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ACER

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Date : 28<sup>th</sup> October 2012

Dear Sir/Madam,

**RE: Forward Risk-Hedging Products and Harmonisation of Long-Term Capacity Allocation Rules**

SSE welcomes the chance to respond to this consultation. SSE is the second largest generator in the UK and the second largest energy supplier. We also have transmission and distribution businesses along with a generation and supply operation in Ireland. SSE has a total generation portfolio around 12 GW of generation capacity including gas, coal and renewables (onshore wind, offshore wind and hydro). Direct responses to the consultation questions are provided in the attached annex and the following outlines what we view as the key issues.

Firstly, we believe there is very little practical difference between FTRs and PTRs (with UIOSI) – both should ensure most efficient cross-border trades happen. However, there may be some small advantages to using FTRs: (i) they provide a better fit with market coupling as they allow all capacity to be allocated implicitly; (ii) some inefficient trades can be made under PTRs because the capacity must be nominated ahead of market coupling and circumstances may change over this timescale; and (iii) larger volumes of FTRs (obligations) can be allocated, since volumes in opposing directions can be netted, potentially allowing greater cross-border competition.

Whether FTRs or PTRs are chosen it is important that merchant interconnectors can be financed on the back of them. This means that if FTRs are chosen then there must be a mechanism for revenues to be allocated to interconnector developers. If FTRs are chosen it is also important to allow PTRs to be used for a transitional period, particularly in markets where full market coupling has not been achieved.

The potential for changes to price zones (set out in the CACM code) could be a major impediment to the development of long-term hedging markets. For this reason, it is vital that price zones are stable over time and any changes are signalled at least 3 to 5 years in advance.

As a final general point we believe the Framework Guidelines are overly prescriptive over how much of the long-term hedging arrangements need to be harmonised. Instead we believe long-term hedging markets should be allowed to evolve naturally in response to market coupling initiatives and according to what market participants are demanding. Moreover, it should be recognised that the optimal trading and compensation arrangements may differ depending on (i) the region including the prevailing generation mixes; (ii) whether the interconnector is regulated or merchant; (iii) whether market coupling is in place; and (iv) the type of interconnector (e.g. sub-sea versus land-based cables).

Regards

Will Steggals

## Annex: Responses to selected consultation questions

**1) Are there other products or options which are not considered in this document that would be worth investigating?**

No

**2) What will be the importance of the long-term Target Model and specifically the design of the forward market and the structure of long-term hedging products once the Day-Ahead and Intraday Target Models are implemented? Do you think your interest and demand for long-term hedging products will change (either increase or decrease) with the implementation of the Day-Ahead and Intraday Target Models? More specifically, what is your interest in cross-border/zone hedging?**

The introduction of full day-ahead and intraday market coupling along with the increase in interconnections and wind penetrations should increase SSE's interest in long-term hedging products such as FTRs and we see these as increasingly important products.

**3) Would long-term hedging markets need to evolve (e.g. in terms of structure, products, liquidity, harmonisation, etc.) due to the implementation of: 1) the day-ahead market coupling, 2) day-ahead flow-based capacity calculation and 3) occasional redefinition of zones? If so, please describe how these changes would influence your hedging needs and strategy. If no evolution seems necessary, please elaborate why. Can you think of any striking change not considered here?**

The potential redefinition of zones is a serious risk for generators and suppliers. It is not clear how the risks of zone changes can be hedged given that FTRs will need to be defined between two zones.

In the case of market splitting it is possible that incumbent generators could be grandfathered new FTRs as compensation for losses – although there are major complexities here (e.g. the volume of interconnector capacity available is unlikely to be sufficient to allow all incumbents to be sufficiently compensated via FTRs).

**6) Would you like to change, add or delete points in this wish-list? If so, please indicate why and how.**

The wish-list is not clear on how capacity holders should be compensated in terms of curtailment – for example should they receive the price paid or the congestion rent. Moreover, it is not obvious that compensation should be completely harmonised. For example, the risk of and duration of outages for sub-sea cables are very different to land-based cables. Depending on whether these are merchant or regulated interconnectors the appropriate compensation regimes (and who pays) may be different.

**8) Which elements of auction rules have regional, country specific aspects, which should not be harmonised?**

The differences in the nature of sub-sea versus land-based interconnectors (where the latter tend to have much longer outages) suggests 'firmness' and compensation arrangements may need to be different depending on the interconnector types.

**9) Which aspects should be harmonised in binding codes?**

The codes should only 'force' harmonisation in areas where it can be proved there are clear benefits to harmonising. Regional harmonisation is perhaps more important than EU-wide harmonisation.

**13) Please indicate the importance of availability of different hedging products with respect to their delivery period (e.g. multi-year, year, semester, season) for efficient hedging against price differential between bidding zones. What do you think of multiple-year products in particular?**

Multiple-year products would be an advantage to increase cross-border competition in the forward market.

**14) What would be your preferred splitting of available interconnection capacity between the different timeframes of forward hedging products? Which criteria should drive the splitting between timeframes of forward hedging products? On some borders, long-term products are offered with planned unavailability periods (because of maintenance work or structural change in the load/generation scheme) or for specific hours (peak and off-peak).**

A mixture of long, medium and short-term timeframes should be offered although, to the extent secondary markets are well-functioning, most capacity should be allocated to long-term timeframes. The duration mix of transmission rights should match those of energy contracts, which range from day-ahead to a few years ahead.

**15) While products with planned unavailability cannot be standardised and harmonised throughout Europe, they enable TSOs to offer more long-term capacity on average than standardised and harmonised products would allow. Do you think these products should be kept in the future and, if so, how could they be improved?**

Yes

**16) Products for specific hours reflect market participants' needs. What should drive the decision to implement such products? How should the available capacity be split between such products and base load ones in the long-term timeframe?**

It should be driven by the relative levels of market demand for different products.

**18) With the potential evolution from PTRs with UIOSI to FTR options, does the removal of the nomination process constitute a problem for you? If so, why and on which borders, if not on all of them?**

So long as FTRs are options rather than obligations (where you have to pay out for a negative price differential) there should be no practical difference and nomination is analogous to exercising an option.

**20) If nomination possibility exists only on some borders (in case of wide FTRs implementation), is it worth for TSOs to work on harmonising the nomination rules and procedures? If so, should this harmonisation consider both the contractual and technical side? How important is such harmonisation for your commercial operation? Which aspects are the most crucial to be harmonised?**

Harmonisation of nomination procedures may not be necessary if PTR are simply seen as a transitional measure before full market coupling and FTRs are introduced.

**22) How do you think the single auction platform required by the CACM Framework Guidelines should be established and organised?**

o How do you see the management of a transitional phase from regional platforms to the single EU platform?

o Should current regional platforms merge via a voluntary process or should a procurement procedure be organised at European Union level (and by whom)?

**o Should the Network Code on Forward Markets define a deadline for the establishment of the single European platform? If so, what would be a desirable and realistic date?**

The timetable should not necessarily be fixed at this stage as it is partly dependent on progress with rolling out day-ahead and intraday market coupling.