[#9]

Pay-as-Cleared vs. Pay-as-Bid

Overview of current proposals

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Pay-as-Cleared vs. Pay-as-Bid
& With vs. without intermediate price cap

Objective of these slides: Bundle all arguments from all stakeholders regarding the four options and find an answer to the following questions:

1. **Is an intermediate price cap appropriate?**
2. **Do we go for Pay-as-Cleared or Pay-as-Bid?**

Note on the auction format: ***Sealed bid is assumed as the starting point****.*
Based on the feedback received during and after the TaskForce on 26/4 when the Sealed Bid and Descending Clock auction format were presented, we currently see no reason to deviate from the Sealed Bid auction format. This topic is not part of the discussion today.

An intermediate price cap seems appropriate

The concept of bid/price caps is as such not innovative as also used in other CRMs: e.g. Ireland, Italy, Poland, UK

- **All capacity providers need a fair and sufficient remuneration for the delivered service ~ sufficiently high intermediate price cap**
  - Not the CRM in isolation, but the CRM and Energy-Only Market together remunerate capacity providers for the overall service they provide, i.e. reliable capacity
  - An intermediate price cap should not obstruct participation (good calibration is necessary)
- **The CRM auction should not lead to undue windfall profits ~ sufficiently low intermediate price cap**
  - There is no economic rationale behind inframarginal rents in the CRM conceived as residual mechanism to the energy market
- **Market power needs to be mitigated ~ intermediate price cap useful**
  - Intermediate price cap can help to avoid economic capacity withholding by incumbents, i.e. strategically withholding certain capacity to raise the remuneration for all other cleared capacity

Conclusion: An intermediate price cap to distinguish between 1-year and multi-year contract is deemed appropriate, but a good calibration is key

Both Pay-as-Cleared and Pay-as-Bid have been put forward

Pay-as-Cleared	Pay-as-Bid
<u>Bidding behavior</u>	
• Rational bidding behavior is to bid in at true costs (=missing-money in CRM)	• No incentive to bid in at true costs (=missing-money in CRM) • View 1: Expectation of risky bidding behavior at expected clearing price • View 2: Expectation of prudent bidding behavior at cost+ • More market monitoring, if possible, might help towards true cost bidding
<u>Efficient selection</u>	
• Because of rational bidding behavior, efficient selection is expected	• Might lead to inefficient(?) selection depending on bidding behavior
<u>Total cost</u>	
• Elevated cost as all selected bids are awarded the market clearing price • Risk of economic capacity withholding thereby inflating prices for all selected capacity	• Might be higher or lower than under Pay-as-Cleared depending on belief regarding bidding behavior and elasticity of demand
<u>Price discovery</u>	
• Transparent price signal – Valuable to small units/new market players	• No transparent price signal (~ *flat offer curve)* • Does this violate the EU Commission's intentions regarding transparency and providing a clear price signal?
<u>Price tendancy to zero</u>	
• Can prices tend to zero given a reliability option mechanism?	• Can prices tend to zero given a reliability option mechanism & Pay-as-Bid price determination?

Disclaimer: This is a non exhaustive summary made by Elia on the basis of arguments received during previous discussions and contributions

Summary

1. An intermediate price cap to distinguish between 1-year and multi-year contract is deemed appropriate, but a good calibration is key

2. Choice between Pay-as-Cleared and Pay-as-Bid depends mainly on:
   - Belief regarding bidding behavior and resulting total cost of CRM and reduction of windfall profits
   - Value of price discovery under Pay-as-Cleared to market participants
   - Whether blocking issues regarding CEP compliancy and/or EC approval are expected by going for Pay-as-Bid (as unusual compared to other CRMs)