Mrs. Fay Geitona
Council of European Energy Regulators ASBL
28 rue le Titien
1000 Bruxelles
Belgium
Per E-Mail an: fg_electricityCACM@ergeg.org

Kontakt	DW	Unser Zeichen	Ihr Zeichen	Datum
DI Ursula Tauschek	223	TA/Sc – 35/2010		10.11.2010

ERGEG Draft Framework Guidelines on Capacity Allocation and Congestion Management for Electricity

Dear Madam,

The Association of Austrian Electricity Companies (Oesterreichs Energie) appreciates the opportunity to comment on „ERGEG Draft Framework Guidelines on Capacity Allocation and Congestion Management for Electricity“ and the related Initial Impact Assessment.
Oesterreichs Energie represents actively more than 130 energy companies in generation, trading, transmission, distribution and sales which is more than 90 per cent of the Austrian electricity generation and the entire distribution.

Introductory remarks

Oesterreichs Energie appreciates the work ERGEG has carried out to identify concrete proposals for the most important features of market design in the field of cross-border electricity markets. Oesterreichs Energie is supportive both of short term action to improve market conditions namely by creating well functioning regional markets and implementing mid term target models to achieve a true internal market.
More particularly Oesterreichs Energie welcomes the effort to re-evaluate and eventually to re-calibrate the design of intraday, day-ahead and forward markets and the role capacity calculation should play.

Oesterreichs Energie points out that ERGEG's consultation comes at the right moment as the Florence Forum, the Project Coordination Group (PCG) and the new AHAG process have broadened the consensus on target models which shall be achieved by 2015.

In a nutshell Oesterreichs Energie
- is very much in line with vast parts of the problems identified and the solutions proposed in the draft guidelines
- feels that ERGEG does not always pay due attention to the transaction costs and negative short and medium term effects when assessing the relevant policy options
- is deeply concerned about the definition of zones especially when taking into account the considerations made in the initial impact assessment which Oesterreichs Energie views as partly incomplete and partly biased.

A) Critique of the definition of zones

Preliminary remarks

It is strange, that months after the positive results of
- Final Everis Mercados Report "From Regional Markets to a Single European Market"[1]
- ERGEG's Regional Initiatives Progress Report[2]
- ERGEG's Strategy for delivering a more integrated European energy market: The role of the ERGEG Regional Initiatives[3]

ERGEG seems to identify large zones as a predominant problem thus loosing out of sight its earlier view on how to reach European market integration.

Merits of large zones

Large zones have increased liquidity where applied. In the case of the German-Austrian price zone, the PHELIX has established itself as a proven benchmark for European electricity prices. This price is the same for the entire market area enabling a level-playing field for all end-users.

Furthermore, it is a liquid market place with a robust price that allows generators, traders and consumers alike to mitigate price sensitivity risks. Only in a large zone, this will add to transparency for all market participants.

Large zones are specifically efficient in fostering competition. Any issues of market powers can be much more adequately dealt with in large zones.

Larger zones might require some redispatching, which is desirable in light of the many socio-economic benefits. In fact, the market design should be further developed to further integrate balancing mechanisms.

[1] Final Report 28/04/09 commissioned by DG TREN
[2] An ERGEG Conclusions Paper, 10 June 2010
[3] An ERGEG Conclusions Paper, 21 May 2010

Österreichs E-Wirtschaft

Brahmsplatz 3 Tel +43 1 501 98-0 info@oesterreichsenergie.at
1040 Wien Fax +43 1 501 98-900 www.oesterreichsenergie.at

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Network congestion must be rectified through investment. The development of the networks cannot be stalled by regulatory proposals, such as splitting up of large zones.

Draft framework guidelines
Oesterreichs Energie appreciates that chapter 1.2.4 introduces the argument of "welfare related to the delimitation of zones" as a point to be taken in consideration. However we are strongly of the opinion that welfare optimisation in a broad understanding from political up to economical dimensions should play a much stronger role.

Oesterreichs Energie cannot support the Initial Impact Assessment (IIA)
The IIA falls short of what an initial impact assessment should be about. Especially in the issue of definition of price zones, the IIA just compares the end results of ideal zones for trading with the current situation.

ERGEG in its initial impact assessment systematically overlooks the dimension of economic and societal implementation constraints, costs and risks. In that respect Oesterreichs Energie very much deplores that the IIA uncritically relies on two studies that have been carried out taking

- Norway and the Nordic market as reference as to justify the slicing and dicing of existing zones[4]
- the US-market with its fundamentally different design from the structure chosen for Europe and recently confirmed namely a decentralised market organisation where bilateral trading practices prevail and a centrally organised market like the one applied by PJM Interconnection [5]

In fact, in its IIA ERGEG reveals a rather disruptive approach to market development. It leads to destroying functioning markets. It is linked to the expectation that in a future system the overall effect on markets will be positive. The assessment systematically overlooks

- the beneficial effect of large zones and their associated high degree of liquidity
- the steps needed from small systems each of which is characterized of lower liquidity to a liquid well functioning overall system.

In the case of natural gas markets, we currently see the opposite development, which is the suppression of small market areas in favour of larger zones despite of existing congestions and taking into account the costs for overcoming them.

Oesterreichs Energie wishes to point out, that grid optimisation is just ONE parameter in the broad context of liberalisation, market optimisation, the framework for future investment and overall social welfare.

[4] Bjoerndal, Mette, Joernsten, Kurt: "Benefits from Coordinating Congestion Management – The Nordic Power Market", Energy Policy, Vol 35, No. 3, pp. 1978-1992,March 2007
[5] Erin T. Mansur, Matthew W. White: "Market Organization and Efficiency in Electricity Markets", June 30, 2009,

Oesterreichs Energie would have expected ERGEG to take into account efforts made in the CWE and Northern region to integrate markets. Oesterreichs Energie warns against changing existent zones without an in-depth analysis on the local and overall effect on market coupling and on the foreseen implementation of flow based capacity calculation in CWE.

The advice ERGEG is providing in its IIA *"If the zones resulting from the division of the network based on its topology are considered too small to ensure liquidity, nothing prevents the creation of liquid hub made up of several zones."*[6] is rather unhelpful as it

- does not take into account the cost in terms of loss of liquidity at least during a transitional phase;
- overlooks the negative effect small zones have on non-incumbents
- is biased in favour of market splitting.
- Creates a trial and error process which is not favouring trust in markets and is totally ignoring costs related to such frequent changes

In fact the IIA states: *"… in an efficiently defined zonal system, the congestion will be managed in the dayahead time frame through market splitting,.."* .[7] This reflects very well the Nordic philosophy but does not reflect the design chosen on the continental market and results vision on market integration set out by ERGEG in 2009 and earlier this year nor does it reflect the target models developed through the PCG-process.

The IIA reveals a strange attitude towards **market power**:

- … "The definition of zones may have an impact on the number of actors within that zone, e.g. a small zone will typically have fewer actors than a large zone; thus raising the issue of market power. However, depending on the present market design, the market power situation as such does not necessarily change with zone size, as it is triggered by the congested network."[8] *…*
- …"It should be stressed that, when reducing the size of the zones, the apparent increase of market share of a given producer in this zone, that may result in an increase of market power, is largely compensated by the increase or the development of competition linked to a better appraisal of true network capabilities and a more efficient allocation of transmission capacity linked to better locational information of bids/offers."[9]

The opposite may well be the case. Experience in small zones tells that market power may constitute an important issue. It is much easier to deal with market power in large zones connected via market coupling and implicit intraday trade. The issue of market power in the balancing time frame can best be dealt with via a combination of a liquid cross-zonal / cross-border balancing market, transparency as to commercially non-sensitive data and market monitoring as to commercially sensitive data.

[6] IIA, p. 33
[7] IIA, p. 33
[8] IIA, p. 33
[9] IIA, p. 34

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Brahmsplatz 3 Tel +43 1 501 98-0 info@oesterreichsenergie.at
1040 Wien Fax +43 1 501 98-900 www.oesterreichsenergie.at

The IIA wrongly plays down the importance of **liquidity**. “Very often, a reduction in the size of the zone is interpreted as a reduction in the liquidity of the day-ahead market. This is, however, too simplistic a view, as the important parameter here is the overall liquidity of all zones covering a given territory.”[10]

This argumentation is not correct. Liquidity is defined for a special product and a product is related to a price zone. A product covering several zones is not supporting activities of producers and consumers in a defined price zone but only a kind of an overall hedge against general price developments. First of all, liquidity constitutes the number one factor for building functioning wholesale and retail markets. Splitting the DE-AT market zone will inevitably reduce liquidity. This in turn will to some degree reduce the reliability of the day-ahead market as an underlying for the futures market. Consequences for the clearing market may be negative, too. This will feed through to non-incumbents and end-consumers.

Furthermore, the continuous process of yearly adjustments of the defined zones will lead to an extremely unfavourable investment climate. Without a clear and robust price signal, which is provided by EPEX Spot today, future investments in generation capacity may not happen at all. ERGEG rightly points out, that increases in renewable energy call for action, but does not at all analyse the impact of its measures.

It is correct that in a longer term the liquidity of a whole region and finally of the Internal Market as such has to be the measure stick. But it would be quite naïve to think, that destroying existing liquidity in any zone automatically results in high liquidity in another zone. Experience gained reveals that small zones and the overall region do benefit from market coupling.

The assessment of policy options, presented in the IIA, highly centres on the **optimisation of the existing network**. This perspective has some merits but does not give the full picture:

1. Markets should be in the centre of the evaluation as the overall exercise is the creation of an internal market for electricity. Exactly, structural price differences between regions should be e.g. the trigger for the necessity of grid investments.

2. The evaluation should take into account planned grid enhancement and grid investment. This particularly true due the integration of wind energy.

3. A logic where congestions always lead to the splitting of price zones would definitely reduce the incentive to invest in needed new transmission lines.

[10] IIA, p. 35

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The IIA is attributing **welfare gains** to a changed zonal division: *"Furthermore, benefits in terms of more correct price signals to generators and consumers would be achieved. This is important both for short and long-term planning of production and consumption."*[11] This may be true in theory. However, having free choice for new locations for renewables and priority dispatch of renewables and nationwide support schemes for renewables in mind, this is simply not realistic.

The IIA's main shortcoming is a lack of thorough analysis and an abundance of opinions. Oesterreichs Energie can neither support nor follow the conclusions that nodal pricing constitutes the ultimate goal in electricity market design. Clearly, this approach has shown merits in the PJM system and likewise, all related problems are not voiced at all. There is no mentioning of the fact, that the EU networks are managed by 48 TSOs in comparison to one operator in the PJM zone. This already should make clear, that any implementation is not only very complex, but also very costly. It is mentioned that nodal pricing requires "uniform" retail prices – which really means a regulated consumer price. We strongly oppose this notion and would urge ERGEG to revise this approach completely. Nodal pricing will not be an option for European networks any time soon and hence should have no room in the guidelines.

Furthermore, we strongly recommend just treating the IIA as a discussion paper and ensuring that it will not be part of the formal guidelines.

Draft Guidelines – Chapter 1.2

In defining a zone for capacity calculation and management ERGEG (1.2.1) chooses a green-field approach. This is in contrast to other chapters of the guidelines – for instance on capacity calculation methods or on forward markets - where ERGEG takes account of specific characteristics of the markets encountered.

The conditions under which one or several control areas may constitute one zone are far too narrow (1.2.3). What is more, the review mechanism described under 1.2.3- 1.2.6 (e.g. yearly revisions of zone sizes) will almost inevitably lead to an erosion of current zone sizes in large countries. As this mechanism exerts pressure on existing large zones while not affecting small zones it is also probable that the new zones will not be regional but sub-national. This seems very similar to the approach taken in Norway and later on applied to Sweden while missing the chance of creating cross-national structures.

Chapter 1.2 falls short of putting the issue of zone delimitation into perspective with the ongoing efforts of regional integration.

[11] IIA, p. 39

B) Answers based on ERGEG's questionnaire

General Issues

1. **Are there any additional issues and / or objectives that should be addressed in the Capacity Allocation and Congestion Management IIA and FG?**

In our view, consistency in terms of scope and principles between the Framework Guidelines on CACM and other Guidelines, including Comitology Guidelines on Transparency, Comitology Guidelines on Governance and Framework Guidelines on Balancing should be ensured, especially taking into account that there will be a time gap between their adoptions.

We would like to point out that in the present draft a number of outlined principles do not fully reflect the features of the PCG target model adopted by the Florence Forum in December 2009. Oesterreichs Energie believes that an excessively general description of the target model may result in the situation when local solutions will be preserved and thus hamper implementation of the European target model. Therefore we call for a much stricter alignment of the draft Framework Guidelines Capacity Allocation and Congestion Management and with the PCG target model and a detailed outline of its main features and principles. For example, in the forward market long term transmission rights should be introduced across all the electricity markets in the EU and should not be replaced by local instruments or products. Another example is the introduction of implicit auctions in the intra-day trading in case of "sufficient liquidity" does not correspond to the agreement in the PCG target model that in principle allows for a possibility to introduce implicit auctions in case of "significant additional capacity".

2. **Is the vision of the enduring EU-wide target model transparently established in the IIA and FG and well suited to address all the issues and objectives of the CACM?**

See above detailed comments under A) Main Concern

3. **Should any of the timeframes (forward, day-ahead, intraday) be addressed in more detail?**

Regarding the day-ahead market, Oesterreichs Energie would like to see a clear reference model achieved in the PCG.

Oesterreichs Energie warns against potential discrimination of PXs. For instance in the CWE region PXs have a proven record of co-operation in the day-ahead framework. Co-operation will be inter-regional as of November 9th.

Co-operation in the intraday-timeframe is underway even if measures that are currently envisaged can only be of transitory nature.

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Brahmsplatz 3 Tel +43 1 501 98-0 info@oesterreichsenergie.at
1040 Wien Fax +43 1 501 98-900 www.oesterreichsenergie.at

DVR 0422100, UID ATU37583307, ZVR 064107101; UniCredit Bank Austria AG, BLZ 12000 Kto. 0064-20418/00

4. In general, is the definition of interim steps in the framework guideline appropriate?

Regarding the day-ahead market Oesterreichs Energie supports the interim steps referred to in the IIA. It has to be mentioned though that flow-based to date is still a theoretical concept. Oesterreichs Energie would still like to see the theory applied in reality. Naturally, further interim steps will be needed.

10-Year Network Development Plan
In our view, the provision (5.1) should put an obligation on ENTSO-E, not on the TSOs to make transparent in the 10-Year Network Development Plan, where congestion usually occurs and how, where and when it is physically relieved by enhancing the cross-border network capacity or by adjusting the critical network elements through e.g. new transmission lines.

Re-dispatching
Regarding the provision (5.4) on avoiding market distortions by the TSOs through the pricing of generation capacity reservation, we suggest that the Framework Guidelines should propose steps towards transparency in the re-dispatching activities. This will make any kinds of distortions more evident.

5. Is the characterisation of force majeure sufficient? Should there be separate definitions for DC and AC interconnectors?

Oesterreichs Energie would like to see a much clearer definition of force majeure to avoid diverging definitions. Oesterreichs Energie view is that force majeure definitions should be harmonised across the EU. Oesterreichs Energie sees no reasons for separate definitions for DC and AC interconnectors.

6. Do you agree with the definition of firmness for explicit and implicitly allocated capacity as set out in the framework guideline? How prescriptive should the framework guideline be with regard to the firmness of capacity?

Oesterreichs Energie believes that the framework guideline shall define firmness of capacity in detail. The provision (5.6) with regard to curtailment of cross-border transactions in emergency situations should be further aligned with the article 16 of the cross border regulation 714/2009 that stipulated that “transaction curtailment procedures shall only be used in emergency situations where the transmission system operator must act in an expeditious manner and re-dispatching or countertrading is not possible. Any such procedure shall be applied in a non-discriminatory manner. Except in cases of force majeure, market participants who have been allocated capacity shall be compensated for any curtailment.”

Oesterreichs Energie supports the view that curtailment of cross-border transactions may only be applied in case of force majeure or in emergency situations. Holders of capacity in the form

Österreichs E-Wirtschaft

Brahmsplatz 3 Tel +43 1 501 98-0 info@oesterreichsenergie.at
1040 Wien Fax +43 1 501 98-900 www.oesterreichsenergie.at

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of PTRs or FTRs shall be compensated by the relevant market spread in emergency situation and by the initial payment (to the TSO, not in the secondary market) in case of force majeure. The provision (5.9) requires TSOs to provide compensation based on the price difference between the concerned zones, which implies a lot of risks for the TSOs. Therefore, they should also be allowed to buy back capacity rights on the secondary market (or via an inverse auction where they buy back from the market).

Oesterreichs Energie does not see any reason why financial firmness may be accepted in case of explicit auctions, but not in the case of implicit auctions. Financial firmness should be accepted in both cases as physical firmness will not always be possible to achieve.

The provision (5.10) allows capacity to be financially firm in case of explicit auctions. In our view, it could be organized as described below. The starting point is nomination of capacity rights at 8h00 Day Ahead. In case TSOs curtail capacity before the PX gate closure, they could pay back the spread between PX (as parties would buy/sell their curtailed position on the PXs). In case TSOs curtail capacity after the PX gate closure,but before the Intraday gate closure, capacity right owners could be paid back the Intra-day price. The question is which Intra-day price should be used as it is evolving over time. Possible solution is the Intra-day spread before the gate closure. In case TSOs curtail capacity after the Intra-day gate, capacity rights owners they could be paid back the balancing spread.

In our view, the Framework Guidelines should include a comprehensive chapter of the firmness rules for all timeframes that are currently spread out across the document. The Framework Guidelines include provisions on firmness for Day-Ahead capacity (2.5), for Intra-day capacity (4.4) and for all nominated capacity (5.10). Therefore, in the present draft document firmness is not guaranteed only for Long Term non-nominated capacity. In this case, the solution could be that the TSOs buy back the non-nominated transmission rights.

7. Which costs and benefits do you see from introducing the proposed framework for Capacity Allocation and Congestion Management? Please provide qualitative and if applicable also quantitative evidence.

Costs and benefits are difficult to quantify. Efficient congestion management will increase competition across Europe and facilitate that consumer prices are based on cross-border competition.

With regard to assessment of costs and benefits of zone delimitation, the draft Framework Guidelines seen to take a rather short term perspective and do not consider the long term effects on investments. Small price zones will increase uncertainty for investments made by energy intensive consumers and generators and will neutralise incentives for further investments in the networks.

Österreichs E-Wirtschaft

Brahmsplatz 3 Tel +43 1 501 98-0 info@oesterreichsenergie.at
1040 Wien Fax +43 1 501 98-900 www.oesterreichsenergie.at

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In our view, in the situation of lack of interconnection capacity, the delimitation of zones might not be able to resolve the risks related to exercising market power. Delimitation of zones into a number of smaller zones may result in lower re-dispatch costs, but at the same time might increase risks of stronger market power exercised in the Day-Ahead trade. On the other hand, in case of larger zones, the prices in the Day-Ahead timeframe will be more competitive, but due to larger need for re-dispatch, the generators might have more opportunities to benefit from higher re-dispatch prices. It seems that the zone delimitation will only result in reallocation of risks and moving costs from one timeframe to another, but will not increase the social welfare significantly as finally it is the consumer, who will have to pay the cost of limited interconnections. A truly effective solution will be to identify the main needs for the new lines in the European grid by making the current congestions fully transparent and do grid investments accordingly.

In fact, it is argued that the delimitation shall be done to enable the integration of the intermittent renewable energy sources. In the view of the Oesterreichs Energie, it will be this intermittency which will still require substantial re-dispatching even with very small zones.

Section 1.1: Capacity calculation

8. Is flow based allocation, as set out in the framework guideline, the appropriate target model? How should less meshed systems be accommodated?

In principle, Oesterreichs Energie agrees with ERGEG's assessment. Just as ERGEG we consider participation of market parties as key for achieving practical solutions. In chapter 1.1.2 it is rightly stated *"…that the practical usage of the FB calculation and allocation start only after the market participants have been allowed sufficient time for their preparation and for a smooth transition to the new arrangement."*

We would still point out, that for now it remains a theoretical target model, which has to demonstrate its merits first. There is potential, that the approach will have to be adapted again.

9. Is it appropriate to use an ATC approach for DC connected systems, islands and less meshed areas?

No comment.

10. Is it necessary to describe in more details how to deal with flow-based and ATC approach within one control area (e.g. if TSO has flow-based capacity calculation towards some neighboring TSOs and ATC based to the others)? Oesterreichs Energie feels that this would be helpful indeed.

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Brahmsplatz 3 Tel +43 1 501 98-0 info@oesterreichsenergie.at
1040 Wien Fax +43 1 501 98-900 www.oesterreichsenergie.at

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11. Is it important to re-calculate available capacity intraday? If so, on what basis should intraday capacity be recalculated?

We fully support the provision (1.1.8) regarding the recalculation of capacity in the Intra-day timeframe. We consider it as crucial to facilitate the optimisation of the usage of the cross-border capacity while ensuring system security. The capacity shall be recalculated based on the changed status of the transmission system, generation and consumption. Oesterreichs Energie believes that the increasing amounts of intermittent generation will make recalculation of intraday capacity even more important. The framework guideline should give a more precise guidance as to the timing and frequency of the intra-day capacity re-evaluation with the purpose of harmonisation of the re-evaluation practices that exist at the moment across markets.

Section 1.2: Zone delineation

See above detailed comments under A) Main Concern

12. Is the target model of defining bidding zones on the basis of network topology appropriate to meet the objectives?

See above detailed comments under A) Main Concern

13. What further criteria are important in determining the delineation of zones, beyond those elaborated in the IIA and FG?

See above detailed comments under A) Main Concern

Section 2: Forward markets

14. Are the preferred long-term capacity products as defined in the framework guideline suitable and feasible for the forward market timeframe?

In Principle Oesterreichs Energie agrees with ERGEG's assessment.

Some complementary comments on long-term capacity products: FTRs and PTRs are important for cross-border competition in the forward markets. Oesterreichs Energie believes that FTRs or PTRs shall be implemented in a consistent way between all bidding zones in all parts of EU. The framework guidelines shall clearly state that all TSOs shall allocate FTRs or PTRs corresponding to the full available capacity. CfDs, as used in the Nordic market, are not fulfilling the requirements to enable cross-border competition in the forward market between fundamental competitors.

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Brahmsplatz 3 Tel +43 1 501 98-0 info@oesterreichsenergie.at
1040 Wien Fax +43 1 501 98-900 www.oesterreichsenergie.at

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15. Is there a need to describe in more detail the elaborated options for the organisation of the long-term capacity allocation and congestion management?

Oesterreichs Energie feels that this would be helpful indeed.

Some initial comments on the organisation of the long-term capacity allocation and congestion management:

Section 3: Day Ahead allocation

Oesterreichs Energie fully supports the target model for the Day-Ahead market based on capacity allocation through implicit auctions via a single price coupling algorithm.

Oesterreichs Energie also welcomes the provision (2.3) stipulating that the price of congestion shall correspond to the difference of the day-ahead electricity prices in the corresponding zones as this implies that there should be no components for grid losses, triads or others in the congestion price.

16. Are there any further issues to be addressed in relation to the target model and the elaborated approach for the day-ahead allocation?

In Principle Oesterreichs Energie agrees with ERGEG's assessment.

The target model shall be described in detail to ensure that it is implemented in the same way around Europe.

Section 4: Intraday allocation

17. Are there any further issues to be addressed in relation to the target model and the elaborated approach for the intraday allocation?

Oesterreichs Energie agrees with ERGEG's assessment on most of the features of a future intraday market.

However Oesterreichs Energie does not see the necessity for implicit auctions for the intraday allocation. This issue has been discussed at length within the PCG and it is our firm belief that for the foreseeable future continous trading should be the way to go.

The target model shall be described in detail to ensure that it is implemented in the same way around Europe. Intraday trading shall be possible at least until one hour before delivery.

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Brahmsplatz 3 Tel +43 1 501 98-0 info@oesterreichsenergie.at
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18. Does the intraday target model provide sufficient trading flexibility close to real time to accommodate intermittent generation?

Yes, In case continuous implicit allocation is implemented around Europe. Oesterreichs Energie believes that pricing of intraday capacity will add complexity to the process without adding substantial value.

Kind regards,

Dr. Barbara Schmidt	DI Ursula Tauschek
Secretary General	Head of Grids

Österreichs E-Wirtschaft

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1040 Wien Fax +43 1 501 98-900 www.oesterreichsenergie.at

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