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EFET feed-back on the Long-Term Capacity Calculation Stakeholder workshop of 20 January 2016

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The European Federation of Energy Traders (EFET)[1] welcomes the opportunity to provide feed-back to TSOs at CWE level on the proposed concepts for harmonised capacity allocation breakdown between the different timeframes (so-called “splitting rules”) and coordinated long-term capacity calculation and allocation. EFET highly appreciates that TSOs organised and invited its members for a brainstorming on possible new concepts on these subjects.

However we would like to have more clarity on the governance of the current process. What is exactly the issue with the current mechanism in place? Which problems are the TSOs trying to fix with these new methodologies?

The first discussions we had during the workshop (i.e. on capacity allocation breakdown rules) gave us the feeling that it was more a market design debate. Indeed some of the proposals aired at the workshop seemed at odds with the core principles of the Regulation 714/2009.

Foreword on long-term capacity calculation and allocation:

As mentioned in previous consultations on the subject, forward markets are an integral part of the electricity market, alongside the day-ahead, intraday and balancing timeframes. Forward trading enables market participants to secure deals (energy and transmission capacity) far in advance of real time, and provide long-term price signals to the market.

Forward trading also represents a key element of risk management through (cross-border) hedging, which is essential for sourcing and providing electricity to customers competitively,

[1] The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent, sustainable and liquid wholesale markets, unhindered by national borders or other undue obstacles. We currently represent more than 100 energy trading companies, active in over 28 European countries. For more information, visit our website at www.efet.org.

as it allows market participants to avoid exposure to short term price volatility and imbalance costs: TSOs, as managers of cross-border capacity, have the ability to manage the associated risks and are the *only* parties in the electricity sector that can do so. Hence TSOs are also the only asset owners and/or operators with an in-built capability to offer primary, physical hedges against future congestion rents through the prior creation of firm cross-border transmission capacity rights.

TSOs in this sense are *natural* sellers of firm transmission capacity rights. Allocation of long-term rights to market participants also provides long-term signals to the TSOs regarding potential congestion on certain cross-border points. This provides an indication to the TSOs regarding forward market activities and could potentially help in forecasting additional congestion revenues that TSOs receive as a congestion income.

These signals to the market and the TSOs however only reflect the reality of market participants' needs and inter-zonal congestions if capacity allocation is maximised as much in advance of real time as possible. In this regard, we would like to remind the CWE TSOS that according to Article 16.3 of Regulation (EC) 714/2009:

The maximum capacity of the interconnections and/or the transmission networks affecting cross-border flows shall be made available to market participants*, complying with safety standards of secure network operation."*

Consequently, we do not agree with the statement of CWE TSOs that "capacity offered closer to real time provides a better economic valuation of cross zonal capacity", and consider this assertion not in line with EU legislation. Obviously, uncertainties are reducing closer to real time, however that does not mean that prices get *better*. One cannot consider that the price for a day-ahead product as determined D-1 is *better* than the price for a year head product. These products are traded at very different timeframes. However a good price formation for forward products is as important (or maybe even more important) than for day-ahead products. Therefore, there is no *better* economic valuation of cross-zonal capacity if it is allocated closer to real time. Finally, we note that there is no attention to possibilities for TSOs to ensure the firmness of allocated capacity by means of cross-border redispatch, cross-border countertrading and buying back capacity rights. These options should be fully considered and should allow TSOs to allocate larger volumes in the forward time frames.

Overall, we feel that there are different understandings on some basic concepts of the market and cross-zonal capacity allocation. These should be discussed first, before jumping into discussing harmonisation of long-term capacity calculation and allocation rules.

On harmonisation of the capacity allocation breakdown rules (so-called "splitting rules"):

TSOs are proposing to implement a set of capacity allocation breakdown rules for the entire CWE region. The target is to have the same division over timeframes (one set of percentages) for the different CWE borders. Moreover TSOs propose *"to reserve at most 50% of ex-post capacities for long-term timeframes due to technical and economical reasons"* as stated in the minutes of the meeting. It seems that TSOs are willing to apply to all CWE borders the ratio observed on Dutch borders (i.e. 50%) between allocated capacity at long-term auctions and the realised flows on calculated capacities (taking into account security margins) to determine the capacity to be offered at the auctions.

EFET considers that the proposed harmonised capacity allocation breakdown rule would result in a substantial decrease in capacities at certain borders. For instance, at the Belgian borders, capacity allocated in the forward timeframe amounts to 80% ex-post (figure mentioned by TSOs representatives during the workshop). EFET does not understand the rationale or the details of the proposed 50% rule and therefore would like to receive a more detailed description of the rule. In any case, EFET members are opposed to the idea that available capacities, as calculated by the TSOs and taking into account security margins, would be reserved for the day-ahead timeframe.

Furthermore, in the specific cases when FTR options are allocated at a specific border, EFET sees no operational or technical justification for allocating below 100% of the available capacity. Contrary to PTRs, which can be nominated, FTRs are financial instruments only and do not grant FTR holders the right to nominate flows. Once only FTRs are issued at a border, the allocation of physical transmission capacity will not be performed before the day-ahead timeframe: physical capacity will therefore be allocated and optimised in the same timeframe. As there is no physical element involvement in the allocation of FTRs in the forward timeframe, no system security argument can be raised to justify the reservation of capacity for the day-ahead timeframe. In this configuration, **any reservation of capacity for the day-ahead timeframe is in breach of Regulation (EC) 714/2009**. We urge CWE TSOs to strictly abide by European legislation when suggesting proposed revisions of the capacity allocation breakdown.

In general, EFET is supportive of a harmonisation of the capacity allocation breakdown rules in order to facilitate market integration but this should not result in any step back at any of the CWE borders. Harmonisation should hence follow the highest common denominator. There are different points in this proposal for which EFET will share its views and reiterate some key principles:

- *CWE TSOs suggest to harmonise/align the type of LT rights on all CWE borders (i.e. move towards either PTRs or FTRs on all CWE borders)*

First of all, the CWE TSOs' reasoning that one single type of long-term rights to be allocated at CWE borders would be beneficial for system and market needs. Additional information on the subject would be welcome to understand the reasons that underpin this position of the TSOs.

CWE TSOs should also bear in mind that FTR options are only at an early experimentation stage as they were introduced on Belgian borders only few months ago. EFET is in principle not against FTRs as long as they come with full firmness and no additional exposure for the market, and that capacity allocation is maximised to 100% of available capacity.

We must also acknowledge that the industry has a better knowledge and practice of PTRs with UIOSI, which are widely used and appreciated across markets. Among the specific characteristics of PTRs with UIOSI, it is important to remember that nomination of forward PTRs also releases capacity in the opposite direction through the netting of nominated capacities operated by TSOs before market coupling.

According to EFET it is premature to make a choice between FTRs and PTRs as we lack experience in with FTRs in CWE at the moment.

- *Limit the allocation of capacities for LT timeframes*

EFET believes it is crucial that forward transmission rights are **issued by TSOs** and offered to the market on all borders between bidding zones to ensure sufficient and proper forward trading and hedging opportunities to market participants. The **sale of transmission rights is a fundamental part of the business of TSOs** and a service that their customers – generation, trading and retail supply businesses – need in order to be able to compete properly in all bidding zones of the internal electricity market.

Market participants need these instruments to achieve efficient cross-border competition along the whole electricity value chain and for all timeframes. Where market participants hold transmission rights, they can compete in a neighbouring forward wholesale market while managing their geographical exposure to volumes and price risks. Auctions of these rights have underpinned the development of cross border liquidity in the continental wholesale power market. The availability of these instruments promotes competition in electricity supply across national and control area boundaries at the wholesale level.

EFET would also like to point out that **a Physical Transmission Right (PTR), a Financial Transmission Right (FTR), and a Contract for Differences (CfD) are not equivalent products.** CfDs, which are not issued by TSOs and which do not directly refer to transmission capacity rights between two bidding zones, **cannot be considered as sufficient for cross-border forward trading or hedging**. These instruments, as well as any other derivatives or instruments negotiated by the industry, can only be considered as complementary to TSOs' essential services to provide an open and non-discriminatory access to network infrastructure.

Unlike FTRs issued by TSOs in quantities referring to available transmission capacity between two bidding zones, CfDs refer to the price difference between a bidding zone and a (virtual) system price. This induces a number of major differences between the two types of products:

- The volume of CfD contracts available for trading is never guaranteed and could potentially be restricted or inexistent in some bidding zones (their availability could also vary in time). This exposes market participants to significant volume risks.
- Contracts or rights offered by non-TSOs do not have any regulatory backing or certainty, and the providers/counterparties can easily disappear. As well as creating a counterparty risk for payments, this also create a barrier to entry for any new entrant in a market based on CfDs since managing these counterparty and regulatory risks will increase costs. By contrast, those risks would be minimised to almost zero for rights issued by TSOs (FTRs or PTRs).
- While TSOs are natural holders and issuers of PTRs or FTRs, they have no interests in CfDs which are not calculated based on the available volumes of interconnections capacities but rather on the analysis of market prices.
- CfDs are pure financial instruments and thus are falling under financial regulations (e.g. MIFID) which are much more restrictive for market participants.

We believe that all TSOs should be issuing forward transmission rights between all bidding areas in order to ensure this minimum level of coupling between forward prices in all bidding zones. This is also required because TSOs should not be withholding transmission rights from the market but should rather sell them on a forward basis to the maximum volume available (as mentioned here-above already).

According to EFET is it important that at the moment of the yearly auction, all the available capacity, taking into account security margins, has been calculated by the TSOs. As much of this capacity as possible (with no reservation) should be made available for yearly and monthly auctions to the market at that point. TSOs should update their computation throughout the year and offer the additional released capacity (if any) during the monthly auctions.

- *Use percentages instead of number of MW*

EFET does not believe that the percentage approach (as suggested by TSOs) is appropriate. There should be a clear and robust method to compute capacity. This should be done in a coordinated way and 100 % of that obtained capacity should be allocated to the market. The method developed and used by TSOs should be fully transparent and public to the market.

On long term capacity calculation:

The proposed improved long-term capacity calculation is aimed to result in a flow-based domain by combining:

- A scenario approach, with flow-based calculation based on the most accurate grid predictions for worst case scenarios for CWE region
- A statistical approach based on FB domains using historical data

The solutions presented by the TSOs at the workshop are at a very early stage of development. EFET has requested at the workshop and will need examples, more precise figures and generally more details on the proposal before taking a position on the proposal.

Stakeholder engagement

Last but not least we understood at the workshop that all conceptual frameworks presented by TSOs are **drafts** which were developed by TSOs from CWE region and **which are still under discussions**. EFET believes that it is **essential to keep stakeholders and regulators involved** in the development of such key principles. Therefore EFET suggests organising **an additional stakeholder workshop** to further discuss LTCC concepts including concrete examples and models.

EFET also calls for a **formal consultation** before any implementation of new methodologies related to the harmonisation of the capacity allocation breakdown rules and the long term capacity calculation.