

DG COMP interim report of the sector inquiry on capacity mechanisms

A EURELECTRIC response paper

July 2016

EURELECTRIC is the voice of the electricity industry in Europe.

We speak for more than 3,500 companies in power generation, distribution, and supply.

We Stand For:

Carbon-neutral electricity by 2050

We have committed to making Europe's electricity cleaner. To deliver, we need to make use of **all low-carbon technologies**: more renewables, but also clean coal and gas, and nuclear. Efficient electric technologies in **transport and buildings**, combined with the development of smart grids and a major push in **energy efficiency** play a key role in reducing fossil fuel consumption and making our electricity more sustainable.

Competitive electricity for our customers

We support well-functioning, distortion-free **energy and carbon markets** as the best way to produce electricity and reduce emissions cost-efficiently. Integrated EU-wide electricity and gas markets are also crucial to offer our customers the **full benefits of liberalisation**: they ensure the best use of generation resources, improve **security of supply**, allow full EU-wide competition, and increase **customer choice**.

Continent-wide electricity through a coherent European approach

Europe's energy and climate challenges can only be solved by **European – or even global – policies**, not incoherent national measures. Such policies should complement, not contradict each other: coherent and integrated approaches reduce costs. This will encourage **effective investment** to ensure a sustainable and reliable electricity supply for Europe's businesses and consumers.

EURELECTRIC. Electricity for Europe.

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KEY MESSAGES

- EURELECTRIC considers the initiative of the European Commission Directorate General for competition (DG COMP) to launch a sector inquiry into capacity mechanisms as a key building block in the elaboration of a new European regulatory framework to make the electricity market design fit for the low-carbon transition. In particular, this is a great opportunity to ensure a more coordinated and market-based approach to capacity mechanisms across Europe in line with the implementation of an efficient and integrated European energy market.
- EURELECTRIC shares DG COMP views that the central objective should be to improve the functioning of the energy market: fully integrate wholesale markets across all timeframes, make the market fit for renewables and vice-versa, ensure that scarcity prices can appear in the market and that customers can react through demand response. A future proof market design should properly value energy, flexibility and capacity.
- Security of supply should be ensured in the most cost efficient way. The reality is however that security of supply is viewed as a common good by national governments which are often not ready to accept the level of security of supply that the energy-only market delivers. They have therefore introduced capacity mechanisms as an additional insurance policy to reduce the risk faced by capacity providers and reach their desired level of adequacy.
- EURELECTRIC supports the Commission assessment that volume-based capacity mechanisms are best suited to address security of supply concerns. Capacity mechanisms should be market-based solutions that deliver power system adequacy by properly valuing reliable and firm capacity. They thereby provide price signals for existing capacity to stay online or exit the market and for/or new capacity to be built in order to reach system adequacy targets.
- EURELECTRIC's reference model for European capacity mechanisms is mostly in line with the model proposed by DG COMP. Capacity mechanisms should be based on an availability model, be both market-based and technology neutral, open to new and existing assets and should allow cross-border participation.
- Strategic reserves can be a solution to address short-term adequacy issues provided their recourse remains exceptional, their size is limited, they are not used to contract new capacities into the system and their impact on the energy market is minimised.
- Tenders for new capacity should be used as a last resort option and only in very specific circumstances.
- The security of supply situation should be assessed at regional level and regional adequacy assessments should be taken into account when introducing new elements to the market design such as capacity mechanisms. Two key elements would imply that Member States express clearly which level of security of supply they want to achieve, based on homogeneous metrics and that the regional adequacy methodology takes into account the economic situation of existing power plants i.e. does not assume that they simply remain open.

- EURELECTRIC welcomes the European Commission’s ambition to consider a standard framework for cross-border participation in all types of capacity mechanisms. The approach proposed by DG COMP is promising and embeds several dimensions that EURELECTRIC has constantly pushed forward:
 - Whilst EURELECTRIC recognises the limited scope of DG COMP’s inquiry, we regret that the proposed approach overlooks the operational aspects of cross-border participation. An appropriate legal and operational framework for managing simultaneous scarcity events is needed to define in real time the energy flows in order to allow the execution of capacity contracts. Ultimately, establishing a regional capacity mechanism would increase cost efficiency by making the process of agreeing procedures during simultaneous scarcity events easier and standardised across a region. We would welcome harmonised guidelines to be developed at European level to pursue and facilitate future convergence having market integration in mind.
 - EURELECTRIC advocates for a principle of exclusivity, ensuring that no double commitment of capacity (or double earnings) occurs in capacity mechanisms targeting overlapping time frames for scarcity or overlapping periods of obligation. This will prevent overcompensation and ensure that cross-border capacity is able to contribute to security of supply without having to rely on a de-rating process.

1. General comments on the interim report and the accompanying staff working document

EURELECTRIC welcomes the interim report and the accompanying staff working document which provide a thorough analysis of the existing situation. **In general, EURELECTRIC can share most of the preliminary findings and tentative conclusions made by the European Commission.**

In particular:

1.1. The context in which capacity adequacy concerns arise

EURELECTRIC fully supports the European Commission's analysis that the transition towards a low-carbon electricity system coupled with certain market and regulatory failures undermining investment incentives have given rise to security of supply concerns in various Member States. Many of them have therefore decided to introduce a capacity mechanism or are on the verge to do so.

EURELECTRIC believes that energy, flexibility and capacity are all needed and should therefore be properly valued in a future-proof wholesale market design.

These three elements of market design should not be seen as opposing each other, but rather as interplaying elements of a more efficient market design to ensure continued security of supply.

- Flexibility should enable the system to respond to short-term variations in the supply/demand balance. This includes short term reserve (generation, storage, demand) to cover potential incidents that decrease power supply to the system or to respond to short-term variations in demand.
- In contrast, capacity should ensure long-term system adequacy in case of extreme load peaks or moments where capacity has to be available to back up intermittent renewable generation. To be efficient, capacity mechanisms should be market-based solutions able to provide sufficient incentives for keeping and attracting an adequate amount of reliable capacity.

As stated in its answer to the European Commission's public consultation on a new energy market design (October 2015), EURELECTRIC is convinced that energy prices that reflect market fundamentals, including scarcity in terms of time and location, are an important ingredient of the electricity market design. However, in the current environment where large amounts of subsidised generation together with other market interventions distort price formation, the electricity system lacks signals both for short-term operations and longer term system adequacy and decarbonisation. The market environment has indeed become increasingly volatile and the risk exposure of investors has therefore increased.

Capacity markets are by no means an alternative to a well-functioning and well-designed energy market. Where found necessary, properly designed capacity markets, developed in line with the objective of the Internal Energy Market (IEM), can be an integral part of a future market design. For instance, well-designed capacity markets and scarcity prices are not mutually exclusive. Indeed, capacity mechanisms, in the form of well-designed centralised or decentralised capacity markets, turn part of the volatile and uncertain scarcity prices into a steadier signal representing the cost of ensuring that the firm capacity needed to meet a certain level of system adequacy is available.

1.2. The need to improve the energy market functioning to attract flexible sources and achieve renewable integration

EURELECTRIC fully supports the European Commission's statement that Member States shall improve the functioning of their markets, as this will positively contribute to adequacy and security of supply by addressing the underlying causes that created their adequacy concerns in the first place.

The implementation of the third energy package and the integration of wholesale markets across all timeframes through network codes is indeed the cornerstone of the electricity market design. This is also likely to require Member States to accept that wholesale prices adequately reflect scarcity situations. To do so, a removal of price caps is needed, even if they are not the main issue, in our opinion, as they are rarely reached. The main issues are ad-hoc regulatory interventions, operation and investment subsidies that distort the market and exit barriers for power plants, leading to prices not going as high as they should.

If Member States choose to maintain support for mature technologies after 2020, it should be done in the most cost-efficient and market-based way to maximise market integration and minimise distortions. Beyond research, demonstration and early deployment, policy measures should not seek to promote specific technologies or projects, but rather support RES development in the most cost-efficient way.

When deciding to support certain volumes, it is important to take into consideration system costs as well as the evolution of demand for electricity to further avoid energy oversupply. Distortions of the merit order should especially be reduced as they lead to inefficiencies and increased costs that are ultimately borne by consumers through policy support charges. They also distort investment signals provided by wholesale market prices which become lower than they would be without such distortions.

1.3. The need for harmonised and more transparent adequacy assessment and reliability standards

EURELECTRIC has always been calling for a regional approach to security of supply. We therefore fully support the European Commission's statement that harmonised and more transparent ways of determining capacity adequacy levels and reliability standards would contribute to the definition of the need for different intervention levels and improve cross-border comparability.

EURELECTRIC strongly supports the establishment of a European framework for the assessment of system adequacy and the design of capacity mechanisms. However, based on current methodologies, such capacity adequacy analyses, including the ones conducted by ENTSO-E, cannot demonstrate nor refute the need for capacity mechanisms. They do not take into account the economic and regulatory environment in which market players make their investments and decommissioning decisions, which is an essential parameter for assessing long-term adequacy. Extreme climate conditions and the temperature sensitivity of demand are also crucial aspects left apart from current adequacy assessments. Furthermore, a well-designed capacity mechanism should send the right signals not to induce the development of unnecessary capacities, depending on the chosen level(s) of security of supply. Therefore, in the short term, this requires developing a regional approach to assessing adequacy and making sure that assessments are based on a common improved methodological framework, complementing and building on national adequacy assessments. Such a work would improve convergence and ensure consistency among the different national assessments.

In particular, a transparent and contestable methodology based on homogeneous adequacy metrics and a set of scenarios commonly agreed by the concerned Member States should be defined to elaborate regional system adequacy assessments. While the choice of adequacy metrics should be harmonised, each country should be free to set its desired level of adequacy. This methodology should inform Member States on whether their chosen adequacy target can be met. Expert groups involving all relevant stakeholders, including market parties, should be associated to the elaboration of the methodology and the assumptions used in these assessments. Based on the results of these assessments, a thorough analysis of the potential solutions necessary to achieve security of supply in the region should be led and discussed with all relevant parties.

Regional adequacy assessments require:

- An analysis of the location of firm capacity, because grid capacity across Europe, and in particular transmission capacities, has an impact on security of supply;
- A thorough analysis of the firm capacity provided by all assets on the supply side and on the demand side, including renewables, demand response and storage;
- An analysis of the economic situation of existing and new assets in the short and long term: if some assets do not cover their estimated fixed costs, the adequacy assessment should anticipate the corresponding closures. Furthermore, the adequacy assessment should anticipate a possible delay of expected entry of new resources.
- An analysis of perspectives for load demand evolutions in each Member States, and in particular of the likelihood of simultaneous peak consumption.

Regional adequacy assessments should be taken into account when introducing well-designed market-based mechanisms. These provide a sustainable and efficient solution to ensure that adequacy targets are met.

Where well-designed market-based capacity mechanisms are in place, they are also a useful tool per se to facilitate the regional adequacy assessment. Indeed, they contribute to revealing the adequacy situation by explicitly valuing the available capacity that is needed to ensure the adequacy target and by identifying the available capacity that is not needed.

1.4. The need to properly design capacity mechanisms in order to avoid undermining the functioning of the electricity market

EURELECTRIC fully supports the European Commission's view that any capacity mechanisms should follow a set of fundamental design features in terms of eligibility, allocation process and product definition in order to maximise cost-efficiency and market orientation.

Back in October 2014, EURELECTRIC already defined the following features for well-designed market-based capacity mechanisms. Whereas contracts signed before the Energy and Environmental State aid Guidelines (EEAG) must be respected in order to avoid negative impact on resulting investment decisions, EURELECTRIC would welcome transitional measures by Member States to adapt in a reasonable timeframe existing mechanisms towards a design compatible with the EEAG.

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| <ul style="list-style-type: none">○ Market-based – Capacity should always be valued in a competitive market. Capacity prices should be allowed to move freely without distortive price regulation. |
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→ EURELECTRIC agrees with the European Commission that price-based mechanisms offering market-wide or targeted capacity payments risk over-compensating capacity providers because they rely on administrative price setting rather than competitive allocation procedure. A competitive allocation process is needed to reveal the real value of capacity and therefore to send adequate signals for market entry, as long as prices are transparently set by the market.

→ Alongside this principle, the form of trading arrangement set for the capacity mechanisms must be defined. Among the six options identified in the interim report for implementing capacity markets, EURELECTRIC favours decentralised obligation mechanisms or central buyer mechanisms, as they are most likely to ensure long-term security of supply in a cost-efficient way.

→ Strategic reserves could serve to solve potential exceptional short-term adequacy issues. The design of strategic reserves should limit as much as possible distortions on the energy market. In particular, they should not serve to contract new capacities into the system, but they should only target capacities for which decommissioning decision is definitive and should not create an exit barrier for non-economically viable generation capacity. Activation of strategic reserves should remain exceptional and their size must remain limited. In addition, as for any well-designed capacity mechanisms, entering into strategic reserves should not be mandatory and should be based on a competitive allocation procedure.

→ Tenders for new capacity should only be used as a last resort mechanism in very specific cases after all market tools to keep guarantee adequacy have been exhausted (e.g. local network congestion issues).

- **Technology-neutral** – All technologies that provide firm capacity should be able to participate in the market without discrimination;
- **Open to new and existing assets** – Market access should be based on a level playing field between both new and existing firm capacity providers;
- **Open to generation, demand response and storage** – All forms of capacity throughout the value chain should be able to participate in the market.

→ EURELECTRIC agrees with the European Commission that 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 a level-playing field is ensured.

- In case a Central Buyer Model is chosen, the outcome of capacity mechanisms should be **capacity contracts** and not only a regulatory commitment.

→ EURELECTRIC agrees that obligations requiring the verifiable availability of capacity resources in (potential) scarcity events are necessary to encourage investment in sufficiently flexible and reliable capacity.

→ EURELECTRIC also supports the need to put in place a penalty regime for capacity providers that, at scarcity moments, fail to make the firm capacity they committed to available. Such mechanism shall reflect the scarcity in the system. Therefore, the penalty regime shall be preferably based on market prices and on common principles to prevent the risk of building capacity not where it is most needed/valued, but where the penalty regime is more beneficial. Harmonisation of penalty regimes will require coordination amongst NRAs and TSOs.

- **Cross-border participation** – capacity mechanisms must be open to cross-border participation to drive regional cooperation and maximise cost-efficiency by taking into account regional interdependencies.

→ Last but not least, EURELECTRIC is in favour of cross-border participation in capacity mechanisms, for foreign capacities that effectively contribute to security of supply. On the one hand, it is an interim step required to move away from today's pure national piecemeal approach. On the other hand, we believe that regional adequacy assessments will also support in the longer run the evolution towards a more regional approach to capacity mechanisms. Regional adequacy assessments and cross border participation into capacity mechanisms should also involve European countries which are highly interlinked and have large interconnection capacities, such as European Economic Area and possibly Energy Community countries.

→ In this perspective, EURELECTRIC welcomes the initial proposal put on the table by the European Commission in Annex 2 of the interim report to stimulate a discussion on this topic. While Member States should be able to choose the most suitable type of capacity mechanism (under specific circumstances and features, depending on the precise adequacy problem to be solved), we fully support the European Commission's ambition to consider a standard framework for cross-border participation in all types of capacity mechanisms. We are therefore providing more detailed comments on this proposal in the second part of this document.

2. Detailed comments on annex 2 on cross-border participation in capacity mechanisms

In its interim report, DG COMP expresses its ambition to propose a standard framework for cross-border participation in European capacity mechanisms, while the overall design of the mechanisms would be fitted to the specificities of each Member State. EURELECTRIC considers such development could be a decisive step forward and would like to contribute suggesting a design that could be broadly implemented in order to maximise the cost efficiency of the mechanisms targeted to ensure security of supply.

The approach proposed by DG COMP is promising and embeds several dimensions that EURELECTRIC has constantly pushed forward. Nevertheless, EURELECTRIC recommends improving further some specific parts of the scheme proposed for discussion.

- Whilst EURELECTRIC recognises the limited scope of DG COMP's inquiry, we regret that the proposed approach overlooks the operational aspects of cross-border participation in capacity mechanisms. Whereas a capacity mechanism based on an availability model indeed only ensures the availability of the resources, the actual dispatch of capacities as well as the energy flows between countries are determined by the energy market rules. With the current legal and operational framework in place, the execution of capacity contracts would not be allowed in case of simultaneous scarcity situations. If a country setting up a capacity mechanism cannot rely on contracted foreign capacities in operation/real time, it will likely adopt a more conservative interconnector de-rating approach and will increase the volumes of capacity procurement at domestic level – therefore making cross-border participation only symbolic. This will also lead to overcompensation and possibly to overinvestment in capacities. As such it is one of the key shortcomings of DG COMP's proposal. We believe this should be properly addressed as part of the upcoming EC legislative initiative on energy market design.
- In addition, EURELECTRIC considers that a simplistic approach allowing for the commitment of the same capacity multiple times conflicts with capacity mechanisms' aim to ensure that Member States' security of supply criteria are respected. Thus EURELECTRIC advocates for a principle of exclusivity, ensuring that no double commitment of capacity (or double earnings) occurs in capacity mechanisms targeting overlapping time frames for scarcity or overlapping periods of obligation. This will prevent overcompensation and ensure that cross-border capacity is able to contribute to security of supply without having to rely on a de-rating process.

With these adaptations, EURELECTRIC believes that the framework for cross-border participation proposed by the EC should apply to all existing or planned capacity mechanisms, regardless of their respective designs and should ensure cost efficiency. This framework should include possible variations, in order to be compatible with all types of mechanisms (centralised, decentralised and strategic reserve).

In this section, the word « interconnector » corresponds generally to the derated contribution [capacity] of imports to security of supply of the area implementing the capacity mechanism. This capacity contribution depends notably on the forecasted cross-border exchange capacity (Net Transfer Capacity) as a result of the ex-ante adequacy assessment. It will depend on (i) the technical availability of cross-border exchange capacities and on (ii) the available margin in the neighbouring areas. The expression “cross-border exchange capacities” refers to the operational capability of the transmission infrastructure to inject energy in operation from a neighboring region to the area implementing the capacity mechanism.

2.1. Settlement of cross-border participation in capacity mechanisms: remuneration of foreign capacity and interconnectors along the principles proposed by DG COMP

EURELECTRIC agrees with DG COMP that cross-border participation must be considered in all types of capacity mechanisms. Indeed, as stated in Article 226 of the EEAG, “any capacity which can effectively contribute to addressing the system adequacy problem” should be able to participate in a capacity mechanism.

Following the position of DG COMP which proposes a common approach to integrate volume-based market-wide capacity mechanisms (see Annex 2, Section 5), we mainly focus the analysis in this section on a similar model. It is based on foreign capacity providers participating directly to the domestic capacity mechanism via the interconnectors, with a capacity product based on availability. Both elements in the value chain should be properly taken into account and fairly remunerated.

Foreign capacity providers should clearly include generation, demand-side response and storage located in a foreign country, but willing to participate in the capacity mechanism of another country. To assess the various situations faced by foreign capacity providers, let us consider hereafter a simplified example with only two areas, A and B. We assume that area A is setting up a capacity mechanism and that capacities in area B can directly participate to it according to the cross-border framework proposed by DG COMP. The participation of capacities located in area B to the capacity mechanism in area A is therefore limited by some interconnector capacity from B to A.

The interconnector capacity considered in this forward-looking analysis should be determined according to an ex-ante regional capacity adequacy study aiming at forecasting the amount of foreign capacity that could participate cross-border in the capacity mechanism. For each border, the interconnector capacity corresponds to a de-rating (reduction) of the available cross-border exchange capacity (Net Transfer Capacity). Such assessment is ultimately a complex process - and might require stronger regulatory oversight from ACER.

This de-rating factor depends on several assumptions made few years ahead of the implementation of the capacity mechanism and related to the market scenarios considered in the underlying probabilistic analysis. These assumptions could include the following elements: the range of risk factors considered, expected/past capacities available in both areas A and B, expected demand evolution in both areas, expected transmission infrastructures between the two areas, relative location of generation and demand, expected demand and generation profiles, historical observations. The de-rating factor shall also take into account assumptions on the management of simultaneous scarcity events, depending on the legal and operational framework in place to manage simultaneous scarcity situations and to define energy flows in real-

time. The assessment of the interconnector de-rating should not be used to minimise participation of cross-border capacity in favor of domestic capacity.

Depending on the value of the interconnector capacity and of the available margin in area B, the settlement of the capacity mechanism in A, including cross-border participation can lead to two situations:

- (i) **Available margin in B larger than the “interconnector” capacity:** B has enough capacity to fulfill its own needs and ensure support to A. In this case, the contribution from area B to security of supply in A is limited by the (derated) “interconnector” capacity between A and B.

If it is more cost-efficient to import more capacity from B to A than the capacity available on the (derated) interconnection capacity B-A, part of the value of cross-border participation should go to the (derated) interconnector capacity (“congestion rent”).

- (ii) **Less available margin in B than the interconnector capacity:** B has not enough capacity to serve its own needs and ensure support to A in a cost-efficient way above the (derated) interconnector capacity from B to A.

Then, all the value of cross-border participation should go to the available capacity margin in B that is selected within the capacity mechanism in A.

In practice, the remuneration of a foreign capacity in B that is selected in a cost-efficient way within the capacity mechanism in A could range from (i) its bid of capacity value on the capacity mechanism in A to (ii) the (cleared) capacity value within the capacity mechanism in A. The difference between the (cleared) capacity value within A and the remuneration of the foreign capacity in B should correspond to the scarcity rent captured by the interconnector B-A.

Concretely, the capacity mechanisms are set up well before operating the markets. The two situations described above are thus based on forecasted/expected assumptions and on the exchange of available capacity margins through derated interconnectors. Of course, when the markets are operating, the energy and flexibility markets will decide how the available capacity should be dispatched and what are the actual energy flows between areas (see Section 2.3. for a basic example).

The obligations and penalties set on all capacities participating in the mechanism should incentivise the availability of the committed capacities in practice/real time. But this “real-time” process of energy/flexibility markets should not conflict with the forward-looking aspects of the capacity mechanisms.

2.2. Discussion on DG COMP's proposal of a standard framework for cross-border participation in capacity mechanisms

EURELECTRIC welcomes the standard framework for cross-border participation in potential capacity mechanisms proposed by DG COMP. It supports the principles that capacity mechanisms should be based on an availability model and that the cross-border participation should reflect the relative contribution of the foreign capacity and the interconnectors.

The obligations and penalties set on all capacities participating into a capacity mechanism, located in the same country/area/zone or in a foreign country/area/zone, should incentivise the availability of the committed capacities. In this way, their cost-efficient dispatch based on a proper functioning of the energy markets, can satisfy the demand in real time and, ultimately, ensure the fulfillment of security of supply criteria. However, EURELECTRIC believes that capacity mechanisms should be looked at from a regional perspective rather than a country-by-country basis to notably match the regional governance process set by the Energy Union agenda. EURELECTRIC has underlined that capacity mechanisms should be well-designed and have a regional perspective to ensure security of supply in a cost efficient way. Ultimately establishing regional capacity mechanism would increase cost efficiency by making the process of agreeing procedures during simultaneous scarcity events easier and standardised across a region.

This section details EURELECTRIC's view on the different steps of the cross-border participation scheme proposed by DG COMP in Section 5 of its Annex 2.

a) Interconnector de-rating

EURELECTRIC considers positively DG COMP's proposal to derate import capacities according to the statistical analysis of historical data or an ex-ante adequacy assessment taking into account a regional dimension. This de-rating process is a key enabler to cross-border participation. It aims at assessing the amount of foreign capacity that could participate cross-border in a capacity mechanism. This will depend on (i) the technical availability of cross-border exchange capacities and on (ii) the available margin in the neighbouring areas. As mentioned earlier, this assessment depends on several assumptions: forecasted capacities and demand in each area, expected demand and generation profiles, transmission infrastructure across the border and within each area, and relative location of demand and supply, etc. The value of the interconnector de-rating consequently evolves over time.

This initial step has a structural impact on the outcome of capacity mechanisms. Relying on such a forecast reinforces the need for a detailed guidance on how regional adequacy assessments should be performed and how their outcomes should be integrated into the setting-up of capacity mechanisms (including cross-border participation).

b) Eligible foreign capacity providers¹

EURELECTRIC considers that a capacity entitled to participate in a mechanism should respect the same conditions as the others regardless of its location, domestic or foreign. EURELECTRIC recommends thus to apply the same eligibility criteria as for domestic capacities, and would encourage harmonisation of products, eligibility, supervision, and testing at a regional level.

¹ [EURELECTRIC, Market design: fit for the low-carbon transition, April 2016](#)

Regarding multiple commitments by the same capacity, EURELECTRIC considers that a simplistic approach allowing to commit the same capacity multiple times conflicts with capacity mechanisms' aim to ensure that security of supply criteria of the Member States are respected. Thus EURELECTRIC advocates for a principle of exclusivity, ensuring that no double commitment of capacity (or double earnings) occurs in capacity mechanisms targeting- overlapping time frames for scarcity or overlapping periods of obligation.

Enabling multiple commitments could require developing a complex set of arrangements between national authorities to establish what capacity is committed where and the likelihood of contributing to security of supply in each. Penalties would likely need to be increased to avoid capacity providers 'overstretching' themselves and receiving overcompensation relative to their (lack of) actual contribution to security of supply in case of common scarcity in committed markets. However, these tighter penalties could have unintended consequences, for example in relation to incentivising new capacity (e.g. CCGT) or entering into contracts with customers (e.g. demand response). This, in turn, may reduce competition in capacity market auctions, to the detriment of consumers.

c) Obligations and penalties on foreign capacity providers

EURELECTRIC considers that the penalty regime should be similar for capacities that are not available, in order to ensure security of supply in the importing market when foreign capacity providers have committed to be.

Furthermore, EURELECTRIC believes that the treatment of penalties in case the actual interconnection capacity is lower than the expected value while committed foreign capacities are available should be clarified: the capacity provider should not have to pay penalties if the interconnector is not available at the level assumed in the capacity mechanism by the de-rating for cross-border participation performed by the TSO.

d) Trading of cross-border capacity

EURELECTRIC agrees with the principle set by DG COMP for transferring capacity contracts (or commitments) within the same bidding zone.

e) Obligations and penalties on interconnector operators

EURELECTRIC considers that the notion of "availability of interconnectors" should be clarified. In operation, the capacity to import electricity from a neighbouring area during all scarcity periods, simultaneous or not, depends on many dimensions: such as the availability of the existing transmission infrastructure (including both transmission network within each area and the cross-border links) or the location of power generation and demand within each area. The net transfer capacity available in operation may be significantly larger than the derated interconnector capacity computed during the initial phase of "interconnector de-rating" and subsequently considered in the cross-border participation framework.

Also, regarding cross-border exchange capacities, it could be useful that DG COMP provides some guidance on how to define responsibilities for assessing the interconnector de-rating, i.e. the level of available cross-border exchange capacity and the risk of paying a penalty if the available level is below the derated level.

f) Competitive cross-border bidding process

In the case of a centralised auction model, the allocation of capacity contracts (or commitments) to the entitled foreign capacities should be based on an implicit auction.

In the case of a decentralised obligation model, the difficulty is to ensure that the various stakeholders are not contracting some foreign capacities above the derated interconnector capacity. One approach to solve this issue is to allow for a continuous trading of interconnection credits corresponding to the (derated) “interconnector” capacity or to have explicit auctions, done initially by the TSOs that are also responsible to make the cross-border exchange capacities available.

In case of multiple capacity mechanisms, capacity owners will have to trade-off between different national mechanisms to value their availability. The resulting decisions will be efficient only if the auctions associated with all mechanisms are perfectly articulated, both in terms of design and timing².

In practice, this raises the question of setting-up a target model for the capacity markets across the EU. A better integration of capacity mechanisms would indeed ease the discussions on cross-border participation.

g) Influencing interconnector flows (without distorting market coupling)

EURELECTRIC agrees with DG COMP’s view that the flows on interconnections should not be impacted by the capacity mechanisms, except in case of simultaneous scarcity situation where energy market do not set cross-border flows. The usual operating rules for energy markets should prevail:

- In the case of scarcity in only one area, energy market functioning should make it possible for this area to import as much energy as needed, regardless of the capacity mechanisms in place;
- In the case of multiple areas facing a simultaneous scarcity situation, power should flow between A and B based on energy market rules (e.g. energy flows should be directed towards the country where the value (€/MWh) is the highest). Nevertheless, all areas should face scarcity prices at the price cap (if any) and thus may all have the same price. In this case, the direction of the power flow is not determined by the price differential (which is zero). If the price cap is higher in country B than in A, this could result in power flowing from A to B. This situation could even occur (i) when there is a capacity market in A and there is none in B, or (ii) when there are capacity markets both in A and B with different levels of target adequacy. This therefore requires:
 - A removal of price caps or at least an harmonisation of their level that reflects the VOLLs and therefore reduce distortions in the execution of the contracts in operation/real-time.

² The simplest solution would be to synchronise (and couple) centralised auctions or decentralised obligations of each area, conform to the target vision developed by EURELECTRIC in its paper: [“A reference model for European capacity markets” \(2013\)](#).

- Ex-ante intergovernmental agreements to manage the simultaneous scarcity situations and define energy flows in operation/real-time in order to allow the execution of capacity contracts. Respecting capacity contracts could lead to load curtailment in the country where capacity has been contracted to support the country with capacity mechanism.

h) Paying for foreign capacity

EURELECTRIC agrees that a foreign capacity participating explicitly in a capacity mechanism should be remunerated in the same way as domestic capacities.

The effective allocation of import capacities within a capacity mechanism should be properly acknowledged, and the remuneration of foreign capacities and cross-border exchange capacities should be set through market processes.

i) Appropriately remunerate interconnectors

Both the foreign capacities and the (derated) "interconnector" capacities should be properly rewarded as they are both committed and required to provide available capacity when needed. The remuneration devoted to interconnector capacities corresponds to the scarcity of this resource compared to the available capacity margin at disposal in the exporting country (cf. zone "B" in the reasoning above) when the bundle cross-border exchange capacities/foreign capacities contributes effectively to the security of supply of the importing market (cf. zone "A" in the reasoning above). Distribution of the remuneration between interconnector and foreign capacities should be revealed by market-based mechanisms.

In particular, as investments in transmission assets are subject to a specific regulatory framework and – similarly to RES assets – rely on support mechanisms, the cross-border exchange capacities should not exceed its total reinforcement costs.

j) Ensuring compliance with the common rules

EURELECTRIC supports DG COMP's view that the legal framework for the management of simultaneous scarcity situations should be revised, independently of the implementation of capacity mechanisms as it is also relevant to the energy market.

2.3. Contribution of imports to security of supply in operation

To be fully efficient, it is important that the cross-border participation framework (including obligations and penalties) remunerates appropriately capacities that are expected to contribute effectively to security of supply. In operation, the contribution of the available foreign capacity via an interconnector should in principle play a key role for system adequacy, through the effectiveness of the energy flows. This contribution could be analysed with the following simplified example.

As stated in DG COMP's section 6 of Annex 2, when area A faces a scarcity situation with its own resources, several types of operation exchange situations may occur in operation, depending on the demand-supply equilibrium in areas A and B:

- (i) **No scarcity in B:** regardless of the capacity mechanisms in A, B has enough capacity to serve its demand and export towards A on the basis of the energy price spread between A and B. In this case, the contribution of imports from area B to security of supply in A is limited by the net transfer capacity (NTC) between A and B.

If the interconnection B-A is saturated, having one more MW of capacity dispatched in area B would be of no direct help for A but having one more MW of net transfer capacity available could improve security of supply in region A.

- (ii) **Scarcity in B:** regardless of the capacity mechanisms in A, B has not enough capacity to serve its own demand and export energy above the net transfer capacity available from B to A (reciprocally). By construction (for a lack of available capacity/energy in the whole region A+B), the interconnection A-B is not saturated by the energy flow.

In the long term, having one more MW of available margin in B could indeed improve security of supply in A. The effective contribution of foreign capacities in B will depend on (i) the technical availability of cross-border exchange capacities and on (ii) the available margin in the neighbouring areas – which themselves depends, inter alia, on the operational rules agreed by the two countries for the management of simultaneous scarcity situations.

In principle, the situation of common scarcity should be avoided following the system adequacy assessment and a proper anticipation (cf. lead time within the capacity mechanism), except for the extreme events, outside of adequacy boundaries set up in the analysis. Therefore, situation (i) is much more likely to occur.

This basic example shows that, when operating the market in real time, the design of capacity mechanism in force in area A (capacity-wide mechanism, strategic reserve, no capacity mechanism) does not influence how existing foreign capacity can contribute to security of supply in A via an interconnector. A capacity mechanism based on an availability model indeed only ensures the availability of the resources: the actual dispatch of capacities as well as the energy flows between countries should be determined by the energy market rules (e.g. directing energy flows towards the countries where the value (€/MWh) is the highest), as long as they deliver price differences between bidding zones.

Whilst EURELECTRIC recognises the limited scope of DG COMP's inquiry, we regret that the proposed approach completely overlooks the operational aspects of cross-border participation in capacity mechanisms. Relying on foreign capacity to ensure national security of supply will indeed require Member States to make a strong political commitment to respecting contractual obligations and refrain from taking measures hindering the execution of capacity contracts in case of simultaneous scarcity situations. For instance, respecting capacity contracts could lead to load curtailment in the country where capacity has been contracted to support the country with capacity mechanism. In such an event, trust and cooperation between the involved Member States is key to ensure that the "solidarity principle" gets priority over the "subsidiarity" principle. This is an essential basis to work on a common approach of adequacy able to guaranteeing security of supply to customers within the target quality level.

Developing an operational process for managing cross-border participation in real time therefore requires:

- The removal of price caps or at least a harmonisation of their level so that prices could reflect the actual value of loss load and therefore reduce distortions in the execution of the contracts in operation/real-time.
- An appropriate legal and operational framework for managing simultaneous scarcity events: the electricity security of supply directive and the network code on emergency and restoration are the appropriate vehicle to do so.
- When energy prices cannot resolve the flow as described in section 2.2 (g), the legal and operational framework will have to be complemented by ex-ante intergovernmental agreements to manage the simultaneous scarcity situations and to define in real time the energy flows in order to allow the execution of capacity contract.
- Additional grid development to address a system adequacy issue should also be considered: an efficient use of interconnections and of the network, as well as their cost-efficient expansion, is indispensable with a view to completing the internal market in electricity with a growing share of RES.
- Ultimately, establishing regional capacity mechanism – with a common capacity sourcing – would increase cost efficiency by making the process of agreeing procedures during simultaneous scarcity events easier and standardized across a region. We would welcome harmonised guidelines to be developed at European level to pursue and facilitate future convergence having market integration in mind.

Annex 1: EURELECTRIC amendment proposals to Guidelines on State aid for environmental protection and energy 2014-2020 (2014/C 200/01) focusing on “Aid for generation adequacy”

EURELECTRIC is committed to developing and communicating its vision of an integrated European electricity market design which ensures that the required low-carbon transition is delivered in the most cost effective manner. In response to past submissions and positions papers, the European Commission invited EURELECTRIC to propose modifications to the Guidelines on State aid for environmental protection and energy 2014-2020 (2014/C 200/01).

EURELECTRIC appreciates this opportunity, and submits the following contribution as a complement to its response to the DG COMP interim report on the sector inquiry into capacity mechanisms. Our proposals for amendments focus on the section on “Aid for generation adequacy” and reflect several of our proposals made to the DG COMP report to ensure security of supply in the most cost-efficient way as well as a more coordinated and market-based approach to capacity mechanisms accross Europe.

3.9. Aid for generation adequacy

Original text	EURELECTRIC’s proposal
(216) With the increasing share of renewable energy sources, electricity generation is in many Member States shifting from a system of relatively stable and continuous supply towards a system with more numerous and small-scale supply of variable sources. The shift raises new challenges for ensuring generation adequacy.	(216) With the increasing share of renewable energy sources, electricity generation is in many Member States shifting from a system of relatively stable and continuous supply towards a system with more numerous and small-scale supply of variable sources. The shift raises new challenges for ensuring capacity adequacy.
(217) Moreover, market and regulatory failures may cause insufficient investment in generation capacity, for example, in a situation where wholesale prices are capped and electricity markets fail to generate sufficient investment incentives.	(217) Moreover, market and regulatory failures may cause insufficient investment in firm_capacity (generation, demand response and storage) , for example, in a situation where wholesale prices are capped and electricity markets fail to generate sufficient investment incentives.
(218) As a result, some Member States consider the introduction of measures to ensure generation adequacy, typically by granting support to generators for the mere availability of generation capacity .	(218) As a result, some Member States consider the introduction of measures to ensure capacity adequacy, typically by granting support to firm capacity providers .
<u>Justification</u>	
<p><i>We believe we should refer to capacity adequacy instead of generation capacity to clearly highlight that firm capacity providers should not be limited to generation, but should also include demand-side response and storage on a level-playing field.</i></p>	

3.9.1. Objective of common interest

Original text	EURELECTRIC's proposal
<p>(219) Measures for generation adequacy can be designed in a variety of ways, in the form of investment and operating aid (in principle only rewarding the commitment to be available to deliver electricity), and can pursue different objectives. They may for example aim at addressing short-term concerns brought about by the lack of flexible generation capacity to meet sudden swings in variable wind and solar production, or they may define a target for generation adequacy, which Member States may wish to ensure regardless of short-term considerations.</p>	<p>(219) Measures for capacity adequacy can be designed in a variety of ways, in the form of investment and operating aid (in principle only rewarding the commitment to be available to deliver electricity), and can pursue different objectives. They may for example aim at addressing short-term concerns brought about by the lack of flexible generation capacity to meet sudden swings in variable wind and solar production, or they may define a target for capacity adequacy, which Member States may wish to ensure regardless of short-term considerations.</p>
<p><i>(220) Aid for generation adequacy may contradict the objective of phasing out environmentally harmful subsidies including for fossil fuels. Member States should therefore primarily consider alternative ways of achieving generation adequacy which do not have a negative impact on the objective of phasing out environmentally or economically harmful subsidies, such as facilitating demand side management and increasing interconnection capacity.</i></p>	
<p style="text-align: center;"><u>Justification</u></p> <p><i>Phasing out environmentally harmful subsidies is a legitimate objective but well-designed market-based capacity mechanisms clearly do not fall within this category. They are measures aimed at counteracting the effect of well-identified market and regulatory failures and at ensuring security of supply.</i></p> <p><i>Demand side management should not be prioritised. However, a level playing field between all types of capacities that can contribute to solving adequacy concerns should be ensured. There should be no discrimination between equivalent capacity providers to avoid significant inefficiencies.</i></p>	

Original text	EURELECTRIC's proposal
<p>(221) The precise objective, at which the measure is aimed, should be clearly defined, including when and where the generation adequacy problem is expected to arise. The identification of a generation adequacy problem should be consistent with the generation adequacy analysis carried out regularly by the European Network of Transmission Operators for electricity in accordance with the internal energy market legislation.</p>	<p>(221) The precise objective, at which the measure is aimed, should be clearly defined, including when and where the capacity adequacy problem is expected to arise. The identification of a capacity adequacy problem should be consistent with the generation adequacy analysis carried out regularly by the European Network of Transmission Operators for electricity in accordance with the internal energy market legislation. Capacity adequacy analysis must be done at regional level and take into account the economic viability of existing and new capacities.</p>
<p style="text-align: center;"><u>Justification</u></p> <p><i>Establishing regional, well-designed, market-based capacity mechanisms requires both that regional adequacy assessments be conducted on the basis of a common, transparent and contestable methodology, and that clearly defined security of supply criteria be adopted. The regional adequacy assessments should include an analysis of the economic viability of generation capacity, demand response and storage in the short and long term to check whether the capacity will effectively be available at the time of delivery, based on economic conditions. These assessments should also look at a range of scenarios, including stress scenarios, and incorporate a number of key assumptions for the future that are agreed at regional/European level (e.g. RES developments, demand, peak demand, fuel prices, etc...).</i></p>	

3.9.2. Need for State intervention

Original text	EURELECTRIC's proposal
(222) The nature and causes of the generation adequacy problem, and therefore of the need for State aid to ensure generation adequacy, should be properly analysed and quantified, for example, in terms of lack of peak-load or seasonal capacity or peak demand in case of failure of the short-term wholesale market to match demand and supply. The unit of measure for quantification should be described and its method of calculation should be provided.	(222) The nature and causes of the capacity adequacy problem, and therefore of the need for State aid to ensure capacity adequacy, should be properly analysed and their consequences quantified, for example, in terms of lack of peak-load or seasonal capacity or peak demand in case of failure of the short-term wholesale market to match demand and supply. The unit of measure for quantification should be described and its method of calculation should be provided.
(223) The Member States should clearly demonstrate the reasons why the market cannot be expected to deliver adequate capacity in the absence of intervention, by taking account of on-going market and technology developments.	(223) The Member States should clearly demonstrate the reasons why the market cannot be expected to deliver the capacity adequacy standards they have defined , in the absence of intervention, by taking account of on-going market and technology developments. These developments should be incorporated into the regional adequacy analysis (they should be clearly described and their impact quantified in an incremental manner).
<p><u>Justification</u></p> <p><i>The evolution of capacity adequacy in any region should be analysed through realistic adequacy assessments, performed at regional level. A range of scenarios, including stress scenarios, should be tested against the adequacy targets defined by member states.</i></p>	

Original text	EURELECTRIC's proposal
<p>(224) In its assessment, the Commission will take account, among others and when applicable, of the following elements to be provided by the Member State:</p> <p>(a) assessment of the impact of variable generation, including that originating from neighbouring systems;</p> <p>(b) assessment of the impact</p>	<p>(224) In its assessment, the Commission will take account, among others and when applicable, of the following elements to be provided by the Member State:</p> <p>(a) assessment of the impact of variable generation, including that originating from neighbouring systems;</p> <p>(b) assessment of the impact of demand-side participation and storage, including a description of measures to encourage demand side management on a level</p>

<p>of demand-side participation, including a description of measures to encourage demand side management;</p> <p>(c) assessment of the actual or potential existence of interconnectors, including a description of projects under construction and planned;</p> <p>(d) assessment of any other element which might cause or exacerbate the generation adequacy problem, such as regulatory or market failures, including for example caps on wholesale prices.</p>	<p>playing field;</p> <p>(c) assessment of the actual or potential existence of interconnectors, including a description of projects under construction and planned;</p> <p>(d) assessment of any other element which might cause or exacerbate the capacity adequacy problem, such as regulatory or market failures, including for example caps on wholesale prices.</p>
<p style="text-align: center;"><u>Justification</u></p> <p><i>A level playing field between all types of capacities that can contribute to solving adequacy concerns should be ensured.</i></p> <p><i>Failures referred to in point d) are nothing else than the “nature and causes of the capacity adequacy problem” that must be “properly analysed and quantified” in application of paragraph (222).</i></p>	

3.9.3. Appropriateness

Original text	EURELECTRIC's proposal
<p>(225) The aid should remunerate solely the service of pure availability provided by the generator, that is to say, the commitment of being available to deliver electricity and the corresponding compensation for it, for example, in terms of remuneration per MW of capacity being made available. The aid should not include any remuneration for the sale of electricity, that is to say, remuneration per MWh sold.</p>	<p>(225) The aid should remunerate solely the service of availability provided by firm capacity provider (generation, demand response or storage), that is to say, the commitment of being available to deliver electricity and how the remuneration for it is set in a market-based way, for example, in terms of remuneration per MW of capacity being made available. The aid should not include any remuneration for the sale of electricity, that is to say, remuneration per MWh sold.</p>
<p style="text-align: center;"><u>Justification</u></p> <p><i>As stated in the guidelines, all capacity providers should be able to participate on a level playing field. Well-designed market-based capacity mechanisms are not only open to generators but also to demand response and storage.</i></p> <p><i>Well-designed market-based capacity mechanisms should not provide a “compensation” but a remuneration, set in a market-based way, for a service (capacity availability) provided to the system.</i></p>	

Original text	EURELECTRIC's proposal
<p>(226) The measure should be open and provide adequate incentives to both existing and future generators and to operators using substitutable technologies, such as demand-side response or storage solutions. The aid should therefore be delivered through a mechanism which allows for potentially different lead times, corresponding to the time needed to realise new investments by new generators using different technologies. The measure should also take into account to what extent interconnection capacity could remedy any possible problem of generation adequacy.</p>	<p>(226) The measure should be open and provide adequate incentives to both existing and future generators and to operators using substitutable technologies, such as demand-side response or storage solutions, as long as they can commit to being available to deliver electricity when needed. The aid should therefore be delivered through a mechanism which allows for potentially different lead times, corresponding to the time needed to realise new investments using different technologies. The measure should also take into account to what extent foreign capacity participating cross-border could contribute effectively to capacity adequacy.</p>
<p><u>Justification</u></p> <p><i>As stated at the beginning of point (226), well-designed market-based capacity mechanisms should be open to all technologies, both existing assets and investments in new generation.</i></p> <p><i>Cross-border participation is a key feature of well-designed market-based capacity mechanisms. Diverging types of capacity mechanisms in the same region could lead to free-riding neighbouring country's capacities and should thus be avoided.</i></p>	

3.9.4. Incentive effect

Original text	EURELECTRIC's proposal
<p>(227) The incentive effect of the aid will be assessed on the basis of the conditions set out in Section 3.2.4 of these Guidelines.</p>	

3.9.5. Proportionality

Original text	EURELECTRIC's proposal
(228) The calculation of <i>the overall amount of aid</i> should result in beneficiaries <i>earning a rate of return, which can be considered reasonable.</i>	<i>(228) Whenever possible, the aid must be determined through a market-based process effectively targeting the defined security of supply objective and addressing the market and / or regulatory failures identified. Should this not be possible, the calculation of the aid should result in beneficiaries receiving payments resembling those that would result from a market-based process.</i>
<p><u>Justification</u></p> <p><i>The value of capacity should be defined in a market-based way and not “calculated” administratively.</i></p>	

Original text	EURELECTRIC's proposal
(229) A competitive bidding process on the basis of clear, transparent and non-discriminatory criteria, effectively targeting the defined objective, will be considered as leading to reasonable rates of return under normal circumstances.	
(230) The measure should have built-in mechanisms to ensure that windfall profits cannot arise.	
(231) The measure should be constructed so as to ensure that the price paid for availability automatically tends to zero when the level of capacity supplied is expected to be adequate to meet the level of capacity demanded.	

3.9.6. Avoidance of undue negative effects on competition and trade

Original text	EURELECTRIC's proposal
<p>(232) The measure should be designed in a way so as to make it possible for any capacity which can effectively contribute to addressing the generation adequacy problem to participate in the measure, in particular, taking into account the following factors:</p> <p>(a) the participation of generators using different technologies and of operators offering measures with equivalent technical performance, for example, demand side management, interconnectors and storage. Without prejudice to the paragraph (228), restriction on participation can only be justified on the basis of insufficient technical performance required to address the generation adequacy problem. Moreover, the generation adequacy measure should be open to potential aggregation of both demand and supply;</p> <p>(b) the participation of operators from other Member States where such participation is physically possible in particular in the regional context, that is to say, where the capacity can be physically provided to the Member State implementing the measure and the obligations set out in the measure can be enforced;</p> <p>(c) participation of a sufficient number of generators to establish a competitive price for the capacity;</p> <p>(d) avoidance of negative effects on the internal market, for example due to export restrictions, wholesale price caps, bidding restrictions or other measures undermining the operation of market coupling, including intra-</p>	<p>(232) The measure should be designed in a way so as to make it possible for any capacity which can effectively contribute to addressing the capacity adequacy problem to participate in the measure, in particular, taking into account the following factors:</p> <p>(a) the participation of generators using different technologies and of operators offering measures with equivalent technical performance, for example, demand side management, foreign capacities that can actually commit to being available through cross-border exchange capacities and storage. Without prejudice to the paragraph (228), restriction on participation can only be justified on the basis of insufficient technical performance required to address the capacity adequacy problem. Moreover, the capacity adequacy measure should be open to potential aggregation of both demand and supply;</p> <p>(b) the participation of operators from other Member States where such participation is physically possible in particular in the regional context, that is to say, where the capacity can be physically provided to the Member State implementing the measure even in the case of capacity shortages in the Member State where the capacity is actually located and the obligations set out in the measure can be enforced³;</p> <p>(c) participation of a sufficient number of generators to</p>

³ Schemes should be adjusted in the event that common arrangements are adopted to facilitate cross-border participation in such schemes.

<p>day and balancing markets.</p>	<p>establish a competitive price for the capacity;</p> <p>(d) avoidance of negative effects on the internal market, for example due to undue export restrictions⁴, wholesale price caps in particular if not harmonised, bidding restrictions or other measures unduly undermining the operation of market coupling, including intra-day and balancing markets.</p>
<p style="text-align: center;"><u>Justification for (a) and (b)</u></p> <p><i>In case of common scarcity events, Member States and TSOs should refrain to take measures hindering the execution of capacity contracts. Respecting capacity contracts could lead to load curtailment in the country where capacity has been contracted to support the country with a capacity mechanism.</i></p> <p><i>Developing an operational process for managing cross-border participation in real time therefore requires:</i></p> <ul style="list-style-type: none"> • <i>The removal of price caps or at least an harmonisation of their level so that prices could reflect the actual value of loss load and therefore reduce distortions in the execution of the contracts in operation/real-time.</i> • <i>An appropriate legal and operational framework for managing simultaneous scarcity events: the electricity security of supply directive and the network code on emergency and restoration are the appropriate vehicle to do so.</i> • <i>When energy prices cannot resolve the flow (e.g. both countries have reached the same level of VoLL⁵), the legal and operational framework will have to be complemented by ex-ante intergovernmental agreements to manage the simultaneous scarcity situations and to define in real time the energy flows in order to allow the execution of capacity contract.</i> <p style="text-align: center;"><u>Justification for (c) and (d)</u></p> <p><i>The risk of free-riding on the capacity contracted by a Member State does exist when this country has lower price caps than its neighbours. Price caps should therefore be removed , or at least be harmonised across the EU and across all market horizons (day-ahead, intraday, balancing markets) to reflect the value of lost load.</i></p>	

⁴ Export restrictions might be allowed in order to avoid free-riding on the capacity contracted by a Member State only.

⁵ In this case, the direction of the power flow is not determined by the price differential (which is zero). If the price cap is higher in country B than in A, this could result in power flowing from A to B. This situation could even occurs (i) when there is a capacity market in A and there is none in B, or (ii) when there are capacity markets both in A and B with different levels of target adequacy

Original text	EURELECTRIC's proposal
<p>(233) The measure <i>should</i>:</p> <ul style="list-style-type: none"> (a) not reduce incentives to invest in interconnection capacity; (b) not undermine market coupling, including balancing markets; (c) not undermine investment decisions on generation which preceded the measure or decisions by operators regarding the balancing or ancillary services market; (d) not unduly strengthen market dominance; (e) <i>give preference to low-carbon generators in case of equivalent technical and economic parameters.</i> 	<p>(233) The measure <i>should</i>:</p> <ul style="list-style-type: none"> (a) not reduce incentives to invest in <i>efficient</i> interconnection capacity; (b) not <i>unduly</i> undermine market coupling, including balancing markets; (c) not undermine investment decisions on generation which preceded the measure or decisions by operators regarding the balancing or ancillary services market; (d) not unduly strengthen market dominance; (e) <i>be technology neutral and ensure a level playing field</i>
<p style="text-align: center;"><u>Justification</u></p> <p><i>EURELECTRIC proposes to clarify the first item. The rationale for this evolution is that investments in transmission facilities that impact on cross-border capacities benefit from a specific investment framework with dedicated incentives. The economic impact of such investments, taken into account the level of incentives (see ENTSOE methodology to perform Cost Benefit Analysis of interconnection development projects), already consider their impacts on security of supply regardless of the implementation of capacity mechanisms. It is therefore not necessary to bridge capacity mechanisms and development of interconnection capacity.</i></p> <p><i>All capacity providers providing an equivalent service to the system should compete on a level playing field.</i></p>	

4. Evaluation

Original text	EURELECTRIC's proposal
<p>(242) To further ensure that distortion of competition is limited, the Commission may require that certain aid schemes are subject to a time limitation (of normally 4 years or less) and to the evaluation referred to in paragraph (28). Evaluations will be carried out for schemes where the potential distortion of competition is particularly high, that is to say, that may risk to significantly restrict or distort competition if their implementation is not reviewed in due time.</p>	<p>(242) To further ensure that distortion of competition is limited, the Commission may require that certain aid schemes are subject to a time and to the evaluation referred to in paragraph (28). Evaluations will be carried out for schemes where the potential distortion of competition is particularly high, that is to say, that may risk to significantly restrict or distort competition if their implementation is not reviewed in due time.</p>
<p><u>Justification</u></p> <p><i>Limiting the duration of certain aid schemes to reduce distortions of competition is a legitimate objective although well-designed market-based capacity mechanisms cannot be concerned by such time limitations as they are not an aid scheme but a structural measure to counteract the effect of well-identified 'market and regulatory failures', and to ensure security of supply.</i></p> <p><i>To optimise existing capacity and manage possible oversupply situations, a lead time of 3 to 4 years should be sufficient. This amount of time also makes it feasible for most new capacity providers to be available at the start of the capacity contract, as it is consistent with the time associated with investment decisions.</i></p> <p><i>As for the duration of the capacity contract, energy markets have failed so far to develop contracts in the time horizon that is relevant for investments. A capacity market can complement this. Indeed, investments in new generation capacity with a lifetime of several decades would benefit from longer-term price signals and from a stable regulatory framework.</i></p>	

EURELECTRIC pursues in all its activities the application of the following sustainable development values:

Economic Development

▶ Growth, added-value, efficiency

Environmental Leadership

▶ Commitment, innovation, pro-activeness

Social Responsibility

▶ Transparency, ethics, accountability



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