

## **AFIEG comments to EU Commission interim report on capacity mechanisms**

July 6<sup>th</sup>, 2016

*The following comments are not classified.*

### **I. Foreword**

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AFIEG (French independent association of electricity and gas) members are active in the French market, either as producers or suppliers. Therefore, AFIEG welcomes the opportunity to bring comments to the EU Commission's interim report on capacity mechanisms.

As a starting point, AFIEG considers that the energy-only market, as it is currently designed, in particular in the French case, neither delivers appropriate long-run signals to ensure security of supply nor allows adequate coverage of the operation costs of power plants which is currently needed for demand-offer balance and security of supply. In absence of additional income, this unsustainable situation would lead to further mothballing of power plants.

AFIEG has participated actively in the capacity market design alongside with other stakeholders and, while generally supporting the mechanism, often has expressed concerns over the market power of the incumbent operators, price instability and lack of visibility for producers and suppliers, which all could impact the functioning of this market.

AFIEG members support DG Competition initiative to initiate a sector inquiry on existing and planned capacity mechanisms within the Member States in order to obtain a profound expertise on the existing models and to define a European framework for the electricity market design. This work aims at bringing more visibility and legal security to capacity mechanisms. This work is even more important because capacity mechanisms could be a necessary component of the future European market design, set up to guarantee security of supply (28 capacity mechanisms have been identified in the interim report, among the 11 countries covered by the inquiry).

However, AFIEG members wish to insist on the urgent need to set up French capacity mechanisms designed to tackle security of supply issues. In addition, they hope that the current procedures will minimize the impact on the timeline of the market kick-off but also, will contribute to the quick resolution of the State Aid cases SA.39621 (2015/C) (In depth inquiry on "Mécanisme de capacité en France").

AFIEG members are quite confident since the French capacity mechanism is identified in the EU Commission interim report, as one of the best two models for dealing with long term adequacy issues.

It is indeed an efficient, market based and volume based model, relying on a competitive and decentralized allocation process.

## II. A need for capacity mechanisms

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**AFIEG agrees that all efforts should be undertaken to reach a well-functioning market. However, a capacity mechanism is still necessary since there are remaining doubts whether all distortions will be phased out in order to enable the energy market to provide appropriate investment signals and to guarantee security of supply.**

AFIEG supports the EU Commission's position which assesses the need to increase all efforts to improve the energy market. Underlying market distortions caused by political and regulatory interventions should be removed in the first place.

However, although all efforts should be undertaken to reach a well-functioning energy market, two uncertainties remain. On the one hand, the consequences may not be politically accepted and, on a second hand, all distortions may not be completely phased out to enable the energy market to provide appropriate investment signals in a phase of low carbon transition dominated by low operating costs. The Commission itself has admitted that certain types of market failures are extremely difficult to correct or need time to be addressed and resolved.

The energy market is torn apart between a proactive energy policy and the need for appropriate investment signal. Therefore market failures are, in many countries, substantial to energy market and therefore, difficult to solve. In some countries, a history of regulatory interventions (price caps, constraints to plant closure, changing policy objectives, distortive RES support schemes, etc...) have distorted the market for years. Since these distortions are an issue for security of supply, the implementation of a CRM could be a fast and pragmatic solution to tackle these regulatory failures.

In the specific French case, the analysis of the recent modelling works from the TSO (RTE) shows the direct relationship between the implementation of CRM and security of supply:

- The 2014 Adequacy report in 2014 showed that ongoing reliability standards – 3 hours of shortfall each year on average, as fixed by French authorities – could reach critical levels from next winter (2015/2016).
- The next RTE Adequacy report published in 2015 showed a much reduced shortfall risks partly because some electricity producers anticipated the implementation of French CRM to avoid mothballing.

The risk of a reduction on reserve margin due to the mothballing of some of the capacities is forecast in case of delay in the implementation of French CRM.

Moreover, AFIEG underlines that the risks associated to the Capacity Remuneration Mechanism (CRM) are mainly related to the everlasting incumbent market power. Indeed, the issues that have not been solved in the French energy-only market (dominant position of EDF, lack of competition, market power

...) will remain in the French CRM. Therefore AFIEG fully agrees with the following paragraph of the Staff Working document: *“The design of the allocation process in a capacity mechanism can also affect competition in the electricity market”*. For instance, the inquiry found that in concentrated markets, capacity mechanisms which are de-centralised (i.e. where the individual suppliers are responsible for estimating and procuring the required capacity), such as the mechanism being developed in France, may act as a barrier to market entry. This is because new entrants are less able to estimate their future capacity needs than established companies with a large and stable customer base are.

The EU Commission’s Energy Union strategy will have to tackle this issue in order to avoid that CRM increase the risk of abuse of a dominant position.

However, delaying the market kick-off schedule is not recommended. It would only result in strengthening the incumbent market power on the generation market while dangerously deteriorating the financial viability of the few power generating assets operated by the competitors (mainly AFIEG members) even though it would postpone a major constraint for alternative suppliers which do not operate any capacity. Considering these issues, AFIEG suggests that the remedies brought to the market design shall be worked out, ideally without amending the current CRM rules.

### **III. A competitive and efficient design for the capacity mechanisms**

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Capacity mechanisms need to be designed carefully. The current electricity market design is not sufficient to convey the right long term investment signals (neither it is sufficient, most of the time, to cover the operational costs). CRM can provide earlier investment signals than energy only market can.

However, AFIEG agrees that the capacity market should be designed in an efficient and competitive way and welcomes the initiative of the EU Commission to establish a set of rules determining the compatibility of a capacity mechanism to the European competition law around 3 criteria.

- On eligibility, AFIEG agrees that *“to obtain as much competition as possible in the capacity mechanism, Member States should design a mechanism that is as encompassing as possible so that different types of capacity providers are effectively put into competition with each other”* and that it should provide cross border participation.
- On the allocation process, AFIEG agrees that it should be organized on a competitive allocation because it *“minimizes the costs of the capacity mechanism, as long as its design ensures competitive pressure and prevents the exercise of market power”*.
- Regarding the capacity product, AFIEG agrees that it should be designed in a way that encourages investment in sufficiently flexible and reliable capacity.

Concerning the specific case of France, AFIEG considers that the French CRM is in line with these recommendations. Indeed, the mechanism is widely open to all potential capacity providers and capacity providers are selected through a competitive allocation process so that it does not distort the market. Moreover, a process is under way to remunerate cross border participations. A consultation is currently carried out by the French TSO in order to establish concrete measures to modify cross border participations in the mechanism.

Moreover, AFIEG members agree with the EU Commission on the fact that the French obligation mechanism is an *“appropriate option to address long term adequacy problem”*.

#### **IV. A necessary European framework for cross-border participation**

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Concerning cross border participations, AFIEG clearly supports the EU Commission’s initiative (annex two) to develop a European standard framework for cross-border participation. A coordinated approach for cross-border participation might be a first step to drive a more regional-based capacity mechanism.

AFIEG welcomes the EU Commission’s approach on cross-border capacity and would like to comment on some points:

- AFIEG is in favor of explicit participation for foreign capacities in the French capacity mechanism
- AFIEG considers that the value of the capacity is both located in capacity production and in interconnexions.
- AFIEG explicitly welcomes that the commitment for cross-border capacity should rely on availability of the capacity rather than on the produced energy.
- The existence of a CRM in one country should not be a prerequisite for the supplier of this country to take part in the CRM of another country. Moreover, the condition of a reciprocal participation should not be required.
- AFIEG considers that the participation in several capacity mechanisms should be possible, and we push for the definition of rules regarding current scarcity.
- The cross border participation should be implemented as quickly as possible but is not a prerequisite for the implementation of the French CRM

In the specific case of France, AFIEG considers that it is necessary that the French CRM evolves in order to be opened to foreign capacities. In our point of view, foreign capacities and interconnections should be remunerated by each national capacity mechanism. The current solution that involves the inclusion of foreign capacities through implicit and statistical participation (Article 3 of Decree No. 2012-1405 of 14 December 2012) is not satisfying. The solution should follow the above comments given by AFIEG, in line with the prescriptions of Annex 2.