ENTSO-E response to ERGEG draft benchmarking report on medium and long-term electricity transmission capacity allocation rules

Brussels, 14 May 2010

Introduction

ENTSO-E and its members welcome the opportunity to comment on the ERGEG draft benchmarking report on medium and long-term electricity transmission capacity allocation rules.

The main objective of this benchmark report is to compare and identify the best practices of ERGEG's Regional Initiatives concerning medium and long-term electricity transmission capacity allocation rules. It considers that the harmonisation of long-term products should be a priority and that consideration should be given to developing a single set of auction rules for medium and long-term capacity rights to facilitate cross-border trade. The driving force behind this public consultation is the ultimate objective of creating a competitive and integrated European market with a level playing field achieved through the development of efficient long-term price signals, competition across interconnections and an efficient linking of the medium and long-term market with short-term price signals.

The following comments outline ENTSO-E's view of the issues raised by ERGEG in its consultation and are intended to contribute to finding an enduring solution to medium and long-term allocation of cross-border capacity on European interconnections. The response is structured into the sections "General Remarks", "Question Responses" and "Comments on Regions".

General Remarks

The key role of the medium and long-term cross-border market is to provide market participants with the ability to manage cross-border risk. The market solution employed for medium and long-term capacity allocation should ensure an efficient, market-linked and non-discriminatory use of cross-border capacity. Two market solutions are currently implemented in Europe:

- Forward transmission rights allocated by TSOs as physical rights through explicit auctions, used across most interconnections in Europe.
- Financial derivatives (CfD) offered by a third-party with no direct link to the cross-border capacity, used in the Nordic countries, including the interconnectors between Nordic countries and Germany or the Netherlands.

ENTSO-E considers it important to maintain a clear distinction between transmission rights that are based on the underlying physical capacity and financial derivatives that are not directly linked with cross-border capacity and can be offered by any third-party.

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The Project Coordination Group (PCG) outlined its Target Model and roadmap for allocating cross-border capacity across all timeframes (including the medium to long-term) to the Florence Forum in December 2009. The PCG came up with a proposed framework for developing the medium and long-term capacity allocation rules across regions, building on progress already achieved and implemented in a number of regions and identifying some open areas for future discussion.

Forward transmission capacity, allocated by TSOs as physical or financial rights[1], should reflect the available physical capacity (i.e. based on capacity calculation) of the system. Transmission Rights should be primarily understood as a hedging tool for those users taking part in cross-border electricity markets.

Following the Florence Forum in December 2009, an Ad Hoc Advisory Group (AHAG) has been established to progress the work already done by the PCG. The AHAG is effectively tasked with the development of a framework guideline on capacity allocation and congestion management. It will focus on three key areas: capacity calculation and intraday trade (led by ENTSO-E) and governance and day-ahead market coupling (led by the EU Commission).

ERGEG is currently drafting an Impact Assessment and the related draft framework guideline on capacity allocation and congestion management. This work is still at an early stage but will no doubt help inform the debate going forward and will ultimately led to the development of Network Codes on capacity allocation and congestion management.

As most regions already have or are developing Physical Transmission Rights (PTRs) with UIOSI, a pragmatic approach would be to make use of and consolidate the progress made to date and consider Financial Transmission Rights (FTRs) at a later date when markets are more mature with market coupling in place and if market participants have indicated their clear preference for financial rights over physical rights. PTRs with UIOSI are an effective tool for maximising the allocation of capacity to the market.
Financial derivatives, although not in the TSOs scope, can operate in parallel with transmission rights. In regions with sufficiently liquid day-ahead implicit auctions and mature financial markets they may be considered as an adequate and valid alternative to transmission rights (e.g. Nordic region).

An appropriate firmness regime needs to be developed in accordance with Regulation 1228/2003 and 714/2009. This is expected to be a major outcome of the AHAG process. A fair balance of risks between market participants, TSOs and end-users needs to be determined in terms of compensation in case of curtailment. The costs of firmness should be fully recoverable from national tariffs and congestion revenues.

Inter regional coordination and harmonisation of the long-term capacity allocation rules is considered in general as a prerequisite to achieving the “ultimate goal” of a “single European market”, but this goal can only be reached if the markets develop inside each region in a coherent way towards the “single European market”.

[1] Under certain conditions, see question 4

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Question Responses

Please find below the responses to the questions as outlined in the draft benchmarking report:

Question 1 – Degree of convergence in long term capacity allocation rules

The Congestion Management Guidelines require that auctions are to some extent coordinated in terms of identical timeframes and gate closure times, identical structure for the allocation of capacity among different timeframes and blocks of capacity sold etc. Congestion-management procedures are required to be compatible across regions.

The draft benchmarking report confirms some convergence of long term auction rules, particularly in terms of conditions for participating in the auctions, the characteristics of the allocated products and the functioning of secondary markets.

Consideration needs to be given to the feasibility of developing a single set of allocation rules within and across regions with the creation of an auction platform or the setting up of an auction office in each region or whether it would be better in the first instance to agree on the timeframes for capacity allocation, the types of product to be offered, the compatibility of auction systems and auction rules with UIOSI and secondary trading.

Progress has been made in each region, however, the specific characteristics of each region to a large extent has determined the level and pace of coordination, with some regions progressing faster than others. It is also possible that a solution considered optimal in one region may not be the preferred solution in another region due to valid and practical considerations specific to that region. What is required is the adoption of compatible solutions between regions with sufficient scope for regional variation which remains consistent with European integration and is fully compliant with the Congestion Management Guidelines.

In regions where forward financial electricity markets are well developed and have shown their efficiency (e.g. Nordic countries), all interconnection capacity may be allocated through implicit auctioning. There is therefore no need to provide a single set of long-term auction rules applicable to all regions, but rather focus on harmonising auction rules in those regions where agreement can be reached on compatible solutions for long-term capacity allocation. When a region develops an auction platform with compatible auction rules it should comprise a secondary market with PTRs and UIOSI.

Question 2 – Harmonisation of auction rules, firmness

The Congestion Management Guidelines provides that access rights for long and medium-term allocations shall be firm transmission capacity rights, subject to UIOLI or UIOSI principles at the time of nomination.

The draft benchmarking report considers that there is a need for further harmonisation on firmness of both allocated and nominated capacities in some regions.

The firmness of allocated rights has an impact on the share of available transmission capacity allocated long-term. The ability of TSOs to hedge and the refinancing options available will dictate the degree of firmness possible.

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ENTSO-E outlined its main views on this topic in the paper *'Firmness of cross-border capacities and compensation schemes in case of curtailments'*, published in January 2009:

- ENTSO-E acknowledges the principle, used on many interconnections, that following gate closure trade across interconnections should be firm, except in the case of Force Majeure or rights and obligations of TSOs in case of emergency situations.
- The compensation scheme in the case of curtailment must be defined according to the Congestion Management Guidelines which explicitly excludes the compensation of consequential losses.
- When defining the compensation in case of curtailment an appropriate balance of risks must be established between market participants, TSOs and end users. All market parties including TSOs, need to be appropriately incentivised to reduce overall risk and cost to the market.
- Regardless of the compensation scheme, for regulated interconnections the distribution of costs falling to TSOs should be ultimately covered by regulated tariffs so that the financing of the companies and consequently network security is not at risk and perverse incentives for reducing the level of cross-border are avoided.

<u>Question 3 – Share of available transmission capacity to be allocated long term</u>

TSOs are required to define an appropriate structure for the allocation of capacity between different timeframes. This can include an option for reserving a minimum percentage of interconnection capacity for short-term allocation, subject to review by the regulatory authorities. In drawing up their proposals, TSOs need to consider the characteristics of the market; the operational conditions; the NTC calculation method (top-down, bottom up); and the level of harmonisation in terms of the percentages and timeframes in place.

The allocation of all capacity in the long-term timeframe would theoretically ensure economic efficiency across the interconnections but may in practice result in insufficient capacity in the short-term timeframe to enable a robust and reliable day-ahead market and may raise the question of firmness. Therefore, it is advisable to allocate a portion of the available capacity for the short-term timeframe to ensure efficient price formation day-ahead, either by reserving some capacity for use day-ahead or allocating the capacity as PTRs with UIOSI or FTRs such that it is ultimately used in the day-ahead market.

The distribution of cross-border capacity allocated between the different timeframes should be decided regionally based on the characteristics of each regional market. The possibility of providing multi-year allocations should also be decided on a regional basis. The adoption of multi-year allocations also raises questions concerning the capacity calculation method and the share of capacity to be made available and whether capacity should be firm or non-firm.

<u>Question 4 – Improvements in long term auction rules</u>

The establishment of PTRs with UIOSI across all interconnections or, when the necessary preconditions are met, the introduction of financial derivatives in mature markets as used in the Nordic region would be a positive step forward. It may also be feasible to evolve from PTRs with UIOSI towards FTRs if certain preconditions are met:

- Market coupling is in place across the interconnections
- There is an appetite for financial transmission rights over physical transmission rights with UIOSI from market participants

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It might also be possible for third-parties to offer financial derivatives not linked with cross-border capacity in parallel to forward transmission rights.

An efficient secondary market for trading transmission capacity rights should be established, along with PTRs with UIOSI.

A harmonised definition of force majeure would be beneficial for all stakeholders. This would apply to both 'force majeure' and also 'emergency situations'.

Finding an appropriate balance of risks between market participants, TSOs and end users on the issue of firmness and harmonising the approach taken across regions, where possible, would be a positive development, with all stakeholders incentivised to reduce overall risk and cost to the market.

Question 5 – Difficulties in long term capacity allocation across several interconnections

The difficulties involved in long-term allocation across several interconnections will be dependent on the allocation rules in use across the interconnections. A single set of auction rules should be in place or where this is not feasible, increased coordination across the interconnectors with harmonised products; timeframes and gate closures should be developed.

Question 6 – Development of auction platforms

There is no uniform approach to the allocation of long-term capacity across the regions with some developing auction offices and others preferring to use liquid day-ahead markets with financial hedging. The Nordic region aside, it is likely that most of Europe will move towards PTRs with UIOSI and will develop auction platforms or auction office(s), first on a regional basis but these may well develop into inter-regional platforms as capacity allocation across the interconnections becomes more coordinated and the products offered are harmonised.

The establishment of an auction office in one region should provide for the future membership of other members once the allocation rules have been coordinated or should enable the future merging of auction platforms into inter-regional platforms.

Question 7 – Any other comments

From a more general perspective, ENTSO-E believes it is highly important that Regulators, TSOs and stakeholders are fully engaged in the discussions about practical implementation issues.

Comments on Regions

ENTSO-E would like to make a number of factual clarifications to the draft Benchmark Report with regard to developments in the regions. These are outlined in the attached annex.

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Annex to ENTSO-E response to draft ERGEG Benchmark Report – Comments on Regions

ENTSO-E would like to make a number of factual clarifications to the draft Benchmark Report with regard to developments in the regions. These are outlined below.

South-West Region

In the region South West (France, Spain and Portugal) there is an absence of mature forward markets and therefore it is of the utmost importance the implementation of coordinated long-term congestion management mechanisms at both France-Spain and Spain-Portugal interconnections, as established in the Annex 1 of the regulation EC/714/2009:

> "3.2. A common coordinated congestion-management method and procedure for the allocation of capacity to the market at least annually, monthly and day-ahead shall be applied by 1 January 2007 between countries in the following regions: (e) South-West Europe (i.e. Spain, Portugal and France)"

Spanish-Portuguese border:

The long term mechanism at the Spanish-Portuguese interconnection is not fully developed by the moment.

In view of the need of a coordinated solution for the Spanish-Portuguese border, the MIBEL Board of Regulators has decided to present in the second quarter of 2010 a coordinated proposal on the most suitable and feasible auction model as regards MIBEL market, as decided in the 8th RCC meeting (November 25th 2009) of the Regional Initiative SW and confirmed in the Draft Action Plan 2010-2012 for the region discussed during the 6th IG meeting (February 15th 2010),

MIBEL TSOs think that the coordination between both borders of the SWE Region is also important. The application of FTRs in the French-Spanish interconnection may only be implemented after market coupling between MIBEL and CWE is in place. In this situation, in a first phase, the application of PTRs + UIOSI method in the Portuguese-Spanish interconnection would provide the required harmonization in the SWE Region until MIBEL is coupled with CWE. At this moment and if the users preferred a financial product, coordinated FTRs in both borders can be applied.

French-Spanish border:

The current mechanism, explicit auction of PTRs associated with UIOSI and with caps to the price differential which are revised annually, is fully in line with the Common Position CNE-CRE of January 2005 and with the national regulations in force in Spain and France. Only a few comments on the Report have to be made:

- Participation at LT capacity auctions

The amount of each (and not the sum of both Bank Guarantees) is at a minimum of 100k€.

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- Nomination and firmness

It should be added that the "curtailment before nomination of both monthly and yearly PTRs" can be performed only before sending the recap (programming authorization at 16h00) of the acquired capacity; meaning that once the recap is sent, the acquired capacity can not be curtailed.

It is not mentioned in the current IFE Rules that, in case of force majeure, participants are reimbursed at PTRs' price paid in the auctions, as stated in the Report.

- The existence of secondary trading

The minimum volume of 1 MW over 1 month applies for the resale of annual PTRs.

Central-West Region

- Participation at LT capacity Auctions :

One condition for participating in the LT Auctions is missing : the Participant shall have signed and abide by the terms of one (1) Nomination Contract;

- Format of LT capacity Auction :

The Yearly and Monthly Auctions take place within a fixed period specified in the Auction Rules.

There is a financial check during the Yearly/Monthly Auction iteration process.

The credit limit of the participant is checked against the amount resulting from the product of the auction marginal price, the volume of the selected bids and the corresponding duration in hours. For Yearly Auctions, only one twelfth of this amount is checked against the credit limit of the participant. The corresponding amount is blocked on the business account.

- Nomination and Firmness :

Correction : "One counterparty (or the user himself) must be designated in each system": It depends on the Borders : for some borders, the nomination agent has to be the participant on both sides of the border, for other borders, the participant has to be the nomination agent on one side of the border at least.

Note that compensation scheme at market spread with caps on FR-BE border has been introduced in the new version of the auction rules which will enter into force with the launch of Market Coupling.

- Secondary trading :

There is no response time indicated in the auction rules for the Joint Auction Office to accept a transfer.

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"If the Joint Auction Office does not issue a Functional Acknowledgement of Receipt for a Transfer Notification, the Transfer Notification in question is deemed not to have been submitted."

In recent years the demand/ usage of capacity transfers was quite low. The reason for this seems not to be the lack of a platform but rather price-formation of transfers: for determining the price of capacity one would generally use the price-forward-curve (PFC). This leads to the same prices/values which can be reached by UIOSI. So it seems that there is by nature no need for this kind of platforms (otherwise already market-actors would have developed this kind of market facilitating tools).
Minor clarifications:
("Nomination and firmness"):
Second clause: "recap" should/ could be replaced by "programming authorisations".

Third clause: In some countries there is no nomination at 8.15. Therefore for clarification reasons it should be called "nomination resp. reservation".

Central-South Region

According to the European Regulation EC 1228/03, the following borders belong to the CSE region: Italy-France, Italy-Austria, Italy-Slovenia, Italy-Greece, Italy-Switzerland, Switzerland-Germany, Switzerland- France, Switzerland- Austria, Austria-Germany and Austria-Slovenia

- Participation at LT capacity Auctions :

For all LT export capacities from Italy and import capacities from France, alternatively to the bank guarantee a cash amount could be deposited on an account kept by TERNA. This also applies for all LT auctions in the direction Switzerland to Italy where the respective cash amount can be deposited on an account kept by Swissgrid as auction operator.

- Format of LT capacity Auction :

The situation described is no longer in place as a common mechanism has been set up in 2010 on the France-Italy border: TERNA is the unique Auction Operator on this border for both directions.

As a consequence, only one bank guarantee is requested to participate on all exporting direction from Italy to other countries and also for the direction France to Italy. In the direction from France to Italy, there is no longer exception: payment has to be done before the use.

The discontinuous annual product is more generally not available during maintenance period and during low consumption in Italy. The maintenance period runs in August and in other months if necessary.

- Nomination and Firmness :

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On the French-Italian border, the programming authorisation is sent in the direction France to Italy, two working days before the execution.

Regarding secondary trading, there is no longer specificities for the direction France to Italy.

Northern Region

It should be mentioned under "the existence of secondary trading" that currently there is UIOLI-principle in place for not-nominated yearly and monthly capacity and that this is planned to be changed into UIOSI from 2011.

France-UK-Ireland Region

FUI notes that the capacity allocation table refers (column three) to the <u>average</u> volume allocated rather than the <u>current</u> volume allocated (correction).

IFA

- Participation in LT capacity auctions

In addition to the paper, a participant must also have BM Units registered. Furthermore, a payment security in the form of credit cover can be of any amount. For clarity, with regards payment security, this amount also takes into account other outstanding liabilities.

- Format of LT capacity auction

For clarity, only base-load products are currently auctioned, although peak/of peak etc products are possible within the IFA rules and technical feasibility etc. Furthermore it should be noted that discontinuous products on IFA are allocated routinely, where a planned outage requires capacity to be scaled back for part of the product period.

The publication of LT auction results process is not accurately described: the preliminary results are published immediately after the end of the bidding period. The checking period lasts two hours, and the final results are then published (no later than thirty minutes after the end of the checking period). Furthermore, the payment is made in advance of the product period commencing in the majority of cases.

- Nomination and firmness

It is written that participants should nominate to one operator only, which is not exactly what is written in the Rules: there is only one CMS system (which is jointly owned by both operators) for nomination, and participants don't need to formally nominate with each operator (this is done by this joint system).

Finally, for clarification, participants' Deemed Metered Volumes (aggregated from nominations across all timescales) are sent by CMS directly to market operators in both GB and France.

South-East Region

In the ERGEG draft benchmarking report on medium and long-term electricity transmission capacity allocation rules there is no data for the South East European (SEE) region, because the SEE region is not under the scope of the activities of ERGEG.

Yours Faithfully,

European Network of TSOs *for Electricity, Brussels*

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