A CRM IN BELGIUM

ANONYMOUS FEEDBACK

Dit is een anoniem antwoord op de "Openbare raadpleging betreffende de ontwerpnota over de parameters waarmee de hoeveelheid in het kader van het capaciteitsmechanisme aangekochte capaciteit wordt bepaald" gelanceerd door de CREG op 22/11/2019. We vragen anonimeit te respecteren voor het volledige document en ten aanzien van alle partijen buiten de CREG.

1. THE CRM IS AT ODDS WITH THE ENERGY TRANSITION

- Over the course of the last two decades, our electricity markets have evolved towards energy-only markets. We believe this is a good evolution: price signals trigger innovation and make the market find the most efficient solutions. More volatile prices on the spot markets stimulate BRPs to manage their portfolios better and are a trigger for demand response and other sources of flexibility to be optimized based on price signals, or to participate in ancillary services. This increases system efficiency.
- This trend continues until today and has not reached its full potential yet in Belgium, due to overcapacity in the Western-European grid, closed balancing markets, and market power by conventional utilities. Yet, a lot of work has been done by the CREG and Elia to open balancing markets and make them more competitive in the last years.
- We believe the CRM as it is currently on the table in Belgium would reverse these efforts, extend overcapacity, and bring a period of stable and low energy (and imbalance) prices. It jeopardizes innovation in the field of flexibility and end-customer participation. It cements the position of incumbent companies and a high share of non-renewable generation in the Belgian electricity mix. The costs will be transferred to the end consumer.
- We fear that the CRM in Belgium will not be efficient and will favour the large incumbents and lead to windfall profits – in particular owners of existing power plants.
- **In conclusion, we believe that a CRM as currently on the table in Belgium is fundamentally at odds with the intentions of the Clean Energy Package and a just and effective Energy Transition.**

2. ABOUT THE CRM DISCUSSION

- **Role of TSO Elia**
  - The CRM law foresees that the national TSO Elia is responsible for carrying out the adequacy studies that inform the need for a CRM and to lead the discussion on the CRM design. Elia will be involved heavily in drafting the Royal Decrees that set the CRM design into stone.
  - Elia as system operator cannot act impartial in this role. As being final responsible for the system security Elia has various reasons to overestimate the need for additional capacity to be contracted under the CRM (a concern confirmed by others, see further) and to design a CRM that fits the TSO's needs. We have the strong feeling the societal goals are not respected or at least not weighed correctly: societal cost (affordability of energy) versus risk of loss of load.

- Elia is trying to conclude the design of the CRM in less than one year, overwhelming market parties with task force meetings and design notes. Not all market players have the time and the means to follow the discussions in detail and to provide feedback.
- It is not clear how much of the feedback provided by market parties will anyway be considered during the drafting of the royal decrees.

- **Position of Belgian industry**
  - FEBELIEC, the federation of large Belgian (energy intensive) industry has been vocally against the CRM. This is remarkable, because policy makers have used the industry as reason to install a CRM in the first place.
- **Parties are hesitant to speak up**
  - We have learned that several market players are hesitant to voice their opinions on the CRM towards Elia because they are in a commercial relation with Elia (as supplier, BRP, FSP…) and have daily interactions with some of their employees. Nobody wants to put such important working relations in danger.
  - Some parties are against the CRM but are afraid that if the CRM gets delayed or removed, policy makers will put cancellation of the nuclear phase-out on the table again (under pressure of the current operator of the Belgian nuclear production park). Market players might fear that even more than a CRM, or do not want to be accused of being responsible for the delay of the nuclear phase-out. They therefore keep their concerns about the CRM for themselves.
  - We believe that the position of Belgian market players is not equally heard, especially the more critical voices, which might give the impression that it is generally accepted in the Belgian energy sector.

3. IS THERE A NEED FOR A CRM?

- **The assessment on the need of a CRM should not be done by the TSO but by independent study consortia**. We do not believe the TSO, responsible for the balance in the Belgian grid and daily management of control power, can be impartial in this discussion. Naturally, Elia will be conservative in its assessment of the adequacy needs because it is evaluated based on the costs of system balancing and will be scrutinized in case it ever comes to brownouts or blackouts. Elia is further a publicly listed company that has been vocal about its international ambitions and wants to maintain a certain public image.
- **The results of Elia are highly debated**. The results of the Belgian adequacy study come to a capacity gap of 3.9 GW in 2025, to respect a LOLE of 3 hours. The review of the CREG indicates that this study shows several weaknesses and errors[1]. Assessment by independent energy experts also indicate that the gap is largely overestimated (for example: Kris Voorspools[2]). An in-depth study of the German adequacy outlook, ordered by the German Ministry for Energy and performed and peer reviewed by independent institutes, also fully modelled the situation in Belgium and indicates that a strategic reserve should be sufficient in Belgium to face the nuclear phase-out[3].
- **From the analysis of the CREG and the Study subcontracted by the German Ministry (see earlier), we would like to highlight the following most striking points, and add some points of our own:**

[1] https://www.creg.be/fr/publications/etude-f1957

[2] https://www.linkedin.com/pulse/capacity-mechanism-elia-versus-creg-kris-voorspools/?published=t

[3] https://www.bmwi.de/Redaktion/EN/Publikationen/Studien/definition-and-monitoring-of-security-of-supply-on-the-european-electricity-markets-from-2017-to-2019.html

- The Elia study uses for the CRM design the worst-case scenario which is a reasonable approach when dimensioning a strategic reserve. For the design of a CRM when capacity investments are supported for several years the average of all scenarios needs to be considered.
- Elia did not model the neighbouring markets in detail and did therefore not model a reaction to rising prices in Belgium.
- It was assumed that there is no further governmental support for CHPs but most importantly the on-site (e.g. at industry) investment of CHPs was not at all taken into account. These investments are likely to be made by industry in times of scarcity to have price and supply security.
- Elia does not calculate the normal LOLE but a so-called market LOLE which is then compared with the normal 3h LOLE threshold. This is comparing apples with pears.
- Elia does strongly neglect the possibility of import from neighbouring countries.
- The Elia study seems to underestimate the revenues of power plants from the energy markets to an extreme extent. So far, Elia did not publish the hourly time series of spot prices that where result of the study. The price forming model seems to deliver highly doubtful results.
- Elia does not calculate the EENS x VoLL (the cost of a shortage). Considering that Elia comes (in the worst-case scenario) to the conclusion of 5-7 hours such an assessment seems to be indispensable.
- Elia does not calculate any scenario with a strategic reserve. The strategic reserve seems to be neglected entirely in the adequacy study.
- The German study sees in none of the calculated scenarios the need for a CRM. Even without the activation of a strategic reserve the LOLE is 0 and only in one scenario larger than 0 but still lower than than 1 h (3h is the threshold for a system adequacy problem). So far, Elia did not explain the difference between the studies. The only explanation brought forward so far is that Elia calculated with 40 weather years and the German study chose 5 representative weather years. We suspect that Elia suggests that the CRM design is determined by the worst-case weather year, which is, as discussed before, the wrong approach.

- **Societal cost**. We miss a proper analysis of the expected societal cost of a CRM versus that of expected loss of load (LOLE). This ultimately sets a cap on how far the CRM can go in addressing adequacy constraints.
- **In conclusion,** we think the adequacy assessment should be revisited because it was performed by the TSO and did not address societal cost linked to number of hours of LOLE. We would like to see an assessment by an independent research institute or consultancy firm, peer reviewed by at least two other – also international - institutes or firms with reputation in the field and by the CREG. Yes, the CRM law prescribes that Elia does the adequacy study, but clearly, that is a flaw in the law. Elia itself should be interested in an independent assessment.

4. NO INDICATION THAT THE STRATEGIC RESERVE IS NOT SUFFICIENT

- **Energy-only markets have been able to resolve tight supply moments until now.**
  - So far, the Strategic Reserve was never activated. The energy-only markets gave sufficient price signals to resolve tight supply periods. The main reason why no new capacity is build is the significant overcapacity in the Belgium market and the political uncertainty concerning the nuclear phase-out.
  - Even the winter 2018-2019, where only 1 nuclear reactor was available and no strategic reserve was contracted, the Belgian grid was fine. There were higher prices in the electricity markets, mostly a result of the unexpectedness of the nuclear outages and the uncertainty related to their comeback. These prices brought significant volumes of new capacity to the market in the matters of weeks.

- A few winters of higher prices might already be enough to trigger market parties to stop mothballing CCGTs and make new investment decisions.

- **Energy-only markets can still be improved.** We believe that energy-only markets have not yet been given the chance to open far enough to provide the necessary investment signals in flexible assets. Some possible improvements are the following:
  - There is still low liquidity on the intraday market as no XBID quarter-hourly prices are given for the BE market intraday.
  - In general, Elia still makes a difference between large and small units on the markets for ancillary services.
  - Full transparency and publication of reserve power bids that allow market participants to evaluate the risk of high imbalance prices.
  - Implementation of a scarcity pricing mechanism in Belgium as suggested by the CREG[4]: "The introduction of a real-time market for reserve capacity is considered by CORE [Department of the Université Catholique de Louvain] as the lowest hanging fruit in the Belgian market design: it is the easiest measure to implement, and it is expected to have a great effect on the long-run incentive to invest in flexible resources."

5. PROPOSED CRM DESIGN

- **Complexity.** Belgian policy makers selected a CRM design based on so-called reliability options, because it offers the possibility for a simple and transparent design. Yet, the direction the current design is going towards is extremely complex. This complexity will, in general, favor larger incumbents over smaller market parties. It also becomes impossible to predict what the performance of the mechanism in real-world conditions will be.
- **Sustainability.** The current CRM design is supposed to be technology neutral. We want to stress that independent of past subsidies, renewable energy and CHPs should be eligible for the CRM. Indeed, nearly all technologies have or are still receiving government support in one way or the other. In times the Belgian governments are lagging behind on their climate targets, it is important to include renewable technologies and technologies that improve energy efficiency in the CRM.
- **Market Power and Windfall profits for existing capacity.** While the CRM design should primarily designed for new capacity we see the risk that there will be high wind fall profits for existing capacity:
  - There is the intention to put an intermediate price cap for CRM bids for existing capacity. The reasoning can only be that exertion of market power is expected.
  - As most existing generation capacity is owned by one market party, this fear is well founded. As a large incumbent it is a reasonable bidding strategy to bid this intermediate price cap as it is guaranteed that still the lion's share of this capacity will be awarded.

[4] https://www.creg.be/sites/default/files/assets/Publications/Notes/Z1986EN.pdf