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EFET response to European Commission consultation on Spanish electricity market reform plan

Executive summary

EFET fully supports objectives set out by the European Union in the Electricity Regulation to ensure that:

- Market prices reflect only supply and demand conditions
- The integration of renewables, demand response - and storage - in electricity markets is improved
- The free movement of electricity within and between Member States is achieved
- There is free entry and exit to the market for all market participants
- Transparent trading of electricity on wholesale markets is possible in all timeframes, both in the shorter and longer term

Regarding the Spanish electricity market reform plan, we believe that the document provides a satisfactory description of the current status of the Spanish electricity system and its progress in implementing EU Regulation.

In addition to the elements laid out in this document, we note that the functioning of the Spanish wholesale energy markets has been affected by numerous regulatory interventions such as:

- The new generation tax established by Law 15/2012
- The inframarginal revenue cap in electricity markets introduced with Royal Decree 17/2021
- The Iberian price control mechanism for gas-fired electricity generation introduced with Royal Decree 17/2021

or simply by the announcement of further interventions such as:

- The clawback of generators incomes from CO2 allowances, as foreseen by Proyecto de Ley 65-1 of 30th August 2021
- The mandatory auction scheme for dominant market participants, as foreseen by Royal Decree Law 17/2021

Regulatory stability and predictability are crucial to enable efficient price formation in the market, to boost liquidity in the market and to build confidence among market participants that they can hedge their positions, protect consumers from volatile energy prices and supply electricity at the least cost.

To address certain regulatory deficiencies and achieve the objectives laid out in the Electricity Regulation, the Spanish authorities will need to take a series of reform measures.

Here are our recommendations as to how the functioning of the Spanish electricity market could be improved:

- 1. Forward markets** – Forward markets are hindered by price interventions. Forward trading and Power Purchase Agreements (PPAs) are the key instruments allowing market participants to hedge risks in the market and to mitigate the impact of short-term volatility. To foster the development of these instruments, regulatory certainty is key
- 2. Price interventions** – Price limits still exist in the Spanish wholesale electricity market in the form of inframarginal revenue cap. Temporary price interventions should be phased out to ensure that market prices reflect only supply and demand conditions and boost forward market with a lean and stable regulatory framework
- 3. Capacity Remuneration Mechanism** – Cross-border participation should be implemented according to the ACER methodology by ensuring compatibility of the different schemes at the maximum possible extent and - where relevant and feasible - harmonization
- 4. Free exit** – Procedures for the closure or mothballing of a power plant should be updated – with clear deadlines for the authorities releasing the authorisation – in order to remove any obstacles to the free exit from the Spanish electricity market
- 5. Scarcity pricing** – Scarcity is signalled naturally by wholesale prices when they are not distorted. We share the scepticism on the benefits of implementing a regulated mechanism that would artificially create a “scarcity add-on” to the wholesale electricity price. This would create different price signals across the European energy market – in contradiction with the objective of harmonized European balancing model – without any proven benefits in terms of incentivising investment in new capacity
- 6. Storage** – Storage can play an important role to guarantee the necessary firmness and flexibility required by the Spanish electricity system and market. We support the market-based development of storage technologies, in the times and volumes required in the National Energy and Climate Plan (NECP). In the situation where a problem with security of supply has been identified, the incentivisation for the development of storage could be warranted. However, in no case would a centralized, parallel and regulated mechanism to procure storage be justified.
- 7. Portfolio bidding** – The full transition to portfolio bidding would represent a huge progress for the Spanish electricity market as it would allow continuous optimization across power generation technologies. It would also provide more flexibility to the system and guarantee the supply of electricity to consumers at the least cost.

The recommendations above are further detailed in the next two sections of this document.

Aspects to be further developed in the draft implementation plan

A. Forward market

The Electricity Market Design (EMD) revision rightly includes measures protecting consumers from volatile energy prices through, among other measures, the promotion of long-term agreements (such as PPAs).

Forward trading and PPAs are the key instruments allowing market participants to hedge risks in the market and to mitigate the impact of short-term volatility. In particular, hedging in the market enables price stabilisation for consumers and revenue predictability for investors.

We believe that the Spanish forward market can be improved by:

- Eliminating market interventions taken in the past two years:
 - the 67 €/MWh inframarginal revenue cap, that creates material barriers to the signature of new PPAs
 - the price cap on gas for power generation, that destroys hedging strategies of market agents in forward markets. With electricity and gas prices decreasing, this measure cannot be longer justified as an emergency measure.
- Ensure that support schemes provide the right incentives and do not drain liquidity from forward markets
- Restricting the application of two-way CfDs to new investments, and only those applying for public financial support (see art.19b Regulation 2019/943)
- Broadening the framework for the removal of barriers to PPAs (see art.19a Regulation 2019/943), incentivising both physically delivered PPAs and indirect (financially settled) PPA structures
- Implementing longer-term transmission rights - 3 to 5 years before delivery (see art.9 Regulation 2019/943)
- Resisting regulated regional virtual hubs and keep the original spirit of maximisation of forward transmission capacity (see art.9 Regulation 2019/943). If finally implemented, Iberia must be integrated into a wider hub in Central Europe to avoid market isolation. The price correlation criteria must not be the guide to conform such hubs in order to reap the real benefit of them

B. Portfolio bidding

The market's ability to provide efficient short-term dispatch and to optimise across technologies must be preserved. This can be obtained through a **full transition to portfolio bidding** as an important feature of the market allowing continuous optimisation. Unit bidding

would pose long-term risk to the efficiency of spot markets, the integration of distributed resources and ultimately our security of supply.

Portfolio bidding allows electricity sellers to aggregate the electricity produced to properly reflect assets and their combined capabilities within a portfolio of assets (generation, storage) and contracts (including demand). It also enables electricity producers to use the flexibility of their assets more effectively compared to individual unit bidding.

This efficient way of managing portfolios is used by market participants in most of Europe, while Spain and Portugal remain the only European countries with mandatory unit bidding in day-ahead and intraday.

C. Free exit

The current regulation in Spain establishes that the permanent closure or mothballing procedure of a power plant requires an authorization from the Regulator and an adequacy assessment of the electricity system from the Transmission System Operator (TSO).

However, no clear procedures or deadline exists for adopting such a decision. Therefore, the market participant owning the power plant might be forced to keep operating the power plant if the request is rejected or no response is received from the authorities.

Regulation (EU) 943/2019 on the internal market for electricity establishes the right for market participants to exit from the market based on their own prospects for the economic viability of their facilities. This is reflected in Art. 3 of the Regulation:

"(N) market rules shall allow for entry and exit of electricity generation, energy storage and electricity supply undertakings based on those undertakings' assessment of the economic and financial viability of their operations;"

Moreover, we expect "free exit" to be explicitly considered within the proposed capacity remuneration mechanism in Spain (not included in the 2021 version) in order to allow market participants to proceed with the temporary or definitive closure of power plants that are not economically feasible.

Therefore, we encourage the Commission to **elaborate on the status of the free exit from the Spanish electricity market** – as no barriers or measures are mentioned in the current draft implementation plan – so that there are no unnecessary, disproportionate, or unjustified obstacles to the free exit, currently and once a capacity remuneration mechanism is implemented.

Detailed comments to the sections of the draft implementation plan

1.2 Capacity remuneration mechanism (CRMs)

Establishing or maintaining a capacity remuneration mechanism (CRM) should not come at the detriment of the design and efficiency of energy markets. Energy markets can respond to the adequacy needs of the system if they are well designed, free of regulatory distortions and well-integrated with other European electricity markets.

However, we also acknowledge they may not always be sufficient to provide long-term investment signals for capacity adequacy and that - if proven so by regional or European capacity adequacy assessments - CRMs may be a response to this problem.

With regards to the Spanish capacity remuneration mechanism, **cross-border participation should be implemented** by ensuring compatibility of the different schemes at the maximum possible extent and - where relevant and feasible - harmonization, in order to make sure all available resources contribute to all Member States' security of supply.

This feature of the CRM is pending from the draft ministerial order consulted back in 2021.

2.1 Removal of wholesale electricity price caps

While we appreciate the adaptation of maximum and minimum matching prices for the day-ahead, intraday and balancing markets according to the European legislation, **price limits still exist in the Spanish wholesale electricity market in the form of inframarginal revenue cap.**

Spain is the country with the lowest inframarginal revenue cap in Europe - at 67€/MWh - and affecting renewables projects functioning without subsidies. This price cap is extremely far from the 180€/MWh suggested by the European Council and emergency measures.

While the European Commission did not recommend extending emergency measures beyond June 2023, caps still remain in Spain and the poor investment environment continues.

We strongly urge for the European Commission to take action and enforce the deadline outlined in Emergency Regulation 2022/1854, and for the Energy Ministers and the Members of the European Parliament not to prolong the measures at national level or in the reform of the Electricity Market Design.

The decision to cap inframarginal revenue caps as a reaction to the 2022 energy crisis is irrelevant in current market conditions because the measure is an obstacle to investments in clean energy sources.

2.2 Scarcity prices

Scarcity is signalled naturally by wholesale prices when they are not distorted.

Prices should be allowed to fluctuate freely and reflect the true value of scarcity during or in expectation of times of system stress and high demand for power; similarly, prices should reflect the value of energy in real time – or expectations thereof in the intraday, day-ahead and forward timeframes – in a transparent manner.

Increasing the efficiency of the market will improve price signals in wholesale markets during episodes of scarcity or surplus. This will ensure that all types of capacity (generation, demand and storage) can be used properly and valued based on a level-playing field.

We share the scepticism on the benefits of implementing a regulated mechanism that would artificially create a “scarcity add-on” to the wholesale electricity price. This would create different price signals across the European energy market – in contradiction with the objective of harmonized European balancing model – without any proven benefits in terms of incentivising investment in new capacity

2.3 Interconnections

We call for the swift development of planned interconnections – alongside a positive cost benefit analysis - so that Spain can reach the 15% interconnection target by 2030 as per Regulation on the Governance of the Energy Union (2018/1999).

In particular, TSOs are required to ensure that at least 70% of the transmission capacity is offered for cross-zonal trade, while respecting operational security limits. It represents a core element to ensure an efficient internal electricity market and it is crucial for meeting several future challenges in Spain’s energy trajectory, including the decarbonization targets.

Finally - as already mentioned in chapter 1.2 - cross-border participation in a capacity remuneration mechanism should be implemented by ensuring compatibility of the different schemes at the maximum possible extent and - where relevant and feasible - harmonization, in order to make sure all available resources contribute to all Member States’ security of supply.

This feature of the CRM is pending from the draft ministerial order consulted back in 2021.

2.4.2 Storage

Storage can play an important role to guarantee the necessary firmness and flexibility required by the Spanish electricity system and market.

We support the market-based development of storage technologies, in the times and volumes required in the NECP. In the situation where a problem with security of supply has been identified, the incentivisation for the development of storage could be warranted.

However, in no case would a centralized, parallel and regulated mechanism to procure storage capacity be justified.

Any development of storage capacity should respect the following principles:

- Guaranteeing the principle of technological neutrality, emphasising the importance of a level playing field for the different technologies and ensuring equal rights and obligations for any type of technology
- Avoiding that the system operator may own, develop, manage and operate energy storage facilities to respect the unbundling principle
- Providing a clear timeline for the implementation of measures to foster storage which is still missing from the draft document

2.4.2 Demand side measures

We appreciate that Spain is already taking action to promote demand side response, and that is foreseeing further measures, such as the development of the figure of the independent aggregator.

2.5 Balancing

We acknowledge that the Spanish electricity system is well on track in the process of implementing the EU Balancing Regulation.

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