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Capacity mechanism: ongoing developments in France and the EU

Energy

France has just adopted implementation measures concerning the capacity remuneration mechanism (CRM). The present note (i) reminds the EU Context, (ii) introduces the French CRM and (iii) gives an outline of the legislation in force in some other States.

EU Context

Insufficiency of an energy-only market

The European electricity market has been impacted in recent years by the increase in renewables and the reduction of conventional coal and nuclear generation, giving rise to concerns that the market may not be able to deliver sufficient capacity adequacy in the coming years.

Conventional generation plants are critical to ensuring security of electricity supply because of the intermittent nature of renewable energy generation. However, they are severely hit by the combination of several factors that have adversely impacted their competitiveness, in particular, the economic crisis affecting power demand, the shale gas revolution in the USA, policies to support renewables that have resulted in drastic reduction of load levels for thermal plants.

In this context, the Commission has recognised that States may need to support a CRM (2013 communication C(2013) 7243).

However, significant differences remain in the design of CRMs. This trend has been highlighted by the Commission in the *Environmental and energy state aid guidelines* (2014). They recognise that such a national approach may be necessary to answer market insufficiencies; they also underline the risk of fragmentation of the EU market.

France

Main goals of the French CRM

The French CRM aims at achieving adequacy between generation and demand for electricity, especially during consumption peaks.

Indeed, electricity consumption peaks are higher in the French electricity market than anywhere else in the EU (especially in Winter, notably because of the greater use of electrical heating in homes).

In addition, in recent years, consumption peaks have continued to progress significantly though the rate of increase in average electricity consumption is declining.

Sources of the French CRM

The French CRM was created in 2010 by the NOME Act *(loi portant Nouvelle Organisation du Marché de l'Electricité – act for the reorganisation of the electricity market).*

An order (*arrêté*) approving the rules for the CRM was adopted on 22 January 2015.

These rules have been elaborated by RTE, the French transmission system operator (TSO), and result from a long process of consultation of market stakeholders that started in 2013.

The CRM should now be operational for Winter 2016/17.

Mandatory Participants in the French CRM

The French CRM identifies 'Mandatory Participants' (*acteurs obligés*):

i. electricity suppliers

ii. electricity network operators and end-consumers (to cover their electricity losses) as far as they do not buy their electricity from a supplier

Obligation to hold capacity guarantees

The French CRM requires Mandatory Participants to hold an amount of 'generation and interruption (or demand-response) capacity guarantees' (*garanties de capacité de production et d'effacement de consommation*). These guarantees are calculated on the basis of:

i. the peak consumption of their clients (or of their own peak consumption, for end-consumers and electricity network operators) for a given year

ii. a security buffer which takes into account interconnections of the national electricity grid with other European grids

The amount of capacity guarantees will be set out for each delivery year (*année de livraison*) by RTE (the first delivery year will start in 2017).

Capacity guarantees will be valid for a year and tradable between CRM participants.

Purchase of capacity guarantees

Mandatory Participants will be able to buy capacity guarantees from electricity generators and interruption operators (the 'Capacity Operators').

The CRM only aims at ensuring that there is sufficient capacity in the market. Therefore, capacity guarantees give no right to power generated by the electricity generator.

Certification of capacities

Capacity guarantees are issued by RTE to Capacity Operators on the basis of certified capacities.

Indeed Capacity Operators must have their capacities certified by RTE. Certification will take the form of an agreement between RTE and the capacity operators.

Only capacities located in continental France and connected to the public transmission or distribution grid will be eligible for certification.

Capacity Operators will be able to file their application for certification of their capacities by a specific deadline set by RTE for each delivery year depending on the type of the capacity concerned (existing, new or future capacity, generation or interruption capacity). For the first and second delivery year (2017 and 2018), application for certification will start as from 1 April 2015.

Penalties

Specific penalties will be imposed on Mandatory Participants that do not hold sufficient capacity guarantees (penalty of up to €120,000/MW p.a. of missing certified capacity) and on Capacity Operators in the event that their actual capacity is lower than provided for in their certification agreement.

Belgium

Shortages in available production capacity remedied by a strategic reserve

Belgium has introduced a strategic reserve mechanism by a federal Law of 26 March 2014. Each year until 15 January, the federal Belgian Energy Minister, based on a probability analysis carried out by the Belgian TSO (Elia), can order Elia to procure a strategic reserve for the next winter period. The Belgian federal energy regulator (CREG) approved the operational rules of the strategic reserves on 5 June 2014.

In order to set up this strategic reserve, Elia can call upon production capacity that has been temporarily, or is scheduled to be, taken out of service. The mechanism allows such capacity to be (re)activated to bridge shortages in available production capacity, in order to match the load required to ensure the country's security of supply.

Germany

Ongoing public consultation on the need for a CRM

Germany does not have a CRM in the form of a capacity market at the moment. However, a form of strategic reserve called 'network reserve' (*Netzreserve*) has been introduced by a legislation that entered into force on 6 July 2013 and will expire on 31 December 2017.

In addition to the strategic reserve, TSOs are entitled and obliged to prevent a disturbance of the electricity supply system through market related measures such as, in particular, (i) the use of balancing energy, contractually agreed upon loads that can be turned on and off, (ii) information regarding congestion management by way of re dispatching and (iii) the mobilisation of additional reserves.

TSOs can also require redispatching measures to be taken by operators of generation and storage facilities with a capacity of 10 MW or more.

The new German government's coalition agreement stipulates the coalition parties' intention in the medium term to develop a CRM, taking into account cost efficiency and consistency with European rules and ensuring a competition-oriented solution, open to different technologies, without further specifying the details of such capacity mechanism.

In October 2014, the Federal Ministry for Economic Affairs and Energy (BMWi) published a Green Paper on electricity market design, discussing different CRM models as well as several approaches towards the optimisation of the existing energy-only market. According to the Green Paper a number of studies conducted on behalf of the BMWi recommend an optimisation of the existing energy only market rather than the introduction of a market-wide CRM.

The BMWi is currently running a public consultation on the Green Paper. A White Paper on the practical measures of implementation is expected to be published in May 2015.

Italy

First capacity auction awaited in 2015

Italy has had a CRM since 2004, which has been modernised with the introduction of an annual auctioning mechanism managed by the TSO (Terna). This new CRM is expected to be in effect as from 2018/19. The general regulation of the auction system was approved by the Ministry of Economic Development on 30 June 2014, but Terna is still in the process of finalising the relevant discipline of the auctions in order to take into account the requirements set by the Ministry.

The first capacity auction should take place in 2015 in relation to peak demand expected in 2018/2019. However, there is no official confirmation that Terna will be able to meet the deadline.

In the meantime, the AEEGSI (the Italian national energy regulator) and the Ministry of Economic Development are working to supplement the existing CRM for the period 2015/17 to prepare the market for the transition to the new auction system.

In this interim phase, Terna should be allowed to enter into option agreements with electricity producers for the purchase of flexible capacity that should cover the 2017 demand (not yet quantified by Terna). The option agreements should be awarded on the basis of competitive processes and the selected energy producers will have the right to a premium for the capacity actually made available.

Spain

Specific incentive mechanisms and absence of a market-wide CRM

Spain does not have a CRM in the form of a capacity market at the moment. However, there exist incentive mechanisms associated with the level of availability of the capacity:

i. compensation may be granted for investments in new capacity, which requires prior authorisation from the Ministry of Industry ('investment incentive')

ii. remuneration to existing plants may be granted in accordance with their installed capacity and level of availability ('short-term availability payments')

The application of the 'short-term availability payments' has been extended during 2015, but is still limited to fuel oil, combined-cycle, coal and hydroelectricity technologies. Allegedly, this incentive could be replaced by a CRM. However, so far no official communication has been published in this respect that provides information on how this market would work.

The 'investment incentive' (fixed, non-market based, compensation to investments in new capacity) remains applicable to plants starting operations before 1 January 2016.

UK

First capacity auction launched for 2018/19

A CRM has been introduced as part of the UK Electricity Market Reform and was granted Commission's approval under State aid rules in July 2014. It is based on a capacity auctions scheme run by the British TSO (National Grid), where the amount of capacity is set in advance by the Government based on analysis from National Grid.

The first auction which took place in December 2014 in relation to 2018/19 concluded without incident, with bidders apparently undeterred by the State Aid challenges launched against the scheme a few weeks prior to the auction date. Indeed, the robust supply/demand balance led to a lower than expected clearing price, delighting Government in an election year but disappointing many in the market who hoped for a greater stimulus. The price may well rise in future years as coal capacity is constrained by environmental factors.

The scheme should also evolve in the future: the Government is pushing on with amendments to address interconnected capacity and there will be smaller changes too, learning from the first full cycle in 2014. Finally, the question of defining the fiscal limits (Levy Control Framework) for the scheme should also be addressed by the incoming administration.

Read more on the EU context and national capacity mechanisms in Europe…

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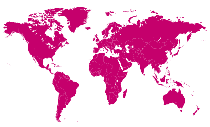

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