

RTE reflection on the evolution of the Capacity Mechanism rules

Evolution of the certification and capacity obligation rules Cross-border participation



EFET contribution – 7 September 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

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 subject¹.

The purpose of this contribution is to provide feedback to RTE 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.

PART I – 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.

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

¹The 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.

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 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. Provided we get more information on the percentages envisaged for each technology, 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.

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.

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. EFET will analyse the opportunity of taking a position on this subject once more details are known.

V. Prevent the risk of margin squeeze at integrated utilities

The Commission is worried that integrated utilities may practice margin squeeze to gain or retain market share. RTE sees two possibilities:

- Force integrated utilities to declare an internal transfer price (included in the reference used for their commercial supply offer)
- Force integrated utilities to communicate to CRE their methodology to take the capacity price into account in their supply offers

EFET does not wish to comment on this matter.

VI. Role of the organised market

According to the current rules, capacity certificates will be exchanged on both the OTC and the organised markets, with EPEX Spot being expected to start auctions soon, 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. RTE proposes the following:

- 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 addition, RTE has developed two scenarios for the longer term. In **Scenario 1**, RTE proposed to introduce more auctions before the delivery year (about one per year is planned for now). The obliged suppliers would be free to cover their obligation according to their own schedule, but capacity providers would have binding requirements in terms of the volumes of certificates they offer at each auction.

Regarding the organisation of a greater number of auctions, EFET is amenable to the idea provided that the exchange(s) is (are) able and willing to organise them. We would like to recall that it is useless to organise too frequent auctions if there are not met with sufficient liquidity. EPEX Spot has conducted extensive interviews with market participants over the 2015-2016 period to assess at which frequency and timing they should organise auctions. We would suggest that RTE and the regulator let the exchange and market participants gain experience before introducing additional, binding requirements.

We welcome the freedom granted to the obliged suppliers in terms of how they wish to cover their obligation. This should of course include the possibility for obliged suppliers to cover their obligation via the OTC market, which should be maintained in any case.

In its **Scenario 2**, RTE focuses on incentivising (or possibly imposing) the participation of both capacity providers and obliged suppliers in the auction in the year before delivery.

We reject an 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 markets to favour the emergence of a transparent price signal and discourage capacity retention and the exclusive recourse to intra-group transfers. To avoid capacity retention, we recommend that CRE carefully monitor the behaviour of market participants to ensure that clearing prices correctly reflect the economic reality.

PART II – Cross-border participation of foreign capacities

As highlighted in previous EFET contributions², we believe that if and when CRMs are established in a specific control area, the contribution of capacities (generation, demand response and storage) situated outside of this area to the zone's security of supply should be duly taken into account.

Hence, EFET has been advocating a reform of the current “implicit” consideration of foreign capacities’ contribution to French security of supply, and the implementation of an “explicit” model where generation, demand response and storage capacities situated outside of the RTE control area may directly participate in the mechanism. In no circumstance should the existence of a CRM in a neighbouring country, or absence thereof, be a reason to exclude foreign capacities from participating in the French CRM. Likewise, while the mutual recognition of third-country capacities’ participation in the CRMs of neighbouring markets is desirable, it should not be a prerequisite to the recognition of foreign capacities’ participation in the French mechanism.

For EFET, the rights and obligations of foreign capacity providers wishing to participate in the French CRM should be exactly the same as those imposed on capacities situated within the French borders, namely:

- the certification of capacities
- the control of the fulfilment of capacity providers’ engagements
- the settlement of possible imbalances
- the possible penalties imposed on capacity providers

A number of rules need to be developed to ensure that these basic features of the French CRM lawfully apply to assets situated outside the reach of French legislation and RTE control. EFET therefore believes that the evolution of the RTE rules to allow for the participation of third-country generation, demand and storage to the French CRM should go hand in hand with practical and legal developments at European level and in neighbouring countries. In the meantime, cooperation agreements at TSO and regulator levels must be developed to ensure that foreign TSOs can effectively perform the above-listed functions carried out by RTE on French territory.

The principles used for calculating the certifiable capacity should be the same as for French capacities. It is important to maintain the simplicity of the French CRM and apply it to foreign capacities in the same manner as it is applied to capacities situated within the French borders. In no case should the French CRM’s availability model be transformed into a delivery model for foreign capacities. The submission of bids with a foreign market operator should be considered sufficient to demonstrate capacity availability. In no instance should the question of cross-border delivery inability because of market suspensions and emergency situations linked to system stress

² For extensive details on this question, please refer to the EFET response to the RTE consultation on the cross-border participation of foreign capacities to the French CRM, 15 October 2015, available at: http://www.efet.org/Cms_Data/Contents/EFET/Folders/Documents/EnergyMarkets/ElectPosPapers/NatRegLevel/~contents/VQZ2CYM5GYDLESUF/EFET_RTE-consultation-XB-CRM_final.pdf.

become a question when assessing the fulfilment of their obligations by foreign capacities: as the CRM is based on availability, the actual delivery of the energy is dealt with through the energy market, for capacities situated within or beyond the French borders alike³.

Further, EFET maintains that the direct participation of interconnections in the French CRM – or any such mechanism in Europe for that matter – cannot be the way to proceed for the opening of cross-border participation in the French capacity mechanism. EFET only supports the direct participation of generation, demand and storage capacities. Given the position of RTE as co-owner and co-operator of all the interconnectors at the French borders, we believe its participation poses questions with regard to the unbundling principle of the Third Energy Package.

For the time being, EFET does not have a definite proposal how the limitations of cross-border interconnection capacity can be taken into account as part of the CRM. In short, **we call on RTE resume its work on the direct and exclusive participation of foreign generation, demand and ultimately storage capacities in the French CRM** and stop working on designs that would comprise a direct participation of TSOs in the mechanism.

A direct and exclusive participation of generation and demand capacities to the French CRM also has the advantage it could be replicable in non-adjacent markets. While RTE could start an experimentation with only neighbouring markets as a first step, we believe the contribution of capacities located in non-adjacent markets should be studied rapidly. The conditions for the capacity certification, availability control, imbalance settlement and penalties for capacities located in non-adjacent markets should, just as for those located in neighbouring markets – be the same as those imposed on capacities located within the French borders.

³ See our response to question 1 of the October 2015 RTE consultation referred to in footnote 2.