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Public consultation on the scenarios, sensitivities and data for the CRM parameter calculation for the Y-4 Auction for Delivery Period 2025-2026

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Centrica Business Solutions comments

June 5th, 2020

Summary of remarks on the intermediate price cap

- CBS strongly supports Elia's proposal to not follow the Fichtner report and to include market response in the short list of technologies.
- CBS however believes that at least two categories of market response should be considered in the short list:
  - one that can and will earn revenues on ancillary services (FCR, aFRR, or mFRR);
  - and one that cannot and therefore won't earn any revenues on those markets, and is also likely to earn little to no money on the energy market.
- CBS finally renews its concerns regarding the risk of exclusion of certain market response MWs. Although being competitive in the CRM merit order, market response MWs presenting the following characteristics risk to be unduly excluded from the CRM:
  - little CAPEX, i.e. not eligible to the absolute price cap for multi-year contracts;
  - high fixed O&M, i.e. much higher than the 20 or 40k€/MW/y of the table.

CBS strongly supports the proposal of Elia to not follow the Fichtner report and to include market response in the short list of technologies

Market response does constitute a diverse technology class, with a wide range of costs (being CAPEX, fixed or variable O&M). However, this statement does not justify the exclusion of this technology class from the short list of technologies that will be considered for the assessment of the worst performer on the market in order to calibrate the intermediate price cap. CBS therefore strongly supports the proposal of Elia to include market response in the short list of technologies.

CBS however believes that at least two categories of market response should be considered in the short list: one that can and will earn revenues on ancillary services (FCR, aFRR, or mFRR), and one that cannot and therefore won't earn any revenues on those markets, and is also likely to earn little to no money on the energy market

While as of today most of market response MWs (especially demand response) are active on the market through participation to the mFRR, where they can capture an availability fee that constitutes if not all at least the vast majority of their revenues, the untapped potential of market response that remains in Belgium will likely not be eligible to participation in the ancillary services (typically with reaction times that are too slow), and will only be offered on the energy market.

With activation prices that are likely to position those MWs at the right side of the merit order, as extreme peakers to cover the very last hours of the demand curve, the revenues such MWs will obtain from activations on the energy markets are likely to be very low, if not zero during most of the years.

Therefore, it is key that for such market response MWs, the calculation of their missing money in the process of identifying the worst performer in the market and calibrating the intermediate price cap takes into consideration little to no revenues from the energy markets as well as from ancillary services.

CBS finally renews its concerns regarding the risk of exclusion of certain market response MWs. Although being competitive in the CRM merit order, market response MWs presenting the following characteristics risk to be unduly excluded from the CRM: (i) little CAPEX, i.e. not eligible to the absolute price cap for multi-year contracts; (ii) high fixed O&M, i.e. much higher than the 20 or 40k€/MW/y of the table

As presented during Elia's CRM Task Force of November 21st 2019 (cf. slides in the Annex for more details), the current design has a blind spot on capacities with high fixed O&M costs and CAPEX which are not high enough to be eligible to multi-year contracts, and therefore to the absolute price cap.

Fixed O&M costs result from the need to remunerate a consumer taking part to a demand response program: indeed, demand response MWs are not built with the primary intention to take part to the market and deliver MWs, but rather to produce goods and services, and to generate value from consuming the electricity. Therefore, DR being a secondary usage, the consumer will ask for a remuneration to cover the burden of this participation.

For the low hanging DR fruits in Belgium, the available flexibility from a single consumer can be counted in MWs. A large part of the untapped remaining DR potential will however involve levels of flexibility typically below the MW threshold. For such sites, with a remuneration from the market or the ancillary services that remains function of the capacity provided (€/MW or €/MWh revenues), overall revenues are likely to be insufficient with historic prices and costs of DR (i.e. the 5 to 15 k€/MW/year fixed O&M costs listed by Elia in the table).

For such sites, the consumers are therefore likely to request higher €/MW or €/MWh prices for overall revenues to remain at levels that will cover the burden of participation. Typically, an industrial consumer will require a certain remuneration threshold to take part to a DR program, else the project will be de-prioritized compared to more important financial challenges at stake.

CBS therefore insists on the fact that elements like an incorrectly calibrated intermediate price cap in the CRM could constitute a blocker to tap the remaining DR potential in Belgium.

In the case actual O&M costs are higher than the ones used to calculate the missing money of the worst performer among the shortlisted technologies in order to set the intermediate price cap, such capacities would unduly be excluded from the CRM, although being competitive:

- Example 1: let's consider a 1 MW market response capacity (from Demand response) taking part to the Y-4 auction. It will be in competition with technologies eligible to multi-years contracts, i.e. which usually have lead times requiring them to take part to the Y-4 auction. Those competing technologies will be able to bid up to the absolute price cap, based on a net CONE starting with a cost of a new entrant up to 80k€/MW/year. The market response MW however will see its bid capped at the intermediate price cap level, based on a missing money starting with fixed O&M costs which according to Elia's table will at the most be around 40k€/MW/year. That's two times lower than the absolute price cap. If the market response MW has O&M costs which are higher than 40k€/MW/year, and/or faces an intermediate price cap which is lower than its estimated missing money, it will not be able to bid as high as the MW eligible to the absolute price cap. As a result, the auction is likely to clear having selected the more expensive MW of the competing technology, rather than the market response MW which got rejected due to the intermediate price cap limitation.

- Example 2: let's consider the same 1 MW market response capacity taking part this time to the Y-1 auction. It will likely be in competition with technologies equally capped at the intermediate price cap. In this configuration the risk would be to not select the market response capacity, because it is not allowed to bid above the intermediate price cap (and therefore not alloced to cover its expected missing money), leading either (i) the auction to not clear and see Belgium lack MWs required to guarantee the required level of security of supply in case there not enough MWs below the intermediate price cap, or (ii) force the MW to take part with the risk to not cover its cost.

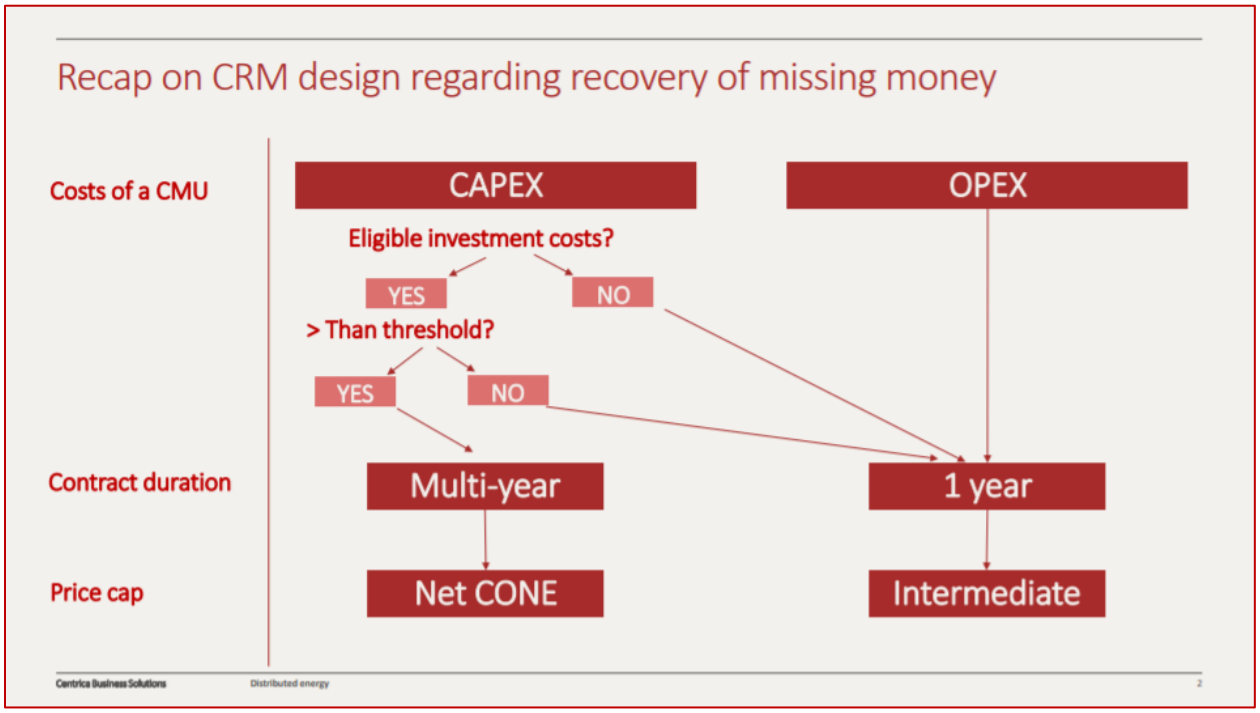
In order to solve these issues and remove the blind spot, CBS believes at least two options are available. **Importantly, none of these options requires to increase the intermediate cap**: this would indeed defeat the purpose of this cap, bringing it too close to the absolute price cap and creating a risk of unjustified cost increase of the CRM for the Belgian consumer:

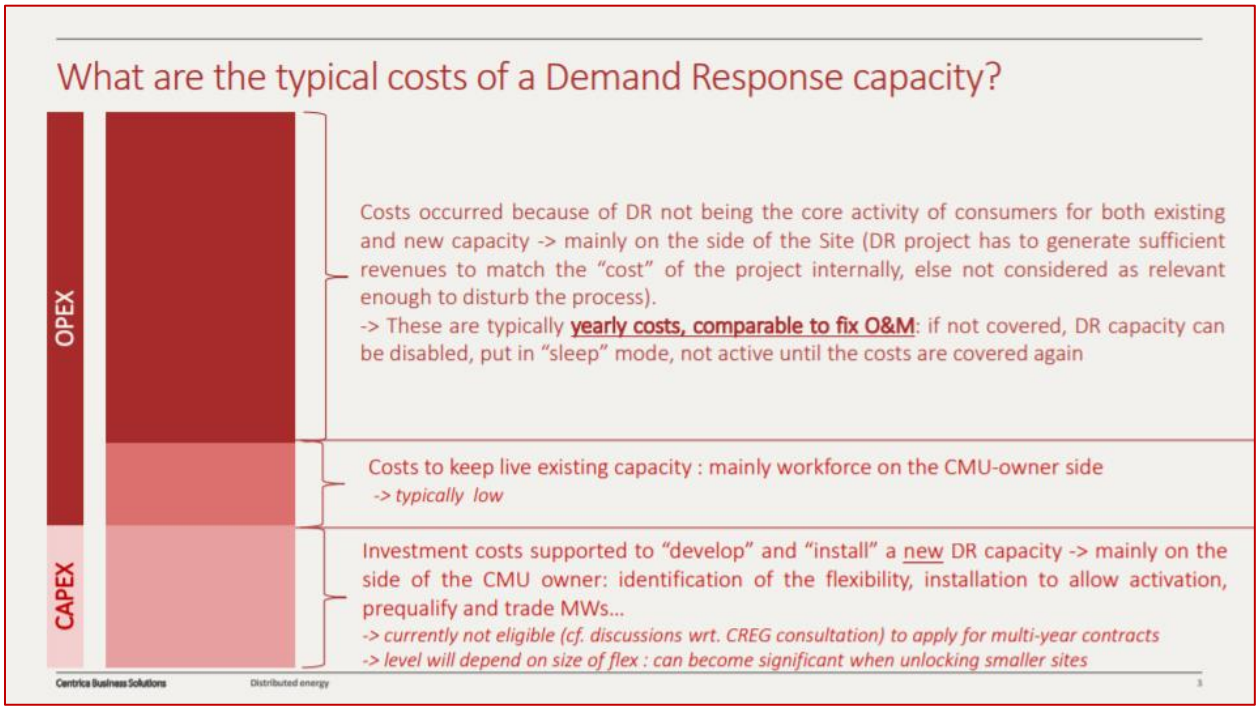
- Option 1: include the fixed O&M costs in the list of costs that are eligible for the multi-year contract threshold, and therefore avoid MWs with high fixed O&M costs to be limited by the intermediate price cap. As these costs are recurrent and occur each year, they can be compared to CAPEX, and therefore could justify application to multi-year contracts. This is however not CBS' preferred option, as it would require heavy changes to the documents framing the eligibility to multi-year contracts. Also, CBS understands the concerns around the need to limit multi-year contracts and believes that most market response MWs could be developed with one-year contracts, based each year on the needs.

- Option 2 (preferred option): exempt capacities from the intermediate price cap, if they are able to justify that their level of expected missing money (based on documented fixed O&M) is higher than the proposed intermediate cap, therefore making it impossible for them to compete on a level playing field with other technology classes in the CRM auctions, and creating a risk to increase the cost for end consumers.

CBS believes Option 2 is best suited to solve the issue without leading to an unmanageable burden for the regulator to analyze the derogations to the intermediate price cap applications that will be submitted by CRM participants. Indeed, the case identified should remain non-structural, as most of the technologies will be properly covered by the intermediate price cap calculation. However, CBS believes a solution is absolutely required, since the market response MWs at risk are key to close the capacity gap and to provide reliable MWs to ensure security of supply in Belgium, at the lowest cost.

ANNEX – Presentation of CBS in Elia's CRM Task Force of 21 November 2019 regarding the intermediate price cap





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There is still a large potential of untapped DSM 2.0 that can be competitive to provide new capacity to the Belgian grid.

- Low hanging fruits of DR are already identified and active on the market:
  - sites with important number of MWs available at once (> 1 MW)
  - and/or with ability to generate availability revenues from ancillary services (lower or no missing money)
- Next fruits are still competitive vs. building new plants for peakiest hours, but can be more expensive to catch and require CRM:
  - lower capacity per site (<1 MW)
  - no participation to ancillary services (less sophisticated/slower assets) = more missing money potential
- Demand Response CMUs are highly flexible (yearly O&M costs mainly): no lock-in of capex if selected in a 1-year contract ; they can be hibernated on a yearly basis
- Compared to the price of low hanging fruits, next generation of Demand Response still has an economic space compared to the net CONE (70k€/MW/y)

Questions around proposed CRM design

- **With the current proposal, we see only one available route for such DR MWs:**
  - DR will almost exclusively be eligible to 1-year contract, and therefore fall under the intermediate price cap
  - "missing money" could go up, close to the absolute cap: there is still an economic space and potential to be in the merit order (as long as cheaper than new built MWs getting multi-year contracts)
  - DR is a very heterogeneous technology class: need to ensure all MWs can participate and be selected if competitive
- **Questions:**
  (i) How would the intermediate price cap calibration take into account these DR MWs?
  (ii) Would this not defeat the purpose of the intermediate price cap, having it potentially close to the absolute cap (net CONE)?

CBS proposal

- **To allow for all DR MWs to take part and be selected (if competitive), and keep an efficient intermediate price cap feature, CBS proposes to adapt the CRM design elements based on the following:**

-> Allow DR CMUs to ask for a derogation to the intermediate price cap, based on the demonstration of a missing money (costs at least, also revenues?) >> intermediate price cap