

Febeliec answer to the Elia CRM Design Note on the Payback Obligation

Febeliec wants to strongly indicate that the answer on this consultation is at best partial as it has currently **no** view on **all** the different pieces of the puzzle concerning the introduction of a Capacity Remuneration Mechanism in Belgium based on reliability options as described in the Electricity Law. Febeliec reserves the right to come back on any of the comments made in this answer, as it has at this point no complete overview and as such can under no circumstance be asked to provide a thorough and complete position.

Febeliec urges Elia but also CREG and the Federal Public Service Economy as well as the Cabinet of the Minister of Energy to provide as soon as possible and in any case before the introduction of the final design for a CRM in Belgium a complete overview of all the intertwined components of the CRM design, including the legal texts such as Royal Decrees and modifications of the Electricity Law to bring it in line with amongst others European legislation, in order to be able to get an overall view on the implications and modalities of the introduction of the CRM to Belgian consumers and the overall energy markets.

With respect to the current proposed design note on only the topic of the payback obligation, Febeliec wants to provide these first preliminary remarks, within the scope described above:

- Febeliec takes note of the description of Elia concerning the concept of reliability options and payback obligation, and agrees that theoretically it contributes to the avoidance of windfall profits, yet does not see how this goal could be achieved in the implementation without applying multiple strike prices as otherwise this would create barriers for entry (especially for technologies such as demand side response with high activation costs). Elia itself writes in the document that *“especially in the strike price design, the level of the strike price – if not well calibrated and not well embedded within a larger design – could risk to constitute such a barrier for entry”*.
- Febeliec also wants to make a clear statements with respect to the criterion of *“overall complexity avoidance”* as referred to by Elia. This criterion is not described in the law and while Febeliec is of course inclined towards, ceteris paribus, a less complex solution, this non-mandatory criterion should be at best only a secondary consideration and should as such not carry any considerable weight in the design choice. Febeliec prefers a robust design which respects the legal criterion of least cost of the CRM, yet maybe more complex, over a simple design that does not comply to this legal criterion nor provide a robust design.
- On technology neutrality, Febeliec is surprised to read that Elia designs the rules *“in order to make sure that all realistically potential technologies are able to participate in the CRM”*, thus directly going against the concept of technology neutrality as some party (Elia?) will have to decide which technologies are *“realistically potential”*.
- With respect to the limitation of the overall CRM cost, Elia states that *“it could be that giving in slightly at one place in the CRM design could leverage more positively in terms of cost management elsewhere”*. While Febeliec is in support of an overall cost optimization, Febeliec does not agree with the proposal by Elia as Elia has not even provided one single quantitative analysis on the total cost and the individual impact of the different parameters nor the interaction of several on the total cost. As such the statement of Elia, while having some theoretical ground, is by no means validated specifically in this context and is as such thus

unacceptable to Febeliec. Febeliec can for example not accept Elia stating that *“a desired volume and price effect in the primary auction is to be traded off with for instance the impact on potential windfall profits resulting from strike price choices”* as no indication of the impact in either situation is provided.

- On the overall payback obligation design, Febeliec regrets that Elia’s proposal does not look into multiple strike prices per auction, or even a strike price per CMU that is included in the bid into the auction, as Febeliec believes that this would reveal in combination with the level of capacity remuneration the real missing-money of a candidate, if any, and would remove much more windfall profits than the current proposal. Moreover, especially when a strike price is to be included in bids in the auction, this would also nullify the discussion pay-as-bid versus pay-as-cleared while not putting at a disadvantage technologies with high activation costs (especially if above the strike price). The auction process could even allow candidates to offer a (limited) number of combinations of strike price and capacity remuneration, showing the trade-off for participants between both. In any case, even under the current design proposal, multiple strike prices will apply, depending on the different contracts (contract durations) that are active at any given moment.
- On the reference price design, Febeliec has no objections towards the proposal of Elia of using the day-ahead market price, as this is indeed a very well-known and transparent reference, but does only accept this in the current context. Scarcity itself still needs to be addressed on the basis of MWs, as the only true sign of scarcity in terms of price is a price level at the price cap.
- On the single versus multiple strike price discussion, Febeliec does not agree with Elia and refers to its previous comments on that topic. Moreover, Febeliec does not agree with Elia that complexity is to be used as a criterion in this discussion; the least cost of CRM remains for Febeliec the only criterion that is relevant in this discussion and under that criterion multiple strike prices provide a better outcome. In any case, Febeliec does not at all agree with the statement of Elia that *“the impact of a single strike price towards the proper functioning of the energy market is more limited. For the energy market, it is relevant to understand how capacities active in the market are impacted by payback obligations and at which price levels those obligations become active”*, as at any given moment and as discussed above multiple different strike prices, resulting from different auctions, will in any case be active. This argument of Elia is thus irrelevant. Febeliec is also surprised that Elia states that *“notwithstanding that it looks appealing at first glance to differentiate between strike price levels on a technology basis, particularly when dealing with the objective to avoid windfall profits and keeping costs low, a closer analysis reveals that this is not straightforward”* as this does not address the issue of the windfall profits and their avoidance, in which context Febeliec strongly refers to the least cost criterion, defined by the law, as opposed to the self-declared complexity criterion of Elia. Febeliec regrets that Elia does not come up with a design that copes correctly and sufficiently with the issue of windfall profits and refers in this context to its proposal for participants to the auction to bid in a desired combination of capacity remuneration and strike price.
- Febeliec takes note of the argumentation of Elia in favour of a single strike price, yet remains with the concern that for technologies with a high(er) activation cost, a single strike price creates a competitive disadvantage, while for those with a low(er) activation price it leads to windfall profits. This creates for example in most cases a very stark contrast between generation and demand side response, putting the latter at a disadvantage as they will have to pay back even without having reached their activation price and thus having earned any money from the energy markets (while the former will in most cases have made substantial

profits) and in order to recuperate their costs to become flexible while also including this outflow of cash due to a too low strike price level as compared to their activation costs, they will have to include all this in their bids into the auction, outpricing themselves. Elia could for example also look into a solution under which CMUs with an activation cost above the strike price level there would be no payback obligation until the reference price has reached their activation cost level (e.g. through the mechanism of the declared market price), after which level they would be subjected to the payback obligation. This would avoid the “valley-of-death” zone for these CMUs, where they would have to reimburse while not having earned anything on the energy market yet (as prices have not surpassed their own activation cost level).

- In general, the strike price must be set at that level of the reference price that justifies reimbursement of obtained capacity remuneration and thus avoids windfall profits, in order to come to a balanced CRM where missing money, if any, is remunerated at the lowest possible total cost for society. In any case and in the strongest possible way, Febeliec objects categorically towards the proposal of Elia to update strike prices of existing contracts towards the last known strike price whenever they are switched between parties on the secondary market, as this undeniably leads to an open door for gaming. Any parties with existing contracts will have a clear incentive to swap their obligations whenever a higher strike price than the one in their contracts occurs, as this would reduce their payback. This would thus reduce the flowback of unneeded and undue remuneration towards society, increasing the overall cost of the CRM, while not providing any additional value (other than potentially simplicity for Elia). This proposal is undeniably and as also already discussed in length during the task force meetings, in breach with the least cost criterion. Febeliec does not even understand why Elia in its design note has proposed this design as it was already shown before the publication of the design note that this design was unsatisfactory and not compliant with the law. For Febeliec, any swap of obligations between actors should not lead to any additional shift of risk from those actors towards the collective, as this would entail a privatisation of profits and a socialization of costs/risks. For Febeliec, strike price should be maintained at any swap of obligations, with the involved parties bilaterally agreeing on how to treat the risk exposure of each involved party. Alternatively, Elia could for example also look into a solution where the strike price will be determined based on an in advance known formula, which would be updated yearly for existing as well as new contracts, thus having at any point all active contracts under the same strike price.
- On the calibration methodology of the strike price proposed by Elia, Febeliec remains concerned as Elia refers to a rolling window of historical DAM curves, while at no point in recent history has there been any real indication of scarcity (prices reaching the price cap or tending towards it, except for specific anomalies not related to scarcity). Febeliec thus wonders whether this approach has even any validity in a discussion on scarcity and adequacy. Moreover, Febeliec also notes that Elia for this methodology will be assessing only weekly peak hours during the winter period, which indeed seems to refer best to any potential moments where system adequacy might be endangered in Belgium in the future, yet still wants to maintain a CRM for all months of the year, with, as also shown by this approach by Elia, not any significance of the non-winter period. Febeliec reiterates thus its proposal to limit the CRM to only the winter period, based on this methodological proposal by Elia. Febeliec furthermore has a conceptual problem with the proposed approach by Elia, as it omits the simple block bids, linked block bids, exclusive group bids or loop block bids as these are not directly visible in the curves; as already addressed by Febeliec at earlier moments, the proposed approach by Elia will undeniably underestimate the potential of demand side

response/market response in the market, as it will also in the discussion on the volume determination.

- Febeliec also has fundamental issues with the pseudo-quantitative approach proposed by Elia for the calibration of the strike price, as the “% in volume” approach gives a range of values (quantitative, even though Febeliec does not adhere to this proposal of Elia) after which Elia will select any value in that range it deems relevant based on its “interpretation of the curve”, which does not sound like a sound and unambiguous approach to Febeliec. In any case, when Febeliec takes into account figure 16 of Elia, it sees rather a clear case for several strike prices (e.g. three, as also indicated by Elia with the orange circles) based on technologies. For Febeliec, this figure is a clear indication that any methodology with a single strike price will never lead to a limitation/avoidance of windfall profits while providing a level-playing field for all technologies and shows that only a solution with multiple strike prices could lead to a correct outcome respecting the legal criteria.
- On the load following ratio, Febeliec understands that Elia tries to find a solution to avoid that participants would have to pay back on a bigger volume than is actually needed/sold in the energy market and while Febeliec appreciates this endeavour by Elia, the proposed approach does not resolve this issue but on the macro level. For individual participants, this rather aggravates an abovementioned discrimination between low and high activation cost technologies, as the former will have their entire volume activated in the energy market, yet will only have to pay back on the lower load following volume (thus increasing their windfall profits), while those with a high activation cost will only see slightly limited their pay back volume, yet they will still be bleeding cash they have not earned in the energy market (as they have not been activated and only need to pay back slightly less). In comparison, they will be worse off than those with low activation cost and higher windfall profits.
- Febeliec appreciates the stop-loss limit proposal on the payback obligation, as this clearly limits the risk for the participants, but two major questions remain. First and foremost, will this stop-loss limit not lead to problems with adequacy in case a participant has already reimbursed his total CRM outcome. It is important that there remains sufficient incentive that the participants remain active in the market even when their full remuneration has been reimbursed, as otherwise system adequacy might come at risk after that point. Second, for technologies with high activation costs, this stop-loss could still result in situations where their full remuneration has to be paid back, while not having earned any additional income on the energy markets, which would mean that their investment costs (e.g. to make their installations flexible) would not at all be earned back, as opposed to technologies with low activation costs, who would not have had to pay back everything and would even have earned windfall profits in almost all situations. Febeliec thus asks Elia to revise the proposal, in order to create a level-playing field as this otherwise would also create an additional negative effect for high activation cost technologies, which they would have to price into their bids, thus making them less competitive, to the detriment of the system and the system cost.