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AEEGSI consultation on firmness regime and compensation rules for 2016 on the AT-IT, FR-IT and SL-IT borders

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EFET comments – 22 June 2015

General comments

The European Federation of Energy Traders (EFET[1]) welcomes the opportunity to provide comments on the AEEGSI consultation on firmness regime and compensation rules for electricity cross-border capacity at the Austrian, French and Slovenian borders with Italy for the year 2016. We understand this consultation document is to be analysed in parallel with the development of the ENTSO-E Harmonised Allocation Rules for Forward Capacity Allocation (HAR), for which the AEEGSI proposals would form part of a border-specific annex. We appreciate the intention of ENTSO-E to start up an early implementation of the network code/guideline on Forward Capacity Allocation (FCA NC) with a view to improve the quality of services and quality of the allocated transmission rights. This is turn would improve the efficiency and increase the liquidity and competitiveness forward market across Europe.

However, we expected the harmonised rules to be fully in line with the Framework Guidelines and the FCA NC proposed in ACER's Recommendation of 22 May 2014, including a higher or improved degree of firmness on most of the borders, if not all. This AEEGSI consultation is highly disappointing as it does not foresee any real improvement to the current firmness regime: market participants are put in front of a choice between no evolution of firmness and improvement in firmness conditions to the detriment of allocated capacity volumes and the facilitation of cross-border transmission risk hedging. Thereby

[1] EFET, 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. EFET currently represents more than 100 energy trading companies, active in over 27 European countries. For more information: www.efet.org

competition at the wholesale level of the electricity market across the Italian borders will remain sub-optimal.

Linking firmness and transmission capacity rights volumes is illegitimate

The analysis that more firmness would necessitate a reduction in capacity rights allocated to the market is based on assumptions and analysis which we would like to comment on:

a) EFET acknowledges that Terna, while adopting a "top-down" approach, intends to allocate the maximum long-term available capacity at the Italian borders according to the calculation methodology adopted: this is valuable and other TSOs should seek to maximise the allocated volumes of fully financial firm capacity rights on other borders as well. However, the determination of interconnection capacity rights volumes to be offered to the market should not be based on economic considerations, **but instead on technical grid calculations**. Responding to question n.1 of the consultation document, we strongly argue that these two aspects should be kept separated. TSOs, as regulated monopolies, have the mandate to allocate available cross border capacity and receive the payment in case of congestion. Establishing such relationship, whereby available capacity is the function of firmness, is illegitimate and distorts market signals. In fact, adding this economic element to the capacity calculation goes against the CACM network code provisions on capacity calculation and provides perverse incentives to TSOs, who are acting as capacity traders rather than regulated monopolies. We do not think that there is financial risk for the TSOs in reality. Compensation for curtailment is covered by congestion income and it can anyway be capped at the value of yearly congestion revenues so the risk TSOs face is unjustified as much as the intention to apply these risks in the calculation of the capacity to be offered. We are not aware of any case or example in Europe that such risk has materialised. It would be interesting in this process to assess what the cost of full financial firmness of Terna in 2014 would have been and compare it with the congestion revenues for the same year. Surely with the approach proposed the results would suggest an increase of capacity offered. An interesting example confirming the low or no risk for the TSOs is the Slovakian-Czech cross-border capacity. Between these two countries there is no congestion hence no congestion income. The market participants nominate capacity on the border and yet in few hours during a year the nomination is curtailed. The compensation for such curtailment is zero (in theory is equal to the congestion revenues). For congested borders that generate congestion income, the main objective should be to use the congestion income to guarantee firmness according to Regulation (EC) N. 714/2009 and ACER's recommendation on ENTSO-E's draft FCA network code. The use of a congested network is not free of charge and congestion costs are an important market signal. The congestion income naturally goes to the TSOs as the main body managing congestion in real time, short and long term. This income should ensure that congestion is managed in an effective way whereby market participants are able to service their contracts.

b) EFET believes that only in case of Emergency Situation (ES) and Force Majeure (FM) should the full firmness of the rights be suspended and a special treatment be necessary, as the risks of such network conditions cannot be anticipated by the TSOs. However, in the past Terna has often used curtailments of forward capacity rights as a preventive measure to manage internal grid issues. We recommend a closer regulatory scrutiny on such 'preventive curtailments' which in our view is overly utilised. Therefore past curtailments cannot be used as a reference. We bring as an example the recent case of 20 March 2015 when the solar eclipse occurred in Europe: NTC values at the Italian borders were decreased from 7620 MW to 1000 MW flat during the complete day in order to isolate the Italian system. The Regulator at p. 8-9 of the consultation document refers in detail to the firmness regime as proposed in the ENTSO-E draft FCA network code. We believe that from the regulator's perspective, the ACER recommendation should be taken as a reference instead. Also, AEEGSI should refer to **existing regulation** rather than to draft ENTSO-E proposals. In particular reference should be made to Regulation (EC) N. 714/2009 on *conditions for access to the network for cross-border exchanges in electricity*. We report below the main points of art. 16 on "General principles of congestion management", which should serve as main guidance:

2. *"Transaction curtailment procedures shall only be used in emergency situations where the transmission system operator must act in an expeditious* ***manner and re-dispatching or countertrading is not possible.*** *Any such procedure shall be applied in a non-discriminatory manner. Except in cases of force majeure, market participants who have been allocated capacity shall be compensated for any curtailment.*
3. ***The maximum capacity of the interconnections and/or the transmission networks affecting cross-border flows shall be made available to market participants****, complying with safety standards of secure network operation. "*

4. *Any revenues resulting from the allocation of interconnection shall be used for the following purposes:*

a. ***guaranteeing the actual availability of the allocated capacity****; and/or*

b. *maintaining or increasing interconnection capacities through network investments, in particular in new interconnectors..”*

If the revenues cannot be efficiently used for the purposes set out in points (a) and/or (b) of the first subparagraph, they may be used, subject to approval by the regulatory authorities of the Member States concerned, up to a maximum amount to be decided by those regulatory authorities, as income to be taken into account by the regulatory authorities when approving the methodology for calculating network tariffs and/or fixing network tariffs.

The rest of revenues shall be placed on a separate internal account line until such time as it can be spent on the purposes set out in points (a) and/or (b) of the first subparagraph. The regulatory authority shall inform the Agency of the approval referred to in the second subparagraph.”

We reiterate the fact the reductions of allocated capacity has never been considered an option both in the FCA or HAR discussions. This would represent a **huge step-back** from the current regime which already stands for significant differences compared to other borders, something that regulators all agreed to avoid in the development of the Harmonised Allocation Rules and made clear to all stakeholders at AESAG meetings in the course of 2014/2015. We expect that improvement remains an objective of AEEGSI too.

c) We question the interpretation of the analysis showed at p. 9 and in the annex about the comparison of long-term capacity rights price and day-ahead market spread at the Italian borders. The regulator on p. 10 of the consultation document seems to go even further stating that ” *The Authority considers it appropriate to investigate the causes of the marked deviation -highlighted by the analysis of TSO – of the differentials between market price and average long-term allocated capacity rights prices (…) and the full understanding of this phenomenon may suggest for the future a revision of volumes allocated on the yearly and monthly horizon, besides of the considerations on the firmness regime discussed here.”*

We consider that such view is incorrect and potentially misunderstood.. When bidding for yearly or monthly capacity, traders take into account the existing, quoted long-term market spread on OTC markets at that point in time. The bidding strategies do not take into account and do not relate to the day-ahead market prices. The day ahead price is unpredictable at that point in time particularly now with significant and ever increasing intermittent generation capacity. There are a set of short-term fundamentals that help in day-ahead price forecast which are not available on a forward basis.

Therefore, if analysis has to be carried forward, it should compare long-term market spreads with long-term allocated capacity rights. The presented analyses and comparisons pose a high risk of misconception of the forward markets which may lead to a tentative to justify a future **reduction of allocated volumes** independently of the review of the firmness regime. We strongly warn against this flowed view and oppose such motivations.

d) As a last remark, the statement contained at p. 10 "I*t is reasonable NOT to consider that the price of Forward Transmission Rights would increase if Transmission Rights were firm because all these prices are very volatile…*" is quite debatable and cannot be used as a support for any justified decision. It is difficult to establish such relationship but rather on the contrary, we would expect the value of transmission rights to increase if their level of firmness improves, mirroring market participant's confidence in the value of the rights they purchase.

Different proposed scenarios for 2016 firmness regime

As stated above, none of the options proposed foresee any real improvement to the current regime: market participants are put in front of a choice between no evolution of firmness and firmness improvements to the detriment of allocated capacity volumes. Therefore, we are not in favour of any of the three scenarios suggested.

Scenario 1 – Retention of the same current firmness regime

This scenario would maintain the current regime, which still stands for differences in the CASC Rules on Firmness of Capacities and Compensation for Reductions for allocated capacity at the Italian borders. This is something EFET has raised on several occasions[2]. These concerns are aggravated by the fact that the NTC at the Northern Italian borders is at times reduced significantly and with very short notice. This is a problem that EFET has also highlighted previously, most recently in our email communication to CASC,

[2] See letter to Terna on Interconnector NTC reductions at the Northern Italian borders and CASC Capacity

Terna and neighbouring TSOs of 19/02/2015[3]. These reductions demonstrate the need for truly Harmonised Capacity Allocation Rules also for the Italian borders. We understand that these reductions are due to the management of the system at times of high renewables production. We suggest that other measures, such as buy back, re-dispatching and countertrading, should be considered before curtailing cross-border capacities, according to Article 16.2 of Regulation (EC) N. 714/2009.

If no improvement of firmness is foreseen for 2016, we urge a full impact assessment of granting more firmness with a yearly cap on income from all timeframes. Market participants would benefit from a truly informed decision made upon a serious, quantitative analysis that would show whether the situation would be sustainable or not for Terna.

Scenario 2 – firmness regime according to HAR on other borders with monthly compensation cap, with "modest" reduction of allocated capacity rights volumes.

We challenge this proposed scenario, as it would go against several ACER recommendations. The FCA NC as recommended for adoption by ACER[4] – which should be the guidance for AEEGSI - foresees a yearly cap based on congestion income from all timeframes. EFET recognises that compensation for curtailment of the allocated rights in case of Emergency Situation can be subject to a cap upon request of the TSOs to the regulators. Nonetheless, this cap should be calculated on yearly congestion income from all timeframes at the concerned bidding zone border. Monthly congestion income caps do not provide any incentive for TSOs to avoid or reduce curtailments nor is it justified in terms of regulatory risk to TSOs or their tariff paying customers to protect income on a monthly basis in this way.

A "modest" reduction of capacity is a highly unclear concept, vaguely defined and highly discretional. We state again that any reduction in volumes allocated would represent a huge step-back from the current situation. Also, it is likely to introduce uncertainty about the amount of transmission rights available from one year to another and to reduce the value market participants attribute to these transmission rights purely because the risk becomes too high for market participants to mitigate.

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[3] See EFET and AIGET concerns over CASC daily and intraday auction cancellations

[4] See Recommendation of the Agency for the Cooperation of the Energy Regulators n. 02/2014, 22 May 2014.

Scenario 3 - firmness regime according to future FCA NC with yearly compensation cap, with strong reduction of allocated capacity rights volumes.

Forward capacity allocation is vital for market participants to hedge their long-term positions and make sure that they are not exposed to short-term price volatility and imbalance costs. This scenario would according to Terna's view of the world entail a heavy, unsustainable reduction of allocated volumes; naturally this cannot be accepted at all.

EFET counter-proposal and final remarks

EFET believes that the only scenario that is compliant with the EU Target Model, the EU Regulation n. 714/2009 and the ACER Recommendation on the FCA NC is to have a full firmness regime with a yearly cap related to total congestion income, accompanied by equivalent allocated capacity rights volumes as they are today - **Option A + full firmness with calibrated yearly cap.**

As explained in the first paragraph at point a), EFET accepts caps on market spread compensation based on yearly income from capacity allocation on all borders of a relevant bidding zone in all timeframes. Capping the amount payable to the value of yearly congestion revenues will sufficiently limit the financial risk for the TSO.

In case the burden for the TSO is unstainable, we request a real analysis of the risks for Terna to allocate and guarantee capacity in this manner. The analysis would include a study on the cost of ensuring firmness: AEEGSI could look at curtailments for the past 3-5 years, based on historical prices and expected premium paid by market participants for fully firm rights) against revenues resulting from the allocation of long-term capacity - monthly and yearly rights. By applying a full firmness regime, it will become easy for AEEGSI and Terna to identify the real costs and benefits of ensuring firmness by running an ex-post analysis. The analysis would include a study on the real cost of ensuring firmness: Terna would then have to identify the real "emergency" or "Force majeure" curtailments, after full firmness is implemented, and would also assess the reduction of risk premium paid by market participants when purchasing transmission rights

EFET reiterate our availability to cooperate with AEEGSI and Terna on this subject and we would welcome an opportunity to discuss our concerns in person.

As a conclusion, we would like to list our main messages:

- Calculation of available transmission capacity and determination of transmission rights volumes offered on a forward basis should not be part of the discussion on firmness
- AEEGSI should ensure there is strict regulatory scrutiny of Terna's decisions to curtail of its use of congestion income
- Fully financially firm transmission rights from the moment of issuance are the target model agreed by all regulators, with a possibility to introduce a cap on yearly congestion revenues which mitigates TSOs' financial risk
- AEEGSI should ensure that there is no step back or decrease of the transmission capacity offered as this will create inefficiencies in the market
- AEEGSI should ensure that the TSO is incentivised to allocate additional capacity volume (to the level it is technically possible) in the forward timeframe and use the congestion revenues to guarantee firmness

We also wish that future consultation documents relating to issues relevant for cross-border Italian and foreign traders, could be available in English language, so as to allow the participation of a wider range of market participants.