

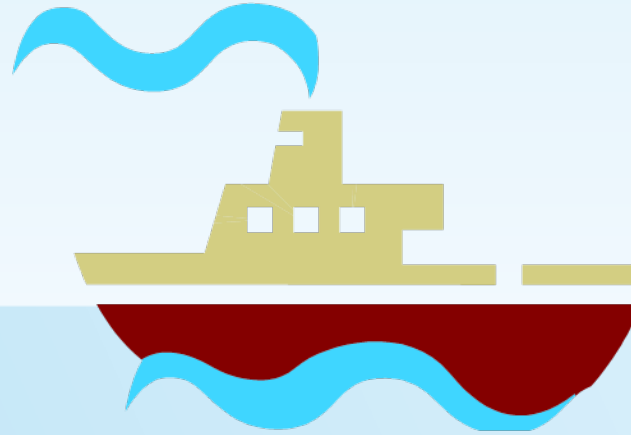
EU Electricity Target Model: Liquidity and access to the market

Paul Dawson

9 December 2011



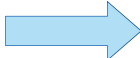
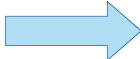
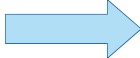
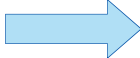
The Union



So what is the biggest problem for the internal energy market in Dominatia-Incumbentia Union?

1. There's only one boat?
2. The boat sails half empty?
3. Boat operator levy?
4. Market and booking timetable?

So what is the biggest problem for the internal energy market in Dominatia-Incumbentia Union?

1. There's only one boat?  Network capacity constraints
2. The boat sails half empty?  Optimal calculation of capacity
3. Boat operator levy?  Optimal sale and expansion
4. Market and booking timetable?  Optimal capacity allocation and congestion management

Target model only address part of the picture

Transmission rights: trading requirements

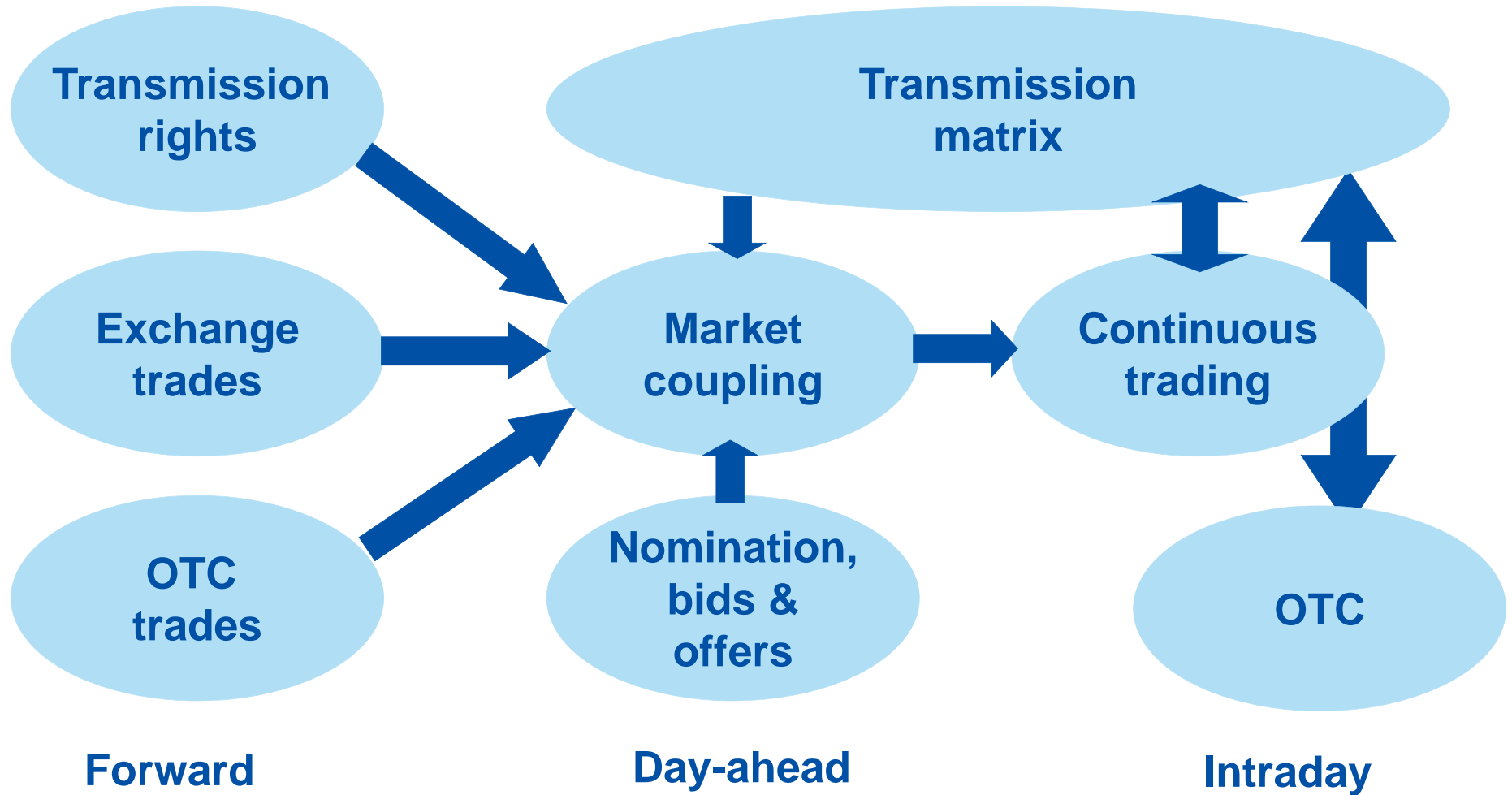
- > Term transmission rights corresponding to trading horizon
 - Spot only price for transport = unhedged cross-border positions
 - reduced competition and liquidity

- > Rights must be financially firm
 - like any other commodity

- > TSOs must sell sufficient rights
 - Nordic CFDs won't - and don't - work
 - Don't overly fragment delivery points

- > Regulatory framework should therefore provide TSOs with incentives:
 - To maximise sales of cross-border capacity
 - To ensure firmness of capacity

EU Target Model



Transmission rights: physical or financial?

- > In theory (or endgame)
 - Indifferent: PTRs (with UIOSI) can do anything FTRs can do
- > In practice (or transition)
 - Comparable, reliable and fair spot indices
 - Avoid unhedgeable basis risks
 - Respect established trading norms (OTC vs exchange)

Immediate move to FTRs may not be possible

Transmission rights: rights or obligations

- > Traders want rights not obligations
 - Efficient and complete hedge for cross-border sales
- > Obligations
 - Compulsory sale of put option to TSO in return for buying call option
 - Hedge no longer complete
- > Better to unbundle at source rather than via secondary market
- > Why not just sell the puts and calls (or uni-directional rights) separately?

Transmission rights: commercial and regulatory issues

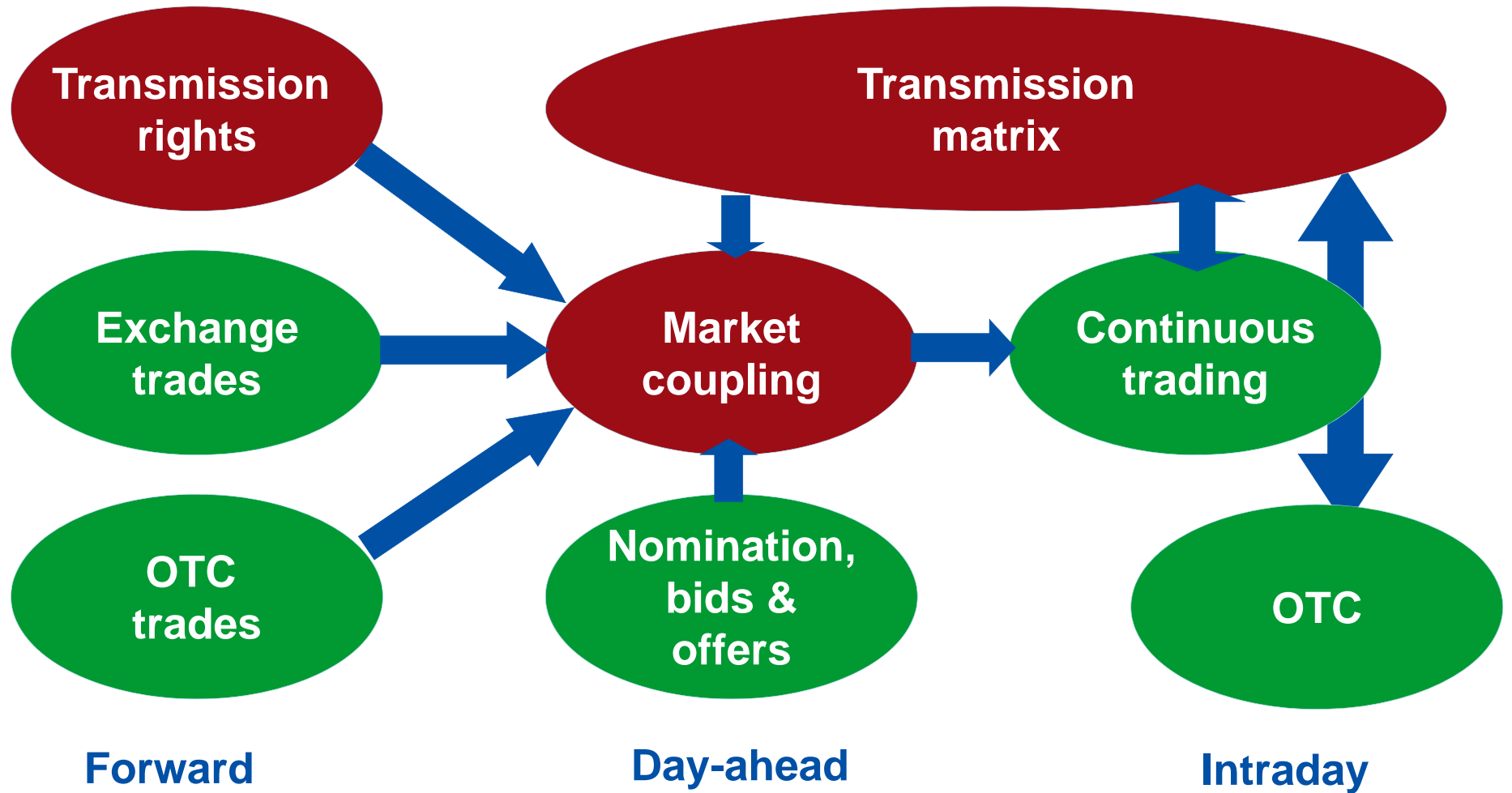
- > Rights hedge market risk, but not credit risk and liquidity risk
- > FTRs are derivatives (PTRs might be)
- > FTRs (or indeed PTRs) could become financial (“MIFID”) instruments
 - Licensing requirements
 - Prudential capital
 - Market conduct regime
- > OTC derivatives regulation (“EMIR”) require mandatory clearing of all standardised derivatives
 - Traders and TSOs required to post and manage collateral

Day-ahead market coupling

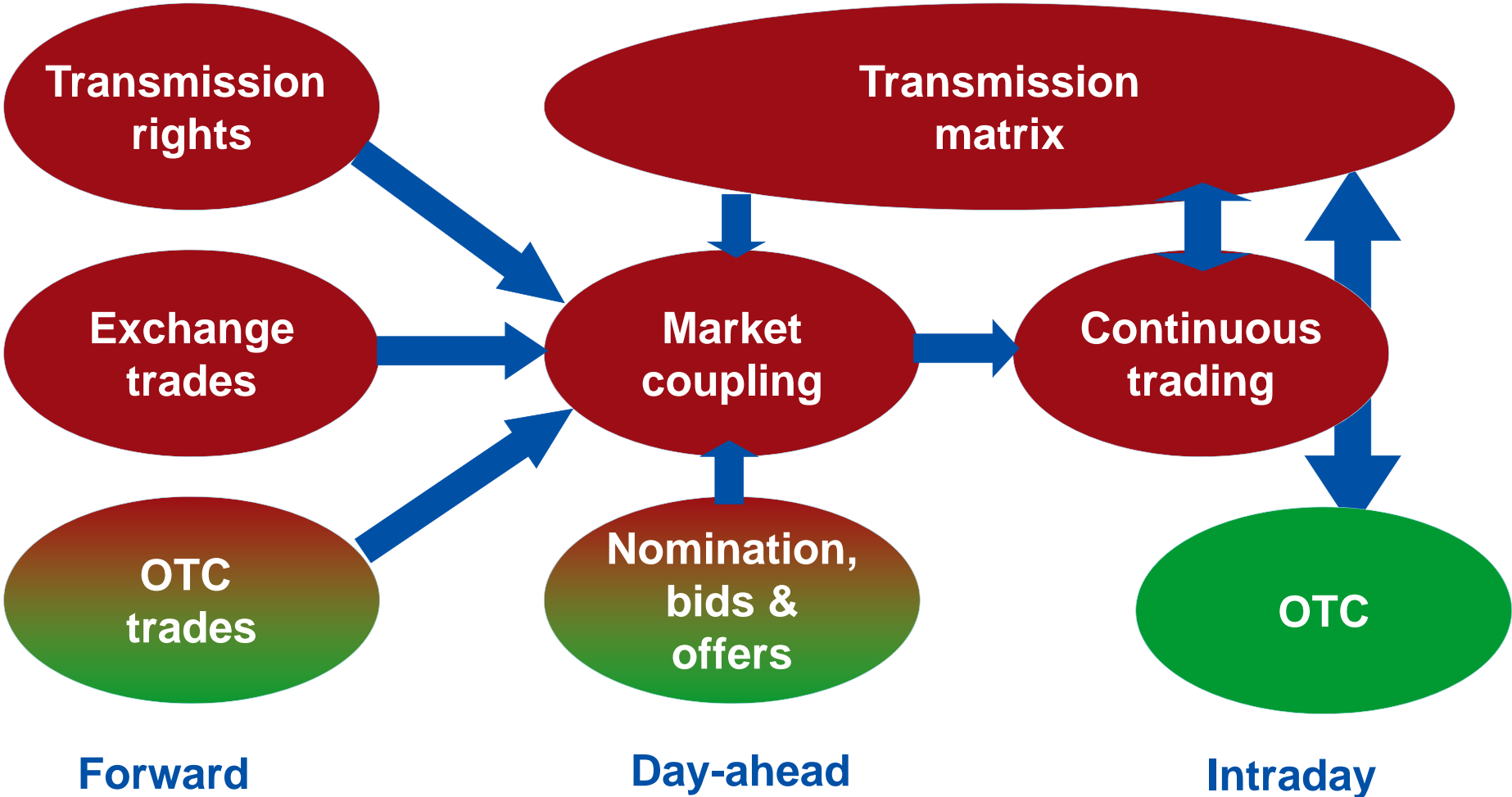
- > Benefits have been oversold
 - Single point “snapshot” of optimal allocation
 - Inefficiency of explicit auctions down to timing differences

- > Not a panacea
 - Physical: capacity provision and calculation
 - Commercial and regulatory: TSO forward sales

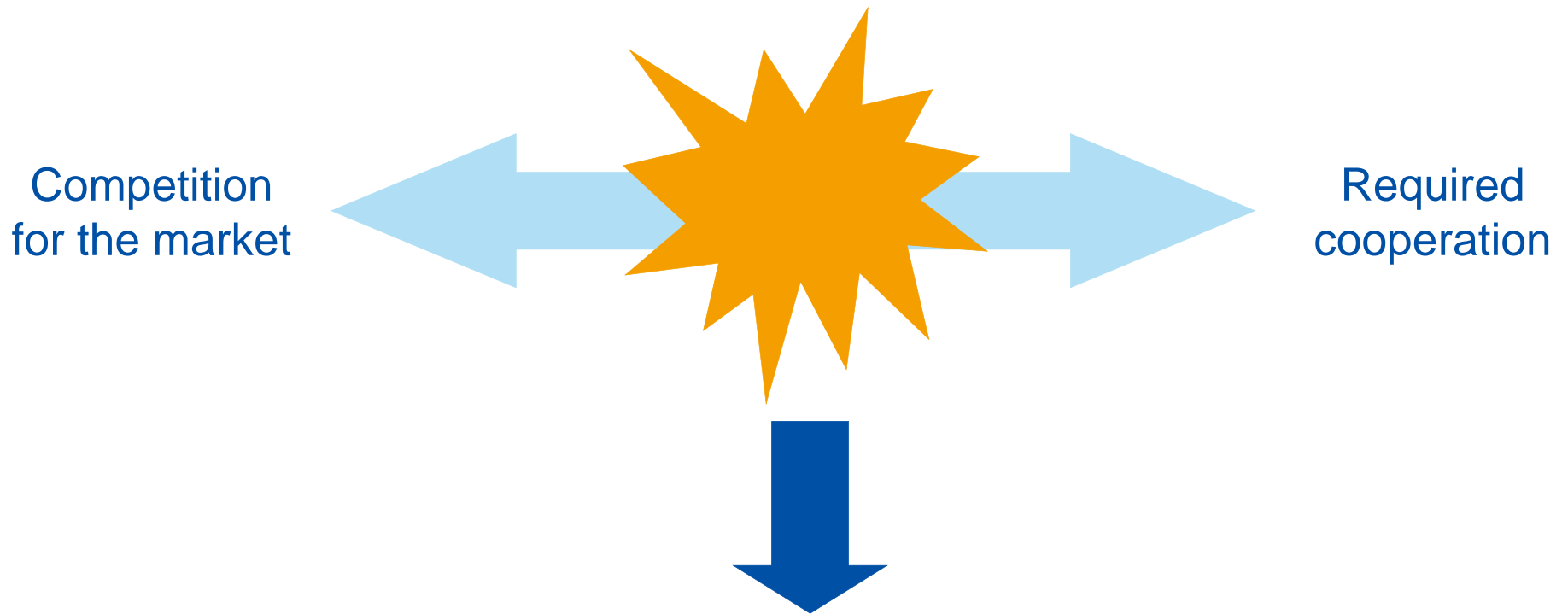
How governance should be



Where governance is going...



The result



Delayed integration
Reduced competition “for the market”
Higher fees, poorer service
Lower liquidity
Need to regulate spot exchanges?

Conclusions...

- > Target model represents significant progress in delivering the single market
- > Focus on forward transmission is particularly welcome, but
- > Target model only tackles part of requirements
- > Structural and governance issues may delay delivery of the target model

... but the competitive world is endangered

- > Off-market subsidies and distortions
- > Non-market interventions
- > The vicious carbon pricing cycle
- > Tariff caps
- > Capacity markets

Let's hope the economic turmoil spurs a renewed drive for competition and efficiency

