CONSULTATION RESPONSE

Proposal for Amendment of Finnish, Estonian, and Latvian TSOs of Baltic CCR TSOs' Methodology for Splitting Long-Term Cross-Zonal Capacity

Brussels, 13 December 2024

General remarks

We are very concerned by the Baltic TSOs' proposal prioritising the maximisation of their congestion income over the maximisation of transmission capacity in these splitting rules.

Allocating long-term transmission rights (LTTRs) at the Finnish-Estonian and Estonian-Latvian borders contingent on a positive financial balance of the TSOs violates Art. 9 of the Electricity Regulation 2019/943 and doesn't meet the criteria of Art. 16.2 of the FCA Regulation 2016/1719.

We urge the Baltic TSOs to issue LTTRs at maximum capacity, at every bidding zone border and with longer maturities. Efficiently promoting hedging and liquidity in forward markets will increase price stability for consumers who wish to be shielded from short-term price fluctuations.

Key messages

1. **Providing cross-zonal hedging opportunities to the market is the primary objective of LTTR allocation – not optimising TSOs' congestion income**
2. **All the capacity calculated as available by the TSOs should be auctioned as far in advance of real-time as possible – no capacity should be withheld even for balancing purposes**
3. **The split between LTTR volumes to be allocated in yearly, quarterly and monthly auctions would better be performed by the market itself**

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Detailed comments

In general, we are quite supportive of the recent move towards the issuance of LTTRs in the Baltic area, including at the Finninsh-Estonian border.

Forward markets are crucial to secure a stable and affordable electricity supply in the energy transition context. They represent 90% of all volume of electricity transactions in Europe, enabling buyers and sellers to lock in prices and volumes in advance, delivering stable consumer bills to customers and managing volatility risks. Liquid and efficient forward markets are also crucial for the uptake of PPAs, securing private investments to finance low-carbon sources of electricity.

LTTRs (in the form of FTR options in the Baltic area), made available by TSOs to the market via transparent and non-discriminatory auctions, represent key tools to help cover basis risk for market participants engaging in forward cross-border trade between adjacent bidding zones. While LTTRs represent only a fraction of the volumes exchanged on the forward market for electricity, their issuance at bidding zone borders reduces cross-border trade risks and can be conducive to increased liquidity in the concerned forward markets.

While we welcome the consultation of the Baltic TSOs on their proposed splitting rules for long-term cross-zonal capacity, the proposal has us seriously concerned on several points:

1. Providing cross-zonal hedging opportunities to the market is the primary objective of LTTR allocation – not optimising TSOs' congestion income

We are particularly worried that this methodology proposal prioritises maximising TSOs' congestion income over maximising the capacity made available to the market to facilitate cross-zonal hedging.

a. <u>The skewed perception of "undervaluation"</u>

The approach proposed by the Baltic TSOs relies upon a perceived "undervaluation of LTTRs", which we strongly disagree with. The price at which market participants are buying LTTRs combines:

- the underlying value of the **spread at the moment of the auction** (i.e. the value of the spread year-ahead or month-ahead)
- an additional **risk premium** translating their vision of the probability that this spread varies
- additional **adjustment factors** having an upward effect on bid price – e.g. expectation of high demand in the auction – or negative effect on the price – e.g. expectation of low demand in the auction, poor LTTR firmness, high statistical

probability of unavailability of the interconnection (frequent curtailments or unplanned maintenance periods, risk of Force Majeure, etc.)

The auction price reflects the market value at the moment of auctioning (forward spread + volatility premium + possible adjustment factors). It does not constitute a "price floor" below which the realised spread (= the spread in the day ahead) cannot go. We also want to remind that the price paid reflects all the risks embedded in the product itself (credit risk, cost of capital, risk of force majeure and "emergency" covering, among others, outages in the grid) and borne by market participants.

Analysing realised day-ahead market spreads to understand LTTR valuation by market participants is highly questionable – and even more so is using historical average day-ahead spreads to set a limit on the LTTR to be allocated according to this methodology.

b. <u>The illegitimacy of congestion income optimisation</u>

For the TSOs to "optimise" capacity allocation based on an analysis of historical data and forecasted prices is beyond their mandate. This is both in contradiction with the word and spirit of:

- Art. 9.1/2 of the Electricity Regulation 2019/943: "Transmission system operators shall issue long-term transmission rights or have equivalent measures in place to allow market participants, including owners of power-generating facilities using renewable energy, **to hedge price risks** [...]. Long-term transmission rights shall be allocated, regularly, in a **transparent, market-based and non-discriminatory manner** through a single allocation platform. The frequency of allocation and the maturities of the long-term cross-zonal capacity shall **support the efficient functioning of the Union's forward markets**.
- Art. 16.2 of the FCA Regulation 2016/1719: "The methodology for splitting long-term cross-zonal capacity shall comply with the following conditions:
    a) it shall **meet the hedging needs** of market participants;
    b) it shall be coherent with the capacity calculation methodology;
    c) it shall **not lead to restrictions in competition, in particular for access to long-term transmission rights**.

The TSOs' allocation of capacity should solely be based on the technical capacity and requirements of the grid. It is not the place of system operators to analyse market data to maximise their benefits from forward capacity allocation. The opportunity for market participants to purchase capacity at a specific price and volume is for them to decide, not for TSOs. We remind the TSOs that by owning the interconnectors, they de facto sit on a natural hedge that can and should be made available to the market as much and as early as possible. Retaining this hedge opportunity from the market based on the expectation of evolutions of market prices – including and possibly inflating the price of transmission rights – could be considered market manipulation.

2. All the capacity calculated as available by the TSOs should be auctioned as far in advance of real-time as possible – no capacity should be withheld even for balancing purposes

We hold, that all the available transmission capacity should be allocated as far as possible before the maturity date and that the volumes should be constantly updated through computation during the year, offering additional volumes (if any) to the subsequent auctions.

Therefore, we strongly disagree with 50% long-term capacity reservation for balancing purposes at the EE-LV border. This capacity reservation is a very significant limiting factor to capacity availability at this border. Reserving cross-zonal transmission capacity specifically for balancing removes available capacity from the allocation in other timeframes and restricts market participants' ability to adjust their positions across the border.

Aside from the principle in itself, we also do not see how the issuance of FTRs (Financial Transmission Rights), with no bearing on the physical capacity that TSOs will allocate or use later, can create a threat to balancing processes or system security.

We urge the Elering and AST to review their approach in that regard and remove the 50% limitation they impose on the issuance of FTRs at their common border.

3. The split between LTTR volumes to be allocated in yearly, quarterly and monthly auctions would better be performed by the market itself

We welcome the fact that the TSOs allocate not only yearly and monthly products at the concerned borders but also quarterly products.

To recall, for market participants hedging is about assessing and covering their positions against a variety of risks: price risk, volume risk, regulatory risk, etc. The further away from real-time, the greater the interest and importance for market participants to cover those risks, including across borders. Long-term transmission rights contribute to reducing these risks in the case of cross-border or proxy hedging. It is therefore vital that TSOs make available to the market the maximum capacity they can as far in advance of real-time as possible.

This means we believe that all the capacity calculated by the capacity calculation process a year ahead should be made available to the market (i.e. 100% of the calculated capacity a year ahead). Further release of capacity at shorter time horizons in the forward timeframe (quarterly and monthly) should be the result of capacity recalculations, or gradual release of the margins and constraints initially applied by the TSOs for year-ahead allocations as uncertainties reduce with real-time getting nearer.

For the avoidance of doubt, and bearing in mind that certain market participants may only wish to purchase capacity for specific months and may be reluctant – or unable – to re-trade purchased yearly forward transmission rights on the secondary market, the TSOs may choose to allocate the 100% of capacity calculated year-ahead not only via yearly products but also via monthly products (but a year in advance). The TSOs could even make sole use of monthly products in the year-ahead, quarterly and monthly auctions, which could be bundled into quarterly or annual blocks in the yearly or quarterly auctions. This distinction between the timing of the auctions and the granularity of the products offered by the TSOs would allow the market itself, at the time of the yearly auction, to perform the splitting of capacity between yearly and monthly capacity in the most economically efficient manner.

Final comments

To ensure the availability of efficient cross-zonal hedging options for the market and contribute to increasing liquidity in the market, we have several suggestions for the issuance of LTTRs by TSOs:

- We recommend the issuance of LTTRs by TSOs at all the Baltic bidding zone borders

- We recommend that TSOs start offering LTTRs with longer maturities (3-5 years) to support the corresponding forward markets, and in turn, facilitate the uptake of physical cross-border PPAs.

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