

RESPONSE FROM THE AGENCY FOR THE COOPERATION OF ENERGY REGULATORS AND THE COUNCIL OF EUROPEAN ENERGY REGULATORS TO THE EUROPEAN COMMISSION'S INTERIM REPORT OF THE SECTOR INQUIRY ON CAPACITY MECHANISMS

July 2016

Introduction

This note contains the feedback of the Agency for the Cooperation of Energy Regulators (“the Agency”) and of the Council of European Energy Regulators (“CEER”) to the European Commission’s interim report (“the Report”) on the findings of the sector inquiry on capacity mechanisms (CMs).

European energy regulators welcome the opportunity to respond to the Report. This response should be read in the light of the previous work of the Agency on CMs, including its Opinion No 05/2013 of 15 February 2013¹, its Report of 30 July 2013², its contribution, jointly with CEER, to the European Commission’s Public Consultation on a new Energy Market Design³ and, more recently, the last edition of its Market Monitoring Report⁴.

In view of the above, we welcome the in-depth and comprehensive inquiry into a selection of CMs which the European Commission is conducting in 11 Member States. The Report’s findings are also extremely relevant for the broader discussion on the electricity market design in the light of the EU liberalisation and decarbonisation policies. Moreover, the inquiry uniquely contributes to the factual understanding of the state of play in electricity markets in Member States and different CM designs. The Report assesses that existing and planned CMs can introduce distortions to the well-functioning of the IEM, in particular if CMs are introduced in an uncoordinated way without taking into account the contribution of various types of capacity resources, in particular from cross-border resources, and when a proper problem identification is not, or not adequately, taken into account.

European energy regulators fully share the concerns expressed by the European Commission regarding the introduction of CMs and the possibility that they may distort cross-border trade and competition in the IEM. Moreover, we are of the opinion that the CMs discussion should progress in such a way that it does not put into question or provide excuses to delay the ongoing implementation of the Third Energy Package, including Guidelines and Network Codes, so that tangible benefits can be delivered to European energy consumers as soon as possible.

Furthermore, European energy regulators broadly endorse the tentative conclusions of the Report, although, in the remainder of this document, we present our comments on some of them.

¹ Available at:

http://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Opinions/Opinions/ACER%20Opinion%2005-2013.pdf.

² Available at:

http://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/CRMs%20and%20the%20IEM%20Report%20130730.pdf.

³ See in particular responses to questions 1, 20 and 21. The contribution is available at:

http://www.acer.europa.eu/official_documents/position_papers/position%20papers/acer_ceer_emd_response.pdf.

⁴ See section 4.3.7 of the report available at:

http://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/ACER_Market_Monitoring_Report_2015.pdf.

Key comments

1. A credible Action Plan for removing the remaining barriers and regulatory failures for all Member States considering implementing a CM

European energy regulators agree with the European Commission that Member States, when considering the implementation of CMs, should first address existing market design failures that represent a barrier to the well-functioning of their energy markets and which created their adequacy concerns in the first place. Indeed, energy markets should be allowed to function fully and unhindered, by removing any price cap or other similar types of administrative intervention and any barriers to cross-zonal trade.

In this respect, we welcome the recommendation in the conclusion of the Report that Member States should present a “credible action plan” to address the remaining market and regulatory failures.

However, the Report proposes that Member States deliver such a credible action plan only when the assessed adequacy problems are of “transitional” nature, as opposed to “long-term and more general adequacy problems”. We believe that providing a credible action plan to address the remaining market and regulatory failures is needed in all circumstances and would actually be more useful where a Member State is confronted with “long-term and more general adequacy problems”. Hence, European energy regulators recommend that all Member States be required to present such a credible action plan when they consider implementing a CM. Furthermore, we believe that it would be helpful to provide guidance on what should be included in a credible action plan. Here we suggest that the following elements are included: (i) an assessment of remaining barriers and regulatory failures, (ii) an assessment of the reasons why these failures have not yet been addressed; and (iii) a roadmap. The latter should list the steps to address these remaining barriers and regulatory failures, when they will be taken and by whom.

2. More guidance on the meaning of transitional capacity problem versus longer-term adequacy problem

The Report considers, in the conclusions, two groups of CMs – tenders for new capacity and strategic reserves, on the one hand, a central buyer mechanisms and de-centralised obligation mechanisms, on the other hand – and argues that the first group is likely to be more appropriate to address “transitional capacity problems”, whereas the second group is more appropriate to address “long-term and more general adequacy problems”.

Given this critical recommendation, the Agency and CEER suggest that the final version of the Report includes a definition of what exactly transitional and long-term adequacy problems are, and which factors determine the nature of the problem a Member State is facing.

3. Explaining the delay in removing market and regulatory failures

The Report could also usefully explain in more detail the factors that hamper Member States in their effort successfully to address the “residual market and regulatory failures”. For instance, the Report argues that smart meters are a requirement for demand-side participation. In the past, some Member States set clear targets to roll-out these smart meters and, in some cases, this started more than a decade ago. Nevertheless, the penetration of smart meters seems to be often far behind these targets,

though the reasons are not clearly explained⁵. We believe that more clarity would be beneficial to understand the persistency of these and other similar delays and what steps have been taken to overcome them. If this cannot be part of the final version of the Report, it is recommended that such an assessment be added to the requirements for a “credible action plan”.

4. Harmonising generation adequacy methods and making reliability standards and associated cost transparent

The Report correctly states that methods to determine the generation adequacy level should be harmonised. In this respect, ENTSO-E’s standards could be further developed. Moreover, reliability standards should be published by Member States and should be based on methods that factor in the actual willingness of consumers to tolerate electricity cuts (‘value of lost load’). This will help Member States assess the benefits of a certain reliability standard target and transparently to report on the associated cost to deliver it.

5. Addressing market concentration

The Report further concludes that, when a Member State assesses to have a long-term general adequacy problem, the “level of competition” in the underlying wholesale market should be the decisive factor in deciding whether to implement a central-buyer mechanism or a decentralised obligation mechanism.

While European energy regulators appreciate that a central-buyer mechanism may be more suitable for concentrated markets, we underline that the effectiveness and efficiency of a CM, whether it is centralised or not, will be enhanced if it is implemented into a well-functioning wholesale electricity market. Hence, any competition concern should be addressed ahead of – or at least in parallel to – the implementation of any CM, for instance through the application of anti-trust legislation.

6. Better pricing of reserves in wholesale markets

Member States should ensure accurate price signals, in particular at times of scarcity⁶. In these (rare) hours, prices provide the incentives for (flexible) generation capacity, demand response, imports and exports within the IEM and, to the extent that they can be internalised in investors’ forecasts or long-term market instruments, to investment in new capacity.

In this respect, European energy regulators stress the importance of fully reflecting scarcity in the energy price. This could enhance the functioning of the Target Model and could address Member States’ security of supply concerns in a more efficient and more IEM-compatible way than the introduction of CMs⁷.

7. Contribution of cross-border flows to adequacy assessment and foreign participation in CMs

The Agency and CEER fully agree that adequacy assessments should be harmonised and conducted at pan-European level, or at least on a regional basis, taking into account the contribution of cross-zonal flows, but avoiding any double counting of resources in different areas.

⁵ See section 3.2.4. of the document referenced in footnote 4.

⁶ This refers to hours when the margin between available capacity and (peak) demand tightens and electricity prices rises above marginal operating costs.

⁷ See page 32 of the document referenced in footnote 3.

We also fully endorse that explicit participation of foreign capacity providers into national CMs through a market-based mechanism should be allowed. In this respect, we note that, as stated in its contribution to the European Commission's Public Consultation on a new Energy Market Design, a few important prerequisites need to be fulfilled to make explicit cross-border participation possible and beneficial:

- a) TSOs are incentivised to make a sufficient and appropriate amount of cross-border capacities available for cross-border trade throughout the year(s);
- b) TSOs are not allowed to adjust, limit or reserve these cross-border transmission capacities at any point in time, including in case of shortage situation; and
- c) TSOs agree *ex ante* on the treatment of local/foreign adequacy providers in case of a widespread shortage situation (i.e. when a shortage situation affects at least two countries simultaneously).

While the fulfilment of condition c) goes beyond the remit of National Regulatory Authorities (NRAs) and requires a strong involvement and commitment of Members States, conditions a) and b) are more in the realm of NRAs.

In this context, European energy regulators believe that the Report should clearly emphasise the importance of the CACM Guideline implementation and, in particular, the development of new capacity calculation methodologies able to create/increase the reliance on the ability of cross-zonal flows to contribute to solving national adequacy issues. The implementation of these methodologies should maximise the capacity allocated to the market, while respecting operational security, and prevent TSOs from reducing capacities at any point in time, including in case of simultaneous market scarcity situations.

8. Compatibility of capacity mechanisms CMs

The final version of the Report could usefully include a section that assesses the extent to which the different types of CMs under consideration could effectively and efficiently co-exist.