



Answer to the consultation

“Proposal for Amendment T&C BSP aFRR”

1. Rejection of the proposal

Next Kraftwerke rejects the “Proposal for Amendment T&C BSP aFRR”.

- **The proposal removes the key element of the market design** which puts step 1 and step 2 in competition. The proposal installs step 1 and step 2 as two independent markets where new market entrants are trapped in step 2 with prices which are no longer representative of the aFRR market. This is entirely against the idea that Elia had when working out the market design. The proposal is no quick fix but a complete change of design. And it changes the design that Next Kraftwerke positively responded to in the previous consultations and based on which Next Kraftwerke made significant investments into the development of aFRR.
- **The market design was not tested with the competition from non-CIPU units:** The high prices that were observed on the market occurred in a market without competition from non-CIPU units. Before a design change can be considered (which should be in any case different from the proposal consulted here) the market design current market needs to be tested with competition from non-CIPU units.
- **No solution for the underlying problem:** The proposal shall ensure a cost reduction for aFRR sourcing with the objective to avoid extreme prices. This cost reduction is however at full expense of step 2 bidders and at the sacrifice of putting step 1 and step 2 in competition. But even though it is turning the design upside down at the expense of step 2 and non-CIPU, it does not even solve the problem that there will be extremely high prices in case a CIPU unit needs to be started up for step 2. The problem therefore remains and will occur again as soon as larger step 2 volume (about 30 MW) is prequalified.
- **Design change implementation costs cannot be the guiding argument:** We also understand that more complex solutions that really fix the issue encountered require additional work from Elia and that the proposed design change is hardly any IT implementation and can be easily implemented. We hope that this was not the guiding argument for the current amendment proposal.

We ask Elia to reinstall the former design and open the market as soon as the first Megawatts of non-CIPU units are entering the market.

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In parallel Elia can then investigate in discussion with all market parties a possible design adaptation for the case that again extremely high prices are observed. The new design adaptation proposal needs to ensure that there is full competition between step 1 and step 2.

Alternatively, we suggest removing market complexity and abolish step 1.

2. Detailed argumentation

2.1 Investments were made based on the former design

Next Kraftwerke and other BSPs made significant investments based on a market design consulted and proposed by Elia. The investment costs for developments in Belgium are particularly high compared to the aFRR development costs in any other country that Next Kraftwerke delivers aFRR in. This is due to the complexity of the market design, the communication requirements by Elia, the local gateway requirements etc. Next Kraftwerke had raised these concerns in several discussions with Elia. We proposed various simplifications that would have reduced the cost significantly without lowering the service quality. We never understood why the design of the pilot project in which already two BSPs participated was not chosen at least for the start of aFRR with non-CIPU units. The development costs for the pilot project were a fraction of the costs to be ready to participate in the current aFRR market. The complexity of development was also reflected by the delay of all BSPs for the market opening date.

However, the BSPs took the investment decision knowing that high costs would be encountered. The decision was taken based on the consulted market design and the expectation that the competition between step 1 and step 2 will eventually also show higher prices and therefore pay back the investment.

Next Kraftwerke did not expect the extreme price peaks bid by CIPU units as observed in the last month. Otherwise, Next Kraftwerke would have pointed this out, but as explained below the proposed link between step 1 and step 2 was the key reason to respond positively to the proposed market design.

2.2 Importance of the competition between step 1 and step 2

It is important to explain why the volume shift between step 1 and step 2 was so important for the BSPs and why it was central for their investment decision.

The reason is that the CIPU units price in all their costs in step 1. In particular the must-run and start-up costs are priced in. They need to do so to guarantee the aFRR service is profitable for them. However, this allows the CIPU units to offer step 2 volume with running plants at very low costs. These costs do not reflect the costs that such plants would have in a market with 4 hour blocks and merit order as envisaged by the European Commission.

Side note: It needs to be pointed out here that we always say that only CIPU units can compete in step 1. That is in fact not true. Whether or not one can be successful in step 1 depends on the total volume one can offer. An owner of a smaller CIPU unit. For instance, a 100 MW plant with 25 MW flexibility can also not be competitive in step 1. The current market design is made for players that can offer large volumes. Any bidder with smaller volumes cannot be successful in step 1 at reasonable prices.

In step 2 the non-CIPU units are therefore put in competition with units that have covered their must-run costs and start-up costs and an additional margin already in step 1.



During the discussion for the current market design, we had explained this problem various times in detail and we stated clearly that we see this as the biggest risk for our investment. Elia's team fully understood these concerns but explained that step 2 auctioned volume would increase if prices are low in step 2. Therefore, eventually the prices for step 2 should rise again. We followed this line of argumentation and accepted the design. It must be obvious that exactly this idea that step 2 auction volume would increase convinced us. **We would in no case have positively responded to a design in which step 2 volume is capped and in which low step 2 prices would not lead to an increase of step 2 volume.**

Next Kraftwerke might not have taken the investment decision for aFRR in Belgium if step 2 volume would have been capped in the original design.

The new proposal of Elia removes just this very key design element that was so important for us.

2.3 Need for higher prices in step 2 to attract new players and new volume

The goal of Elia is to create an open market for aFRR in Belgium. During the last decades, the market was closed for non-CIPU units and many design features were made just for CCGTs which was indeed the only technology present on that market. The latter also because it was simply not possible to enter with other technologies due to these design features (chicken-egg problem).

If the market is now opened, we will see as expected higher prices during certain moments and for the first year or years. These prices are necessary to attract new players and new volume to the market.

By limiting the volume in step 2 to the prequalified volume there is permanent overcapacity. The to be expected low prices will fail to deliver the price signals for new volume.

Higher prices would also be needed to attract new investments in new capacity like batteries.

3. Ideas for a market design fix

As aforementioned Next Kraftwerke asks to reinstall design of November as soon as non-CIPU volume is available or to abandon step 1 entirely.

In the following we still want to give some design change ideas. Nota bene: We do not say that one of the ideas is the perfect solution. We just want to point out that there is a set of instruments that can be considered.

Before a decision is made several solutions and combinations should be analysed.

3.1 Repetition of step 1 auction:

Currently it seems to be the best solution to us that in case prices in step 2 exceed a to be defined maximum and therefore several blocks of step 2 do not fully clear, the 24h step 1 auction will be repeated for the highest volume that is missing in one of the blocks that was not fully cleared.

This would of course mean that Elia sources some overcapacity. This capacity would however be sourced at prices that are not extreme and in case the event will be rare.

Furthermore, the volume of step 2 would then normally decrease due to the high price event.

This adaptation seems for us to be the only possibility to keep the design of Elia and the competition between step 1 and step 2.



3.2 Indivisible bids in step 2

The extremely high prices seen in step 2 could be avoided by allowing those units that also bid in step 1 to spread their costs over larger volume. Currently CIPU units price their complete costs in the first MW selected in step 2 if a new unit needs to be started up. If these units could put indivisible bids in step 2 of for instance 5 MW, this would mean a significant bid price reduction.

Of course, the volume in step 2 should still be sourced by applying a merit order. In case Elia needs to procure indivisible bids to fill the volume and these are marginal, Elia may have to contract overcapacity.

3.3 Remarks explicitly on the current proposal

In this section we make some remarks on the proposal of Elia. This does not mean that we think that the proposal of Elia can be adapted towards a good market design. As aforementioned we reject the current proposal entirely.

Nevertheless, we still want to propose some adaptations that could mitigate the negative impact.

We consider the improvement explained in 3.3.1 as fundamental. If it would not be taken into account Elia would lock out flexible volume present or to be built in Belgium from the aFRR market without reason. Even if 3.3.1 is integrated, Elia would still need to apply a combination of improvements suggested in 3.3.2 to 3.3.3 and possible other improvements to work out a solution that is at least acceptable.

3.3.1 All newly prequalified volume needs to be considered

Not only the prequalified volume of non-CIPU units can be considered for the cap. **All new volume that is prequalified after 6/11 needs to be considered** no matter whether it the prequalified plants are CIPU or non-CIPU units.

Otherwise, Elia would exclude existing or to be built smaller CIPU plants (that do not join the pool of a current CIPU bidder) from the possibility to be selected at fair prices as their volume is not taken into account in step 2 cap. Such units cannot compete in step 1 (see explanations above).

3.3.2 Mark-up price for step 2 by indexation of step 1

As explained before, the prices bid by step 1 units in step 2 do not reflect the true costs for the product as costs are already covered with the awarded volume in step 1 (including a margin).

The true costs can however be retrieved by looking at the bid prices of the first Megawatts of the BSPs with awarded volume in step 1 for the respective upward or downward product. Even though this would not be in line with the idea of putting step 1 and step 2 in full competition, it would at least guarantee that step 2 units receive a fair price for the service offered. In the full merit order daily product as requested by the European Commission this would be the price to be expected.

Example 1/10:

- Downward: In the auction for 01/10/20 the per-CCTU auction cleared on average for 5,92 €/MW. On the all-CCTU auction the first 5 MW were offered at more 40 €/MW/h.
- Upward: In the auction for 01/10/20 the per-CCTU auction cleared on average for 16,77 €/MW. On the all-CCTU auction the first 5 MW were offered at more 50,02 €/MW/h.



It shall be highlighted that these prices are for 24h volume bids. The price these units would offer for a 4h block would typically still be significantly higher. However, after selection in step 1, these units can offer significantly lower prices in step 2 because a significant part or even all their costs are covered by step 1. The step 1 market in which the non-CIPU units cannot compete as market power is exerted with large volumes.

Remark:

- We assume a BSP bidding z MW in step 2 with a price lower than the cheapest first z MW bid in step 1.
- As Elia removes the competition between step 1 and step 2 the following rule shall be applied to ensure that step 2 units receive fair market prices:
 - o Non-CIPU units or CIPU that only bid in step 2 are always awarded before CIPU units that have been bid in step 1 if their bid price is lower than the price for the first z Megawatts in step 1.
 - o These awarded units then receive for instance
 - s times their bid price capped by the price of step 1 for the first z MW with $s \geq 2$
 - or
 - u times the average awarded price in step 1 with for instance $u = 1.5$
 - or
 - ...

There are various solutions possible to pay reasonable price to step 2 units. The above are just very first ideas.

For the increase or decrease of volumes the bid price and not the bid price and not the paid price is considered (under the new rule it can in any case not increase above the prequalified volume).

3.3.3 Cap larger than the prequalified volume and building up of credit

- The step 2 cap that Elia proposes shall be changed into
Step 2 volume cap = $x\%$ all new prequalified aFRR volumes (CIPU and Non-CIPU) after 6/11
- The cap should be combined with a new minimum volume in step 2, replacing the current 10 MW
Step 2 volume minimum = Maximum ($1/x\%$ of step 2 volume cap; 20 MW)
- Additionally, a credit can be built up: If the prices of step 2 are “low” and would trigger an increase beyond the cap (as it would be in the current design), this increase would not increase the volume of step 2 beyond the cap but should be noted as credit. If the market dynamics would later demand a decrease in step 2 auction volume, this decrease will then first be taken from the credit before it decreases the step 2 auction volume.
- x should not be smaller than 200%.



Example:

- $x = 200\%$, prequalified volume 30 MW
- Cap = 60 MW
- Min = Max $[(1/200\%) \times 30 \text{ MW}; 20 \text{ MW}] = \text{Max} [15 \text{ MW}, 20 \text{ MW}] = 20 \text{ MW}$