

To the attention of:  
Mr Christophe Gence-Creux  
Head of Department – Electricity & Chair of  
Market European Stakeholders Committee  
Agency for the Cooperation of Energy  
Regulators  
Trg republike 3  
1000 Ljubijana, Slovenia

Brussels, 6 April 2021

**Subject: Follow-up of ENTSO-E's presentation on remuneration of LTRs at the MESC meeting on 11<sup>th</sup> March 2021**

Dear Christophe,

Eurelectric and EFET would like to share their concerns following the presentation by ENTSO-E at the Market European Stakeholder Committee meeting on March 11, 2021, of a possible modification of remuneration of Long-Term Transmission Rights (LTR) in case of decoupling.

We consider that **the measures proposed by ENTSO-E are not appropriate to address the problem of congestion rent valuation during decoupling events** and remind that **challenging the firmness of LTR could even be detrimental to network tariff payers**.

#### **1. Considerations on the figures presented by ENTSO-E at the MESC.**

The figures presented at the MESC are biased since they compare two independent metrics:

- i) the average daily revenue of LTR auctions (which correspond to the average value of yearly and monthly LTRs over the entire period covered by these products extrapolated for the single days when decoupling events occurred) and
- ii) the revenues captured by the TSOs with the shadow auctions organized during the only three decoupling events over the past years.

The difference is significantly less impressive if we consider that market coupling is in force for more than 10 years in part of Europe. Hence, the metrics we would like to see compared would be:

- i) the total amount of cumulative revenue from LTR auctions since the start of market coupling vs.
- ii) the revenues captured by the TSOs with the shadow auctions during the few decoupling events that happened over the same period.

The figures displayed by ENTSO-E mainly highlight that TSOs do not capture as much revenue as they could from the shadow auctions that they organize as a fallback solution to schedule cross-zonal exchanges when the single day-ahead coupling (SDAC) fails.

We highlight that, on the handful of occurrences of decoupling since the start of DA market coupling, the fact TSOs do not collect the price spread between markets but only the revenues from the shadow auctions are independent from the volume and firmness regime of LTTR on the corresponding borders. Although it can be costly for network tariff payers on that handful of unfortunate days, it is not a loss of welfare from a system-wide perspective, as the value is captured on these days by the market participants that make the most competitive bids in the corresponding shadow auctions. We address how to tackle this redistribution question in the last part of our message.

## **2. Considerations on the rationale for ENTSO-E for changing LTTR remuneration rules.**

The main measure proposed by ENTSO-E to address these situations consists of reducing the firmness of LTTR in case of decoupling. We strongly disagree with the approach and highlight hereafter that this approach could even be particularly costly in terms of congestion rent captured by the TSOs.

In fact, the rationale presented by ENTSO-E has serious flaws:

- The remuneration of LTTR in case of decoupling is presented as an “overcompensation” of LTTR holders. We strongly disagree with this statement. It is striking that the baseline for a “normal” compensation is undefined in ENTSO-E material. We deem that the normal valuation of an LTTR is precisely the price differential between the related bidding zones. The provisions guaranteeing full financial firmness of LTTRs at market spreads were carefully negotiated between TSOs and market participants at the time of the drafting of the FCA GL against the possibility for TSOs to cap compensation on LTTR curtailments at the level of yearly congestion income (monthly for HVDC). We would see a dangerous precedent in going back on this agreement.
- We cannot understand ENTSO-E’s statement that “LTTRs cannot be considered as hedging opportunities against DA congestion pricing”. From the market perspective, LTTRs are exactly used as a hedge against DA congestion prices, i.e. as an “insurance” against a market spread in DA. This is particularly useful to hedge positions in bidding zones where the liquidity of forward markets is limited and to use a proxy towards another, more liquid, forward market is necessary. In this and all other cases, the quality of the hedge for cross-zonal capacity (in particular, in the face of events where congestion prices can be significant) is a key dimension of the price of LTTRs.
- Let us clarify that the wording used by the TSOs that firmness “would be reduced in case of decoupling” means that each LTTR for any delivery period will see its firmness reduced. It should be taken for granted that any change in terms of remuneration rules for LTTRs will be accounted by market participants when they participate in the auctions to allocate LTTRs. Hence, any reduction of firmness, in particular, for events that market participants are unable to mitigate, will reduce the overall value of LTTRs market participants are willing to pay for and significantly affect the revenue that TSOs capture with the sale of LTTRs not only during decoupling events but all year round.
- ENTSOE presents this solution as allowing to secure hedging in a physical way, by participating in the shadow auction process. However, it should not be forgotten that not all market participants have underlying physical assets to effectively nominate energy on the acquired XB capacity so that this capacity would be of no use for them.

Therefore, we are strongly opposed to the idea that the remuneration of LTTR could be altered in the case of decoupling. This goes against the key principle that LTTR is a hedging product for market participants, who would then bear a risk that they have no means to mitigate.

### **3. Considerations on alternative options presented by individual TSOs to amend LTR remuneration rules.**

In addition to the ENTSO-E presentation at the MESC, we have also heard of alternative proposals presented at the national level on which we would like to react:

#### **In the short term:**

- i. *Introducing a cap on LTR remuneration in case of decoupling in the EU Harmonised Allocation Rules (HAR):* This market design feature would come in addition to the cap on remuneration that TSOs can already apply in case of LTR curtailment. Before considering this first proposal, we should first compare the missed revenue for TSO during the unfortunate situations of decoupling compared to the total revenues coming from the allocation of XB capacity at different timeframes since the beginning of market coupling (or at least annually, as this is done in the case of the cap on remuneration in case of LTR curtailments). In addition, we believe that the change would require not only a modification of the EU HAR but also of the FCA GL. The rare decoupling events should rather be minimized by investing in the DA MC process and its resilience but also, when unavoidable, should be organized in a way that the auction results reflect the spread of the market prices (see part 4 for more details).
- ii. *Remunerating LTRs in the function of each LTR holder's participation in the shadow auctions:* Regarding this second proposal, as already pointed out, participating in the explicit allocation of cross-border capacity via shadow auctions does not concern all type of market participants. This approach would be discriminatory against those who have no interest in acquiring physical capacity right in DA.

#### **In the long term:**

- iii. *Replacing the shadow auctions by the IDAs at 3 pm:* Regarding this third proposal, we are against the idea of suppressing the shadow auctions. Using the upcoming IDAs of 15:00 as a basis for the remuneration of LTRs is not tantamount to "replacing" the shadow auctions, but to suppressing the day-ahead fallback options required by the CACM GL. Indeed, it is key that cross-zonal exchanges are allocated before or by the DA auctions, which serves as a basis for the valuation of most forward products and many retail contracts. Finally, local intraday market design features do not necessarily enable all market participants to take part in the intraday market everywhere (it can be partially or fully restricted to asset owners), so that it could once again cause a problem of equal treatment of market participants.
- iv. *Stopping the allocation of LTRs and resorting to other financial products for hedging:* Concerning this fourth proposal, we do not believe that article 30 of the FCA GL allows TSOs to stop issuing LTRs at borders where they were issued at the entry into force of the GL. We support this provision as LTRs are products of ultimate importance and that is extensively used by market participants and for a good reason: Market participants hedge their price risks with them. Abandoning this concept would be a real game-changer for the electricity system as a whole and the impact of it should be compared to the magnitude of the issue we are trying to solve. We do not think it is appropriate. Any proposed change to the FCA GL in that direction would require a much more profound reflection on the subject together with market participants.

### **4. Market participant's proposed way forward**

We are fully committed to helping improve the processes of the shadow auctions.

As mentioned above, the only fundamental issue we have observed in days of decoupling is one of the redistributive effects. To address this redistribution question, we invite ENTSO-E to focus on the management of decoupling events, and investigate, in particular, in the following directions:

- a) avoid decoupling events by reinforced testing/improvements of the SDAC process.
- b) improve communication towards market participants in case of (risk of) decoupling to reduce the level of uncertainty ahead of the shadow auctions.
- c) Improve competition in the shadow auctions, with:
  - a. Continuing to have more training towards market participants to have them more reactive in case of decoupling.
  - b. more time to prepare competitive capacity bids with full information, ahead of the shadow auctions.
  - c. streamline the shadow auction tool to facilitate participation in the auctions, notably for those market participants active on multiple borders.

These improvements will allow the valuation of cross-border capacity allocated under a shadow auction process to better reflect the spread between the energy auction prices in each bidding zones.

In any case, any short-term or long-term modifications of the market design related to LTTRs should be properly assessed in relation to the consequences these modifications may have compared with the expected benefits.

We stand ready to contribute to the forthcoming months with ideas and advice on these matters.

Yours sincerely,



Hélène Robaye  
Chair - WG Market Integration & Network Codes  
Eurelectric



Jérôme Le Page  
Chair – Electricity Committee  
EFET