

## Has the dream of electricity balancing reform in France died again?



### EFET memo – 17 October 2017

Following a long period of consultation on a Green Book presented by RTE in 2016, the French regulator CRE published in June 2017 a decision sketching the roadmap of a reform of electricity balancing in France for the years to come. Hopes were high among market participants for an in-depth reform of French balancing mechanisms with a view to remedy some of the inefficiencies of the current framework, and reap the benefits of the soon-to-be-in-force European Commission Guideline on Electricity Balancing. However, many of these hopes have been crushed. In this paper, EFET would like to share its questions and concerns, and show a more ambitious way forward for the French electricity market.

#### I. Decision to maintain the margin model and impact on the intraday market

In its decision, CRE confirms its vision that it is not necessary to harmonise the balancing processes in order to have market integration. CRE also confirms its intention to maintain the current “margin model” in place in France, whereby the TSO can activate energy (up or down) ahead of the operational window, in order to build margins.

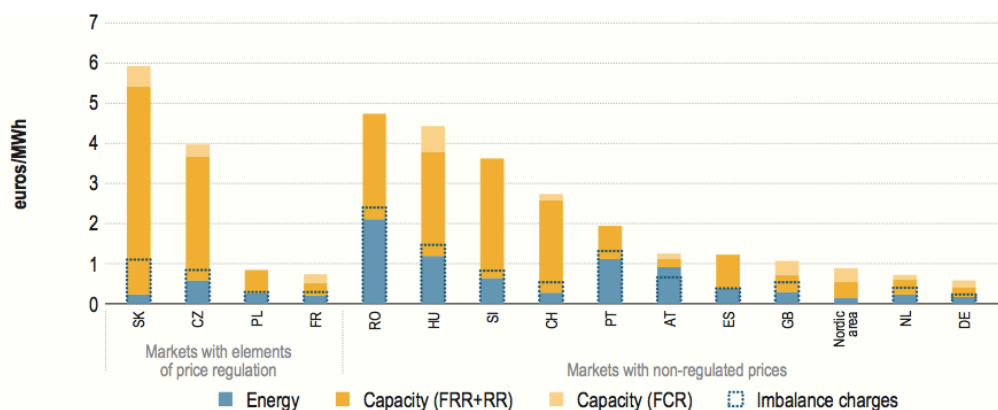
EFET wonders what are the assumptions on which CRE can stipulate that this kind of model has no impact on market integration. **Having a TSO already purchasing energy a few hours ahead of real time in parallel of the intraday market surely has a negative impact on the liquidity of the intraday market, and probably some impact on market integration.** EFET would therefore welcome more clarity on this statement.

CRE also considers that the margin model is not incompatible with the recently voted Electricity Balancing Guideline (EB GL) thanks to the use of specific products. EFET considers that the spirit of the guideline is to maximise the utilisation of standard products, and observation shared by CRE in its consultation document of January

2017 leads us to believe that CRE agrees to this objective. Therefore, **we wonder – as expressed in our answer to the consultation<sup>1</sup> – how the use of standard product will be maximised in France if the TSO has the possibility (via specific product) to activate energy outside the operational window (i.e. up to several hours before real time) for purposes other than congestions.**

EFET also regrets the fact that alternative models are not more considered/studied before making the decision. For instance, CRE confirms that current models allow to achieving an efficient use of resources in the short term. We are particularly interested in understanding more about the assessment of the costs of balancing reserves in France, compared to the costs of balancing reserves in countries with a reactive balancing system. In the recently published Market Monitoring Report 2016<sup>2</sup> from ACER, **we can observe that the costs of balancing capacity procurement and balancing energy per unit of final electricity demand in France are similar, if not lower in Germany (see Figure below).** To quote ACER in its report, “lowering artificially the balancing energy procurement costs through price regulation is counter-productive. The target should not be to guarantee the lowest possible balancing energy prices, but to ensure efficient price formation, i.e. prices reflecting the ‘true’ value of flexibility. In general, price regulation is a barrier to balancing energy prices to reflect this value, and therefore fails to attract the adequate investments in flexible resources from either generation or demand assets. Moreover, relatively low (average) balancing energy procurement costs can be observed in countries without price regulation as shown in Figure 24 for Germany, the Netherlands, the whole Nordic area and Switzerland.”

Figure 24: Overall costs of balancing (capacity and energy) and imbalance prices over national electricity demand in a selection of European markets – 2016 (euros/MWh)



Source: Data provided by NRAs through the EW template (2017) and ACER calculations.

Note 1: The overall costs of balancing are calculated as the procurement costs of balancing capacity and the costs of activating balancing energy (based on activated energy volumes and the unit cost of activating balancing energy from the applicable type of reserve). For the purposes of this calculation, the unit cost of activating balancing energy is defined as the difference between the balancing energy price of the relevant product and the DA market price. Imbalance charges applied in the Nordic market are not included in the figure, as data were not available for all Nordic countries.

Source: ACER 2016 Market Monitoring Report

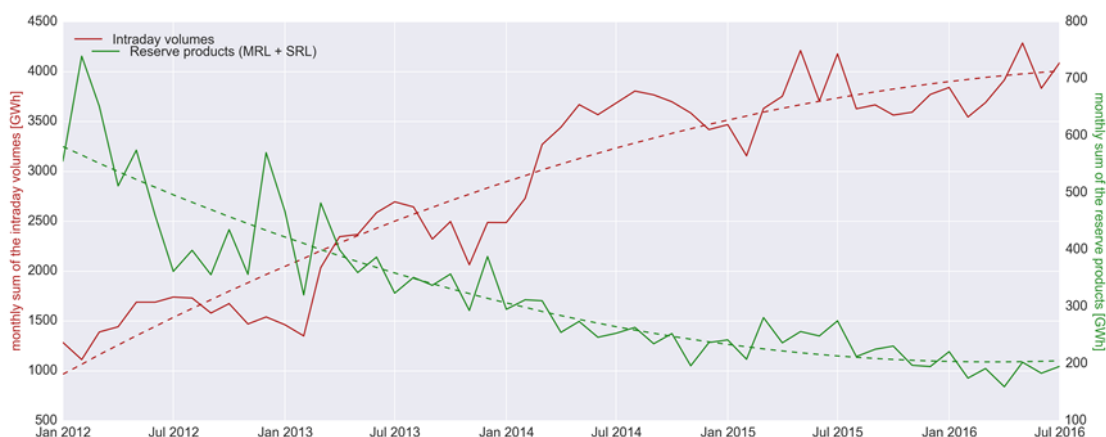
<sup>1</sup> EFET response to the CRE consultation on the electricity balancing roadmap, dated 20 January 2017, available at: [http://www.efet.org/Files/Documents/Electricity%20Market/Spot%20and%20short-term%20markets/EFET\\_CRE-consultation\\_Balancing\\_20012017.pdf](http://www.efet.org/Files/Documents/Electricity%20Market/Spot%20and%20short-term%20markets/EFET_CRE-consultation_Balancing_20012017.pdf).

<sup>2</sup> ACER 2016 Market Monitoring Report, dated 6 October 2017, available at: [http://www.acer.europa.eu/Official\\_documents/Acts\\_of\\_the\\_Agency/Publication/ACER%20Market%20Monitoring%20Report%202016%20-%20ELECTRICITY.pdf](http://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/ACER%20Market%20Monitoring%20Report%202016%20-%20ELECTRICITY.pdf).

We would also like to understand why CRE does not consider that an efficient intraday market could reach the same level of efficiency. CRE argues that market participants do not have a sufficient visibility on the grid situation in order to take the right actions. EFET regrets the lack of considerations of transparency measures that could be taken in order to give the market this visibility.

We welcome the request from CRE to RTE to quantitatively study the possible benefits of a reactive model. However, the first workshop organised by RTE on the subject gives us little hope that a real objective study will be performed. **Given the specifications presented by RTE, the study is bound to over-estimate the additional costs and under-estimate the benefits of a reactive model:**

- The estimation of the additional costs that a reactive model (with reserves) would generate will be computed considering existing imbalances. The benefit of a reactive model is that the imbalance that the TSO has to manage is supposed to be much smaller, given (i) the incentives via an imbalance price correctly reflecting the supply-demand balance of the system, (ii) the exchange of intraday products with smaller granularity and (iii) the extra time given to the market participants to solve their imbalances.
- The improved capability of BRPs to rebalance in the market is of course considered by RTE. However, RTE proposes to study historical imbalances over the second half hour of each hour, versus the imbalance in the first half hour. EFET considers that this does not represent a good estimation of the capability of BRPs to rebalance in the market. Return on experience in some countries is showing a clear trend: the more trades in intraday markets, the smaller the needs for TSOs to activate balancing reserves. To illustrate this, the figure below shows the correlation between the increase in monthly traded volumes in the intraday market in Germany compared to the decrease in monthly volumes of activated balancing reserves since 2012:



Source: Statkraft, based on data from EPEX Spot and regelleistung.net

We therefore strongly advised the regulator to request RTE to review the specification of its study in order to model the full spectrum of what a switch to a reactive model in France would entail.

## II. Improvement of the margin model

Notwithstanding our comments above on the advantages and drawbacks of a “margin model” versus a more reactive model, EFET regrets that **CRE does not propose substantial measures to improve the margin model, despite clear suggestions proposed in most of market participants’ answers to the consultation.**

In particular, EFET is concerned about the limits of this model and about the impact this model has on short-term electricity markets in periods of scarcity. During the cold spell of January 2017, prices on the day-ahead and intraday market remained relatively low, while at the same moment, RTE announced that the available margins were lower than the requested margins. RTE had to activate a significant amount of energy upward during six consecutive days. The amplitude of the activation was not that surprising given the thermo-sensitivity of the French electricity system, but the structural aspect of it was (i.e. the fact that during six consecutive day, RTE had to activate upward – in the past the situation was always remedied within four days). EFET also noticed that the system ran with insufficient level of security on January 25<sup>th</sup>, without significant impact on the imbalance prices.

**The first element to improve the margin model is to increase transparency on the side of RTE.** In his answer, EFET suggested reinforcing transparency around the margins, and in particular having transparency on the actions undertaken by RTE to build the margins, as soon as these actions are triggered (in addition to the requested publications after each ISP). We do not understand why this aspect is not part of the CRE decision: what is preventing the publication (in an anonymous way) of actions taken by the TSO to build the margins? In addition, while EFET took note of the CRE decision to ask an update of the available margins during intraday, we recommend the regulator to request a publication with an hourly granularity.

**The second element is to clarify the “limits” of the margin model:** what happens when there are not enough margins? EFET thinks that a clear scarcity signal should be sent to the market, i.e. that the imbalance price increases all the way up to the value of lost load (VoLL) when margins are exhausted. Without this, the imbalance price is meaningless and does not send an appropriate signal in the other timeframes. As a result, the electricity price in intraday, day-ahead and forward is distorted.

**The third element is to investigate the impact that margins activation ahead of the operational window has on the imbalance price.** When a unit is activated and runs at minimum load, we understand that no action is taken to reduce energy injected elsewhere. When getting closer to real time, this probably means that less mFRR or aFRR must be activated. This hides the true value of energy in real time and has a distortive impact on the imbalance price.

### III. Evolution of aFRR

Another point of concern for EFET is the **lack of ambition of the proposed evolution for R2 (aFRR) activation and R2 procurement.**

**Regarding the activation, we would like to remind that with the current system (i.e. remunerating R2 activation at the day-ahead price), market participants are encountering losses:**

- When R2 is activated upward: a remaining unit (hence out of the money in day-ahead) or a demand response provider is requested to generate more electricity/activate consumption upward. It is paid at day-ahead price, which is most likely lower than the marginal cost of this action, and which in any case fails to represent the value of electricity in real time.
- When R2 is activated downward: a unit that is running (hence in the money in day-ahead) or a demand response provider is requested to reduce production/activate consumption upward. Instead, the relevant BRP is requested to purchase electricity from RTE at the day-ahead price, which means that the margin (delta between day-ahead price and marginal cost) is lost for this BRP. Again, this fails to represent the value of electricity in real time.

**Regarding the activation, EFET does not understand why CRE proposes to wait for the possible launch of the European platform for aFRR to reform the regulatory framework for R2.** Evolving towards merit-order based activation is a no-regret quick win and the future EU platform will anyway be a TSO-TSO platform: the French BSPs will have to communicate with RTE to provide bids to this platform. Setting up the right communication tools and the right activation philosophy will be an obligation in the future, but the work can start today. The proposed draft calendar shows a possible switch to merit-order activation in 2020 which is too far away.

Regarding the procurement, we also regret that CRE considers the lack of competition as a blocking factor to move to market-based procurement of aFRR balancing capacity. **An obligation to supply capacity combined with a secondary market is not a market-based process as foreseen in the balancing guideline.**

### IV. Imbalance price

EFET welcomes the evolution in the imbalance price formation put in place in April 2017. Removing the explicit reference to the day-ahead price is a first step towards a correct price signal in the French imbalance system.

However, **EFET regrets the lack of a clear decision on the k factor. We support a suppression of the k factor at the earliest possible occasion. In addition, as long as the R2 activated energy will be remunerated at day-ahead price, the imbalance price will still implicitly be “polluted” by an irrelevant component.**

Further, as explained in our answer to the consultation, **maintaining a pay-as-bid system for specific products combined with a weighted average mechanism for imbalance price prevents a correct price signal to emerge in real time.** This is certainly worrying if the use of specific products is maintained structurally – and for the majority of the volumes – in France.

In general, **more transparency on the detailed list of balancing orders activated would be welcome**, not only on the weighted average and max/min price, but also on the underlying calculation of imbalance prices.

## **V. Priority of TERRE over the development of cross-border access to the intraday market**

CRE rightfully notes that the evolution towards 48 cross-border intraday gates would be incompatible with the TERRE platform for the exchange of replacement reserve (which needs at least 45 minutes), and expressed a preference to pursue the TERRE project.

We see a number of benefits to the TERRE project, which is the first concrete cooperation project for a common merit order list for the activation of balancing energy according to the Balancing Guideline. The important amount of work put in by TSOs in the design of the TERRE platform will serve as a blueprint for the development of the aFRR and mFRR exchange platforms (respectively PICASSO and MARI). TERRE would also hopefully incentivise RTE to use standard products with marginal price, and reduce the use of non-standard products. Finally, a withdrawal of RTE from TERRE would mean a geographical disconnect between the control areas in the project, making the exchange of RR through a common merit order de facto less attractive for other TSOs.

However, **EFET believes that the further development of close to real time cross-border intraday markets should be a priority.** TSOs as neutral market facilitators should make sure to foster and leave as much room as possible to non-TSO centralised markets for self-balancing. Increasing the number of cross-border gates for the intraday market to 48 would certainly help develop liquidity and competition on the French intraday market, which suffers a lack of both. This would also help avoid any step back from existing market design features, such as the ability to trade 30-minute products at the French-German border.

While we continue to contribute to the development of the TERRE platform with our active participation in the ENTSO-E Balancing Stakeholder Group and TERRE workshops, **we express again our preference to increasing the number of cross-border gates in the intraday market to the establishment of the TERRE platform if a choice has to be made.**

Referring back to our comments on the “margin model”, **we would at least have hoped that the CRE decision to prioritise the TERRE project over the development of cross-border access to the intraday market would have come**

**with a stringent request to RTE to make use of standard RR products as much as possible and drastically reduce the use of specific products outside the operational window.** If the development of cross-border access to intraday markets is to be sacrificed for some time to the development of a TSO-TSO balancing energy exchange platform, we expect RTE to make extensive – if not close to exclusive – use of it when procuring RR.