POSITION

Subject:	FEBEG feedback on the topics presented during the CRM TF #4 on 9.07.2019
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1. Introduction

The proposals for the implementation of a CRM in Belgium are very complex. FEBEG believes that efforts should be done to streamline and simplify the mechanism in order to ensure more participation and competition and by this reducing the overall cost of the system.

2. Principles for the secondary market

- In the current proposal the development of a secondary market is foreseen, in line with the Clean Energy Package. FEBEG wishes to emphasize the importance of a well-functioning and liquid secondary market in order to mitigate the risks of CRM participants.

  Therefore, FEBEG would welcome Elia to:

  - Perform and make public an assessment of the expected liquidity in the secondary market.
  - Take initiative to ensure the facilitation of the secondary market by a third party platform (OTC, bulletin board, …).
  - Facilitate – on a level playing field basis – the transparency on the availability of the capacities tradeable on the secondary market (e.g. REMIT is only > 100 MW).

- FEBEG would like some further clarifications on the eligibility to the secondary market :

  - If the amount of capacity that opts out from the CRM leads to a reduction of the demand curve, it seems logic – to avoid double counting – that these capacities cannot not participate to the secondary market. However, their derated capacity (part not contributing to SoS) could be eligible if available.
  - How will Elia assess the eligibility of the non-contracted (in CRM) demand response to the secondary market (the demand response that is well taken in the demand curve)?

- Could capacities excluded from the CRM (due to the rules on the combination of support) be eligible for the secondary market? Would the «derated» part be eligible?

- FEBEG also has some questions with regard to the contractual framework:

  - Could Elia confirm that all parties willing to participate in the secondary market will need to sign the specific 'contract with the CRM Contractual Party' for the secondary market?
  - Can Elia explain to what extent this contract is similar to, or different from (availability monitoring, etc.) the regular 'capacity contract'?

3. Minimum threshold for participation in the CRM

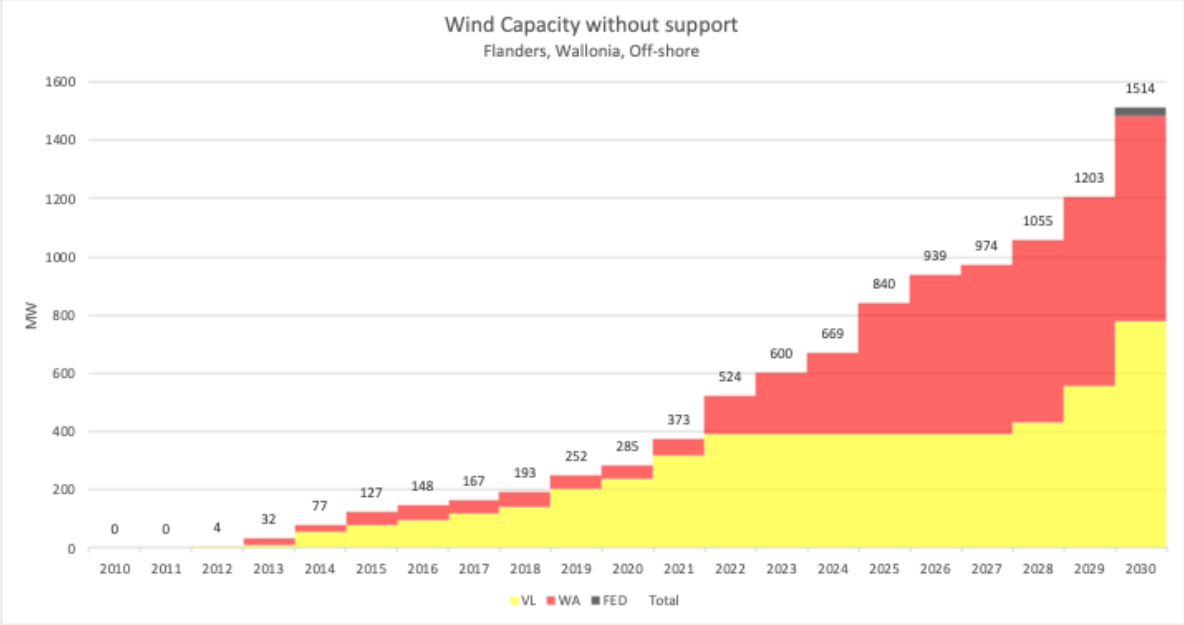
- FEBEG supports the proposition to implement a minimum threshold of 1 MW for the participation to the CRM as aggregation of smaller capacity is allowed to participate to the CRM.
- According to FEBEG, this level of 1 MW is a good balance between opening of the CRM market to sufficient competition and administrative workload and associated costs for both market parties and authorities/Elia. Lowering the threshold would generate a lot of workload and costs for parties having no intention to participate, e.g. costs (Network Flexibility Study, …) linked to the obligatory prequalification of generation assets on the distribution grid, without clear additional benefits for the capacity market as participation of smaller units can already take place via aggregation.

4. Cumulative support

- FEBEG does not agree with the proposition that capacities that benefited from operating aid/production assistance (MWh) in the past are not eligible to participate to the CRM:

  - Past production support in the past does not mean that an existing installation could no longer have missing money issues today.
  - Additionally, some installations will need to invest additional capex in order to be able to stay in the market. These additional investments may not be recovered from the short-term market revenues obtained in the future.

- As illustration, the figure below illustrates the wind capacity that will no longer benefit from operating support in the next years and would potentially be in scope of the CRM. Just for wind, this capacity will reach a total of approximately 840 MW at the 2025 horizon.



Source : based public data

5. Status on pay-as-clear/pay-as-bid

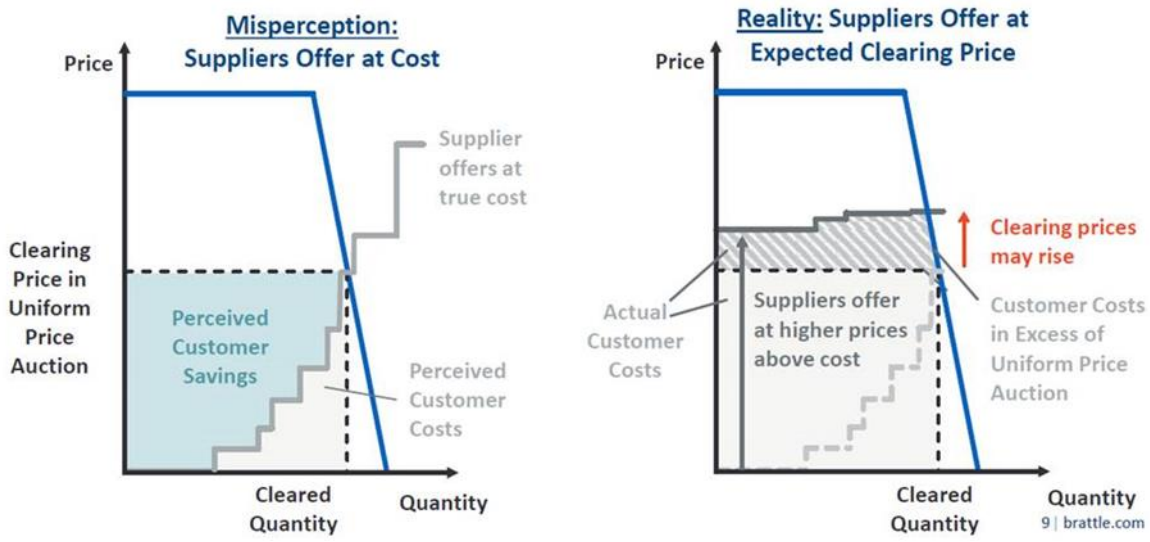
The CRM committee proposed to first set up an auction based on 'pay-as-bid' and then shift towards a 'pay-as-clear'.

- The reasoning behind the choice of the CRM committee seems to be that this 2-step approach would limit some "inframarginal rents" in the first years of the CRM implementation. FEBEG would like to remind the CRM committee on the arguments put forward by FEBEG during the during the CRM task force (23.05.2019). FEBEG explained in is position paper of May 2019 that implementing PAB would not lead to a lower cost (see figure below). This point is well documented in the literature and was for instance recognized in the EU capacity mechanism working group (2015) *"With a pay as bid pricing rule, there may be greater potential for bidders to try and guess the clearing price rather than bidding their true costs, which could lead to perverse outcomes and/or higher costs".*

- Also, as mentioned by the CRM committee on the slide of the TF 09.07.2019, having a pay-as-bid auction is not compatible with the Clean Energy Package's rules that imply that the CRM pricing should be able to tend to 0 in case of overcapacity in the system.

- As a result, FEBEG is not convinced of the choice of the CRM committee and still favors the implementation of 'pay-as-clear' from the start of the CRM for the reasons set forward consistently by FEBEG during the various task forces.

- FEBEG also wonders what would be the modalities (timing/trigger, procedure, etc.) for the change from one to another mechanism and how it could impact the energy and capacity markets? In case the choice of the CRM committee (first pay-as-bid then pay-as-clear) would be allowed by DG Comp, the rules (timing/trigger, procedure) for the shift should be clearly defined and enforced from the start of the mechanism capacity market.



6. Grid constraints

- As a first remark, FEBEG would like to remind the real issue at stake in this context, being the scarcity of the available grid connection capacity. In this respect, FEBEG insists on the responsibilities of Elia:
  - to plan, develop and invest in a proactive manner in the grid;
  - to take all possible measures and to implement all possible technical solutions in order to grant access to the grid for a maximum of grid users and by this limiting the grid constraints considered in the auction algorithm.

- Secondly, FEBEG wants to point out that the proposals for managing the grid constraints are interlinked with the 'prequalification requirements' and the 'procedure for reservation of grid capacity in the Federal Grid Cod'. These building blocks are not fully developed yet. For this reason, the FEBEG comments should be considered as preliminary and no final comments.

- Will Elia also integrate the grid constraints on the gas network or the distribution grid in the auction algorithm? This should be the case ensuring consistency and transparency for market players.

- FEBEG pleads for ensuring transparency both on the different types of constraints as on the results of the auctions (e.g. list of bids without the participant name): transparency is essential to offer comfort to market parties that the applied rules are fair and no discriminatory (no 'black box').

- Globally, FEBEG notices that the additional elements being proposed by Elia to deal with grid constraints lead to a clearing algorithm that goes much beyond the simple "single-round sealed bid" approach described earlier in the CRM discussions, esp. in terms of complexity.

- FEBEG considers it also of utmost importance that all information is made available for market parties on a level playing field basis. Could Elia therefore further clarify how this information would be comparable (or not) to the information provided through the detailed studies paid by market parties? What kind of information would exactly be available for market parties in an ex-ante configuration? How would this information be included in the clearing algorithm proposed?

7. Bidding requirements and market clearing

- FEBEG supports the bidding requirements proposed by Elia and is pleased to see that the bidding requirements are already appropriate to cope with pay-as-clear.

- FEBEG welcomes the proposal of Elia to allow mutual exclusive bids. During the TF, Elia nevertheless warns that there could be a limit – in function of prequalification criteria, investment thresholds, etc – to the number of mutual exclusive bids that can be introduced. In this context, FEBEG notes that:
  - Other factors can increase the need for conditional bids by market players, e.g. the definition of CMU (which has to be clarified), grid constraints etc…
  - Allowing the mutually exclusive bids needed by market participants could increase the number of participating capacity (generation, storage, demand response) to the auction and, hence, increase the competition. This increase in competition should help decreasing the cost for the consumers.

- On slide 7, FEBEG would like to highlight the fact that the choice of the pivotal bid (F rather than E) in the T-4 auction might not be the most optimal solution at the end from a cost optimization perspective (depending on the outcome of T-1 auction).

8. Demand curve

There are two elements in the discussion: (i) the overall shape of the demand curve, (ii) how this shape is translated into numbers when the target capacity is defined.

Regarding the shape of the curve, FEBEG estimates that the demand curve Y-1 should be similar to the demand curve Y-4 (option 1). The following arguments support this position:

- Equilibrium prices are smoothened with downward sloping curves
- Risk of withholding is higher with fixed demand, even small players can have market power
- Market power mitigation was one of the arguments used in the GB market. Extract from the opening decision for the reinstatement of the GB capacity market shows this:

(46) The demand curve gives the Government some flexibility on the amount of capacity to contract from year to year depending on cost. The sloping demand curve allows a trade-off to be made between reliability and cost, so that less capacity is procured in a given year if the price is very high. It also helps to mitigate gaming risks because it provides an auction price cap, and flexibility to procure less capacity if the price is high – both of which reduce opportunities for participants to push up prices by exercising market power.

A similar argument can be found in the Polish scheme *(34)*

- Consistency: When society is willing to procure firm capacity around the target set in Y-4, it should also be willing to do so in Y-1 to some extent esp. to cope with the uncertainty behind the targeted volume (cfr. the probabilistic nature of the adequacy situation).

Regarding the maximum capacity allowed to be procured, i.e. how the sloped curved is translated into numbers when the target capacity is defined, FEBEG is of the opinion that the Elia proposal might not be in line with what is aimed at in the CRM law.

In the Y-4 auction, the maximum capacity to be contracted (point C) should make sure that the volume left for the Y-1 auction allows the participation of capacities with less than 200 expected hours. This could be reached by a sloped curve if the quantity on the x-axis for A/B/C are properly chosen.

In the Y-1 auction, the maximum capacity to be contracted (point C) should make sure that the total capacity actually procured for the delivery year Y is in line with the reliability standards (both LOLE and EENS, in line with the Clean Energy Package).
