

## **ENTSO-E consultation on an amendment to the balancing energy pricing methodology – introduction of a price limit of +/- 15,000 EUR/MWh**



### **EFET response – 2 August 2021**

The European Federation of Energy Traders (EFET\*) welcomes the opportunity to provide comments on the ENTSO-E consultation on adjusting the maximum price for all balancing energy product bids and the maximum value of the cross-border marginal price (CBMP) as well as the minimum price for all balancing energy product bids and the minimum value of the CBMP defined in Article 3(3) of the Methodology for pricing balancing energy and cross-zonal capacity used for the exchange of balancing energy or operating the imbalance netting process – Annex I of ACER decision No. 01/2020 of 24 January 2020.

We believe the proposed amendment should be withdrawn.

Our key points are:

- We oppose price limits, other than purely technical, and call for great care in the consideration of any such limitations to price formation.
- In our view, the proposal describes an economic, not a technical price limit.
- We question the purpose and legality of the TSOs proposal, especially insofar as it seems mainly designed to address a non-evidenced fear of market abuse for which they have no competence.
- The TSOs proposal seems to obliterate the consequences that capping balancing energy prices may have on the imbalance price, and the effect this may have on market participants' ability to contribute to security of supply and system security.
- The TSOs proposal gives the illusion to be a short-term transitory measure. If it goes ahead, we insist there should be a precise deadline and detailed criteria for assessing the continuation/amendment of the measure.

We elaborate below on these different points after a few general comments on price formation and situations of scarcity.

\* The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent and liquid wholesale markets, unhindered by national borders or other undue obstacles. We build trust in power and gas markets across Europe, so that they may underpin a sustainable and secure energy supply and enable the transition to a carbon neutral economy. EFET currently represents more than 100 energy trading companies, active in over 27 European countries. For more information: [www.efet.org](http://www.efet.org)

## **General comments on the free formation of prices and scarcity situations**

### *Undistorted electricity prices as a vital signal for dispatch and investment*

In accordance with Article 3 of Regulation (EU) 2019/943 (the ‘Electricity Regulation’), Member States, national regulatory authorities (NRAs), transmission system operators (TSOs), distribution system operators (DSOs), market operators and delegated operators must ensure that electricity market rules encourage free formation of prices and avoid actions which prevent the formation of prices on the basis of demand and supply<sup>1</sup>.

EFET wholeheartedly welcomed the new provision of the recast Electricity Regulation advocating free price formation. Indeed, only undistorted prices give an accurate signal for bidding and dispatch decisions on the one hand, and can serve as a sound basis for investment and divestment decisions on the other hand.

With an increasing share of intermittent power generation in the European energy mix, precise price signals are needed more than ever to ensure the reactivity of market participants’ bidding and dispatch decisions to rapidly changing demand and supply conditions, including balancing mechanisms.

The development of extra peaking generation units, storage solutions (including power to X assets), demand side management, and other types of flexible assets and services may only materialise if electricity prices accurately reflect the true value of energy – including all its fluctuations – and if economic actors do not face undue barriers to enter electricity markets. Accurate price signals will allow market participants to identify the nature and timing of such investments alongside more traditional investment in generation and transmission capacity.

### *Bidding dynamics in the balancing timeframe*

Balancing Service Providers (BSPs) need to take into account business opportunities in concurrent intraday markets when offering bids for the balancing energy market. To compensate for the reduced chance of activation for balancing purposes, BSPs need to adjust the balancing energy price accordingly.

This consideration always becomes relevant if the asset can achieve a positive margin on the electricity market, i.e. if the asset would be “in the money” in the intraday timeframe. In this case, a BSP decision to commit their assets to the balancing timeframe rather than the intraday market translates into a number of uncertainties:

- the price level in intraday and the missed revenues from not bidding in the intraday timeframe,
- the potentiality of being activated or not in the balancing timeframe (as only the activation of a submitted bid gives BSPs the right to remuneration), and
- the price level of balancing energy.

<sup>1</sup> See also [EFET response to ACER consultation on barriers to efficient price formation and easy participation in European electricity markets](#), [EFET paper on price formation and capacity withholding in light of Regulation \(EU\) 2019/943 and Regulation \(EU\) 1227/2011](#) and [The importance of free formation of prices in the European wholesale electricity market \(2016\) – EFET Discussion Paper](#)

To offset the uncertainty on their final revenue position in the balancing timeframe compared to a more secure financial opportunity in the intraday market, BSPs include opportunity costs in their bidding strategy for balancing energy. These opportunity costs result not only from the expected price level in the intraday market, but also from the probability of securing at least this price level with an activated balancing bid. Particularly for aFRR, with very high product requirements and bids in the second half of the merit order having an expected activation duration of a few seconds, letting BSPs set bid prices at the – potentially high – level they deem necessary is crucial to secure enough balancing energy offers to the TSOs. Hence, any limitation to price formation in the balancing timeframe, for instance in the form of price limits, should be approached with utmost care.

#### *Price fluctuations in a context of scarcity*

In order to give market participants the correct incentive to balance their portfolio, it is crucial that the imbalance price, in line with the Electricity Regulation, reflects the real-time value of electricity, taking into account the physical reality of the assets connected to the grid. Market participants are responsible for balancing their sales and purchases of electricity and shall bear the financial consequences of any imbalance, which is eventually settled with the system operator at the imbalance price. The closer to delivery (real-time), the more volatile imbalance prices may be and the more likely it is for price spikes to arise, as they legitimately reflect imbalances in the electricity system.

A scarcity situation does not mean that the market will not perform its duties. Standard market rules should guarantee the functioning of the electricity market and the contribution of all relevant capacities to security of supply and system security. In fact, a scarcity situation should not be suppressed as long as capacities are available, regardless of the cost of activation. NRAs should ensure that TSOs refrain, as far as possible, from suspending markets, curtailing interconnection or taking any other out-of-market measure. If TSOs have to take such actions and if such actions are likely to affect the market price, NRAs must take measures to avoid or correct the impact of these TSO actions on the electricity price.

As the price of balancing energy constitutes the main component of the imbalance price, measures such as price limits distorting the balancing energy price will affect the capacity of the imbalance price to reflect the true value of electricity in real time. This will be particularly true in times of scarcity, when balancing energy, and in turn the imbalance price, are expected to rise high. Therefore, balancing energy price limits have a strong potential to hamper appropriate reaction by the market in times where clear signals are vital to guarantee security of supply and system security.

Competitive markets can deliver the most efficient outcome when it comes to bidding, dispatch, investment and divestment decisions. This should also be the case for balancing mechanisms that become more integrated, competitive and liquid thanks to the EU balancing platforms. It is in this context that the TSOs proposal to establish a balancing energy price limit should be scrutinised, and with care.

## I. Legal critique of the TSOs proposal

### *Technical vs. economic price limit*

According to Art. 10 (1), sentences 1 and 2, of Regulation (EU) 2019/943 of 05 June 2019, there is "neither a maximum nor a minimum limit" for electricity prices, including balancing energy. The development of balancing energy prices follows the principle of the free formation of prices, i.e. their level is determined by competition according to supply and demand. Only technical price limits within the meaning of Art. 10 (1) sentence 2 Regulation (EU) 2019/943 are legally acceptable, if they are systemically necessary to enable the submission of electronic bids and processing of results (clearing), without limiting the formation of balancing energy prices in accordance with the aforementioned rules.

Art. 30 (2) of the Commission Regulation (EU) 2017/2195 also restricts the introduction of price limits to technical reasons; there is no room for price limits based on other justifications. Even though technical price limits are not defined by the EBGL, it can be assumed that technical price limits only refer to the "mathematic maximum for the algorithm to function without having the purpose of limiting price formation" (see ACER Decision 22/2020 of 5<sup>th</sup> August 2020 in a different context).

Therefore, the determination of a price limit that is not technical is against the European law. This is also in line with ACER's understanding. In Art. 3 (3) of the "ACER Decision on the methodology for pricing balancing: Annex 1" (Annex to ACER Decision No 01/2020 of 24 January 2020), ACER set a technical price limit of +/- 99,999 EUR/MWh for all balancing energy product bids. ACER emphasised correctly that the European Regulations do not allow for any restriction of price formation on the balancing energy markets.

The current TSOs proposal foresees a maximum/minimum price for all balancing energy product bids and a maximum/minimum value of the CBMP of +/- 15,000 EUR/MWh, to be implemented before the go-live of the MARI and PICASSO balancing platforms in July 2022. The TSOs base their proposal based on the following:

*Article 10(1) second sentence of Regulation (EU) 2019/943 allows for technical price limits which may be applied in the balancing timeframe. Therefore, all TSOs understand that Regulation (EU) 2019/943 does not restrict the possibility, provided by the Article 30(2) of the EB Regulation, of introducing technical price limits in the balancing timeframe.*

EFET fails to understand to what extent the price cap value of +/- 15,000 EUR/MWh can be considered a technical limit, and the TSOs provide no explanation in that regard. We see it as an economic limit (based on an ACER estimation of the Value of Lost Load). As market outcomes exceeding this value have already been observed in certain Member States, this price limit can already be assessed as hindering the free formation of prices.

### *Role of NRAs vs. TSOs in market abuse prevention*

The distinction of duties between TSOs and NRAs in terms of price formation stemming from the Electricity Regulation is clear: TSOs shall ensure the free formation of prices in all market segments as neutral market facilitators, while NRAs have the power to monitor markets (including to prevent and sanction market abuse) while ensuring their correct and unfettered functioning. This is clearly laid out in art 10, paragraphs 3 and 4 of the Electricity Regulation:

3. *Transmission system operators shall not take any measures for the purpose of changing wholesale prices.*

4. *Regulatory authorities or, where a Member State has designated another competent authority for that purpose, such designated competent authorities, shall identify policies and measures applied within their territory that could contribute to indirectly restricting wholesale price formation, including limiting bids relating to the activation of balancing energy, capacity mechanisms, measures by the transmission system operators, measures intended to challenge market outcomes, or to prevent the abuse of dominant positions or inefficiently defined bidding zones.*

In the workshop organised by ENTSO-E on 15 June, the TSOs indicated that their proposal of a price limit at +/- 15,000 EUR/MWh for balancing energy prices was justified in part by a desire to prevent market abuse. They indicated that NRAs might act with *ex-post* measures whereas the TSOs can act *ex-ante* with a price limit. The TSOs argued that NRA monitoring might come too late “before some BRPs are driven into bankruptcy”, and that “there is a general preference for preventive measures” in terms of market abuse prevention. In the same workshop, however, the TSOs confirmed that the potential for market power and abuse of market power on the basis of which they justify their proposal was “theoretical”. No evidence of practical market power or market power abuse in balancing energy markets was provided.

With a proposal based on the fear of market abuse, and no evidence thereof to back their claims, the TSOs seek the approval of a measure for which they have no competence, and which is not backed by evidence. Once again, we do not see a price cap applied by the TSOs on this basis as compatible with EU Law.

**The lack of a legal basis for the TSOs proposal is reason enough to reject it.** However, we elaborate further below on a number of elements.

## **II. A proposal that lacks proper justification**

None of the arguments put forward in the explanatory document and the accompanying “study” justify the proposal to introduce a limit to balancing energy prices in our view:

- The explanatory document describes a “historically evolved”, “heterogenous market structure” with the presence of market power and the potential of market power abuse, the “outcome of which is hard to predict”. It also argues that a critical mass of balancing energy providers joining the platforms will be missing at the beginning. The explanatory document does not explain what constitutes a “critical mass”, what would be the “correct” price for balancing energy and what is meant by “heterogenous” or “historically evolved” and why each of these aspects is relevant. The accompanying “study” merely describes the theoretical possibility of market power abuse. None of the documentation provided or referred to by the TSOs make any attempt to demonstrate actual market power, abuse of market power or the reason why existing instruments such as competition law or REMIT would be ineffective in addressing the risk of abuse of market power in this context. Despite requests by stakeholders during the workshop, the TSOs have still not provided this information.

Contrary to the TSOs, we expect that the introduction of the shared merit order across control areas as well as pay-as-cleared pricing will significantly reduce any risk of market power compared to today and lead to significant increases in competition at the

same time as the platforms go live. Therefore, the arguments above constitute no valid basis for the proposed amendment.

- The “study” attached to the explanatory document makes some highly theoretical arguments on why auctions are inefficient in the context of balancing markets. For example, the “study” discusses the concept of “truthful bidding” where the price equals the “cost of energy provision”. This ignores the fact that balancing service providers need to reflect the likelihood of activation as well as their opportunity costs in their energy bids. Overall, the logical conclusion of this “study” would be to not implement a maximum or minimum price, but to use an alternative process to auctions to procure balancing energy.

The “study” is superficial and makes no attempt to look at practical results of auctions in balancing mechanisms, where they are already in use. It therefore provides no relevant argument in favour of the amendment proposal.

- The explanatory document describes the need to limit risks for balancing responsible parties. In our opinion, competitive markets, rather than regulated price caps should serve as the instrument to protect balancing responsible parties. A price limit achieves the opposite: rather than increasing levels of competition, it reduces the attractiveness of the market for balancing energy. Besides, the free formation of prices and strong incentives on market participants to balance their portfolios strengthen the functioning of energy markets in all timeframes and should not be undermined.
- The explanatory document alleges that market participants or TSOs may not have had sufficient time to prepare for a smooth transition onto the platforms. To illustrate this point, the explanatory document describes the failure of TSOs to properly implement the TERRE platform. This is a surprising statement, given that the balancing target model has been under development for the last 9 years, starting with the framework guidelines in 2012. In our opinion, this entire process has been extremely slow and should not be slowed down any further. It is now time to implement the target model, not to overhaul it again.

**It is striking, that none of the arguments of the TSOs are of technical nature. Instead, they focus on achieving a desired price level. This underlines our suspicion that the proposal cannot be considered a technical price limit, but rather an economic one.**

### **III. The questionable choice of the VoLL as a reference for a balancing energy cap**

According to Regulation (EU) 2019/943 imbalance prices must reflect the value of energy in real time. This means that in the extreme case of actual physical scarcity (where the TSO has to shed (part of) the load to maintain the supply-demand balance), the imbalance price must be able to rise to the Value of Lost Load (VoLL).

As we mentioned in our introduction, balancing energy prices and the imbalance price are closely related: the primary component for the imbalance price is the price of activation of balancing energy. The cross-border marginal price for balancing energy activation is calculated for each balancing energy pricing period (BEPP), a time interval set at 15 minutes for RR and mFRR, and at 4 seconds for aFRR. The imbalance price will be calculated as a volume-

weighted average of the marginal prices of balancing energy activation for each of RR, mFRR and aFRR. For aFRR itself, the imbalance price will also take account of the volume-weighted average of the marginal price of each BEPP within the entire imbalance settlement period (15 minutes). All this will have the consequence that the imbalance price will only reach the VoLL in a relevant imbalance settlement period of 15 minutes if:

- the cross-border marginal price reached the VoLL for RR and mFRR, and
- the cross-border marginal price reached the VoLL in every single of the 225 BEPPs for aFRR.

Hence, if the price of balancing energy is capped at the VoLL, it is extremely unlikely for the imbalance price to ever be able to come even close to the VoLL. This is why we question the relevance of the VoLL as a guidance for the maximum price of balancing energy.

In addition, the VoLL differs between individual customers and between Member states, and its estimation is very complex. The proposal foresees that if the maximum balancing energy price is reached by the harmonised maximum clearing price for single intraday coupling in accordance, the maximum price for balancing energy shall be set to 5,000 EUR/MWh higher than the harmonised maximum clearing price for single intraday coupling in accordance with Article 54(1) of Commission Regulation (EU) 2015/1222. This would mean 15,000 EUR/MWh. At the same time, the explanatory document describes VoLL estimates of up to 23,000 EUR/MWh, hence imbalance pricing would effectively be capped well below the VoLL in some Member States.

**Using the VoLL, particularly anything below the EU's highest VoLL for any type of consumer, to compute the price cap for balancing energy leads to a situation where the imbalance price cannot in practice reach the VoLL in all parts of Europe.**

#### **IV. The complex interplay of scarcity components in imbalance pricing and a maximum price for balancing energy**

In addition to balancing energy prices, additional components can be used to compute the imbalance price. Some Member States have scarcity components in place to ensure imbalance prices are sufficiently high during periods of scarcity.

In places where a scarcity component is in place, the proposal to cap balancing energy prices could result in the price of balancing energy remaining below the level of the scarcity component (e.g. Germany). This means that the scarcity component will have a comparatively much greater effect, leading to situations where imbalance prices are predominantly set by regulation, rather than actual balancing activation costs. **As a result, the signal stemming from the imbalance price will be further decorrelated from market fundamentals.**

#### **V. The illusion of a transitory measure**

The proposal foresees that no later than 18 months after the participation of all TSOs in MARI and PICASSO, including the expiration of all derogations according to Article 62(2)(b) EB Regulation, all TSOs shall prepare a report on the proposed price cap and invite stakeholders to submit comments. The report shall justify whether the maximum and minimum balancing

energy prices should be maintained or amended. The final report shall be submitted to ACER no later than two years after the participation of all TSOs in the respective FRR balancing energy platform is mandatory, including the expiration of all respective derogations.

Considering the derogations submitted or planned to be submitted by certain TSOs to join either of the platforms not until 2025, the TSOs proposal means that the price limits for all balancing energy product bids and the maximum/minimum value of the CBMP will not be studied before 2026/2027. Hence, we cannot reasonably qualify the TSOs proposal as a transitory measure.

Moreover, the criteria to be used in the report in order to monitor the effects and justify if caps should be maintained or amended are not described. This again brings uncertainty on the transitory nature of this measure.

**Should the TSOs proposal go ahead, it should contain a concrete deadline for the publication of the report – independent from all TSOs joining the platforms – and detailed analysis criteria to monitor the effects of the cap.**

## **Conclusion**

A measure of such great impact on price formation as price limits should never be taken lightly. When applied to balancing energy bids, it would have effect not only on balancing mechanisms, but also on imbalance pricing and in turn on all electricity market timeframes.

We deem the TSOs proposal as lacking a legal basis, as they have not provided the technical justification for a price limit of balancing energy. Considering that European legislation foresees no other reason to cap balancing energy prices than technical constraints, this is for us reason enough to reject this proposal.

Further explanations provided by the TSOs do not manage to convince us of the greater good of the proposed measure – be it to address an unevidenced fear of market abuse, an inadequacy of auctions in the balancing timeframe, or to allow more time to adapt to new balancing platforms. Adding to this the lack of consideration for the implications that the measure would have on imbalance pricing, we judge the proposal of a balancing price cap and the level at which it is set particularly ill-advised.

We call on the TSOs to withdraw their proposal and to ensure the full application of Annex 1 of the ACER Decision No 01/2020 of 24 January 2020, setting a truly technical price cap for balancing energy at +/- 99,000 EUR/MWh.