MINISTRY OF INDUSTRY AND TRADE
OF THE CZECH REPUBLIC

The Czech Republic´s contribution to the Commission Public Consultation: Generation Adequacy, Capacity Mechanisms and the Internal Market in Electricity

7th February 2013

We welcome the published consultation on generation adequacy, capacity mechanisms and the internal market in electricity. Ensuring long-term security of supply, i.e. meeting the generation adequacy also in coming years in relation to expected consumption, is one of our priorities. We find important especially the assessment of adequate structure of generation in relation to the criteria of the network balance and operability.

Our assessment of the capacity mechanisms for ensuring the installed capacity for compensation of short-term balance, as one of the options for remediation of existing distortion of the electricity market, is based on the needs of the Czech Republic and on the way this concept is addressed in other Member States. Should the capacity mechanism be introduced, it needs to be limited to resources that meet the conditions pursuant to Union acquis communautaire on the protection of the environment. In any case, we insist that prior to the introduction of the national arrangements all Member States must ensure that negative impacts are avoided, in particular on their neighbours.

We expect that the public consultation will contribute to the introduction of mechanisms that will gradually lead to restoration of the functions of the electricity market that will not be distorted by the non-systemic measures. All support schemes must include time criteria and be restricted only to the period necessary for the restoration of the market functions. Because of the existing support schemes (about 20 years), this is a long-term process.

At present, there is an effort to harmonise the applicable regulations via the network codes, regulations or other legal instruments throughout the Union. As a Member State, we welcome this effort, however at all times the specificities of individual Member States or national assignment of competences should be respected to a certain degree.

We understand that the consultation documentation as well as the included questions focuses on the problems related to ensuring the generation capacity for short-term flexible production, i.e. the capacity mechanisms. However, several Member States face the necessity of decommissioning significant generation capacity in the base load and are therefore in an urgent need of the mechanisms for the stabilisation of the investment environment in this sector (UK, CZ, etc.). From this point of view, the document doesn't appear sufficiently focused on the problem of ensuring the generation adequacy in the area of the base load. During the discussions in 2012, the Commission was rightly mentioning both relevant problems - long and short-term. We draw your attention to this matter also in our reply to question n. 12.

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1. Do you consider that the current market prices prevent investments in needed generation capacity?

Yes, the electricity price levels and their development do not provide for sufficiently reliable information for the decisions on investment in new generation capacities. Market prices of electricity are distorted by the massive support of the generation of electricity from the renewable resources; on top of that the price of the emission allowances within the ETS is significantly lower than the price estimates from the past years. Lower demand for electricity resulting from the economic slowdown led to direct drop of the market electricity prices (the price is no longer set mostly by variable costs of gas-fired power plants, but by significantly lower variable costs of coal-fired power plants). Variable costs are also lower as a result of the drop of the prices of the emission allowances resulting from the economic slowdown. Emission allowances as a tool would support investments in low-emission technologies, however given that also this market in quite unstable, they actually bring significant uncertainty in relation to the rate of the recovery of investment.

2. Do you consider that support (e.g. direct financial support, priority dispatch or special network fees) for specific energy sources (renewables, coal, nuclear) undermines investments needed to ensure generation adequacy? If yes, how and to what extent?

Yes, the support schemes for selected technologies, in particular the RES, as set in present, have been providing a market advantage for those technologies in comparison with the unsupported generation sources; such support schemes distort the market and put an excessive financial burden on the end energy consumers and in some cases on the competitiveness of the national economy. The costs of each energy source should also reflect the costs that its deployment brings to the system - the need for back-up by other sources within the system in case of intermittent supply or, for example, the need for increase in the capacity of the transmission systems (in particular in case of RES).

The present level of the electricity market distortion does not give sufficient signals for the investors when they make decisions on the building new, or reconstruction of the existing power plants. The equal responsibility of each generator for the balancing (deviations), regardless of the used technology, should become one of the measures for remedy of the present imbalance of the mix of generation sources and restoration of the fair competition.

The support of and the increase of the capacity of the intermittent generation sources does not increase the generation adequacy and it significantly decreases the rate of return of investments into all other sources needed for the ensuring of the generation adequacy.

3. Do you consider that work on the establishment of cross-border day ahead, intraday and balancing markets will contribute to ensuring security of supply? Within what timeframe do you see this happening?

The introduction of the cross-border day ahead, intraday and balancing markets can by itself contribute to the decrease of variable costs that is essential for the electricity prices while using the existing capacities. The contribution to ensuring the security of supply will be small. The introduction of those harmonised platforms enables the participants of the energy markets to balance their market position in the time period very close to the day and the hour of the supply, to address promptly their surpluses or shortages of electricity and gas and thus contributes to the optimisation of their market positions and the functioning of the electricity and gas systems. Another decisive

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factor is the sufficient capacity of the generation sources in relation to the consumption and the strengthening of the cross-border transfer capacity, which is necessary for the functioning cross-border trade, including its predictable availability for trading without a strong influence of unplanned, non-traded flows, which need to be taken into account when allocating the free transfer capacities. Generation adequacy should be primarily the national issue, alternatively the regional issue.

4. What additional steps, if any, should be taken at European level to ensure that internal market rules fully contribute to ensuring generation adequacy and security of supply?

An undistorted market and a long-term stability of the regulatory framework are essential for ensuring the generation adequacy. Present electricity market has been setting in the long-term the prices at the level of the variable costs. This is why the market needs to be supplemented by the rules on the support of the generation adequacy. The auctions should be used to the maximum possible extent.

The use of, e.g., capacity mechanism or contracts for differences (CFD), at the national level should be allowed to the extent necessary for ensuring of the generation adequacy. At national level, the auctions should be organised as technologically neutral to the maximum possible level, while at the same time ensuring optimal national energy mix.

At European level, it is crucial to allow national solutions and promote in particular systemic solutions, not the exceptions. Moreover, it is necessary to ensure at European level the harmony of all relevant solutions, in particular EU ETS, infrastructure development, investments into the generation, support for low-carbon technologies and a regulation framework that will in its effect ensure the interests of the end consumers (including the industry) in the form of the reliable supply of affordable electricity. Such supply is at present hampered by the non-market support of the RES or introduction of other forms of support and regulatory measures at the generation side.

5. What additional steps could Member States take to support the effectiveness of the internal market in delivering generation adequacy?

The fundamental step is the complete implementation of the Third Liberalisation Package by all Member States and thus ensuring the equal position of all market participants regardless of the state or region.

Any national or regional measures for ensuring the generation adequacy, i.e. creating the conditions for the support of investments in the required generation capacity needs to be in compliance with the Union goals - competitiveness, sustainability and security of supply.

National use of the auctions and other national mechanisms for ensuring the generation adequacy should be on one hand technologically neutral to the maximum extent possible and on the other hand should reflect the need to fulfil the energy mix as defined in national energy policies. In no case should such measures have a negative impact on the security of supply in neighbouring countries. Capacity mechanisms must be restricted to generation sources with low load factor in order to ensure in particular the reserves in generation capacity and address short-term peak load.

6. How should public authorities reflect the preferences of consumers in relation to security of supply? How can they reflect preferences for lower standards on the part of some consumers?

From the security of supply point of view, we understand the electricity supply as meeting the basic

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needs of the end consumers. From this point of view, there is no lower standard. The consumer can in contrary request higher security of the electricity supply, e.g. limit to a minimum the probability of the interruption of the electricity supply to the sensitive manufacturing equipment. This can be technically solved for example by connection to two independent supply points of the distribution network, with corresponding costs for such increased security of supply.

It is appropriate to evaluate by e.g. an appropriately adjusted tariff or by another form of the participation in the 'demand side response' the willingness of the customer to accept, for example, an insufficient capacity in energy generation or transmission in certain states of the operation of the system and to adjust (decrease) their consumption adequately. This can be made subject to existence of adequate technical equipment at the interface between the customer and the distribution network (remote-controlled limiter in case of the smart networks, remote-controlled heating appliances, etc.).

7. Do you consider that there is a need for review of how generation adequacy assessments are carried out in the internal market? In particular, is there a need for more in depth generation adequacy reviews at:

a. National level
b. Regional Level
c. European Level

We are of the opinion that the activities of the ENTSO-E in this respect are sufficient from the internal market point of view. It would be appropriate to supplement those with a regional assessment of the impact of intermittent supply from RES.

8. Looking forward, is the generation adequacy outlook produced by ENTSO-E sufficiently detailed? In particular,

a. Is there a need for a regional or European assessment of the availability of flexible capacity?

The ENTSO-E should assess the regional assessment of the impact of the intermittent generation from RES and its substitution by other sources - the flexible capacity. Pan-European assessment is irrelevant with regard to expected market design (differences in sources mix and shares of intermittent and flexible capacity, size of the territory and different regional conditions).

b. Are there other areas where this generation adequacy assessment should be made more detailed?

We consider all remaining areas within the ENTSO-E assessment as addressed with sufficient level of detail.

9. Do you consider the Electricity Security of Supply Directive to be adequate? If it should be revised, on which points?

We are of the opinion that the Electricity Security of Supply Directive does not require a revision.

10. Would you support the introduction of mandatory risk assessments or generation adequacy plans at national and regional level similar to those required under the Gas Security of Supply Regulation?

The existing cooperation of the TSOs sufficiently covers the evaluation and elimination of risks related to operation of interconnected systems (see e.g. cooperation within the TSC).

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Additional obligatory assessments are not required; however care should be given to solving already known existing problems. (TSC - Transmission System Operator Security Cooperation is a cooperation initiative between thirteen European transmission system operators)

11. Should generation adequacy standards be harmonised across the EU? What should be that standard or how could it be developed taking into account potentially diverging preference regarding security of supply?

European harmonisation of generation adequacy standards is not effective with regard to differences in conditions at the state and regional level.

12. Do you consider that capacity mechanisms should be introduced only if and when steps to improve market functioning are clearly insufficient?

The capacity mechanism should only be introduced where there is no other way of ensuring the market functioning. Present situation in the electricity market in Europe does not provide sufficient information and stability for investments needed for maintaining the security of supply and other Union goals. However, other measures that should precede the introduction of the capacity mechanism are not being used. The full implementation of the Third Energy Package by all Member States is missing as well as the responsibility for all electricity producers (including the production from RES) for balancing (deviations). Well- and predictably functioning EU ETS can also contribute to making decisions on investments into the generation sources.

Capacity mechanism, as a measure substituting the non-functioning market in ensuring the flexible generation capacity or capacity for covering peak loads, will not provide sufficient price signals for investments required for long-term generation adequacy. Any discussion on the introduction of the capacity mechanism should be a long-term one; moreover all possible impacts, including those on the end consumers, including the industry, should be carefully assessed. Therefore, the discussion on the remedy of the market distortions should cover also the long-term solutions towards the goals of the European energy strategy.

13. Under what circumstances would you consider market functioning to be insufficient:

a. to ensure that new *flexible* resources are delivered?

b. to ensure *sufficient* capacity is available to meet demand on the system at times of highest system stress?

Provided it is not distorted by non-systemic measures, e.g. support for RES, a functioning market can in the short and long run provide for both the sufficient flexible generation capacity to cover fluctuations in the consumption and sufficient capacity at the times of the highest peak load. As it is stated also in the consultation documents, reacting to such distortion by targeted support for the flexible capacity will make possible future restoration of the market even more complicated.

14. In relation to strategic reserves:

a. Do you consider that the introduction of a strategic reserve can support the transition from a fossil fuel based electricity system or during a nuclear phase out?

The strategic reserve will increase the cost of the system operation for the end consumers. It is first of all necessary to straighten the market conditions and enable the introduction of the technologically neutral solutions.

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b. What risks, if any, to effective competition and the functioning of the internal market do you consider being associated with the introduction of strategic reserves?

Introduction of the strategic reserve, or another capacity mechanism, will have a strong impact on the market and will further deepen its distortion in relation to the adequate price signals for investments.

15. In relation to capacity markets and/or payments:

a. Which models of capacity market and /or payments do you consider to be most and least distortionary and most compatible with the effective competition and the functioning of the internal market, and why?

The least distortionary model of the capacity mechanism should be technologically neutral, limited only to the sources with low load factor and implemented to the extent necessary for the generation adequacy of the particular Member State.

b. Which models of capacity market and /or payments do you consider to be most compatible with ensuring flexibility in a low carbon electricity system?

Reply provided in paragraph (a).

c. Are there any models of capacity mechanism the introduction of which would be irreversible, or reversible only with great difficulty?

Any model of a capacity mechanism will be difficult to terminate once it has been introduced and used for several years.

16. Which models of capacity mechanisms do you consider to have the have the least impact on costs for final consumers?

While ensuring the secure electricity supply to the consumers, the Czech Republic doesn't at present have problems neither with the generation capacity for the peak loads, nor with sufficient flexible capacity to cover fluctuations of the consumption or the reserve for the intermittent production from RES. We assume that the same will apply for the close future. Therefore our deliberations on the capacity mechanism in the Czech Republic are not sufficiently advanced so as to allow us to respond to the question in detail. In our view, the costs will be more dependent on the details of the parameters of the particular model rather than on the choice of the model itself. It can be assumed that when selecting the model, the Member States will reflect their national conditions including the impact on the end users and industry and existing plus expected generation mix.

17. To what extent do you consider capacity mechanisms could build on balancing market regimes to encourage flexibility in all its forms?

The participation of the supported and unsupported sources within the same market will distort the market and limit its functionality. Therefore those two categories should not be mixed in order to ensure that the sources supported through the capacity mechanism do not distort the balancing market. In contrary, we are of the opinion that the functioning balancing market could support the interest in providing the generation capacity on the market basis.

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18. Should the Commission set out to provide the blueprint for an EU-wide capacity mechanism?

The coordination at EU level of the possible use of capacity mechanisms we consider as effective with regard to their compliance with the goals - competitiveness, sustainability and security of energy supply. We do not regard as neither advisable nor possible attempting to introduce single European capacity mechanism.

The effort to harmonise the approach towards the capacity mechanism in all details will not have the effect proportionate to the effort invested due to too significant differences in the conditions of the individual Member States or regions.

19. Do you consider that the European Commission should develop detailed criteria to assess the compatibility of capacity mechanisms with the internal energy market?

Common criteria for the assessment of different models of capacity mechanism can ensure the harmonised approach within the Union and should therefore by drafted and adopted. However, such criteria should not go in the greatest detail. Prior to implementation, every proposed model will need to be assessed individually with respect to public subsidies and with respect to specific conditions of particular state or region, e.g. the extent of interconnections with neighbouring systems.

20. Do you consider the detailed criteria set out above to be appropriate?

a. Should any criteria be added to this list?

Some proposed criteria require further clarification, e.g. n. 9; only then can the complete list and the weight of individual criteria be fully assessed.

b. Which, if any, criteria should be given most weight?

Preliminary, before the finalisation of the list of criteria (see response in paragraph (a)), we regard the following criteria as the most important - listed in descending order by their weight:

- 3a, b
- 5
- 8b, c, d

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