COMMENTS ON BULGARIAN IMPLEMENTATION PLAN

(Published by DG Energy for a public consultations at: https://ec.europa.eu/energy/consultations/consultation-bulgarian-market-reform-plan_en)

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The document published for discussion Bulgarian Implementation Plan (hereafter – BIP) should be considered in accordance with Article Article 20 of Regulation 2019/943, namely "Member States with identified resource adequacy concerns shall develop and publish an implementation plan with a timeline for adopting measures to eliminate any identified regulatory distortions or market failures as a part of the State aid process."

We welcome both goals and have been advocating for the full liberalization of the power sector in Bulgaria, deeper market reforms and improving the quality of both the regulatory framework and decisions for more than 20 years. However, we have some reservations regarding some of the measures and the proposed timeline for their implementation.

We understand the reasoning behind the proposed termination of the two PPA of TPP Maritsa East 1 and 3, however, we believe this step to be extremely difficult in regard to its legal, financial, and technical aspects. We understand that this is a crucial step in the ongoing process of approving State Aid for the introduction of a Capacity mechanism in Bulgaria, however, we believe that the integration of the two power plants with long-term contracts in the liberalized market is possible and can be done at the appropriate time, following the implementation of a number of important market reforms.

Currently, the BIP proposes the termination of the PPA by end June 2021, which then will be followed by removing the existing quotas and the role of the public provider, and the introduction of a Capacity mechanism. Although the Plan envisions the latter steps to be implemented "immediately after" the termination of the PPA, we have considerable reservations that the Government will stick to this time line. Our concerns come from the bitter experience with reforms in the power sector:

- The recommendations from the European Commission and the World Bank in 2013 were only partially implemented and with considerable delay;
- The introduction of the Day-Ahead Market came only after the Antitrust Procedure against the Bulgarian Electricity Holding was completed in 2015;
- Wholesale market reforms in 2018, relating to accusations of market manipulations, came only after serious backlash from industrial consumers;
- Last, but not least, this year there are two elections in the country – Parliamentary and Presidential – that coincide with dealing with the aftermath of the COVID-19 pandemic.

Reaffirming our concerns is quote from the Plan - "The impending termination of these agreements leads to further uncertainties around future market conditions" (p. 11). Should the introduction of the Capacity Remuneration Mechanism not happen immediately after the termination of the PPAs,[1]

[1] The background and context of the PPAs with ME1 and ME 3 should be taken into account by those who are not familiar with the last 25-30 years of history of Bulgaria's power sector. We give a brief list of the key circumstance in the Annex to these comments

which we believe is a high probability risk, there could be considerable and detrimental consequences for the sector, the economy and the General Budget, which are as follows:

a. A one-sided termination of the two PPA without a compensatory mechanism would create a maelstrom in the power market as both companies might stop their operations and take legal actions against the Government for breach of contract. Although both companies account for only 15% of installed capacity they are vital both for smooth market operations, including for covering household consumption, and for providing ancillary services (in its 2019 Price Decision[2] the EWRC points out that their profile in 2018 is far from baseload generation, which is no surprise as they are very maneuverable). ESO Statistical Yearbook for 2019 notes that during the winter, often due to their flexibility, TPPs in Maritza East compensate for lost alternatives (wind, photo voltaic or hydro plants and imports), supplying more than 50% of the consumption.

b. A sudden termination of the PPAs could translate into a 35-50% loss for the ME Mines and reallocation of social support funds in a situation of a severe fiscal stress due to COVID-19 pandemic of 2020 and the beginning of this year.

c. The social, fiscal and economic side effects of such a policy are not yet calculated but would be far from trivial, and the bulk would be concentrated in the Maritsa East Region.

d. The two TPPs employ more than around 1000 people, and the mines, supplying the plants with lignite, - 7300. Given the expected loss for the ME Mines, probably more than half of their employees will become redundant. Such "market" reform will necessitate substantial non-market subsidies to job losers and their families and would lead to a loss of human capital that otherwise would be needed for the transition to non-carbon future of Maritsa East.

The CRM could be considered as a possible compensatory mechanism through wich the above mentioned detrimental socio-economic effects could be avoided, however, that depends entirely on the structure of the mechanism. Judging from past experience – the renegotiation of the two PPA in 2013-2014 – this is a long and cumbersome process, which may take more than 12 months, and that is if there is an alternative proposition. In the IME's 2016 report – Market integration of power generating companies with long-term purchasing agreements[3] – we've looked at the approach used in Poland and Hungary. These case studies show that there could be an easy transition, given the government is cooperating with the private investors, the latter party has enough time to negotiate with the banking consortia, the European Commission is notified of the compensatory mechanism, which comes into effect with the termination of the PPA.

Although, the current may, somewhat, differ from their experience, the sequence of events should be the same. This way, the detrimental effect to the power market can be minimized, the negative socio-economic effects of a possible shut down of the two generation plants – evaded, and possible legal actions from the investors – avoided. In order for this scenario to be plausible and meet the BIP's deadline for PPA termination, however, the Government and investors need to be in advanced negotiations, which should have already started in 2020. Given the lack of public information on this topic, we assume that is not the case, which is the reason we have considerable reserves with regard to the proposed deadline.

[2] Price decision № Ц-19, 01.07.2019 (Решение № Ц-19 от 01.07.2019 г.)
[3] Available in Bulgarian - https://ime.bg/var/images/IME_Liberalization_Final.pdf

Throughout the years, including during the amendments to the two PPA in 2013-2014, both investors have shown good faith regarding market liberalization. The companies have repeatedly expressed their readiness for PPA amendments since 2007. Furthermore, both investment plans are based on the assumption of market liberalization, which was expected to come into effect by mid-2007. The start, however, was delayed by the Government in order to promote other priorities.

➢ Provisional impacts on investment.

BEMIP discusses needed investment and political risks associated with the power sector of Bulgaria on about 20 pages. The points it makes concern uncertainty and predictability of prices and regulatory affairs.

We think that if the Plan is to be adopted and implemented as proposed, the uncertainty will remain and will be reinforced.

a. The point BMIP makes is that in the future the FDIs are indispensable for the just transition of the Bulgaria's power sector but hides the fact that there is a years-long campaign against FDIs and these two plants in particular; only in 2019 there were 3,500 publication in the Bulgarian media against the PPAs and the two plants in question. This is not the case with any other coal plant operators in Bulgaria, rather the opposite – for most of them there are numerous reports about market misbehavior and political connections but no action by the authorities.
b. The preliminary termination of the contracts with the two power plants will create a mess in the legal order, which will mainly affect the current and future potential investors. The former will have problems finding an effective way to stop production, the latter will not be able to predict even the price of lignite to plan an effective investment. It also make it hard for new investors to determine the timing of when new capacity will be required. This adds to the risk brought forward by changes in environmental regulation and may further reduce the willingness for investors to develop projects.
c. With limited options for diversification of natural gas supplies and given the current energy import dependence (which including the nuclear fuel is about 76% according to latest BAS estimates), the decision proposed by the Plan will further increase both the costs of alternatives to lignite and the import dependency, especially of natural gas and oil from Russia.
d. It is not clear how the changes will affect the investments made in the energy sector and the attraction of new investors in the country. The investments are an important focus against the background of the forthcoming challenges related to the EU Green Deal for Bulgaria.
e. In the beginning of 2019, one of us was invited by the Ministry of Energy for an assessment of coal-to-gas transition costs; thus we found that by that time TPP Maritsa East 1 and 3 were the only operators that had prepared transition plans for the Green Deal.

➢ With regard to the market reforms, we are disturbed by the lack of more wide-ranging measures aimed at improving market efficiency.

a. The liberalized power market (or the electricity exchange, IBEX) is relatively young and characterized by tension, regarding hard to explain price movements, availability of market products, and outright accusations of market manipulation. The EWRC has started many investigations, the first one – in August 2017 – that are yet to be concluded and actions – taken.

b. The liberalized market is characterized by a high degree of concentration, as the EWRC points out in its annual reports since 2016. According to the regulator between 80% and 95%, depending on the market segment, of the power traded on the IBEX is generated by the three State-Owned Enterprises (SOEs) – NPP Kozloduy, TTP Maritsa East 2, and NEK. The Herfindahl–Hirschman Index for the three SOEs is 4700. Terminating the two PPA and integrating the generation into the market, while necessary, will not have a considerable effect regarding state-owned market concentration.
c. The installed capacity of both generations are a mere 15.5% of total installed capacity, compared to 62% for the three SOEs. In its 2015 Antitrust decision on the case BEH - Electricity[4] the Commission points out that "the Bulgarian thermal power plants TPP Varna, TPP Bobov Dol and TPP ME3, which are owned by third parties, have only limited capacity available to produce electricity for the free market since: (a) they are subject to quota obligations to supply electricity for the regulated market; and (b) they also supply electricity to the transmission system operator for ancillary services and cold reserve obligations". Although TPP Maritsa East 1 and 3 will no longer have an obligation to supply their generation to the regulated market, the same applies to the SOEs, however, the former will most likely supply electricity to the transmission system operator for ancillary services and cold reserve obligations, which will not improve market concentration.
d. Market coupling between Bulgaria, on one side, and Romania, and Greece, on the other, would improve market efficiency, but will also have a limited effect on market concentration, which was also pointed out in the Antitrust Procedure. Although the development of a power exchange may have alleviated some of the barriers to electricity imports, the interconnection capacity of the grid remains low – around 7-8% of total installed capacity.
e. A level playing field is not created and/or its framework is far from being implemented yet, vis-a-vis both public and private coal/lignite TPP. Due to cross-subsidization, "blind-eye" attitude to domestic polluting public and private operators (coal/lignite TPPs), direct subsidization of the tate-owned TPP Maritsa East 2, tax payers' coverage of costs of emissions, and the Government subsidizing the operation and infrastructure investments of the privately-owned TPP Varna. Furthermore, there are operators, which are misreporting on burning imported waste, with alleged harm to the environment (there are investigations by the state prosecution on this matter).[5]

Although the BIP proposes removing the existing quotas and the role of the public provider as soon as the second half of 2021, the envisioned full market liberalization at the retail level would continue as late as December 2024. There is not enough information as to the working of the retail market, including the future of the end suppliers. There are far too many possible scenarios for reforming the retail market – some better than others - and the lack of a roadmap for this, revolutionary for the Bulgarian power market reform, is deeply disturbing. We would recommend a more detailed approach with matrix of steps to be implemented, deadlines, responsible institutions, etc.

[4] https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=1_39767
[5] The BEMIP mentions these other plants just in passing, in the context of reviewing minor infrastructure issues but pays no attention to the regulatory privileges they enjoy.

Annex: The Background and Key Developments Associated with the PPAs of ME1 and ME3

1. Both PPAs were signed when Bulgaria had no other option to rehabilitate the system and meet EU environmental standards in the time of EU accession (after a period of 35-years of no new technology installed and a minimal to none observation of environmental standards): interest rates were high due to near default of GOB in 1996-1997 on its foreign debt, hyperinflation and costly (42% of 1998 GDP as estimated by IMF and the World Bank) banking crises. In parallel to concluding the contracts with ME 1 and ME 3, Maritsa East 2 received a special treatment as a beneficiary of a GOB-guaranteed, low-interest loan from the Japan Bank for International Cooperation.
2. Irrespective of some lack of clarity and contradictions between different political views and policy options and instrument, the Energy Strategies of Bulgaria had been always supportive for the investment for the entire period after 1998. The same can be said about the heads of the energy regulatory agency and the energy ministers for the period.
3. The agreements and the GOB guaranteed loan for Maritsa East 2 did not contradict the law (of both EU and Bulgaria), at the time of signing. An additional but important background of the PPAs was the need EU environmental standard to be met during Bulgaria's accession to the Union, ME 3 was the first TPP to become fully compliant with those standards, and then the next was ME 1. Other TPPs were allowed to operate below the standards.
4. The adoption of BEMIP as it is at moment would be somewhat beneficial for these plants but not ME 1 and ME 3.
5. Last but not least, the system was not liberalized not because of the MI 1 and 3 PPAs but because other not-fully-justified projects and plants (e.g. Hydro PP "Tzankov Kamak" and NPP "Belene" – recently freezed for a fourth time since 1985) were given a priority and this priority required a preservation of NEK as a single buyer; this situation of 2004-2006 motivated the postponement of the liberalization and market reforms in the power sector.