CONSULTATION RESPONSE

EFET
European Federation of Energy Traders

EFET response to ACER consultation on the SAP, CID and FRC amendments for long-term flow-based allocation

23 November 2022

The European Federation of Energy Traders (EFET) welcomes the opportunity to provide comments to ACER's public consultation on all TSOs' proposals for amending the following:

- Establishment of the Single Allocation Platform (SAP) in accordance with Article 49 of the FCA Regulation and for the cost sharing methodology in accordance with Article 59 of the FCA Regulation ('SAP Proposal');
- Congestion Income Distribution (CID) methodology in accordance with Article 57 of the FCA Regulation ('FCA CIDM Proposal'); and
- The methodology for sharing costs incurred to ensure firmness and remuneration of long-term transmission rights in accordance with Article 61 of the FCA Regulation ('FRC Proposal').

EFET acknowledges that the amendments to the above-listed methodologies are needed in order to facilitate the implementation of flow-based cross-zonal capacity calculation and allocation in the Core and Nordic Capacity Calculation Regions (CCRs). However, we consider that a fundamental review of the general approach is needed.

Key messages

1. We continue to challenge the value-added of flow-based calculation, and even more flow-based allocation of transmission capacity in the forward timeframe.
2. The optimization function currently foreseen for the flow-based allocation of LTTRs risks leaving some borders with little to no long-term transmission capacity.
3. The organization of massive pan-regional or pan-European auctions poses significant stress on collateral requirements for market participants, at the risk of de-optimizing capacity allocation.
4. Proper assessment of benefits, monitoring and transparency will be key to ensure we preserve hedging opportunities for all and ultimately manage the risk for consumers.

General comments

The value-added of flow-based capacity calculation and allocation in the forward timeframe remains unproven

As the TSOs and NRAs prepare the framework for implementation we still deplore the lack of demonstration that the conditions set under Article 10(5) of the FCA Regulation for the application of flow-based capacity calculation have been met, in particular related to increase in economic efficiency. No assessment was consulted with market participants or made publicly available. Such assessment is a legal requirement and a lax attitude in this respect raises compliance concerns.

As previously mentioned in EFET responses to LTCCM related proposals[1], forward capacity calculation and allocation is critical to allow market participants to hedge their long-term positions across borders. This contributes to limiting their exposure to short-term price volatility and imbalance costs, and in turn helps shielding end-consumers from those risks as well. In this sense, we have also argued in favor of TSOs issuing LTTRs earlier than one year before delivery, in order to boost forward market depth across borders.

Along the lines of the choice for long-term flow-based capacity calculation, that for long-term flow-based capacity allocation has not been subject to a proper assessment of its benefits and drawbacks: Long-term flow-based allocation following explicit bids from market participants is fundamentally different from flow-based allocation under the day-ahead market coupling regime. The nature of forward trading and hedging is fundamentally different from the short-term optimization where physical flows are allocated. Allocation of transmission rights by the TSOs based on expected 'flows', while market participant orders actually relate to electricity derivatives, may generate greater limitations and higher reliability margin throughout longer periods.

The relevance of flow-based allocation in the long-term is further questioned by the financial nature of the transmission rights expressed through the optionality of the FTRs (and PTRs with UIOSI). External constrains, as operational security constrains, limit the maximum import and/or export of a given bidding zone, and reduce hedging possibilities for market participants. Under explicit bidding for cross-zonal capacity, the reduced level of capacity at such bidding zone borders, may increase the hedging costs and affect the bidding behavior of market participants. In turn, this is likely to undermine the assumed efficiency of the flow-based allocation.

[1] See EFET response to consultation on a proposal for long-term capacity calculation methodology (dated 16 October 2020, available at: https://data.efetmembers.org//Files/Documents/DownloadsMember/EFET_TSOs%20consult%20CORE%20LTCC_16102020.pdf), Joint response of EFET and Eurelectric to the ACER consultation on the Core Long
Term Capacity Calculation methodology (dated 30 July 2021, available at: https://efet.org//files/documents/210730%20EFET%20Eurelectric%20CR%20Core%20LT%20CCM%20ACER.pdf).

The choice of optimizing allocation to maximize auction revenue risks reducing capacities to zero at certain borders

The optimization function of the auction algorithm currently foreseen by the TSOs will favour the maximization of auction revenue. This means that forward transmission capacity will be allocated in priority to bidding zone borders with significant price spreads. The quantity of LTTRs allocated at one border will impact the availability of LTTRs at other borders, to respect the flow-based constraints.

We have insisted for the past year that our members use LTTRs chiefly to hedge the volatility of the price spread between two zones – rather than the price spread itself. Such concerns have been raised several times by EFET and other market participants/associations, including during ACER workshops. There is however no sign that these concerns are being heard, and that a solution that does not only increase TSO congestion income is being seriously considered and sought after.

The organization of pan-regional/pan-European auctions significantly raises collateral requirements, at the risk of de-optimizing the auction

As highlighted on previous occasion, the move from sequential auctions (border-per-border) to pan-regional/pan-European ones (one auction for all concerned borders) will significantly increase collateral requirements for market participants. In the Core region alone, collateral would need to back up bids relating to more than 20 bidding zone borders, the capacity of which would be allocated under a single auction.

The longer the maturity of allocated rights, the greater the financial requirement for market participants to put in place extensive collateral on the table. This increases hedging costs for those who can afford it, and may change the bidding behavior of those who cannot. We understand that this matter will be discussed under the HAR consultation, but due to its importance it is noted also under this consultation response.

Way ahead

EFET considers that the progress towards flow-based allocation of the LTTRs is rushed and premature. So far it did not demonstrate added value; the proposed optimization function (article 39.15) appears as suboptimal for market participants; and the massive auctions that will be organized will pose significant challenges in terms of collateral, which may well distort the results of the allocation in a worrying manner.

The implementation of flow-based capacity calculation creates a major change in forward market design. It should be carefully reassessed, and pending a positive result of such assessment, equally implemented and monitored. The application of long-term flow-based capacity allocation is an additional and separate choice, which itself deserves thorough assessment.

Would flow-based capacity calculation and allocation be applied in the Core and Nordic CCRs, ACER should ensure a regular process of monitoring of their effects and economic efficiency. A provision requesting this monitoring, border-per-border, should at the very least be included in either the SAP methodology or the EU HAR to identify borders experiencing lower capacity due to optimization function. Market conditions continuously change and with them also the hedging needs, hence a continuous monitoring should be performed.

The concerns we highlight above are very serious. We should not continue to steam ahead without consideration for the practical consequences of choices made – and still to make.

Specific comments on the SAP proposal

With regards to specific comments, ACER should put strong emphasis on transparency for market participants.

SAP, Annex, 1.2, a, ii; we welcome the transparency, auditability and explainability requirements, however the provision should be clear that transparency is meant for market participants and all related information will be published.

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