EFET Position on ERGEG Draft Guidelines Of Good Practice for Electricity Balancing Markets Integration

July 2006

1. The need for national markets harmonisation

One of the key obstacles to realising a well-functioning Internal Electricity Market is the lack of harmonisation and integration between different national markets. Across the European Union, market participants face radically different market structures and rules, different timetables for the "trading day", different and onerous balancing arrangements, and numerous other artificial arrangements. These collectively raise barriers to the entry of new market participants and significantly reduce market efficiency.

Different market "timetables" can limit market participation across borders, e.g. although some markets provide facilities for intra-day trading up to 1 hour ahead of delivery, others have limited intraday sessions or confine the intraday activity to local balancing actions. This limits the ability of the market to optimise flows within the day between national markets. In addition, interconnectors flows – and hence cross border participants – are often unable to participate in national within-day and balancing markets which again limits the market's ability to optimise flows between national markets.

EFET believes that the key to integrating European Union markets successfully is to maximise the opportunities for the "market to work" by moving to dynamic, flexible, continuous and inclusive trading arrangements. *The primary operational reform must involve broadening and streamlining all national or regional nomination procedures, to facilitate a continuum between "day-ahead" trading and trading within day ("intra-day") and to remove the very last gate closure for each quarter or half hour as close as possible to the real time of delivery.*

2. Intra-day and Balancing

2.1 Firmness and maximisation of capacity; TSO role

TSOs should be offering the maximum practicably attainable amount of cross border capacity, separately estimated for each trading day and hour of the year; and they must offer it on a fully firm basis.

In our recent EFET paper "*More transmission capacity for European cross border electricity transactions without building new infrastructure: Improving*

firmness of capacity rights and maximising capacity allocation using new Regulatory incentives for transmission system operators" (May 2006) we have argued, that improvements to firmness are fundamental to the promotion of more cross border competition in European power markets, and that TSOs must be given incentives to maximise the cross border capacity they allocate to the market.

Robust incentives based regulation is vital for achieving capacity maximisation; and truly maximised availability of capacity across borders will help optimise the utilisation of that capacity by market participants, for flattening out shortages and surpluses between national markets at different times of the year, different days of the week and even different hours of each day. Yet market participants are currently still deprived of such opportunities, partly by virtue of unwarranted capacity reservations by TSOs, often claimed for supposed emergency system balancing reasons.

There are also wider benefits in TSOs taking on the responsibility of offering fully firm transmission capacity rights, including the scope thereby for enhancing market confidence right up to real time. If market participants can be sure that they will not be curtailed, barring true force majeure incidents, without being fully compensated, then allocated capacity rights will be purchased and used or traded in a more efficient manner. This in turn should lead to less risk of imbalance in the intra-day portion of the market.

2.2 Cross border Intra-day

In many European Union countries power trading possibilities still end at the gate-closure for the day- ahead market. It is essential, as a pre-requisite for the optimal efficiency and transparency of balancing markets, that intra-day trading be facilitated by regulators, market operators and TSOs across the whole of the internal market. Market participants will thereby be enabled to refine their wholesale power portfolios up to a point closer to real time, diminish their risks of being out of balance and therefore being obliged to pay imbalance prices, and correspondingly help relieve the balancing burden on grid operators.

EFET refers all ERGEG members to the cross border intra-day plan proposed in the DTe-CREG-CRE roadmap for linking wholesale power markets in France, Belgium and the Netherlands. It identifies the following practicable features in a first iteration of intra-day market linking:

- Cross border intra-day trade should enable both revision of day-ahead positions, in case of physical disturbance, and price arbitrage;
- No particular restrictions should be imposed in terms of nominations (nor implicitly who can nominate);
- As a first step, for obvious operational reasons, the intra-day allocation mechanism should be kept as simple as possible (e.g. a "first-

come/first-served" or a "pro-rata" method) with discrete gate closure times;
- Capacity rights allocated in the intra-day framework should be deemed to entail mandatory use/ nomination of the equivalent energy, rather than offered as an option.

Our vision for more sophisticated, permanent intra-day trading arrangements would comprise:
- Continuous and rolling gate closures within-day, e.g. 1 hour before the start of each hour of the day, with market participants having the option to re-nominate their delivery schedules right up to each gate closure (where those schedules would need to be consistent with their final capacity holdings);
- Last gate closure being positioned as close to real time as practically possible;
- Opening all borders for at least OTC intra-day trading;
- Multiple automatic trading platforms to facilitate cross-border intra-day trading between the most liquid price zones.

For achieving this vision, clearly further harmonisation of OTC procedures, of trading platforms and of market operational rules and timetables is necessary.

2.3 Balancing arrangements

The development of economic and competitive balancing arrangements is axiomatic for realising a real pan-European power market.

Our approach is summarised below:
- Following intra-day gate-closure, the TSO should execute balancing transactions to manage the system balance and any residual system constraints within operational timescales;
- While we would expect the main participants within the balancing markets to be generators and flexible consumers within each national TSO control area, TSOs should investigate methods for allowing wider participation, e.g. by allowing cross-border participants to offer balancing power and ancillary services;
- Following delivery, any imbalances between participants, net physical deliveries/purchases and consumption/sales would be settled at cash-out prices, which reflect the marginal cost of the actions taken by the system operator to balance supply and demand in operational timescales. Wherever possible, the price of actions taken purely to resolve location constraints should be omitted from the determination of price;
- First settlement information should be published in the trading period immediately after the delivery hour;
- Second and confirmatory settlement details should be published about three days later;

- Fixed settlements should then be made within one month.

We endorse the importance of the benefits of balancing markets integration, subject to Regulators insisting on an accompanying compatibility of functioning intra-day trading arrangements (see 2.2 above). The challenge to Regulators is that they not only identify benefits, but work proactively on harmonisation, as advocated already in our EFET paper "*Harmonising the operation of European wholesale electricity markets"* (October 2005).

3. Specific recommendations on the draft ERGEG Guidelines

3.1 We question the ERGEG statement in Section 2,

"...Following gate closure, the TSO will make calls on the bids and offers of generation and load in order to balance the system at least cost. Where intra-day markets exist, TSOs will need to take into account further restatements of bids and offers when making such calls."

In fact Regulators need to intervene to make sure that gate closure is not too early, that gate times are harmonised across borders, and that intra-day optimisation, through bids by market participants later than the traditional day-ahead gate closure, is indeed introduced by each TSO. (See section 2.2 of this paper).

3.2. Under Section 5, sub-section "Acquisition of transmission capacity for balancing purposes" (page 10), ERGEG has included the statement,

"…or a certain amount of capacity can be reserved for balancing purposes by the TSOs".

EFET strongly objects to the idea that TSO might reserve transmission capacity for balancing purposes as long as other market participants can only acquire transmission rights which have to be nominated latest at the day ahead stage. In fact any leeway for TSOs to reserve transmission capacity is a significant hurdle to the further evolution of the needed intra-day trading. A reservation, without substantiation of its necessity for true emergency situations, equates broadly to the TSO holding a free option on interconnection capacity, as an alternative to paying for spinning reserve from generators. To the extent that an inter-connection point from a neighbouring country may perform a function similar to that of a generator on the national system in meeting load, the withholding of capacity at that point by the system operator is tantamount to its "reserving" a portion of a generating unit for balancing purposes. This could be hugely uneconomic (e.g. if the interconnection point does not represent the marginal source of supply). It additionally allows TSOs at will to degrade the quantity of capacity made available to the market. Instead, all TSOs should be obliged to treat

reservations at inter-connection points similarly to generating units via the national balancing mechanism, i.e. if the cross-border capacity is fully committed in advance of gate closure, but a TSO nevertheless wants to hold reserve there, it would be obliged to accept a bid from the capacity holder to buy-back electricity to create the "headroom" to allow a subsequent offer to be accepted in real time (in the same way the TSO would sell-back to a fully committed generator to allow it to reduce their load to create the spare capacity to provide the spinning reserve required).
Regulators will note that their investigation of TSO practices with regard to cross-border reservations must entail opening up TSOs' calculation of combined maxima of national n-1 security criteria, and the application to published NTC values of the ensuing maxima.

3.3. We question another statement in the same section (page 10),

"…whether the interconnection capacity should be reserved for balancing purposes in advance must be determined within the competitive market framework".
As stated above, TSOs should not be permitted at will to reserve cross-border transmission capacity for balancing their systems. Presumably ERGEG intends the formulation "…within the competitive market framework…" to indicate some intention to enquire into the amount of reservations and their purpose, but it is far too vague to reassure us.

3.4. With regard to the "Options for the Integration of Balancing Markets"

(page 14), EFET favours the third option ((fully integrated balancing market), but we realise that the second option (TSO-to-TSO), where the TSOs are responsible for purchasing cross-border transmission capacity for balancing purposes may be the more realistic one as between some less liquid national markets for the time being. However, the emphasis then must be on TSOs indeed purchasing the capacity, rather than taking it from the market for free (see section 3.2 above).

We would be pleased to participate further in the consultation process and the continuing elaboration by ERGEG of Guidelines of Good Practice for Electricity Balancing Markets Integration.