

**Energie-Nederland response to the ENTSO-E consultation
on methodologies for pricing balancing energy and cross-
zonal capacity used for the exchange of balancing energy or
operating the imbalance netting process.**

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Energie-Nederland

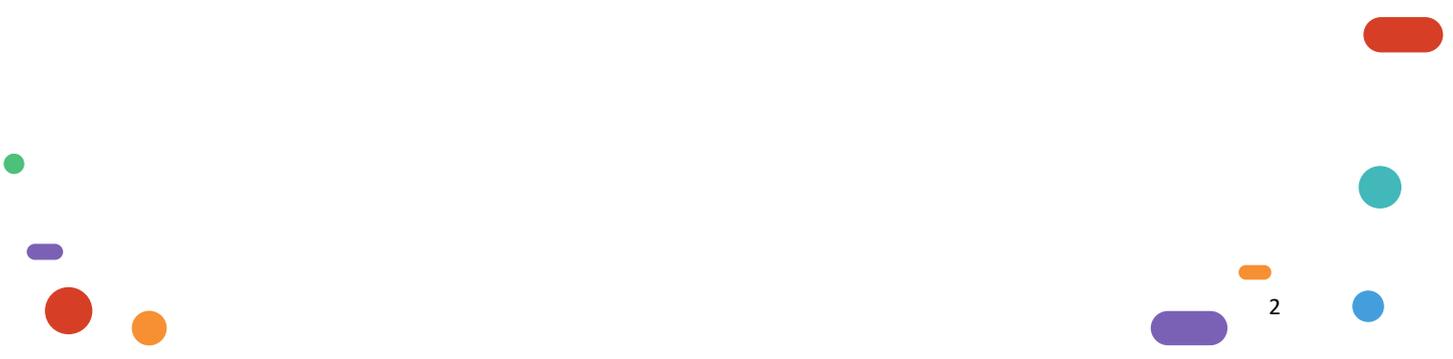
Energie-Nederland is the association representing the commercial participants in the energy market in the Netherlands. This includes generation, trade, supply, aggregation and services companies. Energie-Nederland believes that the transition to a carbon free energy system should be done by using the efficiency and innovation power of the energy market. Creating an international level playing field through market integration is key in this perspective.

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Answers to the consultation questions

The sections below give the consultation questions with our answers. In this paper we have excluded the administrative questions in the beginning and start with question 8.

8. Please add here your feedback on Whereas

Recital 2

Regulation (EC) 2017/2195 (Electricity Balancing Guideline, or EBGL) forms the legislative basis for the Pricing Proposal. The Pricing Proposal should therefore not only take into account the EBGL, but fully comply with this.

Recital 5

Article 30(1)(a) of the EBGL requires the pricing methodology to be based on marginal pricing (pay-as-cleared). To us the introduction of the Balancing Energy Pricing Period (BEPP) in article 3 of the PP is questionable. The EBGL only refers to pricing per Imbalance Settlement Period (ISP) or Validity Period, which shows that legislators considered those to be the relevant time periods where pay-as-cleared applies. The BEPP in case of aFRR is translating to the pay-as-clear obligation de facto into an average price per ISP, which therefore does not comply with EBGL article 30(1)(a)

Recital 8

In our view the correct price signals and incentives for market participants are given by the value of energy in a specific ISP, regardless the properties of the different activated products. The most straightforward solution for the market would be a cross product marginal price per ISP (giving the value of energy in that ISP) that is also used for the settlement of imbalances. As second best one marginal price per product should be the limit. A price per BEPP certainly doesn't comply with the requirements of the EBGL.

Recital 9

We do not agree with the statement that cross product marginal pricing will be inconsistent with the day ahead and intra-day timeframe. Firstly, the timing difference between day-ahead and intraday markets is incomparable to the aFRR and mFRR processes, which both have a Gate Closure Time of 25 minutes and both cover a 15-minute period with similar lead-times and are complements of the integrated FRR process aimed at restoring frequency in a 15 minute period. The logic against cross-product pricing between the FRR processes is therefore absent, as they both deliver a similar service within a similar timeframe with a similar granularity and lead-time. Secondly also the day ahead and intra-day time frames have different properties in the products on that market. It is a mix of single, block and profiled bids not to name even more complicated bids. Nevertheless this leads to a price per market time unit.

Recital 11(a)

What are integrated scheduling process bids? Is that related to Central dispatch?

Recital 11(b)

We don't share the view that 'effective' competition is fostered by artificially increasing the moments of price convergence. BSPs are pricing their bids with a lead-time of 25 minutes for a full validity period, so competition takes place on 15-minute basis, not four second. BSPs at that moment cannot know in advance whether congestion will happen, the size of the imbalance and their impact on the clearing price.

Moreover, BSPs are still in competition even at times of congestion, as part of the imbalance energy may already have been activated cross-border 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 control cycle "BEPP", the Pricing Proposal is actually reducing the effective competition as the incentive for BSPs to bid at marginal price is being reduced. The control cycle "BEPP" will result in BSPs bids being more often paid at the bidding price (either because it is the marginal bid during a "BEPP" or it is being paid-as-bid when ramping down), creating an incentive to increase bidding prices strategically; exactly one of the behavioral consequences that the pay-as-cleared principle aims to remove.

Recital 12

Decreased balancing costs are not a goal in itself. An efficient price for balancing energy optimizes system costs rather than costs for balancing.

Recital 13

See our comments to Recital 9. The PP is not consistent with the pricing in the day ahead and intra-day timeframe. It is aimed at pricing a process rather than energy as in these preceding markets. Unlike intraday and day-ahead the activation of a bid under OC BEPP can lead to different prices for the same delivery period.

Recital 14

The assessment that the current Pricing Proposal lowers barriers for new entrants as no complex probabilistic bidding strategy is required, is incorrect. The control cycle "BEPP" introduces an element of increasing complexity in the bidding strategy, as there are potentially up to 900 clearings with separate pricing points within an ISP. As the bid is paid at a paid-as-bid level for a significant number of cycles (either because it is the marginal bid during a "BEPP" or it is being paid-as-bid when ramping down), it becomes increasingly similar to a paid-as-bid methodology. A known characteristic of pay-as-bid methodology is the need for complex bidding strategies; exactly one of the reasons that marginal pricing (pay-as-cleared) methodology was preferred in the EBGL.

Recital 16

Energie-Nederland does not agree with the conclusion that the PP complies with the objectives nor with the requirements of the EBGL, as detailed above. In particular the PP violates the following criteria mentioned in article 3(1) EBGL:

- (a) fostering effective competition,
- (b) enhancing efficiency of balancing as well as efficiency of European and national balancing markets;
- (d) contributing to the efficient long-term operation and development of the electricity transmission system and electricity sector in the Union while facilitating the efficient and consistent functioning of day-ahead, intraday and balancing markets;

9. Please add here your feedback on Article 1 and Article 2 'Subject matter and scope' and 'Definitions and interpretation' respectively.

Article 2-2-o

The “Balancing Energy Pricing Period” (“BEPP”) is a new time interval that has no link to any existing timeframe. For market participants, both BSPs and BRPs, the relevant timeframes are validity period and Imbalance Settlement Period (ISP), both set in target at a 15-minute period. The EBGL at no time makes any reference to a “BEPP”. The Pricing Proposal should not be allowed to introduce arbitrarily a new term and timeframe that does not complement but contradicts crucial principles and aims of the EBGL. Allowing this would set a precedent that legislation can be undermined through operational codes that simply bypasses elements through the invention of new terms and concepts.

10. Please add here your feedback on Article 3 'General Principles'

Article 3-2

The XBMP for standard balancing energy bids should be calculated per Imbalance Settlement Period instead of the “BEPP”, as this is also the validity period for which bids are submitted. Furthermore, this is also the chosen market time unit for the market and ensures consistency with the preceding markets. The Pricing Proposal recognizes this by equalizing the “BEPP” with the validity period for the mFRR and RR products.

11. Please add here your feedback on Article 4 'Additional Provisions for the Pricing of Standard RR Balancing Energy Product Bids and Standard mFRR Balancing Energy Product Bids with Scheduled Activation Type'

Article 4-1

There is no need for a reference to the “BEPP”. The RR product has a validity period of 15 minutes, equal to the Imbalance Settlement Period in target. The RR product should be remunerated in line with this. It should therefore be sufficient to refer to either the validity period or the ISP of the activation of the RR product.

Article 4-2

The components (b) and (c) implicitly accept the existence of elastic needs in the RR platform. We have consistently disagreed with the use of elastic needs by TSOs. Elastic imbalance demand also allows TSOs to set the settlement price, and thus influencing the imbalance price, This will lead to de-facto price caps on the market. More fundamentally: TSOs should not be allowed to optimise as this is a market task. This is contradicting both the letter and spirit of the Electricity Balancing Guidelines.

We are moreover not convinced by the reasoning of TSOs that only the elastic need allows them to optimize between the different balancing products. The elastic need only replaces price uncertainty, given a pre-defined volume, with volume uncertainty given a pre-defined maximum price. It is not clear why the latter would be a superior design choice compared to the former. On the contrary: TSOs have no price risk (given the financial neutrality) but face a (physical) volume risk.

Regarding the potential use of elastic demand to optimize between Standard and Specific Products, we do not consider elastic bids the appropriate tool to do so.

If TSOs consider the Specific Product necessary for economic reasons (which they shouldn't as this is a market task), it implies some adjustments to the contractual framework for the capacity product while keeping the energy characteristics similar. In that case, there is no need for optimization between the two products through elastic bids as the EBGL foresees a procedure to convert Specific Products into Standard Products. This is more appropriate as it allows direct competition between the two, instead of a 'shadow' participation through elastic bids. If on the other hand TSOs consider the Specific Product necessary for technical reasons, it means that the Standard Product does not meet the needs of the TSO for particular balancing requirements. In that case, the optimization between the Specific Products and the mFRR Standard Product is not based on economic signals, i.e. the price through elastic imbalance needs, but on technical requirements. So also in that case, elastic imbalance needs are not a correct tool to choose between Standard and Specific Products.

The Pricing Proposal again shows the additional, unnecessary complexity introduced by elastic demand while its practical need or use has never been convincingly shown.

12. Please add here your feedback on Article 5 'Additional Provisions for the Pricing of Standard mFRR Balancing Energy Product Bids with Direct Activation Type'

Article 4

There is no need for a reference to the "BEPP". The mFRR product has a validity period of 15 minutes, equal to the Imbalance Settlement Period in target. The mFRR product should be priced in line with this. It should therefore be sufficient to refer to the ISP of the activation of the RR product.

13. Please add here your feedback on Article 7 'Additional Provisions for the Pricing of Standard aFRR Balancing Energy Product Bids'

Article 6-1

As with the mFRR and RR products, there is no need for a reference to the “BEPP”. The aFRR product has a validity period of 15 minutes, equal to the Imbalance Settlement Period in target. The aFRR product should be remunerated in line with this. It should therefore be sufficient to refer to the ISP of the activation of the RR product.

Moreover, the “BEPP” for the aFRR product is proposed to be equal to the optimization cycle of the Activation Optimization Function (AOF), making the creation of the new concept of a “BEPP” in the pricing proposal even more problematic. The Pricing Proposal should not be considered to be compliant with the EBGL’s requirement of marginal pricing (pay-as-cleared) when the XBMP actually applies to a new concept that defines a new period that is not present in the EBGL nor anywhere else in the market. For market participants, submitting one bid price that is subsequently applied to up to 900 separate clearing cannot be considered a marginal pricing (pay-as-cleared) pricing methodology, and is therefore not in compliance with EBGL article 30(1)(a). The bidding behavior of BSPs will consequently not be in line with the expectations that underpinned the EBGL requirement for marginal pricing (pay-as-cleared).

The reasonings put forward by the drafting team of the Pricing Proposal also do not convince for the actual necessity for slicing the remuneration period of 15 minutes into 1 second parts.

- As commented upon in the answer to the question 8, We disagree with the notion that ‘effective’ competition is fostered by artificially increasing the moments of price convergence. 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. BSPs moreover are still in competition even at times of congestion, as part of the imbalance energy may already have been activated cross-border 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 control cycle “BEPP”, the Pricing Proposal is actually reducing the effective competition as the incentive for BSPs to bid at marginal price is being reduced. The control cycle “BEPP” will result in BSPs bids being more often paid at the bidding price (either because it is the marginal bid during a “BEPP” or it is being paid-as-bid when ramping down), creating an incentive to increase bidding prices strategically; exactly one of the behavioral consequences that the pay-as-cleared principle aims to remove.

- We miss a rationale to have congestion to 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 Imbalance Settlement Period is the maximum granularity visible and relevant and if congestion occurs during an ISP, it is

consistent with other markets 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 up to 900 prices, 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. Simplicity has a high value in the market as it reduces entry barriers and therefore fosters completion. The ISP of 15 minutes is a sample that is a good compromise in that perspective.

- Despite assurances during the Electricity Balancing Guideline that price spikes are no longer a reason behind the optimization cycle “BEPP”, there lingers a fear in the explanatory document that extreme prices during short periods would create an unfair price. While a mitigating measure is suggested, it is, correctly, discarded as arbitrary. The activation of an aFRR bid should be considered as necessary for system balance and its price therefore correctly reflecting the cost of the energy required. It is questionable how realistic and necessary such second-long demand spikes actually are. Frequency Containment Reserves are available to deal with the immediate impact of imbalances. Individual TSOs are subsequently required to rebalance in 15 minutes (‘time to restore frequency’). It is therefore extremely doubtful that scenarios with activations of a couple of seconds of extreme volumes, and accompanying prices, are anything but artificial extremes that are actually not required to efficiently balance the system. At the same time, a short-time jump in activated bids increasing the price by orders of magnitudes may no longer be relevant in the target market design of an integrated European market with free bids. If ‘unfair’ prices caused by ‘temporary demand spikes’ is the actual driving force behind the choice for the optimization cycle “BEPP”, TSOs should look towards mitigating measures such as the input towards the PICASSO algorithm and the controller settings (see also general comments).

While the Pricing Proposal does not make a link between the pricing of the balancing energy and the determination of the Imbalance Price (that is the subject of the Imbalance Settlement Harmonisation Proposal), the two are in fact linked. The choice for an optimization cycle “BEPP” will make it impossible to make a direct link between the aFRR balancing energy price and the imbalance settlement price, which leads to a decrease in passive (BRP) contribution to restore the balance (EBGL art 17 explicitly mentions this to be the role of BRPs).

- A weighted average of the up to 900 different prices that are the outcome of the optimization cycle “BEPP” process can be made. This will have a dampening effect on the imbalance price, distorting the incentives for the BSP to deliver the activated balancing energy bids and creating the need for additional, artificial imbalance pricing components and/or penalties. In this perspective it is strange that high prices are a reason for mitigation actions, while in other circumstances additional incentives to increase the balancing price are discussed.
- The marginal price of the up to 900 different prices can be selected. This creates a significant, unallowed, revenue stream for TSOs as there will be a large difference between the cost of the aFRR balancing energy (which will in effect be a weighted average) and the revenue from the imbalance settlement process (which BRPs will have to pay at the marginal price). Also in this case there is a distortion in the incentives between BRPs and BSPs, requiring additional and/or artificial interventions. Moreover, it negates some of the arguments that the Pricing Proposal lists in favor of the optimization cycle “BEPP”, such as artificially inflated congestion rents (in this case replaced by inframarginal rents captured by

TSOs) and increasing revenue at the expense of BRPs (again, in this case captured by the TSO instead of the BSP).

A remuneration based on the validity period or ISP on the other hand, allows for a clear link between the balancing energy price and the imbalance settlement price, especially in the case of cross-product pricing or if only one of the products is activated during an ISP.

Process-wise, we regret the choice for the optimization cycle “BEPP” despite a clear preference from market participants for the quarter-hour “BEPP” (i.e. the same as the ISP or validity period) and the understanding from the workshop of 20/21 June 2018 that mitigating measures are being investigated (“Several mitigation measures to combat unnecessarily high imbalance prices are being investigated.” Minutes of Meeting). None of this is reflected in the Pricing Proposal nor the Explanatory Document. The only clear change compared to the consultation of Q4 2018 is the main line of argumentation that shifted from concerns around price spikes towards the fostering of “effective competition”. The new argumentation also fails to convince of the need for an optimization cycle “BEPP”, creating confusion around the actual decision basis for the choice for optimization cycle “BEPP”.

Article 6-4

It not clear how price indeterminacy could occur, as TSOs themselves exclude elastic imbalance needs and counter-activations from the aFRR process. As a result, the outcome of the Activation Optimization Function of the aFRR process should be a simple upwards or downwards activation, leaving no room for price indeterminacy resulting from the absence of a single intersection point between consumer and supplier curves.

14. Please add here your feedback on Article 7 'Additional Provisions for Pricing of Standard RR Balancing Energy Product Bids and Standard mFRR Balancing Energy Product Bids Activated for System Constraints Purpose'

Energie-Nederland has a strong preference for option 1 where BRPs are not impacted by cross-border congestion management tools. Congestion management is a separate process from balancing and should therefore not impact BRPs.

15. Please add here your feedback on Article 8 'Pricing of Specific Products'

Article 7

The pricing methodology for Specific Products that are converted to Standard Products for participation to the Common Merit Order List (CMOL) should be more prescriptive. Specific Products will be able to compete, through the bid conversion mechanism, with Standard Products on the CMOL. Without clear rules on the pricing of the Specific Products, there can be a serious distortion of the level playing field between Standard and (converted) Specific Products. There should therefore 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 as marginal pricing (pay-as-cleared), Balancing Energy Gate Closure Time, and minimum and maximum delivery time.

16. Please add here your feedback on Article 9 'Pricing of Cross-Zonal Capacity'

No comment

17. Please add here your feedback on Article 10 'Publication and implementation of the PP'

No comment

18. Please add here your feedback on Article 11 'Language'

No comment

19. Please add here general comments on the proposal

We fully support the objective of creating a European balancing market in line with the markets in the other timeframes (forward, day-ahead and intra-day) as this will enable a successful energy transition. That said we notice this concept is severely challenged and we must conclude that the proposed implementation frameworks for aFRR, mFRR and RR give the impression that TSOs see each other as competitors rather than entities that have to work together to operate the single Europe electricity system as one. Many provisions seem to safeguard the autonomy and financial positions. There is reference to national legislation in several articles and an important part of this legislation may be TSO regulation with possibly perverse incentives for cooperation. Here we see a challenge for NRAs to streamline this.

If the NRAs do not succeed it is foreseeable that the effort to set up the European platforms does not lead to any gains in social welfare at all, or worse would lead to a decrease of welfare. Market parties need clear rules and simple processes in order to market the flexible capacity in an efficient way. Correct price formation should ensure that the most economic capacity is activated to solve the imbalance. This will clearly not happen as long as pro-active and reactive TSOs coexist, as proactive TSOs will activate (RR, mFRR) before real-time while reactive TSOs do not.

We have concerns with the proactive way of balancing. Firstly, we do not understand how it is possible to forecast an imbalance. Clarity is requested how this is done, why it is needed (the duty of TSOs is to restore frequency in 15 mins so no need to solve something that has not taken place), and how it is beneficial, as there is always the risk that the forecast was wrong and that the activated capacity is redundant or has aggravated the situation. Secondly, freedom of dispatch is compromised as the flexibility from BRPs are disregarded. Pro-active balancing of a TSO lead to socialisation of energy costs of balancing and thus distorting incentives for BRPs inside and outside an LFC area.

Energie-Nederland believes that the balancing market should be truly harmonized to safeguard a level playing field. Ideally, the balancing market should be seen as the residual market where TSOs keep the system in balance through re-actively activating bids and settling BRPs with the marginal cost of each ISP. This approach will use predominantly aFRR and only occasionally an mFRR product. Such clarity allows BSPs to offer their capacity at the lowest possible price enhancing the overall system. However, this proposal and also the proposals for the other products lack the provisions for the interaction of the different balancing products. Moreover, the pricing methodology is also essential to judge this proposal for implementation. Therefore, we expect a consultation on the complete framework of balancing platforms and their interaction in a later stage.

Price spikes in the aFRR market should signal scarcity to reflect the real value of energy (which we could call 'justified price spikes'). For some TSOs the occurrence of 'unjustified price spikes' appears to be a major concern, underlying the choice for OC BEPP. Energie-Nederland can only endorse the view that unjustified price spikes are to be avoided, but thinks that the mitigation of

this lies on the side of improving and harmonising controller settings and the AOF, not in a market design which increases complexity and lowers transparency and efficiency.

As mentioned in the comments Energie-Nederland's main comments refer to the introduction of the BEPP. This will complicate the market considerably. We acknowledge the potential price "noise" of selected, but not activated bids given the control demand approach. However, in our view this stems from the selection of the control demand approach for the aFRR platform. This approach reduces the need for harmonization and cooperation of TSOs, but as we can see it leads to complex market conditions. We urge the TSOs to reconsider this approach and apply a control philosophy that uses the controller output rather than the input (e.g. the control request approach) for cross zonal exchange. With this approach the above mentioned problem with price "noise" does not occur, leading to a market with much lower entry barriers.