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ACER – Agency for the Cooperation of Energy Regulators  
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Submitted by email to: [consultation2012E13@acer.europa.eu](mailto:consultation2012E13@acer.europa.eu)

Dear Sir/Madam

**Response to ACER's consultation on Forward Risk-Hedging Products and Harmonisation of Long-Term Capacity Allocation Rules**

We are writing in response to ACER's consultation on forward risk-hedging products and harmonisation of long-term capacity allocation rules. JP Morgan is an active participant in cross-border hedging, managing orders for clients seeking to trade in different countries, and we welcome this opportunity to comment on ACER's proposals.

In summary:

- we are in favour of greater harmonisation and transparency in the energy markets;
- we consider that demand for long-term hedging products will continue without significant change following implementation of the day-ahead and intraday Target Models;
- we support having a diversity of hedging products: consequently we would welcome the introduction of further multi-year hedging products and favour maintaining products with planned unavailability; and
- we do not believe it would be advantageous to move from holding auctions sequentially to simultaneously at either side of a border /cable.

We attach our completed questionnaire to this consultation. We strongly support ACER's work towards establishing a single EU energy market and would welcome the opportunity to discuss further with ACER.

Yours faithfully

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**Please provide the Agency with your full contact details, allowing us to revert to you with specific questions concerning your answers.**

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## ***Forward risk-hedging products***

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

No, the products considered by ACER are comprehensive.

- 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?**

We do not think our interest and demand for long term hedging products will change materially when the day-ahead and intraday Target Models are implemented. JP Morgan's interest in cross-border/zone hedging derives from its activity of managing orders for clients seeking to trade in different countries and we believe our clients will still need to trade longer term products e.g. utilities must hedge their power plants. The determination whether to purchase long term hedging products is based on analysis of a variety of market factors, for example, the FX market, fuel markets, views on the economy etc. Consequently, the day ahead market does not comprise a significant component of this analysis and will have a limited impact on longer-term products.

- 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?**

We do not consider there would be a need for long-term hedging markets to evolve. We note that when market coupling was first introduced between Belgium, France and the Netherlands, the way in which market participants traded did not change significantly although the pricing structures did change. Therefore, one possible consequence of the above cited implementation may be changes in price structures, with the prices becoming more closely aligned between countries.

- 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 enabling efficient and effective long term hedging, market participants should be able to:

- trade energy forwards – both physical and financial – which they are able to do today; and
- trade transmission products, which today can be done on a monthly and yearly basis only.

Therefore, we believe efficiency could be enhanced by auctioning transmission capacity for longer time periods, for example, for two and three year periods. Such products should be available across the EU which would necessitate a minimum level of regulatory and technical harmonisation. We believe ACER has identified the criteria which should be used to assess best market design and in particular, would point to liquidity, low implementation costs and reducing operational complexity to the extent possible, with TSOs providing flexibility with regard to scheduling and nomination, as being key criteria.

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

As markets evolve so will techniques for market manipulation. In identifying and preventing such behaviour we think the most effective approach is encouraging transparency across the market. In this regard, we welcome the introduction of REMIT and the current review of MAD. It is important that regulators have the appropriate tools and powers at their disposal and are resourced by staff familiar with these markets.

***Harmonisation of long-term (forward) capacity allocation rules***

**Questions regarding the wish-list**

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

We agree with the points in this wish-list.

**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)?**

We believe the auctioning of products should be harmonised across the EU. Where market coupling has been introduced (e.g. between Germany, France, Belgium and the Netherlands) auctions are not held on a daily basis on these borders. However, on other borders (e.g. between France and Spain, and between France and Italy), the auctions are held on a daily and monthly basis. We appreciate that this discrepancy may be dependent on implementation of market coupling, with the intention to introduce a harmonised approach following coupling. However, we would underline the need for all borders ultimately to have the same auction process for simplification.

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

We do not believe there are any elements of auction rules which are unique to regions and countries and so cannot be harmonised. There is, today, already a significant level of

harmonisation e.g. all trading is in mega watts, frequency and methods for connecting to the grid are the same.

**9. Which aspects should be harmonised in binding codes?**

In line with our response to question 8, we believe harmonisation on a broad basis should be possible.

**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 key obstacle would arise where a network user is only permitted to use a PTR on one side of a border and a FTR on the other side as this requires management of two different risk types: financial and physical. Where a network user is long in physical capacity on one side, the user would need to enter a financial trade to become short in financial capacity on the other. However, after completing such a trade the user would still hold physical risk which they would then need to sell in order to have a flat position. In summary, users need to double up their transactions on both sides of the border where they must hold FTRs on one side and PTRs on the other. To manage their physical and financial exposures, market participants need robust risk management systems to manage the complexity.

### **3.2 Questions regarding potential additional requirements**

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

We do not believe it would be advantageous to move from holding auctions sequentially to holding auctions simultaneously at either side of a border /cable. With sequential auctions, the first auction can be a helpful price indicator to the market regarding volume of interest in buying capacity for the second auction. Moving to a simultaneous model would remove this signal on market sentiment, thereby potentially decreasing transparency.

**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?**

We consider it to be extremely important that the capacity calculations for long-term and short-term capacity are consistent so that it is transparent to the market how pricing is determined in auctions. Equally, capacity should be interdependent and optimised to enable power to flow freely to where it is needed.

### **Products**

**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?**

We believe it is important that there is a diversity of products available with different delivery periods across all zones. As we note above under question 4, we believe further multi-year products should be introduced as currently periods are limited to buying capacity monthly and yearly. The benefits of more regular auctions would be better risk

management through more precise hedging of risks which, in term, would enable market participants to optimise their portfolios.

**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?**

There should be a reasonable amount of volume for each auction with the splitting of available interconnection capacity weighted slightly in favour of monthly and quarterly products. The upfront cost outlay for market participants is less for shorter timeframes and consequently, the ability to purchase products with shorter timeframes will constitute less of a barrier to entry for market participants.

**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?**

Yes, we firmly believe products with planned unavailability should be retained as they allow more capacity to be auctioned and provide fairer pricing as participants know when there is an outage on a cable. To improve these products, ideally the unavailability period should be forecast as accurately as possible to provide participants with a high level of certainty; however, we acknowledge the difficulty of providing complete certainty, given unplanned issues with physical electricity cables will occur. We would also propose, as a further improvement to these products, that where unavailability occurs compensation is relayed more quickly to participants. Currently, compensation is paid at the end of the month: we would support it being paid daily to minimise the impact on firms.

**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?**

The availability of products for specific hours should be driven by market demand in the intra-day market. Without a liquid intra-day market in all countries we do not believe it is feasible to offer such products.

## **Secondary market**

**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?**

Yes we believe the possibility of TSOs being able to buy back long term capacity when they anticipate an issue with the grid should be investigated. Safeguarding security of supply is key and providing TSOs with this power would constitute an important measure in managing grid stability. However, in organising the buyback it is critical to manage the tension between:

- providing market participants with certainty in respect of their rights so there are clear parameters regarding when and how buybacks will be conducted: if participants risked, sudden selling of capacity they held, this would reduce their willingness to enter the market; and
- ensuring TSOs pay a fair price given the broader social context of ensuring energy availability.

We believe one option worth considering would be for participants to participate in buybacks through submitting sealed bids. Such a process should be overseen by NRAs and circumscribed by transparent regulations.

## **Nomination**

- 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?**

The removal of the nomination process with the move to FTR options would not constitute an issue for JP Morgan.

- 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?**

We do not believe a move from PTRs with UIOSIs to FTRs would impact our long-term hedging because we participate in both financial and physical markets.

- 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?**

Yes, we strongly support harmonisation of the nomination rules across all borders and consistency should be sought on both contractual and technical aspects. With respect to how important is harmonisation for our commercial operation, it would contribute to simplifying our operations and increasing efficiency.

## **Auction platforms**

- 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?**

We do not believe there are substantial differences between the various auction platforms as their operations on a day-to-day basis are similar. As a general point, we believe the services could be enhanced by auctions platforms being required to automatically inform participants when an auction will take place, e.g. via email, where participants have signed up for such alerts.

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

- **How do you see the management of a transitional phase from regional platforms to the single EU platform?**
- **Should current regional platforms merge via a voluntary process or should a procurement procedure be organised at European Union level (and by whom)?**
- **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?**

The single auction platform should be introduced on a phased basis by regions. Given that CASC.EU has a proven track record and is used by a large part of the industry, we believe the simplest approach would be to add countries and platforms, on a staggered basis, to CASC.EU.

Ideally regional platforms should merge via a voluntary process and we note there are already discussions for Spain, Portugal and the Nordic countries to join CASC.EU, indicating this is a possibility. However, this should be undertaken in consultation with the NRAs and ACER so that if the voluntary process does not result in delivering a single EU platform, they can implement an alternative solution.

We believe 2014 should be set as the deadline for at least defining the plan for full integration, to bring it in line with the intended completion date for the Internal Electricity Market (IEM). The roll out and testing of the single platform could be conducted after this date, but still within a timeframe sufficiently challenging.