

Public consultation on measures to ensure the adequacy of the conventional means of electricity production in Belgium



EFET response – 6 March 2015

The European Federation of Energy Traders (EFET)¹ welcomes the opportunity to comment on the CREG consultation on measures to ensure the adequacy of the conventional means of electricity production in Belgium.

We thank CREG for allowing EFET to answer this consultation in English and remain at the disposal of the CREG personnel should they have any questions or comments on this document.

CREG questionnaire and EFET responses

1. Identification and quantification of the problem

The problem of adequacy should be quantified by taking into account the potential contribution of demand.

- 1) What do you consider the relevant geographic area to perform the analysis of the capacity need?

With the continuing integration of EU wholesale markets there is a strong need, as discussed in recent European Commission Communications on the internal market² for adequacy to be considered as a European issue and that Member States should seek cross-border solutions to any problems they find before planning to intervene.

The ENTSO-E Security Outlook and Adequacy Forecast reports are a first step in the direction of such a European approach to adequacy assessment. However, the reports so far only

¹ The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent, sustainable and liquid wholesale markets, unhindered by national borders or other undue obstacles. We currently promote and organise the EUC Energy Trading Competition 2014. Contact information on the progress towards this project is available on our website at http://ec.europa.eu/energy/sites/ener/files/documents/2014_ iem_communication_0.pdf.

² http://ec.europa.eu/energy/sites/ener/files/documents/2014_ iem_communication_0.pdf

consolidate the analysis of individual TSOs for their respective control area/country. Market participants still expect a truly European adequacy assessment from ENTSO-E, and regulators should support the requests of ACER and the European Commission in that regard.

- 2) Is there currently a problem of adequacy (given the strategic reserve)? If not, in what timeframe do you think that such a problem could occur? If so, what do you think is the extent of problem?

According to the ENTSO-E 2014 Security Outlook and Adequacy Forecast report³, *generation adequacy is expected to be maintained during the entire forecast period (in Scenario B and Scenario EU20, and in each reference point), however with a considerably decreasing margin level in the 2020s. It must be noted however, that under conservative Scenario A, at the winter reference points at and beyond 2020, the level of adequacy becomes negative, underlining the need for further investments compared to what is confirmed today.*

According to this report, the capacity adequacy in Belgium (and the rest of Europe) appears to be appropriate until 2020. Many uncertainties are highlighted in the 2020-2030 analysis and some scenarios describe adequacy problems beyond 2020 while other do not. A detailed study performed through the Pentalateral Energy Forum (PLEF)⁴ does highlight adequacy issues arising in both Belgium and France, even in the short term.

We reiterate our call for an adequacy assessment to be completed at a pan-European level. Adequacy planning, system operations and security of supply questions are highly interlinked and need to be tightly coordinated across borders. Adequacy assessments should also better take into account market circumstances that could lead generation capacity to leave the market prematurely.

- 3) What is / will be the nature of the adequacy problem (lack of flexibility, lack of base capacity, lack of peak capacity..)?

With regard to possible capacity adequacy, most EU Member States currently have significant over-capacity in generation compared to demand. This is borne out by the latest ENTSO-E report on generation adequacy and current forward spreads. These largely do not yet signal the need for new build, at least not for gas-fired plants. Some adjustment to companies' generation portfolios is likely in coming years and this will take place in parallel to significant and uncertain increases in the share of renewable generation.

When it comes to flexibility, it is important to recall that flexibility is the ability of an asset to change its output and/or off-take. Flexibility is a characteristic of an asset or a portfolio of assets (generation, storage, DSM). Flexibility can bring added value to the system when flexibility is needed. Especially in the time frames from day-ahead to balancing, the market should be able to set the correct value of flexibility. This requires better integrated and less

³ Scenario Outlook & Adequacy Forecast 2014-2030, available at:
https://www.entsoe.eu/Documents/SDC%20documents/SOAF/141031_SOAF%202014-2030_.pdf

⁴ Generation Adequacy Assessment for the Pentalateral Energy Forum, Support Group 2

restrictive market functioning in the day-ahead, intraday and balancing markets.

At the moment, it is difficult to assess whether there is sufficient flexibility available in the market. Low prices on the spot market despite the large share of renewables – even in markets where renewables are commercialised directly on the market – tend to point to the fact that there is currently sufficient flexibility in the system, but that its value remains low.

It is expected that if the share of intermittent RES will further increase, the existing flexibility may not match the new system needs and additional flexibility could be needed. The relevant markets (i.e. day-ahead, intraday and balancing markets) should be able to signal the required flexibility, provided that their design allows them so. The exact amount of needed flexibility volume will also depend on how well RES will be integrated into these markets, and will be able to give and respond to price signals. Market participants will invest in increasing the flexibility of their portfolio as soon as they see a business case signalled by the market.

- 4) How do you explain that market prices do not increase significantly despite the announcement of the need for a strategic reserve of 3,500 MW for next winter?

A considerable body of academic literature discusses potential market failures in the electricity sector and the advantages and disadvantages of introducing capacity mechanisms to supplement normal market processes. These possible market failures can be categorised as follows:

- the need for instantaneous balance in electricity systems and the public good nature of grid stability and generation adequacy⁵,
- the lack of sufficient demand side participation in the market on an hour-by-hour basis meaning price signals are obscured,
- the excessive risk\uncertainty for investors and the lack of sufficient forward price signals,
- the potential impact of the exercise of market power or politically motivated interventions leading to implementation of price caps in either wholesale markets, or for end users.

Overall, the literature suggests that the combination of these market failures and associated regulatory actions may tend to ‘dampen’ price signals in electricity markets so that prices fail to increase to an ‘efficient’ level at times of scarcity.

EFET believes that prices should reflect the reality of supply and demand in a transparent manner. In this perspective, regulators need to improve market arrangements to allow a free formation of prices where offer meets demand. Such evolutions will improve the

⁵ Certainly the need for instantaneous balance does require the existence of a regulated transmission system operator, with the task of residual balancing of the network. It would be inefficient to expect market participants to self-balance on, for example, a second-by-second basis. Therefore the first market failure is generally accepted, and one of the tasks of system operators is to deal with this.

efficiency of the market and sharpen price signals in wholesale markets⁶. Measures, such as the removal of price caps and floors, the removal of exit and entry barriers, the swift entry into force of more efficient capacity allocation solutions such as flow-based market coupling, better access to cross-border intraday trading, intraday gate closures times closer to delivery, and the integration of RES into market mechanisms including exposure to imbalances, will also encourage better liquidity and greater competition in order to deal with both risk and market power issues. More efficient market on capacity and flexibility where and when it is needed.

- 5) What barriers to market entry do you identify for new capacity (production including system security groups / demand side response / storage) at the level of the transport network and the network distribution?

In Belgium, as well as in many other European Member States, price caps and floors, limited access to cross-border intraday trading, intraday gate closure time too far from delivery and the non-integration of RES in market mechanisms constitute some of the main barriers to appropriate price formation and to adequately respond to capacity and/or flexibility needs.

More specifically, the inefficient cross-border intraday capacity allocation mechanisms (“improved” pro-rata allocation with nomination gates every two hours) can create artificial scarcity at some hours when the necessary energy could flow across borders if the mechanism were more flexible.

The different interpretations of “Force Majeure” or “Emergency Situations” clauses, combined with diverse levels of security margin applied by individual TSOs on interconnections are also detrimental to adequacy planning by granting individual TSOs and cable owners excessive flexibility to curtail forward transmission rights before nomination or potentially not to allow the full amount of available transmission capacity to the day-ahead and intraday markets or to cross-border balancing mechanisms (through e.g. stability limits, import/export limits, ramping constraints, interconnection availability). The same applies to strategic reserves, which may not only be dispatched by market price signals but by local TSOs considerations.

These elements show how adequacy planning, system operations and security of supply issues are interlinked and need to be tightly coordinated across borders.

⁶ Making the market more efficient and sharpening market prices will not necessarily translate into higher prices. It will allow prices to better reflect demand and supply.

6) To what extent can renewable energy (especially wind) improve security of supply?

Electricity produced from renewable sources can improve security of supply, like every MWh produced from any other source. The question is rather what effects the current setup with the interaction of a European energy market and national support schemes for renewables has on security of supply?

The generation adequacy issue is complicated by the expansion of renewable generation. Conventional plants will run at lower load factors and have fewer hours in which to cover fixed costs and earn a return. For example, wind generation capacity has a typical load factor of 30%⁷. This may mean that conventional plants that were running at a 60% load factor may in the future only run at a 30% load factor or even less. Broadly speaking this means that spreads would have to be twice as high in the periods they are running in order to cover their fixed costs. Such high prices or spreads can only materialise in periods of scarcity. Acceptance of high prices is therefore required. Occurrence of high prices also comes with a higher risk of brown-outs in such periods of scarcity, the societal acceptance of which needs to be debated.

The rate of deployment of renewables is also creating complications in making investment decisions. In particular, the degree of uncertainty about how quickly renewable penetration will occur leads to concerns about the creation of sunk costs for investors. Although this is commercial reality in all capital-intensive industries, the particular circumstances in the energy sector are probably unique in this respect. In particular, the amount and type of renewable penetration is largely not, as promised, being set by market-based mechanisms like ETS, but instead result from ad hoc government decisions.

Finally, current methods of renewable support make this problem especially acute. In particular, priority dispatch of renewable production, such as enshrined in Belgian law, undermines the optimal dispatch of conventional plants. If renewable producers are not incentivised to respond to market signals, conventional generation may have to perform unnecessary costly stop-start operations. This may even lead to negative prices, thus eroding those plants financial viability further.

It is the view of EFET that one of the key improvements that needs to be made to market design should be the reform of renewable support mechanisms to more market-oriented measures. This reform must be a priority of regulators.

2. Actions for cost reduction

Measures such as the exemption from the federal gas contribution have already been taken to reduce costs for conventional gas units.

⁷ Elia data suggests an approximate 25% load factor for onshore wind and 35% load factor for offshore wind in Belgium.

7) Do you see any other measures that could be taken?

No EFET comment.

8) Are these measures sufficient by themselves?

Market participants will invest in increasing capacity and/or flexibility as soon as they will see a business case. Policy makers should therefore focus on improving the efficiency of the markets and make sure that no measures prevent correct market functioning.

3. Possible actions to increase revenues

Actions may include enhancing the value of kWh produced, flexibility or capacity.

3.1. Improvement of the electricity market measures (Energy Market Only "EOM")

In the current market structure, units are compensated on the forward market in exchange of an option to supply kWh; in day-ahead and *intraday* in exchange of the physical delivery of kWh; and on the *balancing* market for the provision of flexible capacity.

9) How to improve the design of the market in order to satisfy adequacy and flexibility needs by valuing them correctly?

EFET is convinced that a well-functioning market is the answer to many of the questions related to capacity adequacy and/or flexibility. A competitive market gives the correct price signals that will trigger efficient decisions by all market participants, which will in turn reduce costs for end-consumers.

Regulators and governments should focus on a number of fundamental improvements to electricity market design, regardless of whether they are considering capacity mechanisms:

- Integrate renewable energy into the power market design (wholesale market and network infrastructures)
- Develop and improve intraday markets by moving gate closure to H-1 and facilitating cross-border exchanges to make the maximum use of interconnector capacity
- Develop and improve balancing mechanisms, also on a cross border basis,
- Allow free price formation in wholesale markets and remove explicit and implicit caps/floors
- Extend real-time metering to enable demand response.
- Remove unnecessary operational requirements and restrictions on generation companies.

- Improve the functioning of the gas market, avoiding run-or-pay obligations and other restrictions on gas fired power plants and ensuring that power plants have flexible access to transmission networks and wholesale gas markets.
- Ensure a stable and consistent energy policy framework for decarbonisation based on ETS.

These recommendations to improve the energy (MWh) market will enhance the match between supply and demand and encourage the efficient use of all assets (generation, demand-response and storage).

10) Would a strengthened price signals in these markets achieve that goal?

EFET advocates that the development of flexible price signals is necessary for the internal energy market to work efficiently: prices that reflect the oversupply or tightness of the system are necessary to provide the adequate incentive for market participants to hedge their positions in the Day-Ahead and forward timeframe.

It is also relevant for market prices to reveal potential situations of scarcity when all margins become exhausted. This will indeed trigger additional levels of flexibility and/or capacity in generation, demand-side response and storage.

11) What adjustments could be made on the day-ahead and intraday markets for the short-term price to reflect the scarcity of capacity?

Increasing the flexibility in price formation in the balancing energy market to better reflect the associated cost and the removal of the unnecessary barriers to trade in intraday or to offer balancing resources would allow a better reflection of flexibility needs.

12) Are price spikes necessary and sufficient to ensure the adequacy of production means?

As mentioned above, promoting flexibility and transparency in price formation is necessary to ensure the adequacy of production means from a cost-efficiency perspective.

The question on whether it is sufficient is a difficult one, as the market remains distorted by both design failures and regulatory interventions. Such interventions are hard to avoid and are normally not triggered by price spikes or high prices, but by (perceived) higher risks of brown-outs. It is thus fair to say that policy makers have not allowed the market to prove its capacity to answer those problems in practice.

13) What are the conditions for these price spikes to be acceptable from a societal perspective?

From a trading perspective, EFET does not see any source of concerns with more flexible price signals.

It is important to note the complementary role of future/forward products and hedging practices (including of optional products, already available with the existing market design as any other type of energy products) for limiting the impact of price spikes manifesting themselves in the short-term markets. Meanwhile, most electricity is bought and sold in forward markets and we would normally expect projections of tighter supplier-demand conditions to incentivise more forward contracting so that there is spare capacity to contract to manage price risks. In any case only a very small proportion of total demand is affected by price spikes and these costs are faced by supply businesses rather than being seen by customers themselves. The political acceptability of price spikes is therefore rather an issue of serious analysis of the problem in the media and in political circles.

The reality is that average bills over the whole year are the most important point for consumers. The fact that market participants may financially benefit from tight peak periods should not hide the fact that they do operate at a loss in other periods. As long as customer prices over the year remain stable and system security and generation (and load) adequacy are preserved, there should be no undue public intervention on the standard functioning of the market.

Occurrence of high prices however comes with a higher risk of brown-outs in periods of scarcity. The political and societal acceptance of such a risk remains a sensitive issue that has yet to be debated.

Finally, Europe is equipped with market oversight legislation to ensure the transparency of the energy market and prevent market abuse: REMIT and MAD/MAR will avoid risks related to the abuse of dominant power by any market participant, which is often pointed out to justify interventions in the market such as price caps/floors.

14) Are there sufficient incentives on BRPs to achieve system balance?

In order for BRPs to better achieve a balanced position, they require both incentives and instruments. While indeed there remains scope for improving incentives (e.g. fully merit-order based activation of balancing reserves), a true barrier is a lack of effective instruments. The most important of such instruments are efficient and liquid cross-border intraday markets that allow market participants to balance their position close to real time. TSOs and regulators should therefore support the development of flexible intraday markets.

With regard to incentives, EFET advocates an imbalance settlement charge, based on the marginal (i.e. highest accepted) commercial prices offered by BSPs during a given settlement period. Such pricing creates incentives for the BRP to be balanced and to avoid market participants unduly relying on the balancing mechanism.

It is also important that all BRPs should face balancing incentives. Retail suppliers and renewable producers must participate fully in markets and in the balancing mechanisms. This means they should have the same responsibilities as generators and be allowed to provide balancing resources subject to common rules. To maintain a level playing field and to help ensure security of supply, the same principle of imbalance settlement must be applied for load and generation, for example through a unique common balancing group.

15) What is the impact on the behaviour of market participants of rising the price cap to €4,500/MWh in case of structural imbalance?

The boundaries within which the market prices can evolve will define the level of incentive for developing flexible assets. As mentioned above, promoting flexibility and transparency in price formation is necessary to ensure the adequacy of production means from a cost-efficiency perspective. The elimination of artificial price caps can help in that regard, but should reflect market circumstances and not be based on arbitrary levels.

16) Are there enough instruments to secure future costs and revenues (for both the consumer and the holder of capacity)? The volatility of spot prices may be covered by contracting *forward/future* products or options:

- a) What *hedging* products could be developed on the market forward?
- b) How to ensure the liquidity of the market for products with a horizon of 1, 2 or 3 years?
- c) Is there a need for more long-term products (4-5, even 6 years)? If so, how to ensure their liquidity?

As mentioned above, future/forward products and hedging practices (including of optional products, already available with the existing market design as any other type of energy products) are necessary to limit the risk of short-term markets. We believe that the market will deliver the right amounts of capacity adequacy and flexibility that the system needs, at the lowest costs, as long as the energy market is functioning well.

The liquidity of forward/future markets is related to the expectations of market participants, their trust in the forward price curve, and their risk appetite. Limiting political interventions in the market and related regulatory risks will give market participants confidence in the forward price signals to invest in capacity if it is needed. Also, forward products may already be carved up into baseload, peakload, daily and even hourly slices, which contribute to valuing flexibility in the forward/future market.

The market will act on long-term signals: if there is a need to hedge further in advance of real-time compared to current practice today, market participants will trade longer-term products and liquidity will emerge.

17) What is the impact the existing capacity remuneration mechanism (strategic reserve) on the functioning of the market?

EFET's starting point is that, for electricity as in any other sector, the market should ideally perform certain core functions:

- formation of prices so that supply and demand balance,
- allocation of fixed and variable costs,
- organisation of risk management activity, forward trading and the maintenance of spare capacity and storage possibilities,
- provision of incentives for efficient investment decisions.

Policy makers should, therefore, always think carefully before intervening in these areas as there is a clear risk of undermining some of these basic objectives of competitive markets.

EFET believes that policy makers should avoid disturbing price signals in the energy (MWh) market if and when designing capacity mechanisms. The integration of EU electricity markets through the market coupling process relies on well-functioning day-ahead spot prices. Likewise, effective competition in the retail sector relies on efficient and liquid forward markets. Therefore, where capacity mechanisms affect these, they are also likely to have an impact on the EU internal market. Dilution of MWh price signals could also damage incentives to invest in reliable and flexible power generation means. These characteristics are increasingly important as the European market moves towards decarbonisation with larger proportions of renewable capacity.

At the same time, the existing Strategic Reserve in Belgium and CRMs implemented or in discussion in other Member States show that interventions in the market do happen when decision makers expect scarcity and brown-outs to materialise and deem their effects too risky. The Strategic Reserve solution that was implemented last year was not an approach with equal treatment of all capacity providers (see our answer to Q18). EFET is of the opinion that if a CRM is implemented, such CRM should be market-wide with equal treatment of all capacity providers and with cross-border participation.

3.2. Enhancing existing procedures: tender and strategic reserve

Belgium has recently implemented two new mechanisms to deal with need for short and medium term capacity: the strategic reserve and tenders.

18) Is the combination of two mechanisms sufficient to achieve the security of supply goal? If not, please justify.

The Strategic Reserve is not an efficient tool to achieve security of supply. It can only keep units that are closed or mothballed for economic reasons, and not technical reasons (end of lifecycle). Keeping units that are closed or mothballed for economic reasons out of the market, and only activating them at an arbitrarily high level, impacts the correct functioning

of the energy market. It prohibits part of the generation park from participating to the market at cost-reflective prices and thus creates an artificial scarcity.

As far as the tender mechanism is concerned, EFET has in the past expressed its dislike of a mechanism that has not properly identified its purpose (answering flexibility or capacity adequacy?), granting special funding to new CCGT plants (discrimination between technology types and between new and existing capacity) without taking account of the demand-side contribution. We remain of the opinion that the tender mechanism is highly ill-conceived.

19) Do you think the tender mechanism can achieve the goal of maintaining adequacy from conventional units? If not, please provide the reason and indicate adaptations needed in order for it to reach this objective.

No EFET comment.

20) Do you think the strategic reserve in its current version can achieve the objective of security of supply? If not, please provide reasons and indicate whether you support:

- its elimination;
- its adjustment, mentioning the changes necessary to for it to reach the objective.

As mentioned in our answer to Q18, the Strategic Reserve does not contribute to capacity adequacy. It cannot create incentives to retain or replace units that are at their end of life cycle. And it withdraws from the market capacity that fails to earn (part of) their fixed costs, creating artificial scarcity and affecting market prices.

21) What would be the volume of strategic reserve not to exceed? For what reason?

No EFET comment.

3.3. Establishment of a capacity remuneration mechanism (CRM) other than the strategic reserve

Precise identification of the problem

The goal may be to promote demand side response, to keep existing units in the market / off-market, to develop new capacity (if so, what kind: well-adapted, flexible peak capacity to ensure the *back up* for RES production, more capital intensive semi-base load capacity?), to limit the occurrence of price spikes in the market, to align on the practices of neighbouring countries.

22) For what purpose a CRM, other than the strategic reserve, should be set up in Belgium?

As mentioned above, EFET's starting point is that, for electricity as in any other sector, the market should ideally perform certain core functions:

- formation of prices so that supply and demand balance,
- allocation of fixed and variable costs,
- organisation of risk management activity, forward trading and the maintenance of spare capacity and storage possibilities,
- provision of incentives for efficient investment decisions.

Policy makers should, therefore, always think carefully before intervening in these areas as there is a clear risk of undermining some of these basic objectives of competitive markets. Some adjustment to companies' generation portfolios is likely to be necessary in coming years and this will take place in parallel to significant and uncertain increases in the share of renewable generation. This raises the possibility that the outcome is not optimal in a socio-economic sense or does not fulfil particular political objectives. Under these circumstances, there could be some rationale for limited intervention. However, such mechanisms must remain subordinate to the energy (MWh) market in order to avoid major distortion of the role of markets.

23) Which precise problem(s) should it solve?

As mentioned in our answers to Q2 and Q3, given the diverging opinions and expertise on the subject, we cannot conclude with certainty that there exists a capacity adequacy and/or flexibility problem in Europe, or Belgium specifically, at the moment.

In its 2014 Communication on the Internal Market, the European Commission underlined "the importance of a thorough and objective analysis looking into all possible causes of and all potential remedies for security of supply concerns". In line with this thought, we recommend a comprehensive analysis of the perceived problems before taking any decision to implement a capacity mechanism⁸.

Should there be a decision to implement a market-based capacity remuneration mechanism in Belgium, it should only address the issue of adequate capacity. Other elements, including ensuring appropriate levels of flexibility in the system, should be left to the market to resolve.

⁸ On this subject, we remind CREG of its own criticism of the tender mechanism proposed in the 2013 Whatelet plan, which failed to determine whether the mechanism should be designed to answer flexibility or generation adequacy problems (CREG decision (F)130503-CDC-1243 available at: <http://www.creg.info/pdf/Avis/F1243FR.pdf>).

24) Are these problems specific to the Belgian market?

As mentioned in our answer to Q1, with the continuing integration of EU wholesale markets there is a strong need, for security of supply to be considered as a European issue and Member States should seek cross-border solutions.

25) Should it replace the strategic reserve mechanism or be added to it?

No EFET comment.

Need for CRM and timing

26) What solutions could a CRM bring that an improved EOM could not, and why?

No EFET comment.

27) What is the degree of urgency in establishing a new mechanism?

As mentioned in our answers to Q2 and Q3, given the diverging opinions and expertise on the subject, we cannot conclude with certainty that there exists a capacity adequacy and/or flexibility problem in Europe, or Belgium specifically, at the moment.

Given the current state of the electricity market, there is however high urgency to eliminate obstacles to flexible and transparent price formation to ensure the adequacy of production means from a cost-efficiency perspective.

Transient or new market design

Different causes are behind the current declined of profitability for conventional production units: intermittent renewable generation, too many *must run* units, high price of gas relative to electricity prices (due to the demand reduction following the economic crisis, the low marginal cost of RES production, the low price of coal and EUAs).

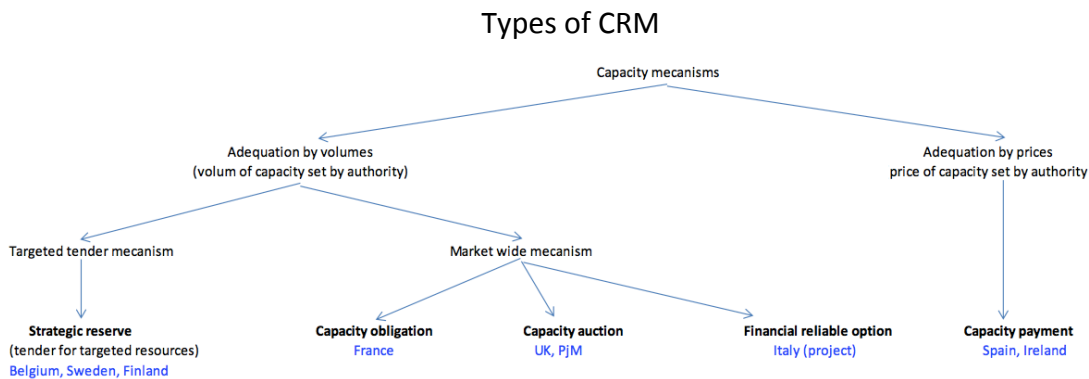
Some of these factors are related to market mechanisms (gas/coal competition, low demand and, to some extent, low price of EUAs), others result of market interventions (support policy for RES).

28) Is the problem to be solved cyclical or structural? Please justify.

No EFET comment.

Type of CRM

The following diagram shows the different types of CRM.



29) Would it be appropriate to opt for a mechanism in Belgium (see Figure 1):

- based on prices or on volumes?
- applicable to all capacities or targeted?
- centralised or decentralised?

Please explain your choice.

If Belgium were to opt for a capacity mechanism (in addition or in replacement of the strategic reserve), it should ideally be market-based, applicable to all capacities and decentralised.

In general, EFET recommends a number of criteria for to evaluate capacity mechanisms. They should:

- avoid distortion or dilution of price signals from energy (MWh) markets;
- be transitory in nature, with a natural dynamic and process towards phase-out of their price signals as generation adequacy improves;
- focus on time periods far enough ahead to limit overlap and interference with forward and future markets in electricity;
- facilitate an active demand side and promote wide consumer engagement through willingness to pay for reliability and/or price stability;
- be non-discriminatory, by taking into account the contribution of non-national generation through interconnection which may decrease local needs;
- be non-discriminatory between new and existing facilities and between different technologies
- minimise centralised management processes and maximise the scope for independent decisions by market participants about their off-take and delivery obligations, so that market dynamics have a chance to function;
- minimise the risk of regulatory failure and of need for redesign (e.g. by avoiding overly complicated mechanisms)
- use market-based remuneration mechanisms (e.g. by means of auctions, tenders, or subscription obligations) without price regulation;
- be suitable for EU wide / harmonised application.

30) Of the five above-mentioned systems, please indicate the one that you think would be the most appropriate to achieve the goal and explain why.

No EFET comment.

31) How can the CRM you propose reduce forecast errors made by the body responsible for volume calculations?

No EFET comment.

Border cooperation

32) Should a Belgian CRM allow the direct participation of foreign capacity? If so, what method of interconnection capacity management should be applied?

National CRMs, if implemented, should be market-based in the sense of market with full competition between all capacity providers with no regulation of capacity prices. National CRMs should take account of the availability or allow the direct participation of capacities across borders. This should not result however in any reservation of cross border transmission capacity.

33) What would be the impact on the energy market of the presence of a CRM in Belgium and an EOM in a neighbouring country?

Well-designed, market-based capacity mechanisms should have no direct impact on energy market prices, since they do not impact the merit order list. However, it is unavoidable that CRM have an indirect impact on wholesale energy prices: revenues to capacity providers derived from capacity mechanisms will lower revenues derived directly from the energy market. Capacity mechanisms therefore have the potential to dilute energy market prices. This effect could extend to neighbouring markets in case appropriate mechanisms for cross-border participation to the CRM are not put in place.

CRM Features

Do you agree with the following principles? If not, please indicate the reason and develop alternative principle(s).

What would be the additional principles to be followed in the design of a CRM in Belgium?

- Performance criteria, control and sanctions

Any mode of capacity remuneration should be subject to performance criteria in terms of availability during peak demand, flexibility and environmental performance, as well as strict control measures and financial penalties in case of unjustified unavailability or inefficient capacity management. Revenues from the penalties should be injected into the running costs of the mechanism.

34) Which performance criteria should capacities meet (availability, flexibility, environmental performance, cost,...)?

A CRM should only target capacity adequacy, and leave other targets to the relevant markets. Mixing several objectives was typically one of the errors in setting up the Belgian tender mechanism in 2013, which has not proved successful.

- Stability of the mechanism

The mechanism must be stable over time, otherwise the risk regulatory will become significant and will substantially reduce the impact of the measure.

35) Do you think that a mechanism resulting from a "political intervention" offers adequate guarantee of stability to promote new investments?

Political decisions to implement a CRM bear significant political risk when it comes to guaranteeing stability to promote new investments. This is especially the case when such political decision is not duly motivated and designed in a way that does not represent a consensus between the government, regulators and market participants⁹.

- Openness to new entrants

The mechanism should be designed to allow new entrants to compete effectively in order not to favour incumbents and avoid an additional barrier to competition in Belgium.

36) Which arrangements should be made in the proposed mechanism to ensure the absence of barriers to entry?

CRMs, if implemented, should not discriminate between new and existing facilities, or between different technologies.

- Technological neutrality

In terms of adequacy, the type of capacity (all means of production, DSM, interconnection and storage) is indifferent; it is the probability of its presence in the system at peak periods that matters. At equivalent probability, all capacities should be allowed to compete to ensure security of supply at the lowest cost.

37) How do you see the interaction between support mechanisms for RES and the participation in a CRM?

As mentioned above, it is the view of EFET that one of the key improvements that needs to be made to market design should be the reform of renewable support mechanisms to more market-oriented measures. This reform must be a priority of regulators.

Should a CRM be implemented, RES-E should be allowed to contribute to the mechanism as

⁹ See examples with the CREG decision (F)130503-CDC-1243 available at: <http://www.creg.info/pdf/Avis/F1243FR.pdf>, or CRE decision of 29 March 2012, available at: <http://www.cre.fr/documents/deliberations/avis/mecanisme-de-capacite>.

any other type of power generation, with a discount coefficient taking account of the average availability of each RES-E technology.

38) Should new and existing production capacities be treated the same way?

CRMs, if implemented, should not discriminate between new and existing facilities, or between different technologies.

39) Should interconnection capacity be considered in the same way as production capacity, DSM and storage?

National CRMs, if implemented, should be market-based in the sense of market with full competition between all capacity providers with no regulation of capacity prices. National CRMs should take account of the availability or allow the direct participation of capacities across borders. This should not result however in any reservation of cross border transmission capacity.

What should a CRM pay for and at which time horizon?

Paying for capacity is equivalent to buying a delivery option for the moment electricity is needed.

40) What should a CRM pay for: the availability of capacity, the likelihood of its presence at the appropriate time, a forward option on energy supply? Please, comment.

No EFET comment.

Compatibility assessment in relation to the objective of maintaining a low price of electricity

Developing a CRM assumes that capacity must be explicitly compensated and equals to socializing the risk that would normally be borne by the investor. This can result in lower financing costs (although there is then a political risk to cover), but it also leads to decisions not taken by investors who bear the opportunities and risks of future revenues anymore, but, at least indirectly, by the public authority. Consequently, investments risk being more capital-intensive than needed. Such political decision can differ from *social welfare* expressed on the market by a price up to the VOLL = *willingness to pay*.

41) How do you see the interaction between the energy market and the capacity market in terms of prices?

As mentioned previously (see our answer to Q33), well-designed, market-based capacity mechanisms should have no direct impact on energy market prices, since they do not impact the merit order list. However, it is unavoidable that CRM have an indirect impact on wholesale energy prices: revenues to capacity providers derived from capacity mechanisms will lower revenues derived directly from the energy market. Capacity mechanisms therefore have the potential to dilute energy market prices.

42) What measures should be taken to avoid excessive compensation of *windfall profits* for certain types of capacity?

A well-designed capacity mechanism, based on competitive, market-based principles, should only provide cost-recovery to capacity that is needed and efficient. Capacity price signals in a market-based capacity remuneration mechanism should naturally decrease as capacity adequacy improves.

43) What do you think will be the impact of the proposed mechanism on final consumer bills? How should the cost be passed on?

As mentioned above, we believe that letting markets send signals in terms of capacity adequacy or flexibility to market participants is the most cost-efficient way to reach these objectives. Market participants will invest in increasing capacity and/or flexibility as soon as they will see a business case.

By artificially pushing signals, for either capacity adequacy or flexibility, policy makers risk creating – or prolonging – situations of a mismatch in the system of required versus available capacity or flexibility. The resulting additional costs will inevitably increase end-consumer bills. As mentioned in the 2014 European Commission Communication on the Internal market, “badly designed schemes will unnecessarily burden consumer bills”.

Compatibility assessment in relation to environmental goals

44) How can the proposed mechanism ensure the achievement of environmental objectives?

As mentioned above, we believe that trying to put criteria on as many objectives as peak availability, flexibility and environmental performance is trying to answer too many elements with a single mechanism.

Transitional measures

45) Pending the possible implementation of a CRM, are transitional measures needed? If so, which one(s)?

If the energy market is further improved, then the market will be able to deliver the needed capacity and/or flexibility at low costs. Such improvements include the removal of price caps and floors, removal of exit and entry barriers, better access to cross-border intraday trading, intraday gate closures closer to delivery and the integration of RES in market mechanisms including exposure to imbalances.

Alternative options

46) Do you have other ideas or suggestions?

No EFET comment.