

ACER consultation on the TSOs' proposal for cross-zonal capacity reservation by way of co-optimisation (art. 40 EB GL)



EFET response – 10 March 2020

The European Federation of Energy Traders (EFET¹) welcomes the opportunity to provide our comments on ACER consultation on the proposal for a methodology for a co-optimised allocation process of cross-zonal capacity for the exchange of balancing capacity or sharing of reserves, pursuant to Article 40(1) of the Commission Regulation (EU) 2017/2195 (the 'EB Regulation').

1. General thoughts on the reservation of cross-border transmission capacity by the TSOs for balancing purposes

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 (intraday in the case of co-optimised capacity reservation), thereby restricting market participants' ability to adjust their positions across borders in the most economically efficient manner, and to contribute to overall system balance.

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 EBGL, 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

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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 onwards) for use by the TSOs in the balancing timeframe would turn the clock back on those improvements. While we understand that the development of the present methodology proposal is a requirement of the EBGL, we invite TSOs and NRAs to refrain from setting up balancing capacity cooperations, whether it be based on co-optimisation or one of the two other options to be potentially developed at regional level (so-called "market-based" or "economic efficiency" allocation methods).

2. General remarks and prerequisites related to the co-optimisation allocation process and its implementation

Bearing in mind our general opposition to the concept of cross-border transmission capacity reservation by the TSOs for balancing purposes (see above), we see a number of limitations in the current proposal of the TSOs:

- a. First and foremost, **co-optimisation in the spirit of the EBGL was supposed to be the most rigorous capacity reservation method out of the three proposed in the Guideline**, with a tool optimising between DA energy bids and balancing capacity bids. In contrast, the so-called "market-based" or "economic efficiency" approaches would be reserving capacity based on forecasted energy and/or capacity bids.

This expected precision in the co-optimisation process is best shown in the EBGL by the absence of a maximum percentage of capacity that is possible to reserve through this process, contrary to the "market-based" method (10% of the CZC) or the "economic efficiency" method (5% of the CZC). The existence of those maximum values for the CZC allocated to balancing capacity is linked to the (potentially miscalculated) estimations of the energy bids and/or balancing capacity bids. On the contrary, the absence of maximum value for the co-optimisation process implies implicitly that the co-optimisation process should result in a perfect economic optimum.

However, because of the complexity of operating the co-optimisation process in a rigorous manner, the TSOs proposal still foresees the possibility of a system whereby market participants would need to choose between submitting DA energy

bids or balancing capacity bids in two separate merit orders. **Indeed, despite repeated requests from market participants, there is no requirement in the methodology to link bids (or make them exclusive from one another).** This means that it is not actually the algorithm that would make optimise between allocating capacity to the day-ahead coupling or balancing, but first market participants themselves. The algorithm will only play its role after individual market participants have made a choice where they place their bids. As proposed, the process is rather equivalent to a co-clearing than a co-optimisation.

This will result in a sub-optimal allocation of capacity between DA coupling and balancing, as market participants will need to forecast the energy price when pricing their capacity bids (including risk premiums associated with uncertainties). To avoid such effects, the final co-optimisation methodology proposal therefore absolutely needs to include the possibility of linking energy and capacity bids in order to limit inefficiencies linked to the concomitance of the two markets.

- b. Even if the possibility to link bids in both markets becomes a reality, **the change in the bidding process of market participants should not be underestimated.** This will require time to adapt and alignment with TSOs in order to design it.

Procuring several standard balancing capacity products in a co-optimised manner requires linking not only between balancing and energy-only market bids but also between the different balancing capacity products. Indeed, as per this proposal and the proposal on the implementation of article 25(2) of the EBGL, there will not be just one type but three standard products for balancing capacity. Three product types means that bids would not be the same and BSPs would be forced to choose one of them. Hence, unaccepted bids for one standard balancing capacity product cannot be subsequently offered for another standard balancing capacity product, as it is done currently.

A complex bid in a co-optimised allocation process has to conditionally link bids for the day-ahead market, aFRR, mFRR and possibly RR balancing capacity. The additional complexity introduced appears hardly feasible, not only from a computational point of view for the clearing algorithm, but also for market parties submitting bids.

- c. Looking ahead at the implementation of the co-optimisation process, **we harbour deep concerns with regard to the functioning of day-ahead market coupling.** We note that the Euphemia algorithm for DA coupling is already at its limit in terms of capability. The reduction of the Market Time Unit to 15 minutes in the future will certainly further strain the performance of the algorithm. Whether or not linked bids are included in the final proposal of the TSOs, the co-optimisation process is likely to have a profound effect on the efficiency of the Euphemia algorithm.

Neither the methodology nor the accompanying explanatory document seem to address this point. We invite the TSOs, together with the NEMOs if not already done, to properly analyse the impact of the co-optimisation process on the performance of the DA coupling before any implementation decision is made, as well as involve and inform market participants accordingly.

In order to make sure the order of priority is clear, we oppose any limitations of the DA coupling process, such as a reduction in the variety of energy products and bidding flexibility offered in DA coupling, to accommodate the algorithmic complexity of co-optimisation; furthermore we also clearly reject any negative effect on the evolution of new products and services offered in DA coupling. We also oppose any prolongation of time needed for calculation or results publication.

- d. The description of **the co-optimisation process implicitly assumes that the energy allocation in DA is ATC-based. However, some CCRs use flow-based (FB) allocation (or will use it in the future), and there is in our view an incompatibility between these two options.** Indeed, in a FB environment, network constraints are related to firm energy net positions (taking into account that certain allocated energy flows can relieve a constraint and allow other flows to be accepted). 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) of EBGL 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 co-optimisation process could be applied in the context of a FB capacity calculation without endangering the management of the grid. We invite the TSOs to find a way to design a FB-proof co-optimisation process; if not possible, this would be major obstacle to the implementation of co-optimisation.
- e. Third, **the co-optimisation process (like the other two capacity reservation processes) ignores the intraday market** by setting the co-optimisation stage in the day-ahead market. This means that, in theory (see our second point below), the value of capacity is only compared between the DA market and the expected value in the balancing timeframe, without taking account of the value of that capacity in the intraday timeframe.

Besides the lack of precision in this approach, it also forecloses opportunities for market participants to adjust their positions in intraday across borders. This contradicts some of the most fundamental principles in the EBGL 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”* and 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”*.

- f. 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 co-optimisation 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.

Below you will find our comments on the questions of ACER.

Q1.1: Please share your view concerning the proposed implementation process

We welcome the introduction of an implementation timeline in the final proposal of the TSOs. We nonetheless have a number of remarks:

- the requirement on all TSOs to perform an impact assessment should not introduce an implicit obligation on all TSOs to establish BCCs
- the elements of the impact assessment are in the remit of both TSOs and NEMOs, it is unclear how it can be performed independently by the TSOs and only communicated afterwards to NEMOs

EFET fails to see the point of performing an impact assessment, if a negative outcome does not lead to a negative decision. Especially, since the list of items to be included in the impact assessment does not contain any assessment of the effect of the co-optimisation process on market participants, but only concerns technical feasibility. So if even these minimum requirements cannot be met, the rationale for nonetheless proceeding with the implementation is unclear.

Instead of lowering the required standards for the impact assessment, we propose to include market-related impacts into the assessment (including effects on algorithm performance and efficiency of SDAC). Several items of concern are listed in our general remarks.

Q1.2: Please share your view concerning the proposed implementation timeline of 12+12 months for submitting new requirements for the SDAC algorithm.

In our response to Q1.1, we mention that the TSOs should work together with the NEMOs on the impact assessment (first 12-month step). TSOs should also work with NEMOs on the establishment of the set of requirements for the algorithm (second 12-month step), rather than just communicate those requirements to the NEMOs at the end of the process. This second step seems much more a task for the NEMOs, and we invite ACER to carefully listen to them in the consultation process before taking a decision on the timeline.

Q2: Please share your view concerning the compensation cap.

This seems a purely TSO-TSO issue. We do not have a defined opinion on the matter. As a principle though, the provision should include minimum regulatory oversight, so as to avoid that inter-TSO compensation problems comes in the way of the proper functioning of a BCC – or worse, SADC.

Concerning the concept of curtailment of CZC, we nonetheless request the following precisions:

- Could TSOs clarify that the balancing capacity itself, contracted cross-border, is not subject to curtailment even if the CZC is curtailed – as the curtailment of CZC should have no impact on contracted balancing capacity and BSP remuneration – and that the compensation referred to in Article 10.4 is therefore only an inter-TSO compensation (related to the additional costs from the procurement of replacement balancing capacity)?
- We consider that, in case of CZC curtailment, BSPs should also be compensated (without compensation cap) for the loss of opportunity of not being activated in the balancing energy market.

Q3: Please share your view concerning elastic demand and possible substitutions between different types of reserve capacity.

We have opposed the principle of elastic demand for in the RR and mFRR implementation frameworks: by pricing their bids and offers, and putting them on the CMOL together with bids and offers from market parties, TSOs are directly active on the market and go beyond their role of neutral market facilitator. Indeed, rather than expressing a clear and straight need for a specific volume of standard balancing energy product, they will tie this need to a price limit. Acting this way, TSOs may also set the settlement price and impose de-facto price caps on the market. TSOs should

simply procure balancing energy to deal with their imbalances, based on their need for different products.

The same reasoning holds true for balancing capacity, where we insist that TSOs define their demand based on system needs rather than prices.

For balancing energy, elastic demand is foreseen for mFRR and RR only, to be subsequently compensated by an inelastic demand for aFRR, in case TSO's demand was not met because of price constraints. Procurement of balancing capacity from standard products in a co-optimised allocation, however, is a one-shot auction. There is no further opportunity to procure the required balancing capacity for the TSO, apart from relying upon specific products or additional means, both of which should be discouraged.

Q4: If you would like to comment on other topics please indicate clearly the related Article, paragraph of the proposal and add a sufficient explanation.

Article 3 'Principles of balancing capacity cooperation'

- Under article 3.2, more explanation would be welcome on how to combine a co-optimisation with the derogation to procure upward and downward jointly and without derogation (treating them separately)? We see implementation challenges.
- Article 3.2: it is not clear what is meant by "integrated product". Could that be clarified?
- In article 3.3, clarification would be welcome on how to combine SDAC for 24h with a minimum contracting of balancing capacity bids period smaller than 24h.
- Article 3.6: what is meant by "for the same activation time"? To our understanding, if CZC capacity is not used for the product it was reserved for, then there is no other choice than a release of this CZC for exchange of balancing with shorter activation times. In general, the mechanism of releasing unused cross-border capacity allocated for balancing is unclear.
- Following our understanding, the contracting period must be identical for the SDAC and for the capacity procurement, i.e. 24h.

Article 4 ‘Notification process for the use of the co-optimised allocation process’

- The period of one month (even if this is a minimum) for notification of a BCC to market participants is way too short. This gives no room to market participants of a future BCC to adapt their IT tools as a consequence of the new process and to adapt to the mentioned “market timeframe”. At least 3 months should be considered. Moreover, it would be useful to also make the link with art 33(1) and 38(1) of EBGL given the overlap of those articles with the content of the present article 4 of the proposal.

Article 5 ‘Timeframe of co-optimised allocation process’

- In article 5.1.b, why is a delay of maximum one hour needed for the notification of selected upward/downward balancing capacity bids to market participants? This does not seem necessary. We don’t understand why the results of the DA market and the selected balancing capacity bids cannot be published at the same time. Especially if bid linkage between balancing capacity and SDAC is provided, the algorithm would need to process both balancing capacity and DA energy bids at the same time, and results would also be available at the same moment.
- Article 5.2(a): for the sake of clarity, the role of “Balancing service provider” should be added to the sentence.
- In article 5.2.c, it is not clear why a conversion of the balancing capacity bids is required.
- Concerning the article 5.2 d: If there are minimum local reserve requirements and/or additional thresholds per product and per direction, we think they should be harmonised at the level of the balancing capacity cooperation to ensure a level-playing field to avoid competition distortions across bidding zones.
- Article 5.2(e): clarification on who sends what to whom would be welcome. The role and responsibilities should be clearly defined, properly applied and harmonised throughout the proposal.
- We understand from articles 5.2.g to 5.2.j that the MCO only gives as output of the co-optimised SDAC, the CZCs allocated for balancing capacity exchange, and that these CZCs are used as input by the TSOs to calculate the accepted balancing capacity bids in each zone. However, to obtain the CZCs allocated for balancing capacity exchange, the MCO has to solve the whole optimisation problem, so it is already able to give the accepted capacity bids in each zone. Therefore, we fail to understand the rationale of the additional step performed by the TSOs. Governance issues between the MCO and TSOs should not lead to extra unnecessary steps in a process that is

already very challenging in terms of timings and complexity. Besides, we underline that this additional step, where capacity is allocated by the TSOs independently from energy, is clearly incompatible with the possibility to link energy and capacity bids, which is of utmost importance for us, as emphasised above.

Article 8 ‘Determination of the actual market value of cross zonal capacity for the exchange of balancing capacity or sharing of reserves’

- Concerning article 8.3, see our response to question 3 of this consultation.
- On article 8.4, it is not clear why a TSO demand for more capacity than the one submitted locally should be automatically price-sensitive. If it is to avoid the risk of "free riding" by some TSOs, we oppose this concept, as we consider that the exchange of balancing capacity (if a BCC is indeed setup by the TSOs) is precisely a means of fulfilling the demand of a TSO even if there is not enough offer in its zone; besides, applying such a provision would lead to a situation where the TSO with insufficient offer in its zone would not cover its reserve requirement as dimensioned pursuant to the SOGL. Therefore, arbitrarily reducing the TSO's demand should not be considered as an option.
- Article 8.4: What does "sufficient" mean here? Sufficient compared to what? Thanks for clarifying this point.

Article 10 ‘Firmness regime of cross zonal capacity’

- Article 10.2: what does "all TSOs process" encompass?
- Under article 10.2, we would welcome clarification on the time schedules for the process of releasing unused CZC for the exchange of balancing energy with shorter activation times in order to ensure feasibility.
- Concerning article 10.5, see our response to Q2.

Article 13 ‘Implementation timeline’

- Article 13.2(d): though we deplore that the co-optimisation process ignores the value of the intraday timeframe, it is not clear in the current state of the proposal why the compatibility of the CZCA with the continuous trading matching algorithm should be assessed.
- Article 13.2(g): it is not clear what the "two-steps approach" refers to?

Article 14 'Publication'

- In articles 14.2 and 14.3, information on allocated cross-zonal capacity for the exchange of balancing energy or sharing of reserves should be published together with DA market results. See our comments on article 5.1.b for more details.
- Art. 14.4.: EBGL states in Art. 12(3(i)) that information on the use of allocated cross-zonal capacity should be published one week after its use at latest. This does not prevent TSOs from earlier publishing of this information. CO CZCA should clearly state when the information will be published, we prefer the earliest publication time possible.
- Under article 14.5, it is still unclear which "approved methodologies" are referred to.

Comments on missing elements in the methodology:

- Article 13.2: we propose to add the following items in the list:
 - Impact of elastic demand on the creation of a price cap in the balancing capacity market
 - Overall impact on the efficiency of the day-ahead and intraday trading, including on efficient utilisation of resources
- It should be clear that the CZC on a BZB that has not been allocated to energy bids in DA (which results in a price coupling on that BZB) nor to balancing capacity (because the TSOs' needs are fulfilled), has to be released to the ID market.

Has the proposed co-optimisation process been designed only for a TSO-TSO model? Would it be compatible also with a TSO-BSP model, as allowed by Art. 35 of EBGL?