

## RTE consultation on the evolution of the Capacity Mechanism rules



### EFET response – 25 October 2016

#### Introduction

The RTE reflection on the evolution of the French Capacity Remuneration Mechanism (CRM) rules comes as a response to the European Commission investigation on the mechanism. The Commission's DG Competition is inquiring into possible distortions of competition brought about by the design of the French CRM, into the appropriateness of long-term prices signals in the French power and capacity markets, and into options for cross-border participation in the CRM. While the Commission has not yet issued its final position on these elements, RTE has initiated a dialogue with market participants on the following subjects:

- Potential distortions of competition: RTE proposes a simplification of the capacity certification process, and a simplification of the capacity obligation
- Potential discriminatory treatment of foreign capacities: RTE proposes a hybrid solution to take account of the contribution of foreign capacities and interconnectors

This EFET response to the RTE consultation focuses on the first of these two points. For further input also on the second point, we refer to our contribution of 7 September 2016<sup>1</sup>. We understand that rules to ensure the cross-border participation of foreign capacities will be developed with a view to enter into force for the delivery year 2019. We welcome this announcement by RTE and invite them to pursue their efforts on that front and stick to the proposed timeline.

<sup>1</sup> EFET contribution on the evolution of the French capacity mechanism rules – certification and capacity obligation rules, cross-border participation, 7 September 2016, available at: [http://www.efet.org/Cms\\_Data/Contents/EFET/Folders/Documents/EnergyMarkets/ElectPosPapers/NatRegLevel/~contents/QV22DPTCX64MV66H/EFET\\_CRM-FR\\_RTE-questions\\_07092016.pdf](http://www.efet.org/Cms_Data/Contents/EFET/Folders/Documents/EnergyMarkets/ElectPosPapers/NatRegLevel/~contents/QV22DPTCX64MV66H/EFET_CRM-FR_RTE-questions_07092016.pdf).

On a general note, EFET has not and will not take a position on the establishment of the French CRM. In our view, **establishing a new CRM or maintaining an existing one should be based on a pan-European capacity adequacy assessment taking account of all capacities** (generation, DSR and storage, including across borders) and an appropriate cost-benefit analysis including alternative solutions.

Besides, we believe that **the consideration or the establishment of a CRM should never be a reason to relinquish efforts to improve the energy market design. Undistorted energy prices give an accurate signal for dispatch on the one hand, and for investment and divestment on the other hand.** Accurate price signals will allow market participants to identify the need and timing for investments in peaking generation units, storage solutions and demand-side management, alongside more traditional investment in generation and transmission capacity. We refer to our Discussion Paper on the free formation of prices in the wholesale electricity market for more details on the subject<sup>2</sup>.

The purpose of this contribution is to provide feedback on the new draft RTE rules from a European market perspective. Experience from discussions on CRMs has shown us that keeping those debates at Member State level risks negatively affecting the well-functioning of the internal energy market, to the detriment of end-consumers at European level.

### **Comments on the evolution of the RTE rules relating to the certification process and the capacity obligation**

As an introduction to this first section, EFET would like to recall its attachment to a number of fundamentals enshrined in the EFET Core Principles, and which constitute the basis of a well-functioning energy market:

- **Competition and market access:** Wholesale markets in all energy commodities and related products and services should be open to competition and intermediation
- **Transparency:** All market participants need access to disaggregated information about underlying supply and demand fundamentals to facilitate wholesale trading of power and gas on a level playing field.
- **Freedom of choice of trading venue:** Wholesale energy market participants should have the freedom to choose how and where to carry out their trading activities. A harmonious co-existence of OTC trading (with or without clearing as appropriate) and exchange-based trading opportunities is the fairest and most cost-effective outcome.

<sup>2</sup>The importance of free formation of prices in the European wholesale electricity market, an EFET Discussion Paper, June 2016, available at: [http://www.efet.org/Cms\\_Data/Contents/EFET/Folders/Documents/EnergyMarkets/ElectPosPapers/~contents/GG H299HP5MPZQ5T5/EFET\\_Free-formation-of-prices-power-market.pdf](http://www.efet.org/Cms_Data/Contents/EFET/Folders/Documents/EnergyMarkets/ElectPosPapers/~contents/GG H299HP5MPZQ5T5/EFET_Free-formation-of-prices-power-market.pdf).

We believe that these principles apply also in the case of CRMs. Granting freedom to market participants in the manner with which they organise the fulfilment of their obligations is, according to us, one of the positive aspects of the decentralised CRM model in France. This comes of course with a greater need for transparency – via the RTE registry – on the one hand, and for regulatory oversight to prevent and sanction market misbehaviour – via European and national competition and/or energy laws – on the other hand.

While we hear the European Commission’s concerns regarding the potential for capacity retention in the French CRM, our remarks below underline the need to focus on improving transparency on the various elements of the mechanism, and reiterating the existing role of the regulator and competition authorities. Ensuring efficient transparency and oversight makes in our view more sense than restricting the mechanism ex-ante.

### **I. Evolution of the capacity certification process**

The European Commission has identified a risk of distorting price signals by way of excessive or insufficient capacity certification. RTE proposes to create a certification “corridor” to define the acceptable level of capacity availability compared to the capacity certification. Capacity providers would need to notify and request an exemption from RTE and CRE should their availability fall below or rise above the corridor limits. The certification corridor would apply until the beginning of the delivery year. The certified capacity would be determined by RTE according to a reference value, based on historical data – over time on recorded availability. The corridor would be defined in per cent of the certified capacity, with different values per technology.

The proposal poses questions as to the treatment of demand-side response (DSR), intermittent generation capacity and new capacity assets. For all of these, the determination of the reference value appears problematic.

EFET understands the corridor proposal of RTE as the main element of its reform to prevent capacity retention. The idea would allow more control on the certified capacities and their availability, while granting a certain level of flexibility to the capacity providers. Given the percentages assigned to each technology in section 6.3.1.3, EFET is amenable to the RTE proposal as a try-out, in the sense that it could limit intentional or non-intentional retention of capacity in the first years of implementation of the CRM. Once more information is available to market participants and the regulator on the functioning of the corridor and on patterns of certification, we propose a review of the proposal to assess its efficiency and necessity. In that sense, we believe that the rules should not set the values of the reference ratio and the acceptability margins for the next five delivery years, but that these figures should be reviewed after one or two years of functioning of the mechanism.

Regarding the difficulties to define a reference value for certain types of capacities:

- For new assets: as suggested the reference value could be based on average assets of the same technology.
- For intermittent generation: extensive historic data is available regarding the availability of each installation. The uncertainty relating to the availability of intermittent generation is already covered by the availability discount.
- For demand response capacity: information ought to be disclosed by the demand response providers in the same way other market participants do. The rapid evolution of their portfolio is not a problem as such, should the notification procedure by RTE/CRE be flexible enough.

For these three types of capacities where uncertainties are higher, a broader corridor – but within reason – could also be envisaged.

## **II. Review the balancing specifications**

According to the current rules, re-balancing, i.e. modifying one's certification level, is possible at zero cost before the delivery year. The Commission is concerned that this could make signals related to real capacity offer and need incorrect. DG Competition is worried that market participants could use this feature to retain capacity until shortly before the delivery year, thereby artificially sustaining high prices for obliged suppliers.

In response, RTE proposes to establish a threshold at 1GW above which rebalancing could not be done at zero cost anymore. The threshold would be calculated at legal entity level. There would be an exemption for unforeseen imbalances.

EFET does not see how the proposed measure would fundamentally improve transparency in the market. The order of magnitude of existing capacities in the market is known, both by market participants and the regulator. If the goal of the measure is to avoid capacity retention, then we suggest that CRE takes a more active role in that regard. The energy regulator and the competition authorities have the power to control and enforce sanctions in case of non-competitive behaviour. The RTE proposal risks transforming the decentralised French CRM model into a heavily centralised and regulated model. Limiting free rebalancing before the delivery year would restrict the right of market participants to decide on the level of certification, depending on their vision of the market and the penalties they are facing in case of deviation from their obligations.

### **III. Review the imbalance settlement calculation**

Once again, the Commission is worried that the imbalance settlement calculation could favour capacity retention and over-compensate capacity retainers once they make this capacity available through the imbalance settlement process. The RTE proposal is as follows:

- Within 1GW of imbalance, the system remains unchanged
- Beyond 1GW of imbalance settlement price, the system is amended:
  - No symmetric, linear imbalance pricing between positive and negative imbalances
  - Higher imbalance penalties for negative imbalances
  - Capped imbalance compensation for positive imbalances above 1GW

EFET is not convinced by the RTE proposal. Should the imbalance settlement price not be enough of an incentive, then the formula should make it more restrictive – in that sense the higher penalties as proposed for negative imbalances makes sense. However, the non-symmetrical formula might create adverse effects as well: the price might artificially be increased. In any case, market participants might adapt their hedging strategies taking into account the penalty risk they are facing.

In general, we reiterate our point that we are not convinced that fundamentally changing the balancing specifications and the imbalance settlement regime is the best way to go about hypothetical market distortions. We believe that CRE and the competition authority have the power to control and enforce sanctions in case of non-competitive behaviour, and should make full use of these powers in case of suspected market abuse.

### **IV. Follow-up of the capacity obligation for obliged suppliers**

We generally welcome the presentation by RTE of its calculation tool to give better visibility on the capacity obligation. We believe that this measure will help bring more transparency into the mechanism, especially considering the difficulty for obliged suppliers to assess their needs up to four years in advance. Indeed, these needs depend on the suppliers' client portfolios, which are expected to be more volatile with increased competition on the retail market.

### **V. Role of the organised market**

According to the current rules, capacity certificates will be exchanged on both the OTC and the organised market, with EPEX Spot being expected to start auctions in December 2016, probably on a yearly basis. The Commission would like to enhance the role of the organised market as they consider organised markets needed to have a reference price emerge. We agree with the rules proposed by RTE in terms of:

- Publication of all information (not aggregated) relating to the OTC transactions (volume, price, etc.) except market participant ID

- Internal transactions of integrated utilities would be concerned

EFET would like to reiterate the vital importance of OTC markets alongside organised markets. **The freedom of choice of trading venue is paramount for market participants, and a founding element of market liberalisation at EU level.** OTC markets are necessary alongside organised markets in order to be able to trade in between organised auction and hedge their positions. Considering that EPEX Spot is for the moment the only power exchange that has expressed interest in setting up an organised market for the exchange of certificates, restricting the possibility for market participants to access the OTC market for that purpose would be tantamount to establishing a monopoly function for the trading of capacity certificates. This seems at odds with the objective that we expect the competition arm of the European Commission to pursue.

While the EPEX Spot auctions will play a central role in establishing a reference price for the capacity certificates, OTC markets will as well. Increased transparency of OTC transactions would facilitate this. RTE should ensure the efficient functioning of the registry to facilitate access to information for all.

In the new version of the draft rules, RTE proposes to impose the participation of both capacity providers and obliged suppliers in the organised market, with increasing obligations to offer certificates in the organised market auction as the delivery year approaches.

We understand the rationale of the measure and note that similar provisions have been established in certain power markets at an early stage of development, so-called “market making” mechanisms. However, **we have concerns with any obligation for capacity providers to offer a certain volume of certificates on the organised market at each auction:** first this is a restriction to the principle of free choice of trading venue; second, we believe it is too complex to assess which level of mandatorily offered volumes would be appropriate given that neither RTE, nor the regulator or market participants have any experience with the mechanism.

There may be merits in ensuring that certificates are openly traded on the market to favour the emergence of a transparent reference price signal, improve liquidity and discourage capacity retention or the exclusive recourse to intra-group transfers. However, by imposing an obligation to offer at least 25% of certificates in all auctions from as early as four years before delivery, the likely outcome of the proposed rule is a fragmentation of trading and liquidity that would make the obligation unfit for its main purpose. To avoid capacity retention, we recommend that CRE carefully monitors the behaviour of market participants to ensure that clearing prices correctly reflect the economic reality. Should this be considered insufficient, we would recommend at most an obligation to offer certificates on the organised market applying only to the year before delivery.