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ACER consultation on the TSOs' methodology proposal for the pricing of balancing energy and cross-zonal capacity

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EFET response – 18 November 2019

We thank ACER for the opportunity to provide comments on the TSOs' methodology proposal for the pricing of balancing energy and cross-zonal capacity.

***Q1**: Do you agree with the replacement of the term BEPP with MTU?*

We agree with the change of nomenclature from BEPP to MTU, but only if ACER sets the BEPP for all standard balancing products on the ISP.

Indeed, a change of nomenclature from BEPP to MTU would have the advantage of ensuring consistency between the EB GL and the Transparency Regulation (543/2013) and CACM GL.

However, the MTU concept includes elements that do not fit if the BEPP is set on the optimisation cycle:

- Indeed, if the BEPP is set on the optimisation cycle, as the TSOs have proposed and we contest (see our answer to question 2), the optimisation cycle of the load-frequency controller is not a "market" time unit. Neither activities nor bids of market participants are based on this time interval. Usage of the term MTU in case of an optimisation cycle-BEPP is misleading, as it implies deliberate market action, which is not applicable in this case.
- If the MTU definition from the Transparency Regulation is to be applied to an aFRR optimisation cycle-BEPP, all the other MTU-related requirements from the Transparency Regulation should also apply accordingly. And while it might actually be interesting to see data and forecasts on load and consumption, as well as unavailability reporting on an optimisation cycle basis, we assume that TSOs would be reluctant to the effort.

If the BEPP is set on the ISP for all standard products, including aFRR, these concerns are alleviated.

NB: for the sake of consistency with our response to this question, we will keep on using the concept of BEPP in our responses to the next questions, rather than MTU.

***Q2**: Do you agree with setting the aFRR MTU equal to the optimization cycle? If not, how would you support the requirement for pay-as-cleared pricing and how would you address the inconsistency between the cross-zonal exchanges and the prices?*

We oppose the use of an optimisation cycle BEPP (or MTU) for the pricing of aFRR.

We detail below our thoughts on the two specific elements of concern to ACER in its question (part 1), our further arguments in opposition to the optimisation cycle-BEPP and in support of the ISP-BEPP (part 2), and our considerations with regard to the compromise option of a FAT-BEPP put forward by some NRAs (part 3).

Part 1: Requirements for pay-as-cleared pricing and consistency between cross-zonal exchanges and balancing energy prices

We stand very firm on the position that the TSOs are misleading the regulators and ACER in their argumentation on these two questions:

With regard to the requirement of the EB GL to have balancing energy bids remunerated pay-as-cleared, we remain of the view that only the ISP-BEPP, not the optimisation cycle-BEPP, guarantees a clear and unbiased application of this EB GL requirement.

We find the argumentation of the Agency that "*the proposed aFRR MTU by the TSOs equal to the optimisation cycle is also legally compliant with the EB Regulation as it establishes at least one price, per imbalance settlement period (Article 30(1)(c) of the EB GL) and sets the marginal price of all activated balancing energy bids in each activation cycle (Article 30(1)(a) of the EB GL)*" quite weak. Indeed the optimisation cycle-BEPP (4 seconds) will create 225 marginal prices over an Imbalance Settlement Period (ISP). However, none of these marginal prices actually "sets" the balancing energy price for the ISP individually. Rather, the TSOs proposal of optimisation cycle-BEPP is to average them into one composite price for the ISP. This composite price for the remuneration of balancing energy cannot be considered as delivering a true marginal pricing scheme. Instead, we see this proposal as a weighted average price scheme based on a number of sub-periods.

Towards BSPs, an optimisation cycle-BEPP would create the issue of providing one price but subsequently participating to 225 separate auctions, each with a separate clearing price. It blurs the distinction between Pay-as-Bid and Pay-as-Cleared, as it artificially reduces the infra-marginal rent that is the basis for a bidding strategy in Pay-as-Cleared systems. Towards BRPs, the optimisation cycle-BEPP results in a drastically suppressed price signal – if there is at least some alignment between

imbalance energy pricing and imbalance settlement price – by providing a weighted average price of the individual activation cycles.

With regard to the consistency between cross-zonal exchanges and aFRR balancing energy prices, the proposal of the TSOs gives a false sense of accuracy between the period for which the balancing energy price is set and the moment during which cross-zonal capacity is used at the activation of the bid. Rather, an optimisation cycle-BEPP actually ensures a lack of consistency between price and use of cross-zonal capacity in all cases, while an ISP-BEPP allows it part of the time.

Indeed, the determination of the cross-border marginal price per optimisation cycle according to bid selection by the AOF is arbitrary. In practice, a BSP bid that is remunerated for a specific optimisation cycle (in a metered TSO-BSP settlement scheme) is not actually activated in that specific optimisation cycle and does not use cross-zonal capacity in that specific optimisation cycle either. Instead, according to the current aFRR product design, this bid is activated and potentially uses available cross-zonal capacity in subsequent optimisation cycles.

The criterion that is chosen to decide whether a BEPP is declared congested or not, is the outcome of the momentary AOF selection result, reflecting TSO demand and current usage of cross-zonal capacity. This is just a snapshot that might never actually occur and be out-dated by TSOs' controller dynamics and subsequent BSP activations affecting cross-zonal capacity once the bid is finally activated.

Using an optimisation cycle-BEPP of 4 seconds while the full activation time of aFRR products is 5 minutes ensures in all cases a mismatch between the period for which the balancing energy price is set and the moment during which cross-zonal capacity is used at the activation of the bid. On the contrary, an ISP-BEPP allows, in its first 10 minutes, that the use of cross-zonal capacity at the time a bid is activated takes place in the same period for which the balancing energy price is set. In the last 5 minutes of the ISP, the use of cross-zonal capacity would span both the period during which the balancing energy price is set, and the next one.

Part 2: Further arguments in favour of the ISP-BEPP and opposing the optimisation-cycle BEPP

You will find below a list of arguments supporting our preference for the ISP-BEPP, some of which have already been expressed in our response to the TSOs consultation on the subject:

a. *The ISP should remain the reference for balancing energy pricing*

The concept of a BEPP is a concept that was never discussed in the EB GL, where only the ISP is mentioned for pricing towards BSPs and BRPs.

For market participants, the only relevant time period is the ISP, set in the EB GL at 15 minutes. It is the basis for pricing signals towards BRPs as well as the reference for the pricing of the energy by BSPs. This price signal will guide all actions taken by

market participants in other timeframes, as intraday, day-ahead and forward markets are all forward markets of the balancing timeframe. We see no fundamental reason to differentiate the aFRR process from other balancing processes (RR, mFRR), which use the ISP of 15 minutes as BEPP. Moreover, the ISH methodology does not provide any guidance on how to combine the different values from each BEPP into the calculation of the imbalance settlement price.

b. *An ISP-BEPP would reflect the value of energy and congestions in the shortest market timeframe*

As mentioned above, the relevant period for market participants is the ISP. This is the shortest timeframe where a price signal is sent to the market. The TSOs argue that an ISP BEPP would artificially create congestions over the whole ISP, while it may only be present in one or a few optimisation cycles. However, as the price signal emerging from such congestion(s) will be reflected in the imbalance price, we see no reason for it to be broken down in 4-second bits and averaged out over the whole period. The correct reflection of congestion towards market participants at every second interval should not be an objective of the platform. Market participants are not seeking cross-border congestion transparency at this granularity as they can anyhow not act upon it. For market participants, the ISP is the maximum granularity that is visible and relevant, and if congestions occur during an ISP, it is correct to reflect this for the entire ISP.

Simplicity or transparency from an algorithmic point of view also does not necessarily equal simplicity or transparency towards the market. If markets have to integrate 225 prices per ISP – including traceability through which congestions they were caused – to check or calculate the balancing energy and imbalance settlement price, it is demonstrably inferior from a transparency and simplicity perspective to a single marginal price per uncongested area.

From an incentives point of view, and as ACER correctly notes, the perfect incentive on BRPs to support system balance would be that all balancing energy products across different processes receive the same marginal price which is equal to the imbalance price – i.e. the marginal price of marginal prices of each standard balancing process. While this solution would indeed reinforce the incentive on BRPs to be balanced, the consensus position between TSOs and NRAs is that the imbalance price would be calculated based on a weighted average of the marginal prices of each balancing process. We do not think that it is the role of ACER to support a further weakening of the concept of marginal pricing by having one of those balancing process actually settling balancing energy on a weighted average basis as well, which is fundamentally what the application of the optimisation-cycle BEPP boils down to.

c. *An ISP-BEPP would foster competition between BSPs*

We also remind the ACER that contrary to what was aired at stakeholder workshops on some occasions, an ISP-BEPP will not lead to de-coupling the different areas. A price differential just means the absence of price convergence – which is not a goal of the EB GL as such. It does not mean that markets are isolated and that there is no competition between these markets. The argumentation that ‘effective’ competition is fostered by artificially increasing the moments of price convergence fully misses the

driving forces behind competition. BSPs are pricing their bids with a lead-time of 25 minutes for a full validity period. BSPs at that moment have no view on the potential appearance of congestion, the size of the imbalance and their impact on the clearing price. Potential exposure to cross-border bids is a more forceful driver behind a competitive market when setting bids compared to a slicing of the validity period into numerous pricing sub-periods. Moreover, BSPs are still in competition even at times of congestion, as part of the imbalance energy may already have been activated across borders prior to the occurrence of congestion. As a result, if BSPs would have increased their pricing in the expectation of congestion, they may simply forego activation as they have moved too far in both the Common Merit Order List and Local Merit Order List. This is very similar to the day-ahead market, where also competition – and its price effect – is present in times of price decoupling. On the contrary, by undermining the marginal pricing (pay-as-cleared) principle through the use of optimisation cycle-BEPP, the Pricing Proposal is actually reducing the effective competition as the incentive for BSPs to bid at marginal price is being reduced.

d. *An optimisation cycle BEPP would increase complexity and reduce visibility in the pricing of balancing energy*

The optimisation cycle-BEPP would entail a significant increase in data and complexity for both BSPs and BRPs. The TSOs claim it will be simpler from an algorithmic perspective. However, such an exponential increase in data to process and check would be problematic for market participants. It furthermore poses questions in terms of transparency towards BRPs, as the imbalance settlement price will be partially determined by the outcome of the 225 clearings of each activation cycle. This would be detrimental to the transparency of the imbalance settlement price.

The optimisation cycle-BEPP would result in 151.200 clearings per week (against 672 for an ISP-BEPP) that can differ from BSP to BSP as their bids may or may not be included in any of the 151.200 clearing outcomes. The necessary IT infrastructure and operational requirements to perform the necessary checks would pose an entry barrier to smaller market participants. True Pay-as-Cleared schemes are proved to be conductive to market entry, and any departure from it should be considered a step backward for ease of market entry.

The TSOs also claim that the optimisation-cycle BEPP of 4 will be more transparent. However, the TSOs have not included binding transparency requirements in their proposal. Judging from experience on, e.g. day-ahead flow-based market coupling, getting full transparency on TSO data in a way that enables market participants to use it for their modelling is particularly difficult (even with precise regulatory requirements in the example of CWE day-ahead flow-based market coupling).

e. *The fear of short price spikes should not be a reason to justify an optimisation-cycle BEPP*

We also do not agree with the concern regarding the problems posed by the potential occurrence of price spikes when using an ISP-BEPP. The simplistic transposition of currently observed prices to a newly defined market using Pay-as-Cleared is misleading.

Similarly, there is no clear reason why congestion during a sub-ISP period should be isolated to this period. Price convergence should not be achieved artificially by measuring it during a finer time-resolution. If at any moment during an ISP, the activation of a local bid is required for congestion reasons, such congestion should be reflected towards BSPs and BRPs during the relevant Imbalance Settlement Period.

f. The application of an optimisation cycle-BEPP for settlement remains unclear

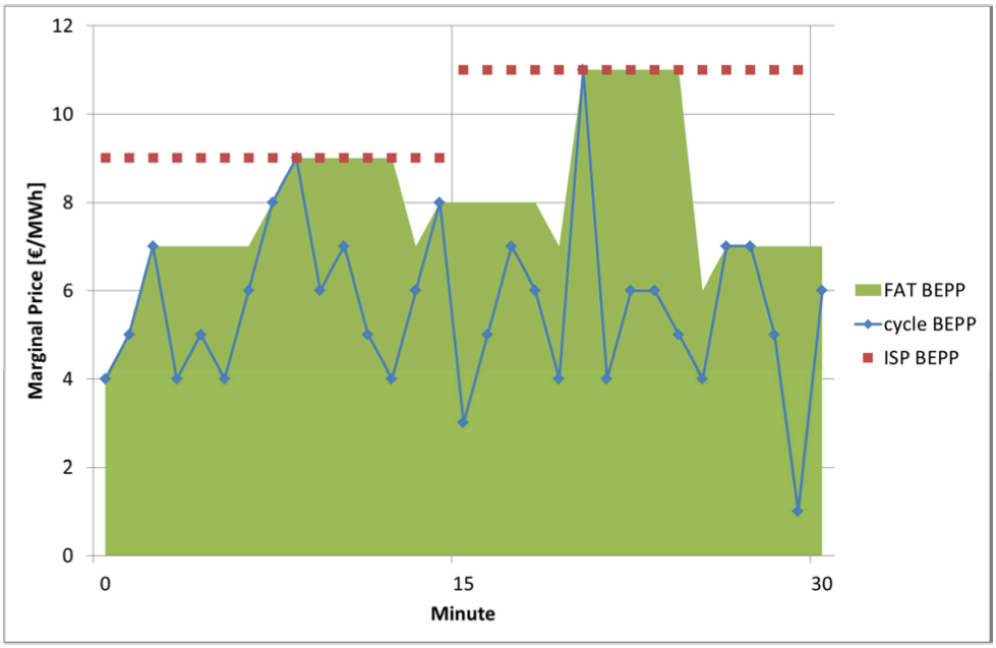
It is unclear, how an optimisation cycle-BEPP should be combined with metered TSO-BSP settlement at 4 seconds. Which volumes should be used for settling at variable marginal prices throughout the ISP? The BSP will deliver the activated balancing energy within the FAT (with or without ramping constraint), but not within the BEPP relevant for pricing. A BSP that is activated for two BEPPs (with different prices) within one ISP will have a certain volume of balancing energy delivered that has to be somehow split between the two prices. From our point of view, there is no straightforward way to do this.

Part 3: Considerations with regard to the FAT-BEPP proposed as a compromise by certain regulators

While ACER does not mention it in its consultation, the non-paper of the regulators briefly mentions that some regulators would support a compromise solution of a BEPP equal to the full activation time (FAT) of balancing energy bids, i.e. 5 minutes.

A first point needs clarification to avoid confusion: a FAT-BEPP would not mean that the ISP would be divided in three equal and consecutive 5-minute FAT-BEPPs. Each FAT-BEPP would be determined based on the moment a bid is selected, i.e. during individual optimisation cycles. Based on this, you will find below our assessment of the FAT-BEPP proposal in relation to the arguments we developed in parts 1 and 2 above:

- *Pay-as-Cleared remuneration*: the FAT-BEPP partly alleviates concerns that we have with the optimisation cycle-BEPP. According to our understanding, the balancing energy price would be used for the duration of the FAT or until a higher price is reached. Each BSP that would provide balancing energy within the required FAT after the activation signal would receive this price. This is illustrated in the graph below (note that for simplification purposes, we reduced the number of blue points indicating prices derived from an optimisation cycle-BEPP approach):



Towards BRPs, the FAT-BEPP results in a dampening of the price signal compared to the ISP BEPP – if there is at least some alignment between balance energy pricing and imbalance settlement price – by providing a weighted average price of the FATs per ISP.

- *Consistency between balancing energy pricing and use of cross-zonal capacity*: on this point the FAT-BEPP ensures perfect consistency between balancing energy pricing and the use of cross-zonal capacity, as the BEPP would reflect the actual dynamics of the aFRR process. Also, this approach can be applied across ISP boundaries to guarantee a consistent marginal pricing remuneration of all accepted balancing energy, which is required for BSP bid preparation. In this sense, this approach is not only superior to the optimisation cycle-BEPP (which, as we explained in part 1, de-connects balancing energy pricing and use of cross-zonal capacity in all cases), but also to the ISP-BEPP (which only partly allows this connection) as there would be no ex-post reward for bids activated earlier in the ISP would occur.

- *Complexity and visibility on the pricing of balancing energy*: as the FAT-BEPP depends both on the FAT itself, but also on the clearing price of each optimisation cycle, there could be in the worst-case scenario as many FAT-BEPPs as there would be optimisation-cycle BEPPs within an ISP. But even in a best-case scenario, this solution does not allow full convergence with the ISP, as the only relevant time period upon which market participants can take action. The FAT-BEPP solution therefore partly remedies the concerns we have with regard to complexity with the optimisation cycle-BEPP, as in most cases it is likely to create much fewer balancing energy prices than with the optimisation cycle-BEPP. However, the number of prices would still be higher than with an ISP-BEPP.

- *Fear of price spikes*: while we remain of the view that the fear of price spikes due to short activations or congestions is unjustified – and TSOs themselves have removed it from their justifications for an optimisation-cycle BEPP in the last explanatory document supporting their November 2018 consultation – a FAT-BEPP would contribute to alleviating concerns on this matter.

As a result of the above, we judge the compromise proposal of certain regulators to use the FAT as BEPP as better solution than the optimisation cycle-BEPP. Nonetheless, we remain of the view that the most appropriate time period for balancing energy pricing is the ISP.

***Q3**: Do you agree that the purpose of using balancing energy bids for system constraints should be considered as an update of the CZC?*

System balancing and congestion management are two very different tasks of the TSOs, which should be defined by clear processes and cost recovery patterns. Indeed, while balancing costs are borne by the BRPs via the imbalance settlement price, congestion management costs are recovered through network charges. There is a clear danger, which we see already in TSO decisions that do not clearly identify balancing vs. congestion management actions, to externalise congestion management costs towards BRPs by limiting the conditions under which balancing would be performed without congestions. This not only has an effect on the balancing market and the imbalance price, but also on congestion management mechanisms themselves, which are key to guide TSO grid management and investment decisions (connection agreements, long-term investment decisions, zonal delineation).

From a theoretical perspective, congestion management actions by the TSOs that reduce or increase cross-zonal capacity should indeed be taken into account when calculating the available cross-zonal capacity for cross-border balancing processes. This means, in very practical terms, that as long as capacity is updated prior to each auction, and that market participants have this information available when placing their bids, capacity ought to be updated to reflect the reality of congestions. However, if a bid submitted to the mFRR or RR processes is to be used to manage system constraints – in the limited time these bids can be used for redispatch purposes as they are submitted very close to real time and have limited time duration – changing the available cross-zonal capacity in the middle of the process would change the condition under which bids have been submitted for the balancing process, and hence change the conditions of the balancing market. Reducing cross-zonal capacity at this stage would result in the activation of bids for congestion management purposes affecting the balancing energy price – and in turn the imbalance price – which would not comply with article 30.1(b) EB GL. This would also be tantamount to using cross-zonal capacity to manage network congestions (“pushing congestions to the borders”), which would violate Chapter III, Section 1 of the recast Electricity Regulation (2019/943) and go against the principles of ACER Recommendation 02-2016.

***Q4**: Do you agree that the CBMP should reflect actually available CZC at the time of the auction?*

We refer to our response to question 3. Cross-border marginal price, by definition, should reflect the value of cross-zonal capacity made available to market at the time of the auction, in any timeframe. Hence, as long as the actually available cross-zonal capacity is updated in order for BSPs to take account of possible changes at the time of the auction, then the cross-border marginal price will naturally reflect the *actually available* cross-zonal capacity. If cross-zonal capacities are modified in the course of the process, such modification would be a congestion management affecting the balancing market and the imbalance price, in violation of article 30.1(b) EB GL and Chapter III, Section 1 of Regulation 2019/943.

***Q5**: Do you agree with the proposed approach for pricing SA and DA mFRR bids?*

First, we would like to reiterate that in order to improve the functioning of the mFRR joint activation process and avoid costly complexity, we strongly recommend that the system be built around the Scheduled Activation (SA) product only. An accurate dimensioning of automatic and manual reserves, especially as the two process would be running concomitantly, would in our view make Direct Activation (DA) of the mFRR product unnecessary. Restricting the standard mFRR product to SA would benefit the system by significantly reducing complexity, lowering cost, and improving transparency**.**

The proposed pricing approach appears to be the only remaining solution, when maintaining the two activation options. As detailed in our response to the ISH proposal, the impact of mFRR-DA prices and volumes in both ISPs on the imbalance settlement needs to be clarified.

***Q6**: Do you agree with the inclusion of a technical price limit at the proposed level? If not, what price limit do you consider as not interfering with the balancing energy market results?*

This proposal goes beyond the scope of existing EU legislation, as article 10.1 of Regulation 2019/943 bans all bidding or clearing limits in all timeframe. The exception in article 10.2 regarding technical limits only concerns the possibility for NEMOs to set technical limits to clearing prices. Considering that Regulation 2019/943 takes precedence over EB GL in case of conflicting rules, we fail to see a legal basis for ACER to have TSOs apply a technical bidding or clearing limits in the balancing timeframe.

From a practical perspective though, we understand the intentions of ACER, and have no opposition to the establishment of a technical clearing limit at EUR 99,999/MWh, in so far as it is above most current assumptions on the value of lost load and should not restrict balancing energy market prices. ACER should seek reassurance from the European Commission that an extension of the scope of article 10.2 of Regulation 2019/943 to TSOs for the balancing timeframe would be acceptable. In any case, any

such extension of the exception rule of article 10.2 should strictly follow the requirements already foreseen for NEMOs: the limit shall only be on clearing prices (not bidding prices), justified for technical reasons (algorithm functioning), and take account of the value of lost load. The basic principle of article 10.1 should remain untouched,

If this technical price limit is established, ACER should make sure that the any measures further restricting balancing energy prices, bidding or clearing, directly or indirectly, are removed in all Member States.

***Q7**: Do you agree with aligning the pricing in these two cases as proposed by the Agency? If not, please specify and justify your preferred solution.*

We agree with aligning the pricing of energy volumes for deactivating bids.

***Q8**: Please comment on other topics indicating clearly the related Article, paragraph and sub-paragraph of the Proposal on pricing methodology.*

Bid conversion: The conversion of specific products into standard products and their inclusion in the CMOL poses questions, as these bids will be governed by different terms and conditions, set at national level. The pricing methodology for specific products that are converted to standard products for participation in the CMOL should therefore be more prescriptive. There should be specific and binding rules on how specific products have to be priced if they are to be admitted to the CMOL through a bid conversion mechanism. This should include elements such as marginal pricing (pay-as-cleared), Balancing Energy Gate Closure Time, and minimum and maximum delivery time.

More fundamentally, it also raises the question why TSOs use these specific products if they can be easily converted into standard products.