

Subject: FEBEG position on the public consultation on CRM Design Note: Auction process

Date: 30 October 2019

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Please find here below the FEBEG's reaction on Elia's public consultation on the CRM design notes (Part II). For the sake of clarity, a separate document has been made for each document under consultation. This document addresses the **Auction Process**.

Disclaimer

The present position is based solely on the documents submitted to consultation. The comments on specific elements are thus based on available information on this specific topic and might evolve as additional elements are clarified in future documents and/or public consultation. Obviously, the availability of all documents in a pre-final stage is required in order to provide a global overview allowing the stakeholders to take a final position on the matter.

1 Auction format

Main comment

The Auction format proposed by Elia in the Design Note is a single-round sealed bid, as opposed to its main alternative in a CRM context, i.e. the multi-round descending clock auction format. The drivers for this choice that are mentioned in the Design Note are:

- Limiting the potential for market power abuse
- Ensuring a level playing field
- Advantages in terms of complexity and flexibility.

FEBEG can relate to the underlying concerns of Elia, but is of the opinion that these concerns can equally be addressed with a multi-round descending clock format.

We believe effective competition and a level playing field will benefit most from a simple and low-barrier design. Irrespective of the Auction format; if the rules are too complex, effective participation of smaller players will be reduced. A competitive bidding process, by price discovery and transparency, will encourage competitive participation.

Several design features are available that could be introduced in the multi-round descending clock in order to further mitigate the risk of market power abuse: sloped demand curve or the price-taker/price maker distinction, participation of all pre-qualified capacity providers, ex-post investigation,...A number of these features are touched upon, but not really investigated in the Design Note. In this respect, FEBEG wonders why Elia departs from the assumption that in the descending clock auction format, the excess capacity after each round would necessarily have to be communicated. If only the price is known, bidders do not know how much volume is remaining which could alleviate concerns regarding competition.

Aside from the fact that FEBEG sees different, better solutions to address market power abuse and level playing field concerns, there are other benefits to a multi-round descending clock that are left unaddressed in the Design Note, such as:

- The fact that a number of European capacity markets already use a descending clock auction format, which could allow capacity holders, regulator and TSO to benefit from the experiences of such markets in Europe, which are faced with the same electricity target models. FEBEG observes that most market-wide capacity markets approved so far by DG Competition are based on the multi-round descending clock auction format (UK, Poland, Italy). The only capacity market that relies on the single-round sealed bid is the all-island Irish Capacity Market, but only for the interim solution. This specific auction design aims at taking into account the so-called “locational issue”.
- Additionally, if at some point a more regional capacity market would be considered, an accordance at this point with neighbouring countries is preferable.
- The fact that a multi-round descending clock auction format better allows a decreasing clearing price up to 0 EUR/kW in case there is no missing money.

1.1 Market power mitigation

We refer to our main comment. It might be worth recalling that without good market rules, market power abuse might be committed by any pivotal capacity provider, whatever the underlying capacity. In addition, the regulator has the means according to the Electricity Law to investigate situations as needed.

With respect to the case study in New England, FEBEG would like to point out that ISO-NE has not followed the advice regarding switching from the descending clock to sealed bid, even if this recommendation has been mentioned for a few years (see e.g. 2014 ISO-NE Market Assessment). FEBEG believes this illustrates that the advantages of a descending clock auction format with appropriate market monitoring still outperform a sealed bid.

1.2 Level-playing field

See main comment.

Conclusion

The arguments of Elia not to choose for a descending clock auction are incomplete and not in line with FEBEGs research. Therefore, FEBEG is questioning whether the management of the grid constraints could be the main driver to propose a single-round sealed bid. This is also the case for Ireland, which chose a single round sealed bid to manage “locational issues”. If this is the case for Elia, then Elia should justify its choice based on this argument rather than on implicit reasoning.

2 Pricing rule

The pricing rule proposed by Elia in the Design Note is a pay-as-bid pricing rule in the first two Auctions that will be organized (i.e. Y-4 Auctions in 2021 and 2022), to be replaced by a pay-as-cleared pricing rule in all subsequent Auctions (both Y-4 and Y-1) that will be organized.

2.1 Pay-as-cleared in the long-term

FEPEG explained in its position paper of May 2019 **that implementing a pay-as-bid pricing rule will not lead to a lower cost**. Indeed, a pay-as-bid pricing rule creates no incentive to reflect the real costs and drives the overall system costs upwards. This point is well documented in the literature and was for instance recognized in the EU capacity mechanism working group (2015):

*“With a pay as bid pricing rule, there may be greater potential for bidders to try and guess the clearing price rather than bidding their true costs, **which could lead to perverse outcomes and/or higher costs**”.*

The various benefits of the pay-as-cleared pricing rule are also confirmed as such in the Design Note:

“In the long-term, the pay-as-cleared pricing rule is considered the better choice in order to stimulate competition, provide a transparent price signal and allow Capacity Remunerations to tend to zero. Besides, the pay-as-cleared pricing rule is also the most widespread approach used in capacity mechanisms throughout the world. (...)

the pay-as-cleared pricing rule has the following advantages. Firstly, an efficient selection – i.e. selecting CMUs with lowest missing-money – in the Auction is guaranteed. Secondly, the Auction’s clearing price can naturally tend to zero when the missing-money in the market reduces. In contrast, under the pay-as-bid pricing rule, bidders never have a true incentive to bid in at zero. Thirdly, pay-as-cleared pricing provides a more transparent price signal over time towards the market. This information can be particularly valuable to small units and new market players, as it may give them a better idea about current and future expected market conditions, thereby encouraging participation over time. The transparent price signal under pay-as-cleared also facilitates the contractual arrangements small players could have to make with aggregators or other facilitators in the process.”

2.2 Pay-as-bid in initial Auctions

Nevertheless, a pay-as-bid pricing rule is proposed for the first two initial T-4 Auctions. This proposal is motivated by the fact that initially, a large number of new CMUs are expected that will have to compete with existing assets that require significantly less capex investments. Therefore, additional measures in the form of the pay-as-bid pricing rule are considered necessary.

However, FEPEG is not convinced of this rationale:

- The distinction between assets in terms of capex investments is exactly dealt with by the contract duration categories, to ensure that all capacities can be competitive in the same auction;
- This approach makes the system less transparent and understandable, especially for smaller parties;
- FEPEG is not aware of any European experience of a CRM using a pay-as-bid clearing rule while at the same time it is acknowledged that the pay-as-clear pricing rule is the more appropriate option;
- It is unclear at this stage which volumes will be auctioned in the first two initial T-4 Auctions, and which volumes will be reserved for T-1. It seems arbitrary to apply the pay-as-bid pricing rule for the first two initial T-4 Auctions as there is no certainty that these will indeed be the Auctions with large new volumes;

- This approach will create an unwanted distinction between capacity participating in Y-4 vs Y-1 for the same delivery year.

As a result, FEBEG strongly pleads for the implementation of the pay-as-cleared pricing rule from the start of the CRM for the reasons set forward consistently by FEBEG during the various task forces.

Additionally, FEBEG does not agree with equaling all inframarginal rents in the capacity market as windfall profits. We refer to the comments made in the FEBEG reply to the Design Note “Intermediate Price Cap”, which should be considered repeated here.

2.3 Switch from pay-as-bid towards pay-as-cleared

In any case, if the pay-as-bid pricing rule is retained temporarily (which FEBEG would deplore taking into account the argumentation in 2.1 & 2.2), FEBEG indeed strongly advocates to have a fixed schedule to ensure simplicity and upfront transparency towards all market actors.

3 Bidding requirements

3.1 General Bid requirements

- Design Proposal #3, second bullet: “Each bid shall include one single volume, one single price and the preferred Capacity Contract Duration component”. The price of a bid is a function of the contract duration, so the bid is only valid for the specified contract duration. The word “preferred” should be removed.
- What exactly is the difference between DP#3, third bullet point and DP#4? Shouldn’t DP#3, third bullet read “The volume of each Bid (...) **shall be equal to** the Eligible Volume”, as the Opt-Out was already applied at this stage?

3.2 Capacity volume of Bids to respect opt-out rules

See comment under 3.1 with respect to Design Proposal #4.

3.3 Linked Bids

Design Proposal #5: Linked bids are allowed for CMUs that are covered by the same signed technical agreement. This proposal raises a lot of questions. What would be the justification for this proposal? Does the expression “signed technical agreement” include existing connection contracts? How will Elia consider a site for which a connection contract is available for the existing capacity while a new technical agreement is agreed or connection contract signed for additional capacity? Is it possible to offer a CMU included in an existing connection contract but not the other CMUs included in the same connection contract (while they remain in the market)? Each bid should be able to be linked. Therefore, FEBEG asks Elia to clarify this condition of the ‘same signed technical agreement’: Why can Elia – during the prequalification not check if the proposed combination of bids is acceptable taking into account all available technical agreements or connection contracts for those bids?.

Additionally, FEBEG doesn’t see why the bid price or the capacity contract duration of two linked CMU’s could not be different: or both linked bids are rejected or both bids are accepted. In the latter case each bid will be remunerated according to the modalities

of the bid. As there's no justification to impose the same bid price or capacity contract duration, we ask for this design proposal to be reviewed.

3.4 Mutual exclusivity of Bids

Design proposal #6: FEBEG welcomes the fact that mutually exclusive bids are allowed. No limit on the number of such mutually exclusive bids is mentioned – is it correct to conclude there is no such limit? This would be supported by FEBEG as:

- Other factors can increase the need for conditional bids by market players, e.g. the definition of CMU (which has to be clarified), grid constraints etc...
- Allowing the mutually exclusive bids needed by market participants could increase the number of participating capacity (generation, storage, demand response) to the auction and, hence, increase the competition. This increase in competition should help decrease the cost for the consumers.

4 Auction clearing

4.1 Objective: Maximize social welfare

On page 19, FEBEG does not agree with equalling all inframarginal rents in the capacity market as windfall profits. We refer to the comments made in the FEBEG reply to the Design Note "Intermediate Price Cap", which should be considered repeated here.

4.2 Ensuring grid feasibility

4.2.1 *What are grid constraints and why are they needed for the CRM?*

- P.22, last sentence: "... before the CRM Auction": isn't it "before the GCT of the Prequalification Phase"?

4.2.2 *When are grid constraints related to the transmission grid needed in the framework of a CRM?*

FEBEG asks transparency on the methodology.

4.2.3 *Which drivers cause which types of grid constraints within the framework of the CRM?*

DP#10 on page 30, second point: does this mean that the auction may include other constraints, e.g. Fluxys or at DSO-level? Can Elia elaborate on this; what are the requirements for other external constraints to be included in the auction? And if not included, how will such external constraints be taken into account? Can these external constraints, for example coming from the DSO grid, interfere with the grid constraints on the TSO grid, or the other way around?

We would ask Elia to not only further elaborate on the external constraints, but also to ensure that – as for the other grid constraints – there's ex ante information available on the drivers for these external grid constraints and the resulting grid constraints are objective, transparent and subject to audits.

4.2.4 – 4.2.5

No comments.

4.2.6

FEBEG would like to get more insights of what Elia means with the following sentence:

“Indeed, application of grid constraints could result in a selection that minimizes total cost for society, with some unselected Bids with unity prices cheaper than the marginal selected Bid, due to the non-acceptance of their coexistence with the other EDS-Bids in the set to ensure grid feasibility.”

Does it mean that cheaper bids in the auction might be rejected because they would be more expensive from a total cost for society perspective (if we would include grid adaptations to facilitate this connection)? Can it then also be concluded that the CRM cost would be higher due to the cheaper bids which were not selected? In this case, the higher CRM costs should be justified by documented lower cost for society.

4.2.7

No comments.

4.3 Tie-breaking rules

In case of tie-break at social welfare and carbon emissions level, Febeg proposes to let the concerned capacity holders submit a new bid instead of applying a random selection. Since it could concern big investment, allowing the 2 players to make a second offer creates an opportunity to increase competition even further.

5 Treatment of Opt-Out Volume

FEBEG understands that a different approach is necessary for (i) participation to the secondary market and (ii) volume requirement, with respect to (i) the Y-4 vs Y-1 auctions and (ii) depending on different types of closure notifications.

Some elements in the proposed approach are however not yet entirely clear, see below.

5.1 Opt-out supported by definitive closure notification

No comments.

5.2 Opt-out supported by temporary closure notification

No comments.

5.3 Opt-out without closure notification

- What is the legal value (and consequences) of the motivation letter for Opt-Out Volume that will not be contributing to adequacy? What if the given reason does not realise in practice? (eg. the planned maintenance works are not executed).
- Below figure 18, should the sentence read “related to the Opt-Out Volume without a temporary closure”?

5.4 Prequalification fast track

For units that go through the fast track Prequalification Process, and are by default considered as Opt-Out Volume, it is unclear to us why they would have to make a choice between “IN” and “OUT” towards the Y-1 auction. They can in any event not participate to the secondary market, and this appears to be an extra administrative burden even though in the end they cannot be obliged in any way whatsoever to act according to their IN or OUT choice.

5.5 Other considerations and practical implementations

No comments.

6 Validation of auction results and transparency

6.1 Validation of auction results

Additional information on the validation of auction results would be welcomed.

6.2 Transparency on Auction results

6.2.1 Auction clearing price

No comments.

6.2.2 Offered & selected capacity

Which information will be shared on paradoxically rejected bids (following application of grid constraints)?

6.2.3 Opt-Out Volume

Will information also be shared on the volumes with choice OUT vs choice IN?

6.3 Transparency towards the start of the Delivery Period

The proposed publication of a yearly report with aggregated information on the Contracted Capacities for the Delivery Period is supported, to avoid that each market party individually would try to compile this information.
