

**CONSULTATION REPORT**

**Modification of the  $\alpha$  parameter in the tariff for  
maintaining and restoring the residual balance of  
individual access responsible parties**

**December 22, 2021**



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# 1. Introduction

Elia organised a public consultation on a modification of the  $\alpha$  parameter in the tariff for maintaining and restoring the residual balance of individual access responsible parties. Elia proposes to introduce as soon as possible in 2022 a calibration parameter which tempers the  $\alpha$  parameter during periods with elevated marginal incremental (MIP) or decremental price (MDP).

In the fourth quarter of 2021, Elia and stakeholders have engaged in bilateral meetings and workshops to discuss the elevated system imbalance costs and possible mitigation measures. During the workshop of October 11, 2021 stakeholders put forward the large contribution of the  $\alpha$  parameter in the total system imbalance cost. Several stakeholders requested an assessment and potential revision (or even suspension) of the  $\alpha$  parameter.

Following its assessment of the  $\alpha$  parameter, Elia proposed a recalibration of the  $\alpha$  parameter. Considering the current energy market context, with elevated system imbalance prices, **Elia proposed on a solution which can be implemented on short notice to maximize the effect for the market parties. Elia invited all stakeholders to submit comments and suggestions they may have on the document submitted for consultation. The consultation period ran from December 3, 2021 to December 17, 2021. During the consultation period, a workshop with stakeholders was planned on December 13, 2021 to present and discuss the proposal.** Elia communicated at the start of this workshop that the validated minutes of this workshop will complement this consultation report. Elia received seven answers on its public consultation:

- BEE
- ODE
- EDORA
- BOP
- FEBELIEC
- FEBEG
- NEXT KRAFTWERKE

All responses are non-confidential and will be published on the consultation page. This report collected all comments and feedback from the market parties received via mail together with Elia's answers. In addition to the consultation report, Elia will publish the reactions of the market parties on its website.

**Elia understands that the majority of the respondents agree with Elia's proposal for a recalibration of the  $\alpha$  parameter (BEE, FEBEG, ODE, EDORA), at least as a short-term solution while continuing fundamental discussions on the  $\alpha$  parameter and the general balancing market design in general.** However, other market parties requested a modification of the proposal for recalibration (BOP), raise fundamental objections (Febeliec) or reject the proposal (Next Kraftwerke). Nevertheless, Elia submitted this proposal, as presented to the stakeholders, for approval to the CREG on December 22 because it is convinced that its proposal is a robust short-term improvement of the  $\alpha$  parameter:

- with no or limited impact on the system security while reducing the imbalance costs for BRPs. This responds to the requests of a large amount of market parties for which Elia engaged in workshop discussions;

- without prejudice to the outcome of further discussions to take place with market parties on the balancing market design and the role of the  $\alpha$  parameter.

## 2. General remarks on the proposal

- FEBEG appreciates the workshops organized by ELIA and stresses the need of a good and transparent collaboration between ELIA and the market parties to address their concerns in the current context of very high imbalance prices.
- While the consultation period for the present proposal is rather short, FEBEG considers that this shorter period is fully justified considering the significant impact of the high imbalance prices on the market and the sense of urgency expressed by different market parties (amongst which FEBEG) for addressing the issue.
- EDORA writes that « *EDORA remercie Elia pour la proposition de recalibrage du paramètre Alpha soumise à consultation, fut-ce dans un laps de temps exceptionnellement court justifié par l'urgence des mesures d'atténuation à prendre pour limiter les pénalités de plus en plus importantes supportées par les BRPs lors des déséquilibres du système* ».
- Lastly, Febeliec wants to stress that it cannot accept a consultation period of only two weeks for a modification with a potentially major impact on the Belgian balancing market, in the short and possibly also long run. Febeliec insists that consultation periods run for at least four weeks, in order to allow the concerned parties to also consult their members. Moreover, the proposed modification is not a minor modification but a fundamental shift in the approach towards the balancing market and as such should in any case not be taken lightly.

Elia recognizes the importance of a good and transparent stakeholder collaboration. On request of the stakeholders, it already organized two workshops on this subject, i.e. on October 10 and December 13, 2021, and one other on the subject of the real-time price to come on January 20, 2022. As explained during the workshop on December 13, the formal consultation period is brought exceptionally to a period of two weeks following the request of taking urgent action by several market parties. Elia believes that an implementation on the short-term maximizes the gains of the proposal, in view of the high imbalance prices witnessed this winter period.

- On the consultation documents, Febeliec wants to stress that the request to modify the alpha parameter did not come from all market parties, but only from the BRPs, and that Febeliec voiced strong concerns about reducing price signals for BRPs (while being open for alternative solutions that give at least similar or better incentives to BRPs to remain balanced).

Elia takes note of this remarks of Febeliec and will take this into account in its future communications. Elia notes that in its proposal, the incentive for BRPs to remain balanced (or help the system) is expected to remain sufficiently high with the proposed recalibration (cf. other answers in this document).

- Febeliec wants to highlight that the revenues from the alpha component are not distributed to the Elia shareholders, but are put on a regulatory account and returned to the grid users through the grid tariffs, in essence reducing the amount grid users have to pay for the system, including the reservation of balancing capacity.

As recurring important negative effects on the system imbalance will negatively impact the grid users through potentially higher capacity reservations, it is important not to forget this aspect.

Febeliec wants to highlight that BRPs are not automatically exposed to increased costs because of the alpha component. Indeed, if the portfolio of a BRP is balanced, there is a zero exposure to the alpha component. Alternatively said, if BRPs are subject to the alpha parameter, this automatically implies they were not in balance and this in the wrong direction (not helping the system).

Elia confirms both elements brought forward by Febeliec.

- Febeliec would further also like to reiterate its long-standing comment on the allocation of the costs of the reservation of balancing capacity to the BRPs instead of the grid users. If done in an intelligent way (e.g. linked to their imbalance positions), this could also give an additional signal to BRPs to ensure that they keep their perimeters balanced, in effect reducing the residual imbalance for Elia.

Elia takes note of this remark of Febeliec but considers this remark out of the scope of the current proposal aiming for a recalibration of the  $\alpha$  parameter as a solution which can be implemented on short-term to affect the elevated imbalance costs of BRPs.

- ODE makes an additional remark for Elia to take into consideration. On page 3 in the guiding document “20211206\_Proposal-Alpha-Recalibration-nl” is mentioned: “Voor de productie van zonne-energie (met steunmaatregelen van maximaal 450 euro/MWh) wordt aangenomen dat deze momenteel geen substantiële rol speelt bij impliciete balancering, gezien het gedecentraliseerde karakter ervan” ELIA assumes that solar power does not play a substantial role in implicit balancing, as solar installations have a decentralized character and there is sometimes high operational support. We believe there is a high potential for solar power to participate in implicit flexibility by reducing production when prices are negative. Recent and future installations have limited to no financial hindrances for participation and for older installation with higher support levels, we will ask the Flemish government to analyze the benefits of a (partial) refund of lost operational support due to participation in flexibility. We want to add that while a lot of solar capacity is distributed, the 1248 biggest installations represent about 20% of the installed solar capacity in Flanders (862 MW out of 4214 MW), with a minimal capacity of 250 kW for these installations. We believe that if the correct market conditions are set, sector-wide participation could follow once a critical market volume is reached.

The remark of ODE confirms Elia’s assumptions taken in the determination of the current imbalance price thresholds used to calibrate the  $\alpha$  parameter. Elia agrees that this assumptions relates to the current market conditions and does not want to exclude on longer term the participation of solar capacity in the balancing time frame. Elia welcomes initiatives which facilitates the participation of flexibility in the market. Elia also refers to its proposals on its consumer-centric market design to facilitate the participation of local flexibility.

### 3. Remarks on the proposal for re-calibration of the $\alpha$ parameter

#### 3.1 General remarks on Elia’s proposal

- BEE specifies its position as “BEE ondersteunt het voorstel om de impact van de alfa-factor bij hoge onbalansprijzen te beperken.”

- EDORA specifies its positions as « dans cette attente [*cf. other remarks of EDORA in this consultation report*], EDORA espère qu'Elia pourra effectivement procéder, dans les meilleurs délais, au recalibrage envisagé. »
- ODE welcomes the constructive approach of Elia to make a compromise 'short run' proposal that is expected to lower the balancing costs in the short term. We do, however, regret that the  $\alpha$ -parameter hasn't been brought to zero, at least until further evaluation of the costs and benefits has been performed [*cf. other remarks of ODE in this consultation report*].
- FEBEG nevertheless [*cf. other remarks of FEBEG in this consultation report*] appreciates the efforts of ELIA to quickly adapt the alpha component in order to reduce its overall impact on the BRPs given the currently difficult market circumstances. As such, FEBEG accepts ELIA's proposal for the recalibration of the alpha parameter as short-term solution.
  - FEBEG confirms the figures on the overall impact of the alpha component as presented by ELIA during the 2 workshops on the imbalance costs: on average, the alpha component represents 25% of the imbalance costs; the cost of the alpha component has increased from 1.9 million euros in 2019 to 19.2 million euros in 2021 (YTD); the impact of the recalibration of the parameters means a delta of ~7 million euros if applied in 2021 (YTD).
  - FEBEG appreciates the efforts of ELIA to come up on a short notice with a proposal to recalibrate the alpha component and thanks ELIA for proposing a quick implementation timeline for the entry into force of the recalibration parameter with 01/02/2022 as go-live date.
  - As the proposed recalibration of the parameters has a positive impact on the BRP's balancing cost, it is absolutely necessary to implement it as soon as possible: the recalibration removes the costs for which it is already clearly demonstrated that they have no incentivizing effect on the behaviour of the BRP's.

Elia takes note of the support of FEBEG, ODE, EDORA and BEE for its proposal of a recalibration of the alpha component as a short-term solution and to move on with the implementation of the proposed recalibration as soon as possible as it helps relieving the elevated imbalance cost for BRPs.

- On the proposal of the modification of the alpha parameter in light of the recent increase of the revenue of Elia from this component, Febeliec has some fundamental objections [*cf. also other remarks of Febeliec*].

Elia takes note of the objections raised by Febeliec. It refers to the answers elaborated in Section 3.2 and 4 of this report.

- Next Kraftwerke appreciates the drafting of the annex document that the alpha parameter brings substantial benefits to Elia in terms of a more reliable system, but we do not think that this document serves as proof that the alpha parameter has the desired beneficial impact. We rather think that no additional alpha parameter is needed to stimulate the BRPs to balance their portfolio. In particular, the alpha factor increases the cost of renewable portfolios which cannot be desired considering that the goal is to achieve even larger shares of

renewables in the future. Next Kraftwerke therefore rejects the current proposal. Next Kraftwerke proposes the complete abolishment of the alpha parameter-at least for the period of increased electricity and imbalance prices.

Elia takes note of rejection of the proposal by Next Kraftwerke. Elia would however like to clarify that the objective of its analysis was to conduct the assessment of the  $\alpha$  parameter in view of a short-term solution to mitigate increasing balancing costs, as requested by the BRPs. With its assessment, Elia did not only explained the reasons for the elevated impact of the  $\alpha$  parameter on the balancing cost in 2021, it also confirmed the relation between market reaction and imbalance prices, i.e. supporting the use of an  $\alpha$  parameter to incentivize market players to balance their portfolios.

Elia wants to remark that a full phase out of the alpha component would require further discussions with the market (in which Elia is currently engaged with the organized workshops) but it cannot be expected that these discussions result in an agreement on the very short-term considering the different positions of the market actors (as demonstrated in the answers of this consultation and the reactions received during the workshop). Elia refers to the answers in Section 4 and 5 of this report concerning the discussions on the long-term evolution of the  $\alpha$  parameter and the balancing market.

- BOP supports a swift response of Elia to modify the alpha parameter in the short term in an attempt to address the rising imbalance costs as observed during the last couple of months, as it is in the interest of society to keep the balancing costs under control, to avoid energy price increases. The modification as proposed in the document under consultation, with some improvements as suggested in the comments below, is a good step in the right direction, but considered by BOP as only a first step in a long-term solution towards a more performant flexibility market.

Elia takes note of the conditional support of the proposal by BOP. It refers to Section 3.2 of this consultation report what concerns the improvement for the re-calibration of the  $\alpha$  parameter, and Section 5 of this consultation report what concerns the long-term solutions.

### 3.2 Remarks for modification of Elia's proposal

- BOP suggests to extend the analysis and justification of the modification of the alfa parameter based on the difference between the spot prices and the imbalance prices, and not the imbalance price as a stand-alone parameter, as it is a better proxy for the imbalance cost and it corrects for the impact of external factor like gas prices and CO2 prices<sup>1</sup>.
  - In the analyses supporting the modification, the total value of the alfa parameter is assessed for a large period of 2020 (11M€) and compared to the same period in 2021 (19.2M€). Elia considers this total value as measure for the impact of the alfa parameter on the imbalance cost. The proposal for

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<sup>1</sup>An imbalance price of 250 EUR/MWh is high when day-ahead prices for that timeframe were 50 EUR/MWh, but low when they were 300 EUR/MWh.

the alfa parameter modification introduces a calibration parameter CP to match the total value of both periods: 10.1M€ in 2020 and 12.2M€ in 2021 after recalibration. In this respect, it is important to distinguish the imbalance cost for a BRP from an imbalance invoice sent to the BRP:

- the imbalance price is the amount of EUR/MWh a BRP must pay or receive for its imbalance volume;
  - the imbalance invoice is the amount the BRP needs to pay to Elia as a result of an imbalance volume and the corresponding imbalance price. It is the difference in the volume produced in real-time vs. the forecasted volume, multiplied by the imbalance price, and is a result of an imperfect forecast;
  - the imbalance cost on the other hand is the difference between the revenue in day-ahead with a perfect forecast (of the volume) and the revenue in real-time. A positive imbalance invoice (i.e. payment from BRP to Elia), does not necessarily mean a positive imbalance cost (i.e. the BRP made a loss because of its imperfect forecast). Elia is using the imbalance invoice in its analyses. But to gain better insights in the effectiveness of the alfa-parameter, and ultimately integrate the right incentives to the BRPs in the design, the analyses should include the imbalance cost to the BRPs.
- A good proxy for the imbalance cost is the difference between the spot prices (DA and/or ID) and the imbalance price, as this parameter is commonly used in the market. We urge Elia to include this imbalance cost parameter in the analysis that needs to support the short-term modification of the alfa-component and tuning of the calibration parameter, as it will better match with commercial practices that will not change overnight. This introduces a better correlation between the alfa parameter and the balancing market dynamics of today. Furthermore, it does not reduce the incentive to the BRPs to continuously improve their position between day-ahead and real-time, as the alfa parameter still functions as an adder to the imbalance price. In the long term revision, it can be further investigated how the common commercial practices can be improved and adopted to further enhance the performance of the balancing market.

Elia thanks BOP for the suggestions to improve the assessment and calibration of the  $\alpha$  parameter. However, Elia is not yet convinced it should build its analysis on the imbalance costs as suggested by BOP. Elia understands the final imbalance cost for some BRPs can be impacted by contractual / commercial practices but Elia doubts if this should impact the calibration method of the  $\alpha$  parameter. To Elia's understanding, market parties should strive to optimize business operations in view of adequate day-ahead, intra-day and real-time price signals reflecting the demand and supply conditions of the market. Furthermore, Elia is not aware of market parties' bilateral agreements and further digging into this topic, as well as the suitability of the calibration, would require time and resources which would jeopardize the implementation of the proposal on the short-term.

Elia also believes that the indicator it uses to study and calibrate the  $\alpha$  parameter is well chosen to assess the impact on the balancing market (taking into account the transfer from BRPs with a short portfolio to BRPs with an excess portfolio). Note that it also used by FEBEG as an indicator in its presentation during the first workshop (October 10,



2021). An analysis of the cost for BRPs would result in additional complexities as the imbalance cost would be different per BRP without necessarily contributing to insights which may improve the calibration of the  $\alpha$  parameter.

Finally, Elia reminds that the imbalance price should provide an incentive for BRPs to balance the portfolio in real-time, irrespective of the conditions in the day-ahead (cf. also discussions on the balancing obligations). With its current proposal, Elia wanted to include a calibration component which reduces the effect of the  $\alpha$  parameter when the  $\alpha$  parameter already reaching very high (or very low in case of system excess) of imbalance prices. As explained in its assessment, Elia believes the effectiveness of the measure is reduced during these periods, as most available flexibility is likely to be activated.

- BOP understands that the recalibration is purely based on a comparison between 2020 and 2021. A correction factor is introduced to make sure that the imbalance cost (actually it is the imbalance invoice) in 2021 is limited to the imbalance cost of 2020. What justifies this choice?

Elia does not agree with BOP's understanding of the approach followed by Elia. Elia proposed recalibrating the  $\alpha$  parameter as its assessment shows that the  $\alpha$  parameter is expected to become less effective at elevated imbalance prices, i.e. when the price is sufficiently high to incentivise BRPs to balance their portfolio. Indeed, Elia thinks the  $\alpha$  parameter is the most effective when facing low imbalance prices during high system imbalances, rather than when facing high imbalance prices during high system imbalances.  $\mu$

The impact assessment conducted by Elia, which is not the same as an objective function, confirms that this relieves the effect of the increasing imbalance prices, and brings back the impact of the  $\alpha$  parameter on the total imbalance costs to the levels of 2020. This indicates that the measure serves its goal and targets specifically exceptional price peaks (as witnessed in 2021) without harming the incentives during low / mid price levels (cf. examples presented in the annex of the consultation). Note that Elia's main objective is to ensure that appropriate incentives are maintained for the BRPs to balance their portfolio.

- BOP suggests for a correction for external factors : the current analysis only provides data on the level of the imbalance price in €/MWh. The market context in 2020 and 2021 is however significantly different with rising energy and CO2 prices, which are reflected in the imbalance bids and thus the imbalance price. To analyse the effectiveness and suitability of the alfa-parameter it is important that these external factors are neutralized before qualitative conclusions can be made. This can be done by using the same proxy for the imbalance cost to the BRPs, i.e. the difference between the spot prices and the imbalance prices.

Elia refers to its previous answers and is not convinced that the calibration of the  $\alpha$  parameter should be made a function of the day-ahead price or be corrected for it. As well during very elevated and very low day-ahead prices, it seems to still be justified to reduce the  $\alpha$  parameter if imbalance prices are already sufficiently high to incentivize the activation of flexibility.

- On the proposed changes, Febeliec, especially in light of the current high price levels on the day-ahead market, wonders whether the proposed values of 200 and 400 €/MWh are proportional and not too low. Febeliec wants to insist that, as also confirmed during the workshop, Elia did not show there was no additional reaction beyond the 400€/MWh threshold but rather that there were not enough data points to draw statistically relevant conclusions from them (while showing even stronger market reactions than at the 400 €/MWh level, even under less frequent occurrences). As also mentioned during the workshop, the most market reaction, insofar capable to react under the conditions of the balancing products, would be at the level of VoLL, which is far

from being reached. The same applies to the level of the price caps on the balancing market, which are much higher. Moreover, while Elia shows that this recalibration would have reduced the alpha parameter revenues in 2021 to the level of 2020, Febeliec does not agree that this is the goal function. The mission of Elia is to maintain the system in balance and overall alpha parameter revenues should be irrelevant from that perspective and definitely not a driver for a modification of the alpha parameter as the goal is not to generate tariff revenues but give an incentive to BRPs (and revenues to be returned to the tariffs in any case).

Elia wants to clarify that its analysis shows that most market reaction is obtained below the proposed thresholds. Additional market response is indeed observed at higher price levels (but the higher the price level, the lower the statistical relevance due to limited observations). Elia also refers to the fact the observations on market reactions are confirmed by comparing two different methods (on observing system imbalance reductions and the schedules of large generation / storage units), as well as observations with other studies on market reaction in the day-ahead market (cf. E-CUBE looking at day-ahead market prices for the construction of the calibration curve of the strike price for the Belgian CRM). It therefore thinks the thresholds are justified.

Elia also stresses it does not propose to cap the imbalance prices, nor to reduce the maximum value of the  $\alpha$  parameter. It only proposes to temper the alpha at periods where imbalance prices are sufficiently high. In periods with high system imbalances and low flexibility, imbalance prices will still rise above 300-400 € and up to the current FRR activation price limits. It is in this price range that Elia doubts that the  $\alpha$  parameter brings large additional contributions to the balancing incentives of BRPs.

Finally, Elia also wants to refer to its answer to the previous question clarifying that bringing back the impact of the  $\alpha$  parameter to the level of 2020 is not the objective function of the calibration.

## 4. General remarks on the existence of the $\alpha$ parameter

### 4.1 On the principle of the $\alpha$ parameter

- Febeliec wants to stress explicitly that the mission of Elia is to maintain the system balanced and not minimize exposure of BRPs to the balancing price. In light of the trend of an ever more short system in the balancing timeframe, one could easily also argue that the alpha parameter should be even more strengthened.

Febeliec wants to highlight it is important to look at the *raison d'être* of the alpha component. The (original) alpha component was introduced because observations at the time of its inception showed that BRPs did not sufficiently (or sufficiently fast) react to imbalances in their perimeters and this for extended periods, thus quite negatively impacting the Elia ACE. Elia is of course only responsible for the residual imbalances, but at that time, the observation was that apparently the Elia imbalance tariff was in itself not giving a sufficient price signal to the BRPs. In order to create an extra incentive for BRPs to balance their own perimeters and reduce the residual imbalances, an alpha component was introduced once a certain threshold of imbalance was exceeded. Based on lessons learned, the alpha component was later strengthened in order to give an even better (faster increasing) price signal to BRPs. Looking at recent balancing market observations, Febeliec can only conclude that Elia is facing ever more often important imbalances (shown a.o. by the more frequent triggering of the alpha parameter). Alternatively stated, this indicates that BRPs collectively ever less succeed

to balance their perimeters and force Elia to cope with ever larger residual imbalances. It has also been shown by Elia that the Belgian system is showing a trend of becoming structurally short in the balancing timeframe.

As such (cf. previous remarks of FEBELIEC), and in order to give the best possible incentives to BRPs to maintain the balance in their perimeter (or help the system, at the condition that they can return to a neutral position whenever the system would need so), Febeliec does not support a modification (reduction) or abolition of the alpha parameter, but would rather argue for a stronger signal to BRPs (whether through the strengthening of the alpha parameter or some other, potentially additional, measures). Febeliec wants to stress again that a balanced BRP is not exposed to the alpha parameters, nor is a BRP helping the system, and neither are BRPs collectively remaining under the alpha threshold; only when BRPs collectively create an important imbalance, the alpha component is triggered to give an additional signal.

Elia agrees that the purpose of the  $\alpha$  parameter is to stimulate BRP's reaction in case of persistent, large system imbalances and shares the concerns of Febeliec about a (risk of) increase of the system imbalance over time if BRPs to not take adequate actions, particularly in view of increasing variable generation such as wind and photovoltaic power. Nevertheless, the  $\alpha$  parameter should remain an incentive to react and not be a mere penalty applied if the market reaction is insufficient to balance the system during periods where flexible means are unavailable to the market.

- Next Kraftwerke comments that in a good functioning system, flexibility is continuously traded back & forth to balance portfolios in the Day-Ahead (DA) market, the Intraday (ID) market and finally by responding to the imbalance price. In our opinion the alpha parameter creates a distortion in this balance, since flexibility could be reluctant to offer their flexibility to the DA and ID market if they can benefit from postponing the flexibility decision to real-time being strongly incentivized by the alpha parameter. This leads to an inefficient use of flexibility, allocated to speculation on the imbalance price, rather than an enabler for larger shares of to-be-balanced renewables in the system. This hurts renewable energy traders, who are paying the bill of this parameter (i) through a less liquid intraday-market (where alpha-based premiums can also be factored in) to timely balance their portfolio and (ii) through correlation of the system imbalance and forecasting errors on renewable power production.

Next to this, the alpha parameter disconnects the imbalance prices from reserve power energy prices. As a reaction in "reactive balancing" is awarded the alpha parameter, revenues in the imbalance market artificially exceed reserve power activation revenues, systematically favoring imbalance speculation over nominating flexibility as reserve power Energy Bids. This disconnection conflicts directly with the goals of increasing the liquidity in the Belgian reserve power markets, and more efficient reserve power markets.

Concerning the argumentation brought forward to justify the alpha factor it is important to note that an increasing reaction during periods with an alpha factor does not prove the positive impact of the alpha factor but can equally just show that :

- flexibility that might be activated earlier is withheld for the period of the alpha factor.
- an increasing reaction in reactive balancing that is supposed to be triggered by the alpha factor might equally be taken away from other earlier markets, in particular from the intraday market.

- An increasing reaction in reactive balancing might be from flexibility that is not offered on the reserve power market, because the activation price income is higher with the alpha factor.

The imbalance 'market' is a great lever for managing the system imbalance. This does however not mean that it is desirable to maximize this leverage, in any way. The alpha parameter distorts the efficient allocation of flexibility in market as it artificially increases the cost of flexibility for all players in all markets, and limits liquidity growth in the Intraday Market, contracted reserve power, and (non-contracted) Reserve Energy. The complete removal of the alpha parameter will reduce portfolio management costs throughout the energy market and therefore also directly reduce electricity sourcing costs for all consumers. Belgium in particular struggles with structural imbalance resulting from the hourly day market products and low liquidity on the intraday market. We therefore think that more effort to improve both these markets has a significant higher value than an alpha factor that rather shifts flexibility from one market to another.

Elia does not expect the alpha to create market distortions and discourage BRPs to offer flexibility on the day-ahead and intraday markets. The imbalance price, including the  $\alpha$  parameter propagates back into the intraday and day-ahead markets and intraday and day-ahead markets should remain equally attractive. In addition, Elia wants to remind that the  $\alpha$  parameter aims at limiting the increase in balancing capacity requirements, which removes flexibility from the wholesale market.

Regarding the disconnection of the imbalance prices from the reserve power activation prices, Elia reminds that both prices have different goals: the imbalance price incentivizes BRPs to keep and/or restore system balance of their imbalance price area in accordance with the Electricity Balancing Regulation, while the balancing energy price reflects the price of the marginal bid selected in the uncongested area by the activation optimization function of the EU balancing platform. In addition, Elia also stresses that not all flexibility necessarily qualifies for the product characteristics of aFRR and mFRR. In its design notes for aFRR and mFRR (and in the T&C BSP aFRR currently under public consultation), Elia proposes a market design that maximizes the possibility for BRPs/BSPs to seize opportunities on both the local imbalance "market" and the cross-border balancing energy market, by allowing BSPs to reduce the volume of free bids after balancing energy gate closure time. Thereby, the "competition for liquidity" between these two "markets" is minimized.

- FEBEG remains of the opinion that the alpha component should be removed when its added value cannot be demonstrated. As the need for this incentive is not clearly demonstrated at this moment and in the current market design, it should be put at '0'. Ultimately, FEBEG remains of the opinion that the alpha component should be removed when its added value cannot be clearly demonstrated. At this moment, a cost-benefit-analysis demonstrating the added value of the alpha component is lacking. According to FEBEG, the overall objective should be to design a balancing mechanism that allows to – to the benefit of the end consumer - maintain the balance of the system at the lowest cost. Simply "shifting" a cost within the energy market (in this case, towards the BRP) does not reduce the cost, because in the end the overall system-costs are born by the consumers. A cost-benefit-analysis potentially demonstrating the added value of the alpha component should therefore clearly illustrate the effectiveness and proportionality of the measures.

On the **effectiveness of the measure**, FEBEG seriously doubts the effectiveness of the alpha component. Indeed, we consider the alpha component to be simply a financial transfer from BRP's to ELIA without bringing a lot of advantages to the system as the BRP's have little means to react on moments of structural imbalances:

- the alpha component results in a leak of liquidity and unreasonably high intraday prices on moments of structural imbalances;
- the obligation to offer CIPU units to the mFRR product – in the future in an even more firm way - does not allow BRPs to optimally react against the alpha component;
- technical and operational constraints on assets do not always allow for a fast and adequate reaction;
- the discrepancy between the income from marginal mFRR price and imbalance price including the alpha component could have additional perverse effects such as higher mFRR capacity prices and lower liquidity from free mFRR bids from non-CIPU units;
- the alpha component did not initiate any major change in the BRP behaviour and did not lead to investments in flexibility. Several more important factors discourage the BRPs – notwithstanding the alpha component – to investment in flexibility:
  - the uncertainty and market risk;
  - complexity of the legal and regulatory framework, and product designs;
  - the cannibalization effect as an investment in a flexible asset could jeopardize the profitability;
  - the technical and operational constraints of certain technologies;
  - the instability of the legal and regulatory framework (design of the products, European harmonization, new interconnections (NEMO, Alegro, ...))
- uncertainty on the evolution of balancing prices with the PICASSO and MARI projects which is aggravated through the various derogations for many TSOs, delaying the full implementation of EBGL;
- huge efforts that are required to develop portfolio of demand response (complexity, operational and administrative burden, reluctance at customers side, not always strong business case resulting in low profitability, ...);
- ○ ...

The first analyses of ELIA backing the proposal for modification of the alpha component are confirming this view:

- the impact of the alpha component on the behaviour of the BRP's cannot be isolated: changing behaviour of BRP's might be induced by other drivers such as increased flexibility means, higher activation prices, bigger share of renewables, better forecasting, etc.
- at high imbalance price (e.g. > 400 EUR/MWh) further price increase doesn't trigger additional flexibility but just becomes a cost which ultimately be passed on to the end consumer.

To the contrary, FEBEG rather sees the alpha component as a huge entry barrier to new market players, which should be a concern for the regulators as it endangers the competitiveness of the overall Belgian market over the long run. Moreover, FEBEG notes that several important BRPs/suppliers have left the Belgian market in the period.

Last but not least, as already mentioned several times, the alpha component is a deterrent to the development of competitive PPAs, which is an essential element for further increasing renewables in Belgium. In the underneath overview the additional imbalance cost in EUR/MW is given per technology. The numbers are based on the DA forecast and production numbers from the ELIA website.

Elia takes note of FEBEG's opposition to the  $\alpha$  parameter and its request to urgently 'suspend or remove it. Elia refers to the justification and discussions with stakeholders when fortifying the  $\alpha$  parameter at the start of 2020. In general, the  $\alpha$  parameter is a dissuasive incentive incorporated in the imbalance settlement process to ensure that BRPs maintain their balance and in particular to avoid large and structural imbalances that would otherwise lead to a future increase in reserve capacity needs. During this revision of the  $\alpha$  parameter, the calculation of the alpha component was changed, so that stronger incentives are given to BRPs during high and structural imbalances :

- Alpha should respond more quickly to changes in the system imbalance and particularly impact in case of structural system imbalance.
- The impact of the alpha parameter in magnitude should be in proportion to the System Imbalance: the impact of the alpha parameter on the imbalance tariff should be larger for large imbalances than for small imbalances.
- In case of low system imbalances the need for an additional incentive is low therefore the alpha parameter can be low as well.
- In case of extremely high system imbalances the additional incentive of a continuously increasing alpha parameter is limited and should not serve as an unnecessary penalty.

Elia also reminds to the discussions of the first offshore integration study (2.3 GW) which was one of the main drivers to fortify the  $\alpha$  parameter. Elia remains convinced that the  $\alpha$  parameter provides additional incentives for the BRPs to balance their portfolios and the system. Although it is not possible to isolate the impact of the alpha on the system imbalance, the reaction of BRPs to imbalance prices is a fundamental element of the reactive balancing model, supported by a vast majority of Belgian market parties, and the reinforcement of the imbalance prices can only contribute to the reduction of the system imbalance. Elia also refers to a stable system imbalance during the last years, despite the large increase in variable generation installed. Removing this incentivizing component, *a fortiori* a few months before the connection to the EU balancing platforms and the (desired) tempering of imbalance prices that should result from a better liquidity of the balancing energy markets, does not seem prudent to Elia and is not supported by market parties bearing the costs of balancing capacity.

It should also be noted also that the alpha does not result in the transfer of costs to every BRP: it only allocates costs to BRPs aggravating the system imbalance, incentivizing them to improve their forecasts, invest in flexibility, etc. rather than socializing additional balancing capacity costs over all consumers.

Finally, FEBEG points to little means available to react on moments of structural imbalances, for various reasons which are listed in its response. Without entering into discussions on these reasons, Elia wants to stress that its proposal for amendment precisely aims at tempering the alpha during such moments of structural imbalances, when imbalance prices will be high.

## 4.2 On the need for a cost and benefit analysis

- On the proportionality of the measure, FEBEG explains that a proper cost-benefit-analysis should also demonstrate that the cost of the measure leads to an overall reduction of the balancing cost for the end consumer.

In other words, the additional risks/costs for the BRP's should be lower than the risk/cost reduction for ELIA. For the abovementioned reasons, FEBEG remains of the opinion that the added value is not demonstrated and therefore regrets that the alpha component is not removed or put at '0', pending additional analyses or considerations that would demonstrate the added value of the alpha component.

- ODE considers the proposed recalibration as a positive step towards reducing the balancing costs in the short term. The assessment that was performed by Elia clearly shows the imbalance costs have been rising in the past few years. The costs soared in 2021, causing a huge extra financial burden on the BRPs and producers of (renewable) electricity. Although it is positive that the proposed recalibration of the  $\alpha$ -parameter is expected to reduce the costs from early 2022, the financial burden of the  $\alpha$ -parameter as we witnessed in 2021 is of course, a big burden on our members. By definition, the use of price adders (like the  $\alpha$ -parameter) disturbs the market since the imbalance price should reflect the actual scarcity that exists. As we head towards a more integrated system where our balancing market is coupled to neighbouring markets, the  $\alpha$ -component again disturbs the market and increases the costs.

The costs and benefits of the added complexity, as well as all the risks involved, that the  $\alpha$ -parameter brings with it, should be thoroughly examined further. A thorough cost-benefit analysis needs to be performed to properly assess:

- If the  $\alpha$ -parameter really adds to a stronger reaction of the BRPs
- If the  $\alpha$ -component leads to lower costs for the end-user

In other words, are the costs that Elia saves by lowering the need for reserve capacity higher than the costs that are transferred to the BRPs? One does not solve the issue by placing the costs and burdens elsewhere, it just (might) become less visible, but it does not disappear. Any additional costs for renewables, should be avoided, as this would be contradicting to the long term ambitious to move towards a very high share of renewables.

- EDORA explains that « *En attendant une analyse plus détaillée des coûts et bénéfices du paramètre Alpha et de son rapport coût/efficacité relatif dans le maintien à l'équilibre du système, EDORA aurait préféré une mise à zéro au moins temporaire de ce paramètre, mais accueille néanmoins favorablement la proposition de recalibrage avancée par Elia, qu'elle considère comme un pas dans la bonne direction.* »

On the requests for a detailed and cost and benefit analysis of the  $\alpha$  parameter of FEBEG, ODE and EDORA: Elia stresses that the assessment attached to the consultation document confirms the positive relation between market reaction and price levels. Although Elia acknowledges in its assessment that it is very difficult, if not impossible, to isolate the effect of the  $\alpha$  parameter when assessing market reaction, this positive reaction justifies that an additional price signal given by the  $\alpha$  parameter contributes to the system balance.

In contrast, a cost and benefit analysis in which the cost of additional price adders for BRPs is set off against the benefits of the system was not envisioned in this study, and cannot be realized on the short-term. Obviously, a better understanding of market sensitivity to price signal will be integrated in the long term discussions, and where possible in a quantitative way, will be the subject of the long-term discussions.



On the proportionality of the measure, Elia wants to remark that a fair allocation of costs is also of importance: the BRPs should be incentivized to limit their contribution to the system imbalance and to the cost of balancing capacity (see also reaction in section 4.1).

## 5. Remarks on the need for discussions on long-term modifications

- EDORA explains that : « *EDORA n'en demeure pas moins intéressée et prête à contribuer à une telle analyse en profondeur et estime que, si celle-ci devait conclure à l'inefficacité du paramètre Alpha, elle devrait pouvoir déboucher à terme, sur une suppression définitive ou une révision plus fondamentale de celui-ci.* »
- ODE thinks the discussion about the use of a price adder should definitely be continued, certainly in light of the future developments regarding real-time pricing related to the consumer-centric market design. We are, obviously, against any distortion of the market signals or functioning, especially when this leads to additional burdens (costs, risks) that could slow down or hamper renewable energy expansion.
- FEBEG is looking forward to and is willing to contribute to the in-depth reflections on the future evolution of the imbalance price in 2022 and beyond. This is a very important topic for FEBEG and further discussions should start from basic market principles such as stated above. These are key elements to enable and foster a well-functioning reactive balancing system. FEBEG welcomes and supports the initiatives of ELIA to organize a debate and in-depth reflections on the future of the imbalance price anticipating future market evolutions. FEBEG is also convinced of the need of this debate and is willing to contribute to developing a view on such evolution of the imbalance price.

FEBEG is concerned about the risks linked to arbitrary set imbalance prices. Ideally, the imbalance price reflects as much as possible the real value of energy. An arbitrary set imbalance price – based on administratively set components – might create some undesired effects, such as:

- Distortion of the price signal : indeed, article 44.1(b) Electricity Balancing Guideline (EBGL) states that the imbalance settlement price should reflect the 'real time value of energy'. The real time value of energy naturally takes account of the risk of scarcity. Therefore, if properly set according to the EBGL principles, the imbalance settlement price mechanism should de facto provide an adequate price in situations of scarcity. As a result, adding an administrative component would be distortive since it would reduce the ability of imbalance prices to effectively reflect the real time value of the energy and would jeopardize the proper signaling function of an efficient imbalance settlement price. It would create counter-incentives and thus trigger inefficient behavior by BRPs.
- Distortion of the level playing field between countries : in addition, since the imbalance settlement harmonization proposal recently proposed by ENTSO-E did not provide any harmonized methodology for such an administrative scarcity component, FEBEG is concerned to see national uncoordinated adders to be developed. The EBGL foresees an integrated balancing market. Implementing such administrative component in a non-coordinated way would lead to different imbalance price



behavior with similar imbalance volumes in the different control areas. This would be a threat to level playing field in the European electricity markets.

- Contradictory to measures to reduce the occurrence of price spikes : the Pricing Proposal currently under consultation by ENTSO-E introduces the new concept of a Balancing Energy Pricing Period (BEPP). One of the objectives to introduce the BEPP is to reduce the occurrence of price spikes. FEBEG questions why on the one hand measures are being formulated to suppress the real-time value of energy, while on the other hand 'incentivizing components' such as the alpha component are necessary to artificially increase the imbalance settlement price. It would be more efficient, more market-based and more transparent to avoid all such artificial interventions into the balancing prices and instead allow the market to function properly.

FEBEG emphasizes the importance of a stable imbalance price design. Investments in flexibility means require a favourable investment climate. To create such a climate, several conditions need to be fulfilled. A stable and foreseeable regulatory framework is in this respect a 'condition sine qua non': therefore, FEBEG urges for a stable imbalance price design reflecting as much as possible real-time value of energy in the market. An imbalance price which needs to serve other objectives than just reflecting the value of energy in the market risks to have to be adjusted frequently in function of the objectives to be met and risks to become very complex as unintended side-effects need to be managed, which is already the case with the alpha component. The addition of adders obviously creates additional administrative burdens as it will require further tweaking: these adaptations triggers long and difficult discussions on the identification and the magnitude of the parameter to be changed. This results in complexity, uncertainty and changing market circumstances which will discourage - rather than encourage investments - in flexibility means.

- BOP explains that in the longer term, the alfa parameter should be revisited and re-discussed in a profound way for several reasons:
  - to make sure the design is optimally fitted for the purpose, i.e. providing the right incentives to BRPs to better balance their portfolios. If however, due to other (more structural) concerns in the flexibility market, BRPs are technically not capable of perfectly balancing their portfolio, the alfa component merely serves as a financial punishment, rather than an incentive. In the end, any cost resulting from a suboptimal balancing market design will be translate into a cost for the consumer;
  - to create a more stable design, including elements that go beyond the imbalance price, that can last for many years. A proper working balancing and flexibility market will be crucial to integrate large amounts of renewable capacity and to facilitate a successful energy transition in general. Short term and temporary modifications are not helpful in creating a stable market environment. Long term visibility and stability are however essential to attract investments in flexibility and improve the balancing means in the market. The academic literature is not supportive of administrative price-adders, and on the contrary argues for a harmonised real-time price;

- to better justify the effectiveness of the alfa-parameter with a profound analysis. Although we appreciate all the work done by Elia in a very short time period, the analysis and impact assessment justifying the current recalibration is rather limited to support the usefulness of the alfa-parameter for the long run.

Elia is very pleased by the willingness of the market to engage in discussions on the longer term design of the balancing aspects. Elia confirms its intention to pursue the discussions initiated on the “real time price” with a view to define with market parties the adequate price signal to balance the system in the context of a cross-border balancing energy market and of the necessity to stimulate decentralized flexibility response. A dialog has been initiated already with several key stakeholders and with the WG balancing and will continue in 2022 (a follow-up workshop is already planned with the WG Balancing on 20 January 2022). Elia takes note of the remarks given and will integrate this in the in-depth reflections on the future of real time price.



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