

Polish model of Capacity Market

The draft regulation of the capacity market in Poland is currently included in the draft bill on capacity market (hereinafter referred to as the "Project"), which was published on 5 November 2016 on a website of the Government Legislation Centre and became the subject of public consultation (<https://legislacja.rcl.gov.pl/projekt/12292758/katalog/12396022#12396022>).

The draft generally corresponds with the assumptions adopted by the Ministry of Energy in the document "Functional solutions for capacity market" (document published on 30 September 2016., hereinafter referred to as the "Solutions"), it being also envisaged that the detailed regulations on capacity market will be set forth in the secondary legislation to be issued by the Minister of Energy as well as in the documents and information published by the transmission system operator (the "TSO") and by the President of Energy Regulatory Office (hereinafter referred to as "ERO"). This alert was prepared based on the assumption that abovementioned secondary legislation will be compliant with the Solutions.

According to the authors of the Project, the primary aims of the Polish Capacity Market are:

- to introduce incentives for construction of new generation capacities, as well as modernization and longer operation of the existing capacities;
- to promote the services related to the demand side response (DSR);
- to secure development of unstable RES installations with stable capacities;
- to secure long-term power supplies to final customers during vulnerability periods.

Basic assumptions of the Capacity Market:

[Players at the Capacity Market] The main participants of the Capacity Market shall be the Capacity Providers offering the available capacity as either owners or operators of the Capacity Market Units (hereinafter "CMU"), i.e.:

- (a) units (groups of units) which generate electricity (hereinafter "CMU G"), or
- (b) units (groups of units) which declare reduction of power consumption (including actual reduction of power consumption and/or generation of power "behind the electricity meters"; hereinafter "CMU DSR").

[Product traded at the Capacity Market] The product offered at the Capacity Market shall be the Capacity Obligation, i.e. an obligation to stay ready to deliver certain volume of the net available capacity – either in form of generation or reduction of consumption – during the so-called Vulnerability Periods occurring within the Delivery Periods.

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Vulnerability Period shall be defined as any peak demand full hours (according to Solutions: any hour from 7:00 am until 10:00 pm on working days) during which the planned reserves of the available capacity being at disposal of the TSO (Transmission System Operator) in excess of the planned demand of the NPG (National Power Grid) are determined within the daily planning process to be lower than the required level of the available capacity reserves – provided that the TSO announces on the occurrence of Vulnerability Period in either Normal (i.e. according to Solutions: 8 hour advance) or Urgent (i.e. according to Solutions: 4 hour advance) mode.

Capacity Obligation shall be offered with respect to the following Delivery Periods:

- (a) calendar year – during the main auction, or
- (b) calendar quarter – during supplementary auctions.

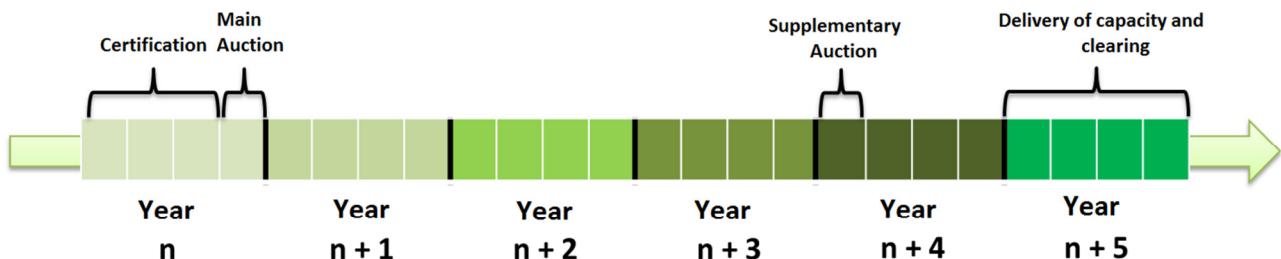
Capacity Obligation shall be specified in the Capacity Agreement concluded upon the auction between the Capacity Provider, the TSO and the settlement operator (a joint-stock company Zarządca Rozliczeń S.A., which will be responsible for payment of the remuneration due to the Capacity Provider) for the period of:

- (a) 1 year delivery – in case of the existing CMU G and CMU DSR,
- (b) up to 5 years delivery – in case of Modernized CMU G, or
- (c) up to 15 years delivery – in case of New CMU G.

[Participation in the Capacity Market] According to the authors of the Project and the Solutions, capacity market is supposed to be technologically neutral, but it should “*consider the parameters of certain technologies contribute to security of supplies*”. Capacity Market will not be open to those volumes of available capacity which benefit from other support systems (e.g. support scheme for RES electricity), such exemption however being not applicable to CHP units, multi-fuel combustion units or hybrid units). It is also planned that the generation capacity located outside of Poland shall not be allowed to participate in the Capacity Market during the first years of its functioning.

[Timeframes] It is expected that the capacities necessary to cover the peak electricity demand in a given year shall be contracted within:

- (a) the main auction – carried out during November-December of the fifth year preceding the delivery period (effectively at least 4 years in advance), and
- (b) the supplementary auction – carried out a year in advance.



As regards the first delivery period, which is expected in 2021, the period between the main auction and the delivery period will be shortened as the Project states that the approval of the Rules of the Capacity Market is to take place at the end of 2017.

The first auctions should be announced by the TSO within 30 days from the date on which the Project enters into force. At the same time, the certificate issued before the first main auction and the first supplementary auction would entitle to participate in the second main auction and the second supplementary auction.

According to the Solutions, the main auctions related to the Capacity Market should be carried out within the period of at least 10 years. The Project does not provide for any limitation to functioning of the Capacity Market but it states that the Council of Ministers shall assess the functioning of Capacity Market by the end of 2024 and shall submit to the Parliament a proposal for amendments and/or elimination of the Capacity Market.

[Certification preceding auctions] Only certified CMUs („CCMU”) shall be allowed to participate in the auctions. Certification will occur in the following stages:

General certification	Main auction certification	Supplementary auction certification
<ul style="list-style-type: none"> the aim of the general certification is to grant the status of the CMU and to gather basic data on Capacity Providers as well as the planned achievable capacity of CMUs within the period of the next 5 years, carried out every year between 1 January and 10 February, obligatory for generation units with gross achievable capacity not lower than 2MW and voluntary for the DSR units. 	<ul style="list-style-type: none"> the aim of main auction certification is to determine the entities which are entitled (and obligated) to participate in the main auction, following verification of legal and technical capability of the CMU to fulfill the Capacity Obligation, only CMUs which passed General Certification may participate in this stage. 	<ul style="list-style-type: none"> voluntary, covers CMUs which are not bound by Capacity Agreement or excess achievable capacity over the Capacity Obligation arising out of the main auction.

Certification can be granted to CMUs with gross achievable power not lower than 2 MW, however, the CMUs representing the aggregated CMU G and/or aggregated CMU DSRs should represent combined gross achievable capacity between 2 and 50 MW. The achievable power of a single CMU G included in the aggregated CMU may not exceed 10 MW. It is also not allowed to aggregate and CMU G and CMU DSR in one CMU.



The certificate may not be issued if the CMU:

- (i) is the beneficiary and does not intend to resign from any other support schemes (green certificates, RES auctions, compensation for stranded costs), such requirement being not applicable to CHP units, multi-fuel combustion units as well as hybrid units;
- (ii) provides TSO with ancillary services.



[Rules pertaining to the auctions] Auctions shall be carried out for the entire area of the NPG through the use of electronic platform.

Available Capacity offered in the main auction is equal to the product of:

- (a) the net achievable capacity of the CMU, and
- (b) the availability correction co-efficient which reflects the actual average availability of the capacity of given type/technology, taking into account planned and unplanned losses of capacity.

According do Solutions, in case of CMUs aggregating capacity sources with different availability correction co-efficient, the lowest co-efficient will apply.

The actual level of support, as well as the functioning of Capacity Market will be regulated on an ongoing basis by the Minister of Energy who will determine the auction parameters (including: demand for the available capacity, , maximum offer prices, number of rounds of auction) based of the proposal prepared by the TSO. As regards the New CMU and Modernised CMU the auction parameters will include also the so-called “attributes” described as necessary requirements for particular technology groups, i.e. unit cost of investment outlay; efficiency of CMU G; unit carbon dioxide and environmentally harmful substances emission; the technical minimum of the CMU G, minimum load changes or the requirements related to the characteristics of start-up.

The Minister of Energy may also introduce additional parameters which will enable to conduct the auctions with respect to the New CMU or Modernised CMU separately. In such case the Minister of Energy will present the expected capacity which must be covered by the New CMU or Modernised CMU and the maximum price for purchase of capacity in those units.

Auction parameters will be accepted by the Minister of Energy not later than 24 weeks before commencement of auctions. Change of the auction parameters will be possible not later than 3 weeks before the commencement of auctions, however every change will allow the CMU to resign from the auction.



During the auction it will be possible to amend the declared validity period of the Capacity Agreement, however it will not be allowed to make any changes to yearly volumes of the available capacity.

In case the auction was carried out in breach of the law or against the conditions of the auction or if the participants of the auction misbehaved, the Minister responsible for energy may annul an auction by way of decision made within 21 days from the completion of the auction.

[Setting the auction prices] The Capacity Market will be based on the Dutch auction system, i.e. the closing price – the price of balance between demand and supply for capacity, specified as a result of subsequent rounds of auction – will be uniform for every CMU winning the auction (“*pay as clear*” auction). If there are separate auction parameters for the New CMU and/or Modernized CMU, the price for capacity delivered by the New CMU and/or Modernized CMU will be established separately and may not be lower than the price established for existing CMU’s.

[Capacity Agreement] It is expected that the Capacity Agreements will be concluded in an electronic form, for each CMU separately, as of, respectively: (i) TSO’s announcement on the outcome of the auction – in case of conclusion of the Capacity Agreement as a result of an auction, or (ii) entry made in the register of the Capacity Market – in case of transactions at secondary market. The template of the Capacity Agreement will be attached to the Rules of the Capacity Market prepared by the TSO.

[Secondary market and capacity relocation] It is expected that CCMUs will be allowed to transfer the Capacity Obligation on a secondary market to another CCMUs, based on an *ex-ante* principle – starting from the date of completion of the supplementary auction (with respect to quarters) until the end of a given delivery year, provided that the secondary market trading will cover exclusively the entire period following the transaction made at the secondary market. Transfer of the Capacity Obligation related to the first year of operation of the New CMU shall not be allowed.

Furthermore, if - during a Vulnerability Period - there is an excess of the Performed Corrected Capacity Obligation over the Corrected Capacity Obligation (see comments below), it will be allowed to transfer such excess to another CMU in a form of the Relocation Volume based on *ex post* principle (i.e. after the Capacity Obligation has been performed in excess).

Secondary market activities, as well as capacity relocation, will be controlled by the TSO.





[Register of Capacity Market] TSO will establish and operate the Register of Capacity Market which will constitute an electronic platform for collecting, processing and exchange of the data and will enable the participants of Capacity Market to make statements of will. The Register will enjoy a presumption of conformity of the entry with factual status and the date of registration of given statement will be deemed as a date of such statement. The register will be established within 3 months from the date on which the Project enters into force.

[Control of investments in New and Modernized CMUs] New and Modernized CMUs will be required to present – before joining the auction – a financial collateral for an amount proportional to the declared available capacity. The collaterals will be released provided that the Capacity Provider proves that:

- (i) certain part (according to the Solutions – minimum 10%) of the total planned investment expenditures were actually incurred and the investment agreements covering certain investment expenditures (according to the Solutions – at least 20%) were entered into – such evidence to be provided **within 12 months from the end of main auction;**
- (ii) Capacity Provider is able to deliver capacity corresponding to certain part of Capacity Obligation established on the basis of corrective availability co-efficient set by the TSO – such evidence to be provided **before the commencement of the delivery period.**

In case the conditions set in points (i) or (ii) above are not met:

- (a) in case of a New CMU – the Capacity Agreement will be terminated, it being specified that if the default refers to condition mentioned in point (ii) above, termination occurs if such condition is not met by the end of third delivery period (year);
- (b) in case of a Modernized CMU – the validity period of the Capacity Agreement will be reduced to 1 year without reduction of the Capacity Obligation (which will force purchases at the secondary market); the Modernised CMU will also not be able to obtain the certificate in the following two certification procedures preceding the main auctions.

[Control of the ability of CMU DSR to reduce capacity demand] CMU DSR are obligated to obtain – not later than 1 month before the year of delivery – a so-called demand-side reduction test certificate (hereinafter, the “DSR Test Certificate”) confirming their ability to reduce power consumption. Issuance of the DSR Test Certificate will require provision (reduction) of capacity during the test on the level of at least 80%, or – in case the Capacity Provider requests so – on the level of 50%. If a DSR Test Certificate has not been obtained before the certification stage, CMU DSR are obligated to present a collateral, which will be released after the auction provided that CMU DSR receives a DSR Test Certificate not later than 1 month before delivery period.



[Performance of capacity obligation] Capacity Obligation will be performed during Vulnerability Periods which shall be defined as the hours set forth in the secondary legislation (according to Solutions – these will be demand peak hours, i.e. any hour from 7:00 am until 10:00 pm on working days) during which the planned reserves of the available capacity being at disposal of the TSO (Transmission System Operator) in excess of the planned demand of the NPG (National Power Grid) are determined within the daily planning process to be lower than the required level of the available capacity reserves – provided that the TSO announces on the occurrence of Vulnerability Period in either Normal (8 hour advance) or Urgent (4 hour advance) mode.

The Capacity Obligation for a given time period may be subject to so-called Justified Corrections (reduction) in case of: (i) the overhaul of the CMU agreed with the TSO, (ii) restrictions to power off-take due to reasons attributable to TSO/Distribution System Operator (“DSO”) (congestion) (iii) characteristics of the start-up process preventing fast activation of generation - in case of unavailability of the power plant due to the characteristics of the start-up process agreed with the TSO during certification process, as well as (iv) exceeding of the operation limits established for a given year in environmental permit – in case such operation limits were presented and agreed during the certification process. Capacity Provider incurs the risk of failure to perform the Capacity Obligation due to other reasons, such as: failure, lack of demand for heat (in case of CHP units), fuel shortages, other technological issues, force majeure.

Capacity Obligation will be settled within the time units used as basic trading periods for the purpose of the Balancing Market, it being specified that settlements will be based on the Corrected Capacity Obligation (“CCO”) and the Performed Corrected Capacity Obligation (“PCCO”), where, according to Solutions

- (a) the value of CCO for a given CCMU will be the product of:
 - (i) the scope of the Capacity Obligation of a given CCMU, and
 - (ii) quotient of:
 - a. the part of the NPG net capacity demand which has not been covered by production of electricity from sources not participating in the Capacity Market; and
 - b. the sum of the Capacity Obligation of all CCMUs reduced by Justified Corrections of all CCMUs;
- (b) the value of PCCO for a given CCMU will be:
 - (i) available capacity of the Centrally Dispatched Power Plant (“CDPP”) at disposal of TSO within the balancing market procedures;
 - (ii) the amount of the net power generated by Non-Centrally Dispatched Power Plant (“non-CDPP”)
 - (iii) capacity notified under a reduction offer by CCMU DSR active on the balancing market;
 - (iv) actual volume of reduction of CCMU DSR which did not offer a reduction on balancing market,
 - in every case increased by Justified Corrections.



If the PCCO (after the allowed relocation of the PCCO) is lower than CCO calculated for a given CCMU in a given Vulnerability Period, the Capacity Provider will be obligated to pay a financial penalty, corresponding to the scope of the Capacity Obligation which was not fulfilled and the rate of penalty determined in the Regulation of the Minister of Energy. The amount of penalties may not exceed: (i) in a single year – the product of an auction closing price and double achievable capacity of given CMU, (ii) within a month – 1/5 of a yearly limit. If PCCO (after the allowed relocation of the PCCO) is higher than CCO calculated for a given CCMU in a given Vulnerability Period, then the Capacity Provider will be entitled to a premium, which - according to the Solutions - shall: (i) correspond to a contribution of a given CCMU to cover the missing volume to fully perform all CCOs, (ii) be financed from redistributing financial penalties for given Vulnerability Period by entities whose PCCO was lower than CCO. The specific methods of determining and ascertaining PCCO and the method of redistributing penalties for premium payments will be defined in the Regulation of the Minister of Energy.

[Budget] The Ministry of Energy estimated in the Solutions that the yearly budget of the Capacity Market will amount to 2-3 billion PLN. The Project and evaluation of its effects do not precise the amount of the budget.

The funds for the budget of the Capacity Market will be gathered from fees payable by final customers, power generators selling the energy to final customers as well as companies distributing electricity and connected to the grid of other DSO (so-called *capacity fees*), such capacity fees being taken into account in tariffs for transmission and distribution of electricity. The rates of capacity fee will be determined and published yearly by the President of Energy Regulatory Office, provided that:

- (a) the household customers without possibility to determine the hourly electricity consumption will pay a flat fee for an electricity meter, depending on the contractual capacity, while
- (b) other final customers will be charged a variable rate, calculated on the basis of the electricity consumed in peak demand hours.

The methodology used for the purpose of the cost allocation between the abovementioned groups of final customers will be stipulated in the Regulation of the Minister of Energy. The President of Energy Regulatory Office is expected to establish and announce the rates of capacity fee for the first delivery year by 30th of June 2020.

[Legislative process] Despite the declared technological neutrality of the Capacity Market and the minimum threshold of achievable capacity allowing to participate in the auction (2MW) the proposed Capacity Market regulation will not constitute a significant support for installations with an unstable generation characteristic (CHP units dependent on demand for heat, RES installations dependent on wind or sun which do not cooperate with energy storages). In reference to the mentioned installations, the obstacles for participation in the Capacity Market will include specifically: (i) prohibition of double support (not applicable to CHP units, multi-fuel combustion units and hybrid units), (ii) correction of achievable capacity by a corrective availability co-efficient which - according to the Solutions - in case



of aggregation of different energy technologies (including stable, such as biogas sources, and less stable, such as wind) will be depended on a co-efficient relevant to the aggregated technology with the lowest load factor, (iii) system of fines for failure to perform the Capacity Obligation due to i.a. technological reasons.

According to the Project, applicability of regulations covering auctions as well as conclusion, performance or settlement of the Capacity Agreements will be subject to the European Commission's consent to introduction of a new aid system on the Capacity Market.



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