

ACER

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Consultation on Forward Risk-Hedging Products and Harmonisation of Long-Term Capacity Allocation Rules

Energy Norway is the non-profit industry organization representing about 270 companies involved in the production, distribution and trading of electricity in Norway.

General comments

Energy Norway welcomes ACER's consultation on forward risk-hedging products, which gives us the possibility to contribute in this debate at a time when ENTSO-E has started its work on the forward network code.

In our view, the main objective of the European market integration is the creation of a well-functioning, competitive market for the efficient use of production - and transmission capacities. As such the priority should be the integration of the day ahead- and intraday markets and network codes that ensure an efficient cooperation between the TSOs to make the optimal transmission capacity available to the market coupling process. Liquid long term markets, which can then develop on the basis of functioning day-ahead markets, are an important reference for power producers and power consumers for their planning and investment and should also be supported.

As Energy Norway sees it, the development of the forward market should satisfy the following main requirements:

- Long-term electricity markets are needed to allow generators, distributors and consumers to hedge their price risk. To this end, other players like banks and independent traders should be invited to provide risk capital and support market liquidity.
- The day-ahead markets should be the basis for the forward markets, and the structure of the forward market should depend on the day ahead market structure. Since neither the physical nor the financial electricity markets have found a stable structure for the future, market design and rules should be kept flexible, to be able to adapt to the change of the generation mix, more intermittent generation, on-going investment in the electricity grid and other factors.

- Any market organisation or product structure should respect the principles of market unbundling. TSOs, as regulated monopoly business, should not be asked to provide products that would expose them to electricity price risk and would thereby make them enter competitive electricity markets beyond balancing/system services.

Concerning the Nordic market area, Energy Norway thinks that our current electricity market design combining a system price and area prices is adapted to our structure with a big number of relatively small price areas, and is therefore fundamentally accepted by all actors. The day ahead market functions well and gives credible reference prices, the forward market offers liquid electricity forwards based on the system price and allows hedging the area price risk by offering CfDs, for the difference between area price and system price.

Any move towards continental type FTRs between area prices within the Nordic countries would not function for several reasons: there is no single area large and representative enough to become the reference area (unlike Germany in CWE). In addition, for example a hedge between Northern Norway (NO4) and Southern Norway (NO2) would have to go via several Norwegian or even Swedish price areas, and such a chain of FTRs is impossible to handle, whereas with a CfD there is always just one step to the system price as the reference.

We are also deeply skeptical towards testing combined systems i.e. introducing an obligation for the TSOs to issue FTRs in combination with our present purely market driven system: in our view, this risks splitting the liquidity between different products (FTRs and CfDs), and risks undermining the liquidity of the Nordic system price, which is the basis for our hedging with electricity forwards.

In addition, it runs against the principles of unbundling and we see nothing to gain by forcing the TSO to enter into the market and to carry electricity price risk. We fear that gains to FTR holders equal losses to the TSO, which would be passed on via the grid tariffs to producers and consumers alike. Risk minimizing action of the TSO could lead to low amounts of the FTR products in the market, introduce new, intransparent incentives concerning the actual handling of the physically available capacity and other undesired side-effects. And on top of that, we think that it is almost impossible and certainly very expensive to control a TSO in a market, where he has such a crucial role and such insider knowledge. Therefore, we are against the TSO carrying electricity price risk by issuing FTRs.

Remaining perceived challenges in the liquidity of certain CfD products should rather be addressed in a fundamental manner by addressing questions such as the number, size and stability of the price areas, possibility of larger cross border price areas, delays in grid investment, grid maintenance timing etc.

Concerning the continental market, the spot marked structure is different (bigger price areas, identical with countries), price coupling is not complete and there is a tradition for the use of FTRs and PTRs. In our view, price coupling should proceed and everything should be done to develop liquid electricity forwards based on credible reference prices, as the easiest hedge is always the direct one i.e. an electricity forward contract where available. In time, if price difference between the countries decrease, the market can also develop in the direction of appropriate reference price and CfD type contracts, if market participants choose to do so. However, in the meantime, there is a tradition for the use of transmission rights and market parties demand them. In our view, the TSOs should move from offering PTRs to FTRs as soon as price coupling is implemented, as all capacity should be available to the day-ahead market coupling to ensure an efficient outcome.

Response to the questions

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

No. The link between the day-ahead market and the long-term market should however be considered in more detail.

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?

Generators and consumers need forward electricity markets of adequate duration and liquidity, linked to the day-ahead price zones in which power is generated and consumed. Having a liquid forward market for all day-ahead price zones is however not likely, and some sort of auxiliary contracts (PTRs, FTRs, CfDs, etc.) will be required. These contracts will however have a weaker liquidity and a shorter duration than the forwards.

A functioning, competitive day ahead market is essential for setting the correct reference prices for long term hedging products. Improving the structure of the underlying day-ahead market should thus be prioritized over a quick introduction of forward products that would have to be changed later to fit changes in the underlying market.

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?

1) The main structure of the day-ahead markets should be agreed before any detailed rules for the forward markets are set. Furthermore, the structure of both markets should be kept flexible so that they can adapt to changes.

2) The forward market structure is only indirectly linked to introduction of the flow based method through the day-ahead market structure. However, if flow-based makes more capacity available to the day ahead markets, price differences between areas could decrease and area prices could become less volatile, which both are developments that support marked liquidity in the forwards.

3) Frequent changes of price zones would decrease the liquidity of the hedging products tied to them. However, there might be long -term structural bottlenecks that justify a change in price zones. From a market point of view, a move towards bigger prize zones would be supported, eventually also across national borders. Increased price convergence through use of flow based could support such moves.

4) What is for you the most suitable Long-Term Target Model (combination of energy forwards and transmission products) that would enable efficient and effective long term hedging? What would be the prerequisites (with respect to the e.g. regulatory, financial, technical, operational

framework) to enable this market design in Europe? Which criteria would you use to assess the best market design to hedge long-term positions in the market (e.g. operability, implementation costs, liquidity, efficiency...)?

In our view, the focus should be on developing functioning spot markets that can support liquid electricity forward markets for a direct hedge, as auxiliary contracts (PTRs, FTRs, CfDs...) tend to be less liquid. However, if those are needed, these forward markets should be adapted to the structure of their spot markets, instead of imposing a harmonised approach that might not fit the local spot market structure.

5) What techniques of market manipulation or “gaming” could be associated with the various markets for hedging products? What measures could in your view help prevent such behaviour?

The best way to prevent market manipulation is to establish competitive integrated spot markets of a certain size, which create a credible reference price, which can serve as a basis for hedging through liquid forward power contracts, reducing the need for secondary products such as PTRs, FTRs and CfDs.

REMIT, MIFID, EMIR, MAD and fundamental data transparency rules applied to all actors on the markets should be enough to prevent market manipulation on any of these markets.

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

Not relevant in our view, as mentioned above, TSO involvement should be avoided.

7) Which aspects of auction rules would be most valuable to be harmonised? Can you provide some concrete examples (what, when, where) of how this could help your commercial operation (e.g. lowering the transaction costs)?

Auctions should be avoided, see response to question 6.

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

Auctions should be avoided, see response to question 6.

9) Which aspects should be harmonised in binding codes?

Auctions should be avoided, see response to question 6.

10) If you are to trade from the Iberian Peninsula to the Nordic region and there existed PTRs with UIOSI, FTR Options or Obligations and CfDs in different regions – what obstacles, if any, would you face? How would you deal with them?

The question is of theoretical interest only. However, if you want to produce power in Norway to deliver it to a customer in Portugal, you would sell the physical power in Norway, and buy physical power in Portugal in order to sell it there, as spot markets are by definition local. Therefore the hedge would be most efficiently done in the local forward market; there is no need of a chain of instruments spanning Europe.

11) Would allocating the products at the same time represent an improvement for market players? Why? Where, if not everywhere, and under which conditions?

No comment, see question 6.

12) How important is it that capacity calculation for the long-term timeframe is compatible and/or consistent with the short-term capacity calculation and that capacity is interdependent and optimised across different borders?

Better coordination between the TSOs to increase available capacity for the day-ahead and intraday markets would be most beneficial for the markets and should be the first priority. It is also important that market actors have a transparent access to these TSO data and analysis processes to improve the functioning of these markets. There are various upcoming network codes and the fundamental data transparency guideline to improve TSO cooperation and information to market parties.

These network codes and guidelines should also improve the long term coordination between TSOs and long term information of market participants with regards to planned maintenance etc.

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?

The main hedging product for fundamental market participants should ideally be the forward electricity contract that their price zone is linked to. Both forwards and auxiliary contracts (PTRs, FTRs, CfDs...) should be defined as financial products, and their time resolution and timing should be left to evolve in the market, based on customer preferences.

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?

See question 13.

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?

See question 6. We do not think, the TSO should play a role.

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?

See question 13.

17) Should this possibility be investigated and why (please provide pros and cons)? In case you favour this possibility, how should this buyback be organised?

See question 6.

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?

In our view, PTRs should evolve to FTRs, so the removal of nomination should not be an issue.

19) How could the potential evolution from PTRs with UIOSI to FTRs on border(s) you are active impact your current long-term hedging strategy?

See question 18.

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?

See question 18.

21) Looking at the current features offered by the different auction platforms (e.g. CASC.EU, CAO, individual TSO systems) and financial market platforms in Europe, what are the main advantages and weaknesses of each of them?

See response to question 6.

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

See response to question 6 and 13.

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

NA

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

NA

25) 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?

NA