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Febeliec answer to the Elia consultation on the suppression of the day-ahead balancing obligation for Balancing Responsible Parties

Febeliec would like to thank Elia for this consultation and wishes to express some major concerns regarding the suppression of the day-ahead balancing obligation for Balancing Responsible Parties.

Febeliec is unpleasantly surprised by the proposal by Elia to suppress the day-ahead balancing obligation for BRPs, as the reasoning of Elia according to Febeliec has some major flaws and is not robust as it boils down to betting on a positive evolution of all related parameters (including in particular liquidity evolutions).

While Febeliec theoretically understands that the real intrinsic value of electricity is only determined in real time upon delivery, and as such the underlying idea of the proposal has some theoretical merits, it is clear that the Belgian electricity system does not start from scratch and is also interconnected with other markets. Undermining one of the fundamentals of the current system, the balancing obligation of BRPs (even though the real time balancing obligation would still at this point be maintained) could result in a domino effect which would cascade through a lot of other adjacent domains, as it could ultimately result in a situation where Elia has to contract ever more backup capacity, at an increasing cost for grid users through tariffs, to ensure that the system can remain balanced in real time if BRPs would no longer be able to solve the balancing of their portfolio. Amongst others, Febeliec is greatly concerned by the fact that this evolution could have an impact on the day-ahead market and reference price, which is being used to a very wide extent in contracts, beyond the scopes of merely the trades that are directly conducted on the day ahead market. At this point, the day ahead market is the **only** market where parties have to divulge their demand and supply positions via a central platform at a set point in time where matching occurs without an identified counterparty, thus ensuring that market power effects are nullified as much as possible (especially in an ever more interconnected European market). The forward markets are mainly there for parties to hedge their costs and revenues, while the intraday market is a continuous and bilateral market, where no central clearing of all supply and demand is done at some point. As such, the day ahead market remains fundamental to ensure a correct price signal and as a result, it would be very imprudent and unwise to jeopardize even the slightest bit this role unless ironclad guarantees can be given that any market model modifications will not have very large ramification (especially in markets with high market concentration). Febeliec also wants to point out that in September 2020, during the period of this consultation, in several Member States prices in the day-ahead and balancing timeframe have risen to significant levels because of mismatches between predictions in (intermittent) generation and demand. Febeliec is not convinced that the proposed approach by Elia will prevent such evolutions, now and even more so in the future. Moreover, while Febeliec appreciates the remarks from Elia on the importance of the imbalance price and the strengthening of this signal, which Febeliec has always supported, this does not justify to abolish an additional security element that is allowed explicitly by European legislation. Last but certainly not least, and even if Elia seems to be very confident about the positive effect of the abolition of the day-ahead balancing obligation (which Febeliec doubts, based on the wording often applied by Elia and further elaborated upon below), Febeliec sees little or no benefits for electricity consumers and thus no reasons why the cost impact (both in positive and negative sense) would be passed through to grid users.. In any case, the European legislation allows clearly to maintain the day ahead balancing obligation when relevant and Febeliec strongly considers this to still be in the case for Belgium.

Below Febeliec will provide a range of comments, remarks and questions related to the analysis and draft report of Elia which should according to Febeliec at least be looked into and answered in the final version of the report:

- Elia often refers to the increasing importance of the intraday timeframe. While Febeliec does not deny this evolution, it would like to see how the liquidity (in all dimensions) of the intraday timeframe compares to the day-ahead timeframe, in order to ensure that this market would indeed allow BRPs to cover their future imbalanced day ahead portfolios after the abolishment of the day ahead balancing obligation. Also, if the intraday market were to solve all these issues and thus be or become very important to the systems, Febeliec would like to know a.o. why TSOs still do not perform a recalculation of cross-border capacities in the intraday timeframe (currently there is only an at best second best alternative being applied, with no guaranteed outcome), as this would clearly be an element that could contribute to intraday liquidity, before dropping day-ahead balancing obligations and counting on the intraday timeframe to allow to solve all issues by the BRPs.

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Febeliec would expect that such measures would be completed before contemplating abolishing the day ahead balancing obligation.

- Febeliec does not see which barriers to spot market improvements are currently created by the day-ahead balancing obligation and would like to see an exhaustive list of these barriers, as well as a description of how the proposal by Elia would solve them, while also including alternative mitigating measures that could be taken (as Febeliec is opposed to any barriers to market functioning, the identification and listing of such barriers should be addressed, also with alternative options). Febeliec was in any case very surprised to read that "*the day-ahead balancing obligation constitutes an important barrier to implement transaction after the closure of the day-ahead market that are valuable for the system*", as Febeliec was of the impression that this was covered by the intraday market. Febeliec is also surprised to see that Elia seems to follow a logic that states that the abolishment of the day ahead balancing obligation may increase the intraday liquidity, as Febeliec does not see any link between both. The intraday market rather provides a (continuous and not centrally cleared at a specific moment) market that allows BRPs to adjust their portfolios in light of incidents occurring after day-ahead clearing, or ever better information on demand and supply as time moves forward; Febeliec does not see how the abolishment of a day ahead obligation in itself would lead to better information over time and thus an improvement of the intraday market and its liquidity, but could rather constitute an additional risk, which would have to be covered by balancing reserves, if the intraday market would not be able to cope with day ahead imbalances and it would be too late to start slow(er) start flexibility.
- While Febeliec could theoretically understand that the day-ahead balancing obligation could push certain BRPs to wilfully provide incorrect balanced nominations, Febeliec does not understand how this could "*jeopardize the quality of the information*" for Elia as Elia does not only use this information for its security assessments. However, Febeliec cannot understand how abolishing a source of information, even if not always flawless (issues which could and should be addressed by other means, including better controls), would lead to better security assessments.
- Febeliec, as already described, strongly encourages a strong imbalance tariff signal, yet wonders whether this signal would be on its own self-sufficient to ensure that all BRPs at all times are compliant with their real-time balancing obligation. Febeliec is most gravely concerned that by abolishing the day-ahead balancing obligation and the related information flow, Elia will be betting on the imbalance price and imbalance markets to solve all issues that could not be solved by the BRPs in the intraday timeframe. While in a first period this could still be true, as parties have not yet fully adapted their bidding behaviour to the new situation, Febeliec is worried that this could over time lead to massive speculative bids ("bets") from BRPs towards real-time, which could then ultimately lead to a need for higher balancing reserve capacity, at a cost detrimental to consumers, or even in the worst case to a system collapse in case Elia due to the very limited timeframe could no longer find sufficient flexibility (e.g. too late to spin up slow start flexibility). Febeliec also wants to point out that even though the imbalance tariff has already been a single pricing system with an accelerator since many years, not all BRPs have always been as judicious in their respect of their balancing obligations, which could even be further aggravated by the proposed abolition.
- While Febeliec appreciates that Elia has to look into the feasibility, benefits and risks of each option, the analysis does hardly provide any quantitative element and most certainly does not provide any financial impact analysis. According to Febeliec, a such important change to the framework should at least be accompanied by a full cost-benefit analysis (including thus a cost impact from a system perspective and overall backup requirements and related costs and not only from the viewpoint of Elia and BRPs, mostly also only reflecting on operational costs and not system impact), especially also in light of the very important amount that is involved in the discretionary incentive of the regulator that is linked to this study.
- As stated above, Febeliec does not understand why Elia opposes the day-ahead balancing obligation with the strengthening of the imbalance price signal. For Febeliec, both can (and currently are) complementary and reinforce the stability of the day-ahead price signal (instead of weakening it as Elia seems to postulate), and in any case both do not counteract each other (which would otherwise already have been addressed by Elia in the past, as the combination is already applied since 2002). Febeliec can also only observe that despite the increased focus on strengthening the imbalance price signal (again, which Febeliec does not oppose), Elia still contracts large balancing reserves; Febeliec does not see how the abolishment of the day ahead balancing obligation could reduce this volume, and rather even expects this volume to increase over time if (perceived) imbalance risk would start rising due to increased uncertainty on BRPs being capable to balance their portfolios in real time. In any case, Febeliec does not understand how allowing BRPs to ask a derogation from the day ahead balancing during tense situations could provide an advantage for the system, or even "might increase the validity and accuracy of the security analysis performed by Elia".

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- In the proposal of Elia, presumably the only element to which Febeliec could agree is that if the decision were to be to abolish the day-ahead balancing obligation, which Febeliec would not find a good evolution, it would indeed be of the utmost importance to apply a stepwise approach, in order to ensure that no permanent and irrecuperable damage is done. Febeliec would strongly urge Elia to provide much more clarity on such intermediate period, both in timing as in scope (e.g. Elia describes categories of BRPs for which a different regime would apply, without specifying what such regime should be; for Febeliec, this should be part of the study, also in light of the quite sizable discretionary incentive that is linked to this study).
- Febeliec takes note that Elia suggest to publish new indicators in case the abolition would be accepted, including the total open position by the BRPs as well as their individual position. Febeliec would like to point out that already for years it has requested Elia to publish an indicator related to the performance of BRPs with respect to their (real-time) balancing obligation in order to provide grid users with transparency on the individual performance of BRPS (a.o. relevant in their selection of a supplier and BRP combo, to ensure that they are not unduly exposed to imbalance prices), which has never been taken up by Elia, while Febeliec understands now that publishing new indicators does not seem to be any issue for Elia. In any case, if the day ahead balancing obligation were to be abolished at all, it would be of the utmost importance to have a check on what capacity would **not** be offered in the day ahead market, in order to ensure that no capacity hoarding would be conducted (especially in a market with very high market concentration) under the pretence that this capacity would be reserved to ensure real time balancing in case liquidity in the intraday market would be insufficient (thus creating a cascade of unwanted effects in a self-fulfilling prophecy which would severely undermine market functioning).
- On reactive balancing, Febeliec is not opposed to this approach, yet is surprised that this is taken as an argument to abolish the day ahead balancing obligation as trader BRPs cannot participate to reactive balancing as they do not have physical assets in Belgium which would allow them to return to a balanced position on request of the TSO. Febeliec considers this argumentation upside down and rather sees this as an incentive for those trader BRPs to acquire physical assets in Belgium which would allow them to conduct reactive balancing. Moreover, as trader BRPs are allowed to trade energy until 5 minutes before delivery (gate closure time), Febeliec wonders how much system gains could be made in comparison to the increased risk and cost perspective.
- On the benchmark with other countries, Febeliec is disappointed that no quantitative analysis was included on the impact of the abolishment of the day ahead balancing obligation. A reference is for example made to the abolishment in the Netherlands, without however any volume nor cost impact analysis. Febeliec also reads that Germany applies a balancing obligation in day-ahead, with imbalances only allowed (to a certain extent) in the intraday timeframe. Febeliec also sees that the benchmark exercise seems to be very limited to only a handful countries (4) and wonders what the situation is in a larger population. Benchmarks as the one conducted by Elia in this framework can also provide other conclusions, as the abolishment of the single balancing price mechanism in Belgium (several countries in the scope of Elia's analysis apply a dual price scheme) or the abolishment of the intraday market (as the United States do not have such a market), both of which Febeliec would find a retrogradation of the current Belgian system, yet could also have been concluded from Elia's analysis.
- On the benefits of virtual bidding, Febeliec has no strong position, yet is nevertheless surprised that the proposal is based on the situation in the US, although no intraday market exists there which exactly allows parties to cover their positions in Europe based on better closer to real time information and thus wonders whether Elia would then plead for the abolishment of the intraday market to allow for a system that copies the US experience. Moreover, Febeliec is also surprised as virtual bidding seems to create a potential for manipulation of day ahead prices, which thus requires additional controls and mitigation measures, leading potentially to a situation where the day ahead balancing obligation would be abolished a.o. because it would according to Elia be too difficult to monitor the correctness in order to allow a.o. virtual bidding which would then yet again require new checks and monitoring on virtual bids, as the ISOs in the US had to implement. Febeliec does also not see what would be the added value for consumers, while it sees new potential risks and costs increases. Elia states that virtual bidding "might" help addressing several limitations of the current Belgian balancing mechanisms (although it remains unclear which ones), although this could also constitute in the creation of a potentially new risk as Elia states the it is non-trivial to define the virtual bidding mechanism in the European context.
- On Elia's comparison of the possible evolutions of the day ahead balancing obligation, Febeliec continues to wonder from which perspective this analysis is conducted: from the perspective of the TSO and its operations, the BRPs and their trading opportunities or the system perspective and the related risks and costs. Based on the document, Febeliec believes that it is for the most part the first, to a certain extent the second but rarely

the last element, which then leads to a very skewed outcome of the analysis with only winners and never a loser, unless of course everything goes wrong and stars do not always perfectly align, in which case the system and society could have to carry a very large burden.

- On the performed cost-benefit analysis, Febeliec is surprised to see that the analysis performed by Elia does not provide any monetary quantification of costs or benefits and only refers to an analysis without any underlying data on the impact on reserves based on a context where "*it can be **expected** that the **greatest part** of the open positions taken in day ahead will be hedged before the last gate of the intraday market*" and that "*the errors of anticipation made by the BRPs in day ahead will **most of the time** not impact the real time system imbalance*" while "*it is very **unlikely** that BRPs take large open positions*". Febeliec strongly insists that a more profound analysis is conducted, exactly taking into account situations where the above would **not** be correct and BRPs would not be able to hedge their portfolios, as such situation would exactly describe the cost side of a correct CBA. On the three cases of the MOG II System Integration Study, Febeliec refers to its comments on that consultation and wants to stress that it is still not accepting a situation where the best case scenario is considering BRPs only covering 65% of their balancing obligation for offshore wind farms. Especially in light of increasing offshore installed capacity in combination with the proposal to drop the day-ahead balancing obligation, this could rapidly lead to a situation where multiple BRPs "bet" in the wrong direction, thus resulting in hundreds of MWs of imbalances, while it might be too late to solve this issue with slow start (generation and load) units, while this ultimately also could result in Elia increasing considerably its contracted reserves in order to cope with the increased uncertainty.

In general, Febeliec wants to remark on the study by Elia that it lacks almost completely any quantitative analysis, especially also in monetary terms, and consists to a very large extent of benefits that "may", "might", "in theory", "suggests", "depending on the behaviour of BRPs", "could", "potentially", "under conditions", … lead to a better (?) situation for (certain) BRPs by allowing them to "bet" on the (in)correctness of the forecasts in the day ahead timeframe based on their (superior?) forecasting models that would allow them to increase their profitability and (eventually) push out lesser performing BRPs from the market. However, Febeliec is very concerned as all (non-guaranteed nor quantified) benefits would be for (a limited subset of) BRPs, while all risks (up to a blackout in case all BRPs massively bet all together in the wrong direction, even despite imbalance tariff incentives, a risk also mentioned by Elia yet (too easily?!) discarded according to Febeliec) would be for grid users (a.o. through additional balancing reserves), including also the shorter term situation where certain less performing BRPs would struggle and disappear, potentially with very large impacts on the system and the costs for grid users, as could be seen in the recent past after the bankruptcy of a BRP. Elia seems to count particularly on the correct anticipation by (virtual) traders for this new proposal to work, yet bases its argumentation on the fact that forecasts are currently not well enough to allow BRPs to be able to balance their portfolio correctly in day ahead (with the potential of trading on a very liquid and deep day ahead market to balance their portfolio). Febeliec is surprised that Elia, which is normally extremely risk averse, seems here to be willing to take a risk on betting that BRPs will not massive bet all together in the wrong direction which could lead to catastrophic results, and wonders whether such approach is warranted and the result of the fact that the incentives for Elia and its shareholders in this are not sufficiently aligned with those of the grid users that have to cover the costs in case of such wrong bet. After all, the Belgian electricity system is not a casino with gambling parties, where in the long run only the house wins.