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Comments on the draft Electricity Balancing Guideline

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EFET memo – 9 March 2017

The European Federation of Energy Traders (EFET) welcomes the advancement of the comitology process for the Electricity Balancing Guideline (EB GL). With the finalisation of the last market-oriented Network Code, the process of integrating the European electricity markets can be further accelerated. The EB GL is a significant step in that direction, as the balancing markets are still lagging behind in their integration compared to the other markets such as the intraday and forward markets. Yet, as the final timeframe of the electricity market, balancing markets perform the vital function of setting the price signal that will be used by market participants in all other timeframes. For EFET, it is not only important that the balancing markets across Europe become more integrated, but also that this integration is done in a way that strengthens and improves the functioning of the market as a whole.

EFET has been following the drafting of the EB GL from the beginning, together with other stakeholders. The EB GL has seen some significant improvements, thanks to the contribution of market participants, ACER and the European Commission. Yet again, some elements over which market participants have raised concerns still remain in the version that was submitted to the Member States by the European Commission. EFET already commented on the draft versions submitted to Member States at the end of June[1] and mid-October 2016[2]. In the present submission[3], we would like to reiterate our view on a selection of changes, highlighting welcome improvements but also pointing to some elements which remain of particular concern.

[1] See the EFET comments on the draft Electricity Balancing Guideline dated 1 July 2016, available at: http://www.efet.org/Cms_Data/Contents/EFET/Folders/Documents/EnergyMarkets/ElectPosPapers/~contents/VK
[2] See the EFET comments on the draft Electricity Balancing Guideline dated 18 October 2016, available at: http://www.efet.org/Cms_Data/Contents/EFET/Folders/Documents/EnergyMarkets/ElectPosPapers/~contents/MQKJJYNFDYMUT3GN/EFET-comments-EB-GL_18102016.pdf.
[3] Based on the version of the Guideline circulated to Member States on 1 March 2017.

There are **major improvements** in the new draft Balancing Guideline for EFET:

- The inclusion of a clear commitment in Art. 3.2(e) that the implementation of the EB GL should ensure that the development of the day-ahead and intraday markets is not compromised. It is essential that the implementation of the EB GL must not negatively impact preceding market timeframes. Therefore, we welcome this new addition to the text of the Guideline, though we would **add the forward market to the list**.

- We welcome the reintroduction of the provision in Art. 24.2(b) that the Balancing Energy Gate Closure Time (BE GCT) "*shall not be before the intraday cross-zonal gate closure time*" (ID XZ GCT). A clear relation between BE GCT and the ID XZ GCT serves to ensure that the cross-border intraday markets cannot be closed after the BE GCT. It avoids the risk of the balancing market removing liquidity from the cross-border intraday market. It is vital that the final decision concerning the BE GTC must not negatively impact the local intraday market(s), weaken existing liquidity or compromise the potential for further developments of these markets (e.g. implementation of a shorter ID GTC). In this sense, however, we deplore the removal of the provision of former Art.16.6 of the draft EB GL version of 24 January 2016 which allowed balancing service providers (BSPs) to declare energy bids that are not linked to a contract for balancing capacity as unavailable for the activation by TSOs, as it would have ensured that the BE GCT does not have an impact on the liquidity of local intraday markets. We believe that this rule can even be improved by automatically releasing free bids from common merit order list that are not needed to fulfil the reserve capacity requirement of the LFC block when the local intraday gate closure time is after the balancing energy gate closure time. This automatic release would allow all free bids to be reused in the local intraday market while keeping contracted bids in the common merit order list even if they exceed the capacity requirement to face any unforeseen event. Restricting this rule to free bids would also avoid the possibility for pre-contracted balancing bids to be introduced in the common merit order list for balancing at inconsiderately high prices, which would virtually exclude any possibility for these bids to be selected for balancing energy although they had already been remunerated through capacity procurement. **We therefore call for the introduction in the final version of the Guideline of a provision similar to Art. 16.6 of the January version that would have the effect of releasing all free bids – and free bids only – in the common merit order list that exceed the reserve capacity requirement of the LFC block at the balancing energy gate closure time, for use in local intraday markets when the latter's local gate closure time is after the balancing energy gate closure**.

- We welcome the introduction of clear target in Art. 53.1 for the harmonisation of imbalance settlement periods (ISPs) to 15 minutes in all control areas within three years, combined with the possibility for TSOs to request a derogation for up to four years from this provision according to Art. 62.2(c) and Art. 62.9. Harmonising ISPs closer to real time as foreseen in Art. 53.1 should promote efficient and liquid markets across all timeframes, including the intraday market, to enable market participants to balance their position as close to real time as possible. However, harmonising ISPs may also come at a cost, as some control areas may not have the market framework that would enable them to reap benefits from a switch to a 15-minute ISP. While we believe that the scope of the exemption of Art. 53.2 – per synchronous area – lacks rationale and applies to no other methodology in the draft Guideline, the explicit derogation in Art. 62.2(c) and Art. 62.9 allows better targeted derogations that will provide the necessary flexibility to adapt systems of varying maturity while ensuring that we maintain the harmonisation target.

- We generally welcome improvements in transparency on TSO activities throughout the new draft of the EB GL that will enable market participants to better adjust portfolios. This includes in particular Art. 12 (general information disclosure on the state of the balancing market by TSOs), Art. 19 to 22 (transparency and governance of the balancing energy exchange platforms), and Art. 37.2 (continuous update of available cross-zonal capacity for the exchange of balancing energy).

On the other hand, the new draft Balancing Guideline has introduced **some changes that EFET considers a step back compared to previous draft versions**:

- We decry the removal of the specific provision of Art. 14.1 of the version of the draft EB GL of 24 January 2017 that "*TSOs shall not provide balancing services to the balancing market*". For EFET, this provision was key to clearly differentiating the role of TSOs and that of Balancing Responsible Parties (BRPs), and to ensuring the integrity of the balancing market. TSOs are the single buyer on the balancing market and have, as such, significant market power. Making sure that they do not offer balancing services on this market warrants the correct functioning of the balancing market and ensures compliance with the principle of unbundling enshrined in the Third Energy Directive. **Therefore, we call for the immediate reinsertion of the sentence "TSOs shall not take the role of balancing service providers neither provide balancing services to the balancing market" as the second principle of Art. 14.1.**

- EFET deplores that the explicit prohibition of price caps and floors for balancing energy introduced in Art. 19.3(d) and Art. 47.2 of the version of the draft EB GL of October 2016 has disappeared. These provisions are now replaced by the new Art. 30.2, which foresees that "*in case TSOs identify that technical price limits are needed for efficient functioning of the market, they may jointly develop […] a proposal for harmonised maximum and minimum balancing energy prices, including bidding and clearing prices*". While Art. 30.2 may have been drafted to accommodate pure technical limits to ensure the proper functioning of the allocation platforms, its current wording opens the door to any type of price limit that would effectively act as price caps and floors. Experience in the elaboration of similar technical price limits in the day-ahead and intraday timeframes[4] that were supposed to reflect the value of lost load (VoLL) has resulted in the confirmation of the existing price caps. Establishing price limits in the balancing timeframe that would have even the most remote possibility to restrict prices is a fundamentally wrong approach that would undermine the functioning of the balancing market and would distort price signals in all other timeframes. In order to allow the balancing market to function optimally, free pricing of balancing energy bids is essential. Only this way can the right price signals be propagated throughout the various market timeframes and help identify, as the case may be, scarcity or surplus. EFET has been advocating the removal of artificial price caps and floors consistently in the past, and we therefore welcome this explicit prohibition in the Balancing Guideline. **We request the suppression of Art. 30.2 and the reintroduction of the wording of the October 2016 versions of Art. 19.3(d) ("*The terms and conditions for balancing service providers shall: […] not impose any floors or caps below the value of lost load on balancing energy prices, including bidding and clearing prices*") and Art. 47.2 ("*Balancing energy prices, including bidding and clearing prices, shall not be floored or capped below the value of lost load.*"), in order to prohibit caps and floors both on bidding and clearing prices**.

- While EFET continues to support the principle of marginal pricing (pay-as-cleared) for the pricing of balancing energy in Art. 30.1(a), we oppose the new wording of Art. 30.1(b) that opens the door for bids used for congestion management to affect the pricing of balancing energy. Indeed, the current wording of the EB GL only warrants that energy bids activated for congestion management shall not set the marginal price of balancing energy, which means that only marginal bids that are used for congestion management will be scrutinised by the TSOs to ensure they do not set the marginal price of balancing energy. We believe that all bids in a joint congestion management / balancing merit order list that are used for congestion management should be scrutinised, in order to assess their effect not only on the marginal price of

[4] See the proposal of the Nominated Electricity Market Operators dated 14 February 2017, available at: http://www.europex.org/wp-content/plugins/download-attachments/includes/download.php?id=3543.

balancing energy, but also on the imbalance settlement price. Only this will ensure that system balancing costs and congestion management cost are properly allocated, the former being borne by BRPs, and the latter being socialised via network tariffs. **Hence, we request the reinsertion of the wording of the former Art. 29.2 of the October 2016 version of the EB GL, which foresaw that "*if balancing energy bids are activated for purposes other than balancing, the price of these activated balancing energy bids shall not determine the imbalance price and shall not set the price of balancing energy*".**

Finally, **EFET considers that some elements remaining in the draft Balancing Guideline are detrimental** to the functioning of the electricity market:

- The cross-border reservation of transmission capacity for balancing purposes poses a serious risk to the availability of cross-border transmission capacity in the preceding trading timeframes. The concept has been rebranded in Art. 38 to 42 of the EB GL, but its effect remains the same: 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 position across borders in the most economically efficient manner. The use of cross-border transmission capacity is a key element in the European market integration of forward, day-ahead and intraday timeframes. A major objective of integration projects such as the EU Harmonised Allocation Rules for forward transmission rights, day-ahead flow-based market coupling and the future platform for implicit cross-border intraday trading are to improve the access and use of such transmission capacity. In its last version, the Balancing Guideline would turn the clock back on those improvements. Further, the limitation of capacity reservation to "*5% of the sum of the maximum available cross-zonal capacity and the reliability margin*" introduced in Art. 42.2 the latest version of the Guideline does not represent a sufficient safeguard for us, especially as it is weakened by the possibility for Member States to derogate from this provision until 2025 according to Art. 62.2(d) and Art.62.9. **EFET strongly insists that all cross-border transmission capacity be made available to the market, and calls for the suppression of the different options for TSOs and DC cable operators to reserve transmission capacity for balancing purposes in Art. 38 to 42**.

- The procurement methodology for balancing capacity remains too vague for EFET, as the term 'market-based method' remains open for interpretation. As this is a key feature in the organisation of the balancing market – including the access of TSO to sufficient balancing capacity – the establishment of a real, functioning market should be better ensured. Only by establishing a primary market to procure balancing capacity are market participants assured that they participate in a free market with correct remuneration of their services. In turn, TSOs are assured that market participants remain willing and available to meet their balancing requirements. The establishment of such a primary market for the procurement of balancing capacity is a necessity, irrespective of whether a secondary market is available. **EFET therefore requests that Art. 32.2 refer explicitly to the establishment of a *primary market* for the procurement of *all* balancing reserves**.

- The option that remains in the draft for TSOs to propose dual pricing for imbalances is prone to maintaining inefficient price signals from the balancing timeframe. Dual pricing has the potential to blur the price signals emerging from the balancing market, and runs the risk to create a barrier to entry for new entrants or market participants with small portfolios. It may also be a deterrent to the application of balancing responsibility for intermittent renewable energy sources in view of their full integration into the market. **EFET therefore calls for the immediate removal of the dual pricing option in Art. 18.7(g) and 52.2(d)**.

- On a last note, we regret that the "Swiss exclusion clause" of Art. 1.5 and 1.6 remains in the Guideline. This clause is further reinforced by the suppression of the provision of the former Art. 12 of the last draft EB GL that requested TSOs to conclude agreements with non-EU TSOs in the same synchronous area. As mentioned in earlier contributions and public statements, EFET is opposed to provisions discriminating against non-EU TSOs and non-EU market participants that may otherwise fully participate and contribute to the single energy market. Efforts to harmonise balancing procurement and settlement rules with markets outside of the EU should not be hampered by legislation when the inclusion of those actors would effectively contribute to creating an integrated European electricity market, to enhancing security of supply, and to increasing flexibility within Europe by allowing for cross-border energy exchange between non-adjacent EU Member States. Therefore, **we call for the swift adoption of a sensible agreement between the EU and Switzerland to enable a seamless interaction between the Swiss and the European electricity markets. Bearing in mind the imminence of the negotiations between the United Kingdom and the EU regarding Brexit, we call for a similar, pragmatic approach in the establishment of rules allowing the GB and Irish markets to contribute to sharing reserves and exchanging balancing energy across borders in Europe**.

The points as listed above are the main elements of improvement, deterioration and remaining concern for EFET in the draft Balancing Guideline submitted by the European Commission to Member States on 1 March 2017. Keeping the points of improvement and addressing the points of deterioration and concern would guarantee major steps forward to ensure a cost-efficient European integration of balancing markets. They would also mean a European balancing market that sets the right condition for a better functioning of markets in all timeframes, to the benefit of European consumers.