

ACM consultation on the Core TSOs' methodology proposal for a market-based allocation process of cross-zonal capacity for the exchange of balancing capacity or sharing of reserves**EFET response – 17 February 2020**

The European Federation of Energy Traders (EFET) thanks ACM for this opportunity to provide comments on the CORE TSOs' final proposal of market-based methodology of cross-zonal capacity allocation for the exchange of balancing capacity or sharing of reserves, in accordance with article 41 of the Electricity Balancing Guideline (EB GL).

We have carefully scrutinised the differences between the initial version of the TSOs' text, open to consultation back in September 2019, and the final version submitted to NRAs in December. We have also read the TSOs post-consultation report, including their statements and/or justifications in reaction to our and other stakeholder comments to their initial text. Despite some improvements in the methodology proposal, we remain concerned about quite a number of elements in the final text. You will find more details about this and amendment suggestions below. These rely in large parts on our response to the initial consultation of the TSOs on this methodology¹.

General comments on capacity reservation by the TSOs for balancing purposes:

Since the early stage of drafting of the Electricity Balancing network code, we have opposed the concept of reservation of cross-border transmission capacity by the TSOs for balancing purposes. Though by the time of the adoption of the EB GL, the concept was rebranded as "cross-zonal allocation of capacity", its effects remain the same.

The cross-border reservation of transmission capacity by the TSOs for balancing purposes poses a serious risk to the availability of cross-border transmission capacity in the preceding trading timeframes. By allocating transmission capacity specifically for use in the balancing timeframe, TSOs remove available capacity from the allocation in

¹ EFET response to the CORE TSOs consultation on a market-based method for the reservation of cross-zonal capacity for balancing purposes, dated 22 October 2019 and available at:
https://efet.org/Files/Documents/EFET_EBGL_Art41_CCR%20CORE_21102019.pdf.

the other timeframes, thereby restricting market participants' ability to adjust their positions across borders in the most economically efficient manner, and to contribute to overall system balance.

The use of cross-border transmission capacity is a key element of European market integration in the forward, day-ahead and intraday timeframes. A major objective of integration projects such as the EU Harmonised Allocation Rules for forward transmission rights, as well as single day-ahead and intraday coupling are to improve the access and use of such transmission capacity by the market. Reserving capacity (from the forward timeframe until the intraday market) for use by the TSOs in the balancing timeframe would turn the clock back on those improvements.

General comments on the so-called “market-based” method for capacity reservation by the TSOs for balancing purposes:

First, the so-called “market-based” method for capacity reservation by the TSOs for balancing purposes is based on a tool optimising actual balancing capacity bids with forecasted day-ahead bids. The allocation process is based on the forecasted market value of cross-zonal capacity for energy bids. The comparison with the actual value of balancing capacity bids is therefore reliant on estimations made by TSOs based on values from the past and not for the delivery day under consideration. We therefore consider that the “market-based” designation chosen for this cross-zonal capacity reservation process is incorrect. While this process reduces complexity, notably in terms of the functioning of the Euphemia algorithm, compared to the co-optimisation method according to article 40 EB GL, it is based on a fundamental uncertainty as to the value of cross-zonal capacity in the day-ahead market. Changes in the bidding behaviour of market participants compared to what the TSOs have modelled or are expecting should not be underestimated. Besides, ignoring the intraday market in the cross-zonal capacity reservation process, in practice, forecloses opportunities for market participants to adjust their positions in intraday across borders and will lead to changes in the bidding process.

Second, the methodology for calculating the market value of cross-zonal capacity reserved for the exchange of balancing energy or sharing of reserves in the current proposal relies on the selection of “reference periods” and possible “adjustment factors”. Neither of the two components is specified further. We therefore strongly doubt that the current proposal is in line with Article 41.1(b) of the EBGL that explicitly requests a “detailed description on how to determine [...] the forecasted market value of cross-zonal capacity for the exchange of energy”. Referring to concepts of “reference periods” and “adjustment factors” and postponing the definition of such elements to the balancing capacity cooperation (BCC) proposals is insufficient.

Third, in the context of the implementation of article 16 of the recast Electricity Regulation approved as part of the Clean Energy Package (Regulation (EU) 2019/943), the TSOs will need to allocate to the market a minimum of 70% transmission capacity respecting operational security limits after deduction of contingencies. As the transmission capacity reserved by the TSOs through the “market-based” allocation process would be used by the TSOs themselves for the exchange of balancing capacity or the sharing of reserves, we would welcome a clear statement by the TSOs that this capacity will not be counted within the minimum 70% threshold.

Fourth, the CORE region is to transition to the Flow-Based Day-Ahead Market Coupling (FBDA) by December 2020. In FBDA, network constraints are related to firm energy net positions, as some flows are necessary to ensure secure grid conditions. However, since there is no certainty about the activation of the procured balancing capacities, their impact on energy net positions is unknown. Given that article 33.7 EB GL forbids that reliability margins are increased to accommodate the uncertainty linked to the activation or non-activation of the contracted reserves (FRR or RR), we do not see how the “market-based” process could be applied in a FBDA environment.

Finally, article 38.8 of the EB GL requires a regular assessment of the need to reserve capacity for balancing purposes. In line with the spirit of this article, we would have expected a thorough assessment of the need to reserve cross-zonal capacity for balancing purposes in the CORE region. There was, however, no real discussion or presentation by the CORE TSOs of the need, benefits and drawbacks of cross-zonal capacity reservation for balancing purposes in general, let alone on the so-called “market-based” approach for such reservation. To date, we remain unconvinced of the necessity of such a market design feature. Contrary to the methodology on capacity reservation for balancing through co-optimisation according to article 40 EB GL, the development of the present methodology for a “market-based” cross-zonal capacity allocation for the exchange of balancing capacity or sharing of reserves proposal according to article 41 EB GL is not an obligatory requirement. Given the overall lack of justification for cross-zonal capacity reservation for balancing purposes, and the missing impact assessment regarding the effects of a so-called “market-based” cross-zonal capacity allocation for the exchange of balancing capacity or sharing of reserves in particular, **we invite ACM, along other individual CORE TSOs and NRAs, to refrain from implementing this cross-border capacity reservation process, or any of the two others foreseen by the EB GL (co-optimisation under article 40, and the so-called “economic efficiency” allocation method under article 42).**

Comments on individual articles:

- *Recital 1.a: [...] The MB CZCA methodology facilitates the objective for the integration of the balancing markets and for promoting the possibilities for the exchanges of balancing services while using market-based mechanisms and contributing to operational security as stated in article 3(1)(c) and article 3(2)(d) of the EBGL by means of a clear harmonised process description for the procurement of balancing capacity across border as detailed in Article 5 of this MB CZCA methodology, make explicit rules on respecting day-ahead markets as detailed in Article 6,7,8 and 9 of this MB CZCA methodology. [...]*

We challenge the assertion of the TSOs that cross-zonal capacity reservation in general, and this methodology for a “market-based” method of cross-zonal capacity reservation, would not compromise the efficiency of the day-ahead market (article 3.2.e EB GL). By allocating transmission capacity specifically for use in the balancing timeframe, TSOs remove available capacity from the allocation in the other timeframes, thereby restricting market participants’ ability to adjust their positions across borders in the most economically efficient manner, and to contribute to overall system balance.

In addition, article 3.1.d of the EB GL also foresees that the implementation of the Guideline should facilitate “the efficient and consistent functioning of day-ahead, intraday and balancing markets”. Besides the fact that cross-zonal capacity reservation by the TSOs removes available capacity from the market – i.e. opportunities to trade and hedge across borders – it also fails to take account of the value of that capacity in the intraday timeframe. Ignoring the intraday market, in practice, forecloses opportunities for market participants to adjust their positions in intraday across borders.

The TSOs have not provided evidence that the present methodology would not actually violate the principles of articles 3.1.d and 3.2.e EB GL. The change of wording between the initial version of the text (“ensuring the development of DA markets”) and the final version (“respecting DA markets”) further weakens the commitment of TSOs that future BCCs would be in line with article 3 EB GL.

- **Article 3.2:** *The Core TSOs that want to establish a BCC in accordance with this MB CZCA methodology, shall publish on the ENTSO-E website the expected costs and benefits of such a BCC.*

We welcome the improvements included by the CORE TSOs in the final methodology proposal. Indeed, article 3.2 now requires that TSOs that want to establish a BCC not only to carry out a cost-benefit analysis (CBA) and share it with the other TSOs of the CORE region, but also to publish it on the ENTSO-E website so that it becomes available to all CORE NRAs and market participants.

However, we’re still missing a number of other requirements to ensure the proper use of the CBA:

- the decision to establish a BCC shall be excluded unless the CBA is positive
- the relevant NRAs’ decision to approve or not a BCC shall take account of the results of the CBA

In addition, we miss in this methodology the regular assessment to be performed by TSOs with regard to the continued necessity or not of a BCC according to article 38.8 EB GL. While TSOs in the consultation report mention that this is included in other parts of the methodology, we see nowhere an explicit requirement for a regular reassessment of the costs and benefits of an established BCC. This provision is actually included in the CORE TSOs’ draft methodology for the “economic efficiency” method of cross-zonal capacity reservation for balancing, at the article 3.8 of that methodology. We would like to see a similar provision (complemented with a precise timing for the regularity of the checks – yearly – and an obligation to disclose these assessments on the ENTSO-E website).

- **Article 4.1:** *In addition to the notification process as referenced to in Article 1.4 of this MB CZCA methodology, all Core TSOs of each BCC within the CCR Core applying this MB CZCA methodology shall inform the Core TSOs and market participants latest by 4 (four) months ahead of the application of this MB CZCA methodology forecast technique consisting of the use of reference periods and adjustment factors to determine the forecasted market value of CZC for the exchange of energy. Core TSOs may provide remarks not later than 3 (three) months ahead of the application. The BCC TSOs shall take the remarks by the Core TSOs properly into account.*

We welcome the clarification by the CORE TSOs that market participants will be informed four months in advance of the application of the MB CZCA, including the forecast technique, the use of reference periods and adjustment factors.

In the consultation report, the TSOs mention that they will consult stakeholders on the implementation of the MB CZCA for each specific BCC, but we do not see any such requirement in article 4. This should be added to article 4.1, in line with the stated intention of the TSOs.

- **Article 4.3:** *Each BCC of the CCR Core applying the MB CZCA methodology shall inform all stakeholders (e.g. NRAs, market participants) and Core TSOs through an online announcement via the ENTSO-e website, at least 1 (one) month prior to the first gate opening of the balancing capacity market. This information will include a detailed description of the BCC specifications: the type of product for balancing capacity exchanged or shared, the bidding zone borders, the market timeframe, the duration of application or the allocation of CZC and time for entering into operation. .*

We believe that one month is too short a timing for a proper preparation of market participants. Market participants need earlier and fully reliable information. We believe that a minimum three-month notice to market participants is necessary for appropriate preparation.

The Hansa TSOs, in their methodology proposal for the implementation of Article 41 EB GL in CCR Hansa, have foreseen a three-month notice to the market for the final BCC rules (see Article 12.5 of the Hansa TSOs final proposal for the implementation of Article 41 EB GL).

- **Article 5.2:** *The market-based allocation process to allocate CZC for the exchange of balancing capacity and/or sharing of reserves shall include the following steps [...]*

An additional requirement should be formulated stating that the calculation of the CZCA must not take longer than selecting bids without using a BCC, which should essentially be a few minutes (if not seconds). With sequential day-ahead procurement of FCR, aFRR and mFRR, market participants will be forced to prepare bids for subsequent markets in less than one hour already. Any additional delay in the

publication of accepted bids will certainly result in a loss of efficiency – which otherwise should be included in the CBA.

- **Article 6.1:** *The process to define the maximum volume of allocated CZC for the exchange of balancing capacity and/or sharing of reserves shall comply with article 41(2) of the EBGL.*

This paragraph rather states the obvious – the need for compliance with article 41.2 EB GL – than provide clarity on the process. We suggest deletion.

- **Article 6.2:** *The maximum volume limitations of allocated CZC for the exchange of balancing capacity and/or sharing or reserves for this MB CZCA Methodology shall be applicable for the combined allocation of all balancing capacity products on a certain bidding zone border and per direction.*

We welcome the clarification by TSOs that the 10% limit is applied over CZCA for all of the balancing products, not 10% for each of aFRR, mFRR and RR, possibly summing up to 30%.

- **Article 6.5:** *TSOs of each BCC of the CCR Core may apply additional lower limits besides the limitations of article 41(2) of the EBGL for the maximum volume of allocated CZC for the exchange of balancing capacity or sharing of reserves within their own BCC. The previous stated may also be initiated at the request of the relevant NRAs. The use of additional lower limits by each BCC for the maximum volume of allocated CZC for the exchange of balancing capacity or sharing of reserves shall be set out in the proposal according to Article 33(1) of the EBGL.*

We welcome the clarification by TSOs that individual BCCs can set only a lower threshold than the maximum 10% of available cross-zonal capacity referred to in article 41.2 EB GL.

- **Article 7.1:** *The forecasted market value of CZC for the exchange of energy between bidding zones shall be defined per MTU of SDAC and shall be calculated in accordance with article 39(5) of the EBGL.*

The article enshrines that the value of cross-zonal capacity is compared between the forecasted DA market value and the value of balancing capacity, without taking account of the value of that capacity in the intraday timeframe. Ignoring the intraday market, in practice, forecloses opportunities for market participants to adjust their positions in intraday across borders. This contradicts some of the most fundamental principles in the EB GL itself:

Recital 12 “The integration of balancing energy markets should facilitate the efficient functioning of the intraday market in order to provide the possibility for market participants to balance themselves as close as possible to real time.”

Article 3.2.e “When applying this Regulation, Member States, relevant regulatory authorities, and system operators shall ensure that the development of the forward, day-ahead and intraday markets is not compromised.”

Article 39.2 of the EBGL explicitly requests the inclusion of the intraday timeframe into the calculation of the market value for the exchange of energy “where relevant and possible”. Presumably, the relevance is undisputable and even though it is difficult to estimate the value contribution of the intraday timeframe, an estimate of zero is just as arbitrary as any other value but certainly wrong. Furthermore, the reasoning in the Explanatory Document that the traded volumes in the intraday timeframe are small compared to SDAC is questionable, particularly given that intraday trading volumes certainly exceed volumes exchanged for balancing.

- **Article 7.2:** *The forecasted market value of CZC for the exchange of energy between bidding zones shall be based on shadow prices of the corresponding hour of the relevant network elements of the reference period. It shall be calculated per MW as the change in total welfare surplus for the exchange of energy resulting from the incremental increase of CZC allocated for the exchange of energy. The forecasted market value of CZC for the exchange of energy is 0 EUR/MW if the market value of CZC for the exchange of balancing capacity or sharing of reserves is in the opposite direction of the congestion direction.*

Article 7.2 mentions the application of “reference periods” for the assessment of the forecasted market value of CZC. It is unclear how an “appropriate reference period” will be defined, especially when market participants will not be part of the consultation prior to the actual application of the methodology.

In addition, we strongly doubt that the reference to “reference periods” without further specification is in line with Article 41.1(b) EB GL that explicitly requests a “detailed description on how to determine [...] the forecasted market value of cross-zonal capacity for the exchange of energy”. Referring to the concept of “reference periods” and postponing the definition of such elements to the BCC proposals is insufficient.

- **Article 7.3:** *Adjustment factors may be applied in a BCC to improve the forecasted value of CZC for the exchange of energy between bidding zones. If adjustment factors are applied, this shall be included and justified in the methodology for the establishment of common and harmonized rules and processes for the exchange and procurement of balancing capacity according to article 33(1) of the EBGL.*

Article 7.3 mentions the application of “adjustment factors” that shall be included and justified in the “methodology for the establishment of common and harmonised rules and processes for the exchange and procurement of balancing capacity according to article 33.1 EB GL”. To us, the description of adjustment factors belongs to the MZ CZCA methodology and not to the one related to article 33.1 EB GL:

- The adjustment factors are inherent to the CZC allocation mechanism that is chosen rather than to the methodology defining the BCC.
- Moreover, the concept of sharing of reserves is not covered by the article 33.1

We strongly doubt that the reference to “adjustment factors” without further specification is in line with Article 41.1(b) EB GL that explicitly requests a “detailed description on how to determine [...] the forecasted market value of cross-zonal capacity for the exchange of energy”. Referring to the concept of “adjustment factors” and postponing the definition of such elements to the BCC proposals is insufficient.

- **Article 7.7:** *The Core TSOs of each BCC of the CCR Core applying this MB CZCA methodology shall monitor, demonstrate and publish on the ENTSO-E website the efficiency of the forecasting methodology, the appropriateness of used reference days and adjustment factors on at least a yearly basis, including a comparison of the forecasted and actual market values of the CZC for the exchange of energy and take appropriate actions in cooperation with the Core TSOs and respective NRAs, where needed.*

We welcome the addition of a publication requirement on the ENTSO-E website to ensure transparency towards NRAs and market participants. However, we believe that TSOs should also publish the forecasted market values themselves, on a continuous basis (with as little of a delay as possible) and not only an analysis of the efficiency of the forecasted market values as currently set out in this paragraph as well as Article 13.7.

- **Article 9.3:** *The objective for the allocation of CZC between SDAC and the exchange of balancing capacity or sharing of reserves shall be the maximisation of the expected total economic surplus for the sum of the expected exchange of energy and the exchange of balancing capacity or sharing of reserves.*

We understand the reasoning for this objective, but changes in the bidding behaviour of market participants compared to what the TSOs have modelled or are expecting should not be underestimated. This will require time to adapt and alignment with TSOs in order to design it.

As we mentioned in earlier points, ignoring the intraday market, in practice, forecloses opportunities for market participants to adjust their positions and will lead to changes in the bidding process.

- **Article 9.8:** *Competition on the allocation of CZC between different BCCs of the CCR Core for a certain BZB shall be approached based on a first-come first-serve principle. The efficiency of such an approach may be evaluated by Core TSOs. Appropriate measures shall be taken to optimise the total allocation of CZC within the CCR Core between different BCCs.*
- **Article 9.9:** *Competition on the allocation of CZC within a BCC of the CCR Core between different products for a certain BZB shall be based by default on a first-come first-serve principle. Each BCC of the CCR Core may deviate from this approach using the thresholds and margins proposed in Article 9.7.*

The two new paragraphs 8 and 9 of Article 9 introduce the concept of competition between BCCs in the CCR Core for a certain bidding zone border. Article 38.1 EB GL clearly states that TSOs need to choose between one of the three types of CZCA when wishing to implement a BCC at a specific bidding zone border. We hence assume that these two paragraphs refer to the competition of BCC for different balancing products (aFRR, mFRR or RR) at the same bidding zone border, not a competition between different types of BCC for the same product at that border. We invite the NRAs to include a clarification in that regard to Articles 9.8 and 9.9.

- **Article 13.3:** *Each Core TSO participating in a BCC shall publish information in accordance with article 12(3)(h) of the EBGL on the allocation of CZC for the exchange of balancing capacity or sharing of reserves pursuant to article 38(1)(a) of the EBGL as defined in Article 5(1)(a) of this MB CZCA methodology and no later than 6 (six) hours before the use of the allocated CZC.*

In the consultation report, TSOs mention that this process takes time, in order to justify that the CZCA be published at the latest six hours before the use of the capacity. However, we failed to see how results of the procurement process can be notified to users one hour after results are known, but not information on capacity allocation. If the cross-zonal capacity allocation process for the exchange of balancing energy or sharing of reserves is completed at the time of the balancing capacity procurement process in the case of the “market-based” approach, it is unclear why CORE TSOs participating in a BCC would wait to publish information on allocated cross-zonal capacity for the exchange of balancing energy / sharing of reserves only six hours before its use. There is a possible gap of up to one week between the publication of the two pieces of information.

For the sake of transparency, and as TSOs have not provided convincing justification for their proposal, we reiterate our request that information on capacity allocation be published together with the results of the capacity procurement process, according to the same timing as laid down in article 13.2.

- **Article 13.5:** *Subject to approval pursuant to article 18 of the EBGL, a Core TSO may withhold the publication of information on offered prices and volumes of balancing capacity or balancing energy bids if justified for reasons of market abuse concerns and if not detrimental to the effective functioning of the electricity markets. A Core TSO participating in a BCC shall report such withholdings at least once a year to the relevant regulatory authority in accordance with article 59 of Directive (EU) 2009/944 and pursuant to article 12(5) of the EBGL.*

It should never be the task of a TSO to decide whether market abuse has been committed, nor to restrict market design or disclosure of price sensitive information on the basis of a fear of such market abuse materialising.

- **Article 13.7:** *Core TSOs of each BCC applying the MB CZCA methodology shall publish the efficiency of the forecasted market value for the exchange of energy to their respective NRAs and market participants to analyse the forecast efficiency.*

We welcome the clarification that the information referred to in this paragraph will be made available to NRAs and market participants.

However, as mentioned in our remarks on Article 7.7, TSOs should also publish the forecasted market values themselves on a continuous basis (with as little of a delay as possible) and not only an analysis of the efficiency of the forecasted market values.