

**EUROGAS RESPONSE TO EUROPEAN COMMISSION'S CONSULTATION ON
GENERATION ADEQUACY, CAPACITY MECHANISMS AND THE INTERNAL MARKET IN
ELECTRICITY**

As an introduction to the formal response to this consultation, Eurogas wishes to share general messages of the association in the context of the introduction of capacity mechanisms in the EU.

- Ideally the commodity price of energy, whether it is electricity, including its carbon footprint, natural gas or any other fuel, should be the driver for competition, determine investment choices and guarantee security of supply (energy-only market).
- During the transition to full integration of a higher share of renewable energy sources, which is fully supported by Eurogas and can be facilitated substantially by the complementary use of natural gas, an energy-only market might no longer work in the power sector. Growing penetration of renewable energy in electricity generation has reduced the operating hours of conventional plants and the spread between base and peak load prices. In some Member States, there is overcapacity or market distortion. Many gas-fired power stations have therefore become uneconomic, and investment plans for new plants are being abandoned.
- Where gas-fired power plants remain necessary to back up electricity supply from intermittent renewable energy sources since other backup options are not available, less flexible or generally less economically efficient, the lack of sufficient revenue and, as a result, the potential mothballing or decommissioning of plants or abandonment of investment plans has caused considerable concern. According to the European Commission's Energy Roadmap 2050, the share of renewable energy in the European energy mix will increase further in all possible scenarios. There is thus evidence that the issues of concern may have a structural character.
- This situation has led some national governments to consider alternative remuneration mechanisms. Capacity remuneration mechanisms for power plants are expected to provide a more assured route for recovering the value of capacity than relying on capturing peak energy prices.
- The European Commission, however, is rightly concerned that poorly designed capacity remuneration mechanisms introduced without proper coordination at EU level risk being counterproductive and having an impact on fair cross-border trade.
- Eurogas notes that the problem of reduced operating hours may not only affect gas-fired power plants. It could also cause congestion, and have an impact on the attractiveness, of other gas infrastructure (particularly underground storage facilities), which are necessary for the delivery of fuel to these power plants at peak times. Therefore, an impact assessment of the introduction of capacity remuneration

mechanisms should concentrate on the electricity market but should also pay due attention to the gas market.

- If an impact assessment indicates that capacity remuneration mechanisms are necessary, they must be designed in accordance with market principles. Special attention should be given to their effect on balancing and intraday markets. Eurogas is willing to cooperate with other stakeholders and with the Commission to develop guidelines and basic requirements for the implementation of capacity remuneration mechanisms.
- However, Eurogas also notes that the energy-only electricity market is currently subject to considerable distortions due to a number of factors, including regulated end-user prices, price caps and floors, restrictions or unnecessary regulatory requirements on plant operations. As renewable energy sources are not yet fully integrated in the market, missing system responsibility for renewable energy sources for meeting scheduling, nomination and balancing requirements is currently another important market distortion, as are certain renewable energy support schemes. Therefore, Eurogas is of the opinion that these distortions, which are closely linked to the need for capacity remuneration mechanisms, should be removed as a priority.
- Furthermore, Eurogas is of the opinion that the achievement of a low-carbon energy market should be driven by fair competition between different low-carbon energy technologies, with the ETS as the key instrument. The choice of the most cost-effective technologies achieving carbon dioxide emission reductions would then be the result of a competitive market.

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

Ideally the commodity price of energy, whether it is electricity, including its carbon footprint, natural gas or any other fuel, should be the driver for competition, and market spreads should guide investment choices and set the security of supply (energy-only market) at the end of the day.

However not only the current market prices but also expectations about long-term future market developments are key for investment decisions. The following elements impact the investment climate in most of the Member states:

- Thermal capacity will be less utilised in the future, which will further challenge the economic situation of conventional plants, including gas fired power plants.
- Uncertainty as a result of unstable legal and regulatory framework, e.g. support for renewables, the future of the EU ETS, new energy efficiency targets, possible capacity mechanisms, taxes and injection tariffs.
- Challenging market fundamentals (e.g. supply, demand, fuel and carbon prices).

Generally, there are doubts whether price spreads beyond the forward markets will allow for covering investment costs in thermal generation, nor whether they will be sufficient to keep existing plants as back-up for intermittent RES.

Current conventional generation is in many cases not economic unless different alternative market design improvements are considered allowing the energy markets to function properly and deliver a fair income. If improvements are implemented and incomes delivered still appear to be insufficient, a capacity market mechanism could be considered.

(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?

Principally, every support scheme for a certain fuel type distorts the level playing field of the internal market, regardless if for nuclear, coal, gas or renewables.

Energy from renewables significantly contributes to Europe's climate objectives. Nevertheless, the support schemes for renewables challenge the economic situation of thermal plants today. In a first stage, i.e. as long as renewable technologies are at a very early development stage and present only a small share of generation, an out-of-market support scheme may be appropriate. However, as renewable technology becomes more and more mature in the following stage and the feed-in of renewables present a significant share of generation, the market of thermal generation becomes more and more distorted. Growing penetration of renewable energy in electricity generation has reduced the operating hours of conventional plants and the spread between base and peak load prices is affected by photovoltaic. The development stages and shares of renewables differ within the European Member States and for this reason also the distortions caused in the wholesale market. The mid to long-term objective should be to integrate renewables fully in the market, to give them system responsibility for meeting scheduling, nomination and balancing.

Eurogas is of the opinion that current distortions as mentioned here and further in the text (see question 4), which are closely linked to the need for capacity remuneration mechanisms, should be removed as a priority. The achievement of a low-carbon energy market should be driven by fair competition between different low-carbon energy technologies, with the ETS as the key instrument. The choice of the most cost-effective technologies achieving carbon dioxide emission reductions would then be the result of a competitive market.

(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 completion of the internal market by 2014 is expected to deliver more integrated 'balancing markets' and better functioning 'intraday markets' both for electricity and for gas. These are intended to use commonly existing flexibility assets in Europe to cope with the increased needs due to intermittent RES and to improve the markets' signalling abilities, which in principle should make transparent needed investments in new and flexible generation capacities. The integration of day ahead, intraday and balancing markets positively contribute to the optimal use of the power system and the optimal generation dispatch resulting in a competitive price for end consumers.

However, there is an urgent need to achieve a fully integrated balancing market. Therefore, we would favour an earlier adoption of the balancing Network Code than foreseen in the Framework Guideline. And it is also deplored that there is little or no progress in the achievement of well-functioning cross-border intraday power markets while this should be within arm's reach.

(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?

Eurogas advises that current barriers and limitations to the energy-only markets should be removed, in the interest of an integrated EU market. In particular:

- The integration of wholesale electricity and gas markets, and thus the improvement of their functioning to achieve the completion of the internal market by 2014, have to remain the priority of policy makers, regulators and involved stakeholders (ENTSO, TSOs, Power Exchanges...). More integrated balancing markets and better functioning intraday markets are central to this. Therefore the European Commission should ensure that the requirements of the third package are fully implemented in each Member State and the timely progress of network codes is maintained.
- The European Commission should increase the pressure on Member States to remove existing distortions such as regulated end-user prices, restrictions or unnecessary regulatory requirements on plant operations, as well as price caps and floors, to allow energy-only markets to have a chance to function properly.
- In the absence of an EU level playing field, inappropriate locational or technological choices of the generation mix could be made due to different investment appetites between Member States and because different technologies are available. Regulatory interventions affecting the generation sectors such as fuel taxes, Robin Hood tax for energy companies etc. should therefore be avoided.
- Grid development to overcome national congestion and development of cross-border capacity should be incentivised.
- Today RES are not yet fully integrated in the market and are not yet fully accountable for the costs that they impose on the system. To benefit a smooth energy system and market, generation from RES should finally be integrated into the market with the same obligations as for other market players, i.e. meeting scheduling, nomination and balancing requirements. Market prices should encourage demand-side response and policy should promote the development of electricity smart metering so that market-based changes in demand contribute to wholesale market spot price formation.
- A free investment choice should be possible, but also, when operators come to the conclusion that plants are no longer profitable, they should be freely allowed to exit definitively (i.e. decommissioning) or temporarily (i.e. mothballing) their power plants
- European Member States should take a harmonised approach for an assessment of the generation adequacy.

All these measures contribute to ensuring adequacy and security of supply but may not be sufficient in some Member States to ensure urgently needed backup investment decisions to cope with intermittent RES, depending strongly on geographical conditions and energy policies.

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

Eurogas has set out above that steps should be taken at EU level and considers that Member States should take measures in line with these steps.

(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?

Our belief is that security and availability of supply is an important requirement for the majority of customers, although this only becomes apparent on the infrequent occasions when supplies are interrupted. At the moment there is little practical means for customers to demonstrate their choice in the trade-off between security of supply and price except for the highest consuming business customers. Approaches need to be pragmatic and recognise that different customers have different needs, preferences and potential to be more flexible or to accept lower standards. Customers should have the option to offer their flexibility and benefit from the market value. Customers' preferences are only actually known once they buy a product or service, therefore the framework needs to be in place to enable companies to develop and offer innovative products and tariffs. Smart meters have the potential to involve customers more and make them understand their costs and bills. Their installation should be explored and benefits analysed with that in view.

(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**

Yes, Eurogas is of the opinion that there is a need for review of how generation adequacy assessments are carried out in the internal market in order to bring more transparency. Transparency is essential to achieve market functioning and therefore the choice of efficient solutions based on competitive elements.

It would make sense to have a common approach and methodology for adequacy assessment at the European level.

To reach European integration, at least a supranational/regional assessment should be carried out. Negative impacts on European competition and market integration because of different approaches in the European countries should be avoided. With the completion of the internal energy market, security of supply becomes a supranational/regional issue and assessment should be carried out in order to come to a level of EU adequacy.

At national level adequacy assessment would probably lead to investment in overcapacity if it did not take into account interconnection with and available capacity in the neighbouring countries.

(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?

No answer.

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

No answer.

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

No answer.

(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?

No answer.

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

No answer.

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

Yes. Eurogas has the position that first of all the steps described in questions 4 and 5, have to be taken at the European level and by Member States to support the effectiveness of the internal market in delivering generation adequacy.

Eurogas believes that current barriers and limitations to the 'energy only' market are closely linked to the need for capacity remuneration mechanisms and therefore should be removed as a priority. This is indispensable if the energy only market is to function efficiently. However, in some Member States there seem to be no political support for removing or reviewing market distortions listed in questions 4 and 5 in the short to mid-term perspective. In these cases it can be observed that the energy only market is failing partially or even mainly due to these out-of-market measures. This depends strongly on the geographical conditions and national energy policies which may result in a missing money and/or a backup problem. In this situation the introduction of a CRM might be an approach to face the economic challenges of thermal generation and present a tool to bridge the missing investment signals from the EOM, and ensure a stable investment climate.

CRM must be designed in accordance with market principles, in such a manner that they have the least impact possible on the functioning of the EOM. Special attention should be given to their effect on balancing and intraday markets.

Eurogas wishes to recall that experience suggests that any strong regulatory intervention, if insufficiently complementary to the existing energy-only market, will lead the market to call for further regulatory interventions to adjust the system. This increases risks for 'spill-overs' to

the natural gas market. Eurogas is also concerned about the possible impact on the operation of and investment in existing and new gas storage capacities. The infrastructure of the natural gas industry allows very well for varying demand and long-term storage. However, this only works when providers of this flexibility receive a market price that covers their costs.

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

a. to ensure that new flexible resources are delivered?

Market functioning is insufficient to ensure that new flexible resources are delivered when needed investment signals are not delivered to investors, although assessments showed that the system needs further capacity to be built. The energy and balancing market should be able to deliver the necessary price signals for flexibility. Therefore authorities should not intervene in the market and accept price signals such as price spikes and price volatility. Monitoring remains of course needed to verify that such spikes are the normal result of supply and demand in the market.

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

Market functioning is insufficient to ensure sufficient capacity is available to meet demand on the system at times of highest system stress in cases when plant operators decide to exit the market because of a lack of profitability (missing money), while these plants are still needed at some moments to meet demand. Regulatory requirements obliging such plants to remain available, in spite of the market signals to mothball or to decommission them, introduce strong regulatory interference with entrepreneurial freedom.

(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 might serve as insurance for extreme cases, e.g. under extreme weather conditions during a transition period. It gives TSOs a last resort when markets are not able to deliver. However, the basic assumption is that the energy market will deliver the correct price signals for required investments.

We do not believe it is an appropriate tool to steer targeted new investments for a low carbon generation. Depending on the detailed design a strategic reserve would rather keep existing plants (independently of their emission performance and ramp-rates) operational. A stable regulatory framework, long-term energy policy and a strong EU ETS would be amongst the more appropriate tools to achieve the climate objectives. However, as stated above, a temporary strategic reserve can help to secure sufficient generation capacity in a transition period.

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?

The basic idea of a strategic reserve is to use the reserve at a very high strike price or if supply does not meet demand on the day-ahead market. This is usually the case at the maximal spot market price. If strategic reserves are used in such a way, necessary price signals in the energy market for existing assets and new-builds are not hindered. However,

there is a risk that strategic reserves might be used for political targets, such as to keep the wholesale price low, i.e. the strategic reserve is activated at a very early stage. This would hinder price signals and distort and negatively affect the respective coupled markets. This would eventually lead to more disinvestments, and thus additional need to place the withdrawn plants under a "strategic reserve", resulting in a downward investment signal (slippery slope) where more and more plants would be placed under the strategic reserve support.

(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?

If the introduction of a capacity remuneration mechanism is considered, the need to avoid market distortions within the European energy market should be taken into account and the market design should be based as far as possible on competitive elements to ensure efficient solutions. To minimise market distortions, and to avoid over-investments, the aim should be to align the market design with neighbouring markets.

The capacity market should be designed in a competitive and efficient way with the following requirements:

- Capacity remuneration mechanisms should ensure the provision of required firm capacity. Flexibility should be adequately rewarded by the spot and balancing market, but if this is not the case, the design for a capacity remuneration mechanism should also consider the flexibility needs of the system.

For example, this is not the case if price signals, such as price spikes and price volatility, are not accepted and prices are capped or if other interventions, such as restrictions or unnecessary regulatory requirements on plant operations, endanger the ability of the market to deliver those flexible resources.

- The requirements should be aligned with the advice of expert groups, and consider import from neighbouring countries to avoid any suboptimal solutions and overcapacity.
- The capacity price should be determined in a competitive way (e.g. auction, traded certificates).
- The approach should be technology neutral provided that different technologies offer the same level of firm and reliable capacity.
- Existing assets should compete with new-builts as well as demand response measures and storage for the most efficient solution by following the approach of "one product – one price".
- The capacity market should be open to electricity undertakings operating in other Member States.

Predictability and reliability are an essential precondition for investors, therefore:

- The creation of incentives for new investments and reliable and transparent market rules are essential to build up confidence in the market. These rules should also determine in which market situation a change of market rules is required and on which basis the change will be made.

- A continuous adjustment of the capacity mechanism creates additional risks for investors and existing operators and makes them reluctant to invest. Therefore, the more self-regulated elements a mechanism offers, the less regulatory interventions are necessary.
- Politicians have to consider the time lag (construction period) between the political decision and the effectiveness of the market reaction. Retroactive changes to the legal framework should be avoided.

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?

The approach should be technology neutral provided that different technologies can offer the provision of firm and reliable capacity to cover system needs. The choice of the best compatible technology should be left to the market.

As explained under 15 a., a capacity remuneration mechanism should ensure the provision of required firm capacity. Flexibility should be adequately rewarded by the spot and balancing market, but if this is not the case, a capacity remuneration mechanism design should also consider the flexibility needs of the system.

The objective of a capacity remuneration mechanism should be to address regional security of supply. Although the three objectives of EU energy policy (security of supply, fight against climate change and competitiveness) are equally important and supported by Eurogas, trying to reach too many different objectives through one instrument could hamper the efficiency of the measure and produce unwanted side effects.

Low-carbon electricity should be addressed through an ambitious greenhouse gas emissions target, an effective ETS and other climate-related measures.

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

If designed as stated in the requirements listed in questions (15) a. and b., a well-designed capacity mechanism should be a self-regulated instrument and should phase out automatically with a remuneration coming down to zero when the market is functioning.

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

The cost for the final customer in an EOM and CRM is set by both price components: the EOM and the CRM.

Eurogas is of the opinion that the CRM should avoid distorting the functioning of the EOM. . Because the costs for the end consumer will strongly depend on the determined level of required capacity, including the determined reserve margin and interconnection capacity, the difficulty lies in setting the parameters at the right level. A too high level of capacity target results in a high CRM price and further reduced price spikes in the energy market, whereas a too low level of capacity target characterised by a low CRM value, should result in higher volatility and higher market prices.

Market-based approaches with as few parameters as possible leaving as much room for the market as possible will create fewer costs compared with models with numerous targets and administratively set parameters. In assessing the total costs for end consumers, not only the very short-term but also the long-term effects should be taken into account. Selective

approaches might be less expensive in the very short-term but more expensive in the long-run (due to slippery slope effects).

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

Capacity-mechanism-supported generation units should be able to participate in the market, including the balancing market.

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

Eurogas considers that a market-based solution on a European level playing field provides the most efficient route forward. As several Member States' regulators indicate an increasing likelihood of insufficient capacity to cover peak demand and for backup purpose, European coordination is needed. Without it, insufficiently coordinated national solutions will proliferate.

The objective of a capacity remuneration mechanism should be to address regional security of supply.

The European Commission is rightly concerned that poorly designed capacity remuneration mechanisms introduced without proper coordination at EU level risk being counterproductive and having an impact on fair cross-border trade. Therefore, capacity remuneration schemes should be based on coordinated principles and address the requirements specified in our answer to question 15.

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

Capacity remuneration mechanisms must be designed and function in accordance with market principles and address the requirements specified in our answer to question 15. Special attention should be given to their effect on balancing and intraday markets and to the coordination of Member States when a CRM is implemented. Eurogas is willing to cooperate with other stakeholders and with the Commission to develop guidelines and basic requirements for the implementation of capacity remuneration mechanisms. Eurogas would like to stress that by assessing the compatibility with the internal energy market not only the electricity market but also the implications for the gas market should be considered.

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

a. Should any criteria be added to this list?

1) The necessity for a capacity mechanisms should be clearly established in the context of:

a) The potential of the identified needs being met in the normal operation of the internal energy market, in particular:

i) increased interconnection and in particular the completion of identified projects of Common interest.

Yes. Many important interconnection projects have been announced in the TEN-E regulation, only few projects have been achieved so far. The PCI process proposed in the new Infrastructure Package is an important improvement, and will help the realisation of highly

needed projects to achieve the three pillars (renewables target, integrated electricity market and security of supply).

The likely time lag (construction period) between the political decision and the effectiveness of the grid infrastructure should be taken into account. While the grid development often cannot keep pace with the increasing installation of RES generation capacities, some local system integrity issues may arise. Local generation capacity might be needed until congestions are removed and interconnection capacities allow imports from another Member State.

ii) steps to encourage effective competition by addressing the position of dominant undertakings.

As the EU objective is to establish a European integrated market, the position of a player in a local market should not be relevant. There are already many other tools to verify the behaviour of dominant undertakings. Transparency is key to prevent market abuse.

b) Alternative, less distortionary measures which could be taken, for example steps to improve energy efficiency or reduce electricity demand.

Eurogas considers that demand side management is needed, as it can resolve part of the problem to the degree it can cap peak demand for a certain time period.

c) Removing barriers to the effective participation of demand in the electricity market.

Yes. To enable end consumers to participate in the electricity market, prices need to be fully liberalised; the smart meters need to be available, appropriate tariffs offered and settlement processes provided.

2) The effectiveness of the capacity mechanism addressing the identified market failure should be demonstrated and that it is additional to what would have occurred under normal market rules.

In question 4, we have listed elements impacting the investment climate in most of the Member States and noted that in some Member States there seem to be no political support for removing or reviewing market distortions in the short to mid-term perspective. In this situation the introduction of a CRM might be a good approach to facing the economic challenges of thermal generation and present a tool to bridge the missing investment signals from the EOM.

Eurogas is of the opinion that once a CRM has been introduced it will be very difficult or even impossible to assess what would have occurred under normal market rules, e.g. which disinvestment or investment decisions would have been made.

3) The duration of the application of the capacity mechanism should be clearly limited and clearly specified,

a) The impact on the market of the introduction of capacity mechanisms should not make it difficult to reverse that decision in the future.

The capacity price should be determined in a competitive way (e.g. auction, traded certificates) and should be a self-regulated instrument that should phase out automatically with a remuneration coming down to zero when the market is functioning.

b) The necessity of retaining reinstating a capacity mechanism should be subject to review.

Yes, but one should take care of the risks of 'spill-overs' due to regulatory readjustments. A continual adjustment of the capacity mechanism leads to additional risks for investors and existing operators and to investors' reluctance.

The more self-regulated elements a mechanism offers, the less regulatory interventions are necessary. Therefore, it should be clear for investors under what circumstances and in what way the mechanism might be reviewed. Retro-active changes should be avoided.

4) Any capacity mechanism should be open to electricity undertakings operating in other Member States, to the extent they are able to make the electricity available in markets to which the capacity mechanism is established.

Yes. Eurogas is in favour and supports power market coupling. Capacity mechanisms should not disincentivise market coupling in electricity.

5) Any capacity mechanism should not act as a barrier to cross-border trade or competition in the internal market by:

a) artificially altering trade flows or the location of production, in particular by:

i) restricting the ability of electricity undertakings in the Member State to sell their electricity to customers elsewhere in the internal market, (i.e. capacity physically located in a Member State should not be reserved for that Member State).

ii) distorting the commercial behaviour of generators in the day ahead and intraday markets.

iii) distorting investment signals in the internal market leading to inefficient locational choices.

Yes. This is linked to the need for a European coordinated analysis of the required capacity level, and to the coordination of CRM between Member States.

iv) distorting investment signals in the internal market leading to the displacement of new investment from one Member State to another.

Same as above.

b) distorting dynamic incentives/crowding out;

i) The incentive on consumers or generators to respond to high prices at periods of scarce capacity should not be diminished.

The occurrence of high prices at periods of scarce capacity can be expected to be reduced by capacity mechanisms. The incentive for consumers or generators to respond to high prices if they do occur should not be affected.

- ii) The mechanism should not undermine incentives on the electricity market to deploy new techniques for demand reduction or electricity storage and generation.*

The most efficient approach to provide capacity at the lowest cost is to create a market-based mechanism where all generation, storage or demand side measures, given that it is offering an identical product, are rewarded at the same value.

- c) creating market power or exclusionary practices;*

- i) The mechanism should not strengthen or maintain the market power of incumbent firms.*

As the EU objective is to establish a European integrated market, the position of a player in a local market should not be relevant. There are already many other tools to verify the behaviour of dominant undertakings. Transparency is key to prevent market abuse.

- ii) The mechanism should not act to maintain inefficient market structures or undertakings, acting to deter new entry.*

The capacity price should be determined in a competitive way (e.g. auction, traded certificates).

- 6) To be non-discriminatory a capacity mechanisms should*

- a) be allocated after an open competitive bidding process.*

Same remark as for criteria 5)c)ii).

- b) allow demand response and energy efficiency solutions to bid into capacity markets on an equal basis to generation.*

The most efficient approach providing capacity at the lowest cost is to create a market-based mechanism where all generation, storage or demand side measures providing firm capacity are rewarded at the same value, given that it is offering an identical product. However, a realistic assessment needs to be made on the economic potential of demand side response. Energy efficiency measures should be very carefully assessed in terms of their actual energy savings on the total demand and in terms of alternative instruments based on the implementation of the Energy Efficiency Directive. The willingness of domestic customers to reduce demand by switching off appliances must be equally assessed.

- 7) Not be confined to any particular generation technology, i.e. being tech. Neutral (insofar as the mechanism is directed towards security of supply concerns – this may not apply if other objectives are also being pursued).*

The approach should be technology neutral provided that different technologies can offer the provision of firm and reliable capacity to cover system needs, as set out under 15 a. The choice of the best compatible technology should be left to the market.

The achievement of a low-carbon energy market should be driven by fair competition between different low-carbon energy technologies, with the ETS as the key instrument. The choice of the most cost-effective technologies achieving carbon dioxide emission reductions would then be the result of a competitive market.

8) *Capacity mechanism should be at least cost:*

a) *The direct costs imposed on suppliers or others electricity undertakings must be kept to the minimum necessary.*

Yes. See also answer 16

b) *Persons providing capacity under the obligation must not be overcompensated.*

If the price is determined in a competitive way there will be no overcompensation.

c) *Any selection process in the mechanism should be conducted in a transparent, open and non-discriminatory way which is market based.*

d) *The duration of any compensation to generators under the mechanism should be clearly justified.*

Eurogas agrees, but any compensation should be part of a stable regulatory framework and not imply systematic regulatory adjustments. As mentioned above, retro-active changes should be avoided.

9) *Costs associated with capacity mechanisms should be allocated to the beneficiaries of secure energy supply with different classes of consumers being treated in a non-discriminatory way.*

Eurogas agrees, but customers can on their own participate in the adequacy via demand response participation (to an extreme, customers that do not care about generation adequacy should simply declare themselves interruptible at any moment for "free" and as a result this would reduce the amount of capacity needed in the system).

Anyway, one should avoid "overcompensation" for generators as well as "double discount" for customers.

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

These are generally valid criteria. The most important criteria are as follows:

(1)

Eurogas considers that the priority is to improve the energy-only market and to assess if current price signals in the energy market are a structural issue or a correct price signal as a consequence of certain market developments (e.g. efficiency gains from market integration and/or from an adjustment process related to an increasing share of renewables).

(2)

The need to avoid market distortions within the European energy market should be taken into account and the market design should be based as far as possible on competitive elements to

ensure efficient solutions. Special attention should be given to their effect on electricity balancing and intraday markets and their impact on the gas market (e.g. on transport capacities, storages) and the possible arising of stranded costs.

(5)

To minimise market distortions the aim should be to coordinate the market design with neighbouring markets.

(6) a)

The price for capacity should be determined by market signals and should be a self-regulated element.

(7)

The CRM should be technology neutral provided that different technologies can offer the provision of firm and reliable capacity to cover system needs, as explained under 15 a.. The choice of the best compatible technology should be left to the market to ensure the most cost efficient solution.