



TSOs consultation on potential market design evolutions of the FCR cooperation



EFET response – 10 February 2017

1. Could you briefly present your company or association and its involvement in the FCR market (volume, technologies...)?

The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent, sustainable and liquid wholesale markets, unhindered by national borders or other undue obstacles. We currently represent more than 100 energy trading companies, active in over 28 European countries.

EFET has welcomed and is actively involved in the initiative of ENTSO-E and TSOs to run pilot projects to help the design and pre-implementation of the electricity balancing target model, since its inception.

2. Do you have some general comments on this public consultation?

EFET welcomes the timely publication of this consultation. The FCR cooperation project, which is already running in practice in six countries, aims to establish one common market for the procurement of FCR. We see this initiative as a learning tool for the harmonisation

of procurement for other balancing capacity products. Hence the importance to get the model right, as well as the governance of this cooperation.

At the time of the projected accession of the French TSO RTE to the FCR cooperation in December 2015¹, EFET indicated that while it supported the immediate participation of France in the cooperation, a broader reflection should be launched on the compatibility of the different national regimes for the procurement of FCR and the possibility to further harmonise these national regimes to improve the functioning of the cooperation, and ultimately market efficiency.

3. Do you have some comments regarding the consultation process?

As mentioned earlier, we welcome the timely publication of this consultation.

However, over the past couple of years, EFET has warned ENTSO-E and individual TSOs of the lack of stakeholder involvement and transparency in decision-making within the Balancing Pilot Projects. For a project like the FCR cooperation, which is already running, a clear governance structure for the adoption/modification of rules on the design and for the monitoring of the operation of the mechanism is needed.

4. Do you prefer changing the auction frequency or keeping the weekly auction? – Please explain your answer

For the moment, the weekly frequency of the tenders seems appropriate to the current framework of the cooperation. The weekly auctions provide a good balance between the required bidding process on the side of market participants and the ability for a broad number of market participants to participate. Additionally, other measures considered in the consultation such as product duration and the transfer of obligations could achieve more in terms of ability of some market participants to contribute to the FCR cooperation without the associated significant increase in the operational burden.

¹ EFET response to the RTE consultation on its participation to the FCR cooperation, 18 December 2015, available at: http://www.efet.org/Cms_Data/Contents/EFET/Folders/Documents/EnergyMarkets/ElectPosPapers/NatRegLevel/~contents/KDF2V29J5Y2FHKTC/EFET-response-RTE_FCR-cooperation_18122015.pdf.

Should it be considered in the future that despite the implementation of these measures, the weekly frequency of the auctions impede the participation of certain categories of market participants, including renewable installation operators and demand response providers, then the auction frequency should be reviewed. However, a modification of the frequency of the tenders would depend on a number of elements:

- expectations in terms of liquidity: monthly or daily tenders may prove unworkable to some market participants, for whichever reason, who would withdraw from this market
- evolution of the rules on secondary trading: provided that secondary trading between BSPs is allowed or pooling arrangements are used, tenders can theoretically be pushed more in advance of real time (e.g. monthly frequency) as BSPs can adjust their portfolios closer to real time

5. If you prefer to increase the auction frequency, what frequency would you prefer: daily all days, daily working days only, other...? – Please explain your answer

See our answer to Q4.

6. Do you prefer a short lead time (GCT D-1 or D-2) or a long lead time (GCT D-3 up to D-6)? – Please explain your answer

The lead time (GCT) should be close enough to real time to ensure the broadest participation of BSPs as possible while making sure that sufficient time remains after GCT to organise a second auction for FCR, in case total demand of the TSOs for FCR could not be covered in the initial auction. Furthermore, the procurement sequence with decreasing product quality (see our answer to Q8) should be maintained.

7. In which case would there be benefits of having a relative long period between the GOT and the GCT? – Please detail your answer

Generally, a longer period between the GOT and the GCT has no disadvantages in our view if BSP can modify their offers until GCT. It may even reduce administrative burdens on the side of BSPs. In addition, for certain holiday situations, it would indeed be useful to have a long period during which the auction is open.

8. What are the relevant interdependencies with other markets? What would be the correct sequence according to you? – Please explain your answer

Units that are capable of providing FCR can usually also provide other reserve and wholesale products. For an efficient allocation of resources it is necessary to procure the product with the highest quality, i.e. FCR, first. All the remaining products should be procured subsequently, in order of decreasing quality.

9. What product duration do you prefer: weekly, weekly peak/off-peak, day (24h), 4 hours, 1 hour, other? - Please explain your answer

The current product duration of a weekly, base product is probably insufficient. More granular product duration allows more types of assets or portfolios to participate in the auction. However, there is a trade off as reducing product duration will increase the complexity and reduce transparency of auction results. An even smaller granularity of, e.g. 4-hourly or hourly blocks, would likely be too complex in combination with a weekly auction frequency and may pose some risks for TSOs in terms of frequency quality. In particular if the duration will be shorter than 4 hours, BSPs will need to have the possibility to bid block offers or exclusive offers. Otherwise the level-playing field between different technologies will not be ensured.

We also believe that in order to ensure fair competition between market participants, establishing a cross-border secondary market is necessary. This would enable all market participants regardless of their portfolio, to participate in the weekly tender and adjust their position closer to real time.

10. If a shorter product duration would be implemented, would linking of bids in time or having multiple products be an important feature or do you consider that only independent auctions should be implemented? For which product duration does the introduction of linked bids in time make sense to you? – Please explain your answer.

In general, linked bids should be avoided to limit complexity in the auction. However, if smaller product durations are introduced, linked bids are required so that the participation of units with significant ramp-up costs and minimum running times of several hours is still possible. Otherwise the total cost of FCR procurement will rise and the efficiency of the system will decrease.

11. Do you prefer divisible bids only or divisible and indivisible bids? – Please explain your answer

As a matter of principle, we favour a harmonisation towards the use of divisible bids throughout the cooperation to improve the most efficient use of all bids. Indeed, the indivisibility of products from Swiss BSPs currently poses problems to the seamless integration of FCR procurement in the existing cooperation. In situations with an indivisible Swiss bid being the last accepted bid, the CMO is split up. Adding more possibilities for indivisible products would increase the occurrences of decoupling. As the market of the FCR cooperation is far larger than any national market, the risk of being the marginal bid is sufficiently limited as to be acceptable.

12. In case indivisible bids are introduced, what should be the maximum bid size? - Please explain your answer

Should indivisible bids be introduced, the maximum bid size should not restrict the participation of certain BSPs in the FCR auction, and hence be smaller than what could reasonably be delivered from a large production unit. If not, the reason for indivisible bids (ability to split must run costs of production units over a larger delivery volume of FCR) would disappear. A maximum bid size value of around 30 MW would, for instance, seem reasonable considering current units while at the same time be significantly smaller than the total demand.

13. Should exclusive offers be allowed or not allowed in the whole cooperation?

– Please explain your answer

The necessity of exclusive offers depends on the product duration. If smaller product durations are introduced then exclusive offers will definitely be required. Also, if indivisible bids would be allowed, it could be beneficial for market participants to allow exclusive offers.

14. Do you prefer symmetric bids, asymmetric bids or the possibility for having both? – Please explain your answer

Traditionally, EFET has favoured symmetric products for FCR as they mirror the inherent symmetry in the FCR signal and limit complexity in terms of auction design and sequencing. However, we also understand how symmetric products could limit the participation of certain BSPs in the FCR auctions.

Should asymmetric bids be introduced, we believe that the possibility to also offer symmetric bids should be kept as this would allow asset owners wishing to provide both upwards and downwards bids to bid in at a lower price as fixed costs can be spread over both directions.

15. If asymmetric bids are preferred, should these be procured in separate auctions for upward and downward FCR or in one auction for both upward- and downward FCR, possibly together with symmetric products?

In case asymmetric bids are preferred, we favour the introduction of separate auctions which do not take place at the same time. Mixing asymmetric and symmetric products may cause unintelligible auction outcomes. However, if linked bids are introduced, a single auction where asymmetric bids can be linked for those BSPs wishing to recreate a symmetric product could be organised. This would allow assets that can provide both upward and downward bids to avoid having to include their fixed costs in both bids. This solution would avoid any increase in overall costs or loss of competitiveness of the bids and therefore ensure the overall economic efficiency of the auctions.

16. In case of separate auctions - which auction should be carried out first? Or should both auctions take place simultaneously?

In case asymmetric bids with separate auctions are preferred, the framework should allow units that can provide either positive or negative FCR to contribute to the best of their ability to the system. Hence, if these asymmetric bids cannot be linked, then the auctions should not be carried out simultaneously: indeed, having simultaneous auctions in this case would mean that the capacity that was not contracted in one auction would not be available for the other one. In case the bids can be linked, then the auctions could take place simultaneously, as there would be no risk that the capacity that were not contracted for either upward or downward regulation would be lost for the other direction.

Should the auctions not take place simultaneously, the sequence of the auctions should remain by decreasing value of the product (see our answer to Q8); the value of each product should be (re-)assessed regularly by the TSO.

17. If asymmetric bids are introduced, would the introduction of energy remuneration and/or BRP imbalance adjustment be necessary?

BSPs should recover the cost of energy in one way or another. If not remunerated explicitly, BSPs should be able to take the energy component into account in the pricing of their bids.

18. Is 1 MW minimum bid size sufficient or would a lower bid size facilitate your participation?

We generally favour maintaining the 1MW bid size for all standard products. Should this significantly hinder the participation of certain categories of market participant in this market, then the minimum bid size ought to be reviewed with close involvement of all market participants.

19. If only one of the following three options would be possible – indivisible bids combined with divisible bids, symmetric bids combined with asymmetric bids, and linking bids in time – what would be most important?

Among the proposed option, EFET would favour the combination of symmetric and asymmetric bids.

20. How do you see the possibility to create different bid structure compared to the need for easily understandable results?

In order to ensure efficient bidding, there should be a clear price signal for each separate product. This price signal will be distorted with complex bid structures. In a small market like FCR, the potential distortion is to be considered with even greater care than in wholesale markets.

21. Please rank the three options in decreasing preference order – Please explain your order preference.

We favour option 1, for transparency reasons.

We do not have a clear preference as to the ranking of the two other alternatives. While option 2 and 3 have their limitations, option 2 would improve overall cost optimisation, whereas option 3 would allow for more intelligible auction outcomes.

22. Is cross border transfer of capacity obligation an important feature? – Please explain your answer

Transfer of capacity obligation is required for secondary trading of balancing capacity, therefore it has to be possible.

Such a mechanism would allow for a larger, more liquid secondary market for the transfer of capacity obligations. The overall benefit of such a mechanism would be a more economically efficient allocation of the capacity obligations and a reduction in risks linked to potential non-delivery.

23. In case you think XB transfer of capacity obligation is an important feature, do you think its relevance decreases when auction frequency increases and when product duration decreases? Is there a specific breakpoint in terms of auction frequency or product duration where it would not be that important anymore? – Please explain your answer

The transfer of capacity obligation within and across control blocks is an efficient means to virtually split up a longer product duration. With short product durations, a reduction in product duration would theoretically decrease the need for the transfer of capacity obligations as the period – and thus the risk – to be covered is reduced. However, the benefit of the ability to transfer the capacity obligation remains present in almost all time horizons as it still contributes to decreasing the risks for BSPs and allows for economic re-optimisation, irrespective of the product duration.

24. In case of implementation would you support a simple mechanism such as first come first served? – Please explain your answer

The first come first served principle would be an acceptable starting point for the cross-border transfer of obligations, as it is simple and easy to implement. An evaluation of the mechanism and possible alternatives could be performed after experience of such transfers has been gained.

25. In case of implementation could you please comment on the example proposal made?

The example offers a good overview of the different steps involved in the cross-border transfer of obligations. However, TSOs should be more ambitious in how close to real-time it remains possible to transfer the obligations. It should also be possible to make transfers in the intraday timeframe, especially if not all capacity was used by the transfers in the day-ahead timeframe.

26. Do you prefer pay-as-bid or marginal pricing? – Please explain your answer.

First and foremost, we want to insist on the need to ensure that the same pricing methodology applies throughout the cooperation.

An evolution towards marginal pricing should be the target of the FCR cooperation. It will align the procurement of FCR on that of other reserve types along the lines of the spirit of the Electricity Balancing Guideline.

The fear of marginal price spikes should not deter efforts on the side of TSOs to implement marginal pricing: TSOs should not base the development of market design options or take any decision in the running of auctions based on prices. For decision-makers such as regulators and governments, the fundamental principle should be that of market efficiency overall, in which case the consideration of overall costs and benefits of marginal pricing should prevail over the consideration of the sole costs of individual auctions when prices spiked.

Also, we would like to remind the TSOs of the FCR cooperation that all Member States participating in the FCR cooperation signed the Joint Declaration for Regional Cooperation on Security of Supply in the Framework of the Internal Energy Market of 8 June 2015. The Declaration stressed that these Member States “*will not restrict cross-border trade of electricity including in times of high prices reflecting market scarcity and [they] will follow EU-regulations on cross- border trade also with respect to ensuring secure system operation*”². We believe these commitment should apply to the procurement of FCR just as much as to the rest of the internal market.

27. Are you satisfied with the degree of harmonisation of the common FCR market (satisfied, mixed, not satisfied)? - Please explain your answer.

EFET believes in the benefits of harmonising rules and arrangements at regional and EU level, if only to ensure a level-playing field between market participants throughout the

² Joint Declaration for Regional Cooperation on Security of Electricity Supply in the Framework of the Internal Energy Market, 8 June 2015, available at: <http://www.benelux.int/files/4414/3375/5898/Jointdeclaration.pdf>.

region. Nonetheless, we think that the decision to harmonise specific market design elements should always be guided by the overall welfare benefits that can arise from it.

The FCR cooperation is already operating on the basis of different FCR procurement models in Austria/Switzerland vs. Germany/The Netherlands. However, improvements in the efficiency of the cooperation through further harmonisation are clearly needed, for example with regard to pre-qualification criteria, penalty clauses and the establishment of a common secondary market for all the countries of the cooperation.

28. Do you consider any of the existing differences as critical concerning level playing field? If yes, please list the most critical differences from your point of view and give an explanation why this is relevant concerning level playing field.

Yes, bridging the regulatory gap on the following differences is critical to improve the level-playing between market participants across the cooperation:

- Backup rules
- Penalty regimes
- Imbalance regimes
- FCR energy treatment
- Prequalification criteria

29. Please list and sort the 3 most important harmonization priorities for your company

Here at the top harmonisation priorities for EFET:

- **Harmonisation of prequalification standards:** the required standards for units to participate in the common market have to be harmonized, as this is the basis for a level-playing field between all market participants in the cooperation. Apart from the pure prequalification tests, additional requirements set on certain units, e.g. storage (30 min criterion), have to be harmonised.

- **Establishment of a secondary market for FCR procurement throughout the region:** we believe that the possibility to exchange reserves between BSPs helps improve the efficiency of the common FCR procurement process. Indeed, the exchange of reserves between BSPs after the auction and closer to real time allows market participants to correct misalignments or underperformance of some of their committed units. Without such BSP-BSP reserve exchange option, especially if this comes with an obligation to have a back-up in market participants' portfolio, market participants are unnecessarily constrained to adjust their portfolio and commitments freely. Besides, it is prone to constrain the volume of reserves available to market. Hence, we believe that a secondary market gives more flexibility to market participants and is likely to free up more reserve capacity – especially if the solution of the weekly tender based on a single product is maintained. A thorough analysis of the welfare cost and benefits of introducing such a measure should be performed by the TSOs in the cooperation.
- **Application of similar availability requirements (including backup), control and penalty regimes in all countries of the cooperation to ensure a level-playing field between market participants:** the rules on control and penalties are based on fundamentally different philosophies depending on the country – e.g. few controls with very high penalties in Germany, compared to regular controls with lower penalties in France. While the outcome of the different systems may be quite similar in the various countries in terms of the actual penalties paid by market participants overall, these differences may represent a significant difference in FCR procurement costs and risk management practices (including margining) at individual BSP level.
- **Standardisation of hardware requirements (measurement of delivery and frequency, communication, IT):** different standards on measurement or communication can cause unfair disadvantages in cost and severely limit market access for specific technologies (e.g. DSM) in different countries.

30. Could you list and sort the 3 most important topics that should be addressed for your company

We refer to our response to Q29.

We would recommend the **establishment of a governance structure for the consultation of stakeholders and co-decision within the cooperation**: over the past couple of years, EFET has warned ENTSO-E and individual TSOs of the lack of stakeholder involvement and transparency in decision-making within the Balancing Pilot Projects. For a project like the FCR cooperation, which is already running, a clear governance structure for the adoption/modification of rules on the design and for the monitoring of the operation of the mechanism is needed.

31. Do you have any other comments regarding FCR?

No further comment.