

Centrica Business Solutions comments regarding ELIAs Strike Price proposal

September 12th, 2019

Centrica Business Solutions (CBS) generally welcomes ELIAs strike price proposal presented during the CRM Task Force of September 5th 2019, which goes in the right direction:

- CBS could consider the choice of a single strike price, if an appropriate price level is defined;
- CBS agrees to remove the payback exemption for forwarding hedging;
- CBS agrees with the payback exemption for planned and unplanned unavailability;
- CBS welcomes the clarification on the stop-loss limit on payback obligations.

If ELIA chooses a single strike price, CBS advocates for a price level above 500 to 800 EUR/MWh, to ensure a fair market access to all technologies, to foster competition and to lower the overall cost of the CRM. In addition, CBS suggests an automatic adjustment mechanism which allows to adapt the level of the strike price according to the historical occurrence of price spikes.

CBS could consider the choice of a single strike price, if an appropriate price level is defined

CBS still argues that multiple strike prices are a solution to capture all technologies, even units with high short run marginal costs (SRMC). We however acknowledge the arguments against multiple strike prices brought forward during the discussion, such as the additional design challenges. CBS therefore could consider the choice of a single strike price as an acceptable alternative, under the condition of an appropriate price level (cf. below).

CBS agrees to remove the payback exemption for forwarding hedging

To the extent that studies are inconclusive and hedging strategies on forward markets are different from market party to market party, CBS agrees to remove the exemption on the payback obligation linked to forward hedging.

CBS agrees with the payback exemption for planned and unplanned unavailability

CBS agrees that payback is only due in case the energy could actually have been delivered to the market. This means that in case of planned and unplanned unavailability, payback exemption applies. It also means that for demand side ToE for wholesale markets needs to be implemented, at the latest before the first auction in October 2021.

CBS agrees with the stop loss limit on payback obligations

CBS welcomes the clarification provided by ELIA, i.e. that the payback obligation is capped at 100% of CRM revenues. This will limit the risk of losses for technologies with higher marginal costs. While this goes in the right direction, CBS would like to point out that additional cost factors will have to be addressed in the further consultation process to ensure the viability of such technologies in the CRM (e.g. cost of availability tests).

CBS advocates for a strike price above 500 to 800 EUR/MWh

It is crucial to design a strike price which allows all technologies to participate to the mechanism, in order to enhance the level of competition, reduce the overall costs for society and comply with national and European regulation.

A recent study by Sia Partners¹ shows that the total potential of conventional DSR capacity in Belgium has increased to around 1.8 GW in the past few years (cf. Annex 1), consisting of residential (0.59 GW), tertiary (0.46 GW) and industrial capacity (0.78 GW). This is complemented by 0.6 GW unconventional DSR, enabled by new technologies such as EV and stationary batteries by 2030. Thus, the total DSR potential equals 2.4 GW, representing over 18% of the Belgian peak load.

While the price range of 500 to 800 EUR/MWh presented by ELIA goes in the right direction, it does not yet capture the marginal costs of many DSR assets in the Belgian market. The 500 EUR/MWh observed in the Irish CRM cannot properly be applied to the Belgian case. In Ireland, *authorities have determined that the strike price must reflect the short run marginal costs of a peaking unit, taking into account fuel costs, carbon cost and the cost of reference of a*

¹ <http://energy.sia-partners.com/20180807/demand-response-prospects-belgium>

demand response unit of 500 EUR/MWh². This does not cover demand response assets in the industry sector with marginal costs reaching several 1.000 EUR/MWh, such as documented in ACERs Final Report on the Value of Lost Load³ (cf. Annex 2) and observed by CBS on the field. OFGEM and DECCs final report on the Value of Lost Load for electricity in Great Britain also shows that I&C customers have a wide range of VoLLs, and different sectors show a wide range of variation. [...] The average I&C VoLL is about £1,400/MWh⁴.

If ELIA chooses a single strike price, CBS advocates for a price level above 500 to 800 EUR/MWh in order to cover the effective marginal costs of the most relevant technologies, including industrial demand response processes. Since not all technologies with high marginal costs can be captured by a single strike price (cf. Annex 3), CBS argues that at least a single strike price above 500 to 800 EUR/MWh should be chosen to:

- limit the share of eligible technologies that will be excluded from the CRM (in particular DSR);
- ensure a fair market access to a broad base of technologies, without having to reimburse revenues not perceived on the energy market;
- foster competition and therefore lowers the overall cost of the CRM;

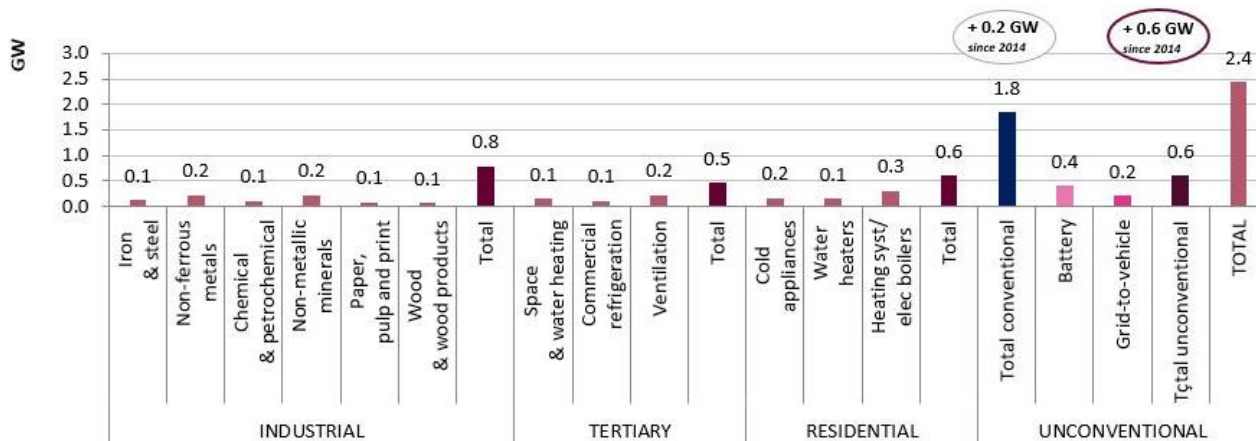
If combined with an intermediary price cap that takes into account expected revenues, this remains an appropriate solution to limit windfall profits for low margin technologies.

Going forward, CBS suggests an automatic adjustment mechanism which allows to increase the strike price whenever the occurrence of historical price spikes exceeds a certain threshold. The main purpose of this mechanism is to avoid that the strike price unduly restricts the participation of technologies with high marginal costs. Indeed, contrary to lower SRMC-technologies which earn revenues during scarcity periods, high SRMC-technologies will have to pay back while not earning market revenues. Therefore, the regular review process of the strike price shall foresee an automatic adjustment mechanism to adapt the strike price based on the historical occurrence of price spikes.

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Annex 1 – Demand response potential in Belgium by sector



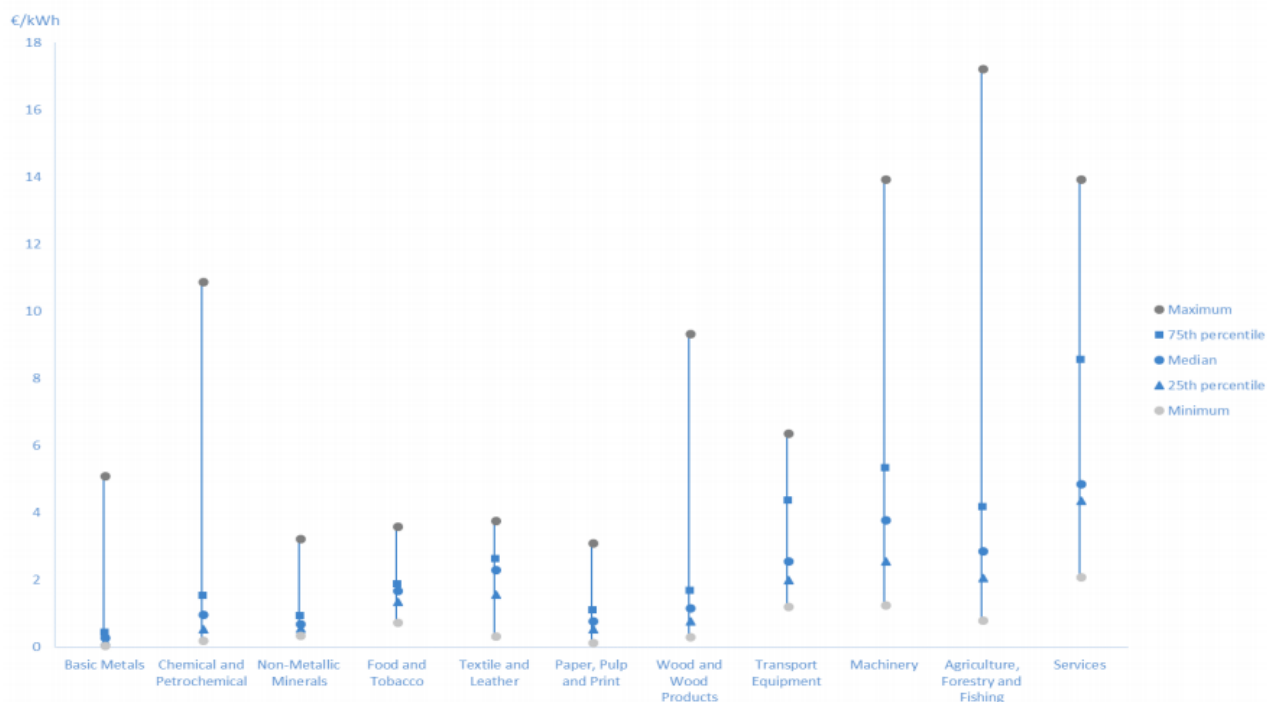
² European Commission – State aid No. SA.44464 (24.11.2017)

³ ACER – Study on the estimation of the value of lost load of electricity supply in Europe (July 2018)

⁴ OFGEM & DECC – The value of lost load for electricity in Great Britain (July 2013)

Annex 2 – Non-domestic Value of Lost Load

Figure 6.7: Estimated non-domestic VoLL ranges across all EU MS by sector (excluding Construction or Transport)



Annex 3 – Assets with high marginal costs are likely to be excluded from the CRM

- Let's assume a 1MW asset of a given technology with marginal costs of 3.200 EUR/MWh, eligible to the CRM
- Let's assume it is awarded at a price of 20.000 EUR/MW/year in the CRM auction
- Let's assume a strike price of 500 EUR/MWh
- During each hour of the year where the BELPEX price reaches levels between 500 and 3.000 EUR/MWh (BELPEX price cap), the asset will have to pay back money to the TSO, without earning revenues on the energy market
- This means that after 8 hours with day-ahead prices at 3.000 EUR/MWh (e.g. during a day with MRC decoupling, or a tight winter season), all annual revenues from the CRM auctions are lost (and the stop loss enters into force)
- This does not yet take into account the fact that CRM revenues need to cover missing money as well as additional costs, such as costs for administrative burdens, commercial prospection, technology infrastructure, availability tests or potential penalties in case of unavailability
- While some of the risk can be hedged by internalizing part of the costs in the capacity bid, it remains to be seen to which extent the risk policy of operators will allow the CRM participation of assets with high marginal costs