Evolution towards a daily procurement of mFRR: Consultation report

Market Development

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1 Introduction

On the 22nd of May 2018, Elia published a study investigating the possible evolution towards a daily procurement (currently monthly) of mFRR including the advantages and disadvantages of such a change. Also the possibility to move to one standardized mFRR product, the impact on reserve sharing as well as the possibility to use non-contract bids for covering mFRR reserve needs were analyzed. A public consultation was organized between 22th May 2018 and 15th June 2018. This report consolidates the received consultation feedback and presents the responses and positions of ELIA regarding this stakeholder feedback.

2 Contribution

ELIA received three contributions during the consultation. All respondents declared that their responses to this consultation are non-confidential. They have consequently been made available on Elia website.

ELIA received non-confidential contributions from:

- FEBELIEC
- FEBEG
- BDRA

Additionally, Elia held a bilateral meeting with each respondent to discuss their feedback.

ELIA would like to thank the respondents for their analysis and contributions to our attempt to improve the Belgian balancing market design.

3 Topics

3.1 Evolution towards a standard mFRR balancing capacity product

3.1.1 Stakeholder's feedback

FEBEG welcomes the proposed evolution to phase out R3 Flex and the introduction of one single standardized reserve product of 4 hours blocks with an unlimited number of activations.

Febeliec stresses the risk of pushing existing flexibility and providers out of the market, which is according to them in particular relevant for the former flexibility which participated previously in the ICH product. This flexibility had to adapt their process to cope with the requirements of R3 Flex.

Febeliec is not convinced of the advantages of moving to a standard product and does not share the believe of Elia that the flexibility currently participating to R3 Flex will still be able to get valorized in the market through participation to the standard product. In many cases, this would also mean that individual grid users will no longer be able to participate directly, but would require intervention of other actors, reducing the upside for them and thus their appetite for participation. Febeliec deplores this proposal, especially so short after the abolition of the ICH product.

Also Febeliec insists that it is the obligation of the BRPs to be in balance. Elia should give clear incentive to BRPs to be in balance (via higher imbalance prices with, for example, steeper alpha factor). In any case it is not the grid user that has to bear the cost of inaction and/or lack of preparation of such actors via reservation price of balancing capacities.

BDRA asks that Elia does not over-dimension the technical requirements of the standard product and asks to keep some proportionate neutralization delays, maximum activation time and maximum number of activations in the standard product. BDRA warns that without doing so the amount of R3 MWs available would be unnecessarily and severely reduced. BDRA give some arguments to support this request:

- Development of intraday cross-border capacity exchanges will reduce the need of R3 in the future.
- Contracted R3 is an insurance to cover exceptional situation when market cannot provide enough capacity.
- The solution to offers very high activation price to avoid activation does not solve the issue as there is still the risk of contractually having to deliver activation. This would leave out of the market MWs engaged in R3 flex today.

BDRA explains once that the unique standard product is implemented; a shift should be made to a pay-as-cleared settlement for the payment of the reservation price.

3.1.2 Elia's feedback

Pay-as-clear settlement

Regarding the proposal to move to a pay-as-cleared settlement, Elia believes that such a decision cannot be taken before a detailed assessment has been made of all the required preconditions and after a specific consultation with the concerned stakeholders. The move to one single standard product is obviously one of the pre-conditions. However, aspects – amongst others - like liquidity of the market and selection rules need to be carefully considered. Therefore **Elia believes that this evolution should not be considered for the time being.**

Incentives to the BRPs

Elia agrees that adequate balancing incentives should be given to BRPs. Therefore Elia has presented recently in the WG balancing a first proposal for modification of the imbalance prices. Nevertheless considering that not all events can be perfectly predicted by BRPs, Elia need to ensure that the right reserve means are available to resolve the residual system imbalance.

Evolution towards a standard mFRR product (end of R3 flex)

ELIA supports an evolution towards one standard mFRR product to make sure its reserved capacity provide an adequate answer to the observed evolution of the system operational needs. The current mFRR flex product characteristics becomes indeed too limited (two hours of energy, 8 hours of neutralization time and maximum 8 activations per month).

However, ELIA also understands the importance of mFRR flex in current market organization and confirms the risks on liquidity and prices BDRA and FEBELIEC highlighted in their feedback.

Considering those two elements, ELIA will propose a transition period for an R3 flex product with updated technical characteristics. ELIA's proposal will be included in the implementation plan of the dynamic procurement that shall be consulted in Q4 2018.

3.2 Evolution towards daily procurement

3.2.1 Stakeholder's feedback

FEBEG points out the risk of uncertainty and volatility of revenue in case of move towards daily procurement. FEBEG sees a negative impact on the business case of the gas-fired plants and explains that the revenue basis for such plants will become less stable.

FEBEG questions why there is a push towards capacities which are highly volatile (RES is weather-driven and load is process-driven) and points out the risk of not being able to contract sufficient volumes. Also possible arbitrage with the day-ahead market (OTC and EPEX Belgium day-ahead) may reduce offered capacity. Some risks regarding the prices are pointed out by FEBEG:

- Possible price volatility and spike on a few (4 hours) blocks
- Possible price increase as suppliers will need to distribute their fixed cost over a lower number of days, taking into account the risk of not being retained in future tenders

FEBEG proposes to procure a part of the mFRR capacity via daily auction (variable mFRR needs) but keep procuring the rest via longer term auctions (base load mFRR needs).

Febeliec underwrites in general the advantages presented by Elia but urges for caution due to the near implementation date proposed and because of some disadvantages pointed out by Febeliec and summarized below as well as potential overestimates by Elia of the advantages.

Febeliec does not oppose Elia in the advantages listed, but expresses its concerns with respect to the disadvantages amongst lower visibility on revenues for providers, especially for industrials which could have a negative impact on business case of demand response. Also the operational burdens are not to be underestimated. Those could be detrimental towards the participation of a sufficient number of stakeholders and hence lead to market concentration within the hands of a very limited number of actors. Despite economic theory, Febeliec is not convince that moving from monthly to daily would allow more volume and lower prices as market in Belgium is not perfect.

BDRA supports a move to daily auctions but raises some remarks on the modalities of such a change. Indeed, BDRA believes that there are some arguments to advocate for organizing the R3 auctions after the DAM rather than before as proposed and asks Elia to pursue concertation to fully assess pros and cons of each solution.

3.2.2 Elia's feedback

- As discussed in the study, daily procurement has many advantages which outweigh its disadvantages. It allows more liquidity, more market dynamics, and better mobility of delivery point between BSPs, the implementation of dynamic dimensioning, an alignment with other reserve products and with other EU countries. Finally it is also a pre-requisite to implement a possible standard mFRR product which is also accessible by technologies with restrictions regarding availability and activation.
- Elia believes that even if a tendering is to be organized on daily basis, still a stable revenue can be generated for most of the assets. Indeed the cheapest flexibility will be still continuously selected for the provision of mFRR reserves. Moreover a daily tendering will also provide opportunities by enabling providers to adjust their bidding strategy more quickly in case they are not selected in a previous tender, avoiding a loss of revenues during a full month.
- Elia agrees that the proposed design might lead to price spikes for specific 4 hours blocks. However ELIA believes that overall a daily tendering will lead to a more efficient market functioning and a decrease of the average sourcing cost.
- The procurement of mFRR reserves before the day ahead market ensures Elia that sufficient flexibility is still available for the participation to the mFRR tender. This would not be the case if the tendering would be organized after the clearing of the day ahead market.
- **Elia will therefore keep the initial proposal to move to daily tendering for all mFRR reserves before Day Ahead Markets.**

3.3 Impact of non-contracted mFRR (free bids) on mFRR balancing capacity to procure

3.3.1 Stakeholder's feedback

FEBEG agrees with Elia's conclusion that making use of non-contracted bids should be done carefully. FEBEG has reserve upon the suggestion of taking free bids offering in the dimensioning of mFRR needs. FEBEG questions how Elia could rely on flexibility of which market participants themselves consider not reliable enough to offer in the capacity auctions. According to FEBEG free bids are expected, this flexibility will be offered in the mFRR capacity auctions

Febeliec considers Elia to be extremely conservative in its approach, which thus leads to a sub-optimal outcome which is not in the benefit of the grid users who have to pay for the reservation of balancing capacity.

BDRA considers that estimating the available amount of free bids to determine the volume to be reserved will not be accurate before the DAM results are known and propose therefore to organize the R3 auctions after the day-head market clearing.

3.3.2 Elia's feedback

- Elia notes that respondents have different points of view regarding the question of whether free bids should be take into account or not.
- As explained in the study, the consideration of non-contracted bids is only possible in case a sufficient high share of non-contracted bids is available on continuous basis. Elia's believes that the long term effects should be considered and that a stable and foreseeable revenue is needed when reserves need to be procured.

  The same principles were considered for the development of our proposal not to procure downwards mFRR reserves in 2019.
- **Elia will therefore keep the initial proposal as made in the study.**

3.4 Impact on reserve sharing

3.4.1 Stakeholder's feedback

FEBEG questions if the availability of 99 % of the cross-border contracts as mentioned in the study is correctly taking into account the available ATC import capacity. If pre-reserving capacity on the ATC for reserve sharing would be considered - which FEBEG understands is not the case - cross-border capacity allocation should be subject to a co-optimization algorithm allowing to define the social welfare optimum between capacity for the flow based solution versus any balancing capacity contracting gains resulting from contracting reserve in neighboring countries.

On the impact of reserve sharing, Febeliec understands the comments made by Elia but wants to point out that Elia is again extremely conservative in the volumes that are taken into account. Febeliec has no issue with such approach, other than the fact that this leads to the inclusion of a large number of security margins at each different aspect of the determination of required volumes and the reservation of balancing capacity, leading to the exclusion of large volumes of potential reserve capacity and thus to a higher required volume to procure. With additional (electrical) borders to arise in future years, Febeliec would like to learn the potential impact hereof on the dimensioning of reserves in Belgium.

BDRA underlines the need to assess the availability of such inter TSO-contracts following the remaining ATC cross-border capacity after the closure of the intraday market. BDRA therefore ask that availability of exchange contracts with other TSOs is assessed using ATC availability after intraday market and not after day-ahead

3.4.2 Elia's feedback

- Overall Elia would like to point out that there is not much flexibility on this topic as the process and rules are governed by legal constraints set out in the EU regulation.
- Regarding the proposal of BDRA to assess reserve sharing after intraday market, Elia recalls that procuring mFRR after day-ahead and intraday market would cause liquidity issues.
- The impact of additional electrical borders on the reserve sharing volumes shall be addressed in future proposals of the LFC block operational agreement.
- **Elia will therefore keep the initial proposal as made in the study**

3.5 Various comments

3.5.1 Dynamic dimensioning

With respect to the FRR dimensioning process, Febeliec is surprised to read that Elia mentions that it might be lacking capacity in periods with real high imbalance risk. Febeliec understood that in the current process, as presented in the Dossier Volumes, such periods are also covered. If not, Elia has accepted a situation with non-covered risks or wants in the future to go even further in building in margins, which would lead to higher costs for grid users. Both approaches present issues for Febeliec and Febeliec thus hopes for some additional clarification from Elia on this point.

3.5.2 Elia's feedback

Elia performed last year a study regarding dynamic dimensioning of FRR needs. In this study the advantages and disadvantages of different methodologies were carefully assessed. The study demonstrated that dynamic dimensioning would lead to a better reliability management and a positive business case following average balancing reserve needs reductions. Febeliec is invited to read the study[1] in case additional clarifications are needed.

[1] http://www.elia.be/en/users-group/Working-Group_Balancing/Projects-and-Publications/Dynamic-dimensioning-of-FRR-needs