“16th Baltic electricity market mini-forum“

Planning and execution of the Baltic common electricity market. First conclusions

Andres Tropp
Eesti Energia AS

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Issues of concern to be presented

1. Transition to fully implicit auctioning

   - Methodology for measuring congestion on Estonian-Latvian border
   - Compliance with EU requirements

2. Lack of liquid financial electricity market instruments

3. The results achieved so far

4. The need for ensuring the level playing field in the market place

5. Conclusions

Transition to fully implicit auctioning (1)

Methodology for measuring congestion on Estonian-Latvian border

- Transition to fully implicit auctioning was made on the basis of assumption that there is no (or very little) congestion between Estonia and Latvia

- Previous results of implicit auctionings for Elspot (day-ahead) market have shown very significant price differences between Estonia and Latvia, which implies on significant congestion (on direction from Estonia to Latvia):

Implicit auctioning:	**Estonian TSO:**
18.06.12 – 07.07.2013: **21,5%**	less than **3%**
July 2013: **51,7%**	**12%**
August 2013: **49,5%**	**8,7%**
September 2013: **67,2%**	**not published**
October 2013: **81,3%**	**not published**

- Estonian TSO measures congestion on the basis of net physical trading flows. Regardless of the results of implicit auctioning TSO has remained confident that there is no (or very little) congestion between Estonia and Latvia. It admits that congestion may emerge after Estlink2 will become operational. This is wrong assumption.

Transition to fully implicit auctioning (2)

- Having scrutinized the results, which Estonian TSO has obtained on the basis of its methodology, Eesti Energia has come to the conclusion that Estonian TSO basically neglects the very existance of the main (day-ahead) market place

- Meaning, regardless of the size of price difference (congestion) in Elspot (day-ahead) market, if intraday off-the-market delivery* from Latvia to Estonia (against congestion) in size of at least 0,1 MWh is made then no congestion is registered for respective trading hour by Estonian TSO

*During 75% of trading hours intraday off-the-market deliveries have been made from Latvia to Estonia since 3rd of June 2013. Mostly in size of less than 10 MWh/h

Conclusions:

1. there is significant congestion between Estonia and Latvia in day-ahead timeframe where market prices are defined but the methodology used by TSO is inadequate and does not enable to reflect the actual situation
2. the decision to make transition to fully implicit auctioning was made on the basis of wrong assumption

Transition to fully implicit auctioning (3)

Compliance with EU requirements

- EC Regulation 714/2009 and FG on CACM foresee that the options for enabling risk hedging for cross border trading are:

    - physical transmission rights (PTR) with use-it-or-sell-it, or
    - financial transmission rights (FTR)

- Unless appropriate* cross-border financial hedging is offered in liquid financial markets on both sides of an interconnector

- None of those instruments are available in the Baltics

*In regions where forward financial electricity markets are well developed and shown their efficiency, all interconnection capacity may be allocated through implicit auctioning

Conclusion: requirements specified in the EC regulation were not met.
Transition to fully implicit auctioning was (and still is) in conflict with EC regulation.
Baltic market require immediate introduction of hedging instruments

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Lack of liquid financial electricity market instruments

- In the Baltic market more than 90% of electricity to retail customers is sold on the basis of annual or semi-annual fixed-price contracts. In order to keep offering such contracts market participants need liquid hedging instruments

- PTR, which will be offered on Estonian-Latvian border starting from 1.1.2014 is necessary for bringing the situation in compliance with the EC Regulation. Even if there will be credible evidence concerning the launch of FTR or EPAD combo starting from mid-2014, Eesti Energia, on the basis of EC Regulation expects that PTR will be offered on month-ahead and year-ahead basis

- Eesti Energia expects that transfer capacity which will be allocated for PTR will take into account current contractual obligations of market participants as foreseen by draft NC on CACM. In terms of Eesti Energia it means that at least 300 MW of transfer capacity should be allocated for PTR

Conclusion: Eesti Energia's future participation in the Baltic electricity market is fully dependet from the structure and liquidity of hedging instrunments which will be offered to the market participants. If TSOs shall offer mostly month-ahead insruments, we shall offer mostly monthly contracts to customers

The results achieved so far (1)

- The EU has set an objective of achieving a common EU energy market by liberalising the markets of Member States and coupling them. This objective was formed in order to achieve transparent, more effective and competitive market conditions, which would produce welfare gains for consumers

- Comparative statistics reflecting the dynamics in the Baltics is the following:

Average electricity prices during the period of:

	03.06.2012-31.10.2012	03.06.2013-31.10.2013
NPS Estonia:	**37,94 €/MWh**	**46,37 €/MWh**
NPS Latvia (ELE):	**42,44 €/MWh**	**56,48 €/MWh**
Price difference	**4,5 €/MWh**	**10,1 €/MWh**

Average transmission costs on Estonian-Latvian border

Explicit auctioning	**3,27 €/MWh**	
Implicit auctioning	**4,50 €/MWh**	**10,11 €/MWh**
Average costs	**4,04 €/MWh**	**10,11 €/MWh**

The results achieved so far (2)

- Coupling of Baltic electricity markets has resulted in significant damage to the previous level of market integration. The Baltic markets are drifting away from each other

- Due to very high and fluctuating price differences between Estonian and Latvian/Lithuanian spot-markets and the lack of price hedging instruments, the largest generator in the Baltic states, Eesti Energia, has stopped concluding new fixed-price contracts with Lavian and Lithuanian consumers

- The latter decision was taken because of losses in millions on euros which Eesti Energia has suffered due to transition to fully implicit auctioning without timely introduction of any price hedging instruments

- Eesti Energia will put forward a claim for damages against TSO(s)

Conclusions:

1. So far clear preference has been given to economic interests of TSOs, the aim of achieving greater overall welfare gains (lower prices) has been ignored
2. The situation requires immediate resolution

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The need for ensuring the level playing field

- There has been lately a discussion in Lithuania about blockage of Russian electricity imports and the need to ensure fair competition in the market place. Eesti Energia supports this debate strongly

- Since the 3rd of June 2013 Estonian and Nordic market participants have paid in average more than 10 €/MWh for crossing the border between Estonia and Latvia (price difference between Estonia and Latvia has been shared by TSOs)

- Russian imports are entering the Baltic market free of any charge, although there are significant price differences between Russian and Baltic power markets. So, basically they use our infrastructure but pay nothing for it

- By using differing cross-border transfer capacity allocation methods for the trading purposes, the Baltic TSOs are undermining the competitive position of Baltic generators

- **Conclusion**: the situation has been discussed in the Baltics for years but not resolved. Eesti Energia will focus on this issue next year and seek assistance from EU authorities

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Conclusions

- Current conflicts with the EC Regulation should be resolved immediately:
- TSO(s) should start using adequate methodology for measuring congestion, which would enable to provide efficient economic signals to market participants and TSOs involved, as foreseen by EC Regulation
- By introducing hedging instruments Baltis TSOs and NRAs are shaping the future structure of the contracts which market participants can offer to customers
- While assessing the measures focus shall be on overall greater welfare gains
- Current energy sector investment climate in the Baltics is bad. It will remain so until level playing field is ensured
- The Baltic NRAs should significantly strengthen their surveillance of the market activities (including activities of TSOs) and react quickly on issues of concern

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