

CONSULTATION REPORT

Public consultation on Terms and Conditions for balancing service providers for automatic Frequency Restoration Reserve (aFRR).

03 July 2023

NON-CONFIDENTIAL



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1. Introduction

Between 24 May 2023 and 25 June 2023, Elia organized a public consultation on its new proposal for Terms and Conditions for balancing service providers for automatic Frequency Restoration Reserve (aFRR) (hereafter referred to as “T&C BSP aFRR”)¹.

The T&C BSP aFRR are developed pursuant to article 18 of Commission Regulation (EU) 2017/2195 of 23 November 2017 establishing a guideline on electricity balancing (hereafter referred to as “EBGL”). The T&C BSP aFRR include the Balancing service provider Contract for the aFRR Service (hereafter referred to as “BSP contract aFRR”).

Elia received 4 non-confidential answers to the public consultation from the following parties:

- Centrica Business Solutions, hereafter “CBS”
- BSTOR
- Febeg
- Febeliec

Elia did not receive confidential answers to the public consultation.

This consultation report contains the overview of the feedback from the stakeholders, and the answers of Elia thereon (in blue in the text).

The feedback received during the public consultation did not lead to a modification of the proposal of amendment of the T&C BSP aFRR.

All relevant information on this consultation is available on the consultation webpage¹. Elia has submitted the final proposal of the T&C BSP aFRR together with the consultation feedback and the consultation report to the CREG in line with EBGL requirements.

¹ Consultation webpage: https://www.elia.be/en/public-consultation/20211208_public-consultation-on-amendment-of-the-tc-bsp-afrr

2. Feedback from CBS

Executive summary

Centrica thanks Elia for the opportunity to provide feedback on the amendment of the T&C BSP aFRR concerning the TCO degradation cap in the aFRR capacity auction.

Preserving transparency and ensuring a level-playing field are crucial for fostering effective competition among all technologies. While we acknowledge the reasoning behind the TCO degradation cap, it is important to carefully consider its implementation to avoid compromising the integrity of price formation and fairness in the market. Centrica would like to share following comments:

- We support a robust design that fosters competition while adapting to changing market conditions.
- We have concerns that implementing a TCO degradation cap jeopardises fair competition.
- We encourage Elia and CREG to consider additional measures for ensuring the effectiveness and transparency of the TCO degradation cap implementation.

Centrica supports a robust design that fosters competition while adapting to changing market conditions

After extensive discussions and collaborative efforts involving Elia, CREG, and market participants, a robust design solution was reached in 2021. It is evident, after two years, that this design is effective and has successfully facilitated the entry of new providers and fostered greater competition in the market.

This being said, we acknowledge the changing market conditions and understand the reasoning behind the introduction of a 20% cap in response to the observed TCO degradation.

[Elia agrees with CBS's observations.](#)

Centrica has concerns that implementing a TCO degradation cap jeopardises fair competition

We strongly express our concerns regarding the potential for certain market participants to exploit the introduction of the TCO degradation cap, enabling gaming of the auction system. An example of this could be the submission of upward-sloping bidding curves, manipulating prices to favor higher volumes at lower costs. Such actions could lead to the exclusion of per-CCTU bids once the cap is implemented. Centrica firmly believes that prioritizing competition over improved Total Cost Optimization is the preferred outcome. Therefore, we advocate for an auction design that eliminates these gaming opportunities.

[Elia is of the opinion that, for such a gaming scenario to materialize, all-CCTU bidders should agree to artificially increase their fixed costs, reflected in the price of the first 5 MWs. Given the current market conditions, the competitive single CCTU bids could indeed effectively be combined with a lower volume offered by an all-CCTU bidder who would not have artificially increased its fixed costs, leading to the non-selection of the other all-CCTU bidders.](#)

Centrica encourages Elia and CREG to consider additional measures for ensuring the effectiveness and transparency of the TCO degradation cap

In the event that the TCO degradation cap is deemed necessary to control system costs, we urge Elia and CREG to incorporate appropriate measures to safeguard the efficiency of this approach and uphold market accessibility for per-CCTU bids.

Our recommendations to encourage a thriving competitive landscape that benefits all industry stakeholders include:

- Strengthening market surveillance to detect and address potentially abusive bidding practices after the cap's introduction.

Elia is performing the necessary market surveillance activities under its PPAT responsibilities to detect and report situations of market abuse.

- Transparently publishing the progression of the TCO degradation after the cap is implemented.

The publications on Elia's website will be adapted in order to provide the market parties with the necessary data to analyse the impact of the TCO degradation cap:

- In the publication of individual bids, an additional column will be added in each direction with the awarded volume after the additional step (*step 5: cap on degradation of the first total cost optimization*) of the awarding procedure. This provides the information on the impact of the implementation of the cap on TCO degradation on the selection of bids
- On the "Auction Results" webpage, next to the reference cost, the uncapped TCO degradation will be added

- Conducting an impact assessment to compare the evolution of costs and competition in the aFRR capacity auction, analyzing a representative time period before and after the cap's introduction.

Elia will monitor the impact of the cap on TCO degradation and report on this during the WG Balancing. This being said, while Elia believes it's important to introduce the cap on TCO degradation, there are a lot of factors impacting the costs of the auctions and isolating the impact of the cap on TCO degradation in the comparison between "before" and "after" the introduction of the cap might not be possible. What can be done is to calculate the costs of the auctions if the TCO degradation cap had not been implemented.

- Proposing a mechanism for removing the cap once it is no longer required and has achieved its intended purpose. This could be triggered by reaching acceptable levels of TCO degradation or the availability of sufficient volumes from new entrants or running thermal units.

Elia agrees that, once there is sufficient volumes from new entrants or running thermal units available, neither the TCO degradation factor nor the RC factor will impact the result of the auction. At this point, those factors as well as the mechanism of the TCO itself may then have become unnecessary and further simplifications could be considered.

In the meanwhile, as described in Article II.9.10 of the Contract BSP aFRR, the CREG has the possibility adapt to those factors if beneficiary for fulfilling the objectives of article 3(1)a and 3(1)b of the EBGL, depending on the evolution of the market conditions.

3. Feedback from BSTOR

BSTOR understands the need for a cap on the TCO degradation and accepts the proposal as this was part of the consensus leading to the new auction principles.

However, as indicated during the working group, BSTOR requests Elia to monitor and report on market entry barriers created by the new auction rules.

The aim of those rules was to find a deviation to the “long term” and Electricity Regulation compliant system of full asymmetric merit order selection that would provide for the appropriate balance between increase of the cost and decrease of the market entry barriers compared to a “fully symmetric total cost optimum” (TCO) selection. Elia is currently monitoring the first element, which is the degradation of the total cost versus a mere TCO and there will even be a cap on such degradation.

For performing an efficient monitoring of this balance, we therefore believe that Elia should also monitor the evolution of the market entry barriers. This can be done by looking to the price of 1st rejected bid in each merit order of each CCTU and each direction, and comparing, for every day, the average price of such rejected bids in each direction with the weighted average price of the selected (per-CCTU and all-CCTU) bids in that direction.

Frequent rejection of CCTU bids which, once aggregated with bids from other CCTUs in a virtual 24h 1MW bid are cheaper or close to the average service price would indicate significant unjustified market barriers which might require lifting up the TCO degradation cap.

Elia reminds that the use of the Total Cost Optimization (TCO) approach is compliant with the Regulation. The TCO degradation cap has never been considered a temporary or exceptional measure. The fact it would constrain the auction result frequently would on the contrary highlight its necessity to keep reservation costs under control. Nevertheless, Elia does not expect the TCO degradation cap to structurally constrain the market results as it should primarily intervene at moments when (thermal) units with large start-up or must-run costs are necessary to cover the requested balancing capacity. This should only happen when the clean spark spread is negative and alternative flexibility is unavailable despite the attractiveness of the aFRR market (the reference price on such days is indeed expected to be high).

In addition, by design, the single CCTU bids that will not be selected as a result of the cap on TCO degradation will in most cases be close to the average service price. A single CCTU bid which is significantly more expensive (more than 120% of the reference cost, taking into account the current value of the RD factor) than the average service price will indeed only be selected when this helps to reduce the total costs of the auction, in which case the cap on the TCO degradation will not impact the selection of that bid.

This being said, Elia agrees to monitor the impact of the cap on TCO degradation and to regularly report on this during the WG Balancing. The publications on Elia's website will also be adapted in order to provide market parties with the possibility to perform their own analyses.

4. Feedback from FEBEG

Overall, FEBEG can accept the proposals of Elia, as it was part of an approach/design agreed upon in the past. However, **we like to underline the following important principles** for FEBEG in this regard. First of all, **a well-functioning market should actually neither need a RC factor nor a cap on the TCO degradation**, so we do regret that these interventions are considered. Secondly, **implementing a cap should be considered as an acceptable temporary solution to limit the impact of the RC factor**.

In the past, FEBEG agreed to the compromise proposal of Elia to introduce a RC factor on per-CCTU offers. At the time this was meant to solve 2 concerns:

- The first capacity selection algorithm (per CCTU) implemented by Elia led to undesired levels of procurement costs;
- RC factor was rather seen as a way to attract new capacities (not able to deliver all CCTU product) in the aFRR market.

While FEBEG followed the market compromise, we experienced a rapid increase of liquidity and additional aFRR capacities (with per-CCTU format) over the past 2 years.

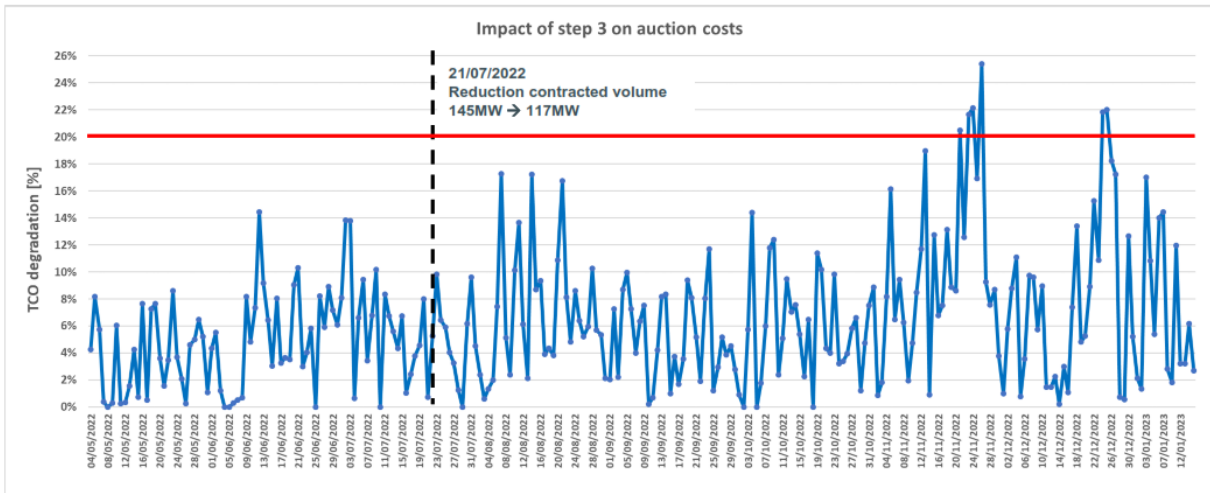
As FEBEG we no longer see the need to increase the procurement costs to attract new capacities, therefore, we can support the proposal of Elia and we are not against applying a cap on the TCO degradation. Actually, we consider that aFRR auctions are already oversupplied.

Finally, as a matter of principle, we believe that a well-functioning market should neither need a RC factor nor a cap on the TCO degradation. This being said, we acknowledge that dismantling those 2 concepts might be heavy in terms of IT and operations at Elia side. For that reason, we can understand the application of a cap as a pragmatic work-around.

Elia would like to remind the rationale for the factors introduced in the aFRR capacity auctions:

- The RC factor has been introduced following claims from market parties intending to bid in “single CCTU” that they would not be able to grasp a fair remuneration compared to “all-CCTU bidders”.
- The TCO degradation factor is meant to avoid excessive increase of the auction costs and hence to ensure the efficiency of the balancing markets, pursuant Article 3 of EBGL. As illustrated in the figure below, this factor is only applied for specific delivery days, where the total cost increase due to the merit-order selection is exceeding 20%.

Consequently, the two factor serve different purposes and are more or less independent. The TCO degradation cap could constrain the auction results even with an RC factor of 0%, if the selection of single CCTU bids just below the reference cost combined with the selection of all-CCTU bids at a very high cost to cover a missing volume of reserves would exceed the TCO degradation threshold.



As described in Article II.9.10 of the Contract BSP aFRR, the CREG has the possibility adapt to those factors if beneficiary for fulfilling the objectives of article 3(1)a and 3(1)b of the EBGL, depending on the evolution of the market conditions. For the sake of clarity, the modifications of those factors would not require significant IT nor operational efforts on Elia’s side, but the modification of the RC factor would not require a change to the T&C BSP aFRR and is therefore not in the scope of this consultation.

5. Feedback from FEBELIEC

Febeliec would like to thank Elia for this latest consultation on its T&C BSP aFRR. Febeliec would like to refer to the very lengthy discussions on this topic during the meetings of the WG Balancing and confirms that the proposal by Elia is a good reflection of the compromise reached during those discussions. Febeliec nevertheless, insists that the ultimate goal is to enable as much participation (and thus liquidity) as possible to the aFRR market, both in capacity and in energy, and thus urges Elia to continue to evaluate the impact of the proposed changes on this ultimate goal.

Moreover, as also discussed, Febeliec insists that the Reference Cost Factor and the TCO Degradation Cap Factor should be revised as soon as possible in order to ensure the lowest possible overall system costs as these two factors currently might provide some beneficial impact for attracting new participants and improving market functioning through better liquidity, but it is clear that these factors should no longer be required in a maturing market. Febeliec thus most strongly urges Elia and CREG to follow this aspect up very closely and abolish or at least reduce their negative overall cost impact as soon as possible.

Elia agrees that developing the liquidity in the capacity and energy markets is key. Elia is continuously monitoring the evolution of the aFRR market and the beneficial impact on the costs, as reported in the WG Balancing of December 2022.

It's important to find the right balance between attractiveness of the market and short-term auction costs. With the variable factors (RC factor and TCO degradation factor), the CREG has the possibility to define whether those factors need to be adapted, depending on the evolution of the market conditions.