

EFET Position on the Draft Forward Capacity Allocation (FCA) network code re-submitted by ENTSO-E on 2 April 2014



19 May 2014

Since the spring of 2012, EFET has been actively cooperating with ENTSO-E, ACER and the European Commission to help developing a robust network code for Forward Capacity (FCA). This effort includes extensive contributions to formal and informal consultations, and active participation at stakeholder meetings. We also voiced our disappointment to ENTSO-E and ACER about the little progress made since the initial version of the network code back in November 2012. Since then, we suggested detailed comments and improvement proposals to this very important network code.

The version of the draft FCA network code submitted by ENTSO-E to ACER on 1 October 2013 presented a vast number of shortcomings, most notably on the subjects of firmness, the obligation for TSOs to calculate and publish Available Capacity and to issue forward transmission rights, and the concept of revenue adequacy. ACER rightly identified these and other points as fundamental weaknesses of the draft FCA network codes in its paper on the firmness of long-term transmission rights circulated on 8 November 2013 and its Opinion on the draft network code of 18 December 2013. EFET voiced its support for these two documents in its letter to ACER of 3 December 2013¹ and a press release dated 4 March 2014².

The draft network code re-submitted by ENTSO-E on 2 April 2014 and its accompanying Firmness explanatory document of 14 January 2014 are both disappointing as far as the content is concerned, and alarming with regard to the network code adoption process.

Very few of the ACER recommendations have been implemented by ENTSO-E in its re-submitted network code, save for stricter implementation timelines. The firmness regime of forward transmission rights remains very weak as the annulment of issued transmission rights or the

¹ Available at:

http://www.efet.org/Cms_Data/Contents/EFET/Folders/Documents/EnergyMarkets/ElectPosPapers/~contents/JVDJCCJL7JHSN9WY/EFET-reaction-to-ACER_Paper-on-Firmness.pdf

² Available at:

http://www.efet.org/Cms_Data/Contents/EFET/Folders/Documents/PressRoom/PressStatements/2006Today/~contents/XCM2KSCAVVSHFAYU/PR-76-FTRs-electricity.pdf

physical curtailment of transmission capacity is not restricted to objectively verified emergency situations and proven cases of emergency situations or Force Majeure. The draft code also still maintains confusion between emergency situations and Force Majeure and the regime applicable to these two types of events. While the possibility to introduce nominal price caps has been removed from the draft code, caps based on monthly congestion rents from forward capacity allocation are still an option, ignoring the compromise solution of caps based on the annual congestion rents from capacity allocation from all timeframes suggested by ACER. Finally, the criteria for the NRA assessment of whether alternatives to forward transmission rights provide sufficient hedging opportunities at each relevant bidding zone have not been detailed, leaving the door open for biased decisions on the issuance of forward transmission rights in certain regions.

Furthermore, the Firmness Explanatory Document issued by ENTSO-E on 14 January 2014 distorts the reality of forward capacity allocation and of the ACER Paper on firmness of November 2013. It bluntly ignores factual data presented by ACER showing that at most bidding zones borders, firmness costs represent a maximum of 1% of congestion income. It also misrepresents ACER's view as believing that "all the risk should be borne by TSOs" when ACER has proposed constructive compromise solution shielding TSOs from exceptional risks related to prolonged unavailability scenarios.

In summary, we are highly concerned about a number of provisions of the re-submitted draft network code that would permit individual TSOs' behaviour to diverge seriously from the spirit of EU Regulation 714/2009 and the intention of the CACM Framework Guidelines. We are also worried about the behaviour of ENTSO-E, which seems to prioritise TSO interests while the network codes should actually focus on the efficiency of the internal electricity market.

Our objective is to ensure that the FCA network Code actually fulfils its potential to push forward the integration of European wholesale power markets and promote the liquidity of forward markets, rather than marking a step back from the principles already established in the Congestion Management Guidelines annexed to the 2009 Regulation. We remain available to help with these tasks and have drafted some initial comments in the sections below.

1. Firmness regime

The current draft of the network code does not comply with the firmness stipulations of the Framework Guidelines and *does not in fact provide for firm access to the grid beyond the day-ahead timeframe of the market at all.*

- a) The Framework Guidelines specify that TSOs may only curtail previously allocated transmission rights in cases of an emergency situation (ES) or *force majeure (FM)* [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.

By contrast, the draft NC [Article 58] states that TSOs have the "entitlement" to curtail (unbounded) as well as in the event of an ES or for *FM*. Curtailments to allocated forward

transmission rights should not be justified as a mean to cope with network security reasons, as TSOs have a set of measures such as re-dispatching and counter-trading to guarantee the firmness of transmission rights and comply with safety standards. **Article 63** of the draft network code introduces a different regime for curtailment under conditions of emergency situation and force majeure. This is superfluous and misleading since it implies that “emergency situation” and “Force Majeure” are the same thing. Also a different definition of Force Majeure is used in the NC compared to the Framework Guidelines.

- b) 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].

By contrast, the draft NC [**Article 60**] allows for a generalised cap to the overall level of compensation (monthly) based on congestion income from the forward timeframe only. We have already experienced such caps on various borders and the fact that they can be used as another form of protection of TSO’s congestion income. Market participants would rather favour the ACER proposal of specific rules that would take into account the congestion income from other months of the year, based on congestion income from all timeframes and subject to NRAs approval after an 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 issuance. In line with this, **Recital 18** and **Article 60** should be amended, and **Recital 19** should be removed.

- c) 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.

By contrast, the “long term firmness deadline” developed by ENTSO-E in the proposed NC [**Article 59**] will have the effect that transmission rights are, in fact, non-firm before nomination. And for FTRs, the definition of “long term” appears to be a period of up to 19 hours before gate closure. This would mean the exercise of this right can literally be changed by the issuing TSO every day.

- d) The Framework Guidelines do not make any particular provisions for DC interconnectors other than the provisions on Force Majeure.

By contrast, the NC [**Article 61.3**] allows TSOs to develop a particular regime for interconnections consisting of a single line.

Contrary to what is stated in paragraph 1.1 of the ACER paper of firmness, firmness costs constitute the costs of physical firmness **or** the costs of financial firmness: TSOs have many instruments at hand to ensure system security such as re-dispatching and countertrading or financially compensate and reimburse market participants for curtailment of cross zonal capacity. An alternative solution consists in a buy-back regime where TSOs can purchase previously allocated rights in the secondary market. There is scope for buyback to be initiated via

a combination of **Articles 48-49** in the draft network code. This combination would appear to make sense and allow TSOs to purchase previously allocated rights in the secondary market or in a bespoke buyback exercise. Under a market-based buyback regime, 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.

A buyback approach can replace the existing wide ranging curtailment possibilities under the “firmness” provisions in the current FCA draft and the scope for withholding of capacity by the TSO under the current draft balancing code. Such restrictions in the use of an essential facility are not consistent with the TSOs’ duties to provide third party access to networks.

EFET would like to stress that if curtailment is the chosen method, the income from the forward transmission rights sold in excess by TSOs could cover the compensation costs. In other words, more congestion income is available to manage physical congestions with remedial actions.

To summarise:

	NC (ENTSO-E)	FG (ACER)	EFET position
Not an ES or FM situation	Entitled to curtail	No curtailment	No curtailment
Compensation before nomination	Capped market spread [monthly]	n.a.	n.a.
Compensation after nomination	Capped market spread [monthly]	n.a.	n.a.
Emergency situation is defined as...	Vague event	Undefined	An operational security event. As defined in OS code.
In Emergency situations...	May curtail (<i>inter alia</i>)	May curtail	May curtail
Compensation before nomination	Price paid	Capped market spread	Market spread
Compensation/ remedy after nomination	Price paid	Capped market spread	Physical firmness
Force Majeure is defined as...	As in the CACM code	As in the FG (not the same)	As in the FG
In cases of Force Majeure...	May curtail (<i>inter alia</i>)	May curtail	May curtail
Compensation before nomination	Price paid	Price paid	Price paid
Compensation/ remedy after nomination	Price paid	Price paid	Physical firmness

2. Obligation to calculate and publish Available Capacity and for a TSO to issue forward transmission rights

We welcome the requirement that all TSOs must offer forward transmission rights at all borders in every direction unless the competent regulator has expressly approved that the TSO shall not issue such rights. However:

- This should be better reflected in the title of section 1, which should be called “Obligation to issue Forward Transmission Rights”,
- We disagree that a derogation to issue transmission rights would de facto constitute a derogation to calculate and to publish the available capacity on each border (cf. **Article 13**, which mentions that “*All Transmission System Operators of 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 timeframes*”). Cross-zonal capacity is part of the fundamental transparency data that all TSOs should calculate and publish in an effective and timely manner for all bidding zone borders and directions, even in the absence of capacity allocation.

Concerning the obligation to issue transmission rights, it is important to recall that TSOs and HVDC cable owners bear special responsibilities as monopolistic 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 that 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.

As a general principle we consider that all TSOs should issue forward transmission rights on all bidding zone borders, independently of the existence (or not) of other local hedging instruments (such as price spreads or CfDs towards the concerned bidding zones). Indeed, forward transmission rights issued by TSOs provide an open and non-discriminatory access to hedging solutions against congestion costs (and the day-ahead congestion pricing), with no additional transaction costs. On the contrary, two opposite CfDs are needed on each border for market participants to be able to hedge against congestion costs and pricing. The issuance of forward transmission rights is therefore important for competition to develop in all bidding zones and not only in virtual zones. It is also essential for TSOs and/or cable owners to offer to the market all the available volumes of cross-border hedging instruments provided by AC or DC interconnection lines. In addition, the issuance by all TSOs of forward transmission rights is all the more necessary that no evidence was developed during the consultation process that the “non-issuance” of transmission rights would bring any benefit to the internal energy market, nor that the issuance of transmission rights could in any measure be harmful to existing, alternative arrangements for forward hedging.

Any decision of regulators regarding restrictions to the obligation to issue cross border hedging instruments must, at the very least, be based on a very serious and up-to-date border per border analysis, based on a minimum number of rigorous criteria. **Article 35.5** currently provides no requirements for justifications and should therefore refer to a minimum list of criteria to be checked. We also believe that **Article 35.2** should not allow regulators to refer to assessments

“not older than four years”, and that any assessment on the basis of which a regulator would grant an exemption according to Article 35.1 would need to be based on the set of well-defined common criteria to be explicitly listed in the network code.

It is also essential that each concerned regulator performs an initial assessment upon entry into force of the code (based on the new list of criteria) and repeat this analysis on an annual basis, due to the fast evolution of markets.

We refer to our suggestions in the Appendix to our letter to ACER of 6 November 2013³ for a list of such minimum requirements. Recommendations as to how regulators should proceed when the liquidity of the market cannot be proven or when the issuance by TSOs of transmission rights would significantly increase the liquidity of existing hedging instruments can also be found in the letter.

3. Revenue Adequacy

We challenge the admissibility of this concept under applicable EU legislation, whether it is applied in the context of the degree of firmness of rights or with respect to UIOSI. TSOs should not be permitted to discriminate against cross border transactions in any market timeframe by invoking a different regulatory formula or a different firmness standard from those which would apply in the case of grid access granted to internal (national) transactions. The same goes for DC cable operators who should not withhold the payments made by Market Participants in order to protect their revenues, thus giving priority to their rights against the functioning of the internal market.

Therefore regulators must ensure that TSOs adhere through the FCA code to strict standards of firmness as a priority to cost recovery and should avoid isolating some particular element of the transmission network which would be granted special treatment or exemptions to EU regulation.

4. Definitions

The draft text appears to suggest that the Commission will now take responsibility for an overarching “Definitions” network code under Article 6(11) of the Regulation. This would be a welcome development since it is anticipated that the network codes themselves will be binding EU Regulations and there is no room for inconsistency and ambiguity.

In our view the concept of “long term” should be removed from this network code and replaced by references to the forward market or “forward rights” as appropriate. The code is about the issuance and use of transmission rights of a duration between one day and 1-3 years. This is not a period usually recognised as “long term” in market parlance.

As far as specific elements of **Article 2** are concerned, we believe that Market Spread should be defined as “the difference between the **hourly** Day-Ahead prices of the two concerned Bidding

³ Available at:

http://www.efet.org/Cms_Data/Contents/EFET/Folders/Documents/EnergyMarkets/ElectPosPapers/~contents/4WXJLYWHREXELRSQ/EFET-comments-to-ACER_FCA-NC_06112013.pdf

Zones [...]”, as a compensation only based on a weighted day-ahead price average would not be a fair solution (and similarly, **Article 40.3.b**) should be modified so that “when the Cross Zonal Capacity is allocated through explicit auction in the Day Ahead timeframe, the Long Term Transmission Rights remuneration shall be equal to the **hourly** clearing price of the daily auction”); **Article 41.1** should foresee that the Nomination or the possibility to nominate exchange schedules should be **at least** hourly, as the possibility to nominate should match the balancing period, thus allowing to trade across borders with the smallest product granularities.

Allocation constraints, which are not referred to in Article 2, should be removed altogether from this network code [**Article 17** especially], as they are not relevant for the forward timeframe.

5. Elements for consultation

The following elements should be included in **Article 5** on the proposals subject to consultation:

- The review of terms and conditions or methodologies, pursuant to Article 9,
- Market readiness for the Flow-based Capacity Calculation Approach, pursuant to Article 15.4.c),
- The content and structure of the biennial report on capacity calculation pursuant to Article 31, at least for the market part of it,
- Principles and implementation measures concerning for Long Term Transmission Rights remuneration, pursuant to Article 40.

Further, Article 5.2.e) should be amended as follows: “e) the decision making process, the impact studies, the minimum requirements for these assessment studies [if not specified in the code], and the market needs for cross zonal Transmission Rights, pursuant to Article 35”.

6. Regulatory Approvals

Most of the areas enumerated in **Article 8(4)** should be the subjects of agreement at regional or European level. With the possible exception of paragraph 8(4)(g), it seems impossible to us that they should be left to purely national resolution.

7. Incentives

The capacity calculation methodology provides little incentive on TSOs to make available the maximum capacity, as requirement of Regulation 714/2009 [Article 16(3)]. One of the elements that TSOs need to consider is the availability of remedial actions to ensure that firm capacity may be provided. There needs to be more details about the type of measures that TSO will be required\permitted to undertake in order to make forward capacity available.

8. Flow-based capacity calculation and allocation

We believe that Flow-based capacity allocation [**Recital 7** and **Article 15.4.c**] should not be introduced for the Forward Capacity Calculation or Allocation. Forward capacity allocation would fundamentally not be "Flow Based" but rather "Request Based" and experience has shown that this approach doesn't work well with optional rights (which can be nominated in a very different way) and does not bring any benefits to the market but rather introduces uncertainty.

As a general principle we would advise against introducing in binding network codes new ideas which were never tested or even which already faced market opposition in the recent past, and to rather concentrate on describing at least what already works well on an industrial basis and what is supported by the market.

At the very least, Article 15.4.c) provide a **minimum** of six months for market participants to adapt their processes and a market consultation to ensure market readiness.

9. Operational Security Limits

These are not needed and should be dealt in the TRM or FRM only. This would otherwise be a way for TSOs to override the capacity calculation methodology without any regulatory scrutiny. **Article 17** of the draft code should be deleted.

10. Control-area based forward capacity calculation and allocation

Article 73, which organises the split of long-term cross-zonal capacity between control areas within the same bidding zone, should be removed. This article is not in line with the Framework Guidelines, and would open the door to forward capacity allocation **within a bidding zone**, thus undermining the bidding zone review process.