

FRAMEWORK GUIDELINES ON ELECTRICITY BALANCING
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DRAFT FOR CONSULTATION
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UNIDEN ANSWER

GENERAL COMMENT

- The proposed Framework Guidelines on electricity balancing aim to set the minimum standards and requirements needed for a competitive, harmonized and effective EU-wide balancing market, concerning cross border and market integration issues.

Balancing is vital for the electricity system and therefore it is important that all the actors adopt a responsible and pragmatic position on this topic, especially with respect to the scope of harmonization and the timeframe of implementation.

- First of all, IFIEC is wondering if market principles can fully apply to electricity balancing. Indeed, some generators currently have strong dominant positions in the electricity market and a generalized balancing market might suffer from abuse of market power. On the contrary, competition should be stimulated by allowing a sufficiently high number of potential suppliers to propose their balancing services.

In assessing whether to create balancing markets or to rely (at least temporarily) on regulated mechanisms, technical constraints and characteristics need to be taken into account, particularly for the frequency restoration reserves but mostly with regard to the frequency containment reserves. Indeed, with its strong dynamic and physical constraints, balancing is all the more specific. The high dependency of balancing models to power generation portfolio decided at national levels also makes balancing very particular. Local constraints and characteristics are then to be taken into account.

- Setting a common merit order across the EU electric system will bring cost improvement for each Member State only under the exclusive condition to apply the pay-as-bid principle. The example of the energy market has shown that marginal pricing doesn't bring a general cost reduction for the end user: an improved system means lower cost for the consumer.

However, the marginal price must be used to establish imbalances cost in order to strengthen the incentive towards all actors to limit their imbalances.

The combination of pay-as-bid for balancing and marginal pricing for imbalances will incentivize TSOs to develop in each control area the most competitive balancing technologies, while competing with other control areas that apply different energy mixes and technologies constraints.

- This is also critical to know who will pay what in such an integrated market when energy mixes are still decided at country level. The impact is also critical because of the national diversities in the financing of balancing costs: such balancing costs are recovered to a variable extent through the transport/distribution tariffs, but the breakdown of remaining costs among the Balancing Responsible Parties (BRP) is not always transparent.

- It should also be stressed that the development of cross-border balancing might be limited by the availability of cross-borders capacities.
- Regarding the timeframe for harmonization and integration, taking into account that electricity market integration is still not achieved, IFIEC proposes to implement a pragmatic step by step approach through regional implementation, starting with a regional monitored implementation.
- The voluntary participation of demand response (load) should be increased compared to today, not only for frequency restoration reserves and replacement reserves but also for frequency containment reserves.

Q1: Do you consider that harmonization of the pricing method is a prerequisite to establish a TSO-TSO model with common *merit order* list for balancing energy? Do you support the use of the pay-as-cleared principle?

Answer 1: Establishing a common merit order model is normally independent from the pricing method. The model should give a signal of the efficiency of balancing allocations, the objective of the harmonization and integration of balancing systems being to guarantee security of supply at a lower cost. In that sense it has not been proven that pay-as-cleared is the most relevant principle. Several other mechanisms (such as pay-as-bid or non-market based approaches) are currently used at national levels. The experience from these markets should be properly assessed, taking into account national characteristics and constraints.

Additionally, bearing in mind the strong electricity price increase since market liberalization due to marginal pricing, electro-intensive consumers strongly stress that the most cost-efficient solution must be implemented: therefore, and to make sure social welfare is increased, the Framework Guidelines should make certain the economical optimum for the whole system is found and is taken into account.

Moreover, unlike for the other standard power products made available in markets, only part of the balancing settlement costs are directly invoiced to the final users. For instance:

- Part of these costs, especially the ancillary system services, is generally integrated in transport tariffs.
- Tertiary or some of secondary reserves are most often costs to be shared internally between BRP.

As a consequence, the move to a market mechanism, particularly with pay-as-cleared principles, will definitely and heavily modify the coherence of the whole system and its cost for the final users.

Q2: Do you think the “margins” should not exceed the reserve requirements needed to meet the security criteria which will be defined in network code(s) on System Operation?

Answer 2: Allowing each TSO to retain some “margins” addresses the issue of non harmonized security criteria across control areas. Nevertheless, it must not allow TSOs to keep their preferred local reserves for themselves instead of sharing them for the common good. As a consequence, to comply with the objective of cost effectiveness across EU, the volume of “margins” must be minimized as far as possible, taking into account structural congestion between control areas.

IFIEC considers that the pricing method can play an important role in preventing countries from strengthening their security criteria to increase their “margin” – and thus retain more of own balancing capacity. In that sense the pay-as-bid method is far more relevant than the pay-as-cleared.

Q3: Do you support to aim at similar target models for frequency restoration reserves and for replacement reserves? Do you think a distinction should be made between manually-activated and automatically-activated frequency restoration reserves in terms of models of exchanges and/or timeframes for implementation?

Answer 3: Frequency restoration reserves and replacement reserves are different in terms of physical properties:

- Activation time can be much lower for frequency restoration reserves
- Most of the frequency restoration reserves are automatically-activated, contrary to the replacement reserves.

Thus, the target models for these two products should not necessarily be similar and timeframe for frequency restoration reserves should be longer.

By the same token manually-activated and automatically-activated frequency restoration reserves should be considered separately in a first step. Nevertheless, for better market integration and harmonization, a common model of exchange could be foreseen on a longer term.

Q4: Do you support the timeframes for implementation?

Answer 4: Given the experience we already have with electricity market integration and bearing in mind that electricity balancing is a more complex issue, we must remain pragmatic: full harmonization is a long process. A step by step approach should be foreseen:

1. Have sufficient liquidity on the electricity market is a pre-requisite to launch a harmonized replacement reserves system. At the moment, IFIEC sees that this condition has not been fulfilled yet.
2. Once there is enough liquidity on the electricity market a harmonized replacement reserves system can be set-up, starting with the harmonization of transactional wickets and balancing period timeframes (e.g.: 15 minutes in Belgium and Germany versus 30 minutes in France today)
3. The third step is the implementation of frequency restoration reserve harmonized system with two sub-steps to take into consideration automatically and manually-activated reserves.

Before subsequent implementation steps for real generalization, pilot regional initiatives on extended control areas (i.e. including several countries), may be proposed to learn from capitalization of experience; Such capitalization of experience shall be shared with market actors and consumer representatives under the guidance of the involved TSO and regulators.

The investment cost of IT development but also adaptation of regulation systems within all concerned BSP shall be carefully investigated ex-ante with a cost/benefit analysis for the social welfare.

Q5: Do you consider regional implementation objectives as relevant milestones which should be aimed at in these framework guidelines on electricity balancing and the Electricity Balancing Network Code(s)?

Answer 5: Regional implementation objectives are the most relevant milestones. As we can observe in the energy markets, harmonization starts between adjacent Member States. The European-wide harmonization can only be performed very gradually through regional implementations. We propose then to set-up a regional monitored implementation (concept of extended control areas), following the above-mentioned step-by-step approach, with precise implementation follow-up, like a yearly assessment of the progress of the coordination done by ACER and ENTSO-E. A cost-benefit analysis of region-wide TSO-TSO model with common merit order for both replacement and restoration reserves should then be performed and submitted to public consultation before going further in the implementation.

Q6: Do you consider important to harmonize imbalance settlement? Do you think these Framework Guidelines on Electricity Balancing should be more specific on how to do it?

Answer 6: Imbalance settlement harmonization is in itself a step further in the market integration. As a consequence it is important to achieve it, but not necessarily on the short term: Member States have very different grid designs, legacy generation, RES-E contributions and it can hardly be performed if electricity market is not fully integrated. Regional implementation (to follow electricity market integration steps) appears to be the best approach.

The symmetry of the imbalance settlement mechanism is key to incentivize all actors: positive imbalances should be treated with the same approach as negative imbalances in order to urge actors to keep permanently their imbalances as small as possible. This treats small and large portfolios equally. On the contrary, asymmetric pricing for imbalance would increase the financial risk of small portfolios much more than for large portfolios. Experience shows that it is much easier to balance a portfolio with many customers than a portfolio with a limited number of consumers: an asymmetric system could then

keep industrial consumers away from the wholesale market, which in consequence is harmful for competition. Symmetry will also allow a better integration of RES-E in the market, once they will be incentivized to do so.

In order to give the incentive towards all actors to limit their imbalances, pay-as-cleared appears to be the most relevant pricing principle for imbalance settlement.

The intraday exchange is going to be developed closer and closer to real time. The development of balancing services, especially cross-border exchanges, should not change actors' behavior to play and make systematic short-term arbitrations between intraday corrective exchanges and voluntary short-term imbalances. The increased use of balancing by actors as a substitute for intraday markets, to make correction of short term imbalances between production and consumption, bears the risk of increasing balancing margin volatility and prices, which would not be a social welfare improvement. As a consequence:

- The imbalance market should not be used for system arbitrage: gaming between electricity market and the imbalance market must be prevented;
- Priority requirements for electric systems safety must be reaffirmed, so as to keep balancing as the last resort resource before to maintain electrical system stability.