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# Febeliec answer to the Elia consultation on the preliminary report on Elia's findings regarding the design of a scarcity pricing mechanism for implementation in Belgium

Febeliec would like to thank Elia for this consultation on the preliminary report on Elia's findings regarding the design of a scarcity pricing mechanism for implementation in Belgium. Febeliec would like to stress that it is strongly convinced that the Energy Only Market (EOM) is still the best market model to guarantee good market functioning and that any intervention on the EOM target model can only be seen as a temporary measure to ensure correct market functioning during a transitional period. Febeliec strongly believes that the price signal given by the EOM, if remaining barriers to market functioning are removed or mitigated and transparency is provided, gives a strong enough price and thus investment signal to suppliers and BRPs. It is the role of the BRP in the market model that for Febeliec remains crucial and central in the European market functioning (which is conceived in a very different way than the US markets that are referred to several times throughout the report and the discussions on scarcity pricing mechanism); the obligation for BRPs to maintain a balanced portfolio, for Febeliec clearly in/towards the real-time timeframe but also already in the day ahead timeframe[1] as is currently the case in Belgium, should be the focus of all concerned market actors, as this guarantees a correct price signal. Insofar system adequacy would be jeopardized, after removing all remaining market barriers, Febeliec is open to look into all possible solutions, with capacity mechanisms as a measure of last resort. With respect to scarcity pricing mechanisms (as opposed to scarcity pricing which for Febeliec refers to the possibility for market prices to rise without price caps, an element now guaranteed under the latest modifications of the European market design with market price caps to rise whenever certain thresholds are reached, thus allowing them to rise towards the level of Value of Lost Load (VoLL) for the segments with the lowest VoLL), Febeliec is not convinced that these will guarantee system adequacy (as opposed to system flexibility availability, which is a different topic and as understood currently not considered at risk in Belgium) while they will definitely increase overall costs for consumers. If however Belgium were to decide to implement a scarcity pricing mechanism, Febeliec sees merits in the so-called Omega proposal of Elia, as it strengthens the price and investment signal towards BRPs to ensure system balance in their portfolios and does not come at a direct extra cost for consumers, who will through competition be able to select the supplier and corresponding BRP that provides them the correct level of price versus adequacy (BRPs with sufficient capacity will be able to avoid very high imbalance tariffs and could even earn money on unused capacity and thus provide better conditions to their clients). Nevertheless, Febeliec wants to stress that it this point it is not convinced of the need for scarcity pricing mechanisms nor capacity remuneration mechanisms in Belgium, other than the currently already deployed strategic reserve which is an out-of-market mechanism and as such does not directly impact market functioning but is rather to be considered as a backstop measure to avoid that capacity would leave the system prematurely.

On the preliminary report itself, Febeliec would like to make following limited set of comments, which is not to be considered as exhaustive and only based on the information that is currently available:

- Febeliec does not completely agree that "peakers and baseload plants must cover their fixed costs from short-run profits". While this might be more directly relevant for the former if looked at a stand-alone scenario, most generation assets are deployed within a larger portfolio. The same applies even more so for baseload plants, where a substantial share of future generation (in some cases, all future generation) is sold in forward markets under a long term hedging strategy (both for the seller and buyer of the capacity and energy), which should take into account all costs, thus also fixed costs. Most suppliers/BRPs only sell a small fraction of the portfolio in short term markets, day ahead, intraday or balancing, mostly based upon ever better information and reduced uncertainty (e.g. related to intermittent generation, planned and unplanned outages, weather conditions, … which can all impact supply). As such, the short term markets, while extremely important for (reference) price formation and matching supply and demand from a dispatch point of view, are not the only relevant revenue stream to calculate overall income and profitability of plants.
- On the restriction of prices (in day-ahead, intraday and balancing markets, as forward markets operate without price caps), Febeliec wants to stress that this issue has been tackled by the Clean Energy Package and

[1] Febeliec refers here to the answers it has provided on the separate consultation on the abolishment of the day ahead balancing obligation for BRPs, a proposal that Febeliec rejects.

corresponding legislation, as market price caps will now increase whenever certain thresholds are reached (and already well below the actual price cap level), thus ensuring that these should not form a structural limitation for prices to rise towards VoLL. Nevertheless, Febeliec is convinced that prices do not have to rise, except for potentially very limited occasions, to such levels as already below the level of overall system VoLL, market opportunities and VoLL levels of certain categories will lead to market reactions (e.g. investment in new generation capacity, demand side response, storage, …). In any case, since the automatic mechanism for increases in market price caps is in place, Febeliec is convinced that this barrier for market functioning is de facto removed and no real limit to price formation still exists.

- On market power mitigation approaches, Febeliec does not understand how Elia sees ex post investigations in bidding behaviour as a possible source of problems towards system adequacy. Febeliec remains convinced that in the European market model, it is important that in the day ahead market timeframe with a pay-as-cleared mechanism all actors offer their assets at their short run marginal cost, to ensure a correct dispatch of capacity while also ensuring the required inframarginal rents to recuperate the total cost of their investment over time with a profit margin (with as only theoretical exception the marginal unit if it were always to be exactly the same unit). To ensure that no market power abuse is applied, ex post investigation to bidding behaviour looking into the correctness of the short run marginal cost approach are for Febeliec key to the good functioning of the market and not at all a barrier. The above-mentioned point on rising market price caps also guarantees that asset owners can bid their real marginal cost and recuperate it via the market. Febeliec insists yet again that it is incorrect to compare practices in the US markets and the European integrated market as they have a completely different set-up and structure and as such are to a large extent incomparable. One crucial difference is for example the European intraday market , which allows for adjustments after the day ahead clearing to allow market players to cope with better information and reduced uncertainty, which does not exist in the US.
- On scarcity pricing mechanisms as a solution of missing money problems, Febeliec is not convinced that this will solve this so-called issue, as it will distribute a supplementary revenue stream, at the detriment of cost to consumers, to a range of market players, without in itself guaranteeing security of supply. For Febeliec, the worst possible outcome would be to reduce the EOM to a mere dispatch model, with a certain level of inframarginal rents, adding on top of that both a scarcity pricing mechanism AND a market-wide capacity remuneration mechanism, as Febeliec is convinced that at least to a certain extent consumers would pay three times for the same capacity. A potentially effective but definitely far from efficient outcome! In this sense, the observation that ERCOT (Texas) might need to add a CRM on top of its scarcity pricing mechanism is quite worrisome and raises questions on the capability of such mechanism to guarantee security of supply. In general, Febeliec wonders whether a tight system from a balancing perspective always is the result of an adequacy issue. While the causal relation might be quite strong in the other direction, it is not a given in this direction, as even important imbalances can also occur at times when overall system adequacy was not at all at risk.
- On the role of operating reserves in an EOM design, Febeliec would like to stress that in the European market design, BRPs are responsible for balancing their portfolios, with the TSOs only responsible for residual balancing, with clear (price) incentives for BRPs to ensure their balance. Moreover, system adequacy in Europe is not a task of TSOs. Stating that beyond the minimum contingency level for reserves, holding more operating reserves would be better, depends on the point of view. From a TSO perspective, this could be the case. However, for the consumers who have to pay for the reservation of such reserves, all extra capacity comes at a cost and anything beyond what is needed for residual system balancing only leads to unwarranted extra system costs and should thus be avoided. The same applies for a certain extent to the level of balancing capacity that is reserved, because when markets become more liquid, it could be less needed to reserve large capacities but rather rely on the (balancing) markets to provide all needed balancing energy to the TSO to maintain residual system balance. Febeliec in any case rejects any proposal that would lead to unneeded expensive capacity reservation, a priori if this is to be paid by consumers. And in any case, and as already mentioned above, Febeliec refuses to accept a system where consumers would be paid twice for the same capacity.
- Febeliec was also quite surprised to observe that the ERCOT example showed clearly that market power abuse is still a very real issue even under the market system with a scarcity pricing mechanism and wonders whether in a highly concentrated market for baseload electricity generation implementing such system would not lead to yet another issue of market concentration that would have to be remediated. In any case, Febeliec strongly insists that the ERCOT example does not seem to be directly implementable in Belgium, as market fundamentals are to a very large extent non-similar and it should thus be avoided to apply a too fast change that could lead to a whole range of unintended and harmful side effects, especially in a broader European context (as the scope of this report is only Belgium).

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- On the potential implementation of a scarcity pricing mechanism is Belgium, Febeliec insists that this should in no way lead to the perverse effect that it would cannibalize the balancing market or alternatively the day-ahead or intraday market. Insofar a scarcity pricing mechanism could lead to additional investments to ensure better system adequacy, this should only be done under the absolute precondition that this does not jeopardize good market functioning, and definitely not in a way that would put Belgian consumers at an additional competitive disadvantage as compared to the neighbouring countries and other Member States.
- On the possible modifications in ERCOT to make the ORDC function more "trigger happy", Febeliec is very worried that such approach would also be followed in Belgium if a scarcity pricing mechanism were to be implemented, as this would definitely increase pay-outs which could potentially lead to additional capacity yet would inexorably lead to again (much) higher costs for consumers. In other words, the calibration of pay-outs and triggers under any possible scarcity pricing mechanism will be of the utmost importance and should be handled with the highest possible caution to avoid overshooting at the detriment of cost for consumers.
- On virtual bidding, Febeliec refers to its comments on the consultation on the day ahead balancing obligation abolition and in general wants to state that it is not convinced that such system is applicable in Europe, which compared to the US markets has a.o. an intraday market, while such virtual bidding also comes with additional challenges with respect to possible abuse. Febeliec is also not convinced that this would bring much additional value to the Belgian system and questions the benefits. Febeliec in any case wants to avoid modifying the Belgian market design to implement potentially unneeded (or even impossible to integrate) solutions which create yet again new issues to solve. Febeliec strongly opposes any system where it would be allowed to hold open positions and hoard capacity for later timeframes, as especially in markets with higher market power concentration this could potentially lead to catastrophic outcomes for consumers and prices.
- On capacity reservation mechanism, Febeliec wants to refer to its extensive comments on these in numerous consultation and discussions. Where Febeliec does not oppose the implementation of CRMs as a last resort measure under very strict conditions and for a clearly delimited timeframe (in line with the Clean Energy package), it is not convinced that a scarcity pricing mechanism will be able to guarantee security of supply in the same way. For both mechanism, Febeliec urges the strongest possible caution as any major modification of the Belgian market design could have very large and long-lasting effects, both wanted and unwanted, and it remains unclear how and when such additions to the current market design could be ended, implying that consumers could be exposed to additional (potentially excessive) payments ad vitam eternam. As stated above, for Febeliec the worst possible outcome would be an EOM with inframarginal rents and scarcity rents on which are added both a scarcity pricing mechanism and a capacity market, as this would potentially guarantee Belgian security of supply yet would at the same time guarantee an exploding system cost for consumers. Febeliec reiterates its believe in the EOM, especially with price caps now in essence abolished under the new automatic increase mechanism. Moreover, Febeliec wants to underline its continuous strong believe in European market integration and the implementation of the electricity target model in all timeframes and as such rejects any possible modification that could jeopardize those targets.
- On Elia's analysis of the CORE proposal, Febeliec takes note of the analysis, including the legal analysis, and wants to refer to all previous comments on the general conditions to which any modification of the EOM, be it e.g. a scarcity pricing mechanism or a capacity market mechanism, should fulfil. On the financing of a scarcity pricing mechanism, for Febeliec it would be difficult to support the implementation of scarcity pricing mechanism if it is not guaranteed that it would bring additional investments towards system adequacy (as compared to system flexibility, which does not seem an issue in Belgium at this point). In any case, in a European context it would be unacceptable that costs for Belgian consumers would explode due to large pay-outs to BSPs all over Europe, without any formal guarantee that this would benefit Belgian system adequacy.
- On Elia's proposal for the implementation of an Omega component next to the alpha component (which Febeliec would not like to see abolished, as it gives an additional incentive to BRPs to ensure that they maintain balance in their portfolio and so decrease overall residual system imbalances to be covered by Elia and paid for by consumers via balancing capacity reservation), Febeliec sees some merits in this proposal as it avoids various elements which for Febeliec would be unacceptable, while it at the same time strengthens the BRP incentive to maintain balance and is self-financed. However, Febeliec at this point remains unconvinced that any scarcity pricing mechanism should be implemented at all in Belgium, as it is not at all convinced that this would lead to a better system adequacy at an efficient system cost! In this sense, even though the Omega factor has some merits, Febeliec is in essence opposed to its implementation at this stage. If such implementation were to be decided, Febeliec insists to maintain a realistic implementation track to ensure that a smooth integration in the current market design can be guaranteed, while it is also essential to ensure sufficient upfront visibility to investors and market actors to adapt their behaviour to ensure that it guarantees the wanted outcomes at the lowest cost possible and without short term child sickness issues.