

CRE consultation on the use of long-term transmission rights at the French borders



EFET response – 18 May 2018

EFET thanks CRE for the opportunity of an open discussion on the very important subject of the allocation and use of long-term transmission rights. The calculation and allocation of cross-border transmission capacity, including in the forward timeframe, is one of the most fundamental tasks of TSOs in the internal power market. The current practices of TSOs in that regard ought to be improved, whether it concerns the allocated volume of capacity, or its repartition between different timeframe. Therefore, we appreciate that the CRE anticipates the debates that will unmistakably take place in each capacity calculation region (CCR) for the implementation of article 16 of Commission Regulation (EU) 2016/1719 establishing a guideline on forward capacity allocation (FCA Guideline).

An informed and transparent debate should contribute to improving the quality of the TSO methodology proposals on splitting long-term cross-border capacity. French borders with neighbouring bidding zones being part of four different CCR, we also see important benefits to the exercise started by CRE in terms identifying the areas for harmonisation between the methodologies of the different CCRs, and ensure coherence in the various allocation processes across Europe.

Question 1: *What do you think is the appropriate breakdown of capacity between timeframes? Which elements do you think are important to take into account in setting the breakdown rules, without necessarily limiting yourself to the criteria set out above?*

General considerations on forward trading and forward transmission rights

Forward markets are an integral part of the electricity market, alongside the day-ahead, intraday and balancing timeframes. Forward trading enables market participants to secure deals (energy and transmission capacity) far in advance of real time, managed price and volume risks, and provide long-term price signals to the market.

Forward trading also represents a key element of risk management through (cross-border) hedging, which is essential for sourcing and providing electricity to customers competitively, as it allows market participants to avoid exposure to short term price volatility and imbalance costs. TSOs, as managers of cross-border capacity, have the

ability to manage the associated risks and are the *only* parties in the electricity sector that can do so: TSOs are the only asset owners and/or operators with an in-built capability to offer primary, physical hedges against future congestion rents through the allocation of firm cross-border transmission capacity rights. TSOs in this sense are *natural* sellers of firm transmission capacity rights.

Allocation of long-term rights to market participants also conveys long-term signals to the TSOs regarding potential congestion on certain cross-border points. This provides an indication to the TSOs regarding forward market activities, possible infrastructure investment needs and congestion revenues forecasts.

These signals to the market and the TSOs however only reflect the reality of market participants' needs and inter-zonal congestions if:

- the capacity allocated by way of long-term rights is financial firm
- the capacity allocation is maximised as much in advance of real time as possible.

The sale of transmission rights is a fundamental part of the business of TSOs and a service that their customers – generation, trading and retail supply businesses – need in order to be able to compete properly in all bidding zones of the internal electricity market. Auctions of these rights have underpinned the development of cross border liquidity in the continental wholesale power market. The availability of these instruments promotes competition in electricity supply across national and control area boundaries at the wholesale level.

EFET view on the capacity breakdown criteria suggested by CRE

- *Criterion 1: sufficient volume for each allocation:*

As a matter of principle, we are opposed to the idea that any share of the available cross-border transmission capacity, as calculated by the TSOs and taking into account security margins, be reserved for the day-ahead timeframe.

It is important that, at the moment of the yearly auction, all the available capacity is calculated by the TSOs. As much of this capacity as possible (with no reservation) should be made available for yearly auctions to the market at that point. TSOs should update their computation throughout the year and offer the additional released capacity (if any) in subsequent auctions.

EFET does not believe that any long-term capacity rights should be withheld from market participants to ensure the liquidity of day-ahead market coupling. There is fundamentally no reason for the TSOs or the regulator to privilege the liquidity of one market over the other. The market, at each given point of time, will give a value to the cross-border transmission capacity, which is as “true” five years or five minutes ahead of real time (see our comments on criterion 3 for more details). The capacity that is allocated by way of long-term transmission rights allows the effective coupling of forward markets across borders, and is re-traded by market participants on the secondary market should its value change.

In addition, we see no reason for TSOs to withhold capacity for the spot timeframe – or the balancing timeframe – for system security reasons.

Whichever the situation that TSOs have to face in the spot and balancing timeframes, they have ample tools at hand to manage it: Indeed TSOs have the possibility to take remedial actions (re-dispatch and countertrading) or to curtail the capacity rights (with appropriate compensation to market participants according to article 53.2 of the FCA Guideline) to ensure system security.

Finally, when it comes to financial transmission rights (FTRs), EFET shares the point of view of CRE that there is no need or justification to reserve any capacity for the spot or balancing timeframes. Indeed, FTRs being only linked to the physical underlying capacity for capacity calculation purposes, no physical event linked to operational security or emergency situations may affect them. We therefore wonder for which reason a quantity of 200 MW is still reserved or day-ahead market coupling at the FR-BE border.

- *Criterion 2: minimum volume of transmission rights for forward hedging:*

For the second criterion proposed by CRE (a minimum volume of forward transmission rights allocated to improve hedging opportunities), EFET is again doubtful of the proposed approach. The proposed approach does not suggest that TSOs allocate the full calculated capacity to the market as far in advance as possible. Rather, the solution proposed by CRE would be of an arbitrary threshold set ex ante for the allocation of capacities at different points of the forward timeframe.

Let's first start on a positive note: we appreciate the intention to make more forward transmission rights available to market participants. And we also think that TSOs should indeed consider broadening the type of forward transmission rights they propose to the market (e.g. semi-annual, quarterly, weekly products) if a need is expressed (see our response to Q3).

However, criterion 2 is fundamentally only a variation of criterion 1, where more focus is placed on the different horizons of the forward timeframe. The thinking behind this approach has the same flaws as criterion 1: when allocating yearly capacity, any reservation of capacity for a later stage, be it for quarterly monthly or day-ahead, destructs welfare. Indeed, the simple fact that TSOs withhold transmission capacity that has been calculated as available at that specific point in time means that the natural hedge that transmission lines constitute is not put to an efficient use. This is a lost opportunity for both the market – increased cost of and possible restrictions to cross-border hedging – and TSOs – lost congestion rent.

Further, the concept of specific thresholds for the allocation of capacity at different points in time would deviate from the notion of economic optimisation EFET is pleading for. We call for capacity calculations that are maximising the overall economic welfare at each point of time.

Looking at forward energy markets to set a minimum threshold does not seem practical. The different maturity of, e.g. calendar, quarterly, monthly and week-ahead energy products means that by definition, the market activity on these products at a specific point of time will not represent the actual hedging needs

of the market. For example, at the time of the allocation of yearly transmission rights for year X, the market for calendar energy products for the corresponding year is normally quite dynamic. However, the market for the quarterly products Q4 of year X is usually less liquid already. Come to the monthly product November X, or week 48 X, the liquidity falls. Would CRE nonetheless persist in researching this possibility, we allow ourselves to remind the regulator that the “financial derivatives market” to which it refers to performs the comparative assessments of various timeframes activity corresponds to a very minor part of forward energy trading. Financial forward markets represent in France only about 10% of all forward trading. Any assessment of the activity of forward markets ought to include physical OTC deals, based on information that CRE can access via the REMIT database.

- *Criterion 3: capacity valued according to system state in real time:*

We very strongly warn CRE against the possible application of criterion 3. Believing that allocating an important part of the capacity closer to real time would better capture the “true” value” of the congestion rent is for us both an error and a possible violation of EU legislation.

First, uncertainties about the state of the system indeed reduce closer to real time. However, this does not mean that prices get “better”. One cannot consider that the price for a day-ahead product as determined D-1 is “better” than the price for a year head product. These products are traded at very different timeframes. Provided that transmission capacity is not withheld from the market, these prices actually all represent the “true value” of transmission capacity, only at different points in time. And good price formation for forward products is as important (or maybe even more important) than for day-ahead products. Therefore, there is no better economic valuation of cross-zonal capacity if it is allocated closer to real time.

Second, the allocation of cross-border transmission capacity in the forward timeframe is a duty of TSOs according to European law. TSOs bear special responsibilities as providers of transmission services. EU legislation recognises them as owners of essential facilities. In this capacity they must, under proper regulatory supervision, grant individual market participants the transmission access products which they legitimately request, including in forward timeframes. In this context, market participants do not expect to be greeted with a refusal of third party access to network infrastructures in the forward timeframe.

- *Criterion 4: independence from network developments*

We share the point of view of CRE that the transmission rights allocated at each border should reflect the availability of physical assets. However, as mentioned above (criteria 1), we remain concerned by the low level of transmission rights allocated by TSOs. EFET member companies have observed ever more instances of TSOs restricting access to cross-border transmission capacity, including in the forward timeframe, in order to manage

internal congestion and/ or to reduce their exposure to re-dispatch expenditures. The practice of reducing allocated capacity at borders in order to avoid internal congestion measures and related costs is forbidden by European Union law (Article 16 and Annex I to Regulation 714/2009).

In short, here are **our recommendations** for the allocation of cross-border transmission capacity:

1. **Allocate the maximum available capacity as calculated by TSO as far in advance of real time as possible**, at least a year ahead, with reductions only possible for system security reasons
2. **Re-calculate available capacities at regular intervals and make this capacity available to the market** at later stages (quarterly, semi-annually, monthly...)
3. **Ensure that forward transmission rights are freely re-tradable on the secondary market** so that forward transmission rights – and the capacity they correspond to – are properly valued in the market even after their allocation.
4. **In case TSOs realise close to real time that they have over-allocated capacity, request that they buy back the capacity.**
5. Ensure that TSOs only make use of **curtailment in the circumstances and according to the firmness rules foreseen in the FCA Guideline.**

***Question 2:** Do you consider it necessary to maintain differentiated capacity breakdown rules between French borders, or do you wish to harmonise these rules?*

EFET always welcomes harmonisation of rules and processes, as it generally simplifies the life of market participants. However, harmonisation is not a goal in itself. We support a harmonisation of the capacity allocation breakdown rules in order to facilitate market integration but only if this does not lead to any step back at any of the CWE borders. Harmonisation by applying our recommendations in our response to question 1 would be very welcome as it would follow the highest common denominator.

EFET is therefore not opposed to a different repartition, as long as the granularity of transmission rights allocated is in line with the granularity of the forward products traded in the wholesale electricity markets.

***Question 3:** Do you consider it necessary to maintain, and if necessary to generalise, the specific allocation timeframes (quarterly, half-yearly) proposed today on the France-Great Britain border?*

EFET members appreciate the availability of semester and quarterly products at the GB borders, since they are in line with the granularity of the electricity (and gas) products traded in GB.

TSOs should consider broadening the type of forward transmission rights they propose to the market at other borders (e.g. semi-annual, quarterly, weekly products) if a need is expressed by the market, and if corresponding energy products are traded.

Question 4: *Do you consider it appropriate to allocate part of the interconnection capacity freed by the expiry of long-term contracts on the France-Switzerland border at long-term timeframes? If yes, which breakdown rules would you propose?*

Yes. EFET thinks that if capacity is made available by the expiry of long-term contracts at the French-Swiss border, it should be allocated to the market. Once again, and referring to our response to Q1, capacity should be made available to the market for the full calculated amount, and as far from real time as possible.

Question 5: *Do the long-term rights currently existing at the French borders meet your needs?*

We are generally concerned with the amount of capacity allocated to the market, in all timeframes. As highlighted in the last two ACER Market Monitoring Reports, there are indications that TSOs may be using cross-border capacity calculation and allocation processes to manage internal congestions and loop flows, in violation of Regulation 714/2009. In recent position papers on capacity calculation (including responses to consultation on capacity calculation methodologies¹, statements linked to discussions on the Clean Energy Package for All Europeans²), we expressed called on regulators and decision makers to ensure that TSOs calculate and allocate cross-border transmission capacity in a transparent manner that ensures a true maximisation of welfare at regional level.

This issue of under-allocation of capacity to the market by the TSOs of course affects the availability of capacity in the forward timeframe as well. We refer to our answer to question 1 for further considerations on the breakdown rules

As mentioned in our response to question 3, the TSOs could consider the allocation of capacity via semi-annual, quarterly and weekly products at the French borders. Beyond this, we would welcome the allocation by TSOs of multi-annual products (two-year ahead, three-year ahead products), which would give even more options to market participants for long-term cross-border hedging.

Finally, as mentioned in our response to question 7, FTR obligations, where they exist, should be allocated in full volume in the forward timeframe, without restriction linked to system security. Also, the applicable rules for FTR obligations curtailment should be reviewed to only allow curtailment in case of force majeure.

¹ EFET, eurelectric, Nordenergi and MPP response to TSOs' consultations on capacity calculation methodologies, last updated on 22 March 2018, available at:

http://www.efet.org/Files/Documents/Downloads/EFET_Eurelectric_MPP_Nordenergi-TSOs%20consultation%20CCM_22032018.pdf.

² "Whatever happened to our cross-border transmission capacity ?", press statement dated 19 July 2017, available at: http://www.efet.org/Files/EFET%20PR111_Whatever%20happened%20to%20our%20cross-border%20transmission%20capacity.pdf; "The CEP should foster – not threaten – the availability of cross-border transmission capacity", joint statement with eurelectric, the Market Parties Platform and Nordenergi, dated 14 February 2018, available at:

[http://www.efet.org/Files/Documents/JOINT%20STATEMENTS/Joint%20Statement%20on%20Art%20%2014_Feb2018\[1\].pdf](http://www.efet.org/Files/Documents/JOINT%20STATEMENTS/Joint%20Statement%20on%20Art%20%2014_Feb2018[1].pdf).

Question 6: *Do you consider that purely financial products exchanged between market participants via an exchange, without the involvement of the TSOs (e.g. contracts for difference on price differentials between zones or equivalent product combinations) could guarantee all the functions now devolved to long-term rights, and why?*

Concerning the obligation to issue transmission rights, it is important to recall that TSOs bear special responsibilities as monopolistic providers of transmission services. EU legislation recognises them as owners of essential facilities. In this capacity they must, under proper regulatory supervision, grant individual market participants the transmission access products that they legitimately request, including in forward timeframes. In this context, market participants do not expect to be greeted with a refusal of third party access to network infrastructures in the forward timeframe.

As a general principle we consider that all TSOs should issue forward transmission rights on all bidding zone borders, independently of the existence (or not) of other local hedging instruments (such as price spreads or CfDs/EPADs towards the concerned bidding zones). Indeed, forward transmission rights issued by TSOs provide an open and non-discriminatory access to hedging solutions against congestion costs (and the day-ahead congestion pricing), with no additional transaction costs. On the contrary, two opposite CfDs are needed on each border for market participants to be able to hedge against congestion costs and pricing. The issuance of forward transmission rights is therefore important for competition to develop in all bidding zones and not only in virtual zones. It is also essential for TSOs and/or cable owners to offer to the market all the available volumes of cross-border hedging instruments provided by AC or DC interconnection lines. In addition, no evidence was ever brought by TSOs that do not issue forward transmission rights, e.g. in the Nordic region, that the “non-issuance” of transmission rights would bring any benefit to the internal energy market, nor that the issuance of transmission rights could in any measure be harmful to existing, alternative arrangements for forward hedging.

Question 7: *How do you explain the overall weakness of the nomination rates of PTRs at the French borders? Would you support the generalisation of FTR-options at these borders? Besides, do you see an interest in the introduction of FTR-obligations?*

EFET generally shares the observations of CRE with regard to the differences between FTR options and PTRs. The nomination or not of PTRs are commercial decisions of market participants, which EFET as a trade association is not privy to.

We are in principle neutral to the issuance of either PTRs or FTR options by the TSOs. However, it is worth noting that the option to nominate PTRs, as such, has a value. Abandoning this to switch to FTRs requires:

- Capacity allocation maximised to 100% of available capacity (system security reservations should not be tolerated for FTRs)
- Full financial firmness of FTRs, and impossibility to curtail for any other reason than Force Majeure (system security excuses should not be tolerated for FTRs)
- No additional exposure for the market, e.g. in case day-ahead markets do not clear

To our last point above: we would like to point out that FTRs, by imposing market participants to close their physical position on the power exchange, exposes the FTR owner to a risk of unserved energy – risk that the owner of a PTR does not have. This risk has been acknowledged by CREG when the decision on FTR at the FR-BE border has been taken. CREG mentioned in her decision that *“En cas d’activation des réserves stratégiques et de recours à des tarifs de déséquilibre de 4 500 €/MWh, la CREG veillera à ce que l’utilisation des FTR Options offre les mêmes possibilités de hedging à ce tarif de déséquilibre que l’utilisation de PTR avec UIOSI”*.

EFET is however opposed to the allocation by TSOs of FTR obligations: TSOs get the congestion revenue in case the request for capacity (with the price > 0) is higher than the available capacity at each allocation. In case the spread is in the opposite direction we don’t see the rationale for paying a negative spread to the TSOs. There is no financial risk for the TSOs in allocating capacity, and FTRs as obligation would only make sense if market participants would trade between themselves such or similar contracts and payment for the negative spread would be the consequence of risk premiums. This is however not the case when TSOs allocate capacity. Should any set of TSOs consider applying FTR obligations at one border, we insist that market participants are consulted well in advance of the possible reform.

Question 8: *What elements do you think can explain the differences in the valuation of cross-border capacity between long-term and short-term timeframes?*

Please refer to our comment to criteria number 3 in question 1.