

Purpose and nature of CCC contracts



EFET Discussion Paper, 20 April 2015

The scope of this EFET discussion paper is to provide support and guidance regarding the qualification of CCC contracts in Italy in light of EMIR and MiFID regulations. We wish to create the framework for a constructive discussion on these questions with both energy and financial regulators AEEGSI and CONSOB and the TSO Terna.

CCC are contracts whose purpose is to hedge the risk of price volatility of transmission capacity rights in Italy (CCT) and in particular the risk of congestion rents volatility. CCC are agreed upon between the TSO Terna and a market participant, linked to physical capacity transmission rights and settled in a contract for the price difference between PUN (the national average price paid by consumers) and the zonal price (price paid by sellers/producers for the relevant injection zone).

What are CCC contracts?

CCC contracts are Transmission Rights used to financially hedge congestion cost volatility in the zonal Italian market.

The Italian market splits into price zones when the network is constrained. Producers/sellers are paid the zonal price while consumers/buyers pay the national price which is the average of the zonal price (the PUN). The price of inter-zonal network capacity (referred to as CCT) is implicit in the day ahead market price.

CCC contracts allow market participants to hedge volatility in the CCT, i.e. the price difference between the PUN and the zonal price. CCC consist of 1 MW contracts for the price difference between the PUN and the zonal price and the volume is linked to the amount of available physical capacity on the network.

Allocation

CCC contracts are allocated by Terna, through annual and monthly auctions, with baseload and peakload profiles.

The amount of contracts allocated is the result of an auction algorithm run by Terna, which ensures that capacity constraints between zones are satisfied.

Market participants must have physical production or import capacity into Italy in order to participate in the CCC auctions.

The CCC rights are of a hybrid nature: CCCs are specific bespoke instruments created by the TSO to the sole purpose of managing physical transmission rights in Italy while at the same time they are look-alike financial instruments under MiFID.

This duality raises uncertainties with regards to their classification under MiFID and EMIR in particular.

EFET strongly believes that CCC contracts should be out of the scope of financial regulation and neither reporting nor any other EMIR obligations should be applied to these. CCC contracts are transmission rights issued by the TSO and linked to the physical capacity constraints of the network and should fall under the scope of REMIT rather than under any financial regulation¹. In fact, when determining² the nature of these contracts in respect with MiFID and EMIR regulation, due consideration should be given to the fact that these have some peculiar features which differentiate them from pure financial products that can be traded on energy markets, like for example Contracts for Differences (CfDs) or futures:

- CCC contracts are not subject to continuous trading, but are assigned by means of a transparent and non-discriminatory auctions based on system marginal prices, following the resolution of Italian NRA (AEEGSI) and based on rules established by the Italian TSO Terna and monitored by AEEGSI itself;
- CCC can't be issued and sold by financial entities or market participants, nor do they have any reference price on the markets; Terna is the only entity entitled to issue CCC by means of monthly and yearly auctions: this makes it impossible to trade CCC on the market on a continuous basis as well as to perform any economic assessment of their mark-to-market value;
- CCC can be purchased only by "injection dispatching operators" (producers and importers of electricity) and there are precise physical limits on the maximum quantity that each operator can obtain. These limits apply to:
 - Terna: the amount of the auctioned CCC can't be higher than the transport capacity of the various transmission lines;
 - the dispatching operator, who can purchase CCC for a maximum quantity determined by Terna according to his production and / or import capacity and depending on the location of its facilities in the Italian Market zones.
- Market participants can purchase an amount of CCC only up to its nominal installed capacity or import capacity. This means Terna issues these rights as a mean to manage internal physical congestion. This income is used for re-dispatching as necessary between

¹ A further argument comes from Booz&Co. (2011) "Physical and Financial Capacity Rights for Cross Border Trade". According to this report - presented to DG Energy - «(...) although the FTR would be similar in operation to a CfD issued by true investment firm, which would clearly be a derivative, the FTR issued by the TSO would be the commodity itself. A TSO-issued FTR, backed by capacity, may also have distinctive detailed terms which would distinguish it from a purely financial CfD with the same headline financial terms issued by a financial intermediary

²ENTSOE has referred to the CCC's as FTRs e.g. in the document 'Transmission Risk hedging Products – an ENTSO-E educational paper', while also concluding that the nature of these FTRs in regards of financial regulation remains unclear (see page 29)

the zones (in the absence of physical transmission capacity to physically flow the power, the TSO lowers the generation output in one zone and increases it in the other). Payments made by Terna to market participants are lower or equal to the congestion incomes.

- Even if there is a secondary market for CCC, however the rights are not traded as such between the market participants, as they are transferred according to the original allocation rules - i.e. contracts can be transferred only among injection dispatching operators and still have to respect the quantitative limits imposed by Terna. In fact the sales of CCC must be accounted in Terna's registry in order to verify that the transfer does not conflict with the CCC allocation rules.

CONCLUSION

CCC are contracts in which the allocation mechanism (system marginal price), the quantity sold, the auction conditions, its limits and the trading possibilities are closely linked to the physical transport and power generation capacity in the Italian electricity market.

Given the particular characteristics of these contracts which (i) are issued only by the TSO following a particular rulebook linked to physical transmission of electricity, (ii) are not subject to discretionary pricing and execution and (iii) are not freely exchangeable or tradable in the markets, CCC should be considered as a bespoke arrangement and therefore outside of the scope of EMIR.

Due to peculiar characteristics of CCC contracts and uncertainty with regards to classification under MiFID, EFET would welcome certain clarifications and the view from the national regulators. EFET offers its availability to cooperate with CONSOB, AEEGSI and Terna by sharing its members' knowledge and experience.