



## **Core TSOs' methodology proposal for an allocation process of cross-zonal capacity for the exchange of balancing capacity or sharing of reserves based on an economic efficiency analysis**



### **EFET response – 21 October 2019**

The European Federation of Energy Traders (EFET) welcomes the opportunity to provide comments on the CORE TSOs' proposal for an allocation process of cross-zonal capacity for the exchange of balancing capacity or sharing of reserves based on an economic efficiency analysis, in accordance with article 42 of the Electricity Balancing Guideline (EB GL).

#### **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 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 “economic efficiency” method for capacity reservation by the TSOs for balancing purposes:**

First, the so-called “economic efficiency” method for capacity reservation by the TSOs for balancing purposes is based on a tool optimising forecasted balancing capacity bids with forecasted day-ahead bids. 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 both the value of balancing capacity, and 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. Ignoring the intraday market, 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 42.1(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 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 “economic efficiency” 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

“economic efficiency” 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 an “economic efficiency” cross-zonal capacity allocation for the exchange of balancing capacity or sharing of reserves proposal according to article 42 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 “economic efficiency” cross-zonal capacity allocation for the exchange of balancing capacity or sharing of reserves in particular, **we invite CORE TSOs to withdraw their proposal altogether.**

Should CORE TSOs persist to issue this methodology, we invite 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 “market-based” allocation method under article 41).

#### **Comments on individual articles:**

- ***Recital 5.1.d:** The EE CZCA methodology ensures that the development of the day-ahead market is not compromised in accordance with article 3(2)(e) of the EBGL. It is specified in Articles 3 and 12 of this EE CZCA methodology, that not used CZC allocated to the exchange of balancing capacity or sharing of reserves shall be released for the exchange of balancing energy with shorter activation times or for operating the imbalance netting process according to article 38(9) of the EBGL.*

We challenge the assertion of the TSOs that cross-zonal capacity reservation in general, and this methodology for an “economic efficiency” 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.

- **Article 1.7:** *According to article 38(4) of the EBGL, CZC allocated for the exchange of balancing capacity or sharing of reserves shall be used by the BCC TSOs, exclusively for the product where it was allocated for, being aFRR, mFRR, or RR. If the CZC is not used for the product where it was allocated for, the CZC shall be used by all TSOs for the exchange of balancing energy with shorter activation times or for operating the imbalance netting process. The reliability margin calculated pursuant to CACMGL shall be used only for operating and exchanging frequency containment reserves, except on Direct Current ('DC') interconnectors for which CZC for operating and exchanging frequency containment reserves may also be allocated in accordance with article 38(1) of the EBGL.*

We welcome the clarification that cross-zonal capacity reserved for a specific product shall not be used for other processes, and that if the capacity is not used for this process, it shall be made available again for the exchange of balancing energy in processes with shorter timeframes, in accordance with articles 38.4 and 38.9 EB GL.

This paragraph is, however, partially repeated in article 3.10 and 11.2. Please make sure the text of the methodology does not reiterate the same rules multiple times.

- **Article 3.1:** *The Core TSOs that want to establish a BCC, shall share with Core TSOs the cost-benefit analysis of such a BCC.*

We welcome the requirement that TSOs that want to establish a balancing capacity cooperation (BCC) should carry out a cost-benefit analysis (CBA), to be shared with the other TSOs of the CORE region. However, we're missing a number of requirements to ensure the proper use of the CBA:

- the CBA shall also be distributed to CORE NRAs and market participants
- 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

- **Article 3.9:** *The Core TSOs shall regularly assess whether the CZC allocated for the exchange of balancing capacity or sharing of reserves is still needed for that purpose. If subsequent assessments show that CZC allocated for the exchange of balancing capacity or sharing of reserves is no longer needed for that purpose, it shall be returned in subsequent capacity allocation timeframes.*

We welcome this provision foreseeing a 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. We would nonetheless like to see it complemented with a precise requirement on the timing for the regularity of the check (article 38.8 EB GL requires at least a yearly assessment) and an obligation to disclose the assessments to the relevant NRAs and market participants.

- **Article 3.10:** *The CZC allocated for the exchange of balancing capacity or sharing of reserves that has not been used for the associated exchange of balancing energy, shall be released for the exchange of balancing energy with shorter activation times or for operating the imbalance netting process pursuant to article 38(9) of the EBGL.*

We welcome the clarification that cross-zonal capacity reserved for a specific product that was not used for this process shall be made available again for the exchange of balancing energy in processes with shorter timeframes, in accordance with article 38.9 EB GL.

This paragraph is, however, a partial repetition of articles 1.7 and 11.2. Please make sure the text of the methodology does not reiterate the same rules multiple times.

- **Article 3.11:** *Each BCC shall include fallback procedures and curtailment procedures on firmness regime of CZC in the implementation methodology of the BCC according to article 38 of the EBGL, commonly agreed by all Core TSOs of the CCR Core. .*

This paragraph refers to an “implementation methodology of the Balancing Capacity Cooperation” including fallback and curtailment procedures according to article 38 EB GL. However, article 38 EB GL does not mention this methodology. Please review the reference to the correct EB GL article.

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

We understand from this paragraph that the TSO wishing to implement cross-zonal capacity reservation according to the present methodology shall:

- first, according to article 150 SO GL, notify all other TSOs of their synchronous area of their intention to use cross-border capacity reservation at least three months ahead
- second, according to this paragraph, inform the other CORE TSOs of the forecast technique consisting of the use of reference days and adjustment factors to determine the forecasted market value of cross-zonal capacity for the exchange of energy, at least three month ahead

We would welcome a clarification by the CORE TSOs whether these timings would be cumulative (i.e. first notification to all TSOs of the synchronous area 6 months before application) or concomitant (both notifications happening at the same time).

Further, with other CORE TSOs possibly providing remarks up until one month before application of the methodology, this leaves less than one month of notice (also taking into account the time needed for the relevant TSOs to implement comments for other CORE TSOs) for the application of the method with certainty about its content. We believe this timing is too ambitious for a proper communication to and preparation of market participants.

We ask that the full methodology, including the forecast technique, is also shared with market participants and consulted upon. The forecast technique being at the heart of the EE CZCA, full transparency on the process is required.

- **Article 4.3:** *Each BCC applying the EE CZCA methodology shall inform all stakeholders and Core TSOs through an online announcement, at least 1 (one) month prior to entering into operation. 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 communication to and preparation of market participants.

Besides, this timing is not coherent with the process of article 4.1, where CORE TSOs can send comments on the application of the methodology to the TSOs that will apply cross-border capacity reservation up until one month before application. This means that up until one month ahead, the specifications for the application of the methodology will not be final for sure. If the relevant TSOs need to implement changes following comments from the other CORE TSOs, the final methodology may only be known until after this deadline of one month before implementation. Furthermore, market participants can provide valuable input concerning issues of the market value of cross-zonal capacity and should therefore be included into the assessment of the BCC proposal, which is to be considered in the timeline of communication.

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

- **Article 5.1.c:** *Notification to the BSPs of selected upward balancing capacity bids and/or downward balancing capacity bids by TSOs shall be done before the GOT of the SDAC.*

This paragraph states that the notification of selected bids shall be done before the GOT of the SDAC. However, as the TSO-BSP GCT takes place before W-1, we ask that the timing for the notification to the BSPs is set far earlier than the GOT of SADC (e.g. before D-1, in order to be able to cope with the potential daily procurement of reserves that has to be organised in accordance with the recast Electricity Regulation).

- **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 42(2) of the EBGL.*

This paragraph rather states the obvious – the need for compliance with article 42.2 EB GL – than provide clarity on the process. We suggest deletion.

- **Article 6.2:** *The 5% of CZC allocated on a market-based process on a Core BZB is determined as 5% of the hourly average offered capacity on that Core BZB for the SDAC in the period from 01 November two years ahead until 31 October of the previous (relevant) calendar year. The respective resulting CZC shall be published by Core TSOs.*

It should be clearly stated the 5% are applied over CZCA for all of the balancing processes, not 5% for each of aFRR, mFRR and RR, possibly summing up to 30%.

- **Article 6.6:** *Core TSOs and Core NRAs of each BCC of the CCR Core may commonly apply additional 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.*

We would welcome a clearer wording that individual BCCs can set only a lower threshold than the maximum 5% of available cross-zonal capacity referred to in article 42.2 EB GL.

We attract the attention of the TSOs to the typo in the text of the proposal (this paragraph should refer to article 42.2 EB GL, not article 41.2).

- **Article 7.1:** *When calculating the forecasted market value of CZC in day-ahead market timeframe, it shall be calculated in accordance with the methodology pursuant to article 37(2) of the CACMGL.*

This paragraph refers to article 37.2 CACM GL. However, the concept of “forecasted market value of CZC” is not covered in the CACM. The link to the article 37.2 CACM GL is therefore not straightforward. Please advise or amend.

- **Article 7.2:** *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 forecasted balancing capacity value, 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 7.3:** *The forecasted market value of CZC for the exchange of energy between bidding zones shall be based on the difference in the day-ahead prices of the corresponding hour in the relevant bidding zones of a reference period in the congested direction. 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 7.3 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 42.1(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 7.4:** *Any application in a BCC of adjustment factors to the forecasted value of CZC for the exchange of energy between bidding zones 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 7.4 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 overarching 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 42.1(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 implementing this EE CZCA methodology shall monitor and report to the Core TSOs the efficiency of the forecasting methodology 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, where needed.*

TSOs should publish the forecasted market values on a continuous basis (with as little of a delay as possible) and not only the efficiency of the forecasted market values as currently set out in 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 expected 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 11.2:** *According to article 38(9) of the EBGL, when CZC allocated for the exchange of balancing capacity or sharing of reserves has not been used for the associated exchange of balancing energy, of the product it was allocated for, it shall be released to all TSOs for the exchange of balancing energy for the same product if possible, and at least it shall be released to all European TSOs for the exchange of balancing energy with shorter activation times or for operating the imbalance netting process according to articles 19-22 of the EBGL. Each BCC shall at any time inform all Core TSOs, on who is the holder of the allocated capacity.*

We welcome the clarification that cross-zonal capacity reserved for a specific product that was not used for this process shall be made available again for the exchange of

balancing energy in processes with shorter timeframes, in accordance with article 38.9 EB GL.

This paragraph is, however, a partial repetition of articles 1.7 and 3.10. Please make sure the text of the methodology does not reiterate the same rules multiple times.

- **Article 11.4:** *Core TSOs shall not increase the transmission reliability margin calculated pursuant to article 21 of the CACMGL due to the exchange of balancing capacity or sharing of reserves for frequency restoration reserves and replacement reserves.*

We welcome this requirement that the application of cross-border capacity reservation should not increase the day-ahead or intraday reliability margins used by the TSOs.

- **Article 13.3:** *Each 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 EE CZCA methodology and no later than 6 (six) hours before the use of the allocated CZC.*

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. For the sake of transparency, this information should be published together with the results of the capacity procurement process, according to the same timing as laid down in article 13.2.

- **Article 13.6:** *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 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 shall 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 EE CZCA methodology shall publish the efficiency of the forecasted market value for the exchange of balancing capacity or sharing of reserves and the efficiency of the forecasted market value for the exchange of energy.*

TSOs should publish the forecasted market values on a continuous basis (with as little of a delay as possible) and not only the efficiency of the forecasted market values as currently set out in article 13.7.