

CREG concept note on measures aiming to improve the functioning of the electricity market



EFET comments – 7 October 2016

Foreword

The electricity sector in Europe is going through radical changes. While the liberalisation process and the harmonisation of electricity systems are progressing, new challenges arise with the growing penetration of decentralised, renewable power generation sources and the concomitant need for improved flexibility. Through all of this, the wholesale electricity market remains an essential foundation for effective competition in electricity supply. It facilitates market entry and exit, enables risk management by producers, suppliers and consumers through forward trading, and ideally will inform all investment and divestment decisions. Supply competition at the wholesale level underpins retail competition, which in turn guarantees customer choice, product innovation and variety, and improved efficiency.

In the view of EFET, market efficiency should be the primary driver of any market design reform proposed by regulators. As a consequence, regulators should refrain from taking measures that could lead to a distortion of the level-playing field in the wholesale market, and ultimately to discrimination between market participants. In that sense we believe that the measures proposed by CREG should follow three key principles:

- They should foster truly free formation of prices
- They should ensure a level playing field between all market participants
- They should be consistent with the target model developed at European level and applied at regional and continental level

EFET is concerned that some of the orientations put forward by CREG in its Note (Z)160711-CDC-1546 do not respect these principles, and henceforth contradict the spirit of the Third Energy Directive. In our detailed reactions below, we highlight a number of elements in the CREG note that risk damaging competition between existing market participants, and deter the entry of new actors on the Belgian market.

Balancing rules

Our major concerns are related to the proposed amendment of the balancing rules.

- **Balancing market vs. adequacy measures:** It is essential to differentiate adequacy measures from balancing rules. Having proper real time balancing price should give the right incentive for market participants to act in the intraday market and close their position there. This should not be linked to very rare moments of adequacy problem.
- **Imbalance Price:** CREG is considering introducing a regulated scarcity component in the imbalance price, on the model of the Operational Reserve Demand Curve implemented in Texas. EFET considers that imbalance prices should reflect the real value of the energy in order to incentivise market participants to balance their positions on the intraday market. In this sense, we are wary of the introduction of regulated components in, as well as caps and floors on the imbalance price. Both indeed risk repressing the ability of imbalance prices to effectively reflect the real value of the energy. The current state of the research presented by CREG on the application of the Texas model to the Belgian market contains more uncertainties than responses to market participants' questions¹.
EFET also encourages ELIA to reassess the imbalance price when the strategic reserve is activated: as a matter of principle, the strategic reserve should only be activated to avoid load shedding. Hence, the current fixed imbalance price of EUR 4,500/MWh **seems too rigid and potentially restrictive**. Efficient imbalance prices should be based on the marginal cost of balancing the system, including the marginal opportunity cost of curtailing load where relevant. We therefore encourage ELIA to re-evaluate the use of a fixed imbalance price in case the strategic reserve is activated.
- **Balancing responsibility:** CREG suggests moving from an obligation of means to an obligation of result for the Balancing Responsible Parties (BRP, or ARP in Belgium), a fundamental change that would resemble the balancing obligation currently existing in Germany. EFET believes that (1) the obligation should remain financial and not regulatory; (2) in any case the granularity of the products should be aligned beforehand; and (3) moving to an obligation of result risks removing the dynamic in the Belgian imbalance market which currently allows ARPs to react to imbalance prices to support ELIA (passive contribution). The TSO supports the possibility for market participants to contribute passively.

¹ In particular: the results of the experience in Texas seem contrasted; it is unclear how it could be transposed from a central dispatch, independent system to a self-dispatch system integrated in the pan-European market; details on the methodology for setting and applying the ORDC adder are still unclear; and the mention of an administered back-propagation mechanism has market participants particularly worried.

More fundamentally, we would like to note that a true obligation of result for balancing will remain a theoretical concept, as there will always be imbalances linked to unplanned outages, suddenly changing weather conditions or unexpected load patterns. This is well reflected in the wording of the draft Electricity Balancing Guideline, which states: “*in real time, each balance responsible party shall **strive to be balanced or help the power system to be balanced***”². Strengthening BRPs’ balancing responsibility is primarily a question of improving financial incentives, so we advise CREG to focus on improving the signals coming from the imbalance price.

- **“Selective” load shedding:** EFET questions the technical feasibility of this measure. How could the TSO or the regulator determine/identify who is the “faulty” ARP? CREG should focus on making sure that imbalance price signals can rise up to the value of lost load to incentivise demand response in cases of potential load shedding. In addition, we believe that the question of load shedding plans should be discussed at least at a regional/CCR level, to ensure consistency with Belgium’s neighbours.

Others points of concerns

- **Bidding zones:** CREG seems to be pleading for **smaller bidding zones in order to avoid loop flows**. We would like to remind CREG that **ENTSO-E is running a formal and detailed study on the bidding zone configuration across Europe** and we believe that one should first wait for the results of ENTSO-E study (expected in 2017) before drawing any conclusion on the bidding zones delineation and possible redelineation. The definition of bidding zones is a complex topic and one should make sure all aspects are considered, amongst which, market efficiency and the robustness of bidding zones delineation. ENTSO-E has run a consultation this summer on this subject, we refer to our response to this consultation³.
The ENTSO-E study is according to us the most thorough process currently in place to assess the efficiency of the existing delineation of bidding zones, and of its potential re-design. This process is also the only one that truly involves market participants. We advise CREG to channel their analysis on the subject through the ENTSO-E process.
In addition, EFET is convinced that this issue loop flows and congestion in general is to be considered in relation to the establishment of market-based re-dispatching mechanisms, as foreseen by the CACM Regulation. In general, we believe that the effects on the market of bidding zones re-delineations are widely overlooked, as proved again the case with the CREG analysis in this note. We refer to our paper analysing the effect on the market of the 2011 bidding zones reform in Sweden for some key pointers on the subject⁴.

² Article 20.3 of the Electricity Balancing Guideline, version of 23 June 2016.

³ EFET response to the ENTSO-E consultation on market efficiency in the framework of the bidding zones review, available at:

http://www.efet.org/Cms_Data/Contents/EFET/Folders/Documents/EnergyMarkets/ElectPosPapers/~contents/5N624T44FQMQRVVKC/EFET_ENTSOE-BZ-consultation_26082016.pdf

⁴ A reality check on the market impact of splitting bidding zones, available at:

http://www.efet.org/Cms_Data/Contents/EFET/Folders/Documents/EnergyMarkets/ElectPosPapers/~contents/4L8JKNAX7C4W4YLS/EFET-memo_Swedish-zones-reform.pdf

- **Transaction limitations:** CREG proposes to introduce **limitations on transactions**. EFET is against the idea to impose limitations on transactions. On the contrary, we plead for the **suppression of price caps** which prevent spike prices from materialising (and hence to reveal the value of energy in real time). EFET also advocates a proper application of REMIT and antitrust legislation so that the natural back-propagation of scarcity prices in day-ahead and forward markets is not unduly hampered.
- **Intraday market:** EFET of course welcomes any measure that would translate into improvements of the intraday market, which will bring more liquidity and overall a better functioning of this market at CWE level.
 - EFET calls for a rapid implementation of the target model, being the full introduction of flow-based capacity calculation for the intraday timeframe.
 - In the meantime, the CWE ATC coordinated process for intraday has proved to provide additional capacity at times. However, we have reservations on the process: (1) we consider that the maximum possible increase of capacity should be requested by default; (2) we need clarity on how the priorities are defined when two requests from the TSOs cannot be granted simultaneously.
 - EFET welcomes the implementation of the quick-wins on the Belgian borders and the move towards 24 gates on both Belgian borders. The increase in the number of gates (from 12 to 24) will enable market players to adjust their position more rapidly and closer to real time.
 - Closure of the market closer to real time: Allowing market participants to adjust their portfolio closer to real time is necessary to improve the integration of the growing share of generation from renewable sources.
- **Model for the Transfer or Energy (ToE):**
 - EFET welcomes the debate on the integration of demand-response in the wholesale market. Demand-side response providers – whether acting as BRPs or independent third-party aggregators – should be treated on a level-playing field with other market participants. We firmly believe that the relationship between electricity suppliers and third-party aggregators should be based on the principle of free negotiation – whether it concerns the remuneration of suppliers or the exchange of data between suppliers and independent aggregators⁵.
 - The regulated formula proposed by CREG for the remuneration of suppliers presents a series of shortcomings: The formula is presented as a fall-back solution in case negotiations between supplier and aggregator do not succeed within a given time. We believe there is a risk that the formula would become the de facto solution adopted by the industry.
 - According to the current state of the proposal, the price formula would offer a “free option” to flexibility service providers (FSPs) and hence distort the level-playing field between market participants. EFET believes it is in contradiction with the principle of liberalisation defended in the Third Package where regulating prices should only be exceptional and under clear circumstances.

⁵ For more details, see the EFET answer to the CREG interim report on measures to improve access to demand-side flexibility in Belgium at:

http://www.efet.org/Cms_Data/Contents/EFET/Folders/Documents/EnergyMarkets/ElectPosPapers/NatRegLevel/~contents/V5W2BJHVBD5LDG9W/EFET_CREG-report-on-demand-response_17022016.pdf