

## ANNEX 1

### CCR Nordic Regulatory Authorities statement of disagreement on the Nordic TSO's proposal on a Nordic capacity market for frequency restoration reserves with automatic activation submitted pursuant to Commission Regulation (EU) 2017/2195 (EB GL)

#### General background on the proposal

On 17 December 2019, Energinet, Fingrid, Statnett and Svenska kraftnät (the Nordic TSOs) submitted revised proposals for a Nordic capacity market for frequency restoration reserves with automatic activation (aFRR) for regulatory approval with the CCR Nordic NRAs.

The TSOs submitted the revised proposals pursuant to EU Regulation (EU) 2017/2195 establishing a guideline on electricity balancing (EB GL). The proposals are interlinked and were submitted for regulatory approval at CCR Nordic with a view to establish a capacity market for frequency restoration reserves with automatic activation (aFRR), cf. the proposal pursuant to EBGL arts. 33(1) and 38(1), based on a so-called market based allocation process for the allocation of cross-zonal capacity, cf. the proposals pursuant to EB GL art. 41(1), and by making an exemption to allow balancing service providers to transfer their obligations to provide balancing capacity, cf. the proposal pursuant to EBGL article 34 (1).

The Nordic TSOs propose to reserve a percentage of the total cross-zonal capacity to the aFRR balancing market, instead of allocating it to the Day-ahead (DA) market.

The bids within the Nordic CCR will be gathered in a Common Merit Order List (CMOL) and will subsequently be activated by a Nordic aFRR activation optimisation function, meaning an automated algorithm for selecting bids.

The inherent downside of implementing an aFRR capacity market in the Nordic area is that the new market effectively takes away cross-zonal capacity from the DA market thereby decreasing the economic surplus from the DA market.

Hence, it is necessary to juxtapose the expected losses in the DA market with the expected reduction in aFRR procurement costs when allowing the exchange of aFRR capacity. Using data from 2018, the TSOs simulated the proposed market set-up and concluded that the loss in the DA market would be smaller than the gains in the aFRR market, which according to the Nordic TSOs yields a net social benefit<sup>1</sup>.

The TSOs currently envisage to launch the aFRR capacity market in Q3 2020 or shortly thereafter.

#### General background on the process

- NVE-RME has been participating in discussions with the CCR Nordic NRAs on an informal basis pending the implementation of EU's third energy package (implemented in Norwegian law as of 1 November 2019), but with the EB GL implementation into Norwegian law still pending.
- The Nordic TSOs' proposal was received by the last NRA of CCR Nordic on the 17 April 2019.
- The CCR Nordic NRAs made a public consultation on the proposals on the NordREG web site between 6 May and 3 June 2019.
- The CCR Nordic NRAs and NVE-RME send requests for amendments for all 3 proposals to the Nordic TSOs on 17 October 2019.
- The Nordic TSOs submitted revised proposals to the CCR Nordic NRAs and NVE-RME on 17 December 2019.
- EV made a public consultation on the revised proposals in the period 9 to 23 January 2020.
- The CCR Nordic NRAs and NVE-RME discussed the revised proposals with the TSOs at a telco on 15 January 2020 and at a meeting on 31 January 2020.

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<sup>1</sup> In the Explanatory Document to the revised proposal pursuant to EB GL art. 41(1), the TSOs estimate the benefit to be of 53 million euro per annum.

- On 14 February 2020 CCR Nordic NRAs decided to refer to the proposals to ACER as the revised proposal pursuant to EB GL arts 33(1) and 38(1) as well as the proposal pursuant to EB GL art. 41(1) were not approvable by any of the CCR Nordic NRAs, while the revised proposal pursuant to EB GL art. 34(1) was not approvable by EV. Further, the CCR Nordic NRAs do not fully agree as to what amendments need to be made to the proposals in order for them to be approvable.

## Summary of NRAs assessment of the revised proposals including diverging views among the NRAs

### *Lack of compliance with EB GL article 38(5)*

Article 10(2) in the revised proposal pursuant to EB GL arts. 33(1) and 38(1) allows the Nordic TSOs to allocate cross zonal capacity for the exchange of balancing capacity by applying the Net Transfer Capacity method until the go live of Flow Based. The CCR Nordic NRAs find that the proposal thereby does not comply with the constraints following from EB GL art 38(5) according to which there can be capacity reservations only if cross-zonal capacity is calculated in accordance with the with the capacity calculation methodologies developed pursuant to Regulation (EU) 2015/1222 and Regulation (EU) 2016/1719.

The CCR Nordic NRAs find that a solution could had been to revise the proposals to take this into consideration in the implementation plan for the market.

Ei, DUR and NVE-RME notes that a strict reading of EB GL art. 38(5) links reservation of capacity for balancing purposes to the implementation of capacity calculation methodology according to CACM and FCA (flow-based for CCR Nordic). However, Ei, DUR and NVE-RME see no immediate and reasonable link between the proposed allocation process and the flow-based capacity calculation method. A strict reading potentially results in a delay of several years before a Nordic aFRR capacity market can be implemented, thus postponing the realization of socioeconomic benefits for the region. Ei, DUR and NVE-RME thus urge ACER to consider whether a strict reading of Art 38(5) aids the overall purpose of the EBGL which i.a. is to integrate balancing markets and enable exchange of balancing reserves.

Secondarily, Ei, DUR and NVE-RME would like ACER to assess whether it could be legally possible to accept an interim period where the capacity is calculated with the capacity calculation methodologies applied in the CCR Nordic today.

EV finds the wording and intention of EB GL art. 38(5) clear and thus, it does not provide room for different interpretations. The intention is to restrict reservation of capacity until the capacities are calculated in a transparent manner with an approved methodology. EV considers EU Regulations, such as EB GL, binding in its entirety regardless of views or opinions around its convenience.

### *Revised settlement scheme*

In article 9 in the revised proposal pursuant to EB GL arts. 33(1) and 38(1), the Nordic TSOs have adjusted the settlement scheme from pay-as-bid to pay-as-clear following the suggestion in the RfA.

The CCR Nordic NRAs and NVE-RME note some aspects of the proposed settlement scheme that may not be compliant with Regulation 2019/943. First the setup includes an administratively defined cost (denoted cross-zonal reservation cost) for cross zonal capacity that may not be compliant with art. 18(6) of Regulation 2019/943. In addition, it seems that the added cost for cross zonal capacity will create revenue priced to the forecasted price difference. This creates revenue for TSOs despite that congestion is not arising in the balancing capacity market time frame thus seemingly not compliant with art. 19 of Regulation 2019/943.

### *Optimisation process*

Art. 4 in the revised proposal pursuant to EB GL art. 41(1) states that a maximum of 10% of the forecasted CZC for each bidding zone border for the day-ahead timeframe shall be allocated for the exchange of balancing capacity.

The text indicates that the amount of capacity available in the optimization (the constraint) could be lower than 10%. Hence, it gives TSOs the opportunity to set different constraints in the optimisation function when deciding the amount of cross zonal capacity that is to be made available for the balancing capacity market. The methodology is not clear whether the maximum capacity always will be available in the optimisation or whether there will be a negotiation by the involved TSOs which can result in lesser capacity made available in the optimization.

The CCR Nordic NRAs and NVE-RME find that the exact TSOs process for CZC determination should be defined in the methodology.

However, DUR and NVE-RME do not see this lack of clarity a reason in itself not to approve the proposal.

In art.12 in the revised proposal pursuant to EBGL arts. 33(1) and 38(1) the TSOs have described the optimisation function. However, the text on the optimisation process or the equation does not state clearly that capacity reservation shall only be made when savings in procurement costs exceed the reduced DA-economic surplus. At the telco on 15 January 2020, the Nordic TSOs stated that this is what happens in the optimization.

The CCR Nordic NRAs and NVE-RME therefore find that it should be clearly formulated in art. 2 that capacity reservation will only be made when savings in procurement costs exceed the reduced DA-economic surplus.

The CCR Nordic NRAs have discussed whether the bid selection and settlement scheme complies with the obligations for TSOs to minimise the overall procurements costs of all jointly procured balancing capacity, cf. EB GL art. 58(3)(a), as further outlined just below.

#### *Settlement scheme*

Article 13 in the revised proposal pursuant to EB GL arts. 33(1) and 38(1) contains provisions on the TSO-TSO settlement in the proposed aFRR capacity market

EV finds that the TSO-TSO settlement includes additional payment from the importing TSO to the exporting TSO as the settlement is based on average prices and not on actual price paid to BSPs. This would mean uncalled income for the exporting TSO and thus, would compromise financial neutrality.

DUR cannot conclude with sufficient certainty that the proposed approach is not compliant with EB GL art. 58 (3)(a).

NVE-RME find the TSOs' proposed approach of minimising the overall socio-economic procurement costs to be reasonable and approvable. NVE-RME consider the wording in EBGL art. 58(3)(a) to be vague and thus cannot find a clear requirement for TSOs to minimise their own procurement costs.

#### *Bid selection*

Ei and EV have concerns with the bid selection and the explanations in Appendix 3 in the explanatory document for the proposal pursuant to EB GL arts. 33(1) and 38(1). As the BSPs are settled by pay as clear the bid prices should only be important in terms of placing all bids in correct price order.

The following is stated in the explanatory document: *In this example, zone B has cheaper aFRR and it is therefore efficient to procure everything there and reserve some CZC capacity. Procuring everything in zone B means accepting a high clearing price in zone B. In this example, we could reduce TSO costs by procuring less in zone B, and thereby reducing the price paid to a large volume of capacity, and instead procuring a small amount of expensive capacity in zone A.*

The proposed bid selection process implies that cheaper bids in B zone are not allowed to compete across the bidding zone border to the maximum extent possible given the maximum reservation possibility suggested by TSOs. Given this information minimizing the bid cost instead of using the cheapest bids given the exchange possibilities (available CZC) will not lead to efficient pricing reflecting the actual scarcity in balancing capacity and CZC and therefore should be amended. Instead the bid selection shall follow the clearing prices, ensuring that the cheapest aFRR capacity resources are fully exploited given the exchange possibilities.

DUR and NVE-RME are not convinced that the proposed bid selection scheme does lead to inefficient pricing.

#### *Gate Closure Time*

Article 6(4), 6(5) and 6(6) of the revised proposal pursuant to EB GL arts. 33(1) and 38(1) include descriptions of the gate closure time. The CCR Nordic NRAs find that the TSOs have provided enough level of detail on the Gate Closure Time and that they have addressed the NRAs' concerns with the overall timing when changing the proposed market clearing to take place D-1.

However, a requirement should be included in the proposal obliging the Nordic TSO need to consult the market actors on the exact Gate Closure Time and that they need to take received comments into account before deciding on it.

For CCR Nordic NRAs and NVE-RME this lacking consultation is not in itself something that would have made the proposal un-approvable

#### *Justification for a Nordic aFRR market*

In the recitals and the explanatory document to the revised proposal pursuant to EB GL art. 41(1) the TSOs have expanded on the justification of how the proposal fulfils the objectives of the EB GL stipulated in EB GL art. 3. Still, the justification is not strong enough – at least for Ei and EV – who miss data from the TSOs showing accuracy of the estimated net social benefit of approximately 53 million euros for the estimated year 2018. The CCR Nordic NRAs and NVE-RME have noted that the impact on all BSPs is not included in net figure. i.e. the impact on SE3 (bidding zone) is lacking. Given the presented impact in SE2 and SE4 the impact is decreased surplus for BSPs also in SE3. This inaccuracy makes the estimation uncertain.

Below are examples of assessments that Ei and EV believe that the Nordic TSOs should have done to improve the accuracy of the estimations:

- how the reservation of capacity affects the DA market for more years than only 2018, to capture the fundamental differences that can occur over time;
- how different levels of reservations impact the DA market, at least showing the impact on the day ahead market when the maximum capacity of 10% is reserved on each bidding zone border (worst case scenario), considering that a simple and transparent forecast model makes it more easy to hold the Nordic TSOs accountable for the capacity taken away from the DA market, while a more complex model presumably is more precise but also less transparent making it more difficult to hold the TSOs accountable;
- distributional effects, i.e. producer surplus, consumer surplus and congestion income per bidding zone for a longer time period than only 2018;
- a comparison for more years than only 2018 of the procurement costs when there is no exchange of balancing capacity with the costs when exchange is allowed in accordance with the proposed market design per bidding zone; the price for the procured balancing capacity shall be determined by pay as clear rather than pay as bid as is the case in the impact assessment in the explanatory document to the revised proposal pursuant to EBGL art. 41(1);

To remedy for the insufficient justification, DUR, Ei, and NVE-RME have been considering whether to make an assessment of the implementation of the market one year after its go-live obliging the Nordic TSOs to propose amendments to the terms and conditions if warranted by the results of the assessment.

EV, on the other hand is skeptical to such an approach arguing that regulatory approval in the first place is contingent upon EV being sufficiently confident of the proposed market-based cross-zonal capacity allocation process from the outset.

#### *The accuracy of the reference day method*

Arts 2(2) and 5(3) of the revised proposal pursuant to EB GL art. 41(1) states that the reference day for which the clearing prices for each day-ahead market timeframe are available for each bidding zone.

EV and Ei consider that the reference day method is not sufficiently proven. Consequently, it should be statistically tested for estimating the probability of its accuracy per bidding zone border

#### *Justification of the mark up*

Art. 6(4) in the revised proposal pursuant to EB GL art. 41(1) propose a mark-up/uplift of 1 euro per MWh for all congested borders, i.e. between the bidding zones that did not have the same price on the reference day. The

mark-up was proposed to be 0.1 euro per MWh when the borders were uncongested on the reference day. This add-on is included in order to take into account the uncertainty of the forecasted market value of CZC.

I.e. this feature increases the price spread observed on the reference day and thereby potentially decrease the amount of cross-zonal capacity for aFRR capacity exchange thanks to administratively set mark up on the forecasted market value.

The analysis provided by TSOs does not provide enough evidence for the CCR Nordic NRAs and NVE-RME to conclude that the forecasting methodology i.e. the reference day method and the markup will ensure an accurate forecast. To assess its accuracy the CCR Nordic NRAs and NVE-RME would appreciate a supporting analysis demonstrating the impact from applying different alternatives i.e. the proposed uplift compared with differentiated uplift levels on different bidding zone borders or a fixed percentage defined by TSOs.

Other options considered by DUR, NVE-RME and Ei have been to use a more conservative uplift or maximum percentage of reserved capacity or to make use of differentiated uplifts at different bidding zone borders. EV argues that to make such amendments is the task of the TSOs rather than the NRAs.

*Justification of exemption to allow balancing service providers to transfer their obligations to provide balancing capacity*

CCR Nordic NRAs and NVE-RME have discussed whether to approve the revised proposal pursuant to EB GL article 34(1) in light of the outcome of the two other revised proposals.

It can be argued that approving the revised proposal pursuant to EB GL art 34(1) would make little sense as it refers to the other two proposals and since the exemption resulting from an approval would only be relevant if the market design proposed in the other two proposals were approved and implemented.

Still DUR and Ei would be ready to approve the proposal. NVE-RME shares Ei's and DUR's views and deems the proposal pursuant to EBGL art 34(1) approvable.

On the other hand EV does not find that the proposed exemption is sufficiently justified to be approved as a stand-alone concept while the market design is not clear.