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**Explanatory document to Energinet, Fingrid, Statnett and Svenska kraftnät proposal for exemption for not allowing balance service providers to transfer their obligations to provide aFFR capacity in accordance with Article 34(1) of the Commission Regulation (EU) 2017/2195 of 23 November 2017 establishing a guideline on electricity balancing**

October 2019

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## Contents

1. Background.....	3
2. Definitions .....	3
3. Applicability and legal basis.....	3
4. Public consultation .....	4
5. Interaction with other aspects of the aFRR market's design .....	4
5.1. Within-zone and cross-zonal transfers .....	4
5.2. The transfer window .....	5
6. Proposal for exemption .....	6
7. Justification .....	6
8. Considerations .....	7
9. Consequences if exemption is not granted.....	7

## 1. Background

The Nordic TSOs – Energinet, Fingrid, Statnett and Svenska kraftnät – (hereafter referred to as “the TSOs”) have mutually agreed to propose a common market for aFRR capacity. The TSOs have, for that purpose, put forward a proposal for the “establishment of common and harmonised rules and processes for the exchange and procurement of balancing capacity” as set out in EB GL Article 33 and 38 and a proposal for the “application of a market-based allocation process” as set out in EB GL article 41.<sup>1</sup> These proposals have been submitted to the Nordic National Regulatory Authorities (NRAs) for approval.

Under the submitted proposals, the TSOs aim to procure aFRR capacity two days before the provision of the same capacity. The contracting period will be set equal to the day-ahead MTU. Procurement will be carried out for each of the eleven LFC areas in the Nordic LFC block and – when economically efficient – transmission capacity between LFC areas will be allocated to the market in order to accommodate the exchange of aFRR capacity between LFC areas.

This consultation deals specifically with the proposal for exemption for disallowing Balancing Service Providers (BSPs) to transfer their obligations to provide aFRR capacity after the aFRR market has cleared.

## 2. Definitions

EB GL, Article 2.26: ‘transfer of balancing capacity’ means a transfer of balancing capacity from the initially contracted Balancing Service Provider (hereinafter referred to as “BSP”) to another BSP;

## 3. Applicability and legal basis

EB GL article 34(1) makes clear that TSOs should generally allow BSPs to transfer their obligations to provide balancing capacity within the geographical area in which the procurement of balancing capacity took place.

If the transfer of balancing capacity requires the use of cross-zonal capacity, the ability of BSPs to transfer this capacity is conditional on the availability of cross-zonal capacity. Capacity may be considered to be available for such transfers either because it was already made available for the transfer of balancing capacity as part of the initial allocation process or because the cross-zonal capacity is deemed to be available as assessed using the probabilistic approach outlined in EB GL Article 33(6).

The relevant TSOs may, however, request an exemption from the general obligation to allow the transfer of balancing capacity among BSPs, described above, in cases where the contracting period for balancing capacity pursuant to Article 32(2)(b) is strictly less than one week. The proposed Nordic aFRR capacity market fulfils this requirement and, as such, the TSOs have sought an exemption for the proposed aFRR capacity market that would effectively disallow the transfer of aFRR capacity bids among BSPs.

EB GL Article 5(3) stipulates that the request for an exemption is subject to approval by all NRAs in the relevant region. This implies that approval must be granted by the same set of regulatory authorities scrutinising the proposal for “the establishment of common and harmonised rules and processes for the exchange and procurement of balancing capacity” in accordance with Article 33(1) of EB GL.<sup>2</sup>

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<sup>1</sup> See <http://nordicbalancingmodel.net/proposal-for-nordic-afrr-capacity-market-and-cross-zonal-capacity-allocation-methodology-submitted-for-regulatory-approval/>

<sup>2</sup> See above

## 4. Public consultation

The TSOs proposed to disallow the transfer of aFRR capacity bids as part of the public consultation on the Nordic TSOs' proposal to establish common and harmonized rules and processes for the exchange and procurement of aFRR capacity (opened 3rd September 2018, closed 4th October 2018). The TSOs received no input from stakeholders as part of this consultation exercise that related specifically to disallowing the transfer of aFRR capacity bids.

To ensure that stakeholders have adequate opportunity to consider and comment on the TSOs' proposal to disallow the transfer of aFRR capacity bids, the Nordic TSOs, are now consulting specifically on this issue.

## 5. Interaction with other aspects of the aFRR market's design

### 5.1. Within-zone and cross-zonal transfers

In considering the potential impact of restricting the transfer of bids, it is helpful to distinguish between:

- Within-zone transfers, in which an obligation to provide aFRR capacity is transferred between eligible BSPs within the same LFC area, and,
- Cross-zonal transfers, in which an obligation to provide aFRR capacity is transferred between eligible BSPs in different LFC areas.

In both cases, the transfer may impact system operations and security, however cross-zonal transfers are more likely to give rise to operational security concerns.

#### 5.1.1. Cross-zonal transfers

The specific concern with cross-zonal transfers is that aFRR capacity may be moved to a bidding zone where there is insufficient cross-zonal capacity available to accommodate the activation of the aFRR capacity. To enable cross-zonal transfers safely, cross-zonal capacity allocations would either have to be amended to support the transfer, or TSOs would have to establish a process through which transfers with unacceptable security impacts could be prevented.

We believe that amending the cross-zonal capacity allocations determined through our proposed market clearing process to accommodate the later transfer of bids does not make sense. In particular, this would make possible the substitution of bids in different LFC areas that the clearing process had explicitly rejected on the grounds that it would entail a net reduction in social welfare, for example by limiting the quantity of cross-zonal capacity made available to the energy market.

The Nordic TSOs could attempt to establish a process for the assessment and approval of requests for cross-zonal transfer. The development and ongoing administration of such a process would entail a cost to the TSOs, and possibly to the BSPs involved.

#### 5.1.2. Within-zone transfers

The transfer of bids within zone may still impact system operations and security. However, to the extent that significant network bottlenecks are accurately reflected in the definition of LFC areas, the likelihood that such a transfer would materially harm system security is relatively low when compared to cross-zonal transfers.

In addition, the bid selection process currently proposed for the aFRR capacity market does not distinguish between different locations within an LFC area. Given the assumed locational equivalence of all offers within the same LFC area within the proposed market process, it may be possible for Nordic TSOs to safely allow the transfer of bids within zone without formal approval by the relevant TSO provided that the system

operator is keep informed of any transfer and the transfer window closes long enough ahead of delivery for the system operator to resolve any operational security issues that may arise.

Establishing a process through which the TSO can be kept up-to-date on within-zone transfers and administering this process would entail a cost for TSOs. There may also be a cost in terms of increased system operation costs where such transfers give rise to operational security problems.

## 5.2. The transfer window

There will be a limited period in which the transfer of aFRR capacity bids is possible, which we refer to as the transfer window. The timing of this window is currently unknown, since the timing of the aFRR market itself has yet to be determined. The remainder of this section sets out the likely range of possibilities. If your answer to the consultation questions would be materially affected by the choice of timings, please make this clear in your response.

The current proposal for the aFRR capacity market implies the timeline of events depicted in Figure 1 below.<sup>3</sup> The aFRR capacity market is closed to new bids at 20:00 CET D-2. The aFRR capacity market is then cleared in the evening of D-2, after which the transfer of bids, if permitted, could take place.

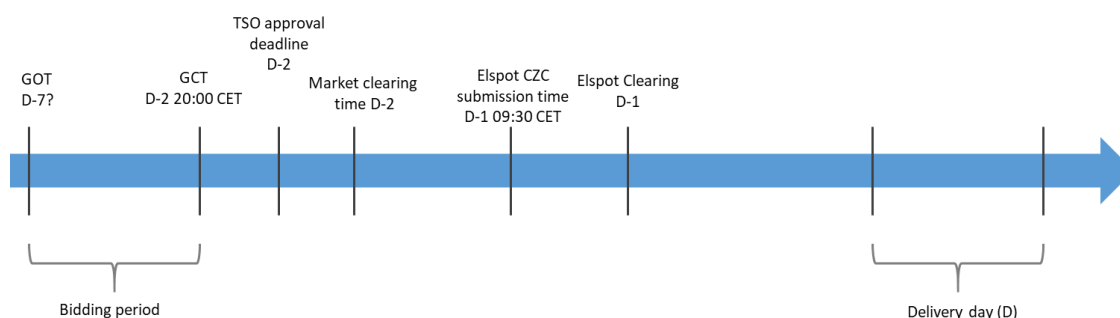


Figure 1. Overview of the market timeline

Assuming that such transfers do not materially affect the availability of transmission capacity among bidding zones, for example because the bids were conditional on the availability of capacity, they could continue up until an unspecified deadline ahead of the delivery period.

Any transfers requiring possible changes to the allocation of transmission capacity between zones would have to be made sufficiently in advance of the notification of available transmission capacities to the day-ahead energy market. This information is submitted at 9:30 CET D-1.

Importantly, the actual timing of the aFRR capacity market could be different than as described in the current proposal and depicted above. The proposal above is likely to reflect the earliest possible clearing of the aFRR capacity market and therefore the longest possible transfer window.

In order to comply with European regulation (Reg 2019/943 art. 6(9)), it will be reconsidered whether gate closure time and the clearing of the aFRR market may need to be moved to D-1. In the event this happens, the transfer window will be shortened accordingly.

The latest conceivable time at which the aFRR market as currently envisioned could be cleared is shortly ahead of the notification of available transfer capacities to the day-ahead energy market at 9:30 CET D-1. As

<sup>3</sup> Full details of the proposal can be found in the proposal documents, specifically those related to EB GL articles 33 and 38, at <http://nordicbalancingmodel.net/proposal-for-nordic-afrr-capacity-market-and-cross-zonal-capacity-allocation-methodology-submitted-for-regulatory-approval/>

such, the plausible range of times at which the aFRR market may be cleared, and at which point the transfer window might open, is from 20:00 D-2 until 9:30 D-1.

## 6. Proposal for exemption

The TSOs are requesting an exemption that:

- The BSP shall not be allowed to transfer their obligations to provide aFRR capacity, i.e. accepted aFRR capacity bid, to another BSP within a bidding zone; and
- The BSP shall not be allowed to transfer their obligations to provide aFRR capacity, i.e. accepted aFRR capacity bid, to another BSP across bidding zone borders.

## 7. Justification

Accommodating transfers while maintaining operational security would impose a real cost on TSOs but would be unlikely to realise any significant improvement in market efficiency.

As noted above, to facilitate the safe transfer of bids, the TSOs would need to create and maintain a mechanism for keeping track of which units held an aFRR capacity provision over time. They would also, at least in the case of cross-zonal transfers, have to develop a process for assessing whether a proposed transfer would harm operational security unacceptably and a process for receiving and approving transfers in line with these assessments. The development and administration of these processes would impose a real cost on the Nordic TSOs and possibly delay implementation of the aFRR capacity market and the realisation of the efficiency and operational security benefits that it is expected to bring.

In our estimation, the possible gains from supporting transfers will be small, owing both to the short transfer window and the relatively small number of BSPs in each LFC area. In theory, enabling transfers allows BSPs to reoptimise the allocation of aFRR capacity provision amongst themselves in response to changing market conditions following the clearing of the aFRR capacity market. However, the transfer window is so short that the value of reoptimisation is likely to be minimal. If the market is cleared instantaneously at 20:00 D-2, the deadline for bids under the current proposal, and the transfer window is closed an hour ahead of the delivery day, in accordance with EB GL Article 34(2), this would leave just 27 hours for transfers. If the aFRR capacity market is cleared on D-1, the window would be even shorter. We do not expect significant reoptimisation efficiency gains in this timeframe.

The scope for the more efficient allocation of transmission capacity is also limited by small set of potentially feasible transfers. Nordic LFC areas are comparatively small by European standards and there is therefore a relatively small number of providers in each LFC area. In many cases, cross-zonal transfers may not be feasible without either harming operational security or using up transmission capacity that is better allocated to the energy market. These limitations on the set of feasible transfers further limits the potential efficiency gains.

The ability to transfer bids could also be theoretically valuable to the extent that the ability to transfer bids helped to reduce the operational risk facing BSPs and BSPs were ill-suited to holding this risk. However, current BSP can manage the financial risks of defaulting on their capacity obligations and, as noted previously, the set of feasible transfers may be very limited in any event, such that BSPs can't cheaply offload their obligation to provide aFRR capacity.

An evaluation including public consultation will be performed within five years after the approval of this proposal. Possible amendments can be initiated based on this.

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## 8. Considerations

A decision to disallow the transfer of bids in the aFRR market's opening stages would not preclude incorporating transfers later. However, the costs entailed in supporting such transfers would need to be justified. Changes to the following could alter the expected balance of potential costs and benefits:

- An increase in the number of BSPs, implying a substantial increase of number of possible transfers.
- An increase in the number of (smaller) potential BSPs for which the financial risk associated with defaulting on a capacity obligations acts as barrier to entry.

As noted above, the transfer of aFRR capacity bids across bidding zones would entail significant additional complexity given the need to assess each transfer's impact on operational security. The TSOs therefore do not consider that incorporating cross-zonal transfers is ever likely to form a natural part of the market's development.

## 9. Consequences if exemption is not granted

If the proposed exemption is not granted, the Nordic TSOs would need to develop additional processes and procedures to support such transfers and make suitable revisions and additions to the legal framework and IT system being developed to support the aFRR capacity market. This would impose additional costs for the TSOs and BSPs and would potentially delay the implementation of the aFRR capacity market, delaying both the efficiency gains and improvements to operational security that it is expected to bring.

As described in section 5.1, the extent of the required changes would likely differ dependent on the scope of the exemption and, in particular, the inclusion of within-zone and cross-zonal transfers respectively. Accommodating cross-zonal transfers would have the most serious impacts, since this would necessitate the development of processes to approve or reject proposed transfers based on the operational security impact. However, allowing transfers of any type would still necessitate the development of new processes, most notably a means for BSPs to keep the relevant TSO(s) informed of transfers ahead of the delivery period.