



– Consultation Response –

Brussels, 6 July 2016

## **Europex response to DG COMP consultation on its “Interim Report of the Sector Inquiry on Capacity Mechanisms”**

### **Introduction**

Europex welcomes the opportunity to provide feedback on the present CRM Interim Report. We are committed to further engage in a dialogue with the European Commission and other stakeholders on this important matter, which has far reaching implications for the efficiency of the wholesale electricity market and the security of supply in the rapidly changing European power system.

Our members are predominantly active in different regional and local settings with different fundamental needs and purposes. This is also reflected in the different scopes of CRMs, including the more limited strategic reserves. Nevertheless, a set of key principles, criteria and delimitations of CRMs should generally be applicable across all European electricity markets.

In the following, we comment directly on DG COMP’s CRM Interim Report while also outlining some general principles for CRMs.

### **1. Generation adequacy and the further development of energy markets**

- a. The continued integration of the EU’s Internal Energy Market (IEM), e.g. Single Day Ahead and Intra Day Coupling, must provide the basis for a sufficient level of supply and demand flexibility in the short-term. In addition, it should serve as the main tool for generation adequacy in the mid- and long-term. This means that any flexibility or generation adequacy measure should be designed and introduced with the common goal of an integrated IEM in mind.
- b. In our view, the primary instrument to address the short term flexibility and mid/long term generation adequacy challenges is the Energy Only Market as reflected via Implicitly Coupled Day Ahead Auctions and Continuous Intra Day Trading. Moreover, a proper interaction with further developed and better IEM-compatible,

balancing arrangements and markets is needed. Wherever possible, market-based reference price signals shall serve as the basis of decision making for market participants.

- c. In member states and regions with acute short and medium term security of supply challenges complementary capacity mechanisms of targeted and limited size can be justified as long as they do not hamper the completion of a well-functioning Internal Energy Market. This could even be the case despite the existence of efficient and free market arrangements in place, e.g. coupled DA and ID markets and forwards hedging. Such capacity mechanisms should only be temporary arrangements and need to comply with the overall goals of an integrated European internal market for electricity. They must be market-based, non-discriminatory and allow that all generation types and demand flexibility (meeting relevant criteria) can be part of it. Last but not least, it should be possible to utilise and coordinate them across zonal/country borders.
- d. Electricity prices formed in open coupled markets must continue to provide reliable and fundamental price signals for short and long term markets. They provide the right incentives for producers to continually act and invest in the markets as well as for distributors/retailers, traders and consumers. Importantly, market price signals also ensure that electricity is imported from the right place at the right time.
- e. A free price formation constitutes the basis for the efficient functioning of the wholesale and retail parts of the IEM. In particular, the existence of regulated end-consumer prices as well as the setting of regulatory price caps must be avoided. Necessary technical price caps will be defined by market venues in a way that does not interfere with the free price formation. In addition, when fundamentally justified, those technical limits can also be amended over time.

## **2. General principles for CRMs**

In our view, when CRMs are introduced, they should only cause minimal distortions to the markets. In order to fulfil this objective, the following issues should be thoroughly addressed:

- a. When designing a CRM, there needs to be clarity about what problem(s) the CRM is meant to address – e.g. risk of short term (peak load) shortages or ensuring long term capacity adequacy?

- b. We agree that the six different types of capacity mechanisms discussed in the interim report are not equally well-suited to address capacity problems. The optimal choice will depend on the nature of the supply/demand flexibility. Furthermore, it must be in line with the generation adequacy problem(s) it is meant to address and with the structure of the relevant member state's or regional electricity market.
- c. It is essential to limit CRMs in size, duration, geographic scope and type of supply and demand resources to ensure that they only cover what they are meant for.
- d. We agree that out of the six types of capacity mechanisms, capacity payments risk either over-compensating (or under-compensating) capacity providers. This is because they are not based on expectations of the supply/demand balance but rather result from an administrative decision that is often not dynamic in practice.
- e. We share the Commission's view that the risk for overcompensation is lower with the four remaining types of capacity mechanisms, which address specific generation adequacy concerns. The choice of the most suitable model depends on the precise adequacy problem to be solved.
- f. If CRMs are part of the main physical liquidity market, e.g. day ahead coupling, it should be ensured that they have limited distortive effects on the flexibility provided in regular orders. This means, e.g., that the CRM/strategic reserve should only be activated, if the DA market first has gone short (or long) and thus may require curtailment. Any activation should ideally only take place above the highest priced commercial orders.
- g. If a CRM is not part of the Day Ahead Market (DAM), but is meant to supply reserves to TSOs for real time system management, there is a need to justify why this would be a better approach than keeping the CRM within the DAM.
- h. Regardless of whether a CRM is included in the DAM or not, it is key to recognise that there is a limited level of resources, which do not become any larger or easier to use, if kept as last resort rather than made available to the market.
- i. It is also key to ensure that:
  - i. All flexible production and consumption is first made available in the Day Ahead Market, then in the ID market and finally in real-time balancing arrangements. Otherwise the resulting price signals will not reflect true scarcity.

- ii. Price signals set in the DA, ID and balancing markets are respected (and not adjusted afterwards through regulatory measures), if the resulting market prices are deemed to be politically sensitive.
- iii. The financial risks (e.g. settlement and clearing) for market participants, power exchanges (NEMOs) and their clearing houses are adequately considered when setting rules for the use of CRM resources and the handling of scarcity pricing in DA/ID markets as well as in balancing arrangements and imbalance settlement.
- iv. It is recognised that true scarcity in the power system is only found in the balancing real-time period. A system-wide VOLL is only relevant at this stage, which means that any balancing price limits must not be below such limits.

## **About**

Europex is a not-for-profit association of European energy exchanges with currently 27 members. It represents the interests of exchange-based wholesale electricity, gas and environmental markets, focuses on developments of the European regulatory framework for wholesale energy trading and provides a discussion platform at European level.

## **Contact**

Europex – Association of European Energy Exchanges

Address: Rue Montoyer 31, 1000 Brussels, Belgium

Phone: +32 2 512 34 10

Website: [www.europex.org](http://www.europex.org)

Email: [secretariat@europex.org](mailto:secretariat@europex.org)

Twitter: Europex\_energy