Febeliec answer to the Elia CRM Design Note on the Auction Process

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 auction process, Febeliec wants to provide these first preliminary remarks, within the scope described above:

- Febeliec understands from the design note that the Demand Curve is not part of the Elia consultation and will be set in an administrative way. Febeliec however wants to stress that the demand curve is an essential element of the discussion on the auction process and the final CRM auction result and regrets that no consultation will be held on this demand curve. Febeliec hopes that there will be a consultation on the input data and methodology of the demand curve.
- Concerning the parties that can or have to participate to the auction as well as the opt-out volume, Febeliec will not repeat its comments here but refers to the relevant consultations and the comments it made on those documents.
- Febeliec appreciates that a consultation procedure for the stakeholders will be foreseen on an yearly basis on the market rules regarding the auction algorithm.
- Concerning the proposal on an auction format based on a sealed bid, at the current stage of the discussion Febeliec can agree with the proposed approach.
- On the pricing rule, concerning pay-as-bid (PAB) versus pay-as-cleared (PAC), Febeliec has a wide range of comments. The most important remark, which has still not been answered at all, nor by Elia nor by those others strongly advocating the introduction of the CRM, remains a clear explanation on the purpose of introducing under PAC an inframarginal rent in the CRM. Whereas Febeliec understands the value of inframarginal rents in the Energy-Only Market as a way for investors to earn back their fixed costs, Febeliec does not see any reason for allowing such rents within a CRM, as the CRM in itself should, if well designed, allow the participants to recuperate their, if any, missing money. Any additional affectation of monetary transfer from consumers above the required level results automatically in windfall profits for those with an offer below the price-setting offer in the auction at the cut-off point between supply and demand and as such goes diametrically against the least cost of the CRM criterion described in the Law. Febeliec will comment on the reasoning provided by Elia in the design note, but strongly regrets the omission of any rebuttal of the above reasoning of Elia,

presented since the beginning and at numerous occasions throughout the discussion on the CRM.

- On the argumentation by Elia that a PAC mechanism allows the outcome to tend towards zero, even though theoretically correct, any level above zero will automatically lead to windfall profits for all participants other than the marginally selected party.
- Elia also correctly states that when a bidder knows he is pivotal and as such is able to influence market prices, he has an incentive to bid in higher than his real expected level of missing money (insofar there would be any missing money); Elia states that such effect "*should be avoided by means of adequate market power mitigation measures*", yet it is unclear which those measures would be nor how they would be implemented and enforced. And even in case such measures would be implemented and successfully enforced, this would still not provide any solution to the unneeded inframarginal rents and thus windfall profits that will be given to all selected bids (safe for the marginally selected one, insofar the level correctly reflecting its real missing money).
- On point 1.3 on complexity and flexibility of the auction format, Febeliec is of course inclined towards, ceteris paribus, a less complex and more flexible solution, yet these criteria should be at best only secondary considerations 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 and flexible, over a simple and flexible design that does not comply to this legal criterion nor provide a robust design.
- Last but not least, Elia states that "*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*", but Febeliec wants to stress that this effect is not guaranteed (Elia also correctly states "can" and "may"), while results from the past are not necessarily a good predictor of the future, as can also be seen for example in the balancing market or many other markets, as market fundamentals and competition will be much more determining. This argument thus does not carry much real weight according to Febeliec.
- On Elia's proposal on pay-as-bid for the first two Y-4 auctions, Febeliec does not necessarily agree with Elia stating that "*given the anticipated Belgian adequacy situation towards 2025 requiring new investments*" as no analysis compliant with the Clean Energy Package has been conducted in Belgium and other studies than Elia's Adequacy and Flexibility study, which is not compliant with the CEP, do not reveal such need. Although Febeliec does not agree with the switch to a PAC auction mechanism, it would like to see the argumentation on the choice to switch from PAB[1] to PAC after the first two auctions and not after a longer period of time, taking into account the first Y-1 auction as well[2]. Competition between new and existing capacity

[1] Elia states correct that PAB cannot avoid inframarginal rents entirely, yet for Febeliec it is clear that PAC can **never** avoid undue inframarginal rents, which Elia in the context of CRM correctly considers as windfall profits. Febeliec cannot understand why for the design of CRM Elia persists in proposing a mechanism that cannot avoid under any circumstance aforementioned windfall profits and as such is by concept not in line with the least cost criterion and in any case is not defending the interest of consumers.

[2] On the level of bids under PAB, Elia states correctly that "*uncertainty might induce lower missing-money participants to bid in lower than the would-be market clearing price under pay-as-cleared*" because otherwise

in the first Y-4 auctions and whether or not new capacity will still be contracted in the Y-1 auction is strongly dependent on the correct analysis of the auction volume reserved for the Y-1 auction for the delivery year.

  - Febeliec strongly opposes Elia's statement "*note that the CRM as being deployed in Belgium is conceived as a remuneration mechanisms complementary to the energy market (incl. ancillary services) to ensure that capacity providers are capable to cover their costs including a reasonable and fair rate of return*" as this is not correct and definitely not in line with the Clean Energy Package, which states that a CRM can only be introduced as a last resort measure to solve system adequacy, and thus not as a mechanism to de-risk assets of capacity providers. Both might coincide but the de-risking can by no means be the purpose of any CRM. Elia states however correctly that ancillary services should be included in the analysis and that any CRM should only cover the residual part, the so-called missing money, insofar there is any.
  - On the switch from PAB to PAC, and notwithstanding the abovementioned remarks, Febeliec takes notate that Elia states that this is done "*to avoid as much as possible inappropriate CRM inframarginal rents , which are to be considered as windfall profit in a capacity market context*". While Febeliec fully underwrites the latter part of the statement, it cannot agree with the first part as the law states a criterion of least cost, without any additional condition.
- Concerning the bidding requirements, Febeliec has following remarks:
  - Febeliec takes note of the design proposal #3 but wonders what the bid price cap will be for multi-year capacity contracts, as these are not mentioned.
  - Febeliec also has questions with regard to a cap of 25MW on bids for a portfolio of aggregated capacities, as this might create barriers for entry by not allowing sufficient effects of scale to be leveraged. Febeliec would like Elia to provide a justification for the introduction of this cap, which does not exist for single CMUs.
  - Febeliec appreciates the efforts by Elia to neutralize physical withholding and hopes that the proposed measures will be sufficient to mitigate such risk, as any physical withholding would have a negative on system adequacy and the cost of the system. In design proposal #4, Elia states that for every CMU there has to be a bid in the Auction for the entire Eligible Volume, but does not mention what the consequences are when a Capacity Holder does not abide to this rule.
  - Febeliec proposes to rephrase the first paragraph of design proposal #5 as the sentence is not very clear and could lead to confusion. In section 3.1 it is stated that Bids corresponding to CMUs covered by the same technical agreement may <u>and should be</u> linked, referring to design proposal #5 which seems to state the contrary. Febeliec believes design proposal #5 should state that CMUs covered by the same technical agreement <u>may</u> be linked and for each CMU at least one of the Bids or the maximum selectable volume of combination of Bids corresponding to a CMU should cover the entire Eligible Volume of that CMU. However, Febeliec does not see any of the design proposals requiring a Capacity

their (unduly high as not reflecting their real missing money) bids would be rejected and they would forego any remuneration at all. Elia concludes correctly that for the first two auctions, according to its proposal, "*applying a pay-as-bid pricing rule in the initial capacity auctions is expected to result in a lower cost of CRM, skimming more CRM-inframarginal rents than would the case when only an intermediate price cap is implemented*", yet does not apply this correct logic to all subsequent auctions

Holder to bid in a combination of different CMUs covered by the same technical agreement in linked Bids as long as there is a separate technical agreement for each CMU and these CMUs are bid in separately as well. Febeliec therefore asks Elia to clarify whether it is a requirement to link all Bids of CMUs covered by the same technical agreement at all times.

    - Design proposal #6 states "Bids not corresponding to CMUs covered by a signed technical agreement" can be within a set of mutually exclusive Bids. Febeliec believes that Elia intended to state that "Bids not corresponding to CMUs covered by different signed technical agreements" can be within a set of mutually exclusive bids, but all CMUs should be covered by a technical agreement, and therefore asks Elia to correct their design proposal.
- With respect to the auction clearing, Febeliec has following remarks:
    - Febeliec remains with questions concerning Elia taking into account the "*highest social welfare*", as Febeliec does not totally agree with the reasoning of Elia that this is equivalent to the lowest cost of the CRM. In general when discussing social welfare it equals to the sum of consumer surplus and producer surplus (plus congestion income in case of cross-border flows). Febeliec does not see why, not even taking congestion income into account in the equation, Elia would take producer surplus into account in the optimization function of a CRM. Theoretically this could mean that Elia optimizes to a minimal consumer surplus and a very high producer surplus, which is not compatible with the lowest cost criterion. For Febeliec, the only valid element here should be consumer surplus, as any producer surplus in the CRM optimization will come from unwarranted inframarginal rents, which Elia correctly refers to as windfall profits. Especially PAC would perform very badly as it leads to explicit inframarginal rents, while PAB can only include implicit inframarginal rents, where mitigating measures can be taken in order to avoid these as much as possible to remain in line with the least cost criterion.
    - Febeliec has strong concerns on the fact that the capacity contract duration for which bids apply is not considered by Elia in the optimization. While Febeliec understands that doing so might be more complex as it would require some assumptions, Febeliec cannot support an approach where this element is left out of scope, as this can lead to a much higher cumulative cost of the CRM over the entire period, which goes against the least cost criterion, even if this criterion would be validated on an annual basis. Febeliec strongly encourages Elia to develop a methodology that takes into account a longer time horizon in the optimization function.
    - With respect to grid feasibility and grid constraints, Febeliec notes that Elia refers to "*the transmission grid, the distribution or other*" and asks Elia to be more explicit on the last category. Febeliec also wants to refer to the parallel bilateral preliminary discussions with Elia concerning CDS, for which one of the topics is to identify which elements should be considered and at what moments in time.
    - Febeliec also wants to add a reservation concerning the discussions ongoing in the working group Belgian Grid, as these discussions have not yet reached their final stage and some key element are still under investigation. Febeliec thus does not want to validate any reference to these discussions at this point.
    - With respect to the drivers for grid constraints, Febeliec takes note that most of the text implicitly or explicitly (e.g. the shown illustrations) only refers to generation assets, and not for demand or demand side response/market response. Febeliec wants to draw the attention to these as it is of the opinion that a different logic applies

to them. Demand sites are always entitled to reduce their consumption level to zero (as no legal obligation to consume exists), which means that in the context of demand side response/market response, no grid constraints can be considered according to Febeliec as this would lead to the very strange situation where demand side response/market response would be not allowed to participate to the CRM for grid constraint reasons but where the same site would still be allowed to reduce its consumption to zero as no consumption obligation can be enforced. Febeliec thus asks Elia to explicitly describe its vision on demand side response/market response, taking into account the above or provide clear justification in case Elia would not follow the logic described by Febeliec.

  - In relation and analogy with the comment above, Febeliec also asks Elia to discuss explicitly how the freeze period with respect to the interaction between CRM bidding and EDS requirements would be applied to demand and demand side response. Elia just added at certain points in the text *"(or storage/demand unit)"* to the description but this does not lead to a clear overview as certain elements, as described above, are completely different. In any case, Febeliec is of the opinion that "*demand unit*" is not correct nor relevant in this context, as in the framework of CRM at best Elia could look at demand side response and not the (bigger) demand unit. This confusion also comes back in the methodology description where Elia refers to additional capacity but where according to Febeliec this can only refer within the context of the CRM to demand side response and not demand and, as described above, thus becomes irrelevant because a demand unit is always allowed to reduce its consumption to zero. Febeliec also regrets that also in this context the illustrations only refer to generation and do not provide any clarity concerning demand and demand side response (nor storage for that matter).
  - Febeliec in any case pleads for transparency on the methodology and the related information to not only for the regulator but also the grid users, both the concerned grid users as well as the grid users in general. On the CRM auction selection outcome for example, Febeliec does not oppose the proposal but regrets that it will function as a black box, which limits the auditability of the process and the transparency towards the grid users.
  - In Design proposal #10 Elia states that external constraints could be facilitated by the proposed methodology. Febeliec believes it should be specified which actions and checks will be done to make sure all relevant constraints are taken into account either in the algorithm or in the feasibility studies of projects.
- With respect to the treatment of the opt-out volume, Febeliec remains with grave concerns with regards to possible gaming, as also indicated during the task force meetings. Febeliec pleads for a system of CRM which only requires volumes to be available during the winter months (cf. strategic reserve) and not all months of the year, as this would solve at least part of this gaming risk[3]. One clear example related to units that are a few months unavailable during the year (e.g. because of a major overhaul or maintenance during the summer) which would thus be excluded for the CRM, but could offer part of their volume via the secondary market, while creating an (artificial) need for additional CRM volumes, while both capacities would then be available during the relevant winter months (thus providing over-adequacy and

[3] Alternatively and in order to have a more refined view on (un)availability, Elia could also take into account the actual period of (un)availability of a CMU in the energy market (instead of winter versus non-winter). This would entail that capacity holders would have to inform Elia in advance of their unavailability during a certain period. Elia could then use this information as input for the volume determination.

increasing the cost of the system without any benefits for society). Febeliec is concerned that the proposed approach could lead to strategic maintenance and bidding behaviour which would go against the efficiency of the CRM. Febeliec reiterates its abovementioned request for a system that only requires availability during the winter period but in case such system would not be implemented asks Elia to provide additional safeguards against gaming opportunities. Febeliec also invite Elia to investigate whether the provision regarding out-out volumes with a definitive closure notification could not be reinforced to avoid any gaming elements there too (units announcing for closure coming back after the auctions). With respect to the provisions regarding temporary closure notification, Febeliec takes note of the proposal that for the Y-1 auction the auction volume is not (!) reduced with the announced volume, and also asks Elia here to further investigate if this could not lead to gaming opportunities, allowing parties to drive up the need for CRM auction volumes artificially. For the opt-out without closure notification, Febeliec refers to the argumentation above and asks Elia to provide additional clarity and reduce the gaming risks (e.g. last paragraph of 5.3).