CONSULTATION RESPONSE

EFET
European Federation of Energy Traders

EFET response to public consultation on the ACER Decision on harmonised allocation rules for long-term electricity transmission rights

Brussels, 26 September 2023 - The European Federation of Energy Traders (EFET) takes the opportunity of the ACER consultation on amendments to the harmonised allocation rules (EU HAR) for long-term electricity transmission rights (LTTRs) to remind that **implementing the flow-based approach for allocating LTTRs without addressing its associated drawbacks poses a serious risk to the forward market development**.

Key messages

1. **The flow-based approach is not suitable for allocating LTTRs** as it fails to offer adequate and efficient hedging opportunities to market participants.

2. The implementation of **flow-based allocation of LTTRs should be put on hold** until its drawbacks related to capacity availability on some bidding-zone borders and high collateral requirements are addressed.

3. **Transparency concerning the entire set of flow-based parameters is essential** for market participants to evaluate hedging opportunities across various bidding zone borders.

4. **Full financial firmness of LTTRs should be guaranteed**. Article 49 of the EU HAR, as proposed by ENTSO-E, does not possess a valid legal basis under the FCA Regulation.

Detailed comments

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

The introduction of flow-based capacity calculation and allocation for LTTRs represents a significant shift in forward market design and as such demands a comprehensive evaluation of its advantages and drawbacks. We have consistently conveyed this perspective, highlighting all the uncertainties and drawbacks of the flow-based approach.

We emphasize that EU legislation promotes efficient forward markets and requires TSOs to provide market participants with sufficient hedging instruments. We deplore that, in its original decision to apply this calculation and allocation method to the forward timeframe in the Core and Nordic regions, **ACER 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 are concerned that this crucial condition is being overlooked. Moreover, article 10.5a) exclusively refers to capacity calculation, not to capacity allocation.

We have consistently highlighted the numerous drawbacks associated with the adoption of flow-based allocation in the forward timeframe. Given that flow-based allocation introduces complexity, additional costs, and high uncertainty regarding allocated capacity on certain interconnections, all without clearly proven benefits in terms of social welfare, it should not be pursued at any cost merely to meet deadlines. The flow-based allocation of LTTRs is an approach focusing solely on the maximization of the economic surplus during the auction. This methodology is not suitable for allocating LTTRs as it fails to fulfil the goal of offering adequate and efficient hedging opportunities to market participants.

EFET deems it essential to tackle the matter of available capacity at interconnections with narrower forward spreads. **We have put forth a proposal to set minimum allocated volumes for each border/direction**. We firmly believe that implementing this quick fix should not be overly complex. This mitigation measure is reasonable and technically feasible. It bears a resemblance to the approach used in the intraday timeframe, wherein a flow-based capacity calculation is performed, followed by an ATC extraction to guarantee availability of capacity at the various borders.

Collateral requirements

With the introduction of flow-based capacity calculation and allocation for LTTRs, a single auction will be performed simultaneously for all bidding zone borders in each CCR where capacity is allocated with the flow-based approach. This causes a significant increase in collateral for LTTR bids, and, where market participants are unable to meet the requirements, could de-optimise the allocation of capacity.

We appreciate the options put forth by ACER concerning the definition and calculation of a cap on collateral requirements. However, neither approach appears to comprehensively resolve the issue.

Out of two options, EFET considers option 2 (cap using forward prices) as more appropriate to adequately reflect the value of LTTRs. We are aware that ACER views this method as complex and has excluded it from further consideration.

Within option 1 (cap option using the average value of the market spread), ACER's proposal is superior compared to the ENTSO-E proposal. However, we deem the day-ahead market spread approach inadequate as a proxy for LTTRs value.

Ultimately, **EFET suggests dedicating the necessary time, effort and resources for the successful implementation of option 2**.

Approach towards bid filtering

ENTSO-E has suggested adopting a similar approach to bid filtering as employed with the NTC approach. EFET regards this approach as inadequate, as it continues to disadvantage interconnections with narrower spreads. This exacerbates the risk for market participants to see very limited volumes of capacity available at certain borders, as their lower-priced bids on interconnections with lower spreads would be automatically filtered out.

ACER rightly highlighted this issue, proposing an approach where bid filtering relies on market results (option 3) and is not conducted before the auction, which is seen as a more suitable solution. However, ACER has ruled out this approach from further evaluation, citing its complexity. As a result, ENTSO-E's approach remains a candidate for implementation starting in November 2024.

Much like our stance on the collateral cap calculation, **EFET strongly disagrees with ACER's approach, which emphasizes ease of implementation to the detriment of efficiency and cost-effectiveness. We call once again to dedicate the necessary time, effort and resources for the successful implementation of option 3.**

Timing for publishing the calculated cap on collateral

According to the proposal from ENTSO-E, the calculated cap for collateral in case of flow-based allocation is published with the final auction specifications, at the latest one hour before the start of the bidding period.

EFET aligns with ACER's perspective that market participants should be allowed sufficient time, from the publication until the start of the bidding period, to alter their collateral before the auction. We propose that **the calculated cap on collateral assessment be made publicly available at least five working days before the start of the bidding period.**

Offered capacity with flow-based in the auction specifications

EFET strongly agrees with ACER that the **full set of flow-based parameters should be made available to market participants, and even suggests going beyond ACER proposal**.

ACER considers that the final offered capacity in case of flow-based should consist of:

1. Power transfer distribution factors (PTDF) per critical network elements (CNEC) and, if applied, grouped network elements (GNEC);
2. Remaining available margin (RAM) per CNEC and GNEC;
3. External constraints (EC) per border directions, where applied;
4. ATC values per border directions, applied for evolved flow-based (EFB) approach;
5. Max Exchanges (MaxBex) per bidding zone border directions;
6. Min Net Positions; and
7. Max Net Positions

Further, **EFET considers necessary to have access to both pre-solved and non-pre-solved flow-based domains, as well as to the complete list of CNEC parameters**, in addition to the CNEC ID:

1. Branch Name
2. Contingency Name
3. EIC code
4. Direction
5. Hub from / hub to
6. Substation from / substation to
7. Element type
8. TSO
9. Fmax
10. Imax
11. U
12. FRM
13. F0core
14. F_uaf
15. minRAM factor
16. AMR
17. Pre-solved (true/false)

Market participants will need the Publication Handbook, as currently available in the Core day-ahead timeframe, which includes information about data and publication times. Furthermore, they will also need an API to request data, mirroring the existing functionality available in the day-ahead timeframe. Access to information regarding allocated volumes, prices, and bidding constraints following the auction settlement is essential.

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

While this issue is not incorporated in the consultation questions, EFET considers the question of financial firmness of LTTRs of utmost significance.

Amending the financial firmness of transmission rights in the EU HAR, as proposed by ENTSO-E, would require a legal basis in the FCA Regulation. However, article 35 of the FCA Regulation is crystal clear: LTTRs are remunerated at the day-ahead market spread when day-ahead market coupling is in place at a given border, whether the allocation 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 day-ahead 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 LTTRs at the day-ahead 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" (2023). 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 events represented:

- on 07/06/2019: 2,8% of aggregated 2019 EU congestion rent (yearly and monthly LTTRs allocation, excl. DA)
- on 04/02/2020: 0,9% of aggregated 2020 EU congestion rent (yearly and monthly LTTRs allocation, excl. DA)
- 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 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 normal day or a day of decoupling at a later stage. Indeed, it cannot be known a year or a month in advance whether decoupling will happen in day-ahead.
- 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 what they are willing to pay for them. 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 and how these side-effects could counteract the objective of the TSOs to reduce payouts 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 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

As the November 2024 deadline for flow-based implementation is not mandated by the FCA Regulation, **we urge ACER to suspend the implementation of the flow-based approach for LTTRs allocation until its drawbacks are effectively addressed** through processes that minimize trading costs and preserve liquidity and hedging opportunities**.**

Contact

Arben Kllokoqi
Director of Electricity Market Design
a.kllokoqi@efet.org