

EFET comments on the ERGEG consultation

ERI COHERENCE AND CONVERGENCE REPORT

Introductory comments

EFET has always advocated the market integration and shown support for the regional initiatives set up by ERGEG. But these regions are advancing at different speeds and might have a different focus at this time. We would like to stress the need for harmonisation between the different rules and procedures discussed and approved in the seven ERI regions.

In order to avoid a theoretical debate, and a stalling of the process in the meantime, we believe it is now time to implement some critical steps, such as a common available capacity calculation model, a continuous cross-border intraday platform, harmonised auction rules, financially firm transmission rights, at least on a “pilot” basis in key regions. Such implementation should be carefully monitored and fine-tuned where necessary.

We refer to our forthcoming position papers, on *Dual-purpose transmission rights* and *Electricity transmission capacity rights: making firmness a reality*, which will be sent to you in a very short time.

Below we detail the most important steps which should be taken to achieve greater convergence between regional electricity markets under seven main headings.

I. Harmonization of congestion management within and between regions

EFET welcomes the ongoing coordination and harmonization within the different regions. But we are concerned that some regional or national developments are not compatible and that there is no coordinated examination of underlying market models, with a view to their future harmonisation.

For instance, the CWE region will implement market coupling using the existing NTC/ATC method of capacity calculation and allocation, because TSOs found that the results of simulating a flow based method were not satisfactory. In the CEE region the flow based method is nonetheless planned to be implemented for yearly, monthly and daily auctions, without apparent heed as to whether between some countries the available cross-border capacity will increase or decrease and without any evaluation of consequences for wholesale level international competition.

Other examples are apparent from the recent suspension of the EMCC and from the failure of the Central South forum to make progress on a coordinated allocation of capacity around the borders of Switzerland. We suspect that in both cases regulators and TSOs should be examining the underlying market design features hampering the closer linking of relevant national power markets.

In the current developments of the CASC-CWE and also the new IFA allocation process, we have some doubts as to whether requirements for a well functioning secondary market have

been taken on board. We have declared good experience with the existing “E-TRACE” platform operated by CEPS in CEE, which allows electronic registration of a secondary capacity assignment by the parties involved in the transaction. We regret that this model has not been taken on board from the beginning of the development of the latest auction offices in Luxembourg and Freysing.

On the other hand, we welcome the fact that the IFA platform will have the ability to offer nomination services. We suggest that other regional AOs, like CASC-CWE and Freysing should also as soon as possible move towards the “one stop shop” for nominations (leading to a unique interface for nomination, not different for each TSO as it stands today).

These examples illustrate that the different initiatives, while they are very similar, are managed in different ways, and we question that the rules will really be coherent and consistent, even once regional auction offices are in place.

While welcoming recent progress in some ERIs, therefore, we call for more effort should be made to establish common regional and inter-regional transmission capacity auction rules, standard arrangements for day-ahead nomination or cash-out of longer maturity transmission rights, and common auction platforms and registries of assigned transmission rights. The clear goal needs to be the adoption across the EU of a standard transmission capacity product, sold on a financially firm basis, and having the same other essential features. Thus regulators and TSOs and power exchanges need to focus more clearly on:

- (Financial) firmness of capacity rights;
- Standard definitions of Emergency Situations and of Force Majeure (justifying curtailment);
- Duration of products (multi annual, annual, quarterly, monthly, etc.);
- Standard assignment and UIOSI mechanisms;
- Standard UIOGPFI day ahead arrangements where coupling is in place;
- Creation of electronic registries for held and assigned rights, allowing flexible assignment timing and slicing of maturities, in order to facilitate secondary trading of transmission rights;
- Cross-border opportunities for intra-day trading (separately treated under point 2.4 hereafter) and bids into balancing markets (2.6).

II. Maximizing the capacity available to the market

As long as there are congested borders that require congestion management rules, the capacities offered to the market need to be maximized. The existing physical capacities have to be efficiently used, i.e. energy flows that run in opposite directions have to be netted. This principle of maximization may only be restricted by network security reasons.

Cross-border capacities should be calculated on a daily basis using up-to-date data. Flow-based capacity calculation and allocation may be technically difficult and contribute to the shifting of internal congestions to the borders, unless the methodology covers flows on all key tie-lines and envisages the possibility of declared congestion even on such lines inside national grids. It seems the consequence of adopting the methodology without such coverage may well entail reductions of the available cross-border capacity between some important adjacent price hubs.

III. Capacity allocation

Day-ahead and intra-day allocation

For day-ahead EFET favours an implicit auction approach which integrates the purchase of capacity and energy. The experience with the trilateral market coupling between Belgium, France and the Netherlands are encouraging. Therefore, we welcome an expansion of this system in the CWE region (Germany borders). The implementation of market coupling on other borders is also welcome. But, as the example of the Danish-German border shows, it needs to be done carefully: intensive simulation calculations should be done well in advance, so as to minimize the possibilities of mistakes such as flows in the direction of the low-price region. (See also main section V. Below.) *Intraday* supplementary cross-border capacity must be made available for nominations via "first-come-first-served" continuous trading, including OTC transactions. (See further main section VI. below.)

Longer maturity transmission rights

There is a clear need for auctioned transmission rights of longer maturity. Power is bought and sold not just spot but also under firm future or forward contracts (different load profiles, multi-yearly, yearly, quarterly, monthly etc) in order to hedge price risks. TSOs can contribute to a liquid and efficient wholesale market by offering buyers and sellers of power matching firm transmission products. It is essential for future liquidity and certainty of price signals that such products become standard across Europe. Thus terms and rules for explicit auctions of transmission capacity rights must be harmonized rapidly within each region as a step towards EU-wide harmonization.

IV. Transparency requirements

Transparency of information about use of electricity infrastructure is important for creating a level playing field. EFET welcomes the improvements, which have been facilitated by the transparency initiatives within the Northern, CWE and CEE regional initiatives. EFET believes it is important that publication requirements are harmonized, data are published in a uniform format and in a common language, and publication is internet-based. We have stated our position more fully in a recent response to the consultation by ERGEG-CESR on market abuse and transparency enhancement. We are now working on more detailed ideas for dealing with information provision by generators during power plant outages.

Another recommendation we make to regulators is to pay more attention to developing a process for the exchange of information *between* TSOs, not only regarding grid topology, but also about the location of load and anticipated location of generation. The final goal should be the development of a common available transmission capacity calculation model for each synchronous area. In doing so the regional models under development should take the necessary information from the other regions at least in the synchronous area¹ but also from adjacent synchronous regions (via DC links) into account.

¹ In particular, Switzerland, which is in the middle of the whole synchronous area, should contribute on equal foot to this calculation process

V. Market coupling

EFET has supported and continues to support efforts for coupling European power markets. We firmly believe that, if properly implemented, market coupling brings benefits in terms of efficient use of interconnections, maximization of available cross border capacity day ahead and facilitation of wholesale tier competition. However, we suspect, that close attention to market model and market operation harmonisation is a pre-requisite for the completely smooth introduction of coupling, especially if volume rather than price based. When harmonized conditions are not in place, it naturally proves tough to ensure full market support and confidence. EFET already addressed the basics of market model harmonization in the position paper “Harmonising the Operation of European Wholesale Electricity Markets” (2005).

Bringing the recommendations in this paper up to date, to address the specific challenge of day-ahead coupling, we advocate:

- Any coupling project must be thoroughly developed and tested;
- Market participants as users must be closely involved in any planned project by a transparent, continuing consultative process;
- The algorithm used must be open for review by market participants, in order to detect weaknesses from the traders’ perspective;
- The algorithm should be robust and should not need “manual” intervention, by setting buffers, applying contingencies and adjusting capacity allocation according to the size of price spreads or according to the existence or non-existence of congestion inside coupled zones;
- Any update of an algorithm or accompanying rules must be completely transparent and accompanied by full written explanations;
- Convergence in the underlying market models of the coupled zones should be tackled openly and persistently, in parallel with day to day operations of the two or more involved exchanges and TSOs.

In regions that are less advanced (like CS or CEE) it would not be so harmful for the market and consumers overall if coupling were delayed, pending a review of fundamental mismatches between the operation of national markets. In and between these regions I resources should be concentrated thus on more urgent priorities such as establishing common harmonised auction procedures, reforming auction rules, setting up power exchanges (to the extent feasible) and developing intra-day markets. In some of the newer Member States, we see also other hurdles to the development of efficient wholesale markets and cross-border competition, like cross-border transaction fees, industrial consumer price regulation, annually allocated NTC reductions (even to zero) and non-market based curtailments. These distortions (which in many cases comprise flagrant breaches of the CM Guidelines or articles of the EU internal market directive) need to be tackled first, otherwise they will severely hamper market coupling projects.

VI. Intraday markets

We see a developing patchwork of “home-made” solutions for intra-day nominations in Europe, some proposals being based on an exclusive, periodic, exchange-run implicit auction. EFET would advocate rather a harmonised, even if pragmatic, approach across the whole UCTE area at least. The ELBAS “rolling bids” model used in part of Scandinavia (with some adaptations to allow also OTC trading, with obligatory use of cross-border capacity) could be implemented very quickly in CWE and then expanded to other neighbouring regions.

The continuous trading model is the preferred solution to meet all wholesale market needs: Implicit or explicit auctions are simply not suited to deal with the new operational constraints (and unexpected openings), which arise as the power system gets closer to real time. The ideal is thus to liberate buyers and sellers to cross several borders with “one mouse click” and with straight through processing. We reiterate our insistence that there should be no capacity reserved by TSOs for intra-day (and balancing) markets.

VII. Balancing

The integration of balancing markets is important but only a little progress has been achieved in this field, the main exceptions being the Nordic region and the French-Spanish border.

Specific reservations of cross-border capacity for balancing energy bids would be undesirable (as stated above), since they would unnecessarily reduce capacities available to market participants day-ahead and over longer maturities. Instead, cross-border balancing trade should be managed by TSOs within the limit of the capacity available after intraday market bids have closed.