ULB UNIVERSITÉ LIBRE DE BRUXELLES

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CfDs

Betting on the market

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TOWARD A NEW ELECTRICITY MARKET MODEL? CAN PPAs AND CFDs CO-EXIST, AND WHAT ARE BEST PRACTICES FOR THEIR DESIGN?

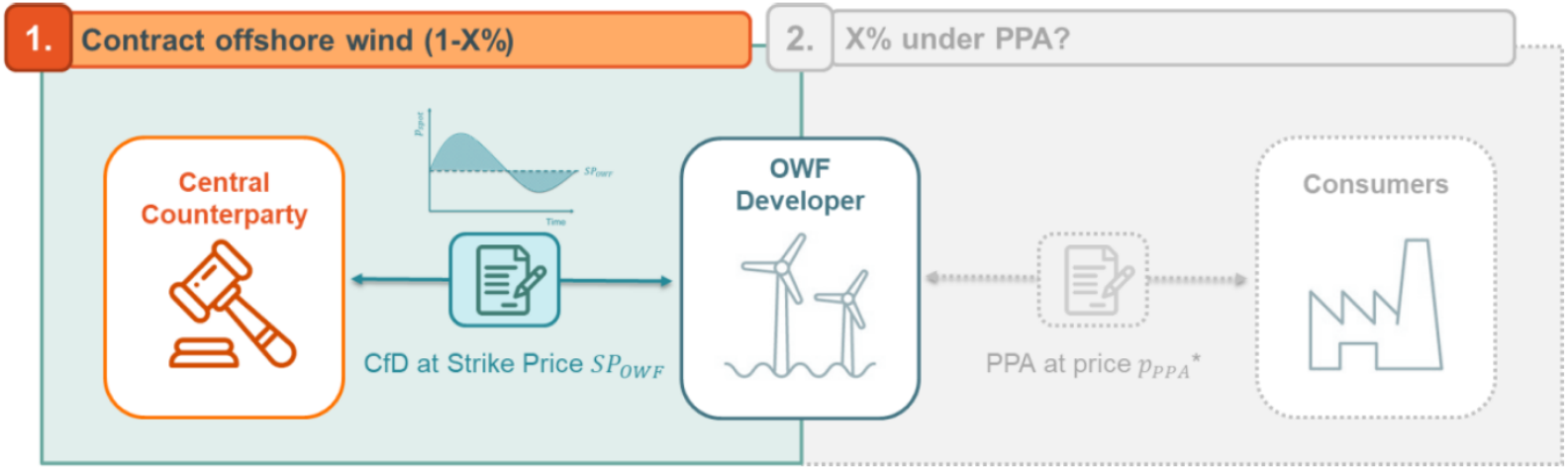
CfDs are likely to play an important role

- Ambitious **RES targets** set by EU and various states
  - Investments are not decided based on market signals anymore: **distortive**!
  - **Support mechanisms** probably needed to reach the targets
- Objective #1: **support mechanism should be non-distortive**
  - For all market timeframes, up to balancing – indispensable for efficient functioning of market & system!
  - Typically achieved by making the support mechanism independent from injection
  - Example: capability-based CfD, financial wind CfD
- Objective #2: **avoid drying out the forward market**
  - The volumes contracted by the states under CfD may prevent market parties to hedge
  - 1 But not necessary to make CfD mandatory! Corporate PPAs can co-exist
  - 2 There is no reason to leave CfD volumes with the states, they should be made available to the market instead

Acknowledging that CfDs have a role to play,
how to maximise their integration in the market?

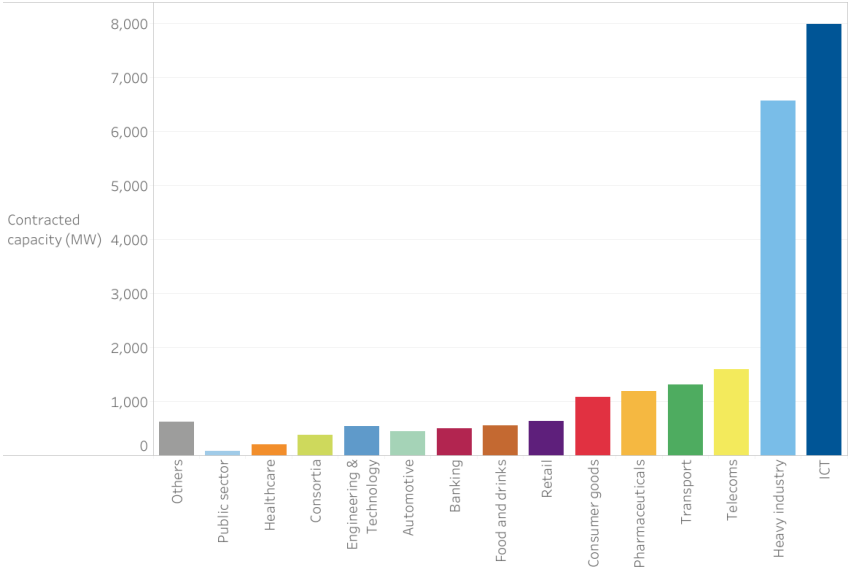
1. Corporate PPAs can co-exist with CfDs (1/2)

- Consumers may have an interest to engage into a corporate PPAs
- The tender design for the CfD may give the possibility to **exempt a certain maximum volume from the CfD ("carve-out")**



1. Corporate PPAs can co-exist with CfDs (2/2)

- Considerations:
  - Corporate PPAs are typically tools for **large players**, better able to cope with the risk profile of long duration forward purchasing
  - Exempting a certain volume may allow these large players to hedge and to benefit from RES development
    - This may otherwise be impossible due to competition law

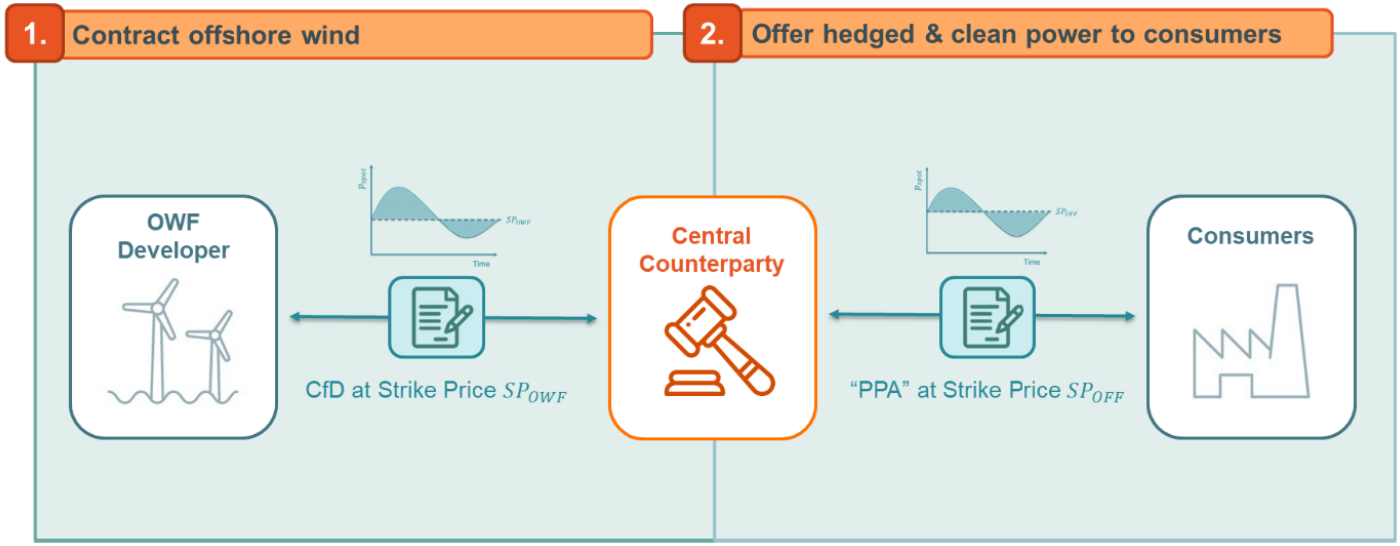


  - The **exemption from CfD** is essentially a **policy choice**
    - Offering the option or not, knowing to whom it benefits
    - The maximum share of exempted volume
  - **Corporate PPAs** should be under **full commercial terms**, with all risks being allocated between the parties to the contract
  - Any state intervention to cover part of the risk (e.g. collaterals) could be considered as a **hidden subsidy** favouring specific parties

2. CfD volumes should be made available to the market

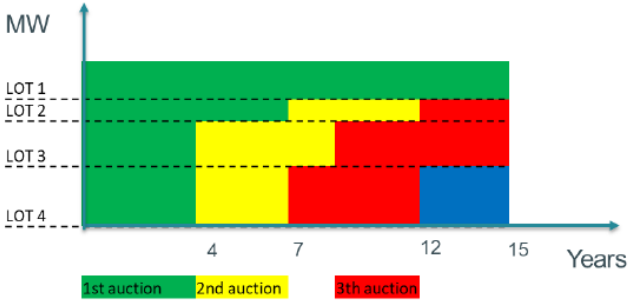
- By contracting CfDs, the states become **"long" renewable** – fully exposed to up or down swings
  - High prices: a lot of money collected, how to allocate it?
  - Low prices: a lot to pay, where to find the money?
- From **consumer perspective**: the access to affordable RES is subject to policy choices – it is **uncertain** as it may change
- Core idea: CfD volume should be made available in forward markets

  ➔ **Back-to-back tender**



2. CfD volumes should be made available to the market

- Considerations
  - CfD volume could be sold in existing forward market, or in new ones to be created
    - Massive RES under CfD would mean massive volume **feeding the forward market**
  - Key feature: the **contract duration** (maturity) could be adapted
    - Wind developers are typically looking towards very long term hedge to lower their financial costs – e.g. CfD for 20 years
    - Consumers have **different hedging needs** – e.g. 1 year, 3 years, 10 years
    - By segmenting the **contract duration**, the state-backed central counterparty can create products more fit for a wide variety of consumers than long term PPAs ➔ policy choice!



    - Some **risks** could also be covered by the central counterparty
      - Allocating the risk to the party most able to bear it
      - E.g. volume definition of CfDs can differ from volume definition in forward market
      - E.g. cross-border price spread could be covered in case consumers and RES are not in the same bidding zone (will become more common with offshore bidding zones)
      - Central counterparty could be left with a gap, positive or negative – but typically less risky than the initial long position!

The two proposals can be combined

- Exemption from CfD and back-to-back tender can be combined

- **States** are in control of **key policy choices**:
  - RES target
  - Maximum share of exemption of CfD, targeting large players
  - Design choices of back-to-back tender
    - Choice of contract duration segmentation and risk coverage will target more specifically some consumer categories

- The **market** takes care of reaching an **efficient outcome** thanks to transparent and open tenders wherever possible, within the boundary conditions of the policy choices

- No need for state intervention in/after the market!