

Invitation to respond to the survey regarding products for the hedging of the cross-border electricity trade risks on the borders within the Baltic countries

From 2010 the Baltic transmission system operators (TSOs) Elering AS (Elering) and AS "Augstsprieguma tīkls" (AST) started to provide electricity market participants (Market Participants) with the Estonia-Latvia cross-border congestion risk hedging instruments – initially auctioning physical transmission rights (PTR) and from 1st of January 2014 AST and Elering are auctioning the new product - Limited-Physical Transmission Rights (PTR-limited). This is a temporary solution until the financial market operator - Nasdaq OMX launches their forward financial risk hedging products in Latvia and in Lithuania. Now the Baltic TSOs would like to move forwards and analyse possibilities to introduce and expand to the Market electricity trade forward financial risk hedging products.

To take next step towards Nordic – Baltic integrated regional market the Baltic TSOs – AST, Elering and Litgrid AB (Litgrid) jointly would like to carry out survey on the Market participants interest in products hedging the cross-border electricity trade risks, recognizing that after the Estlink 2 (DC link between Estonia and Finland) is in operation, the demand for capacity at the Estonian – Latvian border is higher than the available capacity. In the meantime TSOs will continue discussions together with National Regulatory Authorities (NRAs) to follow the agreed actions in BEMIP Action Plan (Baltic Electricity Market Integration Project) by implementing them in most efficient way.

To find the common ground for the most appropriate solution the Baltic TSOs – Elering, AST and Litgrid invite all interested parties to provide their constructive and comprehensive answers to the survey, which is attached as separate document to this letter.

We are waiting for your answers to the Survey by 30.05.2014, 23:00, CET to the email address: Aigars.Silis@ast.lv or send them to the contact address – AS "Augstsprieguma tīkls", Dārziema Str. 86, Rīga, LV-1073 for the attentions to Mr. Aigars Sīlis, Market Analysis Specialist, Electricity Market Monitoring and Market Development Department.

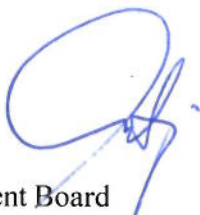
Sincerely yours,

On behalf of Baltic TSOs

Jānis Osītis

Member of the Management Board

AS "Augstsprieguma tīkls"



Survey document

Invitation to respond to the survey regarding products for the hedging of cross-border electricity trade risks on the borders within the Baltic countries

This survey document is issued in the context of the efforts of the Baltic TSOs to make the electricity markets to work more efficiently. This survey's questions aim at identifying, which forward risk-hedging products are best suited for the Market Participants with the considerations of the provisions of the forthcoming European Transmission System Network Codes (particularly NC on Forward Capacity Allocation) as well as implementation of other products on the market.

This document is issued for survey to all interested stakeholders, who are invited to submit their comments by:

30.05.2014

23:00 (CET)

by sending them to the following e-mail address:

Aigars.Silis@ast.lv

or to be delivered by post to the following address: AS "Augstsprieguma tīkls", Dārzciema Str. 86, Rīga, LV-1073 for the attentions to Mr. Aigars Sīlis, Market Analysis Specialist, Electricity Market Monitoring and Market Development Department.

It contains a number of specific questions for the survey. Stakeholders are invited to address the issues raised in the questions, as well as provide any other comment which they might have on the survey and the questions.

Please provide your **written answers in English in a separate survey response letter** and include the following contact information:

Name
Company
Address
Contact e-mail
Phone
Country

Should you need further information with regard to the survey, please contact Aigars Sīlis (aigars.silis@ast.lv).

Note regarding confidentiality: Unless explicitly claimed (indicated) in the survey document (answer sheet) by the respective survey participant, individual feedback information indicated by the survey participant in the survey document shall not be considered as confidential. We advise survey participants to claim confidentiality only on commercially sensitive information. The individual feedback information in the survey document, which is claimed by the survey participant as confidential, shall be used for the Baltic TSOs' common internal purpose only and might be disclosed only to the Baltic national regulatory authorities if such request would be made by them. Irrespective of confidentiality status of the individual feedback information indicated in the survey document, the Baltic TSOs retain rights to disclose/make public results of the survey (the results of the feedback information provided by survey participants) in a consolidated form without identifying names of the survey participants.

Related documents:

- The principles for organizing the auctions of physical transmission rights on Estonian – Latvian border are laid out in the document PTR-Limited Auction Rules:
http://elering.ee/public/Elektriturg/Voimsusoksjon/Limited_PTR_Auction_Rulebook_2014.pdf
- Draft Network Code on Capacity Allocation and Congestion Management (CACM): <https://www.entsoe.eu/major-projects/network-code-development/capacity-allocation-and-congestion-management/>
- Draft Network Code on Forward Capacity Allocation (FCA): https://www.entsoe.eu/fileadmin/user_upload/library/resources/FCA_NC/140402_NC_FCA_Resubmission.pdf
- Regulation (EC) No 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:211:0015:0035:EN:PDF>
- Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:211:0055:0093:EN:PDF>
- Description of the Nasdaq OMX Commodities product – EPAD: <http://www.nasdaqomx.com/transactions/markets/commodities/markets/products/power/epads>

I Introduction

Pursuant to Regulation (EC) No 714/2009 of 13 July 2009, network congestion problem shall be addressed with non-discriminatory market-based solution, which gives efficient economic signal to the electricity market participants (Market Participants) and transmission system operators (TSOs) involved. Network congestion problem shall preferentially be solved with non-transaction based methods, i.e. methods that do not involve a selection between the contracts of individual Market Participants.

The Baltic TSOs - AST, Elering and Litgrid would like to carry out survey on the Market Participants interest in products hedging of the cross-border electricity trade risks.

The goal of the survey is to find the most appropriate forward risk hedging product for the mitigation of the cross-border electricity trade risks for the Baltic Market Participants.

II Background

The demand for the power transmission capacity on the Estonia – Latvia border is higher than the transmission capacity which respectively can be made available by the TSOs - AST and Elering on the interconnector. Since the Estlink 2 (DC link between Estonia and Finland) is in operation, the demand for capacity at the Estonian – Latvian border is even higher than the available capacity and it can be expected that with the opening of new connection between Lithuania and Sweden, lack of capacity may appear also on other interconnection within Baltics or on border with neighbouring countries of Baltic within EU. This creates risks for the Market Participants for their power trading activities and hamper functioning and development of the liberalised power market.

Since January 1st, 2014 AST and Elering jointly introduced long term power transmission capacity yearly and monthly auctioning of Limited Physical Transmission Rights (PTR-limited) on the Estonian-Latvian cross-border on direction from Estonia to Latvia as a temporary solution. When introducing the PTR-limited product on Estonian-Latvian border it was agreed that this will be a temporary solution and will be effective only for 2014 until Nasdaq OMX financial risk hedging products will be introduced in Latvian and Lithuanian bidding areas.

Since November 2012 Market Participants can buy financial risk hedging products for the Estonia market – EPAD (previously known as CfD) Tallinn, which are traded via Nasdaq OMX trading platform. With Lithuania (in 18 June 2012) and Latvia (in 3 June 2013) joining the NPS power exchange the relevance for electricity trade forward financial risk hedging products is increasing also in the bidding areas of Latvia and Lithuania. Therefore the Baltic TSOs together with the Nasdaq OMX are considering launching forward financial risk hedging products designed by Nasdaq

OMX also in these bidding areas. Namely, there is intention to launch EPAD and EPAD COMBO (new product derived from EPAD) on the Baltic power trading market.

For more detailed information on electricity trade forward financial risk-hedging products analysed under this survey please see the appendix “Description of the electricity trade forward risk-hedging products” at the end of the survey.

III Questions

For the consideration of inviting to Market potential new forward risk-hedging product in transparent, non-discrimination and coordinated way the Baltic TSOs invite to provide the answers and comments to the below mentioned questions.

1. General questions:
 - 1.1. Are you trading electricity in more than one Baltic country?
 - 1.2. Are you trading electricity also outside Baltic countries?
 - 1.3. What kind of risk hedging product for electricity trade you are using now?
 - 1.4. Are you interested in risk hedging product for the cross-border electricity trade in the Baltic market?
 - 1.5. Are you participating in power trade between Baltic countries?
 - 1.6. Are you planning to participate in power trade between Baltic countries?

2. Question related to the PTR-limited auctions with sellback obligation:
 - 2.1. Are you participating in the PTR-limited auctions?
 - 2.2. Are you planning to participate (continue participating) in the PTR-limited auctions? If no, please specify reasons why?
 - 2.3. Are you satisfied with the risk-hedging opportunities offered by PTR-limited? If no, please specify reasons why?
 - 2.4. What improvements or modifications do you think would be required to make the product more attractive for your electricity trading business?
 - 2.5. What timeframe for the auctioned interconnection capacity delivery period is important for your electricity trading business – monthly and/or seasonal and/or annual?
 - 2.6. What would be your preferred splitting in percentage (%) of provided for auction interconnection capacity between the different timeframe?

3. Question related to the Electricity Price Area Differentials (EPAD):
 - 3.1. Do you have experience with EPAD product or similar types of products (if yes, please, specify the product)?
 - 3.2. Are you familiar with EPAD product and do you have the understanding of how the EPAD product works?

- 3.3. Do you have interest in EPAD product if it would be introduced in Latvian and/or Lithuanian bidding area?
 - 3.4. If you have interest in EPAD product, when (from summer 2014, from autumn 2014 or from 2015) would you like to have EPAD introduced in the Latvian and/or Lithuanian bidding area?
 - 3.5. Would you be interested and ready to become a market maker (*Market maker is Exchange Member who has entered into an agreement with the Exchange, and agrees to quote bids and ask prices in the secondary market*) for EPAD Latvian and/or Lithuania bidding area if commitment from Market Participants is required?
4. Question related to the EPAD COMBO:
- 4.1. Are you familiar about differences between EPAD and EPAD COMBO?
 - 4.2. Do you have interest in EPAD COMBO product if it would be introduced in the Baltic market?
 - 4.3. If you have interest in EPAD COMBO product, when (from summer 2014, from autumn 2014 or from 2015) would you like to have EPAD COMBO introduced in the Baltic market?
 - 4.4. What timeframe for the delivery period would you like to have for the EPAD COMBO product (monthly and/or seasonal and/or annual)?
 - 4.5. What would be your preferred splitting in percentage (%) of provided for auction interconnection capacity between the different timeframe for EPAD COMBO?

Thank You for your time and answers to the survey questions!

Appendix

Description of the electricity trade forward risk-hedging products

1. PTR-limited

In accordance with the Estonian and the Latvian TSOs' agreement on the PTR-limited auction, Elering provides the auction office service and allocates fixed available transfer capacity to auction participants. TSOs mutually determine amount of the transmission capacity in the form of PTR-limited available for auctions. The available transmission capacity in the form of PTR-limited is auctioned on monthly and yearly basis. The auction price for the auctioned capacity in the form of PTR-limited is determined in the auction in the result of the submitted bids. Participants are informed on the TSOs website of the auctioned available transmission capacities at the Estonia-Latvia border in direction from Estonia to Latvia for the yearly (50MW) and monthly (50MW-150MW) auction and the price floor (minimum price). The auctioned capacity in the form of PTR-limited does not at any time give a right to the participant to use the auctioned capacity for physical transfer of the electricity. The auctioned capacity in the form of PTR-limited is conditioned with the sellback obligation, according to which the auctioned capacity is automatically transferred by TSOs to NPS for the day-ahead power trade and participant receives from the TSO compensation – a sellback price. The sellback price is equal to the electricity (hourly) price difference between the Estonian and Latvian bidding areas of NPS day-ahead trade platform in the direction Estonia → Latvia during the respective auction period (respective month or year). The settlement of the payment is executed in the form of off-set of payments:

- TSOs have to pay the participant the difference between the auction price and (hourly) price difference of the Estonia – Latvia bidding areas, if the (hourly) price difference of the Estonian – Latvian bidding areas is higher than the auction price; or
- The participant has to pay to the TSOs the (hourly) difference between the price difference of Estonia-Latvia bidding areas and the auction price, if the auction price is higher than the (hourly) price difference of the Estonia – Latvia bidding areas; or
- The participant has to pay to the TSOs the whole auction price, if the congestion on the border was 0 (zero) and therefore the (hourly) price difference of the Estonian – Latvian bidding areas was 0 (zero).

Settlements of the auction are made each month.

2 EPAD (Electricity Price Area Differential (*earlier called CfD (Contract for Difference)*))

Electricity Price Area Differential (EPAD) is a forward contract with reference to the difference between the area price and the NPS Nordic system price. EPAD

hedges area price risk. The market price of an EPAD during the trading period reflects the market's prediction of the price difference during the delivery period. The reference price for Nordic DS Future (Deferred Settlement Future) and futures contracts is the NPS Nordic system price. Actual physical delivery purchase costs are determined by actual area prices. EPAD allows members on the exchange to hedge against their area price risk using the Nordic DS Future and the EPAD. EPAD is a purely financial settled product (no physical delivery) and tradable on the secondary market on NASDAQ OMX between a seller and a buyer. TSO is not involved in the trading of this product. The amount of EPAD contracts in the secondary market is not limited to the physical transmission capacity.

3. EPAD COMBO (a derivation product from Electricity Price Area Differential)

EPAD COMBO is Nasdaq OMX new under development product and the Baltic States potentially might be the first market where the EPAD COMBO could be implemented. Before introducing EPAD COMBO the EPAD must be available on both sides of the interconnector. EPAD COMBO hedges cross border trading risk.

A general difference between EPAD and EPAD COMBO is how the products are structured and sold on the market. EPAD is used for one area price risk hedging, but EPAD COMBO for cross border trade risk hedging between two price areas by selling and buying two EPADs at the same time. The initiator of the auction is TSO, who provides EPAD COMBO product (EPAD on both sides of the interconnector) for the auction in primary market. During the auction the EPADs in both sides are traded as a COMBO by the Market Participants in the auction platform managed by Nasdaq OMX. The EPAD COMBO market is defined as a secondary market for the auctioned EPAD COMBO. TSOs are not involved in the secondary trading market of EPAD COMBOs.