Comments on The Interim Report of the Sector Inquiry on Capacity Mechanisms

6 July 2016

Introduction

IFIEC Europe is an international non-profit association of scientific nature, established in 1989 and governed *as association internationale sans but lucrative (aisbl)* under Belgian law with its premises in Brussels / Belgium.

IFIEC Europe represents the interests of industrial energy users in Europe for whom energy is a significant component of production costs and a key for competitiveness in their activities in both Europe and throughout the world.

IFIEC Europe was founded on the belief that competitive energy supply, responsible use of energy and consumer choice and flexibility, are the necessary ground rules for competitive and sustainable industrial activity in Europe.

IFIEC Europe represents 16 national European federations that comprise - on a cross-sectoral level - those industrial sectors for which energy is a significant component of production costs. IFIEC´s membership represents a diverse set of industries including: aluminium, automobile, brewing, cement, chemical, copper, fertilizer, food, glass, industrial gases, metals, paper, pharmaceutical, plastics and steel.

General Comments

IFIEC Europe welcomes this sector inquiry into this very important but also highly controversial subject. We appreciate being given the opportunity to react to this interim report and remain available to discuss relevant issues further in detail with the Commission.

Energy and climate policy needs to take into account EU competitiveness as one of its guiding principles. Electricity market design should be based on balancing the traditional three pillars (**competitiveness, security of supply and sustainability**).

Power market design should be such that it leads to competitive electricity prices and low regulatory risk. This is essential for the attractiveness of Europe for the operation of current industrial activities and future investments. IFIEC is very worried about the future of industry in Europe.

As all technologies, renewables should be integrated into the market as soon as possible without subsidies. IFIEC is therefore in favor of rapidly phasing out RES support. If RES support is continued, it should be allocated on market-based procedures, RES producers should respect the same balancing requirements as other producers and priority dispatch should be ended. IFIEC also clearly wants to point out that the current European carbon Emissions Trading Scheme (ETS) must not be used as a tool to promote renewables. This would require very high CO_2 prices (depending on the technology, but in any case a multitude of current prices), which would be unbearable for manufacturing industry in the current ETS frame.

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On the need to introduce Capacity Remuneration Mechanisms, IFIEC takes note of the ongoing discussions on the ability of Energy-only markets (EOMs) to deliver competitive prices and security of supply at the lowest possible cost, two of the major goals of the electricity markets liberalization project. Although IFIEC remains a supporter of EOMs and notes this model should, in ideal circumstances, lead to these two objectives, we also cannot but take note of several major interventions (e.g. renewable subsidies, artificial price zones, nuclear / coal phase out in regions) being the root cause for insufficient results of the liberalization process both in terms of competitive prices and security of supply concerns. In more detail:

- RES is pushed into the system via substantial (national) direct and indirect subsidies and often without balancing responsibilities and with priority access to the grid;
- Public Service Obligations of all kinds are imposed to generators, suppliers and grid operators in many countries, and often environmental and even social policy is financed at the expense of electricity consumers through grid charges, surcharges and taxes, etc.;
- Technology choices are not left to the market (within norms set by the authorities, such as environmental requirements, safety rules, technical requirements, …) but (mostly national) governments prefer to determine the required volumes of each technology, which leads to higher system costs (more expensive technologies, higher than necessary capacity reserve margins, no or limited market access for demand response, …);
- Market integration is not optimised, and interconnector capacities are not optimally used for market coupling (see comment below on p. 9, 2.1.1., 2nd §);
- In general, energy policy is insufficiently harmonized on the European level or even at regional level, and all too often national authorities take decisions that are not fully aligned with their neighbors'.

In this environment, market distortions cannot lead to correct price signals, and this can only be corrected by even more market distortions and government intervention. IFIEC regrets that, rather than aiming at taking away the distortions that prohibit the EOM to function correctly, authorities are concentrating on introducing additional measures that will lead us further away from the competitive, liberalized and integrated markets that were the objective of the successive electricity market liberalization directives.

For IFIEC Europe, first the root causes of the problem, namely market distortions, should be resolved:

- phase out subsidies for current renewables technologies (which should rapidly become fit for the market) and, in general, support only R&D and small-scale demonstration projects
- allow and promote voluntary demand response in all market segments
- fully integrate all generation plants of all technologies into the market, and impose balancing responsibility on all producers

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- removal of all disturbing government interference with market functioning
- removal of conditions for sustained market abuse by dominant players
- improve the competitiveness of the European natural gas market by diversifying supply sources - e.g. by allowing exploration of shale gas where economically and environmentally justified - in a well-functioning market, in order to improve economic viability of existing and foster investment in new flexible gas-fired power plants
- increase transmission and interconnection capacity wherever economically justified and optimize allocation and congestion mechanisms in a non-discriminatory, cost effective way, a.o. to allow for the common use of spare capacity on a larger geographical scale
- stimulate research into economically viable storage.

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Even then, if a CRM is introduced, it should comply with a number of strict requirements:

- it should aim at solving a specific, well-defined problem (e.g. generation adequacy issue: local peak demand, system imbalance because of intermittency)
- the need for its introduction has to be well analyzed and documented (incl. cost impact assessment)
- it should be temporary (investments in additional generation capacities, flexibility sources and/or increasing interconnections and transmission capacities will progressively reduce the size of the problem), cost efficient and have minimum impact on market functioning and integration
- the uncoordinated introduction of multiple CRMs aiming at the same problem in a single regional electricity market should be avoided
- it should be financed by those who created the problem the CRM aim to solve (e.g. CRMs are not to be financed by baseload or off-peak consumers)
- It should be non-discriminatory i.e. everyone should be able to participate (load, production, storage), compensation should be fair and equitable for all participants and participation should not be limited to national players.

Specific comments (pages and §§ refer to the staff working document)

- p.4, 1.1., 2nd §

  In IFIEC's eyes, it is more specifically the massive subsidization of the roll-out of renewables combined with lack of balancing responsibility and priority grid access for renewables. Throughout the interim report, this nuance is lacking and subsidies and priority access could be considered as the "elephant in the room"…

- p. 5, 1.3. 4th §

  In the list of items to make the Commission understand better, IFIEC would like to

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add (as a second bullet point)

- the reasons why security of supply might be threatened

- p. 6, 1.4., 2nd §

  Apparently, very few end consumers have responded to the questionnaire (it is not clear for IFIEC what "Demand Response" stands for in the overview in annex 1). In any case, IFIEC (as a representative federation of industrial consumers) is available to discuss relevant issues further in detail with DG Competition.

- p. 9, 2.1.1., 2nd §

  IFIEC would like to question the statement that "The implementation of market coupling has enabled an optimal use of interconnector capacity". This is denied by reports a.o. by ACER (see ACER Market Monitoring Report 2015, http://www.acer.europa.eu/Official_documents/Publications/ACER%20Market%20Monitoring%20Report%202015%20%20%20Document%20hist/ACER_Market_Monitoring_Report_2015%20-%20Original.pdf, p. 219: "*There is significant scope to improve cross-zonal capacity calculations to use interconnectors more efficiently. The Agency recommends TSOs to implement FBMC, execute more frequently capacity calculation computations near gate closure time, and when doing so, coordinate better these calculations among TSOs regionally*." or the CREG Study (F)160324-CDC-1520 (Study on the price spikes observed on the Belgian dayahead spot exchange Belpex on 22 September and 16 October 2015), p. 62: "*122. The elevated day-ahead prices on the 22nd of September and the 16th of October is caused by a combination of the inefficient and discriminatory use of cross-border capacity and low available generation capacity due to planned and forced outages. The analysis of both cases makes it very clear that non-competitive flows, for the largest part loop flows, have priority access to the cross-border capacity, regardless of the scarcity of this capacity or the willingness to pay for it. Sometimes much more than half of the observed physical flow are non-competitive flows. This is even true if market participants are willing to pay the maximal price of 3000 €/MWh27, which increases the risk for security of supply.*"

- p. 10-11, 2.1.1 and 2.1.2

  IFIEC would like to refer to the higher mentioned "elephant in the room"…

- p. 16, 2.1.3.1., last §

  Maintaining sufficient generation capacity and/or flexibility (in generation, load and storage) is, in the first place, the responsibility of the market players in the electricity system. TSOs are only responsible for residual balancing, e.g. in case of major incidents in generation or transmission. Market functioning should therefore deliver an investment signal in the first place between market players: imminent scarcity will push up forward prices and (closer to real time) spot prices, lead to scarcity peak prices and incentivise market actors to invest in order to be able to balance their portfolio. The interim report seems to underestimate this market aspect, which is the

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motor of a well-functioning energy-only market. Intervention by TSOs and/or public authorities should only occur if that market mechanism fails.

- p.25, 2.2.1, 1st §

  IFIEC is interested to know on what basis Member States expect reliability problems in the future. With the evolution from regulated to liberalized markets, the system's reserve capacity should gradually fall (because of its high impact on system costs), and the flexible generation capacity it holds will be partly replaced by demand response, storage and other forms of flexibility. This is inherent to and one of the advantages of an energy-only market.

- p. 26, 2.2.2., last §

  The elephant in the room…

- p. 26-29

  See comment on p. 16, 2.1.3.1., last §. Moreover, the interim report only looks at the spot market in this section, were prices are indeed determined by the marginal cost of the marginal unit. Very often, end consumers are, however, supplied through forward contracts, the prices of which are determined by "portfolio bidding" and the average cost of a set of generation units (combined with flexibility sources such as demand response and storage).

  p. 29, 2.2.2.1., 1st §

  On the spot market, normal bidding behavior consists of offering all available generation units at marginal costs….

- p. 29, 2.2.2.1., last §

  IFIEC supports the Commission's observation that wholesale market participants are able to hedge against price peaks. Domestic end-consumers can be shielded from short-time price peaks by signing contracts based on average prices. Therefore, price peaks on the wholesale market do not necessarily translate into price peaks at retail level. Hence, they do not pose a social problem and should be politically acceptable.

- p. 30, 2.2.2.2., 2nd §

  The elephant in the room…

- p. 30, 2.2.2.2., last §

  IFIEC does not see why electricity generators would have insufficient information about their competitors' investment decisions.

- p. 31, 2.2.2.2., 1st §

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Of course there is more risk for investors in a liberalized market than in a regulated market! The advantage of the liberalized markets is in the partial disappearance of reserve capacity margins (lower system cost) and in lower profit margins for generators and traders (competition-driven compared to “imposed” by regulation). The investment signal comes from the electricity price, not from the generators’ profit margin (as is the case for all well-functioning commodity markets)! And the overall benefit is indeed for the consumers, as is the goal of the liberalization process…

- p. 31, 2.2.2.3.

  For IFIEC, it is clear that ANY consumer wishing to participate in the market will need a smart meter, capable of measuring flows in both direction and close to real time. Without this, it is impossible to take advantage of price volatility in the market.

- p. 32, 2.3.1., last §

  For its position on Demand Response, IFIEC would like to refer to the position paper attached.

- p. 35, 2.3.1., last §

  ETS reform is not a means to stabilise or set the price of carbon, but should ensure reduction of GHG at the lowest costs. It is important that the ETS reform delivers a well-functioning ETS with sufficient protection for carbon leakage sectors including measures like dynamic allocation that remove the need for further triggering the MSR.

- p. 124, 6.3., last §
  The elephant in the room…

IFIEC Europe represents energy intensive industrial consumers where energy is a major component of operating costs and directly affects competitiveness.

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