

Core TSOs consultation on a methodology for splitting long-term cross-zonal capacity



EFET and MPP response – 10 July 2019

The European Federation of Energy Traders (EFET) and the Market Parties Platform (MPP) welcome the opportunity to provide comments on the ENTSO-E consultation on splitting rules for forward capacity allocation in the CORE capacity calculation region. Forward capacity allocation is critical to allow market participants to hedge their long-term positions across borders and make sure that they are not exposed to short-term price volatility and imbalance costs.

Comments on individual articles

- **Article 2.2:** *In this Core TSOs' Long-Term Splitting Methodology, the following definitions shall apply:*
 - a. *“Initial Long-Term Capacity” means the capacity on a bidding zone border in a given direction resulting from the year ahead long-term capacity calculation based on the methodology in accordance with article 10 of the FCA Regulation, possibly reduced by reservations for the day-ahead time frame before splitting long-term capacities for bidding zone borders where physical transmission rights are allocated in the long-term time frames, that could be done based on article 2.6 of Annex 1 of Regulation (EC) No 714/2009.*

The CORE LTSR methodology presents a new concept which is absent from all other LTSR methodologies in other capacity calculation regions (CCRs): “Initial Long-Term Capacity”. It is a key element used in subsequent articles, that sets the starting point to for the splitting methodology itself.

If our understanding is correct, the TSOs propose that splitting of capacity happens based on this concept of “Initial Long-Term Capacity”, i.e. after the year-ahead capacity calculation process and taking account of reservations of capacity for the day-ahead time frame. We strongly disagree with the concept of “Initial Long-Term Capacity”, as it is a way to limit the allocation of 100% of the available capacity right after calculation.

We reiterate what EFET mentioned in other positions on LTSR methodology proposals for other CCRs¹, that all the available capacity calculated as available year ahead should be made available to the market as soon as calculated, without specific reservations for monthly auctions or the day-ahead timeframe. Further release of capacity at shorter time horizons in the forward timeframe (monthly or other) should be the result of capacity recalculations, or gradual release of the margins and constraints initially applied by the TSOs for year-ahead allocations when uncertainties reduce as real time gets nearer – **more explanation and details on our approach and concrete proposals in our comments to article 3.1**

The justification given at **point 3 of the Explanatory Document** to support a reservation of capacity for the day-ahead timeframe is insufficient and weak. First, the Explanatory Document makes a distinction between PTR and FTR options, hinting implicitly at the fact that reservation of capacity for the day-ahead timeframe in case FTR options are allocated by the TSOs makes no sense. However, article 2.2 still opens the possibility to reserve capacity for the day-ahead timeframe even in case FTR options are allocated. Second, and more fundamentally, the argument on a possibility for TSOs of “underselling” forward transmission rights does not properly understand hedging practices from market participants. The comparison of the forward transmission rights price and the day-ahead market spread between two bidding zones does not take account of the risk premiums included by market participants in their hedging strategies. The same mistake is made **in point 5.1 of the Explanatory Document** to justify a reservation of capacity from the yearly to the monthly auctions. Besides the weakness of the TSO analysis on this matter (see our comments on article 3.1 for more details), we do not agree with giving a role to TSOs of analysing market prices to determine capacity allocated to the market. The TSOs allocation of capacity should solely be based on the technical capacity and requirements of the grid. It is not the place of system operators to analyse market data or forecast prices such as the marginal price of LTTTs in order to maximise their benefits from forward capacity allocation. We remind the TSOs that by owning the interconnectors, they *de facto* sit on a free hedge that can and should be made available to the market as much and as early as possible. Retaining this hedge opportunity from the market based on expectation of evolutions of market prices could be considered market manipulation.

- **Article 3.1:** *In case of AC interconnectors, one half of the Initial Long-Term Capacity will be offered to the subsequent yearly capacity allocation session at the Single Allocation Platform*

We believe that all the capacity calculated by the capacity calculation process year ahead should be made available to the market (*i.e.* 100% of the calculated capacity year-ahead), not one-half. Further release of capacity at shorter time horizons in the forward timeframe (monthly) should be the result of capacity recalculations, or gradual

¹ EFET responses to the TSOs consultation on Channel , SWE and Hansa CCRs Splitting Rules for forward capacity allocation, dated respectively 15 April, 30 April and 27 May 2019, and available at: https://efet.org/Files/Documents/Downloads/EFET_ENTSO-E%20consult%20Channel%20Splitting%20Rules_15042019.pdf, https://efet.org/Files/Documents/Downloads/EFET_SWE%20Splitting%20Rules_16042019.pdf and https://efet.org/Files/Documents/Downloads/EFET_Hansa%20Splitting%20Rules_27052019.pdf

release of the margins and constraints initially applied by the TSOs for year-ahead allocations as uncertainties reduce with real time getting nearer.

For avoidance of doubt, and bearing in mind that certain market participants may only wish to purchase capacity for 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 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 yearly 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 to perform the splitting of capacity between yearly and monthly capacity in the most economically efficient manner.

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. It is therefore vital that TSOs make available to the market the maximum capacity they can as far in advance of real time as possible. 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 in particular, 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.

We also believe that this approach is in line with article 9 and 16 of the FCA Regulation. Indeed:

- Article 9 states that *“All TSOs in each capacity calculation region shall ensure that long-term cross-zonal capacity is calculated for each forward capacity allocation and at least on annual and monthly time frames”* – Our proposal still foresees a calculation of capacity year-ahead and each month.
- Article 16 states that *“The TSOs of each capacity calculation region shall jointly develop a proposal for a methodology for splitting long-term cross-zonal capacity in a coordinated manner between different long-term time frames within the respective region”* – The article does not mandate TSOs to decide on a split, but to design a methodology for splitting capacity; with our proposal, the market would decide on the split, based on rules and auction design agreed between the TSOs and NRAs.

The TSOs should not hide behind a supposed obligation hidden somewhere in article 16 to issue capacity at the yearly and monthly auctions:

- First, there is no such obligation in the FCA Regulation. The obligation is to calculate and offer capacity for the yearly and monthly **timeframes** (i.e. the products), but not necessarily at each auction. With our proposal, there may indeed be occurrences of monthly auctions without capacity available – though

with monthly recalculation and relaxation of TSO constraints, this should happen rather rarely. However there will not be occurrences of market participants not being proposed monthly or yearly products – and those will be subscribed exactly in the amount and proportion that is most economically efficient.

- Second, the proposal of the TSOs does not guarantee that the 50% of the “initial long-term capacity” withheld for monthly auctions will actually be allocated at the monthly auctions. Indeed, there may be occurrences where the monthly recalculation of capacity will result in an assessment by the TSOs that they cannot release the 50% of the initial capacity that they withheld. So with the TSO proposal, there is actually no guarantee that market participants will always have access to either yearly or monthly hedging products in the proportion they need.

Once again we’d like to point the weakness of the analysis of the TSOs in point 5.1 of the explanatory document on MPs hedging needs. Firstly, we like to think that MPs know best what their hedging needs are, and when “[a] majority of traders”, including EFET and MPP, request this capacity maximisation as early as possible in all consultations on the subject since the drafting of the FCA Regulation, that should probably be an indication that the status quo proposal of the TSOs **shall not** meet those hedging needs. Secondly, for the TSOs to make market analysis based on historical and forecasted prices is beyond their mandate. The TSOs allocation of capacity should solely be based on the technical capacity and requirements of the grid. It is not the place of system operators to analyse market data or forecast prices such as the marginal price of LTTRs in order to maximise their benefits from forward capacity allocation. Finally, on a technical level, the analysis in this subchapter does not understand market fundamentals. There can never be “too much capacity of such LT-product” allocated; the opportunity for market participants to purchase capacity at a specific price and volume is for them to decide, not for TSOs. We remind the TSOs that by owning the interconnectors, they *de facto* sit on a free hedge that can and should be made available to the market as much and as early as possible. Retaining this hedge opportunity from the market based on expectation of evolutions of market prices – including and possibly to inflate the price of transmission rights – could be considered market manipulation.

To conclude, we have fundamental objections with the overall approach proposed by the TSOs in this draft methodology. We believe that TSOs go beyond their mandate in trying to impose to the market what TSOs consider market participants’ hedging needs are. The practical solution we propose has the added value of maximising capacity allocation as far away from real time as possible while securing capacity for the yearly and monthly timeframes, with a split decided by the market itself. It is also in line with the FCA Regulation’s spirit and letter.

Should TSOs decide to stick to their initial proposal, we request that the submission of the methodology that they will submit to the NRAs be accompanied by a full justification why they dismissed our practical proposal.

- **Article 4.1:** *In case of DC interconnectors, the Initial Long-Term Capacity is split into two equal fractions.*

Our comments to article 3.1 apply equally to article 4.1.

Additional comments

There is no provision on the publication of capacity allocation data by the TSOs, as it is the case in certain LTSR methodologies for other CCRs. For instance the Hansa and Baltic LTSR proposal foresees the publication of the marginal auction price and the demand curve for LTTRs for each time frame.

When deciding on the specification of transmission rights auctions, TSOs should make sure that the auctions are organised sufficiently in advance of the period covered by the transmission rights to fit the hedging needs of market participants.

Last but not least, we call on the TSOs to support the development of secondary markets for the exchange of forward transmission rights at all bidding zones borders in Europe. Such markets are part of market participants' hedging needs and will further improve the economic efficiency of hedging practices in the market, allowing easier access to transmission rights even after the initial auctions.