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federation of belgian industrial energy consumers

Febeliec answer to the Elia consultation on the remuneration of mFRR and aFRR capacity: pay-as-bid vs pay-as-cleared

Febeliec would like to thank Elia for this consultation on the remuneration of mFRR and aFRR capacity (pay-as-bid PAB vs pay-as-cleared PAC). In general, Febeliec would like to state that it follows the theoretical approach by Elia on the merits of PAB vs PAC, as it has also already indicated in the past. The concern for Febeliec lies mostly in the opportunity to switch from PAB to PAC in light of the specific situation in the Belgian (balancing) market, with a very high concentration and a fairly limited liquidity. Febeliec is mostly concerned that costs for grid users would explode under a move from PAB to PAC if not all preliminary conditions are fulfilled to provide a competitive environment. Febeliec understands that there is a chicken-and-egg dilemma here, and that market attractiveness is important to attract new entrants, but that these might also entail an extra cost burden, especially in the short run (as could also be observed in Switzerland). Febeliec believes that a range of expected evolutions in the near future (e.g. aFRR new sourcing approach, evolution towards a European balancing market) might provide the necessary liquidity to the Belgian balancing market to minimize the risk of very substantial cost increases for consumers. Moreover, as also indicated in the analysis, Febeliec believes that it would be wise to repeat the analysis on a wider dataset, as it is especially unclear what the impact will be of a winter period data or the effects of covid-19 on the results.

Febeliec also has following punctual comments and questions:

- Elia states that for the mFRR capacity a distinct clearing price for mFRR Standard and mFRR Flex will be needed (which Febeliec supports), yet Febeliec is surprised to see that Elia also that's that the clearing price for mFRR Standard should at least be equal or higher than the mFRR Flex clearing price. Febeliec understands this from a structural perspective, over an entire period, yet wonders whether this constraint should also be applied for each punctual day. Febeliec is concerned that this constraint could lead to unnecessary and undue cost increases.
- On market liquidity and competition, Febeliec does believe that over the last few years a large effort has been done, in particular also by Elia, to increase liquidity and competition (e.g. by making products technology neutral), yet is not convinced that current liquidity and competition levels are sufficient for move from PAB to PAC (both in mFRR and especially aFRR). The Elia assessment shows that in some particular instances mFRR Standard was provide by only one BSP, that the HHI was often quite high, that liquidity was at "*some moment near critical levels*". Febeliec is, as already indicated, strongly concerned that "*if the transition period of several months or even a year would pass before the advantages of moving to a paid-as-cleared design kick in, a substantial increase in total procurement costs is certain*", which would be unacceptable for Febeliec as long as costs are passed through to consumers without any incentive for other involved parties to evolve as soon as possible towards the promised ultimate benefits.
- Febeliec does believe that also revenues from the balancing market can provide an investment signal in additional (flexible) capacity. However, Febeliec is also concerned that capacity would be double remunerated in case of the introduction of a CRM in Belgium, as that capacity will already be remunerated via the CRM and would also be remunerated a second time via the balancing market, while those revenues would not necessarily be discounted in the bids for the CRM (in particular in case of limited liquidity and competition). Febeliec is also concerned as it does not believe that Elia has taken such revenues into account in its assessments regarding security of supply in Belgium, clearly indicating a risk of double remuneration at the detriment of grid users.
- Febeliec is, as already indicated, of the opinion that liquidity is a precondition to avoid market power and market power abuse, yet while Elia mentions that a "*decent level of liquidity still remains a genuine prerequisite to implement marginal pricing*", it does not provide for any quantitative threshold to consider liquidity sufficient. Also an important element is the available volumes in the market after clearing (e.g. market tightness) is a very important element, as the evolution of this parameter over time can be essential, especially in case required balancing volumes to be contracted would increase over time.
- On the theoretical discussion of the merits and disadvantages of PAB versus PAC, Febeliec also refers to its comments on this discussion in the framework of the CRM. Febeliec wants to reiterate here that while indeed under PAB bidders could try to artificially push prices up by adding extra profit margins, this could result in an outcome where they end up with nothing (too greedy could lead to no revenue at all), which should also put a limit under this behaviour. Nevertheless, it is clear hat liquidity is, whatever the clearing mechanism, an essential element of any well functioning market.

- On the examples of other European Member States that have introduced or will introduce pay-as-cleared in the clearing mechanism, Febeliec lacks information on the (quantitative) evaluation of the before and after situation, a.o. with respect to liquidity and competition (e.g. HHI, number of actors and new entrants, offered capacity versus required capacity, …) in order to be able to fully understand the implications from a Belgian perspective. Febeliec also strongly wants to point to the Swiss experience, where the decision was reversed after a substantial cost increase, which remains Febeliec's strongest concern in this discussion.
- On the cost benefit analysis, Febeliec takes note of the double digit cost increases (even up to 18,1%), especially considering that the applied dataset might not be fully reflective of the market situation over an entire year (including winter) or a period without covid-19 (where the impact could go in two directions). In any case, as long as consumers have to carry the costs for the balancing capacity and activations, for Febeliec it would be unacceptable and even unconceivable to take any risks on such substantial cost increase, especially taking into account the already very dire financial situation of grid users in this crisis period. Febeliec thus asks for the utmost carefulness from the side of Elia and CREG before taking the very impactful decision to move from PAB to PAC.
- Febeliec also takes note from the confirmation by Elia that mFRR Standard is more expensive than mFRR Flex and thus reiterates its request not to abolish mFRR Flex too soon, as this would firstly increase the overall costs of balancing, as the overall procured volumes would remain the same, while this could also impact liquidity in a negative way.