July **2023**

UFE Response to All TSOs' proposal for amendments of the methodology for Harmonised Allocation Rules for long-term transmission rights

7. Please provide your view on setting collaterals according to a cap

UFE thanks ENTSO-E for the opportunity to respond to the consultation "All TSOs' proposal for amendments of the methodology for Harmonised Allocation Rules for long-term transmission rights".

While we can welcome this intention (cap on collateral) of ENTSO-E, we miss a clear and serious explanatory material to understand the changes and implications of such a cap on collateral requirements. We call for a full text proposal and an assessment of the effects of such a cap on collateral requirements before submitting this new methodology to ACER. This will be necessary for us to provide a clear view on the proposal – and for ENTSO-E to truly comply with their consultation obligations under the FCA Regulation.

8. Please provide your views on the method for calculating the cap

While the idea of a cap on collateral seems positive, it all boils down to whether the cap actually decreases collateral burden for market participants. The cap doesn't guarantee a lower collateral requirement: sometimes the bid price could be lower than the cap (in which case the cap is not useful), it only becomes a limit of collaterals in case of skyrocketing market prices.

In any case, looking at the current proposal**, it seems clear that looking at DA spreads as a basis for the cap does not make much sense**. It might be more relevant:

- To compute collaterals based on the final auction price. In other words, calculate the collateral amount within the allocation, that way there is no filter of bids prior the allocation. N-side has proposed a solution to calculate the collaterals within the allocation and based on the final auction price.
- To use the average observed forward spread instead during a certain period since the FTR auctions concern forward maturities (and not day-ahead), using the average observed forward spread instead during a certain period. It is important to make sure that the

reference price used to compute the cap is in line with the maturities of the FTRs. We suggest Entso-E to engage into discussions with data providers in order to obtain the necessary data.

We are also strongly concerned about the stricter rules dealing with the case of one market participant defaulting, and the consequences this would have for all other registered JAO users. It is absolutely not acceptable to have market participants paying for the defaulting market participants.
This is a key issue for us (see our proposal question 9).

In any case, as mentioned above, we reserve our opinion on the appropriateness of the ethodology for now until:

1. ENTSO-E provides an assessment of how the proposed cap and methodology would effectively decrease collateral volumes for market participants,
2. ENTSO-E provides an actual text proposal to market participants, according to its obligation under the FCA Regulation.
3. ENTSO-E makes sure market participants collateral will not be impacted by defaulting market participants

9. Please provide your view on the penalty mechanism
In the consultation text, the proposal "If such dunning process is again not successful, the MP will lose all rights on awarded capacity from the day after the dunning process ended. JAO will collect collaterals from MPs, given in form of bank guarantee or cash deposit all open amounts, to balance open invoices." can be interpreted as: should a MP be in default (ie not paying the needed amound), there would be a call made to others MP to "fill the gap".

We are also strongly concerned about this stricter rule dealing with the case of one market participant defaulting, and the consequences this could have for all other registered JAO users. It would absolutely not acceptable to have other market participants paying for the defaulting market participant. This is a key issue for us.

To avoid misunderstandings, we recommend specifying in the EU HAR text that JAO will collect collaterals from the **concerned** MP.

10. Please provide your view on the altered auction timings

The addition of the altered auction timings is not very clear and more details and clarity should be provided before changing any timing.

Other comments:

⇨ **Long-Term Flow based allocation implies a significant impact for collateral requirements:**

UFE wants to highlight that the move to Flow Based Allocation implies a significant impact for collateral requirements. We understand that the collateral requirement has not been adapted/modified to the allocation of more than 20 borders at the same time: therefore, Market Participants will have to provide at once the full amount of collateral corresponding to the “sum” of all the induvial borders they are bidding. This leads to several side effects:

- **It will increase the amount of collaterals requested from market participants**, because they will need to provide collaterals on all borders on which they would like to bid. Subsequently, some market participants will have to select fewer borders on which they can bid and probably submit less bids, with a lower price.
    - We therefore want to reiterate our concern that performing an auction with only a limited set of buying orders challenges the potential merit of such an auction. In order to properly assess the situation, we suggest performing an analysis to test to which extent the set of buying orders would be limited by collateral.
    - In addition, we think that the constraint related to collateral (ie the limitation in terms of bidding a market participant will have to respect) should be integrated into the optimization algorithm, in order to make sure that the best combination of bids is selected (instead of an ex ante arbitrary selection).

- T**he important amount of collateral requested will discriminate small market participants** who will not be able to gather the necessary funds to secure their participation to the auction (market entry barrier). As a result, small market participants will not have access to hedging opportunities, which is in contradiction with the FCA regulation. Only big companies will have access to LT market CORE.

- Furthermore, under NTC allocation each border auction was performed on different period which gives the time for market participants to adapt their bidding strategy based on what was allocated at first. **With the LTFB allocation**, as all borders are run at the same time, **market participants will not have the opportunity to have a “ second chance” to get LT rights on other borders**, they will have only one opportunity.

- **Last but not least, we consider that the required collateral (for both Flow Based and ATC) seems disproportionate compared to the risks TSOs are bearing**. Indeed:
    - Article 22 mentions that the validity of the collateral requirements should be 30 days after the end of the Product Period;

- Article 66 says that the payment for long term rights shall be settled before the start of the Product Period; We suggest that the validity of the collateral should end right after the payment of the acquired rights.

⇨ **UFE is opposed to the establishment of Long-Term Flow Based allocation whose added value has not been sufficiently demonstrated:**

From a more general perspective on the LTFBA project, UFE is opposed to Flow Based allocation whose added value has not been sufficiently demonstrated by ACER and is hence not compliant to FCA guideline article 10.

- Most importantly, it has not been proved that FB allocation will lead to more cross-zonal capacities being allocated, which should be the ultimate goal given the need for long-term hedging under current circumstances.
- More worrying, the recent simulations performed by TSOs show that some bidding zone will have very low/zero volumes allocated at their borders. This is in contradiction with the foundations of the article 30 of FCA regulation, which states that TSOs should provide enough hedging opportunities to the market. These extreme situations, where no capacity is allocated, could also lead to operational security risks as the fallback of the Day Ahead Capacity Calculation is the capacity allocated in the Long Term timeframe.
- Should LTFBA were to be implemented anyway, it is key that TSOs investigate possible mitigation measures, such as imposing a minimum volume at each borders, ensuring that no bidding zone becomes isolated in the forward market.

⇨ **The new article 49 proposed by ENTSO-E is not compliant with the FCA Regulation and should therefore be deleted:**

Regarding the addition of the new article 49, UFE would like to highlight that a cap on LTTRs remuneration is neither permitted by the FCA Regulation, nor economically justified.

First, UFE would like to remind that the main objective of financial firmness of LT capacity allocation (LTTR remuneration at day ahead market spread) is to allow the market participants to hedge position across borders.

Second, even if UFE understands TSOs concerns regarding the remuneration of LTTRs in case of decoupling (day ahead market spread VS day ahead shadow auction prices), the recent decoupling events do not corroborate this concern. Indeed, on the recent decoupling events (2019, 2020, 2021), the total amount compensated by TSOs to market participants (as LTTRs) represents a very small part of the total revenue incomes for the TSOs across the whole year (coming from the allocation of cross zonal capacity on Long Term auctions). Furthermore, caps on the remuneration of long-term transmission rights are reserved to cases of curtailment.

Third, UFE shares ACER's Decision 15-2021 where ACER ruled out such a proposal underlining that there is no legal basis to implement a remuneration cap in case of decoupling and that a modification of EU HAR would imply a change to the FCA Regulation.

Article 35 of the FCA Regulation lays down rules for the remuneration of LTTRs. It requires the remuneration to be equal to the market spread for implicit auctions or their fallback in day-ahead. We therefore do not understand why and disagree with the fact that this point is being brought again in the debate.

Finally, UFE would like to remind that market participants are not responsible when a decoupling occurs, it is not in market participant's hands, and they are suffering from it. While there were several decoupling cases since 2019, the focus of TSOs and NEMOs should be on the robustness of the algorithm and the whole day ahead market coupling process. Instead of changing the EU HAR, the focus has to be on the reinforcement of the testing/improvements of the SDAC process to avoid any decoupling event in the future.

In case it happens, shadow auctions should be maintained, and training sessions like the ones organized in the last years should be maintained (these sessions however duly require the presence of all TSOs). Communication towards market participants in case of (a risk of) decoupling should also be improved.

The new article 49 proposed by ENTSO-E is not compliant with the FCA Regulation and should therefore be deleted.