

ACER Public Consultation on the amendments of the regional design of long-term transmission rights for the Core Region**EFET response – 30 August 2019*****Topic 1: Introduction of FTR Options on the bidding zone border FR-DE/LU***

3.1 Do you support the proposal of TSOs with regard to the introduction of FTR Options on the FR-DE/LU border as of 1 January 2020?

Yes, under a number of conditions listed in our response to question 3.2.

3.2 Please specify your arguments, and in particular any objection you may have.

As we mentioned in our response to the CORE TSOs consultation on the subject¹, we are in principle neutral to the issuance of either PTRs or FTR options by the TSOs, bearing in mind a number of prerequisites.

Indeed, while most PTRs currently allocated at the CWE borders are not nominated – hence used as FTR options – the introduction of FTR options at these borders (and the FR-DE/LU border in particular) comes with some **disadvantages** for market participants. The post-consultation report of the TSOs² does not address these questions in a satisfactory manner.

First, FTR options potentially expose market participants to high imbalance prices in case of partial clearing. As the TSOs mention, the risk of partial clearing has very low probability, but in case it materialises, it would have very important negative consequences. The TSOs and most NRAs seem to agree that forward transmission rights are intended to cover against price risk in the day-ahead market only, at the

¹ EFET response to the CORE TSOs consultation on the design of forward transmission rights, dated 7 March 2019 and available at:

https://efet.org/Files/Documents/Downloads/EFET_CORE%20TSOs%20consultation%20FTRs_07032019.pdf.

² Consultation report by the TSOs on the second amendment to the CORE CCR regional design of LTTRs, dated 1 April 2019 and available at:

https://docstore.entsoe.eu/Documents/Network%20codes%20documents/Implementation/ccr/methodologies/core/fca-deliverables/core-lttrs-art-31/201903_Core%20LTTR%20design%20second%20amendment_Consultation%20Report.pdf.

exclusion of later markets. In particular, the view of NRAs that “*LTTs should, similarly as other futures and forwards traded on power exchanges, hedge against the (difference of) day-ahead prices, not against the imbalance prices in case of partial day-ahead market clearing. It is therefore preferred that the same hedging standard is maintained for LTTs as for other hedging products available on the market*” is new to us and particularly worrying:

- First, this statement mixes different concepts and instruments that are not comparable. Forward transmission rights – or LTTs – hedge against price risks between two bidding zones, while futures and forwards – traded not only on power exchanges, but actually for the most part on OTC markets – hedge against price risks within bidding zones. The former are hedging instruments proposed by the TSOs, the latter transactions freely concluded between market participants.
- Second, we wonder what is the legal basis of the above-mentioned assertion. Nowhere in the FCA Regulation (nor in Regulation 2009/714 or Regulation 2019/943) is the concept of hedging limited to day-ahead. Limiting the hedging potential of forward transmission rights to price risk in the day-ahead market at the exclusion of later timeframes is clearly an over-interpretation of the FCA Regulation. As a matter of clarification, the same applies to forward transactions within bidding zones, which the existing regulatory framework does not limit the hedging potential to the day-ahead market.
- Third, the interpretation of the TSOs and most NRAs does not fit the reality of hedging practices of market participants. Indeed, we observe that on days when instability in the market creates fears of partial clearing, market participants do nominate PTRs in much higher proportions. This is clearly a sign that PTRs are currently being used to hedge against price risk irrespective of where this risk materialises (in the day-ahead market or in later timeframes). As a matter of clarification, the same applies to forward transactions within bidding zones, whose hedging potential is not limited to the day-ahead market as the transacted volumes do not necessarily need to be traded again on the day-ahead market. Hence, they can also hedge against price risks in the balancing market within a bidding zone.

Therefore, we believe that the interpretation of the TSOs and most NRAs is misguided, and we reiterate our call for a backup mechanism to cover any risk related to unserved energy in the concerned bidding zones in case FTR options are being used.

Second, it does not seem that the TSOs quite understood our comments related to tying the market to power exchanges, and the administrative and financial burden that ensues. In the consultation report of the TSOs, it is mentioned that the participation to PTR or FTR auctions on JAO is free of charge. This is quite right, but not really the question at stake. What we actually wanted to attract the attention of the TSOs to was the fact that the use of FTR options forces market participants who have concluded forward transactions on two sides of a bidding zone border to go on exchange(s) *at the day-ahead stage* to close their physical positions: without PTRs, no physical hedging

instrument can back OTC cross-border forward transactions anymore. With PTRs, market participants could rely purely on OTC transactions if they chose to nominate their PTRs. Hence, the use of FTR options restricts market participants' ability to weigh the benefits and drawbacks – in financial terms and practical arrangements – of using OTC platforms or power exchanges for their physical cross-border transactions. And trading on power exchanges comes with a specific administrative and financial burden – such as mandatory membership to the power exchange, clearing fees, reporting, etc.

Third, we deplore that the TSOs or NRAs still have not taken action with regard to the review of article 56.3 of EU HAR for the case of FTR options. Article 56.3 lays down the rules for curtailment of allocated rights, i.e. one of the elements of the firmness of long-term transmission rights which is of course of utmost importance for market participants. EFET does not agree with the possibility for TSOs to curtail allocated FTR options for reasons of system security: since FTR options cannot be nominated, their allocation cannot have any impact on the state of the system, hence TSOs bear no physical risk. Therefore, we do not see any reason to apply a curtailment for system security reasons to FTR options. Only curtailments in case of Force Majeure should be applicable for FTR options. While FTRs curtailed to ensure that operation remains within Operational Security Limits shall be compensated to market participants at the market spread, this compensation is subject to a cap. Hence, article 56.3 creates a risk of curtailment and incomplete compensation for cases that are not justifiable in practice. We therefore reiterate our call for TSOs and NRAs to request a review of this article, especially given the increasing number of borders that will use FTR options going forward.

Against the backdrop of these disadvantages, limited **advantages** are put forward by the TSOs in the consultation for a switch to FTR options. On our side, the operational advantage will be reduced as market participants will need to continue managing potential physical nominations of PTRs on other borders tightly connected to the CWE region, e.g. at the Swiss borders.

The first of these advantages is related to the allocation of capacity in the forward timeframe versus day-ahead, as TSOs state that the total NTC could be given to the market in the form of forward transmission rights if FTR options are allocated in place of FTRs. However, we still see confusing wording in the consultation report. We recall our principle that all the capacity available (as the output of the long-term capacity calculation process) should be allocated in the forward time frame as far in advance as possible, irrespective of whether PTRs or FTR options are being issued by the TSOs. We acknowledge that the current practice of the TSOs is that part of the NTC is reserved for the day-ahead market when they allocate PTRs in the forward timeframe – for fear of seeing all allocated PTRs nominated by market participants. In this sense, the allocation of FTR options should really result in all the NTC calculated in the forward timeframe being allocated to the market, without any reservation for the day-ahead timeframe. We hope to see this principle applied in a strict fashion if the switch to FTR options is indeed decided.

The second advantage put forward by the TSOs is that the total NTC would be available for day-ahead market coupling, therefore raising welfare benefits. Given the very low proportion of PTRs currently nominated at the CWE borders, close to the total NTC is already allocated in the day-ahead timeframe, so the situation will improve but only marginally in that regard. However, we don't see that this will create welfare benefits overall: while social welfare may increase in day-ahead market coupling itself, this will be to the detriment of social welfare created in the forward OTC market, and accompanied by lower congestion rents as the characteristics of FTR options are less protective than PTRs for market participants – deterioration of the hedging potential due to the absence of possibility to nominate – thereby reducing the value at which market participants may want to acquire those rights. Without additional backing, we don't think that TSOs can justify a switch from PTRs to FTR options on supposed welfare gains from a global perspective.

Finally, we understand that FTR options will ease processes for TSOs by lifting a form of uncertainty on their side related to potential PTR nominations. This improvement would be welcome, though it has limited impact on market participants.

Further, we would welcome clarification by the TSOs on their intention to maintain the application of the Long-Term Allocation patch (LTA patch) in day-ahead flow-based market coupling after switching to FTR options. Our understanding is that this patch was intended to ensure that the results of day-ahead allocation would allow all allocated PTRs to be nominated, thereby preserving system security in such extreme cases. So far, the LTA patch was maintained for CWE borders using FTR options (BE-FR, BE-NL, AT-DE/LU). With the potential to nominate transmission rights disappearing in the whole region after the planned switch to FTR options, we would welcome an open dialogue with TSOs on maintaining or not the LTA patch in CWE flow-based market coupling (and CORE/Nordic flow-based market coupling in the future) in the context of a switch to FTR options at all CWE borders.

In summary, we reiterate the requests below before a switch from PTRs to FTR options at the concerned borders:

- Proper justification of the reasons for this switch and an assessment of its benefits from a global social welfare perspective;
- Cross-border transmission capacity allocation maximised to 100% of the available capacity at the time of calculation (system security reservations should not be tolerated for FTR options);
- Full financial firmness of FTRs, and impossibility to curtail for any other reason than Force Majeure (system security justifications for curtailment should not be tolerated for FTR options);
- No additional exposure for the market, e.g. in case day-ahead markets do not clear;
- Debate on maintaining the LTA patch in CWE day-ahead flow-based market coupling.

Topic 2: Introduction of FTR Options on the bidding zone borders AT-CZ and AT-HU

4.1 Do you share the concerns of the Agency regarding the proposed conversion of PTRs into FTR Options in the middle of the year 2020?

Yes

4.2 Which of the above two alternative options for implementation of FTRs Options on the bidding zone borders AT-CZ and AT-HU do you support?

Option 2: introduction of the FTR options at the beginning of the next calendar year (1 January 2021)

4.3 Do you have any other comment regarding the shift from PTRs to FTR options on the AT-CZ and AT-HU borders?

1. Switch from PTRs to FTR options at the AT-CZ and AT-HU borders

While we are generally neutral to the issuance of either PTRs or FTR options by the TSOs, we refer to our concerns and requests exposed in topic 1 of this consultation.

In particular, the risk of partial coupling is heightened in the case of bidding zone borders between markets with low liquidity, which is the case for the AT-CZ and AT-HU borders. Therefore, our request for a backup mechanism to cover any risk related to unserved energy in the concerned bidding zones in case FTR options are being used is all the more relevant for these two borders. We would oppose the introduction of FTRs options at the AT-CZ and AT-HU borders before any assessment of the situation has been made and solutions proposed.

2. Timing of the switch

We share the Agency's concerns regarding the automatic switch of already allocated PTRs to FTR options PTRs in the middle of 2020, and recommend the application of option 2. We understand that the date of 1 January 2021 is indicative, based on the assumption that day-ahead market coupling will be implemented at the AT-CZ and AT-HU borders in the course of 2020. Should market coupling be delayed and only implemented in the course of 2021, the switch to FTR options should likewise be postponed to the start of the following calendar year.

This proposal of automatic switch of already allocated rights comes without a justification of the TSOs. We can only guess that the TSOs do not **wish** to implement market coupling at these borders with PTRs. However, market coupling, including flow-based, has functioned and continues to function with PTRs, and TSOs have not proved that market coupling with PTRs at these borders would be infeasible. Hence, we do not understand the rush to switch from PTRs to FTR options and modify the characteristics of already allocated rights, nor the uncertainty that TSOs create for the

market with this proposal. It disregards responses from market participants to the above-mentioned consultation by the CORE TSOs and the following consultation on the EU HAR in June³, and shows either ignorance or disregard for hedging practices of market participants.

Second, market participants buy a certain hedging instrument from the TSOs for defined reasons, based on its full set of characteristics – including the possibility or not to nominate a forward transmission right. Those characteristics contribute to determining the value of the instrument. In no way should TSOs give themselves the right to go against basic principles of contract law and modify the specifications of a product that they have already sold to the market.

Third, we deem this proposal non-compliant with the FCA Regulation and the EU HAR. Both the Regulation and the EU HAR foresee that transmission rights shall be firm, with specific conditions for their curtailment. Nowhere in the Regulation or the EU HAR is a possibility to amend the characteristics of a right that has already been allocated.

As a conclusion, we call on ACER to set the switch from yearly PTRs to yearly FTR options at the start of a new allocation of yearly rights, without affecting already allocated rights (option 2).

If, against all the experience gathered over years on the operation of market coupling with PTRs, the concerned TSOs still deem it desirable to switch from PTRs to FTRs in the middle of a year, then the TSOs should not change the characteristics of already allocated rights: rather, they should buy them back and re-issue capacity in the form of monthly FTR options for the rest of the running year.

³ EFET response to the TSOs consultation on the review of the EU Harmonised Allocation Rules, dated 20 June 2019 and available at:
https://efet.org/Files/Documents/Downloads/EFET_TSOs%20consult%20EU%20HAR_20062019.pdf.