

To:

Mr Alberto Pototschnig
ACER - Agency for the Cooperation of Energy Regulators
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1000 Ljubljana
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Brussels, 8 August 2013

Subject: Comments to ACER on the draft LFCR and Electricity Balancing network codes

Dear Mr Pototschnig,

The European Federation of Energy Traders (EFET)¹ wishes to thank you for the opportunity to provide comments on the draft Load Frequency Control and Reserves network code (LFCR code) that was submitted to ACER by ENTSO-E. In this letter we will also refer to the current draft of the Electricity Balancing network code for which the ENTSO-E consultation period finishes on 17 August 2013. These codes, which we believe must be considered as a package, are central to market design, the future success of the internal market and the integration of renewable production into the electricity market.

General

The general view of EFET is that, although the drafts have some positive features, a substantial amount of work is still needed to finalise the codes so that they make a positive contribution to these objectives. Likewise, the draft codes do not fully reflect requirements of the separate but related Framework Guidelines on System Operation and on Balancing. With respect to the LFCR code, all the points set out below were made during the formal consultation and were largely not taken up by ENTSO-E in the final draft. We believe that ENTSO-E has not properly taken these comments into account and has given insufficient reasons for rejecting them. We would therefore request that you consider them in forming your opinion of the LFCR code.

Our overriding view is that the codes need to facilitate and maintain the integrity of intraday electricity markets as their primary objective. Most of the €3bn expected gains

¹ The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent and liquid wholesale markets, unhindered by national borders or other undue obstacles. EFET currently represents more than 100 energy trading companies, active in over 27 European countries. For more information at: www.efet.org.

from integration of balancing markets as modelled in the EU Commission study can, in fact, be realised in improved intraday market functioning and integration. Indeed, one of the examples used in the study, between the UK and France, highlights this well since the scope for intraday trading between those Member States is currently limited to two auction slots per day. Improving this to continuous allocation would realise most of the potential gains. The additional benefits from linking balancing arrangements are probably secondary compared to this.

The remainder of this letter sets out our main areas of comment on both codes. Specific proposals for improvements to individual Articles in the LFCR code are given in the Annex. Once the Balancing code consultation period is finished, we will also forward individual comments on that code.

Insufficient clarity of roles and responsibilities

The delimitation between the intraday market and TSO operation is not sufficiently clear. This is important as (i) the market should have maximum possibilities (i.e. trading opportunities) to balance their positions and (ii) TSO balancing actions, albeit sometimes unavoidable, should be limited to what is not balanced by the market itself.

To this end, BRPs should be able to use all available assets to balance positions in intraday, with an intraday gate closure time (GCT) as close as possible to real time (not later than one hour, ideally 15 minutes before real time), thus naturally decreasing the need for reserve products or for TSO activation of balancing resources (both national and cross border).

In particular, the conditions for procurement of Replacement Reserve (RR) or Reserve Products need to be more detailed and/or revised, as well as the Rules for the activation of such reserves. They should also be subject to proper regulatory scrutiny and to transparency Rules. As a general principle, the activation of reserves before intraday GCT should be discouraged as long as the market can be expected to act first (to that extent, a TSO incentive for efficient activation and use of balancing reserves might be considered).

The condition for TSO procurement and activation of balancing reserves also raises a number of fundamental questions that should be addressed in the network code to ensure consistency and meet the objective of market integration which are still missing in the draft codes:

- What are the general rules for choosing reserve contracts rather than balancing energy only?
- How are different types of products ranked and activated?
- How are imbalance prices calculated when reserve products are activated?
- How do TSOs ensure maximum competition by not imposing unnecessary constraints on reserve providers, while still taking into account their legitimate needs?

Insufficient harmonisation and regulatory oversight

There has been little attempt in the codes to develop common rules with respect to load frequency control or balancing/imbalance. In total, the draft LFCR code has 54 headings covered by various operational agreements between system operators in Articles 10-18. Of these, only 33 items are subject to regulatory approval, of which only 13 are at synchronous area level and none at all at European level. Meanwhile under seven headings areas, there is merely a requirement on TSOs to notify their decisions to regulators. This potentially leaves around 14 subjects (54-33-7) where national regulators are neither involved nor even informed of the decisions to be made by TSOs. At the same time, in the Balancing code, there are 37 subjects covered by regulatory approvals but only 7 of these are proposed for resolution at EU level with the rest at national level, or within “Co-ordinated Balancing Areas (CBAs).

It is recognised that TSOs are at very different starting points and that harmonisation will not happen overnight. However, at the very least, the codes should clearly set out some common general references in the following areas:

- roles and requirements on BRPs, BSPs, and TSOs,
- procurement process and timetable,
- format for standard products description,
- target timetable for gate closure, including for the intraday market, and settlement (leaving the maximum possible opportunity for market parties to resolve their own imbalances although without unduly compelling TSOs to act inefficiently),
- general rules regarding the merit-order based activation of all types of reserve,
- imbalance principles and price calculation methodology.

Without these basic arrangements in place it will be difficult to ensure proper integration at EU level. Currently, there are a number of different balancing arrangements in place in Europe, each one adapted to the technical and legal requirements of the corresponding area. Already, several successful pilot projects (e.g. IGCC) have been implemented which demonstrate that significant benefits can be achieved easily through cooperation, even between different balancing regimes sharing common basic principles. The potential benefit of any change to an existing system needs to outweigh the implementation costs and risks. Therefore, we propose a gradual implementation of balancing integration, based on cost-benefit analysis (including how balancing arrangements modifications may affect the outcome of market coupling and intraday market integration).

In addition, the network codes, taken as a whole, allows for at least six or seven different overlapping and contradictory set of “zones” and “areas” that serve to fragment rather than integrate electricity markets. To ensure efficiency, bidding zones for the day-ahead and intraday market should be consistent with “relevant areas” with respect to imbalance. And these need to be large enough to include a wide range of buyers and sellers in order to maintain wholesale market liquidity and the prospect of meaningful competition between different providers.

Finally, the Balancing code allows for the maintenance of various idiosyncrasies in terms of market design, for example so-called “central dispatch” models, as well as the possibility of uncontrolled derogations from EU legislation to be issued by national regulatory agencies. Although these concepts were included in the Framework Guidelines, they are arguably not consistent with the Directive. In addition, the envisaged derogation process would need to be assessed against the standard European legal frameworks in this respect. ACER should reconsider the approaches taken in this area and should, instead, only allow for time-limited extensions of existing market arrangements that are non-compliant with the target model.

Clarification of requirements on market participants and timetables

There are a number of basic requirements on market participants that need to be further developed and clarified:

- The code should **encourage market participants to become active in the intraday market**, by setting the correct incentives to BRPs. Any interaction with the intraday market, reducing liquidity or trading possibilities, needs to be carefully considered. As stated above, the primary integration benefit originates from well-developed intraday markets and this needs to be established and preserved.
- The code indicates that the balancing gate closure time shall be after the intraday gate closure time both for within-zone and cross-zonal exchanges. However, this is not sufficiently clear as intraday markets are currently not well developed. The network code should **fix the target timing of the balancing gate closure time no further from real-time than one hour**, and ideally 15 minutes.
- There is a requirement for all market participants to be covered by the network codes (“all injections and withdrawals”). However it would also be useful to state that this requirement also **applies to renewable generation and retail suppliers** (potentially in the recitals).
- Market participants are permitted to **modify energy bids until balancing gate closure time/activation**. However this eventually **needs to be made consistent with the functioning of any future CMO algorithms and time needed for matching**. This potential issue should not be dealt with through earlier gate closure, especially since the ranking of the different offers can be updated on a continuous basis and matched very quickly when activation is needed.
- The Electricity Balancing code favours a **pricing structure** (including for settlement of imbalances) **based on the principle of being at least equal to the marginal activated balancing action**. This is welcome as harmonisation of imbalance rules is a positive development with respect to market integration more widely. This basic principle may, however, need to be adapted to ensure compatibility depending on the extent to which pre-contracted reserve is used for balancing purposes.

TSO-TSO model without CMO

The LFCR code and the Balancing code have been largely written around the concept of TSO-TSO exchange of both balancing energy and reserve. This is not consistent with the Framework Guidelines or the target model which is that balancing energy should (eventually) be exchanged **once a common merit order arrangement is in place**. Similarly for the exchange of reserve, the Framework Guidelines envisage a TSO-BSP arrangement based on a “multilateral reserve trading model involving TSOs and BSPs of two or more control areas, through a common procurement process”.

By contrast, the draft LFCR network code envisages, almost exclusively, TSO-TSO exchange of both energy and reserve immediately after the entry into force of the code. Furthermore the development of the common merit order is postponed for [x years] and the draft Balancing code places a number of hurdles in the way of the CMO being developed – cost benefit analysis etc.

It is the view of EFET that it is only through either a TSO-BSP model or a CMO model that the right to cross-border exchange of services under the EU Treaty is maintained. Therefore, in the absence of any CMO, any exchange of energy or reserve should be performed on a TSO-BSP basis or not at all. Otherwise there is no incentive on TSOs to develop the CMO.

Cross-zonal capacity reservation and scope for sharing\exchange

The degree of freedom for TSOs on the amount of reserve products to be procured across borders and on the use of transmission capacity is too high. More scrutiny is needed in this respect to ensure that the code reflects the Framework Guidelines². As currently drafted, the LFCR code takes an arbitrary approach to defining what is a “surplus” for which bilateral exchange is appropriate. This could, in fact, distort cross-border competition by setting up inadequate constraints on what is or what is not a surplus.

² “The Network Code on Electricity Balancing shall forbid TSOs to reserve cross-border capacity for the purpose of balancing, except for cases where TSOs can demonstrate that such reservation would result in increased overall social welfare and provide a robust evaluation of costs and benefits. The modalities for the assessment of cross-border capacity reservation shall be defined in the Network Code on Electricity Balancing, avoiding undue discrimination between TSOs and market participants using the cross-border capacity in particular with regard to firmness. [...]The Network Code on Electricity Balancing shall require that any decision on cross-border transmission capacity reservation for balancing is taken on a case-by-case basis, by relevant NRAs supported by a full cost-benefit analysis and market consultation, in a transparent, non-discriminatory, fair and objective manner.” *Framework Guidelines on Electricity Balancing, FG-2012-E-009, paragraph 4.3*

“The Network Code on Electricity Balancing shall define and allow the following models for exchanging *reserves*, as well as their prerequisites in terms of coordination, arrangements and guaranteeing operational security:

- to exchange surpluses of *reserves* through a bilateral *reserve* trading model: this model refers to bilateral exchanges of *reserves* between two adjacent areas in which reserve procurement processes have not been integrated, nor harmonised;
- to implement a multilateral *reserve* trading model involving TSOs and BSPs of two or more *control areas*, through a common procurement process: this model refers to multilateral exchanges of *reserve* between two or more adjacent areas in which reserve procurement processes have been harmonised and integrated into a common procurement process.” *Framework Guidelines on Electricity Balancing, FG-2012-E-009, paragraph 3.4.2*

With respect to cross-zonal capacity reservation, it is the view of EFET that the TSOs should only make use of transmission capacity once the intraday market has closed, that is to say when the market can no longer use transmission capacity. Before intraday gate closure, the maximum capacity must be allocated to market participants, without any TSO curtailment or reservation, as set out in the Regulation 2009/72. The only indirect way for TSOs to take into account potentially unused cross-zonal capacity would be through a statistical approach or a D-1 forecast.

Excessive scope for interference in commercial operation

The LFCR code leaves significant and unacceptable scope for intervention by TSOs in the commercial operations and property rights of market participants. Specifically, open-ended possibilities for TSOs to restrict ramping of generation plant (Articles 26-28), to introduce ill-defined “mitigation” measures (Article 29) and for ad hoc intervention in the event of “exhaustion” (Article 42) have no place in a network code that is supposed to be a platform for competition and the internal market. These measures should be clearly limited to network constraints and carefully monitored.

Similar problems exist in the draft Balancing code that appears to allow for TSOs to be BSPs themselves, contravening the unbundling requirements of the Directive. Likewise reserve procurement rules which allow for price caps or compulsory participation are similarly not appropriate or consistent with the objectives of the internal market legislation.

Transparency

There is also a **general lack of dialogue and an inappropriate level of transparency that will be required from the TSOs**. As already noted, the LFCR network code leaves a long list of important elements open to later decisions by the TSOs in no less than 9 different types of agreements (Articles 10 to 18). None of these agreements are subject to a formal consultation process. Furthermore, the same lack of a public consultation of market parties is to be found in the NRA approval process in Article 4. The result is that market parties are effectively shut out from the technical foundations on which the balancing markets will be based. This makes the network code a rather empty document, granting too much freedom to TSOs to define fundamental features without taking into account market participants’ views on technical and economical requirements and limitations.

At the same time, notification and information dissemination by the TSOs are too late for market participants to be of any practical use. Concerning the Imbalance Netting Process, Article 40(1) provides for an implementation notification of only three months, while this implementation will affect commercial positions – taken by market players when they are contracted for FRR and RR services – for a duration that would exceed these three months. Additionally, the information on the Imbalance Netting Process (article 70(1)), the needed FCR (article 74(1)) and FRR (article 75(1)) comes too late for market participants to act upon. The information provisions should be adapted to the market terms where these services are contracted.

Conclusion

All of the above issues need to be resolved in order for the codes to make a positive contribution to the internal electricity market, which is the primary objective of the Regulation under which the codes are to be adopted. As they are currently drafted, the codes will, at best, merely set in concrete the current status quo. At worst they could unduly restrict competition in procurement of balancing resources, allow TSOs to interfere with access to cross-zonal transmission capacity or even lead to a significant extension of TSO influence in the competitive market, in direct conflict with the unbundling requirements in the parent legislation: i.e. the Directive and the Regulation.

You will find detailed comments on individual articles of the draft LFCR code in the attached annex. Should you have any questions or comments regarding this letter or its annex, please do not hesitate to contact us.

Yours sincerely,



Jan van Aken
Secretary General

ANNEX COMMENTS ON INDIVIDUAL ARTICLES OF THE DRAFT LFCR CODE

Recitals

The recitals are not just vague words which form the background for the operative Articles in the network code. They may, in fact, eventually be used by the Court of Justice in interpreting the requirements of Community legislation and are hence important. Although this point has been made repeatedly in all consultations, the recitals retain concepts that are inconsistent and alien to the objectives of the Directives and Regulation. The following recitals should be revised.

- (3) Remove the reference to the TSOs having a “supply task”
- (4) Remove the reference to “as one entity”
- (11) Remove “or for economic optimisation”
- (17) Delete the last sentence

Article 2

We strongly oppose the idea that different definitions can be used in different network codes (for example “Connection Point” and “Operational Security”). For “Operational Security”, we would prefer the definition given in the draft LFCR code to be used and the CACM code to be revised accordingly. The current CACM code definition is very vague.

Definition of “Replacement Reserve”: if the definition remains as it is, there needs to be additional detail on the rules for activation, including transparency, and incorporation into the imbalance pricing methodologies etc., either in the LFCR code or the Balancing code.

Definition of “Exchange of Reserve”: the definition in the LFCR code should be replaced with the definition in the draft Balancing code.

Article 3

This text in 3(1) and 3(2) has appeared in all the System Operation codes. It is, at best, meaningless and non-operational. At worst it could be seen to give TSOs unlimited powers to intervene in commercial decisions on the grounds of “optimisation” or “assignment to the real originator”. EFET has repeatedly requested for this Article to be deleted from the network codes.

Articles 4-5 and 10-18

Article 4 of the draft code takes a very selective approach regarding the elements that are subject to regulatory approval referring to individual paragraphs. This means that anything not mentioned can be revised by one or several TSOs under Article 10-18 without regulatory approval. Regulators need to be very careful about what appears on each list. In general, the items listed below raise questions in this respect.

Article 4

- 2c. FRR technical requirements (Article 47.3) -> Article 4(4)
- 2e. RR technical requirements, (Article 49.3) -> Article 4(4)
- 3a. Mitigation measures (Article 29) -> deleted or moved to Article 4(4) [it is already mentioned twice]
- 3c. Limitations on FRR capacity for cross border activation (Article 37.7) -> Balancing code Article 7(4)
- 3d. Limitations on RR capacity for cross-border activation (Article 38.7) -> Balancing code Article 7(4)
- 3e. Changes to Power Generation \ Demand (Article 42.17) -> delete or Emergency code
- 3h. FRR availability requirements (Article 47.2) -> Article 4(4)
- 3k. RR availability requirements (Article 49.2) -> Article 4(4)
- 3m. Limits for exchange of FRR (Article 54) -> Balancing code Article 7(2)
- 3n. Limits for exchange of RR (Article 56.2) -> Balancing code Article 7(2)
- 4c. Mitigation measures (Article 29) -> delete (see below)
- 4j. Limits on cross synchronous FRR exchange (Article 62.1) > Balancing code Article 7(2)
- 4l. Limits on cross synchronous RR exchange (Article 64.1) > Balancing code Article 7(2)

Article 5

- 1b. Ramping restrictions on DC cables (Article 27) -> same process as “Allocation constraints” in CACM
- 1c. Ramping restrictions on generation \ demand (Article 28) -> delete (see below)
- 1d. TSO notification (Article 40.1) -> delete (see below)
- 1e. Measures in alert state (Article 42.12) -> delete (see below)

Article 10

- c. Frequency Quality Parameters (Articles 19.6) -> Article 4(4)
- d. Error Target Parameters (Articles 20.1) -> Article 4(4)
- h. Ramping restrictions on DC cables (Article 27) -> same process as “Allocation constraints” in CACM
- i. Load frequency control structure (Article 30) -> Article. 4(4)
- n. Operational procedures in non-Normal state (art. 42.11) -> delete (see below)
- o. Roles and responsibilities of the TSOs for netting (Article 39.2) -> Balancing code Article 7(2)
- q. Rules for operation in normal\alert state (Articles 42.6 and 42.12) -> delete (see below)
- x. Methodology to limit exchange of FRR across synchronous areas (Article 62.1) -> Balancing code Article 7(2)

- y. Methodology to limit exchange of RR across synchronous areas (Article 62.1) -> Balancing code Article 7(2)

Article 11

- c. Ramping restrictions on generation \ demand (Article 28) -> delete (see below)
- f. Limitations on FRR capacity for cross border activation (Article 37.7) -> Balancing code Article 7(3)
Limitations on RR capacity for cross-border activation (Article 38.7) -> Balancing code Article 7(3)
- h. Exhausted FRR and RR (Article 42.9) -> delete (see below)
- i. Escalation procedure (Articles 46.4 and 48.7) -> Article 4(3)
- m. FRR availability requirements (Article 47.2) -> Article 4(3)
RR availability requirements, (Article 49.2) -> Article 4(3)n
- n. Limits on exchange of FRR\RR -> Balancing code Article 7(4)
- s. Measures requiring changes in Active Power Production (Article 42.17) -> delete (See below)

As for the CACM code, NRAs should, under Article 4, be able to “require” changes rather than “request” in Article 4(8).

Article 19(6)(b)

Revise: “Stakeholders shall be consulted on all frequency quality target parameters.”

Article 25

Delete: it merely says that OS code may be applied and is redundant.

Article 27 and 28(1)

Delete: this is dealt with in the CACM code under “allocation constraints”. It should not be duplicated here.

Article 28(2) and 28(3)

Delete: vague ad-hoc restrictions on market participants are not appropriate. Ideally Article 9(14) of the NC OS code should also be removed but the proposed text goes far beyond this.

Article 29(1)(b)

Delete.

Article 31

If TSO use RR they must have an RR Process. Aren't 2b) – 2d) also necessary?

Article 35

Add "while maintain the integrity of the intraday market".

Article 36

The article gives the impression that netting is optional for TSOs. Modify as follows "Each TSO shall ~~have the right to~~ implement the Imbalance Netting Process for LFC Areas within the same LFC Block [...]".

Article 38(2)

Add: "d) intraday capacity allocation and trading".

Article 40

This also implies everything is optional for TSOs.

Article 42 (8) (9) (12-14) (17)

These ad-hoc "exhaustion" possibilities should be deleted. Such interventions are not necessary and discourage efficient reserve procurement.

Article 46

- 2.j.ii The ad-hoc limit to "sharing" of 30% should be removed or modified to reflect a statistical approach and the level of TRM.
- 4 Delete this ill-defined "escalation process".

Article 48

- 4. Revise in line with Article 46 above.
- 7. Delete.

Article 50

- 2. The exchange of FCR is allowed at 30%. But the FG says that only "surplus" can be exchanged bilaterally between TSOs. So where does this 30% come from? Should be limited to amount of TRM?

Article 54/62/64

Please add: "Until a CMO is in place in accordance with Article XXX of the NC EB, TSOs shall contract with BSPs directly for the purposes of exchanging reserve."

Article 54

The ad-hoc limit to exchange of 50% should be removed or modified to reflect a D-1 statistical approach.

Article 56

The ad-hoc limit to exchange of 50% should be removed or modified to reflect a D-1 statistical approach.