

# Preface

Efficient operation and optimal expansion of the transmission network system are some of the most complex and challenging issues that we are faced with in operational market and regulatory policy design for liberalised electricity markets. Financial transmission rights (FTRs) – the theme of this book – represent an interesting and welcome addition to the “box of tools” of market-based, regulatory instruments and mechanisms for effective network operation and regulation.

The actual, real-world situation in most liberalised electricity markets is characterised with insufficient investment in the transmission network, resulting in binding capacity constraints, network congestion, and welfare losses to society, compared to an optimal expansion path. Inadequate operational rules for the handling of such constraints have added to the failure of the regulatory system to effectively cope with network issues of a long-term as well as a short-term nature.

The ambition of the editors of the book – Juan Rosellón and Tarjei Kristiansen – has been to produce a book that can be “an accessible source to researchers and professionals working with financial transmission rights (FTRs) and electricity market regulation”. I think that they have admirably succeeded in their objective and task. The collection of chapters presents an up-to-date survey and stocktaking of FTRs as a regulatory policy instrument, with a well-balanced blend of theoretical and practical contributions. The editors should also be credited for not overstating the case for FTRs in electricity market and network regulation, pointing to some of their weaknesses and limitations, e.g. in relation to optimal transmission investment, and emphasising the need for coordinating the use of FTRs with other regulatory instruments to achieve stated policy objectives.

A fundamental question in electricity market design is to what extent market transactions and price formation in electricity markets should be separated from considerations of transmission constraints and network congestion issues. I think there are strong arguments for adopting a two-step procedure: first, establishing prices in efficiently functioning electricity markets and, then, solving the network problems that this market allocation may create, rather than in one simultaneous operation. In particular, if transmission network and transmission system operation

issues are allowed unduly to set the agenda for market operations, we may end up with an imperfectly functioning market system as a totality.

In such a perspective, FTRs may be considered as a bridging or “intermediary” instrument between the market and network parts of the system. The primary role of FTRs, as I see it, at least at this stage of development of market design, is to function as a transmission congestion risk hedging instrument, comparable to the role that financial derivatives play as hedging instruments on the market side. To further develop and introduce FTRs in this capacity should be a regulatory policy priority. Further research and refinement seem to be needed before FTRs can be introduced effectively as an instrument for transmission network investment, for mitigating market power, and for dealing with other regulatory issues and challenges arising in a liberalised electricity market system. The book also gives well-founded guidance and direction for such research and refinement.

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Financial Transmission Rights  
Analysis, Experiences and Prospects  
Rosellón, J.; Kristiansen, T. (Eds.)  
2013, XXX, 418 p., Hardcover  
ISBN: 978-1-4471-4786-2