

**Response of the European Federation of Energy Traders (EFET)
to the public consultation of the Directorate-General for Energy on
“The Future Role of Regional Initiatives”**

15th February 2011

In this response the European Federation of Energy Traders (EFET)¹ would like to concentrate on the main initiative in the CEE region – the implementation of Flow-based Allocation (FBA) of cross-border capacities.

The CEE region has been working on the idea of a FBA approach to congestion management for already several years. Numerous studies and analyses have been conducted and many dates for the implementation of FBA in CEE have been postponed, including as it seems the objective for the first quarter of 2011.

EFET supported all studies and analyses performed up to date regarding the flow-based implementation. Nevertheless we believe that it is time for a more pragmatic and realistic approach to avoid the continuous uncertainty and false implementation alarms.

EFET acknowledges the efforts made by CEE Regulators, TSOs and other stakeholders involved in this project. We also fully agree with all decisions made so far to postpone the implementation, as we believe that there are many good reasons for that. We are afraid that the planned implementation of FB explicit allocation in the CEE region will in fact reduce not only the capacity, but also social welfare. On the other hand, in our view the flow-based algorithm for calculation of capacity combined with NTC-based allocation would strike the right balance and encourage trading.

Without entering into the technical details of FBA and NTC, we would like to highlight the main concerns regarding the FBA approach and the associated uncertainty.

1. Based on the conclusions of the study “FBA Efficiency Analyses”, presented by the consulting company Consentec, the allocated capacity decreases by 42% when all cross-border directions are taken into consideration and by 23% when only profitable cross-border directions are taken into consideration. Apart from the presented slides we are not aware of a published study that elaborates on the details and reasons for such a decrease. EFET is of the opinion that this decrease will have a negative impact on cross-border trading, increase the spread, and ultimately reduce social welfare.
2. One of the major flaws of FBA is that it uses economical signals to resolve physical congestion. This can actually lead to greater congestion. There is no netting, which is one of the principles of congestion management, and as a result the optimisation is reduced. EFET is concerned that the FBA method in the explicit mode increases the opportunity for market manipulation.
3. The FBA approach suggests that more capacity will be available at day-ahead auctions and there will be a decrease of available capacity at long-term auctions, particularly yearly auctions. This contradicts the approach of EFET, which requires maximisation of long-term capacity to support long-term contracts and manage the risk of volatile prices. As a result, long-term

¹ The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent and liquid wholesale markets, unhindered by national borders or other undue obstacles. EFET currently represents more than 90 energy trading companies, active in over 27 European countries. For more information: www.efet.org.

liquidity is reduced, hence, the ability of the market to hedge, which can lead to volatile prices in daily auctions.

4. The FBA method creates high degree of uncertainty on the level of capacity that is made available for the daily auctions. With the NTC approach, the available capacity (ATC) is published for each profile before the auction. This is an important input for market participants. In the absence of such an input with FBA, the uncertainty will increase and traders will have less knowledge on the cross-border availability, which will then affect their decision on cross-border pricing and optimisation. This also proves that the flow-based method should not be implemented in conjunction with explicit auctions.
5. We understand that FBA is a more conservative approach with respect to TSOs' network security. If higher risk should be the reason to migrate from the NTC to the FBA approach, it should be highlighted that the NTC approach proved in practice its reliability and we did not see that risk materialise.

Given the above problems, EFET is concerned about the FBA deficiencies and the implementation target for the explicit capacity market. We are also worried about the priority given to FBA over the market coupling model, which we consider strategically much more important and a step forward towards creating a single European electricity market. The Flow-based method could be a workable method for the calculation of capacities, but there is too much uncertainty involved if such an algorithm is also used for the allocation of capacities. The launch of a new immature method would jeopardise directly the idea of the single European electricity market.

Moreover, recent discussions showed that there is no clear vision how to merge regions with different ways of cross-border capacity allocation into the target model. It is very likely that if the CEE region starts to allocate capacities by means of explicit FBA it will not be possible to couple the region with the existing market coupling of the Central Western European (CWE) and North Western European (NWE) regions. As the latter is based on NTC implicit allocation, the FB explicit allocation in the CEE region would have to be stopped and NTC allocation would have to be reintroduced.

At this stage, after the successful takeover of all CEE cross-border capacity auctions by the Central Allocation Office (CAO) (excluding intra-day), we strongly believe that the focus should be put on day-ahead market coupling with an NTC method and a clear roadmap for its implementation in CEE should be created. This is also very important given the positive experience of the CWE region with ATC market coupling.

Obviously, the FBA approach is still not ready to go live. In fact, the Flow-based approach should not be implemented at all with explicit-based allocation, for the abovementioned reasons. The CEE Regional Initiative stakeholders should prioritise the implementation of NTC-based market coupling and continue to work on testing the FBA in an implicit environment. Such an approach will give a clear message to all stakeholders, particularly TSOs and PXs/Market Operators as leading bodies in the market coupling process.

EFET believes that this approach will be considered by the CEE Regulators and the CEE TSOs.

We remain at your disposal for any additional clarifications and consultation.