

Date: October 21st, 2019

Subject: MPP answer to Core TSOs consultation on a methodology for economic efficiency allocation process of cross zonal capacity for the exchange of balancing capacity or sharing of reserves

The Market Parties Platform (MPP) welcomes the opportunity to provide comments on the draft methodology for an economic efficiency allocation process of cross zonal capacity for the exchange of balancing capacity or sharing of reserves of the Core TSOs.

MPP acknowledges the possibility for TSOs to propose this methodology as prescribed in EBGL Article 42. If TSOs decide to set up a Balancing Capacity Cooperation, MPP would like to remind that the allocation of CZC for the exchange of balancing capacity or sharing of reserve should be the outcome of a market process. This implies that the market values of different products being traded and arbitrated should be exclusively determined by the market itself and not by an estimation of TSOs. The economic efficiency allocation process is based on reference periods and adjustments factors for the forecast of the market value of CZC for energy bids and for balancing capacity bids. MPP is against the implementation of the economic efficiency allocation process as currently proposed by TSOs, because this is not the role of the TSOs to forecast market values that can lead to highly inefficient capacity allocation as the forecasts might turn out to be false. In any case, MPP considers that the economic efficiency allocation process could only be envisaged as an interim solution in case the co-optimization process cannot be developed in the near-term (e.g. due to the algorithmical complexity to be handled); the long-term target should remain co-optimization, as apparent in the EBGL.

Moreover, the Capacity calculation taking place potentially much later than the determination of the CZC for the exchange of balancing capacity or exchange of reserves (in D-2 vs. at least D-7 pursuant to EBGL Article 42(1)), it is likely that the TSOs will have to forecast (at unusual timeframes) the CZC between bidding zones. This is another parameter which is forecasted by TSOs and which will enlarge the uncertainty cone in terms of market efficiency.

MPP also wonders whether the methodology proposed by TSOs, which implies that there is one CZC "optimal" split decision for each reserve allocation, is in line with the EBGL. Indeed, Article 38(2)(b) states that "*The proposal for the application of the allocation process shall include [...], in case of allocation process based on economic efficiency analysis, **the volume of allocated cross zonal capacity** and the actual economic efficiency analysis justifying the efficiency of such allocation*". This seems to imply that this volume is fixed once and for all, and not re-evaluated for each balancing capacity allocation. This would also be more consistent, because if the evaluation is performed each time, MPP does not see the benefit (neither for TSOs nor for MPs) of using the economic efficiency method rather than the market-based method (it is not more complicated to just wait until the balancing capacity GCT to perform the CZC split, rather than doing it *ex-ante*). Maybe the only advantage of the economic efficiency method would be to give MPs more visibility, because the

respective shares of CZC for energy and for reserves are known before MPs submit their bids? Could the TSOs clarify this situation?

Independently of the previous paragraphs, MPP regrets that the proposal is not sufficiently developed for being able to react or propose alternatives. This is particularly true for the concepts of reference period and adjustment value. In the frame of the proposed methodology, they are of utmost importance for the calculation of the market value of CZC for energy and balancing capacity bids, though they are only mentioned, and no detail on how they are designed, how they will be put in place is disclosed.

Should the TSOs/NRAs still decide to implement the economic efficiency allocation process within one BCC, then MPP would like to share some thoughts on the use of reference periods:

- The past does not repeat itself => not accurate nor reliable, as required under art 39.5(b) of EBGL. At the very least, a thorough analysis based on historical data should be performed to identify the explanatory variables which best account for the observed price differentials, and could be used to forecast future price differentials. Any simplistic approach, e.g. considering that “the same day in the previous week/month/year” is a relevant reference, should be excluded.
- There is a lack of data/sample to choose from as reference period (e.g AT/DE BZ splitting only one year ago)
- They are price impacting features that are not repeating so often, such as grid element or production unit outage.
- Prices are function of fundamentals that are, to a certain extent, forecastable, but also of the risk the MPs see in their activities, which is not forecastable.
- MPP considers that the periodic review of the efficiency of the forecasting methodology by the relevant regulatory authorities, as foreseen in EBGL Article 39(6), should not only be a possibility, but an obligation.

In Flow Based, network constraints are related to firm energy net positions (taking into account that certain allocated energy flows can relieve a constraint and allow other flows to be accepted). However, since there is no certainty about the activation of the procured balancing capacities, their impact on energy net positions is unknown. Given that Article 33(7) of EBGL forbids that reliability margins are increased to accommodate the uncertainty linked to the activation or non-activation of the contracted reserves (FRR or RR), MPP does not see how the market-based process could be applied with a FB capacity calculation without endangering the grid. MPP invites the TSOs to find a way to design a FB-proof market-based process; if not possible, this would be major obstacle to the implementation of the economic efficiency allocation process.

As regards the input for the calculation of the market value of CZC for energy bids, the wording of the methodology seems inconsistent with the explanatory document: the latter refers not only the forecasted energy price differentials, but to the whole forecasted DA offer-demand curves, allowing to

obtain the relationship between the CZC allocated for energy exchanges and the associated marginal surplus. Taking as input the forecasted energy offer-demand curves and not only the forecasted price differentials would allow to have an adaptive allocation of the share of CZC for energy exchanges, whereas if the input is only the price differential, it already incorporates a hypothesis on this share. MPP therefore asks clarification about the input used for the calculation.

Specific comments

Whereas

- MB CZCA may be applied before the go-live of DA FB MC (target 12/2020).

Article 1 – Subject matter and scope

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Article 2 – Definitions

- (d) & (e) refer to the “change of economic surplus” resulting from the incremental increase of the CZC allocated for the exchange of:
 - balancing capacity or sharing of reserve (d)
 - energy (e)

As detailed further on, MPP has concerns on the calculation of this relative value for the energy given the only use of price spreads (and not the bids themselves) as input, which is an absolute value.

Article 3 – Principles for each balancing capacity cooperation within the CCR Core

- (6) & (7) refers to the undefined terms “minimum contracting period” and “minimum validity period”. A clear definition of those two terms would be welcome.
- (9) states that “if the CZC allocated for the exchange of balancing capacity or sharing of reserves is no longer needed for this purpose, it shall be returned in subsequent capacity allocation timeframes”. However, MPP would better see the termination of the timeframe rather than the return of the capacity to subsequent capacity allocation timeframes. Otherwise, how would be treated the balancing capacity bids already selected? Would a TSO need to rerun a local auction for the procurement of balancing capacity as the CZC is not available for that purpose anymore?
- (11) refers to an “implementation methodology of the Balancing Capacity Cooperation” including fallback and curtailment procedures according to article 38 of EBGL. Nevertheless, article 38 of EBGL does not mention this methodology.
 - Review the reference to the correct EBGL article, if any
 - Fallback and curtailment procedures being of critical importance for Market Participants, MPP asks to apply article 10 of EBGL by organizing a public consultation on this “implementation methodology of the BCC”.

- More generally, all this article 3 should be in the “implementation methodology of the Balancing Capacity Cooperation”, and not in the CZCA methodology

Article 4 – Notification process for the use of the market-based allocation process

- (1) provides the possibility to CORE TSOs that are not members of a BCC to provide remarks on the forecast technique related to this EE CZCA methodology and applied in the concerned BCC.
 - MPP considers that the forecast technique should also be shared with MPs and be consulted. The forecast technique being at the center of the EE CZCA, full transparency on the process is required.
 - MPP questions the fact that the forecast technique for the market value of CZC for balancing capacity bids is not subject to the same treatment as the one for energy bids.
- (2) refers to the sharing of the CZCA optimisation function with CORE TSOs.
 - This is not clear when it has to be done.
 - As the CZCA optimisation function has a direct impact on the results of the CZCA, it should also be shared with MPs and undergo a public consultation.
- (3) refers the features of the BCC to be shared. Those that are mentioned are the minimum minimumorum to enable the working of a BCC, but as previously mentioned, full transparency on the forecast technique as well as the CZCA optimization function is also required.
- (3) refers to a lead-time period of 1 month. This is clearly insufficient. MPs require sufficient time to review (and probably adapt) their IT and operational processes. 6 months is considered as a minimum lead time.

Article 5 – Timeframe of market-based allocation

- (1.c) states that the notification of selected bids shall be done before the GOT of the SDAC. This is correct, however as the TSO-BSP GCT takes place before W-1, MPP would propose to set a timing for the notification to the BSPs way ahead of the GOT of the SADC (e.g. before D-1, in order to be able to cope with the potential daily procurement of reserve that has to be organized in accordance with art of the E-regulation)
- (2) lists the steps to be taken for the allocation process of CZC. The CZC domain is not mentioned but will be an input of this process. However, this is not known yet for the considered delivery day. Will that result from an additional capacity calculation before or again be a forecast of TSOs based on historical data? In the current process applied (and to be applied) in the CWE region (in the CORE region), the CZC is only calculated in D-2 and is publicly disclosed in the morning of the DA.
- (2.c) lets us think that there are TSOs performing the CZCA optimization function, and other not. Could you clarify who will perform such task, how will it be organized amongst the TSOs of the BCC.

Article 6 – Process to define the maximum volume of allocated cross zonal capacity for the exchange of balancing capacity of sharing of reserves

- (1) refers to article 42(2) of EBGL where it is stated that the maximum volume of allocated cross zonal capacity for the exchange of balancing capacity of sharing of reserves “*shall be limited to 5 % of the available capacity for the exchange of energy of the previous relevant calendar year between the respective bidding zones,...*”. Can you justify the Y-2 1.11 to Y-1 31.10 period that is considered under (2)?
- (2) refers to the market-based process whereas this proposal describes the economic efficiency approach.
- This is not clear how the maximum value will be updated along time. Will that be done each year?
- (3) sets the rules for new interconnectors that are defined as interconnectors that went operational after 18.12.19. For an equivalent Fmax, the maximum value will be much higher for new interconnectors than for the others. This is due to the application of the 10% on the active power capacity on one hand and on the average offered capacity on the other hand (read taken into account all externalities such as loop, transit flows, etc.).
- (4) paraphrases the article 42(2) of EBGL and the future harmonization between the co-optimized and market-based allocation process. Could you clarify how do you interpret this article.
- (6) opens the possibility for TSOs to apply additional limits besides the limitations of article 41(2). MPP would welcome the reasons why this would be applied and recalls that the additional limits cannot contradict EBGL.

Article 7- Determination of the forecasted market value of cross zonal capacity for the exchange of energy

- (1) refers to article 37(2) of the CACM GL. However, to our knowledge, the concept of “forecasted market value of CZC” is not covered in the CACM. The link to the article 37(2) of the CACM GL is therefore not straightforward.
- (3) makes reference to “*reference period*”. There is no other detail on those reference periods. However, there are critical to the good working of the EE CZCA.
- (4) mentions the application of “*adjustment factors*” that shall be included and justified in the “*methodology for the establishment of common and harmonized rules and processes for the exchange and procurement of balancing capacity according to article 33(1) of the EBGL*”. To us, the description of adjustment factors belongs to the EE CZCA methodology and not to the one related to article 33(1) of EB GL:
 - The adjustment factors are inherent to the CZC allocation mechanism that is chosen rather than to the overarching methodology defining the BCC.
 - Moreover, the concept of sharing of reserves is not covered by the article 33(1)
- (5) And vice versa.

- (6) is not clear. If it refers to that fact that energy bids will materialize in electricity flow over the (relevant) network elements whereas balancing capacity bids will not *per se* materialize in electricity flow because it will depend on the balancing energy needs of the TSOs, then it should be clarified in that sense. Moreover, we fail to see what is meant by a “*negative effect ... on the relevant network element*”.
- (7) only consider the CORE TSOs to be included in the yearly feedback loop. We fail to understand why NRAs and MPs are not included in it.
- As already mentioned in the introduction, it is not clear how to calculate the market value of the cross zonal capacity for the exchange of energy. As detailed under article 2, the market value is the change of economic surplus and not the economic surplus itself. So, without any information about the energy bids, but only the prices spread between BZ, it seems complicated to calculate the marginal value of the CZC and to cover all the spectrum (0 to 100% CZC for both purposes).

Article 8 – Determination of the forecasted market value of CZC for the exchange of balancing capacity or sharing of reserves

- (2) makes reference to “*reference period*” and “*adjustment factors*”. There is no other detail on those concepts. However, there are critical to the good working of the EE CZCA.
- (3) And vice versa.
- (4) states that the reference periods shall be based on the latest available information. This is a bit vague as it can indicate that the best reference period are the last ones in times, which is not *per se* true as the market fundamentals can evolve quickly.
- (5) only consider the CORE TSOs to be included in the yearly feedback loop. We fail to understand why NRA and MP are not included in it.

Article 9 – Determination of the allocated volume of CZC for the exchange of balancing capacity or sharing of reserves

- (5) does not explain what the starting point for this incremental analysis should be.
 - Either it starts with 100% of the CZC allocated to the energy bids and the CZC is gradually transferred to the balancing capacity/sharing of reserve as long as the marginal economic surplus of CZC for balancing capacity/sharing of reserve is greater than the one for the exchange of energy
 - Either, it starts with 10% of the CZC allocated to the balancing capacity/sharing of reserve energy bids and the 10% is gradually decreased towards 0% as long as the marginal economic surplus of CZC for the exchange of energy is greater than the one for balancing capacity/sharing of reserve
- (7) does not detail the circumstances under which the CORE TSOs / NRAs may apply those additional thresholds and/or margin to reduce CZC for the exchange of balancing capacity or sharing of reserves.

Article 10 – Pricing of cross zonal capacity

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Article 11 – Firmness regime of cross zonal capacity

- (2). How the CZC allocated for the exchange of balancing capacity or sharing of reserves that has not been used for the associated exchange of balancing energy of the product it was allocated for, can be released to “all TSO for the associated exchange of balancing energy for the same product”? BCC and common balancing platform make use of standard product with common activation deadlines. So that if the CZC has not been used for a product, it can just not be used by this same product (due to the harmonization of the activation timing...) but only for the activation of the subsequent ones.
- (2) mentions the role of “holder of the allocated capacity” which has not been covered before. More info would be welcome.

Article 12 – Sharing of congestion income from CZC

- (1) Wording issue in the sentence. How can a “Congestion income generated by ...”, which is expressed in euro be shared with a “congestion income distribution methodology”, which is a methodology? Replace share with by according to.

Article 13 – Publication

- (3) could be clearer. The reference to article (5.1.a) of this proposal seems not relevant as not related to publication elements
- (7) MPP would like to see such a publication each and every year in line with the feedback process proposed under the article (7.7) of this proposal.

Varia

Based on article 39.5(a), that describes how TSO can assess the market value of CZC for energy bids:

1. Use of transparent market indicators that disclose CZC’s market value;
2. Use of a forecasting methodology enabling the accurate and reliable assessment of the market value of cross-zonal capacity ==> This is the one chosen by TSOs in this proposal.

MPP proposes an alternative based on the first point rather, e.g. the OTC day-ahead quotations for next day:

- either as a reference to check the market value derived from TSOs’ forecast (e.g. the difference between the two should not exceed x%),
- or as the only input, with which the actual market value for reserve exchange is equalized, giving the associated CZC to be allocated to reserve exchange.