

18 July 2022

## The possible developments of the EU electricity forward market

The European Federation of Energy Traders (EFET<sup>1</sup>) welcomes the opportunity to provide comments to the EU Agency for the Cooperation of Energy Regulators (ACER) and the Council of European Energy Regulators (CEER) consultation on the EU electricity forward market.

### 1. Executive summary of EFET points

In times of volatile and high energy prices, forward markets are key enablers of a secure, affordable and decarbonised supply of electricity. This market segment represents close to 90% of electricity transactions in volume in Europe, showing the importance it represents to bring electricity from the power plants to the consumers. We welcome the fact that ACER and CEER show their commitment to the Internal Energy Market by seeking to improve this segment of the market and have taken the initiative to draft this policy paper.

However, the better should not be the enemy of the good. We fear that ACER and CEER have been carried away in an analysis of the situation of forward markets and in proposals to improve them that does not stand the test of what forward markets are designed for, and how they are used. In particular:

- **We disagree with most of the problems described by ACER and CEER as hampering an effective use of forward markets by their participants** – in particular, ACER and CEER seem focused on the way in which long-term transmission rights (LTTRs) are allocated – or not – and how this would be the main blocker to efficient forward markets. This shows a misconception of the weight that *cross-zonal transmission risk hedging* bears in the overall risk hedging strategy of market participants, which focuses primarily on the forward *electricity* market.
- **The number one no-regret option to improve access to cross-zonal transmission risk hedging options is the issuance of LTTRs by all TSOs** – this should be a mandate at all bidding zone borders, in both directions, to the

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<sup>1</sup> The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent and liquid wholesale markets, unhindered by national borders or other undue obstacles. We build trust in power and gas markets across Europe, so that they may underpin a sustainable and secure energy supply and enable the transition to a carbon neutral economy. EFET currently represents more than 100 energy trading companies, active in over 27 European countries. For more information: [www.efet.org](http://www.efet.org)

maximum amount of capacity calculated as available at the time of the auction. This mandate should also be extended beyond the time horizon of one year that currently exist, with auctions three to five years before delivery. We would like to see a strong push by ACER and CEER on this rather than, e.g., the implementation of forward flow-based capacity calculation and allocation everywhere, which has proven to be a rather regrettable option even before its implementation.

- **Proposals to create complex hub systems or to establish implicit auctions of forward capacity lack proper evidence of their expected added-value** – by adding complexity to the system these long-term reform options risk hurting forward electricity market liquidity. Further, there is no conceptual demonstration of the capacity of these schemes to increase liquidity, let alone pull the existing one from liquid bidding zones. Empirical evidence of regions using similar setups (system price in the Nordics, PUN in Italy) have rather shown poor results in terms of attracting and/or conserving forward electricity market liquidity.

Any reform should serve to improve the liquidity and competition in the forward timeframe. While we welcome improvements to the allocation of LTTRs in Europe, this reform should primarily focus on fostering liquidity and competition in the forward electricity markets. We believe that the Electricity Directive and Regulation give ACER and CEER a mandate to look beyond LTTRs and the existing limits of the Forward Capacity Allocation (FCA) Guideline.

## **2. Terminology and problem definition: ACER and CEER's problem definitions require further discussion and understanding of market participants' usage of forward markets**

We strongly disagree with most of the problem descriptions provided by ACER and CEER. We agree with the terminology definitions. You will find below our detailed comments on each one of them.

Problem 1, lack of liquidity in small bidding zones: we agree that a lack of liquidity is an issue in many European bidding zones. However, we disagree with ACER and CEER that it is the responsibility of the bidding zone to develop the liquidity, and that conflicting goals exist between short-term market efficiency and liquidity in the forward market. Limiting national market framework and interventions affecting market participants' need or capacity to hedge their positions are mainly to blame for this. In small bidding zones, the problem is particularly acute, as they would combine these shortcomings with fewer local market participants, often higher barriers to market entry and fewer underlying volumes to hedge (compared to a larger zone).

However, any of these concerns should be tackled by already existing processes and reports such as the bidding zone review or ACER's established methodology and analysis on barriers to market entry and price formation.

Problem 2, hampering forward markets: we disagree with the ACER/CEER reasoning. Proxy hedging, i.e. taking a position in the forward market of a bidding zone which is not the one where the exposure lies, is neither a choice, fundamentally, nor enabled by long-Term transmission rights (LTTRs):

- It is because there is no liquidity in the "home market" that market participants must find proxy hedge in another one
- Proxy hedges are generally concluded way before LTTRs can be purchased: proxy hedging is used specifically for long maturity contracts (two to five years ahead), while LTTRs can only be purchased one year ahead at best
- LTTRs are hedging instruments against the variation of the price spread between bidding zones; hence, LTTRs may complement a proxy hedging strategy, but only where a price spread volatility risk exists

In short, it would be far simpler for market participants to hedge in their home market rather than using proxy hedging. In this context, LTTRs can help reduce risks of market spread volatility. But proxy hedging happens also without LTTRs – and at a massive scale: either when there is no market spread volatility risk (no need), when there are no LTTRs between the two markets (no possibility), or when the market participant didn't secure LTTRs in the auction (no luck/insufficient LTTRs/forward trading far before LTTRs auctioning).

Problem 3, no secondary market: we agree with ACER/CEER reasoning that auctions are infrequent: yearly LTTRs are only issued once a year and the resell process is only active in the monthly auctions, which is the only "secondary market" existing for LTTRs in practical terms. Transmission rights need to be fungible in a secondary market. This, however, is impossible given the low volumes of LTTRs offered by TSOs. Market participants rather hold on to their LTTRs instead of offering them on the secondary market. Making sufficient capacity available by TSOs is a prerequisite for establishing a functioning secondary market. Liquid secondary markets for capacity would allow market participants to manage their transmission capacity portfolios, giving especially the possibility to "slice and dice" i.e. turn an annual or monthly right into hourly pieces, just as traders already do in the case of their wholesale electricity transactions. Secondary markets would also enable TSOs to buy back in the market any proportion of rights they turn out to have oversold in advance, for example in order to manage unexpected operational circumstances identified in advance.

Problem 4, barrier to bidding zone reconfiguration: we strongly disagree with the views presented by ACER and CEER and question the reasoning behind this problem. This might entail a reconsideration of our zonal model – which is not desirable – or a preference for smaller bidding zones. Moreover, this statement denotes an understanding of "bidding zone reconfiguration" that only considers making them smaller/splitting them.

For enlargements/merger of bidding zones, this would not be a problem. Having smaller bidding zones should not be an objective in itself.

The objective of bidding zone reconfigurations should be to have efficient markets and networks, without any bias/prejudice regarding the bidding zone size. Forward market liquidity is not a barrier to the reconfiguration of bidding zones: rather, it is a criteria to carefully consider when studying bidding zones reconfiguration, in order to reach a welfare optimum that balances short-term dispatch efficiency with long-term market efficiency.

Problem 5, inadequate maturities: we agree. TSOs should give the possibility to the market to benefit from the natural hedge of the transmission grid in Y+2 and Y+3, allowing all market participants to complement their hedging strategies in the forward market and protect themselves, when needed, against price spread volatility.

By limiting the allocation of LTTRs to one-year ahead and month-ahead auctions (and products of corresponding maturities) – without even mentioning the borders at which no LTTRs are allocated – TSOs are missing important congestion rent. All in all, between the increased TSO congestion rent and the improved hedging opportunities for market participants, the allocation of longer maturity products would be beneficial for final consumers.

Problem 6, inefficient products: we disagree. EFET is of the opinion that Physical Transmission Rights (PTRs) based on the "Use It or Sell It" (UIOSI) principle or Financial Transmission Rights (FTRs) as options (not obligations) are the long-term hedging products which should, at a minimum, be offered by TSOs between all bidding zones across Europe. These products give the maximum flexibility for market participants to compete across borders, hence foster liquidity and guarantee easier market entry to cross-border market participants. The introduction of pure transmission obligations could be developed by the industry itself and should only be considered after the TSOs have established a healthy market for transmission rights as options.

If the functionality of anticipated netting was considered as part of the TSO activities, additional consultation and details would need to be considered. An important requirement would be to avoid splitting liquidity of the limited volume of available rights. Therefore, this function could also be added as an option to existing LTTRs. Another simple alternative would be to limit TSO activity to optional rights based on the volume of available interconnection capacity volumes and to let the industry develop the adequate regime for obligatory rights as they require very different competencies and processes.

When issuing FTR options, TSOs get the congestion revenue in case the request for capacity is higher than the available capacity at the time of the allocation. In case the spread is in the opposite direction in day-ahead, there is no rationale for paying a negative spread to the TSOs. Indeed, there is no financial risk borne by the TSOs in allocating this capacity. Considering that caps can be introduced by TSOs on the remuneration of curtailed LTTRs according to article 54 FCA (and all TSOs have done so), there is no financial risk for the TSOs in allocating capacity.

FTRs as obligations 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.

In addition, EFET would like to stress that FTR options, contrary to FTR obligations, actually have a positive impact on liquidity in the forward electricity market. Indeed, when market participants buy an FTR option, they have optionality in their portfolio to manage. When their option is moving in and out of the money (i.e. when the forward value of the spread is varying around the value at which they bought the FTR option), market participants have to adjust their hedges accordingly by entering into forward electricity transactions (buying/selling forward contracts). This increases the liquidity in the forward electricity market. For FTR obligations, this optional aspect is inexistent, and the related hedging activity on the forward electricity market also does not exist. Replacing FTR options by FTR obligations would actually be detrimental to the liquidity in the forward electricity market.

Problem 7, undervaluation of capacities: we strongly disagree with this problem description of ACER/CEER and are of the view that this needs further discussion and clarification. The price at which market participants are buying LTTRs combines:

- the underlying value of the spread at the moment of the auction (i.e. the value of the spread year-ahead or month-ahead = forward price in B – forward price in A)
- an additional risk premium translating their vision of the probability that this spread varies
- additional adjustment factors having an upward effect on bid price – e.g. expectation of high demand in the auction – or negative effect on the price – e.g. expectation of low demand in the auction, poor LTTR firmness, high statistical probability of unavailability of the interconnection (frequent curtailments or unplanned maintenance periods, risk of Force Majeure, etc.)

The auction price reflects market value (forward spread + volatility premium + possible adjustment factors) at the moment of auctioning. It does not constitute a “price floor” below which the realised spread (= the spread in day-ahead) cannot go. We also want to remind that the price paid reflects all the risks embedded in the product (credit risk, cost of capital, risk of force majeure and “emergency situation” covering, among others, outages in the grid) and borne by market participants.

We do not understand ACER/CEER position that LTTRs should systematically be sold at least at a price equal or above market spread. This theory seems to ignore the very different timings of valuation of LTTRs vs. day-ahead market, and the various elements that enter into the valuation of LTTRs. ACER/CEER should provide more explanation and an updated analysis should they wish to pursue more work in this area.

Finally, we challenge ACER’s and CEER’s analysis of risk premiums ex-post, based on day-ahead market results: when bidding for LTTRs, market participants only have their own projections of the where the day-ahead market will probably clear, years or months

ahead. Analysing realised day-ahead market spreads to understand LTTR valuation by market participants is highly questionable and the conclusions drawn from that analysis rather unhelpful.

**Problem 8, non-coordinated assessments and decisions:** we agree. Article 30 FCA GL states some general rules for NRAs to evaluate the sufficiency of hedging possibilities (analysis + market participant survey) and subsequently decide whether TSOs should offer LTTRs or provide other hedging alternatives. However, this process is not really working (1) when it comes to how the NRAs decision is made, and (2) when it comes to how NRAs enforce their own decision.

Evidence from the April 2017 decision of the Nordic NRAs on the subject shows that NRAs can forego the conclusions of independent experts and the recommendations of the market participants survey and have not even followed suit to make sure their questionable decision does in fact improve hedging opportunities<sup>2</sup>.

### 3. Basic policy changes: not all of ACER's and CEER's proposed improvements are so "no regret"

1. **We disagree on the alignment of CNTC and FB requirements between the forward and day-ahead timeframes.** Flow-based should not be an objective in itself, it is a tool. Flow-based makes sense in timeframes that manage flows – like day-ahead. The forward timeframe does not manage flows – and with ever more borders using FTR options, the link to flows is getting even thinner. The objective in forward is to ensure the availability of hedging tools for market participants.

We are already seeing the limits of a flow-based approach in forward with the discussions on long-term flow-based allocation. Market participants have expressed clear worries that flow-based allocation of LTTRs will not fully cater to their needs in terms of cross-border hedging opportunities.

A change of paradigm towards mandatory flow-based capacity calculation and allocation in the forward timeframe would require a deeper analysis – including of all collateral/side impacts – and a quantitative study. We understand from a recent JAO publication and survey that moving to a central flow-based auction generates

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<sup>2</sup> Context: In April 2017, the Nordic NRAs analysed hedging opportunities in the Nordic area, where no LTTRs -are issued by TSOs. In the report the NRAs commissioned to the independent consultant Houmoller Consulting, the data analysed and the experience of market participants showed that the existing setup of a Nordic system price and EPADs does not always provide efficient hedges in DK1 and DK2. Both the assessment performed by Houmoller Consulting and the results of the market participant consultation point to the issuance of transmission rights by the TSOs at the DK1-SE3, DK2- SE4 and DK1-NO2 bidding zone borders as a complement to the existing EPADs. Recommendation: The Danish and Swedish NRAs confirmed the assessment of the independent consultant that there were insufficient hedging opportunities in DK1 and DK2. The issuance of forward transmission rights by the TSOs as a complement to the existing EPADs was the easiest remedy, supported by the majority of market participants who responded to the consultation, and which has already proven its reliability in other parts of Europe.NRAs decision: However, for unclear reasons, the NRAs have decided not to request their TSOs to issue transmission rights according to article 30.5(a), but to request the TSOs to "make sure that other long-term cross-zonal hedging products are made available to support the functioning of wholesale electricity markets" according to article 30.5 (b). Absence of follow-up: In the case of such a decision to ensure alternative long-term cross-zonal hedging opportunities according to article 30.5 (b), article 30.6 requires the TSOs to develop proposals within 6 months and implement them within another 6 months (12 months in total following the NRA decision). Five years later, the TSOs have not proposed any alternative to the existing framework, and the NRAs have not made them accountable for it.

a huge impact on collateral for market participants that could jeopardize any positive impact of organising such an auction (due to the bidding restrictions).

- 2. We agree with the proposal to introduce monthly baseload products also at yearly auctions – provided that this also means that the full capacity calculated year-ahead is allocated to the market.** This idea was initially brought forward in 2019 in a very different context (the decision to have flow-based capacity calculation and allocation for the Nordic and Core regions was not taken at that time). Hence, a full re-assessment of this alternative capacity allocation proposal should be performed given the new context in those CCRs. In any case, we still believe that all the capacity calculated in the capacity calculation process year ahead should be made available to the market (i.e. 100% of the calculated capacity year-ahead). Further release of capacity at shorter time horizons in the forward timeframe (monthly) should be the result of capacity recalculations, or of gradual release of the margins and constraints initially applied by the TSOs for year-ahead allocations as uncertainties reduce with real time getting nearer. This should also go hand and hand with the development of a secondary market to facilitate the retrade of LTTRs by market participants and allow TSOs to buy back transmission rights in case their initial allocation was too generous.

For avoidance of doubt, and bearing in mind that certain market participants may only wish to purchase capacity for specific months and may be reluctant to re-trade purchased yearly forward transmission rights on the secondary market, the TSOs may choose to allocate the 100% of calculated capacity year-ahead not only via yearly products (that should remain) but also via monthly products (but a year in advance). For example, **the TSOs could make sole use of monthly products in the year-ahead and monthly auctions, which could be bundled into multi-month or annual blocks in the yearly auction.** This distinction between the timing of the auctions and the granularity of the products offered by the TSOs allows the market itself, at the time of the yearly auction, to perform the splitting of capacity between yearly and monthly capacity in the most economically efficient manner.

We believe that the solution mentioned in the paragraph above is the best solution to reach the objective of the FCA Regulation in general, and its article 16, i.e. **meeting the hedging needs of market participants.** In the manner described above, it will be the market itself adjusting the split of capacity to the hedging needs of its participants at each auction<sup>3</sup>.

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<sup>3</sup> More on this:

[https://data.efet.org//Files/Documents/Downloads/EFET\\_ENTSOE%20block%20bids%20LTTRs\\_01042021.pdf](https://data.efet.org//Files/Documents/Downloads/EFET_ENTSOE%20block%20bids%20LTTRs_01042021.pdf)

- 3. We believe a major no-regret measure forgotten by ACER and CEER is the issuance of LTTRs by all TSOs** at all bidding zone borders, in both directions, to the maximum amount of capacity calculated as available at the time of the auction (see next section) and earlier than one year before delivery (see option 1 in section 5). This could be implemented rapidly, with only benefits for the market and society at large.

#### **4. The need for intervention regarding the issuance of LTTRs: mandate TSOs issuance**

To recall, for market participants, hedging is about assessing and covering their positions against a variety of risks: price risk, volume risk, regulatory risk, etc. The further away from real time, the greater the uncertainty and therefore the greater the interest and importance for market participants to cover those risks, including across borders. They do this mainly on the energy market.

To accompany this hedging of energy-market risks, market participants may want to cover their risks related to the availability of transmission capacity. This is the case of positions across a bidding zone border, or in case of proxy hedging. The issuance of LTTRs helps them do that. As highlighted in our comments on Problem 8, there is for the moment great disparity between Member States on the issuance of LTTRs. We call for LTTRs to be made available to the market by all TSOs at all bidding zone borders, in both directions and to the maximum amount of capacity calculated as available at the time of the auction, all this earlier than one year before delivery. This is for us a no-regret measure.

Our thoughts on the four options presented by ACER/CEER are the following:

- Option 0: status quo. As highlighted in our discussion of Problem 8, doing nothing on the regulatory framework around the allocation of LTTRs means leaving this in the hands of local authorities. In certain cases, these seem more inclined to preserve a certain market model, rather than listen to the recommendations of the users of their markets. Further, such local decisions have the tendency to ignore the increasingly interconnected nature of our markets. While harmonization should not be a goal in itself, common rules mandating the issuance of LTTRs should facilitate market entry for non-local market participants. In the specific case of the Nordic market, with an existing – though insufficient – financial market for hedging, EPADs could be kept alongside forward transmission rights, as they can complement each other.
- Option 1: coordinated assessment and decisions on hedging opportunities. We disagree with the reasoning of ACER/CEER. It seems that LTTRs are seen as a “regulatory intervention”, while we consider the issuance of LTTR is a “normal” process that should be mandated. Today, the single allocation platform (JAO), as



the tool for the auctioning of LTTRs, is already in place, and all TSOs already have an obligation to calculate forward capacities at all bidding zone borders, even if they do not issue LTTRs. Hence, we fail to understand which significant “administrative efforts and costs for TSOs” a mandate to issue LTTRs would bring about.

This could be perceived as a second-best option, though we fear that the decision-making process at CCR level would not necessarily go smoothly. This is exemplified in many CCR-level methodologies still to be approved, many years after the adoption of the electricity market Guidelines.

- Option 2: mandatory intervention. We support the mandatory issuance of LTTRs, as an essential part of the TSOs’ “public service” activities, as regulated entities. Since the start of the liberalisation of the electricity sector, EFET has supported the issuance by TSOs of forward transmission rights at all bidding zone borders in Europe and in all directions. LTTRs should be allocated to the full amount that the underlying infrastructure can offer for each timeframe, as calculated in advance of delivery. The issuance of forward transmission rights at all borders in all directions allows to:
  - o guarantee that a certain minimum volume of products will always be available and offered on a transparent and non-discriminatory manner through organised auctions
  - o provide substantial congestion income to TSOs by allowing them to extract the maximum value out of the network infrastructure they manage in advance of delivery
  - o provide better and more reliable visibility for market participants as to the total volumes of cross-border transmission hedging products
  - o ensure that the capacity that is offered to the market is maximised at all points in time and that any variations of these volumes is published in a timely and effective manner
  - o provide valuable signals as to the structural value of cross-border capacity, from a “congestion” point of view. This is useful for all market participants and for TSOs and regulators, whereas the daily price signals are much more volatile. For example, forward allocation provides clear market-based price signals as to the need for additional infrastructure investments

Finally, we believe this would avoid problems with non-coordinated assessments and decisions (option 0) and lengthy and conflictual approval processes at CCR level (option 1).

- Option 3: no regulatory intervention. We disagree with this approach, and we believe there is a wide confusion in the ACER/CEER proposal between forward energy markets and LTTRs. In this section, we do not talk here about forward energy contracts in one bidding zone, but about transmission risk hedging products that allow the integration of those forward contracts. TSOs own and operate the transmission grid. Hence, they should provide access to it. Again, LTTR should not be seen as “regulatory interventions”. The main drawback of this

approach is that it does not address at all the need for integration of forward markets and assumes that the liquidity (of energy products) will be sufficient in all bidding zones.

In the Nordic region, the management of transmission risk hedging products was left entirely to the market (EPADs are provided by market participants themselves, not the TSOs). The dwindling liquidity of these products since the early 2010s has shown the limits of this system.

## **5. Other interventions: focus on multiyear-ahead allocation of LTTRs, and incentivise voluntary market-making mechanisms; study and further consult the possibility of LTTRs for non-neighbouring bidding zones**

Option 0, status quo: bidding zone border LTTRs. As highlighted in many of our recent interventions<sup>4</sup>, we believe that forward markets can be improved. With appropriate reform, they can contribute even more than they do today to a secure, affordable and sustainable supply of electricity to consumers.

Option 1: increased number of allocation and product timeframes. As mentioned above, we strongly support this proposed intervention to increase the time horizon of LTTRs. This is a no-regret measure. Currently, market participants only have the possibility to hedge their cross-border transmission risk very late (typically November Y-1) compared to when they conclude transactions on the forward electricity market. The maturities of LTTRs should be aligned with the maturities of forward products in the market. It would allow market participants to hedge their cross-border transmission risk together with other risks in the market.

TSOs own and operate the grid. TSOs have reasonable visibility on the availability of the transmission grid two-three years ahead. They could easily already issue part of the available capacities two-three years in advance. We also support the increased number of auctions and steer the development of secondary market.

As we build experience on auctions two to three years ahead of delivery, we will be able to start discussing the issuance of LTTRs even further away from real time. This would help aligning the maturity of LTTRs with that of long-term PPAs.

Details on the duration/granularity of products, timing of allocation and frequency/dates of the auctions should be carefully assessed and discussed with market participants.

Option 2: Zone-to-zone LTTRs. This proposal needs further discussion with market participants due to its complexity. The option to allocate LTTRs between non-neighbouring bidding zones after the introduction of flow-based capacity calculation and

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<sup>4</sup> [https://efet.org/files/documents/20220216%20EFET Insight 01 forward trading.pdf](https://efet.org/files/documents/20220216%20EFET%20Insight%2001%20forward%20trading.pdf)

integrate it in the legal framework could be an option. There may be issues of liquidity fragmentation with many combinations. This proposal is not answering all the hedging needs of market participants except for proxy hedging.

Option 3: zone-to-HUB LTTRs. We have serious doubts this proposed intervention. This proposal is unlikely to solve the problem of liquidity in individual bidding zones. The hub will be liquid, but market participants will continue to have exposures in individual bidding zones. They will be left with a transmission risk (spread and volatility) from the hub to the zone. We have concerns on how the liquidity on the hub-to-zone LTTRs will be guaranteed.

This option is shifting the issue of liquidity from individual bidding zones to the zone-to-hub LTTRs, not resolving it. We already have liquidity hubs in Europe (Germany for instance), the advantage of which is that they are actual bidding zones. Ensuring that sufficient LTTRs are allocated at all borders in Europe, and as early as possible, is a way to bridge the liquidity gaps between different bidding zones.

Option 4: forward market coupling with CfDs. We strongly disagree with this proposed intervention. It resembles an extension of the Nordic EPADs model, which has shown serious limits, albeit giving the mandate to TSOs to issue the instruments. The benefits of this option also have little to do with the objective of the forward market and the FCA Guideline. The flexibility to change the bidding zones should not be an objective of forward market design. The efficiency of this market in providing hedging opportunities and allowing market participants to hedge their exposure is.

This option entails the establishment of hubs, and like in option 3, we consider that the big threat/risk is the liquidity on the hub-to-zone CfDs. Further, the CfDs and forward capacity (implicitly) would then be traded separately. We do not see why it would be an advantage to allocate capacity without having to sell FTRs separately. This option does not simplify the market, it rather makes it more complex. It also comes with question marks about integrity of the European market when it is said that interfaces between regional hubs poses a challenge, with particular reference to the SWE region. Moreover, governance issues and lengthy implementation could interfere with other regulatory priorities.

Option 5: forward market coupling with futures. We disagree with this proposal. Similarly to option 4, we sense that it comes more from an objective to have increased flexibility to reconfigure bidding zones, rather than to improve forward markets.

We do not understand how this option improves the situation compared to the current situation with continuous market within bidding zones and periodic LTTR allocation: rather, it seems to export Problem 3 (lack of continuous LTTR allocation) to the entire forward energy market. Indeed, market participants appreciate the ability to fix their price/risks – and possibly reoptimize this position – at any point in time. Establishing an implicit auction for energy and capacity would mean forcing the market into trading at one specific moment. There is no guarantee that liquidity will be there at the moment of the auction. And this idea does not address the needs of the market and its desire to have continuous possibilities to hedge in the forward market.

Option 6: Market making. We agree with the principle of voluntary market making organised by power exchanges to boost forward electricity trade. However, we do not see a role for TSOs in performing market making. They are neither participants nor operators of electricity markets. We fear that this proposal confuses the legitimate role of the TSOs in making LTTRs available to the market, and a hypothetical illegitimate role of the TSOs to act on the forward electricity market.

Voluntary market making organised by power exchanges needs to be implemented together with other measures, otherwise it will not drastically change the situation or boost forward electricity market liquidity.

## **6. Type of products offered by TSOs: maintain existing PTRs and FTR options with full financial firmness**

Option 0: status quo. We agree with the continuation of the issuance of PTRs with UIOSI and FTR options, with full financial firmness in case of curtailment (subject to caps on total annual congestion income, as per article 54 FCA).

To ensure full financial firmness, we would nonetheless suggest amending the existing framework around the qualification of curtailment of FTR options: curtailment of LTTRs to ensure operations remain within operational security limits should only apply to PTRs, not to FTR options. FTR options cannot be nominated, so their allocation cannot have any impact on the state of the system, and TSOs bear no physical risk linked to their allocation. Therefore, we do not see any reason to have a possibility of curtailment for system security reasons in the case of FTR options (as currently foreseen in article 53.1 FCA). Only curtailment for Force Majeure should apply to both PTRs and FTR options (e.g. for IT system failure).

Option 1: PTRs and FTR options with reduced firmness. We disagree with this policy option. It is similar to the status quo, except in case of day-ahead decoupling: the LTTR remuneration would be equal to the shadow capacity price and not to the spread between two zones. This is a poor incentive on TSOs and NEMOs to avoid day-ahead decoupling, and it does not provide a sufficiently high level of hedging.

Transmission rights must be firm. TSOs, as natural sellers of firm transmission capacity rights, have the ability to manage the risks involved, enjoy a variety of operational and physical means to adjust those risks, and indeed are the only actors in the electricity sector that can do both. The transfer of the “firmness risk” from market participants to TSOs (in exchange for payment) will result in an overall efficiency and welfare gain. Trust in firmness, defined in the CACM GL as ‘a guarantee that cross-zonal capacity rights will remain unchanged and that a compensation is paid if they are nevertheless changed’, is a necessary condition for the successful integration of electricity markets. The potential interruption of exports during emergency or scarcity conditions can be a major barrier to

the development of (long-term) cross-zonal trade<sup>5</sup>.

Finally, any reduction of LTTR firmness will be accounted for by market participants when they bid in long-term auctions. Hence, a reduction of firmness, in particular for events such as decoupling that market participants are unable to forecast or mitigate, will reduce the overall value they place in LTTRs, and are willing to pay for – not just during days of decoupling, but all year long. This could significantly affect the revenues that TSOs capture from the sale of LTTRs<sup>6</sup>.

Option 2: FTR obligation. We strongly disagree with this policy option. When issuing FTRs, 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 do not see the rationale for paying a negative spread to TSOs (which is the case for FTR obligations, not FTR options). Considering that caps can be introduced by TSOs on the remuneration of curtailed LTTRs according to article 54 FCA (and all TSOs have done so), there is no financial risk for the TSOs in allocating capacity. FTRs as obligations 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.

## 7. Analysis and conclusions

First, we are somewhat puzzled by the reasoning behind some of the problems – some relevant, some outside the scope of forward markets – identified by ACER and CEER. Other issues that should be tackled for market participants are complexity, regulatory uncertainty and liquidity fragmentation. All these should be added to the list.

Second, we agree that some intervention is needed to boost liquidity and competition on forward electricity markets. However, many of the solutions presented by ACER and CEER do not seem to comprehend forward market dynamics, while other seem to be mixing questions relevant to the hedging of transmission risk (LTTRs) and that of hedging of energy market risks as such.

Efficiency of forward electricity markets requires liquidity. Liquidity requires simplicity and transparency. Some of the ACER/CEER type of interventions (options 2 to 5) would introduce high levels of complexity that could jeopardize the attractiveness of forward markets. Among the type of interventions identified, Option 1: increased number of

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<sup>5</sup> Schittekatte, T., Reif, V., & Meeus, L. (2020). The EU electricity network codes (2020 ed.) technical report, July 2020.

<sup>6</sup> For more, see :

<https://efet.org/files/documents/210827%20Electricity%20Committee%20CR%20LTTR%20remuneration.pdf>

allocation and product timeframes, and Option 6 market making, are the most suitable for market participants.

## **8. Recommendations and proposed actions need to be built on market participants needs**

We recommend the following actions to be taken:

- Mandating the issuance of forward transmission rights (FTRs) by TSOs at all European borders and in all directions (Option 2: mandatory intervention) – without reducing their firmness
- Developing up to three to five-year-ahead forward transmission rights to start matching the contract duration of PPAs (Option 1 increased number of allocation and product timeframes)
- Promoting forward market liquidity by introducing voluntary market-making incentives in illiquid markets (Option 6 market making, but organised by NEMOs on a voluntary basis)
- Removing any barriers to and providing incentives for the conclusion of traditional and multi-year contracts such as PPAs as market-based solutions for long-term hedging (new option). ACER and CEER could support this with an analysis of the existing market frameworks that deter the conclusion of such contracts (e.g. mandatory auctions at fixed price, price control measures in spot markets, balancing mechanism that prevent the back-propagation of the true value of electricity in real time, non-phased out regulated retail tariffs, etc.)

However, we disagree with the following proposed actions:

- alignment of requirements of day-ahead flow-based allocation on the forward market (no regret Option 1)
- allocation of zone-to-hub FTRs by TSOs, at the very least without further analysis (Option 3)
- forward market coupling with CfDs (Option 4)
- market coupling with energy futures (Option 5)
- reduction of firmness of existing LTTRs (Option 1)
- introduction of FTR obligations (Option 2)