

## Position Paper on ERGEG Public Consultation

# Draft benchmarking report on medium and long-term electricity transmission ca- pacity allocation rules

Berlin, June, 1st 2010

The German Association of Energy and Water Industries (BDEW) represents 1,800 members of the electricity, gas and water industry. In the energy sector, we represent companies active in generation, trading, transmission, distribution and retail.

## **General Remarks**

BDEW welcomes ERGEG's efforts on this comprehensive report and supports the findings. In order to develop towards a fully integrated internal electricity market, we also see the need for further harmonisation of long- and medium-term products including a single set for medium and long-term capacity rights.

Mid-term and long-term transmission capacity products play an important role in cross-border trading. They are needed to facilitate cross-border hedging activities. Power companies usually sell their production several years in advance, so a suitable forward market for capacity products is needed to hedge price risks. Currently, we see a liquid wholesale market for up to three years in many countries. For cross-border trades via interconnectors where capacity is often limited, energy companies need to have access to long term capacity products.

### **1 Do you think that an important degree of convergence has been reached in terms of conditions for participation in the auctions, the characteristics of allocated products and the functioning of secondary markets?**

The agreement of a common target model in the PCG work has been an important step towards a harmonised approach also guiding regional markets to convergence to the target model. However, as pointed out by ERGEG many issues remain to be addressed and worked upon. We would like to point out the evolution of auction rules, operational simplifications, operational and structural coordination between TSOs (for example through auction platforms), definition and firmness of the allocated products as well as maximisation of cross border capacities.

When it comes to the actual auction rules and operational procedures, BDEW only sees true convergence for cases where several borders are administered by one common auction office and one set of auction rules. Today only one such regional auction office is in place: CASC-CWE. Even though most issues have been harmonised, the CASC-CWE auction rules have still different regulations for specific borders when it comes to firmness, compensation and nomination gate closures. However, there is only little experience in long term capacity auctions.

Other regional experiences suggest that inter-regional project guidance is also necessary as well as a step by step approach in order to build on a reliable operational process.

Due to the fact that a multitude of borders are visible through the flow modulation, the risk premium should be reduced and not added up. The result should be more available capacities for the market based on a flow modulation.

## **2 Do you think that a special attention should be paid by ERGEG on lack of harmonisation of auction rules, lack of firmness of both allocated and nominated capacities and long term financial capacity products not allocated by TSOs?**

Yes, BDEW considers these issues as crucial and thinks that ERGEG has properly identified some of the major issues that have to be addressed. It is essential that ERGEG continues its harmonisation stimulation on auctioning rules in order to maintain a positive momentum in this field.

Long term financial capacity products not allocated by TSOs do not exist. In the Nordic market Contracts for Difference (CfD) can be traded, but they are used to hedge the difference between a bidding area and the virtual system price and they are not related to transmission capacity at all. We see no reason that ERGEG should pay any attention to the CfD market. Instead ERGEG should ensure that transmission rights are auctioned by the TSOs for all borders between bidding areas.

However, any mechanism chosen should be subject to regulatory approval especially any costs for TSOs for guaranteeing firmness have to be approved by the national Regulators.

Further comments on firmness are stated at question 4 "improvements on auction rules".

## **3 What share of the available transmission capacity should be allocated on long-term basis and what should be reserved for short-term allocations? Please, give your justification for the proposed shares**

The PCG model recognises the importance of long-term hedging and therefore the need to propose longer-term products. Closely related to this requirement is the maximisation of available capacities over timeframes relevant for energy trading.

An example for repartition (until markets are liquid) could be orientated at the aspects agreed in the PCG model (while we consider these figures as additive):

- 10% of capacity should be auctioned for Y+3
- 20% of capacity should be auctioned for Y+2
- 40% of capacity should be auctioned for Y+1

with the remaining available maximum capacities being offered to the short timeframes up to d+1. In any case should always be 100% of the maximum available capacity is auctioned to the market. These shares probably fit best to the long term trading activities and the already existing future products for power.

#### **4 What concrete improvement in long-term auction rules would you propose?**

Various improvements are still needed depending on the region. The following comments illustrate the wide range of topics that still need to be addressed.

##### ***Rules improvements***

###### Harmonisation and reinforcement of the **firmness** of capacities before and after nomination

The TSOs should be offering the maximum practicably attainable amount of cross border capacity, separately estimated for each trading day and hour of the year; and they should offer it on a fully at least financial firm basis.

In our opinion, “fully firm” for this purpose entails the provision of compensation at the full cross border market spread if a TSO has allocated capacity and subsequently withdraws it for any reason (other than narrowly defined force majeure). Alternatively, the TSO could buy back capacity from the secondary market in cases where they deem this necessary (while there should be no fee attached for this). These improvements to firmness are fundamental to the promotion of more cross border competition in European power markets.

###### Network security and emergency

The case of emergency on network security needs a clear definition of a limited emergency situation or security events. Even though the regulation requests that clear definitions should be implemented in action rules.

###### Products

Offering a product range which is common in most explicit auctions, limited to daily, monthly and calendar yearly products, thus no seasonal, quarterly, weekly or other annual (with particular starting date, discontinuous products) or special products (e.g: monthly baseload only in one direction) would promote further harmonisation. With the standard daily, M and Y products, traders could build the position they need. No reservation should be made for intraday.

###### Removal of trade barriers:

Any barriers that prevent cross border trades without contributing to network charges should be eliminated.

###### Secondary markets:

To facilitate an efficient secondary trading of capacities the use of widespread tools should be enabled, also to make their access easy through traders’ screens.

Consistent intraday systems as well as uniform nomination schedules and trading windows for the whole European region are essential for well functioning secondary markets. The ultimate goal should be one single scheduling system.

### ***Operational improvements:***

The overall goal should be to set up one single auction platform for the EU/EEA region with fully harmonised contractual rules. Reduction of the number of auction platforms through a progressive concentration on the main regional platforms, such as CASC-CWE (also with integration of Swiss and Italian borders) and CAO should be the intermediate steps. Therefore, we see the following issues to be improved:

- Reduction of the number of contracts for transmission rights across several borders when possible
- Automated process, simplification of operations and reduction of redundant processes.
- Operational firmness (fast confirmation message and associated guarantee on the transaction).
- If last minute cancellations of planned capacity auctions are happening, this must be accompanied by an explanatory statement.
- Publication of offered capacities: three weeks in advance for yearly auctions and one week for monthly auctions.

### ***Coordination improvements:***

Coordination between regional projects paired with market-oriented priorities is essential in order to implement high quality and reliable cross border services and to maximise the added value for the market (social welfare).

Furthermore, regional coordinated capacity calculation needs improvements in order to maximise the volume and firmness of allocated capacities through a common grid model and coordinated network management procedures. Therefore timing and fall-back solutions should be harmonised (see reliability improvements).

### ***Reliability improvements:***

To improve reliability interregional time schedules should be better coordinated. The definition of fall-back processes and coordination of back up procedures such as request for quotes in order to prevent cascading defaults should be harmonised.

### ***Transparency improvements***

Transparency should be improved which includes:

- Harmonised publication of capacity allocation results.
- Centralised publication of capacity allocation results.
- Historical data of the auction (in excel and xml format).

- Access to auction results, even if the participant did not gain any capacity or did not participate to the auction.
- Historical available, obtained and nominated capacities (TSOs should make a link in their website towards the auction platform/website).

***Implementation improvements:***

Possible improvements in the implementation of long term auctions could be made by:

- Regular reporting from the cross border projects to the markets and consultations of market participants concerning functionalities, priorities and timing.
- Ensuring that sufficient time is guaranteed for market participants to adapt their internal process when new developments are implemented; including the identification of potential cross-project interferences.
- Reporting on the quality of the service: quality of the results, number of fall-back activations and cost of the service.

**5 What are the main difficulties, concerning auction rules, for trading electricity on a long term basis from one country to another crossing several interconnections?**

Operational constraints may constitute implicit barriers for multiple cross border trading, such as time schedules (registration for more than 20 different auction procedures, including reading and checking the individual auction rules, needs to take place within 2-3 weeks), multiplicity of IT systems in use, lack of operational and financial firmness and any other uncertainty on multiple cross border possibilities.

**6 How do you see the development of auction platforms and what would you consider the most efficient solution for the internal electricity market (a more centralised approach or the current decentralised one) taking into account the developments on the solutions for day-ahead and intraday timeframes?**

Generally, we support the path towards a single auction platform.

Alternatively, we would also support a small number of auction platforms with a high degree of reliability, good quality and cost-efficient service as well as harmonised rules. We believe that CASC-CWE could be the nucleus for this (certainly appropriate fall-back solutions need to be there). In any case, as we already see several platforms, we do not see the need to establish new ones; rather the existing ones should be used to cover additional borders. In any case, there should be an evolution path towards one single platform.

The most important criteria during these phases should always remain the reliability, quality and cost of the service.

In any case it is essential to quickly fully harmonise the auction rules, as we even see different rules for specific borders auction at the same platform.

## **7 Any other comments.**

N.A.

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