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European Federation of Energy Traders



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- EFET believes that cross border transmission capacity rights should be **firm**, **maximised** and **tradable** in secondary markets
- Firm capacity rights means that if capacity is curtailed compensation is paid at the full market spread (unless in cases of tightly defined force majeure)
- Firmness is important and feasible because:
 - It is **essential for proper market functioning**
 - **TSOs** are the **only natural sellers** of transmission capacity
 - Offering firm capacity **does not significantly increase TSO businesses risk**

- It is vital to ensure firms can hedge their (primarily) long-term positions through buying firm capacity rights
- Capacity rights must be contractually binding and span months to several years to become truly tradable
- In practise, market participants cannot hedge risks only through financial solutions (e.g. CFDs or FTRs) because:
 - No market participant (apart from the TSOs) can manage the risks involved in issuing such hedges for transmission risks
 - Most market participants need to buy hedges, not sell them. This creates a one sided market (only buyers and no sellers)
 - A primary supply is needed so trading of financial contracts take place on the back of physical contracts
 - Nordpool is an example of the financial solution not working

TSOs are natural sellers



- TSOs are the only players in the market that can offer hedges through fully firm cross border transmission capacity
- TSOs are natural sellers of transmission capacity, because:
 - Income is proportional to congestion and potential costs if there is a need to curtail (TSOs are long transmission while all other market players are short transmission)
 - TSOs have other ways to manage the risks

Firmness does not significantly increase TSO business risk



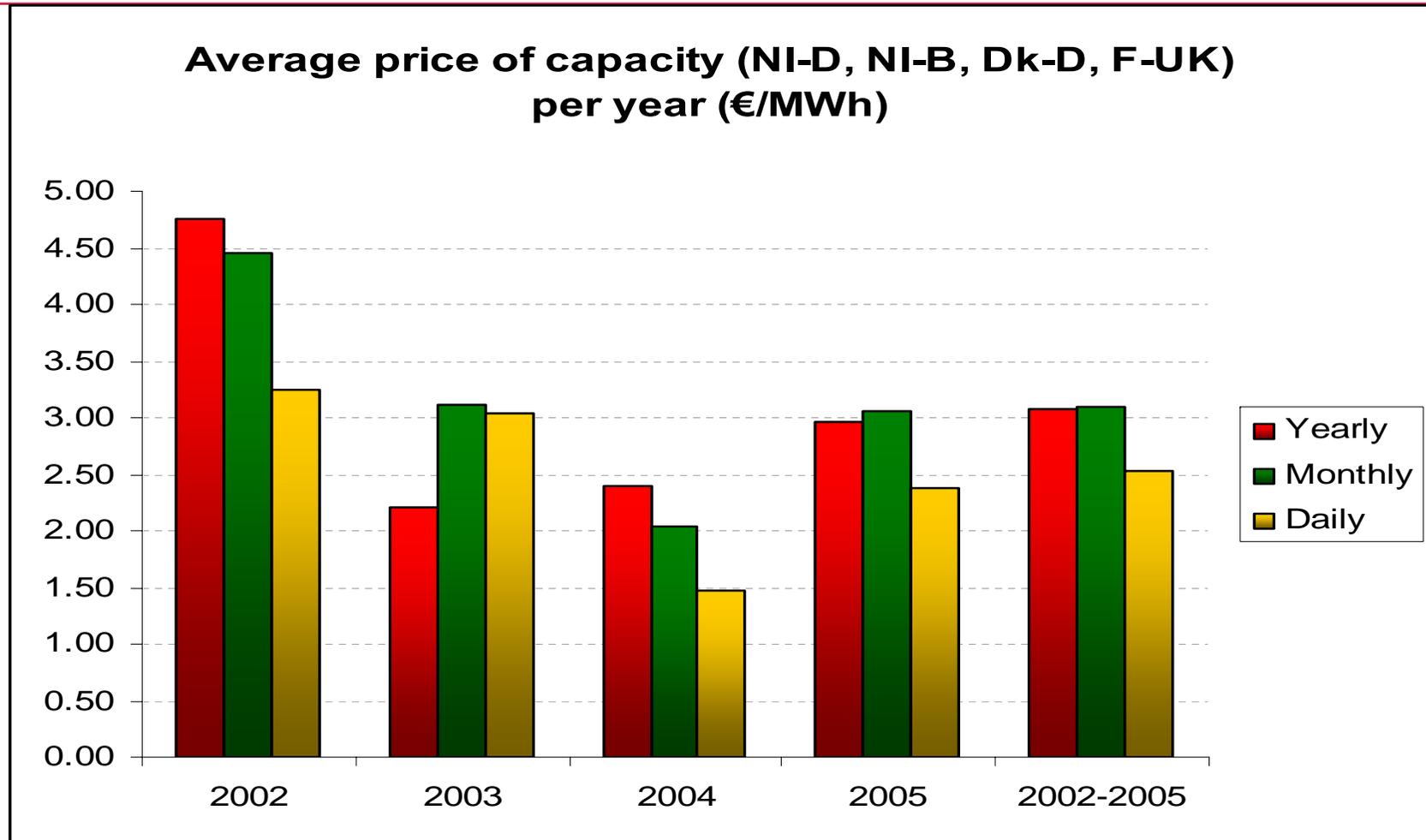
- TSOs receive revenues from selling (long term) capacity that can be used to buy back capacity short term if required
- TSOs only need to buy back capacity if they curtail or misjudge capacity availability
- Revenue is proportional to potential curtailment costs (increases if a border is more congested)
- TSOs have other ways of managing the risks
- TSOs would only bear a small **residual** risk of the market significantly mis-pricing congestion

Example using real 2002-2005 data

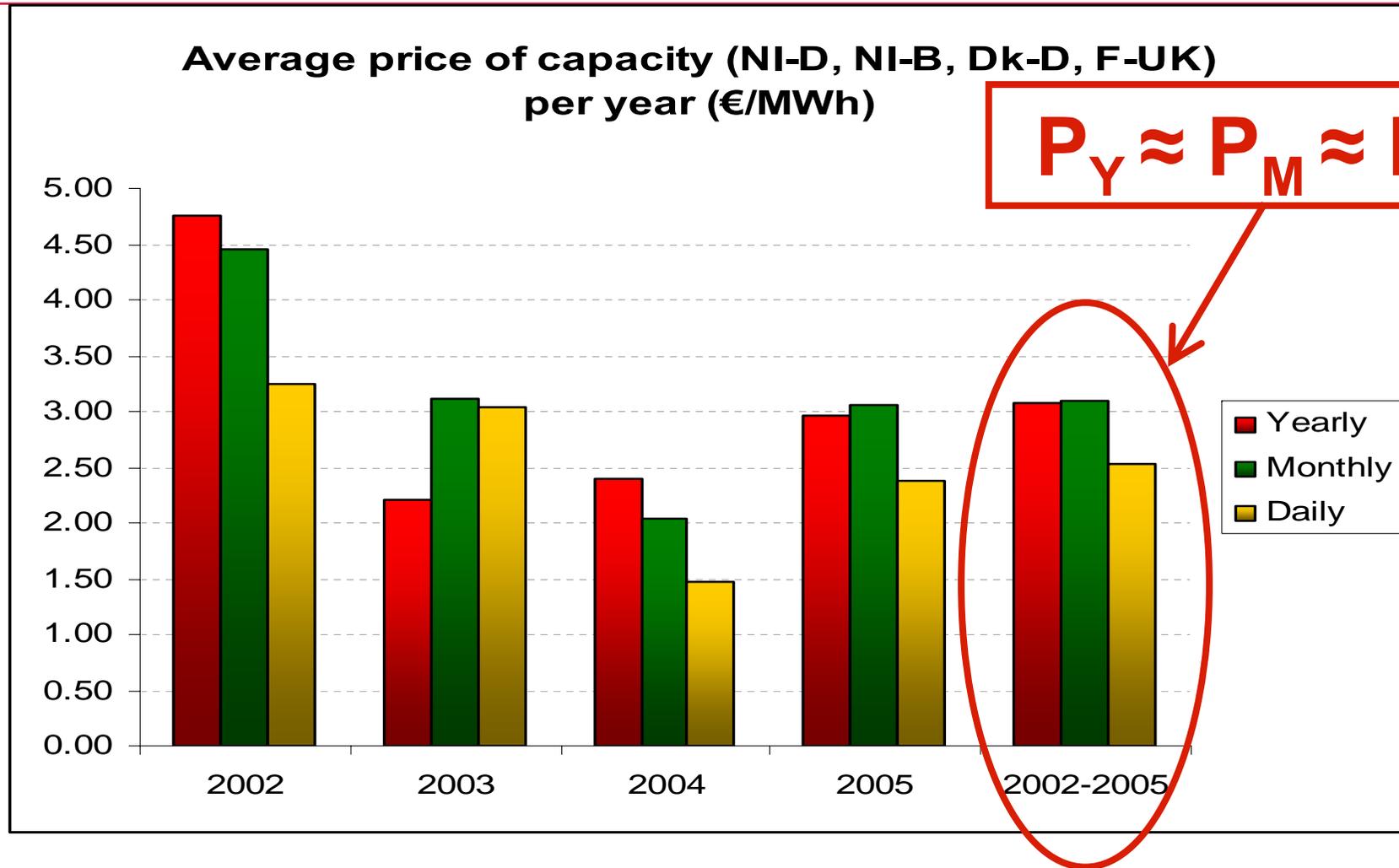


- If a TSO sells fully firm capacity one year ahead...
...and then buys back 100% of that capacity for 100% of the days over the whole coming year
⇒ A net result of a small profit to the TSO
- Of course this simple example contains very cautious approximations:
 - TSOs only need to buy back a small fraction of the capacity for a small part of the year
 - Re-dispatch instead of curtailment may be cheaper
 - Other technical options may be available to manage the congestion rather than automatically curtailing cross border capacity
 - The TSO can build new lines to manage long term congestion
- If capacity available increases then the price differentials and spikes will also be reduced

Example using real 2002-2005 data

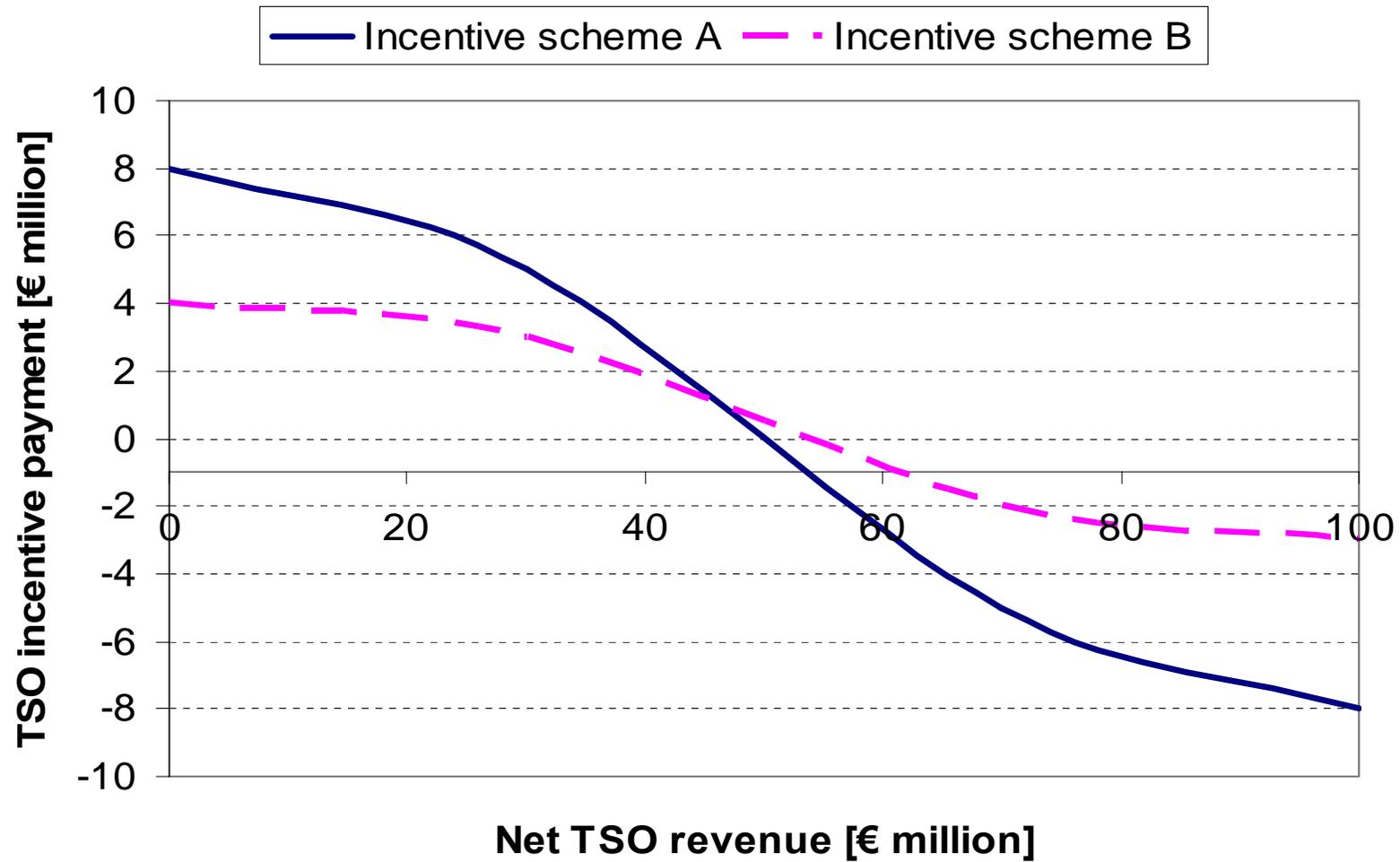


Example using real 2002-2005 data



- Revenues should (in priority order) be used to
 1. Ensure firmness
 2. Manage congestion (i.e. rescheduling or buying back capacity sold to the market)
 3. Upgrade lines
- Revenues should **only as a last resort** be used to reduce grid fees
- Incentives regulation **must** allow TSO's to benefit from doing a good job

Rough financial incentive scheme



Concluding remarks



- TSOs have a vital role in facilitating market functioning and competition by ensuring firmness and maximisation
- Some issues can be progressed immediately.
- Others issues require discussion between TSOs and regulators (e.g. incentives)
- EFET does not pretend that it will be fast to implement all these proposals, but wishes to engage in debate
- EFET has published a detailed paper on firmness and maximisation

Proposed action points



EFET seeks commitment now from TSOs and Regulators to progress the following simple issues:

- Agree to the priority order for use of auction revenues this year and implement a priority order for the use of auction revenues by mid 2007
- Publish detailed information about how the auction revenues have been used on an annual basis
- Publish an initial outline for how incentives regulation can be introduced by the end of 2007
- Publish analysis, methods and data on how cross border capacity NTCs are calculated to improve transparency

Thanks for your attention



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