

Traders' views on future forward electricity markets: a response to the European Commission consultation on revising the Forward Capacity Allocation Guideline

Brussels, 30 September 2024 – **Forward markets are key enablers of a secure, affordable, and decarbonised supply of electricity.** As we gradually come out of 5 years of upheavals in energy supply and demand, the upcoming review of the Forward Capacity Allocation (FCA) Guideline comes at the perfect time to assess the value – and need to finetune – our forward electricity markets. With this in mind, **we call on the European Commission to focus on preserving liquidity in existing hubs and improving the design of zone-to-zone transmission rights to facilitate hedging on the efficient natural hubs that exist today.**

Key messages

1. **Build on what is working** – by preserving liquidity on existing natural hubs and being extra careful with experiments like regulated regional virtual hubs that could limit our ability to shield consumers from price fluctuations
2. **Improve how we make use of the infrastructure** – by maximising the cross-border transmission capacity that grid operators offer to the market with zone-to-zone Long Term Transmission Rights (LTTRs) at each border, in both directions
3. **Facilitate risk management over far longer periods** - by making LTTRs available 3 to 5 years ahead of delivery for better cross-border hedging, including via transnational Power Purchase Agreements (PPAs)
4. **Secure the conditions for effective risk management** – by enforcing the strict conditions imposed by the Electricity Market Design (EMD) reform with regard to any potential future State interventions into the electricity market

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Detailed comments

Part I: Evaluation of current forward markets

a) Assessment of the electricity forward markets

- 1 Is there, in general, sufficient availability of hedging instruments on the forward markets to effectively perform hedging corresponding to your risk profile?

Yes

- 4 Is there, in general, sufficient liquidity on the hedging instruments on the forward markets to effectively perform hedging corresponding to your risk profile?

Yes

- 5 Please list the products for which you encounter insufficient accessibility (in terms of effectiveness and liquidity) and provide a detailed answer to explain what problems you encounter in BZs where availability is insufficient (f.e. lack of competition, market too small, none of the available liquid products is a good proxy, inadequate cross-zonal hedging instruments, ...). In case you identify a lack of liquidity in some or several of the markets you resort to, please estimate the slippage costs that result from this lack of liquidity - if possible.

Our members actively engage in forward trading across Europe, with over-the-counter (OTC) forward contracts – both cleared and non-cleared – and future contracts negotiated on power exchanges. In the rest of this consultation, we will refer to all these activities as “forward trading” or “the forward market”.

Forward markets are key enablers of a secure, affordable, and decarbonised supply of electricity. This market segment represents close to 90% of electricity transactions in volume in Europe, showing the importance it represents to bring electricity from the power plants to the consumers.

The level of liquidity of forward markets varies from one bidding zone to the other, with the German-Luxembourg (DE-LU) bidding zone serving as a reference as the most active and liquid forward market in Europe, where market participants can:

- trade cheaply thanks to low transaction costs (small bid-ask spreads),
- find a wide diversity of counterparties (high number of market participants, each with a small market share)
- hedge efficiently three to five years before delivery (deep market with a medium-term trading horizon).

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Other markets can serve as a local or regional hub (Nordic area, France, Hungary): they present interesting trading opportunities, though their level of liquidity, number of market participants and/or trading horizon does not match that of the DE-LU bidding zone. In most other bidding zones, the liquidity of forward markets is rather low.

It should be noted that market participants located in any bidding zone in Europe are able to trade forward deals in the bidding zone of their choice and hedge their positions in another market – so-called “proxy hedging”. Proxy hedging is a widespread practice that allows market participants to hedge in what they regard as the most suitable market for them, even if that market is not where they will be ultimately exposed. This is done in particular when other markets present longer maturities (where there are bids and offers earlier ahead of delivery than their home market), and/or when it is cheaper to transact in other bidding zones (where the bid-offer spreads are smaller than their home market).

Considering the size of the overall forward market in Europe, it is widely acknowledged that not all bidding zones can be home to a mature, liquid forward market. Ensuring that market participants can continue to perform proxy hedging in the bidding zone of their choice is therefore vital.

Compared to hedging in a market participant’s home market, proxy hedging embeds an extra risk linked to the fluctuation of the price difference – so-called “spread” – between the home market and the market where the proxy hedging is performed – so-called “basis risk”. Market participants are happy to add this basis risk when it is cheaper or easier to manage than not hedging or than hedging in their home market. There are also tools to manage and reduce this basis risk: purchasing Long-Term Transmission Rights (LTTRs) from the TSOs; or trading “spread contracts” OTC or on power exchanges.

We consistently advocate in favour of TSOs making available to the market the natural hedge they possess with cross-border transmission lines, by way of issuing LTTRs. LTTRs are efficient tools to improve reduce basis risk and hence lower the cost of cross-border transactions (including proxy hedging), for the ultimate benefit of consumers.

All TSOs should offer LTTRs to the market at each bidding zone border, in both directions. TSOs should allocate transmission rights for the maximum available capacity calculated as available before each auction, without reservation of capacity for subsequent timeframes. The TSOs issuing LTTRs for longer maturity could also enhance hedging opportunities and increase the uptake of cross-border PPAs that are often concluded on longer than 5-year duration, without sufficient options to manage basis risk for now. Offering LTTRs with a maturity matching – or closer to – the investment horizon could facilitate longer cross-border PPAs that in turn help unlock new investment in the energy transition. Finally, LTTRs should be freely re-tradable on a secondary market organised by the TSOs/JAO.

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Trading spread contracts on the market is a free activity that market participants can engage in, and which does not necessitate specific regulation. It is a widespread practice based on various types of specific or standardised products. In the Nordic area, a variant of that activity is based on Electricity Price Area Differentials (EPAD) contracts, which cover the basis risk between Nordic bidding zones and the Nordic system price. Where they are available and liquid, EPADs are a tool that allow market participants to reduce basis risk, especially at all the bidding zone borders where LTTRs are not allocated by TSOs. In the particular case of EPADs, we have observed liquidity problems (with ongoing actions attempting to solve them, still to show results). We insist that all types of spread contracts can efficiently coexist with LTTRs. Forward markets could be further improved by ensuring that all TSOs allocate LTTRs at each border in both directions, starting with the borders that suffer the most from poor availability of market-based spread contracts.

- 6 Are additional measures needed to improve the ability of market participants to hedge price risks in the forward markets?

Yes.

If yes, which ones?

- Safeguarding the ability for market participants to hedge in the market of their choice
- Ensuring all TSOs issue LTTRs at each bidding zone border, in both directions
- Maximising the volume of LTTRs issued at each auction, with a minimum volume of LTTRs allocated at each border (ATC allocation, or ATC extraction with minimum RAM from a flow-based calculation)
- Issuing longer-maturity LTTRs (at least 3 years ahead of delivery, up to matching the full time horizon of PPAs)
- Studying the possibility for TSOs/JAO to organise a secondary market for LTTRs
- Ensuring regulatory stability and restricting wholesale price control measures to the strict conditions imposed by the EMD reform

- 12.1.1 In case you have physical assets or activities (demand, retail supply, generation): to what degree or percentage do you hedge price risks related to these assets?

Energy Traders Europe does not have physical assets.

- 12.1.2 In case you have physical assets or activities, please describe in broad terms your hedging activities.

Energy Traders Europe does not have physical assets.

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- 12.2 In case you have physical assets or activities (demand, retail supply, generation) and in case you do not hedge (a part of) your physical assets or activities, what are the main reasons for not hedging (f.e. availability of hedging products, costs of hedging, risk management choice

Energy Traders Europe does not have physical assets.

- 12.3 In case you have physical assets or activities (demand, retail supply, generation): would you hedge a larger proportion of physical assets if the market conditions were more favorable? In this case, which conditions would need to be met?

Energy Traders Europe does not have physical assets.

b) Cross-zonal forward hedging

- 13 Is the status-quo regarding the availability, design and type of cross-zonal instruments adequate to meet your hedging needs?

Yes

Please provide a detailed answer

We fully support TSOs offering LTTRs to help reduce the basis risk faced by market participants engaging in cross-border transactions.

We do not see our support for LTTRs as maintaining the status quo: we consistently advocate in favour of TSOs making available to the market the natural hedge they possess with cross-border transmission lines, by way of issuing LTTRs. LTTRs are efficient tools to improve reduce basis risk and hence lower the cost of cross-border transactions (including proxy hedging), for the ultimate benefit of consumers.

All TSOs should offer LTTRs to the market at each bidding zone border, in both directions. TSOs should allocate transmission rights for the maximum available capacity calculated as available before each auction, without reservation of capacity for subsequent timeframes. The TSOs issuing LTTRs with longer maturity could also enhance hedging opportunities and increase the uptake of cross-border PPAs that are often concluded on longer than 5-year duration, without sufficient options to manage basis risk for now. And LTTRs should be freely re-tradable on a secondary market organised by the TSOs/JAO.

Trading spread contracts on the market is a free activity that market participants can engage in, and which does not necessitate specific regulation. It is a widespread practice based on various types of specific or standardised products. In the Nordic area, a variant of that activity is based on Electricity Price Area Differentials (EPAD) contracts, which cover the basis risk

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between Nordic bidding zones and the Nordic system price. Where they are available and liquid, EPADs are a tool that allow market participants to reduce basis risk, especially at all the bidding zone borders where LTTRs are not allocated by TSOs. In the particular case of EPADs, we have observed liquidity problems (with ongoing actions attempting to solve them, still to show results). We insist that all types of spread contracts can efficiently coexist with LTTRs. Forward markets could be further improved by ensuring that all TSOs allocate LTTRs at each border in both directions, starting with the borders that suffer the most from poor availability of market-based spread contracts.

- 14 When trading in another bidding zone, what products do you use (if any) to cover the basis risk?

LTTRs

EPADs

EPADs supported by TSOs (as auctioned by Svenska krafnat - SvK)

Future spreads

Italian CCC (transport capacity fee hedge)

products

Others - please specify:

Other: please specify

Depending on their interest and location, our members use a variety of basis-risk management tools, including all those listed above.

In cases when there are no cross-border hedging instruments available (due to them not being issued at certain borders, their maturity not long enough, or the cost of LTTRs too high) basis risk can be left open and/or managed alternatively, including through spread contracts.

Market participants also engage in foreign exchange transaction to hedge their cross-border transactions, at the very least when there are different currencies between the home market and the market in which they trade.

- 15.1 Hedging instruments issued or supported by TSOs: Have you traded cross-zonal hedging instruments issued or supported by TSOs in the last 3 years

Yes

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- 15.2 Hedging instruments issued or supported by TSOs: Do cross-zonal instruments supported by TSOs satisfy your hedging needs (in terms of maturity, frequency of auctioning, type of product, ...)? If not, please elaborate your answer

As representatives of market participants trading in European power and gas markets, we advocate for the maximisation of hedging opportunities to stabilize price risks and provide flexibility that in turn, protect consumers from volatile electricity prices.

To provide better hedging opportunities, LTTRs should be allocated at each border and in both directions, with longer maturities in more frequent actions on the condition that maximum available transmission capacity will be auctioned.

- 15.3 Hedging instruments issued or supported by TSOs: After acquiring a FTR option, do you engage in delta hedging for the acquired option on the electricity forward obligation market?

Yes

- 15.4 Hedging instruments issued or supported by TSOs: On a scale from 1 to 10, do you consider that the LTTRs' price reflects the forward market fundamentals

10/10

Please elaborate your answer (date, border, data, etc)

The price of LTTRs in the auctions is the best estimate by the community of market participants of the value of the transmission rights at the time of the auction, based on forward market fundamentals. That valuation is not only looking at the static price of forward markets at the time of the auction though: it includes a dynamic valuation of the probably of fluctuation of market prices. Hence, it would be misleading to try and seek a 1-to-1 correlation between the forward price spread between two zones and the value of the corresponding LTTRs in an auction.

It is worth noting that, in turn, LTTR auction results do affect forward market prices, and as such end of forming part of the forward market fundamentals.

Finally, we note that, in Member States that have adopted them over the past few years, wholesale price control measures have altered forward market fundamentals and in turn impacted LTTR prices. This is one of the unfortunate consequences of these measures and we call on the European Commission to ensuring that Member States observe the strict conditions imposed by the EMD reform with regard to any potential future intervention into the electricity market.

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- 15.5 Hedging instruments issued or supported by TSOs: should you have identified a potential disconnect between LTTR and forward market fundamentals, do you see any risk of contagion across market segments (through arbitrage, for instance)?

We do not perceive any such disconnect, or a risk of related contagion.

C) Future-proofness: expected evolution of the Forward market

- 16.1 Do you consider that the following policies and market trends have an impact on the hedging incentives of market participants on the forward market: Contracts for difference (as a state-aid scheme) (Scale 1-10)

9/10

- 16.2 Do you consider that the following policies and market trends have an impact on the hedging incentives of market participants on the forward market: Power Purchase Agreements

6/10

- 16.3 Do you consider that the following policies and market trends have an impact on the hedging incentives of market participants on the forward market: Capacity remuneration mechanisms

9/10

Other policies and/or market trends - please specify:

All the policies linked to long-term tools aimed at the stabilisation of revenues or expenditures have an impact on the forward market – but it can be positive or negative.

Regulated mechanisms such as Contracts for Differences (CfD) or Capacity Remuneration Mechanisms (CRM) help stabilise electricity producers' revenues – and, in some cases, consumer bills. They should be carefully designed so as not to disincentivise forward trading. We insist that CfD schemes or CRMs, where they are needed, be complimentary to electricity markets so as not to drain liquidity in any market timeframes – including forward – or negatively affect dispatch signals¹.

¹ See our guidance document for Member States on the design of 2-way CfD schemes, available at: <https://cms.energytraderseurope.org/storage/uploads/media/cfdguideling-energytraderseurope-05092024.pdf>.

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Market-based instruments such as PPAs can generally be perceived as “prequels” to the forward market. As such, they are a hedging contract for longer time horizons than the usual maturity of forward electricity market. Since they generally either secure a price or a volume but rarely both, there is a natural incentive for PPA contracting parties to trade these positions on the forward market as soon as liquidity is available. Hence, PPAs are rather conducive to forward trading than negatively affecting it.

On a broader note, the European Commission should be mindful of how financial regulation can impact trading on forward electricity markets. The latest MiFID II review proposal suggesting to restrict the Ancillary Activity Exemption may lead certain market participants to reconsider their volume of activity on forward electricity markets, especially non-hedging. To preserve the liquidity on forward electricity markets, it is important that financial regulation maintains the rules that have been tailored to the energy market’s specificities and, in particular, preserves the MiFID II Ancillary Activity Exemption in its current form.

- 17.1 How do you expect the forward markets to evolve in the next 5 to 10 years with respect to hedging needs:

The rise of intermittent renewable sources of electricity, the market entry of new participants such as demand-response providers, and the gradual uptake of electricity storage and power-to-X operators leaves us to expect growing hedging needs on the market – but also more diverse hedging practices – on forward markets and through PPAs.

We see a future with a higher probability of electricity price and volume volatility, where hedging will become more important as a way for market participants to stabilise revenues and deliver more predictable prices for consumers.

As an example, PPA contracts have seen growth every year since 2014, with an exception in 2022, followed by a sharp rise in 2023 and the first half of 2024 (Pexapark). Offering LTTRs with a maturity matching – or closer to – the investment horizon could facilitate longer cross-border PPAs that in turn help unlock new investment in the energy transition.

- 17.2 How do you expect the forward markets to evolve in the next 5 to 10 years with respect to trading volume:

Given the predictions of European Commission regarding the rapid we expect trading volumes to increase in all market timeframes, including forward. Adding to this the growing hedging needs we expect in relation the rise of intermittent renewable electricity production and accompanying technologies (see our response to Q 17.1), this should translate into higher trading volumes on forward markets and for PPAs – all things being equal.

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However, this assumption relies on a number of conditions:

1. Safeguarding the few forward markets that are currently liquid – and being extra careful with experiments that could damage trading conditions and market efficiency, such as the development of regulated regional virtual hubs.
2. Ensuring that all TSOs maximise the cross-border transmission capacity they offer to the market at each border, in both directions, by way of LTTRs allocated as far in advance from delivery as possible. No bidding zone border should be left without access to capacity in the forward timeframe.
3. Designing regulated revenue stabilisation mechanisms such as CfD schemes and CRMs in a way that preserves incentives for market participants to engage in forward markets and PPAs contracting.
4. Aligning Member States' legislations regarding the issuance of guarantees of origin (GoO), so that every MWh of electricity produced from renewable energy sources can secure GoOs that can be valued as part of a PPA.
5. Making sure that financial guarantee schemes are in place in all Member States or at EU level to facilitate the conclusion of PPAs over long time horizons.

17.3 How do you expect the forward markets to evolve in the next 5 to 10 years with respect to the maturities of products:

Given the rapid pace of the green transition across Europe, including renewables, demand-response, storage and power-to-X, the conclusion of private long-term contracts will be key to secure financing alongside public subsidies. The efficient functioning of the forward market and PPAs will be key to facilitating this growth and providing liquidity.

We already see more diverse products being traded on forward markets, alongside the traditional baseload calendar products: peak-load forward products, long-term but short-delivery products, forward spreads, physical and financial PPAs, etc. This shows the ability of market participants and trading venues, such as future exchanges, to create the products needed when there is demand for them.

To accompany this movement, we also observe that some network operators have started offering LTTRs over longer time horizons – e.g., on the IFA 1 and 2 interconnectors between Great Britain and France – or are considering doing so soon – e.g., ongoing discussions between RTE and Elia to issue 2-year ahead LTTRs at the French-Belgian border. Longer maturity LTTRs help reduce basis risk earlier in cross-border transactions on forward markets, and they can contribute to the uptake of cross-border PPAs, thereby helping unlock new investment in the energy transition.

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- 17.4 How do you expect the forward markets to evolve in the next 5 to 10 years with respect to active players (f.e. type of players, shares, etc)

The green transition has seen a number of new actors emerge over the past decade, such as demand-response providers and aggregators or electricity storage operators. More are likely to emerge in the coming years, including all the participants engaged in power-to-X activities. The flexibility services in which many of them engage of course concern spot markets and balancing mechanisms, but they also comprise forward markets. We expect to see this wide diversity of market participants increasingly engage on forward markets as their market share on spot market grows.

- 17.5 How do you expect the forward markets to evolve in the next 5 to 10 years with respect to products:

As noted in our response to Q 17.3, we already see more diverse products being traded on forward markets, alongside the traditional baseload calendar products: peak-load forward products, long-term but short-delivery products, forward spreads, physical and financial PPAs, etc. This shows the ability of market participants and trading venues, such as future exchanges, to create the products needed when there is demand for them.

As flexibility needs grow and diversify in the years to come, we can expect new products on the market to emerge.

- 17.6 How do you expect the forward markets to evolve in the next 5 to 10 years with respect to the evolution of liquidity

All things equal, the increasing electricity production and growing hedging needs we expect should translate into higher trading volumes on forward markets and for PPAs (as noted in our response to Q 17.2).

However, this assumption relies on a number of conditions:

6. Safeguarding the few forward markets that are currently liquid – and being extra careful with experiments that could damage trading conditions and market efficiency, such as the development of regulated regional virtual hubs.
7. Ensuring that all TSOs maximise the cross-border transmission capacity they offer to the market at each border, in both directions, by way of LTRs allocated as far in advance from delivery as possible. No bidding zone border should be left without access to capacity in the forward timeframe.
8. Designing regulated revenue stabilisation mechanisms such as CfD schemes and CRMs in a way that preserves incentives for market participants to engage in forward markets and PPAs contracting.
9. Aligning Member States' legislations regarding the issuance of GoOs, so that every MWh

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of electricity produced from renewable energy sources can secure GoOs that can be valued as part of a PPA.

10. Making sure that financial guarantee schemes are in place in all Member States or at EU level to facilitate the conclusion of PPAs over long time horizons.

If we experience a rise in forward market liquidity, it remains to be seen whether this would translate into liquidity spreading over more markets, or liquidity increasing in the already most liquid markets.

- 17.7 How do you expect the forward markets to evolve in the next 5 to 10 years with respect to the evolution of liquidity needs

The higher the liquidity, the lower the transaction costs and the easiest it is to trade for the benefit of both producers and consumers. Hence, in essence, the liquidity needs of market participants are and will always be higher than the liquidity that the market can offer.

As a reference, the gross market churn rate of the most liquid gas market (TTF) in the EU is around 60, when the gross market churn rate of the most liquid electricity market (DE-LU bidding zone) is around 10. There will always be a need – or at least a desire – for liquidity to improve in forward electricity markets.

- 17.8 How do you expect the forward markets to evolve in the next 5 to 10 years with respect to share of volume traded among the different bidding zones:

Our European energy system and market is more and more intertwined, and we see growing volumes of transactions in the day-ahead and intraday markets, both within and across bidding zones year-on-year. Cross-border transactions in spot markets are optimised via market coupling and can be clearly identified based on the cross-border transmission capacity explicitly or implicitly used by market participants.

The forward market is a very different market, where cross-border transactions – including proxy hedging – precede and far exceed the cross-border transmission capacity made available to the market by the TSOs via LTTRs. Indeed, as things stand, market participants located in any bidding zone in Europe are able to perform proxy hedging in the bidding zone of their choice, i.e., hedge their positions in another market than their home market. As noted in our response to Q 6, proxy hedging is a widespread practice in today's market.

As we expect forward trading volumes to grow over the next 5 to 10 years (see our response to Q 17.2), we equally proxy hedging and other cross-border transactions to grow.

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- 17.9 How do you expect the forward markets to evolve in the next 5 to 10 years with respect to the configuration of bidding zones:

A second bidding zone review is currently ongoing, with ENTSO-E expected to give recommendations by the end of 2024. We don't wish to pre-empt the TSOs' analysis or the ultimate decision of Member States – alternatively the European Commission – on their recommendations.

However, we insist on the importance of a thoroughly quantified analysis of the effect of bidding zone re-delineations on the efficiency of the electricity market, chiefly forward liquidity. Bidding zone re-delineations could have severe adverse effects on the liquidity of forward markets – and damage all the growth expectations laid out in our responses to Q 17.1 to 17.8.

- 17.10 How do you expect the forward markets to evolve in the next 5 to 10 years with respect to any other trends (please specify):

The European Commission should be mindful of how financial regulation can impact trading on forward electricity markets. The latest MiFID II review proposal suggesting to restrict the Ancillary Activity Exemption may lead certain market participants to reconsider their volume of activity on forward electricity markets, especially non-hedging. To preserve the liquidity on forward electricity markets, it is important that financial regulation maintains the rules that have been tailored to the energy market's specificities and, in particular, preserves the MiFID II Ancillary Activity Exemption in its current form.

Part II: Assessment of potential improvement to the forward capacity allocation by TSOs

a) Evolution of the current design for TSOs to support forward market

- 18 Frequency: How frequently should the auction of long-term transmission rights (supported by TSOs) take place? Should the frequency of auctions differ depending on the maturity of the LTTR? If yes, what frequency would you propose for which product and maturity? Please provide a detailed answer

We have limited experience on the question of multiple auctions for the same product (e.g., two auctions for calendar LLTRs, instead of the usual one auction). In general, we believe it can be a useful tool, on the condition that TSOs offer more capacity to the market – or at the very least perform a new capacity calculation to update their reliability margins (TRMs).

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The example we have seen so far at the French-Belgian and French-German borders for calendar LTTRs for 2024 show very limited progress in terms of capacity availability with a 2-step auction of 2023 compared to the 1-step auction of 2022²:

| | | offered capacity | | vs. 2y average | | vs. 5y average | | requested capacity | | vs. 2y average | | vs. 5y average | | allocated capacity | | vs. 2y average | | vs. 5y average | | price | weighted average | vs. 2y average | | vs. 5y average | | |
|-------|--------|------------------|-----|----------------|------|----------------|------|--------------------|-------|----------------|------|----------------|------|--------------------|-----|----------------|------|----------------|------|-------|------------------|----------------|--|----------------|--|------|
| FR>DE | Sep-23 | | 500 | | 100% | | 100% | | 9069 | | 147% | | 160% | | 500 | | 100% | | 100% | 6,27 | | 6,39 | | 113% | | 216% |
| | Dec-23 | | 500 | | | | | | 7998 | | | | | | 499 | | | | | 6,52 | | | | | | |
| DE>FR | Sep-23 | | 300 | | 100% | | 100% | | 5699 | | 202% | | 183% | | 300 | | 100% | | 100% | 12,89 | | 9,66 | | 18% | | 38% |
| | Dec-23 | | 300 | | | | | | 5797 | | | | | | 300 | | | | | 6,43 | | | | | | |
| FR>BE | Sep-23 | | 700 | | 112% | | 113% | | 9267 | | 126% | | 148% | | 700 | | 112% | | 113% | 3,18 | | 3,16 | | 102% | | 145% |
| | Dec-23 | | 900 | | | | | | 11113 | | | | | | 900 | | | | | 3,14 | | | | | | |
| BE>FR | Sep-23 | | 125 | | 100% | | 114% | | 2192 | | 134% | | 137% | | 125 | | 100% | | 114% | 10,09 | | 7,41 | | 12% | | 27% |
| | Dec-23 | | 125 | | | | | | 2422 | | | | | | 125 | | | | | 4,73 | | | | | | |

Increasing the frequency of auctions for the same product needs a cautious approach, as simply having more auctions without more capacity could lead to splitting the liquidity in these auctions. Without sufficient volumes at each auction, the cost of LTTRs would likely go up, diminishing the potential of LTTRs to reduce the cost of cross-border hedging.

- 19.1 Volume: How should the total volume of offered cross-zonal capacity be split among products across different maturities (monthly, quarterly, yearly)? Should more capacity be allocated to shorter maturity, longer maturity products or equally in general?

Before thinking about product maturities, it is key that the European Commission and national regulators make sure that the TSOs carry out their duty from the Electricity Regulation of maximising the transmission capacity they make available to the market via LTTRs.

The TSOs should allocate straight away all the capacity that they have calculated as available before each auction, without reservation of capacity for subsequent timeframes. For instance, at the auction for calendar LTTRs, all the capacity calculated by the capacity calculation process year-ahead should be made available to the market (i.e., 100% of the calculated capacity year-ahead), not just a fraction of that capacity.

Further release of capacity at shorter time horizons in the forward timeframe (monthly auctions) should be the result of capacity recalculations, and gradual release of the margins and constraints initially applied by the TSOs for year-ahead allocations as uncertainties reduce with real time getting nearer (i.e., 100% of the recalculated capacity month-ahead). No capacity should be withheld in the monthly auctions for the day-ahead market.

For 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 calendar LTTRs on the secondary market, the TSOs may choose to allocate the 100% of capacity calculated year-ahead not only via calendar products but also via monthly

² Energy Traders Europe table, based on JAO data.

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products (but a year in advance). This distinction between the timing of the auctions (year-ahead, month-ahead) and the granularity of the products offered by the TSOs (calendar LTTRs, monthly LTTRs) 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.

- 19.2 Volume: Should the auctions of cross-zonal instruments foresee any safeguards or automatic volume adjustments in case of lack of sufficient interest in the auctions?

No

- 19.3 Volume: How should the forward transmission capacity be offered? (Coordinated vs uncoordinated way in each border, statistical vs scenario-based calculation, thresholds, split, allocation, possibility of offering longer maturities, etc)

We raise the attention of the European Commission that even if the question targets capacity *allocation*, many of the examples given in brackets relate to capacity *calculation*. We will make this distinction in our response below.

1. Capacity Calculation

As far as the *calculation* of capacity is concerned, we are rather agnostic to either the flow-based, the coordinated NTC or the uncoordinated NTC calculation approaches. In all these cases, we believe that the quality of the grid models used by the TSOs as well as the TRMs they use to ensure system security will have a heavier bearing on the capacity calculated as available than the calculation approach itself.

As far as statistical vs. scenario-based approach – once again a calculation topic – this rather depends on the time horizon at which capacity is calculated. Beyond a year or two ahead of delivery, it seems unlikely that a scenario-based approach would result in any capacity calculated as available. Hence, a statistical calculation is warranted before the issuance of multi-year LTTRs.

2. Capacity Allocation

a. Flow-based allocation

Moving to capacity allocation, we disagree with the approach chosen by ACER for the Core and Nordic regions to use flow-based as an allocation method for LTTRs. Flow-based makes sense in timeframes where flows are nominated by market participants and managed by TSOs– like day-ahead or intraday. The forward timeframe does not manage flows: allocation of LTTRs by the TSOs is based on expected 'flows', while market participant orders actually relate to electricity derivatives. Combined, they may generate greater limitations and higher reliability

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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 Financial Transmission Rights (FTRs) or Physical Transmission Rights with Use-It-Or-Sell-It mechanism (PTRs with UIOSI), where the link to physical flows becomes even thinner.

The flow-based approach to the allocation of LLTRs induces a choice of optimising allocation to maximise the revenue generated by the LTTR auction. This means that forward transmission capacity would be allocated in priority to bidding zone borders with significant price spreads, whereas borders with small price spreads may see very limited to no LTTRs allocated. The quantity of LTTRs allocated at one border will impact the availability of LTTRs at other borders, to respect the flow-based constraints. However, we have insisted for the past three years that our members use LTTRs chiefly to hedge the volatility of the price spread between two zones – in addition to the price spread itself. Hence, the optimisation function of the current ACER proposal for a flow-based allocation does not satisfy our needs to see LTTRs allocated at all bidding zone borders, whether the absolute price spreads are big or small.

In addition, the move from sequential auctions (border-per-border) to pan-regional/pan-European ones (one auction for all concerned borders) in a flow-based allocation will significantly increase collateral requirements for market participants to be able to bid in the LTTR auction. In the Core region alone, collateral would need to back up bids relating to more than 20 bidding zone borders at once, 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 consider that the move towards flow-based allocation of LTTRs is rushed and premature. So far ACER did not demonstrate the added value of this approach for the allocation part; the proposed optimisation function appears as suboptimal for market participants; and the massive auctions that will be organized will pose significant challenges in terms of collateral and availability of LTTRs at certain borders.

While there have been signs of acknowledgment of part of these concerns, we are worried that ACER is pushing the TSOs to steam ahead for a flow-based allocation of 2026 calendar products. Considering that flow-based allocation makes no sense in a timeframe when flows are not actually allocated, and all the problems that come with it in terms of capacity availability and collateral, we believe that flow-based allocation should be explicitly excluded from the FCA Guideline going forward.

b. Capacity splits

As mentioned in our response to Q 19.1, The TSOs should allocate straight away all the capacity that they have calculated as available before each auction, without reservation of capacity for subsequent timeframes. For instance, at the auction for calendar LTTRs, all the capacity calculated by the capacity calculation process year-ahead should be made available to the market (i.e., 100% of the calculated capacity year-ahead), not just a fraction of that capacity.

Further release of capacity at shorter time horizons in the forward timeframe (monthly auctions) should be the result of capacity recalculations, and gradual release of the margins and constraints initially applied by the TSOs for year-ahead allocations as uncertainties reduce with real time getting nearer (i.e., 100% of the recalculated capacity month-ahead). No capacity should be withheld in the monthly auctions for the day-ahead market.

For 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 calendar LTTRs on the secondary market, the TSOs may choose to allocate the 100% of capacity calculated year-ahead not only via calendar products but also via monthly products (but a year in advance). This distinction between the timing of the auctions (year-ahead, month-ahead) and the granularity of the products offered by the TSOs (calendar LTTRs, monthly LTTRs) 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.

c. Longer maturity LTTRs

We support the TSOs issuing LTTRs for longer maturities, i.e., three to five years in advance of delivery. We already observe that some network operators have started offering LTTRs over longer time horizons – e.g., on the IFA 1 and 2 interconnectors between Great Britain and France – or are considering doing so soon – e.g., ongoing discussions between RTE and Elia to issue 2-year ahead LTTRs at the French-Belgian border. Longer maturity LTTRs help reduce basis risk earlier in cross-border transactions on forward markets, and they can contribute to the uptake of cross-border PPAs.

19.4 Maturities: How to define the ideal maturities for cross-zonal instruments? Please provide a detailed answer

Hedging is about assessing and managing risks, including price and volume risks. A good indicator is the maturity of the liquid forward electricity market in Europe (the DE-LU bidding zone): it starts forming 3 to 5 years before delivery, which indicates an appetite – and capacity – to trade at that point in time. Hence, we encourage TSOs to issue LTTRs 3 to 5 years before delivery.

CONSULTATION RESPONSE

- 20.1 Maturities: Should the maturity of cross-zonal instruments be the harmonized at EU level, regional (per capacity calculation region) level or not at all?

EU level.

Please provide a detailed answer

LTTR allocation rules are already harmonised at the EU level via the EU Harmonised Allocation Rules (HAR). The EU HAR have promoted positive harmonisation of allocation rules, and we don't see a reason to change that approach for the moment.

- 21.1 Type of products: Should LTTRs only be issued as baseload products or should other types of products be envisaged?

Should the TSOs think of options to provide additional volumes of LTTRs for, e.g., peak load delivery, we would be happy to review the results of their research. Attention should be paid to make sure that such alternative LTTR design does not come at the expense of the existing volumes of baseload LTTRs made available to the market. In any case, we do not believe this is a matter to be included in legislation for now, considering how little such alternative designs have been research, let alone tested.

- 21.2 Type of products: What are the advantages and disadvantages of LTTRs defined as options?

LTTRs defined as options can be either PTRs with UIOSI or FTR options. These are the only LTTRs used in the EU for the moment.

In both cases, against a fee paid to the TSO during the auction (LTTR price paid by market participants to the TSOs), they provide market participants a firm financial coverage against the risk of a positive price spread between two neighbouring bidding zones at the time of delivery (compensation by the TSOs of the market participants at day-ahead price spread).

For market participants, it allows to cover all or part of the basis risk induced by their cross-border transactions.

For TSOs, it allows to generate revenue from transmission capacity that, at the time of the LTTR auction. It should be noted that the day-ahead coupling algorithm includes a Long-Term Allocation (LTA) patch which makes sure that the flow-based domain is at least as large in each direction as the volume of PTRs with UIOSI and FTR options that have been allocated. And it should also be noted that in case TSOs need to curtail LTTRs for security reasons, the compensation at the day-ahead price spread is capped to the level of annual TSO revenues from congestion rent – and in case of curtailment for reasons of Force Majeure, the TSOs only reimburse the price initially paid by market participants for the LTTRs.

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All in all, fully financially firm LTTRs as options represent a fair compromise between the TSOs' capacity to make part of the cross-border capacity available to the market in advance of delivery, as they possess this natural hedge of the physical cables that would otherwise remain unused; and the interest of market participants to purchase LTTRs to cover their basis risk.

21.3 Type of products: What are the advantages and disadvantages of LTTRs defined as obligations?

LTTRs defined as obligations are FTR obligations. They are not in use in the EU for the moment.

With FTR obligations, against a fee paid to the TSO during the auction (LTTR price paid by market participants to the TSOs), they provide market participants a firm financial coverage against the risk of a positive price spread between two neighbouring bidding zones at the time of delivery (compensation by the TSOs of the market participants at day-ahead price spread) like a PTR with UIOSI or an FTR option; but it also includes an obligation for market participants to compensate the TSOs for a negative price spread between two neighbouring bidding zones at the time of delivery.

For market participants, it allows to cover all or part of the basis risk induced by their cross-border transactions. But it also includes an extra risk of "double penalty" in case the day-ahead spread is opposite to the direction in which they bought their FTR obligations (they pay the LTTR price + they compensate the TSOs).

For TSOs, FTR obligations allows to generate revenue from transmission capacity that, at the time of the LTTR auction. In addition, there is a potential extra revenue compared to PTRs with UIOSI or FTR options in case the day-ahead spread is opposite to the direction in which some of the market participants bought their FTR obligations. However, considering that market participants face more risks with an FTR obligation, they may also price them lower than PTRs with UIOSI or FTR options. In turn, this would reduce TSO revenues from the LTTR auctions.

For both TSOs and market participants, FTR obligations would also require setting aside collateral for the whole duration of the LTTR delivery period, unnecessarily locking financial resources for months or years. As a reminder, in the current setup with FTR options or PTRs with UIOSI, TSOs don't need to set aside collateral, and market participants only need to do so at the period of the LTTR auction.

All in all, LTTRs as obligations represent a less fair compromise between the TSOs and the market, as TSOs don't face any risks or costs in case the day-ahead spread is opposite to the direction in which some of the market participants bought their FTR obligations. It also represents an extra financial burden for both TSOs and market participants.

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Hence, we oppose a move to FTR obligations at any border in the EU. Should this be tested however, we recommend that TSOs keep issuing at least part of the LTTRs volume made available to the market as options, so that the appetite of the market for FTR obligations can be tested against that for FTR options in real-life conditions.

21.4 Type of products: What are the advantages and disadvantages of LTTRs defined as Physical Transmission rights (PTRs)?

As mentioned in our response to Q 21. 2, against a fee paid to the TSO during the auction (LTTR price paid by market participants to the TSOs), PTRs with UIOSI – like FTR options – provide market participants a firm financial coverage against the risk of a positive price spread between two neighbouring bidding zones at the time of delivery (compensation by the TSOs of the market participants at day-ahead price spread).

The advantage of PTRs with UIOSI over FTR options lies in the fact that market participants can nominate PTRs and this option has incremental value. If they nominate PTRs, market participants don't need to rebalance their position on the day-ahead market in two zones. Among other things, this means they don't need to be members of and transact through day-ahead power exchanges. This decreases transaction costs compared to the use of FTR options only.

Other than this, PTRs with UIOSI work just like FTR options, enabling market participants to either use nominate the LTTR, or get compensated by the TSOs for the positive day-ahead price spread. In practice, PTRs with UIOSI are not often nominated, and mostly used as FTR options.

21.5 Type of products: What are the advantages and disadvantages of LTTRs defined as Financial Transmission Rights (FTRs)?

As mentioned in our response to Q 21. 2, against a fee paid to the TSO during the auction (LTTR price paid by market participants to the TSOs), FTR options – like PTRs with UIOSI – provide market participants a firm financial coverage against the risk of a positive price spread between two neighbouring bidding zones at the time of delivery (compensation by the TSOs of the market participants at day-ahead price spread).

As mentioned in our response to Q 21.3, we favour keeping FTR options over introducing FTR obligations, as the latter entail an extra risk for market participants that does not correspond to one actually incurred by the TSOs.

22.1 Should cross-zonal hedging instruments be issued : (No space for detailed answer, elaboration in 22.2)

on bidding zone borders only
as a combination of two futures contracts

CONSULTATION RESPONSE

22.2 Which of the above solution(s) would be the most resilient to potential changes in the markets (i.e., increased deployment of renewables, less hedging demand due to flexible demand, offshore bidding zones and bidding zones reconfigurations, volume contracted under power purchase agreements, etc)?

To further elaborate on the previous answer, we hold “allocating LTTRs at bidding zone borders only” as not the status quo. There are still borders where LTTRs are not offered by TSOs, and at most other borders the conditions of allocation can be enhanced. To improve LTTR allocation, attention needs to be placed on:

- Ensuring all TSOs issue LTTRs at each bidding zone border, in both directions
- Maximising the volume of LTTRs issued at each auction, with a minimum volume of LTTRs allocated at each border (ATC allocation, or ATC extraction with minimum RAM from a flow-based calculation)
- Issuing longer-maturity LTTRs (at least 3 years ahead of delivery)
- Studying the possibility for TSOs/JAO to organise a secondary market for LTTRs
- Ensuring regulatory stability and restricting wholesale price control measures to the strict conditions imposed by the EMD reform

The combination of forward or future contracts – sometimes bundled as spread contracts – is also an option available to and widely used by market participants. These are however private contracts that do not require any regulation as part of the FCA GL, contrary to the products proposed by the TSOs.

We are critical of experiments that could damage trading conditions and market efficiency within and across bidding borders, such as the development of regulated regional virtual hubs. We believe they deserve extensive assessment and testing before any decision is made, let alone introduced in the FCA Guideline.

22.3 Should cross-zonal hedging instruments be issued from any zone to any other zone or from any zone to a regional hub, should it remain possible to trade cross-zonal hedging instruments on border-to-border basis?

Yes

Please comment on your answer:

We are critical of experiments that could damage trading conditions and market efficiency within and across bidding borders, such as the development of regulated regional virtual hubs. We believe they deserve extensive assessment and testing before any decision is made, let alone introduced in the FCA Guideline.

Market participants should be free to engage in trading in the market of their choice as they do today, letting hubs emerge naturally based on where liquidity actually is. Seeking to force

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liquidity to move to regulated regional virtual hubs by way of issuing LTTRs from bidding zone to hubs risks rendering these LTTRs useless for market participants at the very least, and splitting the liquidity of existing natural hubs at worst.

We refer once again to the preliminary results of the study that Energy Traders Europe, Eurelectric and Europex commissioned to Compass Lexecon indicating that regulated virtual hubs are no silver bullet to improve forward markets. We call the European Commission to focus on preserving liquidity in existing hubs and improving the allocation of zone-to-zone LTTRs, in line with the underlying physical transmission lines that span bidding zone borders.

22.4 If TSOs were to allocate cross-zonal capacity on zone-to-hub product (f.e. LTTRs), would you subsequently trade the futures with the corresponding underlying system price?

It depends.

Please comment on your answer:

We are critical of experiments that could damage trading conditions and market efficiency within and across bidding borders, such as the development of regulated regional virtual hubs. We believe they deserve extensive assessment and testing before any decision is made, let alone introduced in the FCA Guideline.

In an effort to forecast the effects on forward markets of setting up regional virtual hubs, Energy Traders Europe, Eurelectric and Europex commissioned Compass Lexecon to perform a forward-looking, quantitative study – which shows that setting up regional virtual hubs in the Core region would bear more risks than benefits.

Preliminary results, based on virtual hub prices calculated from forward prices of underlying zones weighted by each zone's electricity consumption, indicate that:

- Price spreads between local zones and existing natural hubs (like Germany or Hungary) are less volatile than when using a VTH
- Local zones correlate better with existing natural hubs than with a VTH
- Price spreads distribute unevenly with existing natural hubs or VTH

All this means that proxy hedging is generally safer and less costly in existing hubs like Germany or Hungary than it would be on a regional virtual hub. As a consequence, hedging will mostly remain on local zones and existing natural hubs, while some market participants from a few specific zones may find an interest and start hedging on regional virtual hubs. This will have the adverse effect of splitting liquidity between regional virtual hubs and existing natural hubs, with efficiency losses compared to the existing setup. This will translate into higher hedging transaction costs for market participants, and ultimately higher costs for consumers.

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Requiring TSOs to issue zone-to-hub LTTRs is unlikely to remedy this de-optimisation of forward markets: they would be less adequate instruments than current zone-to-zone LTTRs as traders should continue to proxy hedge on existing natural hubs. And they would increase the TSOs' financial exposure, with LTTRs disconnected from physical cross-border lines.

In summary, virtual hubs are no silver bullet to improve forward markets and should be discarded from inclusion in the review of the FCA Regulation. Instead, market participants and operators call the European Commission to focus on preserving liquidity in existing hubs and improving the design of zone-to-zone LTTRs to facilitate hedging on the more efficient natural hubs.

- 23.1 System price / hub: If you have experience with the trading on the Nordic electricity forward market: Please provide feedback on the current market design of the Nordic region based on a system price

Data from the Nordic area shows that after the split of the Swedish, Danish, and Norwegian areas into multiple bidding zones, liquidity in forward markets in the region gradually dropped. Though the Nordic system price – a calculation based on realised day-ahead prices in each of the Nordic bidding zones, and without capacity constraints – is a useful indicator, as a virtual hub it is not backed by underlying physical assets (production, storage, consumption). Liquidity on forward derivatives based on the Nordic system price started falling in the 2010s, with many market participants of the region hedging at least part of their positions from certain Nordic bidding zones on the more liquid DE-LU bidding zone by now.

The liquidity of EPADs has also dwindled over the past decade – and it remains to be seen what effect the involvement of TSOs in the selling of EPADs may have in the long-run, both on the liquidity of EPADs themselves and of the forward market in the Nordics. We remain of the view that all TSOs should issue LTTRs at each border in both directions.

- 23.2 System price / hub: If you have experience with the trading on the Nordic electricity forward market: Would forward market based on zonal futures and zone-to-zone LTTRs be more appropriate for the Nordic Market to achieve higher liquidity for all Nordic market participants?

Yes

Please comment on your answer:

Yes, TSOs making LTTRs available to the market at every bidding zone border, including those in the Nordic area that are within a Member State, can improve the situation in the Nordic area. All types of spread contracts can efficiently coexist with LTTRs. Forward markets could be further improved by ensuring that all TSOs allocate LTTRs at each border in both directions, starting with the borders that suffer the most from poor availability of market-based spread contracts.

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All things equal, it remains to be seen whether the issuance of EPADs by TSOs will be sufficient to see liquidity pick up again in the area. But this will leave more options to market participants in the region to hedge their positions in the market of their choice and access a wider variety of cross-border hedging tools.

24.1 Firmness of products: How does the non-financial firmness of cross-zonal instruments impact your interest in such instruments?

Reduced firmness of LTTRs would mean they cannot serve anymore as a tool that fully protects against basis risk for the amount of LTTRs purchased. This will lower the interest of market participants in buying these rights, and consequently decrease the prices they offer for LTTRs during auctions – with negative consequences for the TSOs' congestion income. The deteriorated hedging conditions for market participants and the lower congestion income for TSOs would come at a price for consumers.

Maintaining the full firmness of LTTRs is crucial for their effective functioning and market trust. Financial firmness should be guaranteed all the time, including periods of market decoupling – save for Force Majeure events – as per the existing provisions of the FCA GL.

24.2 Firmness of products: Should cross-zonal instruments issued by TSOs be fully firm?

Yes

Please elaborate on pros/cons

We believe that the firmness of LTTRs should be upheld in all possible situations, including market decoupling – save for Force Majeure events. Reduced firmness of LTTRs would mean they cannot serve anymore as a tool that fully protects against basis risk for the amount of LTTRs purchased. This will lower the interest of market participants in buying these rights, and consequently decrease the prices they offer for LTTRs during auctions – with negative consequences for the TSOs' congestion income. The deteriorated hedging conditions for market participants and the lower congestion income for TSOs would come at a price for consumers.

We understand TSOs' concerns regarding periods of higher compensation during unfortunate events of market decoupling, which nobody can predict and – market participants even less than TSOs – can control. However, according to our estimates, these compensations play only a small part of the total yearly congestion incomes of TSOs and therefore, should not be the basis for the reduction of firmness.

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- 24.3 Firmness of products: In case LTTRs are concluded on a firm basis and in an obligation-type, how should the counterparty risk of TSOs be managed, in order to ensure holders of the LTTRs are able to collect the payout that is owed to them?

We remain opposed to TSOs issuing FTR obligations, and suggest we stick to optional rights as is the case today. As mentioned in our response to Q 21.3, FTR obligations represent a less fair compromise between the TSOs and the market, as they put a higher level of risk on market participants that does not correspond to any risks or costs faced by the TSOs.

We also believe that the switch to FTR obligations would indeed result in the need for TSOs to set up a whole system to manage counterparty risk. As things stand, we don't see the added-value of a system change on this front.

- 24.4 Firmness of products: Do you see any financial stability risk arising from the non-firmness of those instruments (i.e., counterparties not receiving their forecasted payouts and being left unhedged)?

As mentioned in our response to Q 24.1 to 24.3, we oppose the reduction of firmness of LTTRs.

- 24.5 Firmness of products: Should LTTRs be concluded on a firm basis, what sort of risk mitigation tools do you believe the SAP should be subject to in order to manage the risks?

We lack information on JAO's risk mitigation tools in particular, and more generally on TSOs congestion rents, as well as payouts to LTTR holders. Experience seems to suggest that TSOs have sufficient congestion revenues to fully back LTTRs even during rare cases of market decoupling.

In the absence of a clear demonstration by the TSOs, we will deem any proposals to reduce the firmness of LTTRs as not proportionate.

- 25 Revenue adequacy: How to maintain revenue adequacy for TSOs (i.e., that day-ahead congestion income is sufficient for LTTR payout)? Should revenue adequacy be maintained for each market time unit or on a less granular basis (f.e. at least daily monthly or annually)?

The price of LTTRs is the best estimate of the value that market participants place in the long-term option it gives them to hedge their basis risk, based on market fundamentals at the time of the LTTR auction. Comparing the LTTR price, set months or years ahead of delivery, to the price spread in the day-ahead market ignores the reality of the time lags between the LTTR auction and the spot market. It also contradicts the very principle of LTTRs, which are tools made available by the TSOs precisely to help market participants manage the fluctuation of price spreads in the day-ahead market.

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On a practical note, we also hold that there is no clear demonstration backed by data proving that TSOs have faced unbearable costs related to LTTR compensation, including in the rare cases of market decoupling.

- 26 Secondary market: Should there be an active secondary market for cross-zonal instruments issued by TSOs?

Yes

Please comment on your answer

Transmission rights need to be fungible in a secondary market organised by a Single allocation platform (SAP). However, this is currently hampered not only by the fact that TSOs never engaged in developing this secondary market, but also by the low volumes of LTTRs offered by TSOs. Making more capacity available to the market by way of LTTRs is a prerequisite for an efficient and functioning second market. Indeed, as things stand, market participants rather hold their rights than offer them on the secondary market

Having an efficient secondary market will enable market participants to manage their transmission capacity portfolios and divide monthly rights into hourly pieces, just like they do in wholesale electricity transactions. TSOs will in turn be able to buy back rights they oversold to manage unexpected operational circumstances identified in advance.

- 27.1 Secondary market: If a secondary for cross-zonal instruments were to be organized, how and where should this secondary market be organised: please select (several choices possible)

Single Allocation Platform (SAP)

Others, please specify

Other - please specify

The TSOs and JAO seem best equipped to organise a secondary market for now. However, should they continue to choose not to do so, we support the possibility of organising a tender for the administration of secondary markets by a market any private entity, based on the input and expectations from the market participants.

In the Nordic area, (primary and) secondary markets for EPADs are already organised via power exchanges.

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- 27.2 Secondary market: Do you see benefits in the possibility of transferring Financial Transmission Rights from the SAP to a power exchange?

We have no clear view on the benefits, drawbacks, or feasibility of LTTR transfers from the SAP to a power exchange.

- 27.3 What are your views about the possibility for the SAP to match opposite bids for LTTRs without the allocation of cross-zonal capacity where possible?

We have concerns as to the rationale for TSOs to match opposite bids for LTTRs. This would only concern FTR obligations, which we do not support.

Besides, it is questionable whether this matching could work in an explicit allocation system, and whether it would work without matching capacity and energy in the forward timeframe. We have repeatedly expressed our opposition to any form of "forward market coupling: forward electricity trading mainly consists of derivatives, and the LTTRs that are allocated do not correspond to actual physical capacity. Hence the concept of market coupling – which we have support for day-ahead and intraday markets – cannot be transposed to forward markets.

- 27.4 What are your views about the possibility for SAP to optimize the allocation of yearly, quarterly and monthly products when they cover the same delivery period?

We believe that market participants themselves, not JAO or the TSOs, should take care of the optimisation of LTTRs. Indeed, as mentioned in our response to Q 19.1, The TSOs should allocate straight away all the capacity that they have calculated as available before each auction, without reservation of capacity for subsequent timeframes. For instance, at the auction for calendar LTTRs, all the capacity calculated by the capacity calculation process year-ahead should be made available to the market (i.e., 100% of the calculated capacity year-ahead), not just a fraction of that capacity.

Further release of capacity at shorter time horizons in the forward timeframe (monthly auctions) should be the result of capacity recalculations, and gradual release of the margins and constraints initially applied by the TSOs for year-ahead allocations as uncertainties reduce with real time getting nearer (i.e., 100% of the recalculated capacity month-ahead). No capacity should be withheld in the monthly auctions for the day-ahead market.

For 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 calendar LTTRs on the secondary market, the TSOs may choose to allocate the 100% of capacity calculated year-ahead not only via calendar products but also via monthly products (but a year in advance). This distinction between the timing of the auctions (year-ahead, month-ahead) and the granularity of the products offered by the TSOs (calendar LTTRs, monthly LTTRs) 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.

- 28 How to take into account the existence of preexisting intergovernmental agreements when calculating forward transmission capacity? [Background: preexisting intergovernmental agreements refer to agreement on physical delivery of electricity between two Member States]

We understand that existing bilateral agreements guaranteeing certain levels of capacity would become void anyhow with the full implementation of the already approved capacity calculation methodologies. Whether this is to be reconsidered in full, or transition periods should be established should be discussed and consulted with market participants.

b) Alternative designs to support cross-zonal hedging in the forward markets

- 29 What other measures could be necessary to improve the availability of hedging opportunities so that hedging needs can be addressed with hedging products that are both liquid and provide efficient hedge?

For more liquidity, TSOs should offer all the available capacity for LTTR auctions at each border and in both directions, with longer maturities and robust second auctions. These measures will increase hedging opportunities to cover cross-border risk and in turn, could also lead to the increase in the uptake of cross-border PPAs.

- 30 Are the forward hedging instruments offered by TSOs necessary to support the functioning the forward market? Can cross-zonal price risks be sufficiently hedged with other available products listed by power exchanges (spreads, EPADs)?

TSOs are best equipped to offer LTTRs due to the natural cross-border hedge they possess with cross-border lines. These LTTRs contribute to reducing the basis risk inherent to cross-border transactions, including proxy hedging.

While our members do make use of market products – OTC or on exchanges – to further reduce basis risk, it would be a shame to pass on the opportunity offered by LTTR to contribute to decreasing operational costs, making cross-border hedging cheaper and therefore lowering end-consumer bills.

- 31.1 Among these key evolutions proposed by various stakeholders to improve the LTTR design, please select your favorite one(s):

Zonal futures combined with LTTRs on bidding zone borders

Other model

CONSULTATION RESPONSE

Potential other model, please define:

As mentioned, we support all TSOs offering all the capacity calculated as available at each border in both directions, with longer maturities and accompanied by a secondary market. Contrary to what is portrayed in the consultation, this is not the status quo and would represent an improvement to the current situation.

We are critical of experiments that could damage trading conditions and market efficiency within and across bidding borders, such as the development of regulated regional virtual hubs. We believe they deserve extensive assessment and testing before any decision is made, let alone introduced in the FCA Guideline.

- 31.2 Alternatively to issuing LTTRs, TSOs could allocate capacities to support other products. The two models below have been identified by stakeholders. Please select your favorite one:

Other model

Potential other model, please define:

The liquidity of EPADs has also dwindled over the past decade – and it remains to be seen what effect the involvement of TSOs in the selling of EPADs may have in the long-run, both on the liquidity of EPADs themselves and of the forward market in the Nordics. We remain of the view that all TSOs should issue LTTRs at each border in both directions.

We are strongly opposed to experiments related to some sort of market coupling of capacity and energy in the forward timeframe. Forward electricity trading mainly consists of derivatives, and the LTTRs that are allocated do not correspond to actual physical capacity. Hence the concept of market coupling – which we have support for day-ahead and intraday markets – cannot be transposed to forward markets.

- 31.3 Which model (from all the models listed in questions 31.1 and 31.2) do you deem the most appropriate in terms of addressing the existing problems?

We support option A with all TSOs offering all the capacity calculated as available at each border in both directions, with longer maturities and accompanied by a secondary market. Contrary to what is portrayed in the consultation, this is not the status quo and would represent an improvement to the current situation.

We reiterate our caution against the establishment of regulated regional virtual trading hubs. At present, we believe there is no justification for their introduction. We refer again to the preliminary results of our study that indicate the adverse effect that the introduction of regulated regional virtual hubs may have on forward markets.

CONSULTATION RESPONSE

- 31.4 Which model (from all the models listed in questions 31.1 and 31.2) do you deem the most appropriate in terms of being robust for future potential market changes?

We support option A with all TSOs offering all the capacity calculated as available at each border in both directions, with longer maturities and accompanied by a secondary market. Contrary to what is portrayed in the consultation, this is not the status quo and would represent an improvement to the current situation.

We reiterate our caution against the establishment of regulated regional virtual trading hubs. At present, we believe there is no justification for their introduction. We refer again to the preliminary results of our study that indicate the adverse effect that the introduction of regulated regional virtual hubs may have on forward markets.

- 32 What could be the adequate geographical scope of a regional system price and how should this scope be determined?

We are critical of experiments that could damage trading conditions and market efficiency within and across bidding borders, such as the development of regulated regional virtual hubs. We believe they deserve extensive assessment and testing before the idea can be refined and implemented.

Market participants should be free to engage in trading in the market of their choice as they do today, letting hubs emerge naturally based on where liquidity actually is. Seeking to force liquidity to move to regulated regional virtual hubs by way of issuing LTTRs from bidding zone to hubs risks rendering these LTTRs useless for market participants at the very least and splitting the liquidity of existing natural hubs at worst.

We refer back to the preliminary results of the study that Energy Traders Europe, Eurelectric and Europex commissioned to Compass Lexecon indicating that regulated virtual hubs are no silver bullet to improve forward markets. We call the European Commission to focus on preserving liquidity in existing hubs and improving the allocation of zone-to-zone LTTRs, in line with the underlying physical transmission lines that span bidding zone borders.

- 33 How should a system price be calculated:

Other

Please provide details on your previous answer

We are critical of experiments that could damage trading conditions and market efficiency within and across bidding borders, such as the development of regulated regional virtual hubs. We believe they deserve extensive assessment and testing before any decision is made, let alone introduced in the FCA Guideline.

CONSULTATION RESPONSE

We reiterate our caution against the establishment of regulated regional virtual trading hubs. At present, we believe there is no justification for their introduction. We refer again to the preliminary results of our study that indicate the adverse effect that the introduction of regulated regional virtual hubs may have on forward markets.

34.1 Do forward markets need to be supported with market makers?

It depends

34.2 Should market making be:

Voluntary (subject to commercial arrangements)

34.2.2 How should market making costs be covered?

The cost of existing voluntary market-making schemes is usually borne by power exchanges through incentive schemes (e.g., waiving fees). Power exchanges may see an interest in this as it can help liquidity develop on their platforms. Cost recovery arrangements between the power exchanges and the national regulators could also be established.

34.3.1 What entities would be most suitable to act as market makers?

Large market participants with physical assets
Large market participants without physical assets
Else

Potential other entity, please precise

Market making should always be voluntary and non-discriminatory. All market participants willing to get involved in voluntary market-making should be eligible.

We see TSOs as neutral market facilitators, not market participants, and therefore advise against their involvement in market-making.

34.3.2 Under which conditions/requirements should those entities act as market makers?

We believe that the best way forward in voluntary market-making is to provide the right incentives for market participants. Lowering costs of using market platforms (such as waiving fees) can usually be one of them and does not require any regulatory intervention.

CONSULTATION RESPONSE

c) Role of Single Allocation Platform (SAP)

35.1 If you traded LTTRs: On a scale from 0 to 10, how satisfied are you with current SAP (JAO) services?

Energy Traders Europe does not directly trade LTTRs.

35.2 Please provide detailed comments to justify the score given

Energy Traders Europe does not directly trade LTTRs.

36 What are your suggestions to improve the functioning of SAP (JAO)?

In general, we have three broad recommendations regarding the functioning of JAO:

- Improving reliability in light of recurrent operational problems
- Ensuring more accountability for problems directly linked to JAO operations
- Establishing clear chains of responsibility between JAO and the TSOs in order for market participants' claims to be heard in case of allocation problems originating at the TSOs' side

37 What should be the role of the SAP in your view? Should SAP be involved in the organization of the secondary market for LTTRs and how exactly?

The TSOs and JAO seem best equipped to organise a secondary market for now. However, should they continue to choose not to do so, we support the possibility of organising a tender for the administration of secondary markets by a market any private entity, based on the input and expectations from the market participants.

38.1 What should be the potential changes to the current knowledge, functioning and organization of the SAP to manage the auctioning of LTTRs on a larger scale, should the electricity market design become much more reliant on those instruments?

As representatives of energy traders, we are not in a place to recommend any specific changes to the knowledge, functioning and organisation of JAO. We reiterate our three broad recommendations regarding the functioning of JAO:

- Improving reliability in light of recurrent operational problems
- Ensuring more accountability for problems directly linked to JAO operations
- Establishing clear chains of responsibility between JAO and the TSOs in order for market participants' claims to be heard in case of allocation problems originating at the TSOs' side

CONSULTATION RESPONSE

- 38.2 What should be the potential changes to the current knowledge, functioning and organization of the SAP to facilitate secondary markets for LTTRs?

The TSOs and JAO seem best equipped to organise a secondary market for now. However, should they continue to choose not to do so, we support the possibility of organising a tender for the administration of secondary markets by a market any private entity, based on the input and expectations from the market participants.

- 38.3 What should be the potential changes to the current knowledge, functioning and organization of the SAP to generally manage the risks to which it is exposed (e.g., operational risk)?

We recommend that JAO and the TSOs acknowledge that there are recurring performance problems on the platform or stemming from the TSOs themselves. These sometimes lead to the cancellation of auction, which can be seriously damaging to market participants. There is a need to assess technical remedies to these problems and set performance standards, monitored by NRAs.

- 39 Would you suggest any improvement to the transparency and overall functioning of the auctioning process?

No further comments.

- 40 CfD coupling: Should the allocation of transmission capacity to support the forward markets be performed by SAP or by a nominated exchange? Please provide details supporting/explaining your response.

We have repeatedly expressed our opposition to any form of "forward market coupling: forward electricity trading mainly consists of derivatives, and the LTTRs that are allocated do not correspond to actual physical capacity. Hence the concept of market coupling – which we have support for day-ahead and intraday markets – cannot be transposed to the forward market and would deteriorate its efficiency.

- 41 In your view, what would be the potential impact of the application of financial regulation (EMIR, MIFID, etc), should JAO undertake activities that are regulated under the financial rulebook (e.g., operating a secondary market for trading in financial transmission rights)? What is your view on the appropriate regulatory oversight set-up, considering the various activities JAO engages in (shadow auction for DA market, data services for capacity calculation and allocation, ...)?

No further comments.

CONSULTATION RESPONSE

Part III. Conclusion

42 Feel free to add any other element you would like to share

Forward markets are key enablers of a secure, affordable, and decarbonised supply of electricity. This market segment represents close to 90% of electricity transactions in volume in Europe, showing the importance it represents to bring electricity from the power plants to the consumers.

The forward market allows buyers and sellers of electricity to agree on and lock prices and volumes far in advance of the time when energy is actually produced or consumed. Securing a contract in advance at a price that is beneficial to both the buyer and seller is a key part of the risk hedging strategy of electricity producers, traders, and suppliers. It allows them to:

- manage the volatility of real-time electricity prices;
- prepare for uncertainties and ensure they can always supply customers; and
- allow some companies to offer long-term/fixed price contracts to customers.

The energy supply crisis of 2021-2023 had severe consequences for many European consumers and businesses. In the midst of these tense times, forward electricity markets contributed to shielding consumers from short-term price fluctuations. This doesn't mean these forward markets are perfect, but it means we can build on the solid foundation we already have.

The level of liquidity of forward markets varies from one bidding zone to the other, with the German-Luxembourg (DE-LU) bidding zone serving as a reference as the most active and liquid forward market in Europe, where market participants can:

- trade cheaply thanks to low transaction costs (small bid-ask spreads),
- find a wide diversity of counterparties (high number of market participants, each with a small market share)
- hedge efficiently three to five years before delivery (deep market with a medium-term trading horizon).

Other markets (Nordic area, France, Hungary) can serve as a local or regional hubs, while in most other bidding zones, the liquidity of forward markets is rather low. Market participants located in any bidding zone in Europe, however, are able to trade forward deals in the bidding zone of their choice and hedge their positions in another market – so-called “proxy hedging”. Market participants from all over Europe find each other and transact on the most liquid hubs, and as such form a much more integrated market than what meets the eye at first glance. Ensuring that market participants can continue to perform proxy hedging in the bidding zone of their choice is therefore vital for the capacity of all European market participants to hedge themselves efficiently.

CONSULTATION RESPONSE

This is why we look in quite a critical manner at the establishment of regulated regional virtual trading hubs. In an effort to model the effects on forward markets of setting up regional virtual hubs, Energy Traders Europe, Eurelectric and Europex commissioned Compass Lexecon to perform a forward-looking, quantitative study – which shows that setting up regional virtual hubs in the Core region would bear more risks than benefits. Preliminary results indicate that proxy hedging is generally safer and less costly in existing hubs like Germany or Hungary than it would be on a regional virtual hub. And that establishing regulated regional virtual hubs would have the adverse effect of splitting liquidity between regional virtual hubs and existing natural hubs, with efficiency losses compared to the existing setup. Hence, we do not see virtual hubs as a silver bullet to improve forward markets. Instead, market participants and operators call the European Commission to focus on preserving liquidity in existing hubs and improving the design of zone-to-zone LTTRs to facilitate hedging on the more efficient natural hubs.

So, what can be done for now? Not dwelling on the status quo, for sure, but actually building on and improving the system that we currently have. This includes:

1. Safeguarding the few forward markets that are currently liquid – and being extra careful with experiments that could damage trading conditions and market efficiency.
2. Ensuring that all TSOs maximise the cross-border transmission capacity they offer to the market at each border, in both directions, by way of LTTRs allocated as far in advance from delivery as possible. No bidding zone border should be left without access to capacity in the forward timeframe.
3. Designing regulated revenue stabilisation mechanisms such as CfD schemes and CRMs in a way that preserves incentives for market participants to engage in forward markets and PPAs contracting.
4. Aligning Member States' legislations regarding the issuance of GoOs, so that every MWh of electricity produced from renewable energy sources can secure GoOs that can be valued as part of a PPA.
5. Making sure that financial guarantee schemes are in place in all Member States or at EU level to facilitate the conclusion of PPAs over long time horizons.

These are not small steps – and some of them are already advancing through pilot projects and incremental improvements. But we believe they are key to making sure that forward electricity markets provide an even better contribution to a secure, affordable, and decarbonised supply of electricity in Europe in the future.

CONSULTATION RESPONSE



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