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CONTRIBUTION

From:	General Secretariat of the Council
To:	Working Party on Energy
Subject:	PL, FR, UK, IT, EL, HU, IE comments on the Electricity Regulation

Delegations will find in annex the PL, FR, UK, IT, EL, HU, IE comments on the Electricity Regulation (capacity mechanisms).

Common position of Poland, France, United Kingdom, Italy, Greece, Hungary, Ireland on capacity mechanisms in Electricity Regulation

Cognisant of the difficult and complex negotiations to date on Chapter IV "*Resource Adequacy*" of the Electricity Regulation and new challenges that the EP proposal poses in this matter, we would like to present our common position regarding capacity mechanisms. These main points express our shared concerns and views as an input to the further discussions during the trilogues. We are ready to work constructively in order to find a solution for this complex issue that will result in a comprehensive and well-balanced approach taking into account the specificities of each Member State.

Member States should be able to design the most appropriate mechanism to ensure their own security of supply

Consumer protection is at the core of the Clean Energy Package proposal: an essential component of this objective is to guarantee security of supply. It is our shared conviction that a broad spectrum of capacity mechanisms can play a useful part in fostering resource adequacy in European electricity market design.

Member States have a fundamental responsibility to maintain security of supply. As such it should ultimately be for them to determine whether it is necessary to introduce a capacity mechanism within their own market, as well as to decide on the most appropriate and proportionate form of mechanism to address the adequacy concern, all subject to state aid approval. Each Member State has its own specific characteristics and needs, and is already required to perform a thorough assessment of its adequacy before applying the most appropriately tailored solutions. Therefore, **Member States should be able to decide which form of capacity mechanism is the most suitable for them taking into account the result of the relevant assessments and their own specific characteristics, while remaining fully compliant with EU legislation.**

All capacity mechanisms should be treated on the same footing

As clearly stated in the European Commission *Final Report of the Sector Inquiry on Capacity Mechanisms* (2016), **different resource adequacy problems and structural issues are best resolved using different, appropriate solutions**. Market-wide capacity mechanisms are likely to be more appropriate where long-term adequacy concerns are identified, as stated in the report: "*Such a mechanism can exchange the potential revenues from uncertain periods of high prices at times of scarcity for a regular, guaranteed income stream. It can therefore increase investment certainty*". Such capacity mechanisms are a useful tool to deliver incentives for investments in new and clean capacity.

One of our concerns is a lack of balance in the EP approach to different types of capacity mechanisms. The new regulatory framework should encompass the diversity of capacity mechanisms, setting principles and rules that would apply similarly to all capacity mechanisms. One form of capacity mechanism should not be favoured over the other designs.

Consequently, we cannot agree on giving priority to strategic reserves as the best and preferred way to solve adequacy concerns. Furthermore, all capacity mechanisms, including strategic reserves, should fulfil the emissions performance standard requirements set by the new Regulation. In addition, utilization of capacity mechanisms should not result in limiting incentives for the development of balancing market services and other new services e.g. flexibility, storage and demand response. Therefore, **strategic reserves, as a non-market based but fully administrative measure, should be limited to operating in only critical situations** (e.g. in extreme system stress events).

Market-based capacity mechanisms, in full compliance with state aid regulations, can be a useful part of European Market Design

It should be underlined that capacity markets, which are market–based tools, need to meet the strict conditions included in the 2014 Environment and Energy Aid Guidelines (which are at the core of state aid regulatory policy). Therefore, **capacity markets are well-targeted tools aimed at addressing structural and long-term adequacy problems, accompanied by a precise market impact assessment.**

While designing capacity mechanisms individual MS conditions should be taken into account

Proper and appropriate adequacy assessment is a key tool in discovering resource adequacy problems. With closer integration of markets, the development of regional and European adequacy assessments is an important step towards greater energy security and closer cooperation between Member States in this field. However, neither a single European study nor regional assessments can replace national adequacy assessments. Since security of supply and adequacy issues can manifest themselves locally, national assessments are essential to address these relevant local problems and specificities with a greater sensitivity. **The outcome of a European adequacy assessment should not be the deciding factor in whether a capacity mechanism can operate; rather, it should be used to complement national and regional assessments in determining whether one is permissible.**

In our view, it is clear that electricity market reform is the first step in addressing the problems in electricity markets. **MSs designing the capacity market,** as a part of notification procedure, **already need to prove that the notified tool is a well-targeted measure complementary to the electricity market, within the context of highly ambitious reforms of the overall electricity markets towards stronger integration at the European level and better participation of all resources in the market.** Therefore, **we do not support the idea of preparing implementation plans as a preliminary step to assess the necessity of introducing capacity mechanism.** In our view, the procedure proposed by the EP is far too complicated, contains too many conditions and some of them seem to be unjustified and unnecessary, especially considering the requirement on Member States to design and notify schemes in accordance with the strict conditions of the 2014 Environment and Energy Aid Guidelines. They might be more costly than a capacity mechanism, and most importantly the prescribed measures might not solve the adequacy problems.

A gradual transition towards a new regulatory environment is necessary to provide appropriate incentives

The upcoming legislation must send the right signal towards the markets, while ensuring predictability, credibility and smooth continuation of both investment transactions and business activities. It is important to protect legitimate rights arising from valid contracts. These contracts should be protected for their entire contractual term, without a requirement to adapt them to the Regulation. Installations that have already concluded contracts before the date of entry into force of Electricity Regulation should be permitted to receive payments until the expiry of the contracts.

In the spirit of the state aid guidelines, capacity mechanisms should be subject to periodical review which takes into account developments in the electricity systems and the effects of the implemented market reforms. However, we also consider it necessary to ensure sufficient stability in the regulatory framework to reduce the cost of uncertainty, and thus, the cost of security of supply for consumers. In this regard it is important to consider that capacity markets are targeted to address, amongst others, the missing money problem, and to reinforce long-term investment signals.

Well-designed, market based capacity mechanisms, accompanied by market reforms can be an essential tool for managing the transition towards a low emissions electricity system at lowest cost. Suitable environmental performance standards, expressed in terms of unitary constraints or average limits per year, should apply to planned capacity mechanisms as well as approved ones, while upholding valid capacity contracts and providing a transitional period to meet a country's adequacy indicators. In order to achieve those targets, it is necessary to distinguish the rules that apply to *existing* and *new* installations. The definition of which installation is *existing* and which is *new* must be clearly outlined. The delimitation point to distinguish these two types of investments should be set as the date of the ***final investment decision relative to the date of entry into force of the Regulation*****.**

We agree that the most emitting existing installations should be gradually phased out of capacity markets, taking into account the security of electricity supply concerns and commissioning of new low emission installations. **Nevertheless, a suitable and realistic transition period for existing installations that do not yet meet the emission criteria should be considered. Transitional eligibility of those units to participate in capacity markets is important in order to help meet a country's adequacy target and incentivize investments in emissions reductions technologies for these units as well as for new units.**