

AEEGSI consultation document n. 592/2017 on the capacity mechanism



EFET response – 18 September 2017

The European Federation of Energy Traders (EFET¹) thanks AEEGSI for the opportunity to provide an input on its consultation on the planned capacity mechanism in Italy.

As stated in several occasions, in our view, it is fundamental that capacity mechanisms, where implemented, are carefully designed in order not to interfere with the free formation of price signals in the energy markets. Below we have provided our feedback on the specific questions which are relevant for EFET

Q1. In merito alla DSR impegnata, si condividono le considerazioni sopra riportate? In caso di risposta negativa, si prega di motivare.

EFET believes that DSR should directly participate in the capacity mechanism, with the same rights and obligations of all other capacities . From this perspective:

- the European Commission Guidelines on State aid for environmental protection and energy 2014-2020 require from Member States “an assessment of the impact of demand-side participation, including a description of measures to encourage demand side management”², in case of a capacity mechanism implementation;
- In the UK capacity mechanism, active DSR participation is defined with reference to a commitment to reduce the import of electricity and/or export electricity generated by on-site generation units which are owned by the DSR provider. ³
- In the French capacity mechanism, DSR is treated with exactly the same rights and obligations as power generation, with the only exception that DSR certification and participation is optional when power plants have an obligation to get certified and to participate in the mechanism
- In Italy, DSR is participating in the ancillary services market under UVAC pilot projects launched by Terna earlier this year.

In case the proposal will be implemented, we believe that the settlement arrangement for DSR shall be completed with the definition of a minimum set of requirements. These come necessary for consumers to be subject to the same rights and obligations of production units and to establish a truly technology

¹ The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent and liquid wholesale markets, unhindered by national borders or other undue obstacles. EFET currently represents more than 100 energy trading companies, active in over 27 European countries. For more information: www.efet.org

² ([http://eur-lex.europa.eu/legal-content/IT/TXT/PDF/?uri=CELEX:52014XC0628\(01\)&from=DE](http://eur-lex.europa.eu/legal-content/IT/TXT/PDF/?uri=CELEX:52014XC0628(01)&from=DE))

³ Decision C (2014) 5083 of DG Competition

neutral” capacity mechanism. In particular, as foreseen in Terna’s capacity mechanism scheme, DSR providers shall have the obligation of;

- Offering on MSD the quantity of qualified capacity, at least for a minimum quantity of hours in the year;
- Offering availability to disconnect from the grid,

In addition, we highlight that the discount applied to the capacity mechanism tax burden (“onere netto del mercato della capacità”) shall be applied only to the qualified amount of capacity effectively offered on MSD.

Q2. Si condivide l’orientamento secondo cui il prezzo di esercizio rimanga un parametro rappresentativo del costo variabile di produzione anche nel caso in cui sia prevista la partecipazione attiva della DSR al mercato della capacità? In caso di risposta negativa, si prega di motivare.

EFET believes that any interference of the capacity mechanism on the free formation of power prices should be absolutely avoided. We are concerned that a strike price calibrated on the variable costs of an OCGT will be set at a too low level, with the risk that it implicitly ‘caps’ the market. Such situation would distort the natural formation of prices and lead to inefficient price signals. Overall, we cannot accept that revenues coming from the energy only market are capped by the capacity mechanism.

As specified in previous consultation documents, EFET believes it is essential that the strike price level is set well above any normal and tight market conditions and therefore above the costs of the most expensing capacity in the market. This price should in fact be set at a level which would be reached only in case of severe scarcity. Given that the load will also be entitled to participate to the MSD and to the capacity scheme, we believe it is necessary to calibrate the strike price level on the demand side response (DSR).

We do not share the analysis carried out by AEEGSI and in fact we doubt that the reliability options’ strike price, set at the OCGT variable costs, might guarantee an effective participation of DSR in the capacity mechanism: **we would like to refer to a study performed by REF-E, an independent consultancy, that we attach to this consultation response, which concludes that the cost of DSR activation is in the range of 300-500 EUR/MWh.** This range could be used as a basis to set the strike price in the capacity mechanism. This also would be in line with the strike price level set in the pilot project on the access of demand to the MSD (400 €/MWh), launched by Terna earlier this year.

The same study also concludes that a low strike price would affect cross-border price spreads and, as a consequence, lead to inefficient import/export flows: in particular, ex-post simulations show that with a strike price set at the variable costs of an OCGT, exports from Italy to France would considerably increase for a significant number of hours.

Therefore, we call AEEGSI to seriously reconsider the methodology and assumptions behind the strike price setting. The value of the strike price should be increased well above the proposed level, in order to reduce the risk of interference with the normal functioning of forward, spot and ancillary services markets in Italy.

Q3. Si ritiene che sia opportuno che una parte del fabbisogno di capacità non sia soddisfatta nelle aste madri e sia riservata alle aste di aggiustamento che si svolgono l'anno prima dell'anno di consegna? In caso di risposta negativa, si prega di motivare.

EFET does not support the proposal to retain part of the capacity needs on the base of Terna's evaluation on the first main auctions ("aste madri") in order to facilitate DSR participation. First, the procedure seems very uncertain and not transparent, since the amount of retained capacity will be decided after Terna's assessment based of the estimated DSR participation for next years. Second, we highlight that the main auctions are designed to allow long-term investment signals to emerge. Besides, the adjustment auctions ("aste di aggiustamento") are implemented for the re-negotiation of capacity commitments closer to real time: reducing upfront the amount of tradable capacity in the 'mother' auctions may negatively affect the provision of the right signals by the capacity mechanism.

Q4. Si condivide l'approccio descritto sopra in merito alla metodologia di determinazione del prezzo di esercizio? In caso di risposta negativa, si prega di motivare

For the reasons mentioned above in our answer to Q2, we believe that AEEGSI should reconsider the methodology behind the strike price calculation. In addition, due to the introduction of a cap on the premium for existing plants, the increase or even the elimination of the strike price becomes even more necessary.

Q5. Si condivide la metodologia utilizzata per la definizione dei valori dei premi corrispondenti ai diversi punti della curva di domanda? In caso di risposta negativa, si prega di motivare, fornendo – ove disponibili - informazioni quantitative a supporto delle controdeduzioni.

In general, we underline that the calculation of the CONE is done using the maximum capacity in MW of a peak power plant, which is not coherent with the fact that plants are remunerated on the basis of the portion of capacity that can be qualified in the capacity market ("CDP"). Besides, an amortization time of 25 years appears too long in comparison with the 15-years premium the new power plants receive after stipulating capacity contracts; also, inflation rate or taxes are not considered. These inconsistencies should be solved and clarified before the start of the capacity mechanism.

Q6. Si condividono gli orientamenti dell'Autorità in merito alle misure di contenimento dell'esercizio del potere di mercato nelle prime aste del mercato della capacità? In caso di risposta negativa, si prega di motivare.

We do not share the proposal to establish a cap or a 'bid cap' on the premiums in EUR/MW potentially recognised to holders of existing capacity contracted through the mechanism. In line with our general refusal of caps/floors in any sort of market and the potential discrimination between existing and new capacity, we believe that by squeezing the cap to a very low level such as 20.000 EUR/MW, there is the real risk that the procurement of resources for system adequacy of the and the actual scope of the capacity mechanism, which consists in valorising the existing capacity and letting investment signals for new capacity to arise, completely fails. Hence, we suggest removing this limitation and returning to the original proposal of a cap equal to 75.000 EUR/MW.

Q7. Si ritiene che sia opportuna l'adozione della sopra descritta modalità di applicazione graduale del mercato della capacità? In caso di risposta negativa, si prega di motivare.

As stated above, it is fundamental that the strike price does not act as an implicit cap on free price formation on the wholesale market. Hence, EFET strongly supports the proposal to increase the strike price, as proposed for the first phase of implementation. However, we do not share the proposal to reduce the demand curve values, which should not be modified, not to risk hindering the capacity mechanism from guaranteeing adequacy in the long term.

Moreover, we underline that just doubling the proposed strike price level calibrated on the OCGT would still be insufficient to ensure that the normal operation of power markets is not disturbed by the capacity mechanism. We demand that the strike price is set at a higher level by the go-live of the mechanism, in line with our response to Q1 and Q2.

Conclusions

EFET believes that the design of the capacity mechanism should avoid disturbing the correct formation of price signals in the energy markets and should be free from caps/floors. Hence, we demand:

- An increase of the strike price, which should be calibrated on the demand-side. Moreover, this is needed to fully incentivise the participation of DSR to the mechanism and to have a truly technology-neutral capacity mechanism;
- The removal of both caps and 'bid caps' on premiums for existing capacity. We recommend returning to the original proposal of a cap equal of 75.000 EUR/MW.

We remain available to discuss these issues in details.