

TSOs proposal for amendments of the aFRR implementation framework and the balancing pricing methodology

Brussels, 12 December 2023. The European Federation of Energy Traders (EFET) takes the opportunity to respond to the TSOs consultations on:

1. amending the balancing pricing methodology, according to Article 30(1) of Commission Regulation (EU) 2017/2195
2. Implementation framework for the European platform for the exchange of balancing energy from frequency restoration reserves with automatic activation (aFRR) and voluntary elastic demand.

We appreciate that the TSOs gave a sufficient time to respond to these important consultations, the public workshop and the interactions at the last Electricity Balancing Stakeholder Group (EBSG).

General comments

We highlight that:

- The report presented to ACER on the price incidents is not available and the applied methodology is questionable, as already stated in the EFET response to the EBSG in May 2023. Nevertheless, the conclusions drawn from the report and presented with an at least implicit suspicion for abusive behavior by market participants, are used as motivation for the proposed mitigation measures.
- The theoretical reasoning in the explanatory document is contradictory. It is explained why the balancing energy market hardly meets any prerequisite for a marginal pricing market. The expected market outcome, however, is taken from literature for a market under perfect conditions. Furthermore, it is neglected that a significant share of the settlement is performed according to the pay-as-bid principle.
- The TSOs had proposed, 15 months ago on 26 August 2021, to lower the technical price limits from €99,999/MWh to €15,000/MWh and from -€99,999/MWh to -€15,000/MWh. ACER rejected this proposal on 25 February 2022 (Decision No. 03/2022), because it was not compatible with the principles of operation of the electricity market in accordance with Art. 3 (a) and (b) of the Electricity Market Regulation, as the proposal restricts free price formation. This assessment also applies to the new proposal, as the legal situation and the applicable principles have not changed.
- **It is yet too early to apply the next mitigation measures;** more time should be given for the market to evolve. Insufficient market liquidity, which is identified as a

current short-coming, will be resolved with numerous additional countries participating in PICASSO by July 2024.

- TSOs could also investigate the optimization of processes at their side. In its 2023 Market Monitoring Report (MMR), ACER refers to the possibility for “[...] optimizing the availability and use of physical transmission capacity at the time of the incident to increase the amount of cross-border capacity for balancing purposes.”. [[ACER MMR, page 38](#)].
- We oppose the position of some TSOs that the proposed mitigation measures would be a precondition to join the PICASSO platform. There is the clear, legal deadline of July 2024 for TSOs to join the platform, and this deadline should be respected. Only by extending the PICASSO platform can the market fully develop.

For these reasons, we do not support mitigation measures that would further restrict the market as this would be counterproductive and lead to an even further reduced market participation.

Report and Methodology

The report is not available and only the slides shown at the EBSG 05/23 can be commented on.

As requested in the amendment for the pricing methodology, all TSOs are requested to produce a report to ACER including market concentration measures if the CBMP reaches 50% of the transitional price limit. This threshold has been exceeded multiple times in Q4/22 and Q1/23 and parts of the report are presented in the slides (market indicators on slide 36 and 38).

The market indicators HHI and RSI are calculated for individual auctions and are plotted for those quarter-hours where a price incident was observed. The implicit conclusion that is suggested with this illustration is that price incidents are related to market power. Market concentration measures should, however, be applied on (HHI) or be evaluated over (RSI) a significant period of time (usually one year) to provide meaningful results. In a situation with little to no free bids, an $RSI < 1$ will be calculated for any BSP, not only the one with the largest bid volume.

Applicability of auction theory for balancing energy markets

The theoretical reasoning on the expected market outcome is flawed. On the one hand, it is acknowledged that necessary preconditions to apply results from auction theory are not met, on the other hand any bids beyond the ones to be expected under perfect market conditions (marginal cost) are considered exaggerated.

“bidding close to marginal costs should take place in the balancing energy market according to the fundamentals of the applied market design”

“Such market power may lead to strategic bidding, meaning financial/economic withholding, which involves bidding in prices higher than the marginal bid to be expected under perfect market conditions.”

vs.

“the closer a market comes to meeting these conditions, the more likely marginal pricing will lead to competitive prices and efficient market results. The Balancing Energy market according to EB Regulation hardly fulfils any of the conditions.”

It is an intellectual leap to address a natural discrepancy between real world market outcomes and academic text book literature with a price cap. This logic would require the introduction of price caps for just about every traded good in the world. If the TSOs view is that balancing markets are fundamentally not competitive, an argument we would not support, the logical policy response would need to be much more fundamental than to only lower the price cap in the existing market.

Furthermore, it is omitted that with the choice of a 4-second BEPP, a bid towards the end of the merit-order has a high chance of being remunerated on a pay-as-bid basis (non-AOF volumes); for mFRR this holds for DA bids. Obviously, this option is considered in the bid preparation and is yet another reason why the market outcome might not be identical to a marginal pricing market under perfect literature conditions.

The prices observed in the balancing energy market are the outcome of competitive market activities, taking into account all of the obligations, restrictions and opportunities involved (i.e. free formation of prices).

Market liquidity and market concentration

Generally, there is no physical scarcity in balancing markets. In most of the markets there is abundant prequalified capacity or technically capable units available. The TSOs restrict the market concentration measurement to the BSPs active in the balancing energy market. This does provide an incomplete picture.

It is each BSP's individual commercial decision to participate in the balancing capacity and energy markets. Reasons for not participating can be related to the commercial attractiveness of the market:

- Small activation probability
- Price limits
- No release of unused bids

or other issues:

- Operational complexity of the target model
- Regulatory concerns

Neither of the currently proposed measures will increase the attractiveness of the market and may further aggravate the issue of limited liquidity and the observed market concentration.

The current accession roadmaps, however, do provide a natural mitigation measure for increasing market liquidity. Most liquidity concerns, if any, will be addressed in July 2024 when the TSOs will access the platforms.

Specific comments on mitigation measures:

CBMP based on LFC activation

There is no quantitative assessment provided for the effectiveness of this measure. Only with a graphical illustration in the Explanatory Notes, the envisaged effect is highlighted.

The choice for the CBMP determination based on bid selection was well considered and in our view is still valid. Advantages of the current approach outlined in the Explanatory Document of the initial Pricing Proposal included “[...] transparency, auditability and robustness of the price determination approach. The price determination is not affected by local behaviour of TSOs or BSPs [...]” and according to stakeholder preference the “simplicity of the approach and consistency with other market time frames, that also determine the prices based on the clearing result.”

The disadvantage that “cross border marginal price directly derived from AOF could be very sensitive to large variations of aFRR demand and / or netting possibilities” were supposed to be mitigated: “[...] with a BEPP based on the AOF optimisation cycle, the impact of the price spike is confined to the volume exchanged / activated during the related optimisation cycles only”.

Furthermore, there were good reasons for not relying upon a decentralised price determination “mainly due to the lack of transparency”.

In our view, without a quantitatively substantiated assessment and measures to ensure that the transparency, auditability, and robustness are not compromised, changing the CBMP calculation is currently not sufficiently justified.

Price Cap

The adjustment to $\pm 10.000\text{€}/\text{MWh}$ until July 2026 for balancing energy bids is premature and unjustified. We stress that sufficient incentive compared to ID should be maintained.

A “price incident” is just a reporting threshold, there is no immediate system or market impact. A reduced transitional price limit of $10,000\text{ €}/\text{MWh}$, implies that the price incident

threshold then be reduced to 5,000 €/MWh, causing further price incidents at lower price levels, triggering additional discussions on the need for additional mitigation measures. This would create a vicious circle with endless discussions on the occurrence of 'problematic' price signals and the need to remedy them.

We strongly oppose the argumentation behind lowering the imbalance price cap linking it to market concentration and the apparent ineffectiveness of REMIT to deal with market abuse. The REMIT guidelines is the applicable legislation to address the root causes of any market abuse. It far exceeds the role of TSOs to assess the occurrence of market abuse and use any such assessment to implement preemptive market-suppressing measures. Also the use of (lower) price caps to combat operational errors is unacceptable; if such errors do occur frequently – and TSOs provide no such evidence – additional checks could be introduced to prevent them without suppression of market functioning.

We conclude that the proposed price limit is of a commercial nature and does not constitute a technical price limit. As a commercial price limit, the TSO proposal violates EU Regulation 2019/943, and for this reason, it should not be submitted to ACER. The TSOs view the technical price limit as a means of regulating the bidding behavior of the bidders. However, according to Article 10 of the Electricity Regulation, this is explicitly not the case. The ACER decision from 15 months ago also supports this perspective. It would be up to the legislator, not the regulatory authority, to make such a change.

The TSOs have not provided any evidence that the technical price limits are necessary for the efficient functioning of the market in accordance with Article 30(2) of the Regulation 2017/2195 (EB GL) and no new arguments have been brought forward in the accompanying document. The current proposal also lacks any explanation of the extent to which and why the balancing energy market is currently not functioning, even though there is currently a (temporary) price cap.

Finally, we express significant concerns regarding planning uncertainty in the context of fluctuating price caps. The concern lies in the dynamic nature of these price caps, which can undergo alterations depending on market circumstances (energy crisis, balancing costs, etc.). This poses a challenge for market participants who commit to multi-year contracts incorporating these cap elements. The need for renegotiation arises each time a change is anticipated, creating a lack of legal certainty regarding the stability of contract terms over the agreed duration. Introducing legal clauses to address this risk proves burdensome for market participants.

Elastic aFRR demand

It is noteworthy that TSOs are starting to introduce an element of discretion regarding frequency quality, while persisting in enforcing stringent balancing requirements on market participants.

We are worried that the introduction of elastic aFRR demand might lead to TSO relying upon more (new) specific products, which is to be avoided. Elastic aFRR demand must not foster the use of specific products.

With appropriate dimensioning in place, there should not be any need for additional elastic demand. However, with the necessary limitations and conditions, it may make sense for TSOs to not exceed the quality target at any price. Limitations/conditions would include the ex-ante definition and publication of price level, clear explanation on how to avoid it becomes a price cap, limitation to volumes exceeding pre-contracted volumes, avoiding reliance on specific products, avoiding reduction of pre-contracted volumes and relying on free bids.

If an introduction is foreseen nonetheless:

- an additional item in Article 3(4) should be added:
 - e) use specific products to compensate unsatisfied elastic demand.If the requirements in Article 3(4) are not fulfilled, the option for using elastic demand for aFRR should be revoked.
- the design should ensure that TSOs are prohibited from deducting available non-contracted balancing energy bids ("free bids") from their aFRR needs in their national dimensioning methodologies, without subsequently activating those non-contracted bids.
- TSOs using elastic demand shall publish the elastic demand curves in advance, rather than after their application, as suggested in the explanatory document. This proactive transparency is essential to provide market participants with adequate visibility on the merit order and associated activation probabilities.

Contact

Lorenzo Biglia
l.biglia@efet.org