



EFET response to:

ERI Convergence and Coherence Report - An ERGEG Public Consultation Paper

September 2007

EFET very much appreciates the opportunity to contribute to your public consultation on the ERGEG's Electricity Regional Initiative Convergence and Coherence Report. We have actively participated in the seven ERI regions meetings and consultations since 2006 and we agree that priorities and solutions adopted in each of the ERGEG ERI regions have to be coherent with each other and potentially enable convergence to the single market.

We provide answers (in italics) to ERGEG questions in the consultation paper as follows:

– Capacity calculation

- The level of transparency of the current and future capacity calculation methods applied by the different TSOs;

As we have underlined in our latest position on transparency of information¹, EFET considers that the current methods are non-transparent. In the future there is a need for transparency and harmonisation of capacity calculation methods, as well as of key input assumptions, such as the reference base cases used by the TSOs. The information should be made available at least across each distinct price zone.

- The need and the importance of long term (year, month) capacity rights (physical or financial) and the associated need for long term capacity calculation; and

Both the issuance of, and scope to trade in, long-term capacity rights (we prefer the term “transmission rights of longer maturity”) are crucial, as EFET has indicated repeatedly. This is probably one of the most important requirements of a well functioning European power market, as explained in detail in our position paper on firmness and maximisation of cross-border transmission capacity².

¹ See section five of “Transparency of information about the availability and use of infrastructure and the promotion of competition in European wholesale power markets”, EFET updated position, May 2006, available on www.efet.org

² “More transmission capacity for European cross border electricity transactions without building new infrastructure”, EFET position paper, May 2006, available on www.efet.org

- Which information should be published in the case of a flow (PTDF) based capacity allocation? Indeed, some implementation scheme may imply that ex-ante cross border day ahead capacity estimation should not be available anymore.

We wouldn't expect fixed figures for auctioning of capacity for each border, but we would expect a published estimate of how much capacity may be allocated for that border, based on indicative flows and past experience. Given the lack of transparency surrounding the calculation of cross-border capacities at present, it is difficult to foresee the exact scope for improvement through the introduction of PTDF calculations and allocation. At worst a 'black box' TSO-run scheme of this nature could result in significant risks for traders, if ignorant of the logic behind the decisions taken by TSOs. For some borders it may thus prove desirable to stipulate a minimum commercial profile measured in hundreds of MW, in order to stimulate market certainty and underpin expected price signals between normal price zones. Another option might be to transition gradually towards complete flow-based allocation by retaining a dynamic NTC-based annual auction allocation for a period.

- Is there any added value of implementing PTDF-based allocation method without an implicit allocation method or an explicit auction of obligations to nominate?

Yes. Market participants consider such a method, entailing full netting and reduction of the short term TRM, as long overdue especially for the day-ahead market, on the assumption it affords TSOs a more realistic chance of maximising week-ahead and day-ahead capacity offered at borders.

It is important to those traders trying to compete internationally, who supply into territories where they may not enjoy any generation or retail supply portfolio, to be able to hedge their transmission positions physically (or financially in a directly equivalent manner), on the basis of only natural, not artificially induced, transmission constraints. To do so, they should be able to purchase in a primary auction transmission hedges from TSOs, over maturities equivalent to those commonly observed in the wholesale commodity market. A secondary market in transmission rights will also enable TSOs occasionally to purchase back oversold capacity, as well as or instead of paying market participants to take on nomination obligations.

- Long and medium term capacity allocation

- Current auction procedures as well as the products auctioned are different in some aspects:
 - a. Can different auction procedures (where to go to acquire capacity, nominations, functioning of secondary markets, time frame... etc.) on different interconnections hamper cross border trade where a market player wishes to or must trade over more than one interconnection?

Yes. Complexity and variety in auction platforms or rules may deter cross border market entry, especially by smaller or distantly situated new entrants.

- b. Can different auction products (product profile, duration, degree of firmness etc) on different interconnections hamper cross border trade where a market player wishes to or must trade over more than one interconnection?

Yes. If auctioned transmission products are not homogenous it will make it difficult to create a liquid secondary market in transmission capacity rights.

- c. To what extent can the harmonisation of auction procedures and products contribute to a convergent development?

In most regions harmonisation could only improve matters! In particular the market in transmission rights needs to be as flexible and adaptable to hedging requirements, as is currently the cross-border wholesale market in electricity, over most of central and North West Europe, as a pure commodity.

- Can the coexistence of PTRs and FTRs on different borders reduce the degree of hedging for a market player who wishes to or must trade over more than one interconnection? Can such coexistence on different borders cause any other obstacle to cross border trade where a market player wishes to or must trade over more than one interconnection?

We see no necessary conflict in the co-existence of PTRs and FTRs as long as some borders are subject to day ahead implicit auction and some are not; but FTRs like PTRs must equally be issued by TSOs as fully firm rights exchangeable for financial compensation in market coupling processes, right up to the day-ahead gate closure time. This implies that both PTRs and FTRs should be issued and traded in the same way, and fully harmonized in terms of contractual structure.

- Day ahead capacity allocation:

- Can day-ahead NTC based allocations and flow (PTDFs) based allocations coexist as such?

Yes. The introduction of true flow based calculation and allocation must be a rolling target across Europe.

- Can day-ahead market coupling and market splitting coexist as such? Would you consider market splitting (a single power exchange) more efficient, in the longer run?

Yes, they can co-exist for the time being. Competition between power exchanges is currently desirable as is competition between power exchange based and over the counter (OTC) trading. Nonetheless, complete harmonisation of the wholesale power market model (and probably a corresponding unification of power exchange operations) across Europe is required in the long run.

- Does the linking or merging of regions using implicit auctions require a high degree of harmonization of “algorithms” and to some extent products and legal framework?

Linking through implicit auctions must be accompanied by the issuance of longer maturity transmission rights and the stimulation by appropriate regulatory incentives of efficient primary and secondary markets in transmission rights. Ultimately, complete harmonisation of products and contractual terms will be necessary. EFET has already drafted a standard capacity rights trading contract and accompanying explanatory notes, as the basis for part of the (commercial) legal framework required.

- Do you regard “volume coupling” (each PX participating in a joint auction office still calculating own prices, but based on auction office calculated volumes on interconnectors) as a flexible option in a transitional period towards a price coupling?

Yes. It might be considered as a transitional solution as long as power exchanges are not granted exclusivity over minimum volumes of traded electricity as a consequence.

– Intra- day:

- Should regions pursue the implementation of continuous trading platforms?

Yes.

- What could or should be the geographical scope of such continuous trading platforms?

EFET advocated plug-in, non-exclusive platforms for continuous intra-day trading³, where platforms are not exclusive but are linked electronically in real time to a multi-TSO matrix system for calculating and updating available capacity (these systems each covering at minimum one normal cross-border price zone).

- Will the development of several competing intraday platforms in the same geographical area not be detrimental to the development of liquidity in intraday?

Platforms competition will be efficient and not detrimental to liquidity, as long as each platform links to the same TSO matrix system. Liquidity must be considered in terms of the volumes traded across all platforms and/or by different means. There is evidence that the addition of new trading means may improve liquidity. Take for example the ability of many investors now to trade company shares via the internet, rather than having to ring a broker or physically visit a bank to do so.

- If, for liquidity reasons, one single intraday platform appears to be relevant, who should offer this service? TSOs? PXs? Other? Should it be regulated, and how?

We are doubtful that the use by a PX of an implicit bidding methodology for allocating capacity intra-day will prove the most efficient for increasing cross-border trade. Anyway in principle, neither a TSO nor a PX should be granted platform exclusivity and routine regulatory supervision should then not be necessary. Competition should prevail also at intra-day between modes of trading through exchanges, brokers, pure counter-party OTC etc. Regulators and TSOs should not focus on finding a platform the market wants to use, but on approving common standards and respectively maintaining a matrix system, each of which could allow maximum flexibility for the market to develop. If a quickly implemented cross-border intra-day solution only seems possible in a given region by starting with one single platform, EFET could live with a temporary dispensation, subject to regulatory supervision. That supervision should concentrate on keeping the adopted scheme commercially and technically open to further plug-in platforms.

– Balancing:

- Is the harmonization of the remuneration schemes for balancing bids/ offers (pay-as-bid versus pay-as-cleared) a pre-requisite to the integration of balancing markets?

Most likely not, although no uniform EFET view has yet been developed.

- Is the harmonization of the methods, which determine the share of automatically activated reserves and manually activated reserves in the balancing reserves procurement a pre-requisite to the integration of balancing markets?

³ See the matrix from Section four of “Intra-day power markets within and across European national frontiers: A practical approach to facilitate wholesale liquidity”, EFET Position Paper, December 2006, available on www.efet.org

No uniform EFET view yet developed.

- To what extent a common intraday trading platform could be used for or interact with balancing trades?

An efficient and liquid intra-day platform should be usable by market parties as late as one hour (in some markets even 45 minutes or 15 minutes) before real time, and in this manner should eliminate a significant proportion of existing balancing requirements.

- Could “TSO to TSO” balancing trades co-exist with “Actor to TSO” balancing trades? Could both processes co-exist and interact using a common balancing trade platform?

Yes. They could coexist as long as the regulators are satisfied that TSOs have not retained “free options” by reserving cross-border capacity for themselves in case of their mutual balancing needs. EFET has previously described (Firmness and Maximisation paper 2006) why it is unnecessary to reserve in advance cross border capacity for use in real time exclusively by TSOs.

- To what degree should TSO to TSO coordination be enhanced or merged for national balancing markets to become properly integrated?

If in effect merging their balancing markets, TSOs should develop a common and interactive generation plant-dispatching model.

- Transparency:

- Is the described coordination of regions concerning the treatment of transparency sufficient?

The standards for transparency about the use of power sector infrastructure should be uniform at least across each cross border price zone.

- What should be expected or required in terms of a harmonised level of transparency across the EU?

As emphasised in our paper on transparency⁴, complete data about the use of interconnection capacity and production of all generation plants is needed as close as possible to real time.

- Governance and regulation:

- Who should preferably be the owners of joint auction offices? How should “shares” (ownership and voting rights) be determined?

No uniform EFET view yet developed.

- Should auction offices, interconnectors operators and PXs disposing of all or part of interconnection capacity (disposing of an “essential facility”) be regulated?

No uniform EFET view yet developed.

- Which governance elements could ensure non discriminatory access of additional owners to a joint auction office?

No uniform EFET view yet developed.

⁴ “Transparency of information about the availability and use of infrastructure and the promotion of competition in European wholesale power markets”, EFET updated position, May 2006, available on www.efet.org

- Could you mention other important governance requirements for PXs and auction offices
 - a. Providing “essential facilities”?
 - b. Undertaking purely competitive business?

No uniform EFET view yet developed.