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Date: 8 November 2005

Dear Sirs,

**Introduction of auctions on the Swiss/German/Austrian border**

We have been informed that explicit and joint auctions are foreseen between Switzerland and Germany and between Switzerland and Austria from the start of 2006.

EFET welcomes efforts to improve capacity allocation methods across borders and the introduction of market-based methods, insofar as these manage genuine cross-border congestion, improve transparency and facilitate increased trading. Moreover, we appreciate the introduction of the schedule-balance group system FPBG, as it is based on European

standards, supposed to facilitate cross border trading and establishes ETrans/Swiss grid as single point of contact.

Nevertheless, we do have a number of concerns regarding the auction and allocation mechanism design. Our main concerns regarding FPBG were already brought up in a separate letter to ETrans and shall not be repeated here.

In general, we believe that auctions must be compatible with the European legislation in order to improve market confidence, market efficiency and trading. Keeping this in mind, our major reservations can be summarized as follows:

### ***Absence of consultation with users***

Until the Bundesnetzagentur recently invited users to comment on the proposed rules, no opportunities appear to have been provided for European market participants and regulators to debate the introduction of an auction allocation mechanism on the Swiss/German/Austrian border. We believe that this process started late and could have been proposed by the Swiss and others in the early stages to reduce the risk of putting in place an allocation mechanism that could hinder efficient market operation.

### ***Transparency***

The method for determining the net transfer capacity between Germany, Switzerland and Austria needs to be transparent and more information is required on how physical constraints have impact on the available contractual capacity. Article 5(2) of the Regulation 1228/2003 on conditions for access to the network for cross-border exchanges in electricity requires that TSOs publish a general scheme for the “calculation of the total transfer capacity and the transmission reliability margin”. Furthermore, there might be a risk that the congestion is internal to Switzerland, Germany or Austria so we would like information about the real bottleneck, schedules and power flows.

### ***The status of congestion management and capacity allocation not clear***

Given the lack of an organised market platform in Switzerland, congestion management measures at borders should be restricted to time frames when and directions on which real congestions actually occur. Otherwise, free trading activities will be hindered and market distortions can be artificially created.

As a matter of fact the border between Austria, Germany and Switzerland had practically never been congested until November 2004. Since then, congestions have occurred only in the direction from Austria/Germany towards Switzerland and only during the winter period.

Therefore, auctions at the Austrian-German-Swiss border must be restricted to timeframes when and directions on which congestions are expected. Applied to the Swiss situation, this means no auctions from Switzerland towards Germany, and no auctions – whether monthly or daily – from Germany towards Switzerland during (summer) periods when congestions can be excluded. Allocation mechanisms of capacity should however be the same in cases when there is congestion and when there is none, but of course prices should be set to zero by default when there is no congestion. However, there may also be situations when the request for monthly/daily capacity exceeds available capacity (and the auction clears above a zero price) whereas the nominated and netted schedule eventually falls well below the available

capacity. In these circumstances, we consider that the congestions can, and should, be managed by the TSO beforehand, as this would be much more efficient.

### ***Increasing cross border capacity***

Increasing cross border capacity is arguably even more important than managing congestions. As you are aware, TSOs have an obligation to maximise the capacity available to market participants. TSOs should also use the revenue received from the auctions to make capacity firm by relieving physical congestions through dispatching in the short term and investments in the long term if the congestion persists.

Given Switzerland's central location in a densely meshed European transmission grid, close, multilateral coordination with the neighbouring TSOs is of paramount importance to optimize the cross border capacities offered to the market. This applies in particular at the borders between Switzerland, France, Germany and Austria, where physical power flows are extremely volatile, both with respect to their size and direction. In such situations, coordinated mechanisms that enable to take into account the actual flows are far more than fragmented bilateral allocations on each border, based on static NTC values and different capacity models.

### ***Lack of firmness of offered capacity***

The Regulation requires that TSOs offer "transmission capacity that is as firm as possible", and that transactions should be curtailed only where "redispatching or counter-trading is not possible". Thus it is imperative that proposed auction rules do not include the potential for curtailment in the case of significant load flow changes or power plant outages. This would be comfortable for the TSO to use cross border capacity as a cost-free alternative to balance unexpected changes to demand and supply and would fail to fulfil the Regulation's requirements in Article 6 (2) requiring compensation of any curtailment except in cases of force majeure.

In case of capacity restrictions, TSOs must face the full cost of curtailing cross border capacity so that they are not biased towards curtailing interconnection capacity instead of redispatching internal plant. In return for market participants paying for capacity through an auction, TSOs must compensate market participants for curtailment at the full market spread.

### ***Secondary capacity market***

It is important that the allocated capacity is utilized economically. Since market participants have no obligation to use the capacity that they hold, it is important that if they do not use the capacity, other participants who value the capacity more should have the opportunity to use it. To ensure that allocated capacity remains fully available it therefore requires:

- An organized secondary market to facilitate the transfer of capacity between market participants; and
  - The identification and release of unused capacity before delivery (through a "Use it or get paid for it" mechanism).
- In order to assure that TSOs are not being paid for capacity twice, the revenues generated in the second allocation should flow back to the previous owner of the capacity rights.

Hence, we strongly recommend to apply Use it or get paid for it instead of UIOLI between nomination of yearly/monthly rights and the D-1-allocation process. Moreover, if UIOLI is applied from D-1 to Intraday, capacity allocated within the intraday market should not be charged additionally, and in particular not with D-1 prices.

A secondary market is an essential requirement of any market-based system for capacity allocation and management and this is recognized in the Auction Guideline 8 in the Annex to Regulation which requires capacity to be “freely tradable under TSO is notified that the capacity bought will be used”.

### ***Other requirements***

The rules must contain mechanisms for market participants to be able to purchase firm long-capacity rights to lock in the transmission cost for longer-term cross-border deliveries thereby to promote cross-border competition. The rules must also address the continuing ability to trade within intraday from Germany to Switzerland.

We suggest, as work gets underway to harmonise the markets more, that a formal and transparent consultation process is initiated to consider how cross border arrangements may be effective.

In order to allow flexible and efficient intraday trading, mechanisms should be set up as follows:

- Continuous intraday trading based on firm nominations\* and continuous netting. In particular, intraday trading must be unrestricted, (i) when there is no congestion, or (ii) in the direction opposite to the congestion.
- Capacity rights that were not nominated in the D-1 procedure must be given to the intraday market.
- Netting of schedules in opposite direction after D-1 nomination, therefore increasing the available capacity offered in the intraday market.

We are more than happy to discuss the issues raised in this letter further if you wish. Please contact Bruno Gaillard, Chair of the EFET Switzerland Task Force. We have also attached two EFET position papers on congestion management to provide you with more complete picture of EFET’s position on how to manage this very important issue.

Bruno Gaillard

Chairman EFET TF Switzerland

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\* The existence of a cross border balancing trade may also require the purchasing and reservation of capacity rights without firm obligations



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