

EFET response to the ENTSO-E consultation on the TSOs' proposal for amendments of the methodology for Harmonised Allocation Rules for long-term transmission rights

Brussels, 8 July 2023 – The EU Harmonised Allocation rules are going through a series of amendment proposals in the context of their adaptation to future flow-based capacity allocation. We thank ENTSO-E for this new consultation, though, as emphasised in our previous communications, the flow-based approach to capacity allocation in the forward timeframe comes with substantial drawbacks.

Key messages

1. **We continue to challenge the added value of flow-based allocation of transmission capacity in the forward timeframe.** This substantial shift requires a proper assessment of benefits, which still has not been made publicly available.
2. **We welcome the willingness of TSOs to find a solution to decrease the burden of collateral in pan-regional auctions.** Nevertheless, the proposed amendments to the EU HAR, while providing a cap on collateral, do not fully address the issue.
3. **We consider that that the backward-looking approach to day-ahead prices for the collateral price cap calculation does not reflect the reality of bidding in the forward market.** This may render the price cap useless and result in deoptimized bidding. We consider the use of use of forward prices is a more adequate measure to set the cap on collateral.
4. **We consider the approach of filtering the lower-priced bids, in case the credit limit is lower than the maximum payment obligation, as sub-optimal and discriminatory.** Effectively, bids on interconnections with lower anticipated spreads will be filtered out, without differentiation of their intrinsic and extrinsic values.
5. **We reiterate that the review of the EU HAR should not be the occasion for TSOs to default on their obligation to guarantee the financial firmness of transmission rights according to the FCA Regulation.** Caps on the remuneration of long-term transmission rights (LTTRs) are reserved to cases of curtailment. No specific cap to the remuneration of LTTRs can be legally added for cases of day-ahead market decoupling with the existing legal framework. We also believe this would not make sense economically.¹

¹ More details at: https://www.efet.org/files/documents/20230511_CR_ENTSO-E%20EU%20HAR.pdf

The implementation of flow-based capacity calculation and allocation creates a major change in forward market design and deserves a thorough assessment of benefits. We have expressed this view on several occasions, pointing out to the downsides of the flow-based approach – some of which we repeat in our detailed comments below.

Should flow-based capacity allocation nonetheless be implemented in the forward timeframe, we support the objective of easing the increased collateral requirements. This is one of the operational drawbacks that, in addition to complexity, substantially adds to costs of hedging.

Detailed comments

A review of the flow-based approach to LTRs allocation is a must

EFET understand that the TSOs are to amend the EU HAR in order to respond to the ACER requirement to implement flow-based capacity allocation in the forward timeframe. We remind that the objective of EU legislation is to enable efficient forward markets with sufficient hedging instruments made available to market participants. We deplore that ACER, in its original decision to apply this calculation and allocation method to the forward timeframe in the Core and Nordic regions, has not demonstrated that “the flow-based approach leads to an increase of economic efficiency in the capacity calculation region with the same level of system security”, as per article 10.5a) of Regulation 2016/1719 (FCA Regulation).

We have continuously outlined the many drawbacks associated with the implementation of flow-based allocation in the forward timeframe. As flow-based allocation brings complexity, additional cost and high uncertainty over available capacity on certain interconnections without clearly proven benefits in terms of social welfare it should not be pursued at all costs only to meet deadlines.

We draw your attention to the EFET response to the ACER consultation on the SAP, CID and FRC amendments for long-term flow-based allocation submitted to ACER on 23 November 2022, which summarises our reservations related to the implementation of flow-based capacity allocation.²

Better optimisation in filtering bids is necessary (Article 34)

We understand that bid filtering, when the payment obligation (considering the price cap) is higher than the credit limit, is applied for the NTC-based allocation in the one auction per border/direction setting. With flow-based allocation, the approach proposed by the TSOs

²More details at:
<https://efet.org/files/documents/221124%20Electricity%20Committee%20CR%20ACER%20FB%20forward%20allocation.pdf>

results in an arbitrary filtering of lower-priced bids on different borders/directions that are part of the single flow-based auction for each region. This bid filtering would discriminate bids at borders with lower spread. The allocation algorithm assumes that the highest bids are more important for market participants, disregarding the lowest priced bids which, even though are valued at the forward spread, are filtered out from the auction.

Market participants risk of losing opportunities to secure cross-zonal risk hedging instruments on the borders with lower forwards spreads but high(er) volatility.

Price cap calculation for the purpose of collateral requirement should be forward looking (Article 34)

While the idea of a cap on collateral is positive, it all boils down to whether the cap actually decreases the collateral burden for market participants. As a reminder, the risk here is that, with a single pan-regional auction, bidding is de-optimised because of collateral constraints.

The proposal to use the day-ahead spreads does not make much sense. The cap should be set according to forward spreads observed as close to the auction as possible, yearly spread for year-ahead auction and quarterly/monthly/weekly spread for quarter/month/week-ahead auction.

Provisions related to default and potential contribution in payment should be clarified

The provisions of the EU HAR should be clear on how the potential gap between the maximum payment obligation and the credit limit on the one hand, and the potential default in payments on the other hand, is recovered.

The proposed amendments to the EU HAR are not clear in this important issue. Hence we request full clarity on the calculation of potential contributions by market participants to recover the unpaid gap.

Publication of the price cap ahead of the start of bidding period is needed (Article 29)

According to the EU HAR, the price caps on collateral applied for a specific auction is published one hour before the start of the bidding period together with the final auction specification.

We consider that this information should be published well before, at least 2 days ahead of the auction. This will ensure that market participants can alter their credit limit and increase it should the cap be higher than expected or vice versa.

Auction dates and invoicing/payments periods to enable reuse of credit limit (Tittle 10)

The timeline of the yearly, monthly and other auction periods is not clear in the proposed amendments to the EU HAR. With increased collateral requirement, it is becoming even more important to enable the re-use of the credit limit for subsequent allocations.

Auction participants should have the invoices and sufficient time for payment of capacity allocated in previous auctions before the subsequent auction is opened. This way, their credit limit would be reset and reused for the following allocation. This had less importance in the NTC allocation where auctions per individual borders were set on different dates and the re-use was possible. With one single pan-regional auction, this will have a substantial impact on the value of collateral. Hence, the timing of auctions, invoicing and payments should allow for an optimal use of the credit limit.

The financial firmness of LTTRs should be maintained even in case of day-ahead market decoupling

We consider this matter of crucial importance. Amending the financial firmness of transmission rights in the EU HAR would require a legal basis in the FCA Regulation. However, article 35 FCA Regulation is crystal clear: LTTRs are remunerated at the DA market spread when day-ahead market coupling is in place at a given border, whether the allocation actually occurred implicitly or via a fallback process. The sole exemption to this principle of financial firmness is in article 54 FCA Regulation, which allows caps on LTTR compensation – not remuneration – only applies to curtailed LTTRs.)

The case of decoupling being explicitly foreseen in the FCA Regulation, and still providing remuneration of LTTRs at DA market spread, **the new article 49 proposed by ENTSO-E is not compliant with the FCA Regulation.**

Aside from its unlawfulness, we also believe that this measure makes no economic sense, as mentioned at previous occasions. For such a significant departure from the well-established principle of financial firmness of LTTRs, we would expect the TSOs to properly assess and demonstrate:

- a) **the necessity of the proposed measure:** i.e. that the existing remuneration rules put an unsustainable financial burden on the TSOs even with a few rare days of decoupling;
- b) **the proportionality of the proposed measure:** i.e. that a modification of the remuneration rules does not have a detrimental impact on the allocation of LTTRs and their value, and eventually improves social welfare.

Regarding point (a) on the necessity of the measure, the TSOs changed their narrative on the remuneration of LTTR at the DA market spread in case of decoupling from a question

of “overcompensation” (2022) to a question of “fairness and level-playing field between market participants and tariff payers”. A few thoughts around that:

- "Tariff payers" are consumers, which do not only pay tariffs, but also energy. The question of fairness should hence not only look at what could be saved on the tariffs part of an electricity bill from lower remuneration of transmission rights, but what could be lost on the energy part of the electricity bill from higher cost of trading linked to lower firmness of transmission rights (see point b).
- The discussion of tariffs themselves fundamentally boils down to the original argument of the TSOs claiming that full financial firmness of transmission rights even in case of decoupling leads to an unbearable financial burden for TSOs, that is then passed through tariffs onto consumers. As we are lacking information on TSOs congestion rent (either aggregated or per border) as well as on payouts to LTTR holders, the only numbers that we had at hand to perform some type of analysis – despite repeated requests – are those presented by the TSOs at the MESC and Florence Forum meetings of the spring of 2021. When reverse-engineering these numbers, we can observe that the LTTR payout on the decoupling event represented:
 - o on 07/06/2019: 2,8% of aggregated 2019 EU congestion rent (yearly and monthly LTTRs allocation, excl. DA)
 - o on 04/02/2020: 0,9% of aggregated 2020 EU congestion rent (yearly and monthly LTTRs allocation, excl. DA)
 - o on 13/01/2021: 2% of aggregated 2021 EU congestion rent (annual LTTRs allocation only, excl. monthly LTTRs and DA)

The data presented by the TSOs shows that LTTR remuneration during days of decoupling was far from reaching the congestion rent they collect in each concerned year, even if looking only at forward allocation revenues (i.e. not taking account of additional transmission revenues from DA).

Regarding point (b) on the proportionality of the measure, we miss an assessment by the TSOs of the effect that their proposed measure may have on the allocation of LTTRs and their value, as well as on social welfare in general:

- The idea that firmness would only be affected in in case of decoupling is also misleading: indeed, changing the rules of LTTR remuneration in case of decoupling effectively diminishes the firmness of all LTTRs at the time of allocation, whether or not they are redeemed on a day of decoupling at a later stage, since it cannot be known a year or a month in advance whether decoupling will happen in DA.
- Any change in the LTTR remuneration rules will be accounted for by market participants when they bid in long-term auctions. Hence, any 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. This could significantly affect the revenues that TSOs capture from the sale of LTTRs all year round.

- In addition, lower firmness of LTTRs will translate into less ideal hedging opportunities for market participants. All things equal, a lower risk coverage would translate into directly higher costs to hedge a specific risk on the market, costs which will ultimately be passed on to consumers.

Since the start of this discussion in 2021, the TSOs failed to forecast the magnitude of both the loss of revenue from the allocation of diminished LTTRs for all delivery periods, and the increase in the cost of hedging for the market. Whether these side-effects could counteract the objective of the TSOs to reduce pay-outs to LTTR holders during days of decoupling for the benefit of consumers should have been properly analysed by the TSOs as part of their proportionality assessment.

In conclusion, and in addition to the unlawfulness of the proposal, the TSOs have still not demonstrated that their proposal is either justified or proportionate to the aim they pursue. We request the deletion of this proposed new article 49.

Conclusion

EFET considers that the progress towards flow-based allocation of the LTTRs is rushed and premature. **We invite TSOs to address the important operational issues, such as but not limited to available capacity on borders with lower spreads and increased collateral requirement.** This should be the objective before the decision on implementation.

Further, in addition to the unlawfulness of the proposal related to financial firmness of LT transmission rights, the TSOs have still not demonstrated that their proposal is either justified or proportionate to the aim they pursue. **We request the deletion of this proposed new article 49.**

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