriented priority in order to implement high quality and reliable cross border services and to maximize the added value for the market (social welfare)
- Regional coordinated capacity calculation improvements in order to maximize the volume and firmness of allocated capacities through common grid model and coordinated network management procedures
- Timing and fall back coordination (see reliability improvements)

Reliability improvements

- Inter regional time schedule coordination
- Definition of fall back process and coordination of back up procedures such as Request for Quotes in order to prevent cascading defaults

Transparency improvements

- Harmonised publication of capacity allocation results
- Centralised publication of capacity allocation results
- Historical data of the auction (in excel and xml format), structured to allow quantitative analysis
- Harmonised format (i.e. in rows date/hour, in column capacity, price, etc.)
- Access to auction results, even if the participant didn't gain any capacity or didn't participate to the auction
- Historical available, obtained and nominated capacities (TSOs should make a link in their website towards the auction platform/website)
- Access to individual corporate data on the auction website/platform (detailed invoices, cash movements on business bank accounts)
- Ex ante publication of planned outages of cross border transmission lines as well as real time publication of unexpected outages of cross border transmission lines (see good practice Nordpool)

Implementation improvements

- Regular reporting to the market of cross border projects and consultation of market players concerning functionalities, priorities, timing.
- Ensuring that sufficient time is guaranteed for market players to adapt their internal process when various evolutions are implemented. Identification of potential cross projects interferences.

- Reporting on the quality of the service: quality of the results, number of fall back activations, cost of the service.

5. What are the main difficulties, concerning auction rules, for trading electricity on a long term basis from one country to another crossing several interconnections?

Operational constraints may constitute implicit barriers for multiple cross border trading, such as time schedules, multiplicity of IT systems in use, lack of operational firmness and any other uncertainty on multiple cross border possibilities.

6. How do you see the development of auction platforms and what would you consider the most efficient solution for the internal electricity market (a more centralised approach or the current decentralised one) taking into account the developments on the solutions for day-ahead and intraday timeframes?

EFET favours the solution of a common European model as soon as possible. However, such a model should be implemented only once enough maturity is reached and when a high quality level of service guaranteed (including an efficient regional fall-back mechanism). Then, an extension of the service area or a common market interface between various service providers or an integration of service providers is suitable.

The most important criteria during these phases should always remain the reliability, quality and cost of the service and evolutions should only bring improvements.

7. Any other comments.