

## EDF Response to ERGEG Public consultation on its draft benchmarking report on medium and long-term electricity transmission capacity allocation rules

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12<sup>th</sup> May 2010

EDF first of all welcomes the opportunity given by ERGEG to comment on this report on medium and long-term electricity capacity allocation rules. This document, based on a comprehensive pan European benchmark, addresses accurately the improvements already achieved and those to be enhanced.

EDF considers the promotion of cross-border trade in electricity of the utmost importance to achieve an integrated European electricity market which depends on three main action plans:

- the development of cross-border electricity exchanges through investments in physical interconnection where structural congestions exist,
- the maximization of the capacities allocated to the market by TSOs and,
- the improvement of the congestion management modus operandi.

From EDF perspective, the issues related to the strategic model on congestion management and capacity allocation have been clarified through the targets proposed by the Project Coordination Group (PCG) and adopted at the December 2009 Florence Forum.

**EDF raises the crucial need for implementation of the mechanisms described by the PCG targets and the maximization of the forward explicit auction capacities offered to market players, to link forward power markets of neighbouring countries with consistent capacity allocation and congestion management.** The subject of this consultation, related to medium and long-term timeframes, is critical regarding the hedging activities of the European market players and the development of liquidity on the European forward power markets.

The third Energy Package and the European Commission orientations also support evolutions meant to foster integration of national electricity markets. EDF stresses that the bottom-up approach through the European Regional Initiatives (ERI) provides results, in particular in the harmonisation of the rules and products allocated as well as the common platforms (CASC in the CWE region and CAO in the CEE region), and the combination with the top-down approach (PCG targets and the Capacity Allocation and Congestion Management Framework Guidelines) could lead to the next improvements, mainly towards greater firmness of capacity rights.

EDF adds that enhancements on the forward timeframe allocation rules are highly dependent on major pre-requisites :

- the achievements on day-ahead markets coupling,
- the existence of robust forward markets and,
- a pan-European harmonisation on capacity calculation.

Regarding specifically the medium and long-term allocation rules, EDF agrees that important steps have been taken in terms of convergence. Still, depending on borders, **many harmonization actions (rules, conditions for participating and platforms) have still to be implemented.** An important improvement to be carried out by the European regulatory authorities and NRAs is the financial firmness of allocated forward capacities, as recommended by the PCG targets. TSOs should not carry, in the end, the financial risk incurred by the costs of guaranteeing financial firmness (use of congestion revenues) but they have to be encouraged to use the most efficient counter measures in order to diminish these costs.

## 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?

### Characteristics of allocated products

As presented in the benchmarking report, it seems that most of the analysed interconnections offer allocated products with similar characteristics: continuous yearly and monthly baseload products including Use-It-or-Sell-It principle. But depending on the interconnection, the level of firmness embedded can be different as well as the share of allocated capacity in forward timeframes. **As recommended by the PCG targets, all forecasted capacity should be allocated to the market players through forward auctions and financial firmness of those capacities should be ensured.**

More precisely, **the allocated products should take into account the power markets specificities on each side of the border and be in line with the market players requirements.** For example, the set of products offered on the French-UK border includes half year products in order to cope with the UK power market needs. **EDF raises the importance of the necessary link between forward power markets and the capacity products allocated to the market players.** In fact, in order to integrate the European power markets on the forward timeframe, it is necessary to offer to the market players capacity products consistent with forward market liquidity on each side of the interconnection.

### Functioning of the secondary market

The functioning of the secondary markets is quite similar across Europe:

- resale possible in the forthcoming auctions,
- transfer to other participants (down to individual hours and through 1 MW units),
- and the Use-It-Or-Sell-It (UIOSI) principle.

The possibility offered to the market players by the secondary markets is important but still not fully used.

For these reasons EDF is supportive of the recommendations presented in the report concerning the development of a harmonised and anonymous platform for capacity transfers between participants (including TSOs if they need to buy-back the capacity allocated previously to ensure firmness) and the publication by the TSOs of the capacity holders.

### Conditions for participation

Regarding the conditions for participation in the auctions, the multi-country players have to face many different rules of participation, different IT Systems, different financial guarantees (with amounts varying between 50 to 500 thousand euros) and different legal obligations that may represent obstacles for new market participants.

## 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?

### Harmonisation of auction rules

EDF considers of the utmost importance the harmonisation of auction rules within an ERI (like the CWE region with CASC), but this harmonisation should be also addressed for all the borders of countries overlapping various ERIs (like France and Germany) where rules depending on the considered border could be very different.

**EDF believes that, temporarily, if TSOs provided a maximum of forecasted capacity on a long-term basis, Physical Transmission Rights (PTR) - applied with the UIOSI principle - would bring sufficient performance in regard of the overall objectives.**

A purely financial medium and long-term capacity allocation (Financial Transmission Rights – FTR) corresponds to an advanced stage of the PCG targets and can be considered as an optimal objective, only achievable in the context of mature day-ahead coupled markets, bringing high confidence to the market parties.

Indeed, FTR are the best products for hedging players portfolios and allow a high degree of flexibility, from an operational point of view.

### Firmness

The propensity of the TSOs to allocate all the forecasted capacity on a long-term basis is linked to their willingness to support the financial risk of curtailment. Indeed, it brings up the issue of firmness (financial or physical) of capacities, whether allocated or nominated.

The pricing realised by market players for the forward auctions include the status of the related firmness for the offered capacity. This valuation is different whether the risk is taken by market players (without the levers) or by TSOs (having the levers<sup>1</sup>). Thus, TSOs are the most appropriate players to bear the risk of limitation or reduction of allocated capacities.

Furthermore, making TSOs bear the financial risk of limitation or reduction of allocated capacities will probably incentivise them to diminish the cost incurred through a better scheduling of the grid maintenance, programmed reduction capacity as well as a balance between curtailment and possible counter-measures.

In addition, limitation or reduction of allocated capacities, according to the European Regulation (1228/2003/EC), shall be used in emergency situation when TSOs do not have alternative solutions (redispatching and counter trading).

Indeed, **firmness of allocated capacities is a financial issue whether TSOs have to use counter measures to ensure the physical capacity or have to compensate the limitation or reduction of allocated capacities at market spread.**

**For the above reasons, EDF believes that if TSOs were asked to offer firm forward capacity, allowing market players to better hedge their transmission costs and to integrate the forward power markets through price convergence, TSOs should financially compensate market players for any reduction or limitation of the allocated capacity.**

Still, even if part of this financial risk should actually be offset by the higher value of medium and long-term interconnection capacity, the European regulatory authorities and NRAs will need to work along with TSOs in order to set mechanisms that ensure their financial neutrality. EDF would support the idea that the costs of firmness incurred by the TSOs could be annually or monthly capped at the collected congestion revenues.

**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.**

As recommended by the PCG, **EDF wishes the maximization of the forecasted capacity to be allocated on a long-term basis.** In a temporary phase, a reserve of 20% of the capacity for the day-ahead market, to create confidence and be sure that physical interconnection capacity will be released for market coupling, would be acceptable.

**EDF wants to point out that interconnection capacity that is not allocated to market players before the day-ahead market coupling is a waste of hedging opportunity.** Currently, TSOs are not encouraged to maximize the capacities offered to the market players in a forward basis. For example, on the France-Germany border, the capacity offered on the forward timeframe represents roughly one third of the total volume allocated. With the CWE coupling foreseen in September 2010, the issue of the maximisation of

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<sup>1</sup> Considering the levers described by ERGEG in the July 2008 « Firmness of nominated transmission capacity » report.

the forward capacity offered will be underlined. **EDF recommends that NRAs monitor (via an incentive scheme for example) TSOs in order to promote the necessary maximization of the forward capacities offered to the market players.**

The split between the different maturity products should ensure the possibility of the market players to hedge part of their portfolio exposure against spot markets volatility. This split depends also on the forward market liquidity. Thus, **the share of capacity allocated for each maturity should be determined by the market players requirements.**

EDF stresses on the importance to provide market players with long-term capacities consistent with multi-annual products on forward electricity markets.

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

EDF believes in the strong interest to:

- maximise the share of capacity offered to market players in medium and long-term timeframes,
- provide them with longer-term products,
- through European harmonisation, develop firmness of the interconnection capacities ensured by the TSOs.

Moreover, all ERIs should set as an absolute priority to harmonise the rules and the auction platforms within an ERI and between ERIs.

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

The main difficulties to trade multi-interconnection capacities between not neighbouring countries are the lack of harmonisation of the auction platforms and rules (products, participating conditions, level of firmness, etc.) as well as the very limited number of transactions on the secondary market.

#### **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?**

EDF is in favour of common auction platforms with a common set of rule and this should be made not only within a ERI but between ERIs. Those common auction platforms should communicate together for region's overlapping common countries (like France and Germany).

#### **7. Any other comments:**

The harmonisation of rules, platforms and characteristics of the products could be done via the bottom-up approach but, regarding the maximization of the forward capacities allocated and the financial firmness associated, a top-down approach should be preferred.

Indeed, regulatory gaps creating undue and prejudicial restrictions on trade between Member States persist, such as the "triad mechanism" in UK, and should therefore be eliminated.

Finally, EDF indicates that any improvement should consider the central position of the Swiss grid connections cross-road status within Europe, and the EU Commission be invited to pursue the negotiations opened in 2007 with the Swiss authorities.

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