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Position Paper

All TSOs Proposal for Amendments – aFRR IF (Art. 21 of EB Regulation) and Pricing Methodology (Art. 30(1) of EB Regulation)

Version: final

1 BDEW general comments on balancing high price mitigation measures proposed by All TSOs

- The report presented to ACER on the price incidents is not available and the applied methodology is questionable. Nevertheless, the conclusions drawn from the report and presented with an at least implicit suspicion for abusive behavior by market participants, are used as motivation for the proposed mitigation measures.
- The TSOs had proposed, 15 months ago on 26 August 2021, to lower the technical price limits from €99,999/MWh to €15,000/MWh and from -€99,999/MWh to -€15,000/MWh. ACER rejected this proposal on 25 February 2022 (Decision No. 03/2022), because it was not compatible with the principles of operation of the electricity market in accordance with Art. 3 (a) and (b) of the Electricity Market Regulation, as the proposal restricts free price formation. The TSOs have not provided any reason that would lead to a different assessment by ACER now.
- It is yet too early to apply the next mitigation measures, more time should be given for the market to evolve. Insufficient market liquidity, which is identified as a current short-coming, will be resolved with numerous additional countries participating in PICASSO in 2024. According to section 9(6) of the pricing methodology, TSOs shall carry out an assessment of the functioning of the balancing market 36 months after the deadline for the introduction of the European balancing platforms pursuant to paragraph 1. The start of the period therefore requires at least one year with all TSOs participating in the platforms.
- During several occasions, BDEW has expressed its concerns of proposing the implementation of limits of balancing energy bids as it hinders the free formation of prices. Planned and unplanned perpetuate adaptions of the market and the reduction of price limits discourage potential market participants. Against this background, it might negatively affect a quick introduction of PICASSO in many countries.

For these reasons, we do not support any mitigation measures further restricting the market as this would be counterproductive and leading to an even further reduced market participation.

As the German TSOs organized within BDEW are, among others, responsible for the drafting of the proposal and this consultation paper, the following BDEW comments have been developed without the German TSOs.

2 Feedback on the proposed amendments to the aFRR IF (Article 21 of EB Regulation)

BDEW has always emphasized the importance of TSOs refraining from influencing market outcomes.

Different to mFRR, where a non-activation can be compensated by subsequent aFRR, there is no fallback measure left for aFRR. System security should not be subject to commercial optimization.

In consequence, TSOs might consider relying upon specific products, which is definitely to be avoided. Elastic aFRR demand must not foster the use of specific products. BDEW therefore insists that specific products should not serve as supplementary tools in case the demand for aFRR cannot be met.

With an appropriate dimensioning in place, there should not be any need for additional elastic demand. The slides shown at the EBSG indicate, that there is a tendency at small TSOs to rely upon demand above the dimensioned amount.

For the reasons given above, we reject the introduction of elastic demand for aFRR. Moreover, the existing governance framework is deemed inadequate to ensure ongoing adherence to this objective. BDEW is concerned that monitoring and enforcing the future use of elastic demand for aFRR for purposes other than those explicitly stated could pose unforeseen challenges.

If an introduction is foreseen, nonetheless, BDEW advocates for a well-defined and enforceable governance structure. Besides, a regular reassessment of the use of elastic demand for aFRR shall take place.

Furthermore, an additional item in Article 3(4) should be added:
e) use specific products to compensate unsatisfied elastic demand.
If the requirements in Article 3(4) are not fulfilled, the option for using elastic demand for aFRR should be revoked.

3 Feedback on the proposed amendments to the Pricing methodology amendments (Article 30(1) of EB Regulation)

<u>**General remarks on the motivation behind the proposed price limits**</u>

In principle, BDEW expresses reservations about proposed impositions of limits on balancing energy bids, contending that such measures impede the free formation of prices. Namely, the prices observed in the balancing energy market result from competitive market activities that consider all obligations, restrictions and opportunities. The imposition of low-price limits obstructs the unrestricted formation of prices and diminishes the appeal of potential new market participants.

With regard to the continuous discussion of other parties joining the European balancing platforms MARI and PICASSO, their proper market functioning is perceived by BDEW as a prerequisite for their successful implementation. BDEW anticipates that the European balancing platforms will derive advantages of the pooled liquidity from these platforms and therefore envisions this can be achieved through an effective collaboration across various countries.

Of course, it is each Balancing Service Provider's (BSP's) individual commercial decision to participate in the balancing capacity and energy markets. However, the restrictions for not participating can be related to the commercial attractiveness of the market, expressed through the following:

- Small activation probability
- Price limits
- No release of unused bids

or other issues, such as:

- Operational complexity of the target model
- Regulatory concerns

BDEW is of view that the currently proposed measures will not target a significant increase of the attractiveness of the market. Rather, they will further aggravate the issue of limited liquidity and thus the alleged market concentration.

The current accession roadmaps, however, do provide a natural mitigation measure for increasing market liquidity.

Additionally, BDEW raises questions concerning the role and responsibility of TSOs in proposing measures, even if only limited to aFRR. While the establishment of a price cap should always be grounded in a robust economic rationale, BDEW cannot observe any continuative analysis behind the proposed price limits. On the contrary, BDEW's objection is directed at the rationale behind reducing balancing prices based on concerns of market concentration.

Furthermore, despite ACER clarifying in its previous decision that it did not consider maximum or minimum prices to be appropriate tools for addressing market abuse or manipulation, TSOs have once again utilized such unsubstantiated allegations as justification, effectively implying a lack of confidence in the efficacy of REMIT. BDEW advocates for the implementation of REMIT guidelines as the most effective measure to tackle abusive strategic bidding. BDEW therefore strongly disputes the numerous references in the explanatory document to market abuse, upon which TSOs base their argument for lowering the price cap.

In the explanatory document it is described that the necessary preconditions for applying results from auction theory also for balancing markets are not met. Still, the justification by the TSOs for the proposed mitigation measures relies on auction theory, assuming that any bids deviating from this theoretical approach are exaggerated bids and thus may indicate abusive behaviour. We do not support this conclusion.

While TSOs use the Value of Lost Load (VoLL) as a reference, BDEW does not consider it a valid basis. VoLL is individual for each customer and challenging to predict. Furthermore, it varies among the different countries in the European balancing cooperation. VoLL is not a useful indicator in this context: whilst balancing energy is typically only activated for a small number of seconds and serves to ensure system integrity, VoLL represents consumers' willingness to pay for security of supply in a more general sense, typically for longer periods of time and on the assumption that system security is provided.

In compliance with the amendment for the pricing methodology, all TSOs are required to submit a report to ACER, including market concentration measures if CBMP reaches 50% of the transitional price limit. This threshold has been surpassed multiple times in Q4/2022 and Q1/2023. Parts of this report were presented at the EBSG in May 2023. The market indicators Herfindahl-Hirschman Index (HHI) and Residual Supply Index (RSI) (slides 36 and 38) are calculated for individual auctions and plotted for those quarter-hours where a price incident was observed. It is implicitly suggested in this illustration that price incidents are linked to market power. However, market concentration measures should be applied over a significant period of time (usually one year) to yield meaningful results. It also has to be considered that not only submitted energy bids, but all prequalified aFRR capacity exerts competitive pressure onto the market for balancing energy. In a situation with limited or no free bids, an RSI < 1 will be calculated for any BSP, not only the one with the largest bid volume.

Comments on the new technical price limit

The proposed reduction in the price limits for balancing energy by the TSOs lacks a justifiable foundation. In their previous proposal, dating 26th August 2021, to lower the technical price limit from 99,999 €/MWh and -99,999 €/MWh to 15,000 €/MWh and -15,000 €/MWh, respectively, TSOs had rationalized this reduction by asserting its necessity for the efficient functioning of the market.

Both in the past and presently, the TSOs have not presented any evidence indicating that the technical price limits are necessary for the efficient functioning of the market, as per Article

30(2) of the EB Regulation. Furthermore, no new arguments supporting this stance have been advanced in the explanatory document. The current proposal also lacks an explanation of the current inadequacies in the functioning of the balancing energy market, despite the existence of a (temporary) price cap. The explanatory document vaguely suggests potential market power and its abuse as a plausible reason. With the introduction of platforms, BDEW anticipates well-functioning markets, emphasizing that the shared merit order across TSOs and the implementation of pay-as-cleared pricing will markedly reduce the risk of market power compared to the present scenario, fostering heightened competition as the platforms become operational.

BDEW had previously participated in the TSOs' consultation and has chosen not to reiterate all the arguments in this subsequent consultation. For a comprehensive review of all positions from the previous consultation, please refer to the position paper dating back on 8th November 2021. Overall, BDEW advocates for free price formation and opposes commercial price limits that impede it.

BDEW therefore opposes the foreseen imposition of constraints on balancing energy prices as they explicitly impede the free formation of prices.

Technical price limits should exclusively be established to mitigate risks associated with human errors or malfunctions in the underlying technical systems, including algorithms and similar mechanisms. They should not be imposed for economic reasons, such as a mere reduction in costs. Since technical price limits cannot be implemented solely for the purpose of enhancing market's efficiency, BDEW does not regard the proposal put forth by the TSOs as constituting a technical price limit; rather, it would be more accurately characterized as a commercial price limit.

Instead of pertaining to technical aspects, the arguments presented by the TSOs are oriented toward a fundamental shift in the market. In this context, the TSOs' arguments are confined to general considerations regarding the positive impacts that lower balancing energy prices could have on consumers and grid operation. Supposedly, achieving such prices can only be realized by constraining bid prices in a manner that restricts free pricing. The rationale provided by the TSOs predominantly revolves around non-technical facets, specifically concerning price levels, generalized and unsupported allegations of market power among BSPs, and the reduction of risks for specific categories of balancing responsible parties.

The proposed price limit by the TSOs could also potentially lead to the withdrawal of flexibility providers from the market or impeding their entry into the balancing market. The explanatory document, without substantiation, implies that prices above the proposed maximum for aFRR were not justifiable, which BDEW contests.

BDEW concludes that the proposed price limit is of a commercial nature and does not qualify as a technical price limit. The TSOs view the technical price limit as a tool for regulating the bidding behavior of bidders. However, as per Article 10 of the Electricity Regulation, this should explicitly not be the case, a perspective also upheld by ACER in a previous decision. Any change in this regard should be within the purview of the legislator, not the regulatory authority.

To address TSOs' concerns about potential transition risks, ACER endorsed the introduction of a temporary price cap in its decision on 25th February 2022, applicable for up to four years. During this period, TSOs are required to regularly report to ACER and conduct an assessment of the balancing market's functioning after 36 months to determine whether other technical price caps are necessary for efficient market functioning (see Article 9).

Therefore, the current proposal by the TSOs is in any case premature with regard to timing of the aforementioned assessment as mandated by the pricing methodology. Given that the market is not yet fully developed and not all TSOs have joined the platform, BDEW believes that further maturity and investigations are necessary before implementing such measures.

Even if a change in the transitional price limit is considered a risk mitigation measure for the upcoming phase of additional TSOs joining the platform in 2024, BDEW sees no reason to alter the permanent price limit.

<u>Comments on the new transitional cap</u>

The same argumentation as for the new technical price limit also applies for the new transitional cap. BDEW believes that also concerning the proposed transitional cap of 10,000 €/MWh requires further comprehensive discussion and explanation.

Should a reduced transitional price cap of 10,000 €/MWh be implemented, questions arise about whether the price incident threshold would then decrease to 5,000 €/MWh, potentially leading to more price incidents. Additionally, BDEW queries whether this would trigger further mitigation measures.

Also here, BDEW argues that establishing such a price cap without demonstrating market manipulation makes it challenging to assert that all observed bids above 10,000 €/MWh are irrational. Therefore, claiming that a 10,000 €/MWh price cap will not force units out of the market raises doubts. The elasticity of demand should effectively address concerns about price sensitivity.

Again, if altering the transitional price limit is being considered as a risk mitigation measure for the anticipated phase of additional TSOs joining the platform in 2024, we find no justification to modify the permanent price limit.

Comments on CBMP based on LFC activation

No quantitative assessment has been presented to ascertain the effectiveness of this measure. The explanatory document offers a graphical representation to emphasize the anticipated impact. The decision to determine the CBMP based on bid selection was carefully considered and, in our opinion, remains valid.

The advantages of the current approach, as elucidated in the explanatory document, encompasses transparency, auditability, and the robustness of the price determination approach. The determination of prices remains unaffected by the local behaviour of TSOs or BSPs. Additionally, the simplicity of the approach and its consistency with other market time frames that also determine prices based on the clearing result are emphasized. Consequently, BDEW urges TSOs to intensify efforts to enhance transparency in CBMP formation, regardless of the CBMP determination.

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