

Explanatory note to the NEMOs' proposal of the amendment of the HMMCP methodologies

October 2022

Introduction remarks

On 15/09/22 NEMOs submitted to ACER a proposal for revision of the HMMCP methodologies, in line with requirements set forth in Article 4, point 3 of HMMCPs themselves. The general aim of the proposal is to take into account the solicitations received from ACER and EC on the need for a revision of the existing methodologies, as well as the outcome of the public consultation on the same topic run by the NEMO Committee from 24/05/2022 to 15/07/2022. With this respect, the proposal is fundamentally searching a balanced approach between three main requirements:

- a) Making the triggering of price limit increases less sensitive to occasional and non-structural events, in order to avoid unnecessary increases in the cost of collaterals or operational risk and further turmoil in the already critical conditions affecting wholesale markets following the beginning of the Ukrainian crisis. With this regard, it has been noticed that both the two price spikes registered in the last months¹ represent cases of very occasional events, reflecting purely local and temporary conditions of scarcity of supply, which should not be considered sufficient to induce wider and longer-term consequences on the operation of wholesale markets.
- b) Minimizing the risk that the price limit set forth in the methodology become a “price-cap” limiting price formation, in line with the spirit and the letter of article 10 of EU Regulation 2019/943. The HMMCP allows for price limit only as a technical way to allow manage in an efficient way the cost of collaterals which Market Participants have to post to Organized Market Places in order to enter into wholesale negotiations, but such price limit should never prevent the free formation of prices on the market. That’s why the HMMCP provides rules to amend the price limit when this is being approached, in order to minimize the risk of reaching it and thus limiting the wholesale prices.
- c) Ensuring maximum transparency and ease of implementation of the new rule, with the goal of promoting reliable operation of the DA and ID Market Coupling activities from both NEMOs and TSOs and Market Participants. A rule which is simple and transparent while efficient is key to ensure that any price limit increase can be timely and reliably implemented by NEMOs (including amending and testing of new limits), in order to prevent risks of decoupling, but also can be model and anticipated by Market Participants, in order to allow them properly prepare and adjust their bidding strategies in a consistent way.

¹ Reference is to the price spike of 2,712.99 €/MWh and 2,987.78 €/MWh registered in France on 03/04/2022 which triggered the increase of DA price limit from 3.000 to 4.000 €/MWh, and to the following one of 4.000€/MWh registered in Lithuania, Latvia and Estonia on 16/08/2022, which did not lead to price increase to 5.000 €/MWh for the reasons mentioned hereafter: Following confirmation of ACER and EC, and after the publication of the Presidency Summary from Extraordinary TTE (Energy) Council Meeting of 9 September 2022, where it is stated that “Ministers also called for sending a signal of confidence to the electricity market by immediately suspending the automatic increase of the maximum clearing price threshold on the electricity market.”, NEMOs and TSOs performed all the necessary activities to suspend automatic increase of the maximum clearing price.

As a summary, and according to the draft methodology submitted to ACER:

- NEMOs still will modify price limits when they must
- NEMOs will decrease operational and financial risks when they can
- NEMOs will keep a simple and easy way to implement the rule

NEMOs kept promoting the EU harmonization in their proposal. NEMOs took advantage of the HMMCP revision in order to introduce in the DA HMMCP specific provisions to rule the evolution of the minimum price limit, foresee a mechanism for decreasing back the maximum price limit under certain conditions, and in the ID HMMCP, introduce specific provisions related to the IDAs.

1. DA HMMCP

The main changes introduced on DA HMMCP relate to the following areas.

a) The proposal suggests to keep the values of maximum and minimum price on 3000€/MWh and – 500€/MWh respectively as initial reference values.

Indeed, as of October 2022 (the present document drafting date), the maximum price is at 4000€/MWh. Nonetheless keeping in the methodology, the value of 3000€/MWh does not mean there shall be an automated decrease back once this methodology enters into force. The 3000€/MWh serve as an initial reference of the floor value. In case there is a decrease mechanism included in the methodology (see below NEMOs' proposal in this sense), the maximum price shall never decrease below this 3000€/MWh threshold.

b) The proposal makes the definition of the triggering event for price limit change less sensitive to local and temporary events and ensure that price limits changes are not triggered in a sequence

In the current methodology, the maximum price limit increase is triggered if the clearing price exceeds a value of 60% of the SDAC HMMCP in one hour and one bidding zone.

All NEMOs propose an adaptation of the triggering mechanism, so that an increase occurs in a situation reflecting a rather structural issue, and not an occasional isolated event on the market. Therefore, all NEMOs propose the following trigger of the price increase: the market clearing price exceeds 70% of the SDAC HMMCP, in a number of MTUs (market time unit) representing at least 5 hours, in at least 3 different days, within 10 rolling days from the first price spike.

Different considerations led to this proposal:

- The 70% threshold is higher than the current 60%, hence it makes the trigger more difficult to reach – and reduce in this way the risk of oversensitivity. Still, the parameter does not enter the range [80%-100%] where the slopes of the demand and offer curves are very strong and the curtailment could be reached due to sudden scarcity of offer.
- The proposed cumulation of MTU allows to better differentiate an isolated event from a structural issue, while the multiple MTU context was taken in account to define the total sum:

- 5 hours may be composed of five 60 min MTU, or twenty 15 min MTU, or a combination of both (three 60 min MTU and eight 15 min MTU, etc.). The same aim is followed by setting the condition of 3 different days. On the contrary, the number of bidding zones where such an event occurs is not considered: if for the same MTU in different bidding zones the price cap is reached, it is considered as one single price spike, and the MTU is counted only once within the sum of 5 hours. The rationale behind is that the price spike occurring simultaneously in more than one bidding zone is likely part of the same trend, therefore while counting it only once, it avoids the redundancy.
- In addition, to better take in account the structural aspect and distinguish it from the conjunctural one, a rolling period is introduced, exceeding intentionally one week slot: this shall allow to reflect situations that would be linked e.g. with a specificities of weekend days (in other terms, a structural issue linked to some seasonality). After consideration, all NEMOs precautionary assess not to include among triggering conditions a threshold relative to the volume of trades concerned by the price spike: it is assumed that this might increase the complexity of the SDAC-wide harmonization and introduce discriminatory aspects, given that the bidding zones are of different sizes and might present local specificities.

Besides, in case of a maximum price limit increase, the amount of increase is confirmed at the level of 1000€/MWh applied already in the current methodology. This is considered appropriate to prevent a too frequent triggering of price increases, in reply to isolated events.

Examples of how the amended triggering mechanism would work:

		Day 1	Day 2	Day 3	Day 4	Day 5	Day 6	Day 7	Day 8	Day 9	Day 10	Overall sum (h)	3 different days ?	Increase triggered ?
Situation 1 (France 04/04/22)	MTU	2H										2	No	No
	BZ	1 BZ												
Situation 2 (Baltics 17/08/22)	MTU	1H										1	No	No
	BZ	3 BZ												
Situation 3	MTU	1H	1H		1H							3	Yes	No
	BZ	2 BZ	1 BZ		2 BZ									
Situation 4	MTU	1H	4 x 15 min						3H			5	Yes	Yes
	BZ	2 BZ	1 BZ					4 BZ						

If the NEMO proposal had already been implemented – the two occasions with peak prices in France in April and the Baltic countries in August (see Situation 1 and Situation 2 in the table) – would not have led to increase in the Maximum clearing price.

- Peak price in France: two hours with price above 60% of 3000 EUR/MWh
- Max price in Baltic states: one hour with max price and curtailment of 2,4 MW at 4000 EUR

c) The proposal introduces a limited freezing period between the price spikes and the price limit increase, in order to secure reliable implementation of the changes and stable operation of markets.

A freeze period is introduced, going from the moment of triggering the increase until its application: it means that if any price spikes are reached during this period, these events will not activate another increase process.

On one side, such proposal aims at securing the market coupling operations, allowing NEMOs and TSOs to implement and properly test the needed changes in the MCO assets supporting market coupling function, but also allowing Market Participants the necessary time to anticipate future changes and amend their bidding strategies and tools.

On the other side, the proposal contributes to the previously mentioned goal to contain the number of prices increases in the short term, as it is considered that the potential further price spikes taking place in the so called freezing period would represent a simple confirmation of the ongoing short term trend.

At the same time, in order to minimize the risk that the setting of price limit and their amendment process turns into a price cap limiting an efficient price formation, all NEMOs consider appropriate to keep this freeze period as short as possible: keeping it limited to the transition period between a trigger and the implementation of the new maximum avoids overlapping/parallelization of several cap increase processes. For this reason, the implementing time has also been reduced from five to four weeks. Further reductions have been assessed, but discarded as ultimately considered too risky from the perspective of the secure and reliable implementation of price limit change initially mentioned.

d) The proposal introduces the chance for a decrease of the maximum clearing price if the max value has shown to be unnecessarily high

A possibility to also decrease the maximum clearing price back to a lower level after it has been raised - following a certain period in which no thresholds have been reached and the increased maximum clearing price shows to be unnecessarily high - has been widely proposed by stakeholders.

The question was therefore included in the consultation and in general all respondents were positive to implementing such a mechanism.

Arguments supporting a possibility to decrease the maximum clearing price is the impact that a very high technical price limit can have on collateral requirements and trading limits. A very high technical maximum clearing price induces risks to market participants without clear benefits in terms of functioning of the market and free price formation. Collateral requirements, trading limits and risks are all aspects that may

have implications where (f.i. bilateral trading vs on the exchanges) market participants choose to trade electricity and thereby indirectly affect the liquidity in the day-ahead market.

NEMOs have therefore proposed that the maximum clearing price can be reduced under the following conditions:

- The technical maximum clearing price has been increased by 1000 EUR/MWh at one or more occasions from the 3000 EUR/MWh initial limit.
- There has been no observation of price, in any single bidding zones or any single MTU, above 70% of the previous technical maximum price limit.
- The observation period since the last increase of the maximum price limit is at least 12 months.

Nonetheless, the Harmonized maximum clearing price can never be reduced below the initial price limit of 3000 EUR/MWh.

Naturally, the concern is whether such a decrease of the harmonized technical maximum clearing price could imply a barrier to the free price formation.

NEMOs believe that the automatic adjustment mechanism, both upwards and downwards, respect the requirement to not restrict the free price formation.

- Upwards: in situations when peak prices are reflecting a structural change to a more strained market and thus a need to increase the price to facilitate for activation of flexibility in consumption that are not normally needed (Value of Lost Load)².
- Downwards: after a longer period with stable lower prices due to over time a well-balanced market with regards to supply and demand.

The technical maximum clearing price is in both cases defining extreme borders with sufficient margins away from where the price formation takes place. By this the methodology provides a well-balanced and proportional approach between the objectives for an efficient market, and the need to protect consumers and the impact of collateral.

e) The proposal makes the Harmonized Minimum Clearing Price dynamic

The Harmonized Minimum Clearing Price for SDAC is in the current methodology set to -500 EUR/MWh. Unlike the Harmonized Maximum Clearing Price, there has not been defined any mechanism to extend (reduce) the minimum clearing price should there be a need for this.

On 24 April 2022, it was observed negative prices in the Dutch bidding zone (The Netherlands) as low as (negative) -222,36 EUR/MWh (Hour 13 on 24 April).

² The requirement on the VoLL (Value of Lost Load) is not explicitly taken into account but shall be adequately substituted precisely by the abovementioned adjustment mechanism of the maximum price increase, and under advisable conditions; decrease the technical maximum price.

Although the technical minimum limit of -500 EUR/MWh, based on historic observations of negative prices, seems to be sufficient to allow free price formation, most of the stakeholders in the consultation supported the implementation of an automatic mechanism also for the negative limit.

2. SIDC HMMP

a) HMMCP for ID continuous is well working and requires no change

NEMOs do not propose any amendment to the existing SIDC HMMCP for continuous trading, for three reasons.

First, the current mechanism is embedded in the approved methodology decided up by ACER in 2017 and as such is fully compliant with the general regulation.

Second, on the market side, the current price limit for continuous trading is set at a level of 9.999 EUR/MWh, which is considered not putting at risk the principle of free price formation on the continuous trading.

Lastly, amending the mechanism to apply to the continuous market a scaling mechanism which has been conceived for the auction markets would add significant complexity, without delivering additional benefits in consideration of the level of the existing price limit. With this respect, it has been considered that the scaling mechanism implicitly applied by the existing rule linking SIDC price limit to the SDAC price limit is adequate and satisfying.

b) The SIDC harmonized minimum and maximum clearing prices for continuous and Intraday auctions

Intraday auctions – IDAs – are expected to be implemented by 2024 and technical HMMCPs need to be defined.

Due to the auction mechanism of the IDAs, to be organized similarly as the SDAC auction, it could seem natural to apply the same principles as for the SDAC auction. However, IDAs and ID continuous trading share the same or similar trading period and delivery horizon and therefore NEMOs have proposed to apply the same price limits and the same mechanism to IDAs as it is applied to the SIDC continuous trading.

With this approach NEMOs avoid the existence of arbitrage³ between these two markets, which may occur when - due the existence of different maximum/minimum price limits - in one of these two markets prices have reached the maximum/minimum price limits. This applies specifically to the IDA3, which will be organized at 10:00 am and such auction concerns the MTUs for the remaining part of the day.

Also, applying the same min and max price limits on IDAs and SIDC secures operational reliability by avoiding separate implementations and updates of the technical limits in different instances of the same

³ An arbitrage is the simultaneous buying and selling of securities, currency, or commodities in different markets or in derivative forms in order to take advantage of differing prices for the same asset.

MCO asset. Furthermore, it facilitates harmonization for market participants in bid submission, trading limits etc.

Annex: Reminder - legal framework

- REGULATION (EU) 2019/943 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 5 June 2019 on the internal market for electricity, namely art.10 Technical bidding limits.
- ACER Decisions No. 04/2017 and No. 05/2017 for SDAC and SIDC HMMCP, respectively.