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COMMISSION DECISION (EU) 2024/560

of 8 December 2023

granting the Kingdom of Spain a derogation from certain provisions of Regulation (EU) 2019/943 of the European Parliament and of the Council and of Directive (EU) 2019/944 of the European Parliament and of the Council as regards the Canary Islands

(notified under document C(2023) 8638)

(Only the Spanish text is authentic)

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) 2019/943 of the European Parliament and of the Council of 5 June 2019 on the internal market for electricity ([1]), and in particular Article 64 thereof,

Having regard to Directive (EU) 2019/944 of the European Parliament and of the Council of 5 June 2019 on common rules for the internal market for electricity and amending Directive 2012/27/EU ([2]), and in particular Article 66 thereof,

Whereas:

1. PROCEDURE AND THE SCOPE OF THE DECISION

(1) On 23 November 2020, the Kingdom of Spain ('Spain') submitted to the Commission a request for derogation (the 'Application') for the non-peninsular territories of the Canary Islands, Balearic Islands, Ceuta and Melilla (jointly, 'NPT') in accordance with Article 64 Regulation (EU) 2019/943 and Article 66 of Directive (EU) 2019/944.

(2) The Application initially asked for derogations from Article 8 and Article 54 of Directive (EU) 2019/944 and from Articles 3, 6, 7(1); 8(1) and (4), 9, 10, 11, Articles 14 to 17, Articles 19 to 27 and Articles 35 to 47 of Regulation (EU) 2019/943. That Application did not specify the duration of the requested derogation.

(3) On 18 March 2021, the Commission published the Application on its website and invited Member States and stakeholders to provide comments by 30 April 2021.

(4) The Commission requested from Spain additional information on the derogation request on 17 August 2021 and 16 December 2021. Spain replied on 4 October 2021 and 17 January 2022. In the latter submission, Spain modified the scope of its request for derogation as follows:

— the request for derogation from Article 8 of Directive (EU) 2019/944 was withdrawn for all NPT;

— the request for derogation from Article 54 of Directive (EU) 2019/944 was withdrawn for the Balearic Islands and Ceuta;

— Spain included a new request for derogation from Article 40(4) to (7) of Directive (EU) 2019/944 for all NPT;

— the request for derogation from Article 3, first paragraph, points (d), (f), (g), (h), (i), (l), (m) and (q) of Regulation (EU) 2019/943 was withdrawn for all NPT;

([1]) OJ L 158, 14.6.2019, p. 54.
([2]) OJ L 158, 14.6.2019, p. 125.

— Spain also withdrew the request for derogation for all NPT from Article 16(1) and (2), Article 20(1) and (2); Article 21(1) to (6); Article 22(1), except for points (f) and (h); Article 22(4); and Articles 35 to 47 of Regulation (EU) 2019/943;

— Spain set out a limited duration for the requested derogation for the Balearic Islands and Ceuta until the total integration of these territories with the mainland (not expected before 2030).

(5) This Decision should cover the Canary Islands only. The derogation requests submitted by Spain concerning the NPT of Ceuta, Melilla and the Balearic Islands should be addressed in separate Decisions of the Commission on derogations.

2. **THE CANARY ISLANDS**

The electricity system and electricity market in the Canary Islands

(6) The Canary Islands constitute one of the outermost regions recognised under Article 349 of the Treaty on the Functioning of the European Union ('TFEU') and thus fall into that category for the purposes of the application of Article 64 of Regulation (EU) 2019/943 and Article 66 of Directive (EU) 2019/944.

(7) According to Spain, the non-peninsular territory of the Canary Islands covers six isolated electricity systems: Tenerife, Gran Canaria, La Palma, La Gomera, El Hierro and the Lanzarote-Fuerteventura system, which links the islands of Lanzarote and Fuerteventura via two 132kV cables.

(8) According to Spain, in 2019, more than 75 % of the Canary Islands' installed electricity capacity was covered by traditional thermal power units (coal, gas, diesel). The share of renewable energy has steadily increased since 2018, especially in the larger islands (Gran Canaria and Tenerife) where it represents a significant share of the installed capacity. Spain notes, however, that the uptake of renewable energy in non-peninsular territories is lower than in mainland Spain due to the small size of the territory and constraints linked to obtaining the necessary environmental permits for new generation capacity, the higher need for dispatchable generation to guarantee security of supply ([3]) and the limited storage capacity.

(9) Spain notes that the Canary Islands are characterised by their small market size, which prevents them from reaping the benefits of the economies of scale present in the mainland electricity system and that they face higher fuel costs. Their historical isolation also results in a greater need for installed reserve capacity.

(10) Spain further notes that almost all thermal generation in the Canary Islands is directly or indirectly owned by Endesa S.A. As a result, even if the increasing roll out of renewables is facilitating the entry in the market of competing undertakings, Endesa S.A. will still produce most of the electricity in this non-peninsular territory.

(11) According to Spain, those market specificities entail higher electricity production costs compared to the mainland and lack of attractiveness for new undertakings to enter the market, and as a result no effective competition has developed in the Canary Islands.

(12) In view of the problems associated with the lack of competition and high costs and despite the measures adopted to promote competition and introduce economic incentives to encourage operational efficiency of installations and reduce generating costs, Spain submits that it has not been possible to establish a market mechanism which is identical to the one in place on the mainland.

([3]) Spain explains that the coverage rate because of rolling reserves for non-peninsular systems is in the range of 40 to 70 % compared to a 10 % needed in the mainland system.

(13) Spain further explains that electricity generated in all the NPT, including the Canary Islands, is excluded from the bidding system on the mainland market. NPT electricity systems use a mechanism of economic precedence for dispatch ([4]):

— the system operator ranks the generation plants in order of economic merit based on variable costs until demand is covered, taking into account the technical constraints and the reserves necessary to guarantee electricity supply;

— the demand side (direct consumers and suppliers) notifies the system operator of the hourly demand in the electricity systems of each NPT;

— following the daily dispatch, the demand side purchases the energy at a price equivalent to that of the bidding system on the mainland.

(14) According to Spain, this mechanism takes account of the high electricity generation costs and specificities of the NPT and aims to ensure that consumers and suppliers in those territories are not exposed to the higher cost of producing electricity in the NPT compared to mainland Spain, this being based on inter-regional solidarity principles.

(15) Spain further explains that electricity generation in the NPT constitutes a system of regulated remuneration instead of a market remuneration system and is applied in conditions where a wholesale market could not function and where costs, for geographical and territorial reasons, are higher than electricity generation costs in mainland Spain.

(16) Spain notes that the mechanism ensures that the electricity system and the public budget cover the extra cost resulting from the difference between the higher generating costs in the NPT, and the electricity price equivalent to that on the mainland, so that all consumers pay the same for electricity, irrespective of the system in which they consume it.

(17) According to Spain, the regulation of the activities of transmission and distribution of electricity in the NPT is similar to that on mainland Spain.

(18) In relation to the retail market, Spain explains that final customers in the NPT have a right to choose their supplier on the same terms as final customers in mainland Spain. Similarly, the concept of vulnerable consumers is defined for the whole of Spain and, in general, supply is organised uniformly throughout the country. In this respect, Spain notes that there are no differences between the mainland and non-mainland retail markets.

Overview of the legal framework for the NPT

(19) Spain explains that Law 24/2013 sets out that the supply of electricity in the NPT is subject to a specific regulation. It also sets out that this activity can receive an additional remuneration to cover the difference between the costs to generate electricity in the NPT and the revenues from the sales of electricity in these territories.

(20) Spain notes that Law 17/2013 sets out the general provisions for the guarantee of supply and increase of competition in the electricity systems in the NPT. ([5]) In particular, Article 5 of Law 17/2013 provides that the pumped hydropower storage facilities in the NPT whose main purposes are to guarantee supply, ensure system security and integrate non-dispatchable renewable energy sources, are to be owned by the system operator.

(21) Spain indicates that Royal Decree 738/2015 regulates in detail the activity of producing electricity and the dispatching procedure in the electricity systems in the NPT as well as the remuneration scheme of this activity. The remuneration scheme is based on two remuneration components: one for the investment made and other fixed costs, and one for the variable costs incurred during operation. The objective of this remuneration is to cover the extra costs of electricity generation in the NPT. The Royal Decree 738/2015 defines the extra cost as the difference between all the costs of generation and the price paid in the electricity dispatch run by the system operator.

([4]) The framework is set out in Royal Decree 738/2015 of 31 July 2015 (Real Decreto 738/2015, de 31 de julio, por el que se regula la actividad de producción de energía eléctrica y el procedimiento de despacho en los sistemas eléctricos de los territorios no peninsulares) ('Royal Decree 738/2015').

([5]) Ley 17/2013, de 29 de octubre, para la garantía del suministro e incremento de la competencia en los sistemas eléctricos insulares y extrapeninsulares.

(22) Additionally, the Royal Decree 738/2015 introduces a competitive procedure for the selection of new capacity and capacity to be refurbished.

(23) The Commission notes, in this regard, that the remuneration mechanism set out in Royal Decree 738/2015 received State aid clearance by the Commission in its Decision SA.42270 'Spain Electricity production in Spanish non-peninsular territories'. ([6])

3. THE REQUESTED DEROGATIONS CONCERNING THE CANARY ISLANDS

(24) The request for derogation submitted for the Canary Islands is based on its status as an outermost region in accordance with Article 349 TFEU.

3.1. Derogation pursuant to Article 66 of Directive (EU) 2019/944

(25) Spain requests a derogation from Article 40(4) to (7) and from Article 54 of Directive (EU) 2019/944 as regards the procurement of ancillary services by the transmission system operator ('TSO') and the prohibition of transmission system operators to own, develop, manage or operate energy storage facilities.

3.2. Derogation pursuant to Article 64 of the Regulation (EU) 2019/943

(26) Spain requests a derogation for the Canary Islands from the following provisions of Regulation (EU) 2019/943:

— the market principles in Article 3(1), points (a), (b), (c), (e), (j), (k), (n), (o) and (p);

— electricity trading rules pursuant to Article 6, Articles 7(1), 8(1) and 8(4), Articles 9, 10, 11,14, 15, 16 and 17;

— the rules on congestion income set out in Article 19;

— Articles 14, 15, Article 16(3) to 16(13), Articles 17, 19, Articles 20(3) to 20(8), 21(7) and 21(8), 22(1), points (f) and (h), 22(2), 22(3) and 22(5), and 25(2) to 25(4) for any new support capacity mechanisms that might be established in the future;

— Articles 14 to 17, 19 to 27, 35 to 47 for the existing mechanism defined in Royal Decree 738/2015.

3.3. Duration of the requested derogations

(27) Spain considers that the integration of the NPT in the Iberian electricity market depends on the existence of interconnection with the Spanish mainland. Spain notes that due to the geographical distance of the Canary Islands with the mainland, building interconnectors with the mainland would be impossible or too costly. Hence, Spain considers that the derogations for the Canary Islands should not be subject to any time limitation.

4. COMMENTS RECEIVED DURING THE CONSULTATION PERIOD

(28) As described in recital 3, throughout March and April 2021, the Commission carried out a public consultation.

(29) All the comments submitted in response to the public consultation concerned the derogation requested by Spain from Article 54 of Directive (EU) 2019/944 regarding ownership, management and operation of storage facilities by the TSO.

([6]) Decision of 28 May 2020, *SA.42270 (2016/NN)* – Spain Electricity production in Spanish non-peninsular territories, C(2020) 3401 final.

(30) Respondents to the public consultation were against granting such derogation, as it would legitimise a project according to which Red Eléctrica de España S.A.U. ('REE'), the Spanish TSO, has been allowed to develop the Chira-Soria Project in the Canary Islands without tendering procedure ('the Chira-Soria Project') ([7]), as required by Article 54 of Directive (EU) 2019/944. Respondents noted that the fact that the derogation also covers the other NPT is not relevant because the orography of the Balearic Islands and the small size of Ceuta and Melilla would not allow for pumped hydropower storage in those territories ([8]).

(31) Respondents indicated that mere insularity is not a sufficient justification to derogate from the tendering requirement set out in Article 54 Directive (EU) 2019/944, given that private parties had reportedly shown an interest in the Chira-Soria Project. They claimed that this interest was not considered in view of Law 17/2013.

(32) Respondents further highlighted that the Spanish regulatory authority, the Comisión Nacional de Mercados y Competencia (CNMC) and the Spanish Council of Estate have expressed concerns about the Royal Decree 738/2015 and the role of REE in owning pumped hydropower storage facilities and, at the same time, being the entity on which, in first instance, the administrative process of authorizing pumped hydropower storage facilities depends.

(33) Respondents also raised arguments of economic nature. They stressed that in the Canary Islands this kind of storage is affected by the low availability of stored water, thus needing the desalinization of seawater. This entails high energy costs and reduces substantially the efficiency of the Chira-Soria Project. In this regard, respondents referred to the wind-pumped hydro power station Gorona del Viento at El Hierro Island whose efficiency is 43 %, far from the 70 % to 80 % efficiency levels of similar power plants in the mainland.

(34) Respondents claimed that the budget estimation for the Chira-Soria Project has doubled even before the start of its construction and referred to studies that suggest that other solutions (e.g., interconnections, distributed storage, electrochemical storage, hydrogen) would be more economically efficient. They also referred to the financial burden for consumers related to the high cost of the investment. They underlined the very high production costs of the only similar facility in the Canary Islands, Gorona del Viento. In view of the less favourable location of the Chira-Soria Project, according to the respondents record high costs per MWh could be reached, diverting money away from investment in other forms of flexibility, including flexibility provided by households and the TSO.

(35) Respondents also noted that in addition to not being economically justified, the Chira-Soria Project does not contribute to the integration of renewable energy. They referred to 'consulted experts' according to whom the energy stored will mainly originate from fossil-fuel energy produced by existing old thermal facilities that cannot be shut down at night-time. They noted that new storage technologies (batteries and hydrogen) and the emergence of electric vehicles would render the Chira-Soria Project unnecessary and constitute more efficient, transparent and rapid means for greening the energy system.

(36) Finally, respondents noted that the Chira-Soria Project raises environmental and social concerns. They claimed that the construction affects five Natura 2000 sites and has not undergone an environmental impact assessment.

([7]) The Chira-Soria Project concerns the construction of an energy storage facility (pumped storage hydroelectric power plant) of 200 MW installed capacity and 3,5 GWh energy storage capacity in the island of Gran Canaria. For more information about the project see: Central hidroeléctrica de bombeo reversible Salto de Chira | Red Eléctrica (ree.es).

([8]) Pumped hydropower storage would qualify as a storage facility pursuant to Directive (EU) 2019/944.

5. ASSESSMENT OF THE DEROGATION REQUEST CONCERNING THE CANARY ISLANDS

5.1. Outermost region that cannot be interconnected with the Union electricity market

(37) In accordance with Article 64 of Regulation (EU) 2019/943, a derogation from the relevant provisions of Articles 3 and 6, Article 7(1), Article 8(1) and (4), Articles 9 to 11, Articles 14 to 17, Articles 19 to 27, Articles 35 to 47 and Article 51 of that Regulation may be granted in two cases:

(a) for small isolated systems and small connected systems, if the Member State(s) can demonstrate that there are substantial problems for the operation of those systems. In such a case, the derogation is to be subject to conditions that aim to increase competition and integration with the internal market for electricity;

(b) for outermost regions with the meaning of Article 349 TFEU, if they cannot be interconnected with the Union's energy market for evident physical reasons.

(38) In accordance with Article 66(1), first subparagraph, of Directive (EU) 2019/944, a derogation from the relevant provisions of Articles 7 and 8 and of Chapters IV, V and VI may be granted for small isolated systems and small connected systems, if the Member State(s) can demonstrate that there are substantial problems for the operation of those systems. Article 66(2), second subparagraph, of Directive (EU) 2019/944 sets out that for outermost regions within the meaning of Article 349 TFEU that cannot be interconnected with the Union electricity markets, the derogation is to be subject to conditions aimed to ensure that the derogation does not hamper the transition towards renewable energy.

(39) Both under Regulation (EU) 2019/943 and Directive (EU) 2019/944, in the case of outermost regions, the derogation is not to be limited in time.

(40) The Canary Islands constitute one of the outermost regions recognised under Article 349 TFEU and thus fall into this category for the purposes of Article 64 of Regulation (EU) 2019/943 and Article 66 of Directive (EU) 2019/944.

(41) Currently there are no plans to connect the mainland Spain's electricity systems to the Canary Island's electricity systems. Spain explains that, given the distance, there is no possibility to integrate the Canary Islands at a reasonable cost, and also that the integration of the islands has serious limitations due to their topography, as they are volcanic islands with a very rough seabed.

(42) Hence, the Commission considers that the Canary Islands fulfil the criterion set out in Article 64(1) of Regulation (EU) 2019/943 and Article 66(2) of Directive (EU) 2019/944 that they cannot be interconnected with the Union's energy market for evident physical reasons.

(43) Accordingly, pursuant to Article 64(1) of Regulation (EU) 2019/943 and to Article 66(1) of Directive (EU) 2019/944, Spain is not obliged to demonstrate that there are substantial problems for operation of the electricity systems in the Canary Islands. The derogation should be granted for an unlimited duration.

5.2. Scope of the derogation

5.2.1. *Articles 54 and 66 of Directive (EU) 2019/944*

(44) Article 54(1) of Directive (EU) 2019/944 prohibits transmission system operators from owning, developing, managing or operating energy storage facilities.

(45) Article 54(2) of that Directive provides for a possibility for Member States to derogate from this rule where the facilities are fully integrated network components and the regulatory authority has granted its approval or where all the conditions set out in points (a) to (c) of that paragraph are fulfilled.

(46) As stated in recital 38 above, pursuant to Article 66(2), second subparagraph, of Directive (EU) 2019/944 Member States can request a derogation from the rules in Chapter VI (including Article 54) for outermost regions within the meaning of Article 349 TFEU that cannot be interconnected with the Union electricity markets, subject to conditions aimed to ensure that the derogation does not hamper the transition towards renewable energy.

(47) Hence, in addition to applying the derogation possibility in Article 54(2) Directive (EU) 2019/944, Spain may request a derogation to the Commission from Article 54 of Directive, as regards the Canary Islands, by reference to Article 66.

5.2.1.1. The Application

(48) As described in recital 20, Article 5 of Law 17/2013 provides that the pumped hydropower storage facilities in the NPT whose main purposes are to guarantee supply, ensure system security and integrate non-dispatchable renewable energy sources, are to be owned by the system operator.

(49) In the Application, Spain points out the challenges linked to the deployment of renewable energies in the Canary Islands. Spain explains that all renewable power plants in one island produce electricity under the same meteorological conditions, unlike it is the case in mainland Spain. As a result, as more renewable energy generation is deployed in the electricity systems of the Canary Islands, complying with the security of supply standards becomes more difficult. This might limit the uptake of renewable energy sources in the long-term.

(50) According to Spain, ownership of pumped hydropower storage facilities by the TSO in the specific cases included in Law 17/2013 does not prevent private investors from owning such facilities, a situation which would also contribute to guarantee the security of supply. All pumped hydropower storage facilities, regardless of ownership, must participate in the dispatch of electricity, although pumped hydropower storage facilities owned by the TSO are to be integrated as an ancillary service to ensure supply and security for each system.

(51) Spain thus requests the derogation from Article 54 of the Directive (EU) 2019/944 for the Canary Islands in accordance with Article 66 of the Directive.

(52) Specifically, the derogation request as submitted by Spain would apply to the ongoing Chira-Soria Project, and to any future pumped hydropower storage facilities owned by the system operator where this is justified as the best alternative in accordance with the legislation in force.

5.2.1.2. Assessment

(53) As stated in recital 45, the Commission notes that Article 54 of Directive (EU) 2019/944 already includes, in its paragraph 2, a possibility for Member States to derogate from the rule in paragraph 1 of that Article, namely that transmission system operators are not to own, develop, manage or operate energy storage facilities.

(54) In view of the possibility set out in Article 54(2) of Directive (EU) 2019/944, the Commission considers that a derogation from Article 54(1) pursuant to Article 66 of the Directive, for all types of energy storage technologies, is not justified.

(55) However, taking into account their status as outermost region and the orography of the Canary Islands, with limited options for connection between the different islands, the Commission considers that a derogation from Article 54(1) of Directive (EU) 2019/944 pursuant on Article 66 of the Directive limited to pumped hydropower storage facilities is justified.

(56) Pumped hydropower storage facilities allow increasing the security of supply and the integration of renewables by way of providing a source of renewable flexibility to the electricity system, helping to balance excess supply and avoid curtailment. It is considered the key technology for an optimal integration of intermittent renewable sources (e.g., wind and solar). ([9]) Hydropower productivity, however, reflects the climatology, topography and water resources of each region and the facilities are location specific.

(57) The Commission considers that ownership of pumped hydropower storage facilities by the TSO may be justified in very specific cases, such as in the Canary Islands, where those facilities are necessary for guaranteeing the security of supply of and the integration of renewable energy sources and where the electricity systems of the Canary Islands count with limited options for low carbon flexibility.

(58) Moreover, due to the current conditions of the electricity market in the Canary Islands (see section 2), it appears that commercial investments in pumped hydropower storage facilities cannot be promptly facilitated, despite the urgent necessity for facilities which provide low carbon flexibility. This is because hydropower projects have longer pre-development, construction and operational timelines than other technologies with investment risks being higher, which may require specific policy instruments and incentives as well as longer-term policy perspective and vision. The urgency of such projects, in view of the planned uptake of renewable energy generation in the near future ([10]) and of the system operation challenges which the Canary Islands appear to be facing ([11]) is of such importance that the Commission considers that in the case of this outermost region, Spain should not be required to comply with the conditions set out in Article 54(2) of Directive (EU) 2019/944.

(59) A derogation from Article 54(1) of Directive (EU) 2019/944 pursuant to Article 66 of the Directive limited to pumped hydropower storage facilities should not prevent the market-based development in the Canary Islands of storage projects based on this type or other type of technologies. Considering the commitments of Spain as regards the decarbonisation of NPTs such as the Canary Islands, as the generation for renewable sources increases, in addition to pumped hydropower storage facilities, energy storage facilities based on other technologies will likely be needed to ensure security of supply.

(60) The Commission further highlights that the obligation of TSOs to own and operate energy storage facilities in non-peninsular territories set out in Law 17/2013 appears to be based on criteria that differ from those set out in Article 54 of Directive (EU) 2019/944. The present Decision merely assesses whether the requirements for a derogation pursuant to Article 66(2) of Directive (EU) 2019/944 are met and does not pre-empt the Commission's assessment of the compatibility of Law 17/2013 with the requirements set out in Directive (EU) 2019/944.

5.2.2. *Article 40(4) to (7) of Directive (EU) 2019/944*

(61) According to Spain, the lack of effective competition in the generation segment prevents the establishment of undistorted electricity markets in the NPT. In particular, it prevents the transmission system operator from establishing and operating a balancing market in the Canary Islands, including procuring market based non-frequency ancillary services.

(62) Given the absence of a balancing market and of a market-based procurement of non-frequency ancillary services in the Canary Islands, the Commission considers that derogations from the obligations in Article 40(4) to (7) of Directive (EU) 2019/944 in accordance with Article 66 of the Directive are justified.

([9]) Hydropower and pumped hydropower storage in the European Union: Status report on technology development, trends, value chains and markets, JRC 2022: https://setis.ec.europa.eu/document/download/82e6a3ad-74f1-4f6d-b2be-006df2de2007_en

([10]) See for example the measures described in the Draft Update of the Integrated National Energy and Climate Plan (2023-2030) submitted by Spain concerning the Canary Islands, aiming to achieve the decarbonisation by 2040 (page 144): https://commission.europa.eu/publications/spain-draft-updated-necp-2021-2030_en. See also Ley 6/2022, de 27 de diciembre, de cambio climático y transición energética de Canarias.

([11]) Antonio Morales exige al Ministerio acciones urgentes para acabar con la inseguridad y el riesgo de apagón general en Gran Canaria - Cabildo de Gran Canaria - Portales Web Cabildo GC.

5.2.3. *Chapter II of Regulation (EU) 2019/943: General rules for the electricity market – Articles 3 and 6, Articles 7(1), 8(1) and (4), Articles 9, 10 and 11*

5.2.3.1. The Application

(63) According to Spain, the lack of effective competition between generators prevents the establishment of non-regulated electricity markets. The dispatch decisions in NPT including the Canary Islands are based on technical and economic criteria for which it is not always possible to apply market rules. Additionally, Spain explains that price formation in the NPT is not based on the offer and demand in those territories, but on that of mainland Spain, to prevent that consumers in NPTs pay the extra costs of electricity production in those territories.

(64) Based on those facts in previous recital, Spain requests a derogation from the following provisions of Article 3, first paragraph, of Regulation (EU) 2019/943:

— points (a), (b), (o), (p), since according to Spain prices in the markets at stake cannot be freely formed based on offer and demand, and there are no forward markets operating in these territories;

— point (c), since Spain considers that the market rules that facilitate the development of flexible generation and demand might not be applicable in the territories;

— points (e) and (k), since according to Spain generators are not responsible for selling the electricity they produce (it is instead the task of the system operator to decide which power plants should be dispatched) and cannot submit aggregated offers;

— point (j), since Spain considers that the storage strategy in these territories might require that energy storage has priority and is not on equal footing with other generation facilities;

— point (n), for which Spain notes that in principle the entry and exit of electricity generation could be based on the undertakings' assessment of the economic and financial viability of their operations, but that in practical terms it is not possible for generation companies to participate in the system without being granted a regulated payment regime by which the generation costs can be covered.

(65) Regarding Article 6, Articles 7(1), 8(1) and (4), Articles 9, 10 and 11, Spain highlights that although the electricity system in the NPT is governed by a dispatch system that operates in a way similar to the Union electricity markets, for example with daily and intraday dispatches, it constitutes a regulated system. The purchase price is based on the mainland price and not on the recognised costs incurred by generators in carrying out their electricity generation activities, including the balancing services. On this basis, Spain requests a derogation from Article 6, Articles 7(1), 8(1) and (4), and Articles 9, 10 and 11 of Regulation (EU) 2019/943, since there is no balancing market in the non-peninsular territories including the Canary Islands, and neither is there the possibility of integration with the Union day-ahead and intraday markets due to their isolation.

(66) With regard to Article 7(1) and Article 8(1) and (4) of Regulation (EU) 2019/943, Spain notes that due to the isolated nature of the NPT, dispatches are operated independently of the mainland and Union markets – aside from the reference price for the purchase of energy being based on the mainland price – with the dispatches being based on hourly schedules.

(67) Likewise, in accordance with the above, the integration of forward markets, technical bidding limits and the value of lost load referred to in Articles 9 to 11 of Regulation (EU) 2019/943 are considered by Spain as not applying to dispatches in the NPT.

5.2.3.2. Assessment

(68) Concerning the request for derogation from Article 3, first paragraph, of Regulation (EU) 2019/943, the Commission considers that:

— since electricity prices in the Canary Islands are not formed following a market-based approach but via a special regulated mechanism whereby the system operator carries out the generation dispatch for each of the isolated electricity systems, a derogation from Article 3, first paragraph, points (a), (b), (e), (k), of Regulation (EU) 2019/943 is justified;

— since there is no forward market in the Canary Islands and the system operator's dispatch involves weekly, daily, intraday forecasting as well as deviations in real time, a derogation from Article 3, first paragraph, points (o) and (p), of Regulation (EU) 2019/943 is also justified;

— while acknowledging that the current regulated system and particular characteristics of the Canary Islands might render more difficult the development of more flexible generation, low carbon generation and more flexible demand, the application of the market rules is still required to incentivise their development to the extent possible. Thus, the Commission considers that a derogation from Article 3, first paragraph, point (c), of Regulation (EU) 2019/943 is not justified;

— Article 3, first paragraph, point (j), of Regulation (EU) 2019/943 does not prevent that priority is given to energy storage projects in the Canary Islands, if for example, those projects are considered as the best option to ensure security of supply in the Canary Islands. Thus, the Commission considers that a derogation from Article 3, first paragraph, point (j), of Regulation (EU) 2019/943 is not justified;

— in relation to Article 3, first paragraph, point (n), of Regulation (EU) 2019/943, the entry or exit of an undertaking in the market for electricity generation should depend on that undertaking's assessment of economic and financial viability, taking into account the possibility to receive the regulated remuneration mentioned in recitals 15 and 16. Hence, a derogation from Article 3, first paragraph, point (n), of Regulation (EU) 2019/943 is not justified for the Canary Islands.

(69) With respect to the requested derogation from Article 6, Articles 7(1) and 8(1) and (4), Articles 9, 10, 11 of Regulation (EU) 2019/943, those provisions refer to requirements regarding the forward, day-ahead, intraday and balancing markets. Based on the information submitted by Spain, it appears that those markets cannot be implemented effectively in the Canary Islands (recital 12), considering the particularities of the electricity systems in this territory. Hence, the Commission considers that a derogation from those provisions is justified.

5.2.4. *Chapter III of Regulation (EU) 2019/943: Network access and congestion/management – Articles 14 to 17 and Article 19*

5.2.4.1. The Application

(70) Spain explains that the requirements set out in Articles 14 to 16 and Article 19 cannot be applied in the NPTs, because the TSO carries out the generation dispatch for each of the isolated electricity systems and those systems do not constitute separate interconnected bidding zones. Those dispatches take into consideration the energy transferred via links between islands in the Canary Islands system (i.e., between Lanzarote and Fuerteventura). In the event of congestion in those links, the TSO reorganises the dispatch of the available generating capacity, taking into account mainly technical criteria, to ensure supply. Spain also explains that since the NPT do not constitute separate bidding zones, there is not an associated cross-zonal capacity market and thus no congestion income is generated.

5.2.4.2. Assessment

(71) The derogations from Articles 7(1) and 8(1) of Regulation (EU) 2019/943 have the effect of not including the electricity systems in the Canary Islands in the integrated day-ahead and intraday markets. Therefore, some provisions relating to the functioning of those markets will necessarily not apply to the Canary Islands.

(72) Moreover, The Canary Islands are not considered a separate bidding zone. Articles 14 to 17 and Article 19 of Regulation (EU) 2019/943 relate to bidding zones and the management of the capacity and congestions between bidding zones. Since each of the electricity systems of the Canary Islands does not constitute separate bidding zones, the provisions referring to bidding zones are not applicable to the Canary Islands. Hence, it follows that a derogation from the requirements in Articles 14 and 15, Article 16(3) to (13), Articles 17 and 19 of Regulation (EU) 2019/943 is not justified.

(73) Moreover, Article 16(1) and (2) of Regulation (EU) 2019/943, which contain general principles regarding congestion management apply to the Canary Islands because those principles provide guarantees to market participants that the TSO is to address congestion problems with non-discriminatory market-based solutions and use transaction curtailment procedures only in emergency situations. Hence, the Commission considers that a derogation from Article 16(1) and (2) of Regulation (EU) 2019/943 is not justified.

5.2.5. *Chapter IV of Regulation (EU) 2019/943: Resource adequacy – Articles 20(3) to (8), Article 21(7) and (8), Article 22(1), points (f) and (h), Article 22(2), (3) and (5), and Article 25(2) to (4)*

5.2.5.1. The Application

(74) Spain explains that, due to the isolation of the NPT, the resource adequacy assessments carried out by the system operator for each of the NPT are independent, and they are not integrated into the European resource adequacy assessment or into the Spanish mainland resource adequacy assessment. Therefore, Spain considers that some of the provisions in Chapter IV are not applicable to the NPT. Spain underlines nevertheless that the current national rules aim, in so far as possible, to provide for an equal treatment between the non-peninsular territories and the mainland market, for example, as regards the levels of security of supply or the methodology for carrying out resource adequacy assessments.

(75) Spain argues that adequacy in the NPT is ensured by the specific mechanism for allocating new capacity set out in Royal Decree 738/2015 as described in recitals 21 to 23. Spain considers that this mechanism should be maintained given the unique nature of the NPT, and thus requests for a derogation from Articles 20(3) to (8), Article 21(7) and (8), Article 22(1), points (f) and (h), Article 22(2), (3) and (5), and Article 25(2) to (4).

(76) Spain argues that the resource adequacy assessments in the NPT comply with the principles included in Article 20(1) and (2) of Regulation (EU) 2019/943. Spain further explains that where adequacy concerns are identified, those are tackled with a call for a competitive bidding procedure (as set out in Royal Decree 738/2015) combined with the assessment of auctions of capacity of renewable origin. These are procedures for which, according to Spain, the requirements in Article 20(3) to (8) of Regulation (EU) 2019/943 cannot be applied.

(77) Spain explains that the provisions included in Article 21(7) and (8) of Regulation (EU) 2019/943, which refer to the temporary nature of capacity mechanisms, are not compatible with the mechanism set out in Royal Decree 738/2015. It states, however, that for any future new capacity mechanisms the requirements in Article 21(7) and (8) of the Regulation will apply.

(78) Spain notes that the mechanism set out in Royal Decree 738/2015 is also incompatible with the following provisions of Regulation (EU) 2019/943:

— Article 22(1), point (f), which sets that the remuneration is to be determined through a competitive process, because according to Spain the remuneration in the existing mechanism is not based on a competitive process, but on a benchmark installation to incentivise efficiency;

— Article 22(1), point (h), which sets that capacity mechanisms must be open to the participation of all resources that can provide the required technical performance, because according to Spain the mechanism is applied only to dispatchable installations;

— Article 22(2), which sets a list of design features that strategic reserves must comply with, since according to Spain it makes reference to balancing markets that do not exist in the NPT;

— Article 22(3), which sets additional requirements to capacity mechanisms other than strategic reserves, since according to Spain the existing mechanism does not comply with those requirements: the retribution does not tend to zero when the capacity level supplied is adequate, the retribution is not only linked to the capacity and the capacity obligations are not transferable;

— Article 22(4), which incorporates CO_2 emission limit requirements on capacity mechanisms, since according to Spain the current mechanism does not include any requisite of this nature, but it does allow to set technical limitations;

— Article 22(5), which requires the adaptation of capacity mechanisms that apply on 4 July 2019.

(79) Spain explains that the reliability standards for the non-peninsular territories are not aligned with the requirements in Article 25(3) of Regulation (EU) 2019/943, since they do not take into account the cost of new entry. Spain adds that even if the standards were the same, they might evolve to stricter values at a different pace, based on which they request a derogation from Article 25(2) to (4) of Regulation (EU) 2019/943.

5.2.5.2. Assessment

(80) Article 20 of Regulation (EU) 2019/943 addresses resource adequacy in the internal market for electricity and sets out obligations for Member States on how to monitor resource adequacy and how to act when resource adequacy concerns are identified, namely by developing an implementation plan with the aim of removing regulatory distortions, ensuring market-based balancing procurement, or removing regulated prices, among others. The Commission notes that the Canary Islands are subject to a resource adequacy assessment which it is not integrated in the European or national adequacy assessment. Moreover, as most market rules cannot be applied in the Canary Islands (see sections above), most of the elements in the implementation plans pursuant to Article 20(3) of Regulation (EU) 2019/943 are not applicable to the regulated wholesale market in the Canary Islands. Therefore, the Commission considers that a derogation from Article 20(3) to (8) of Regulation (EU) 2019/943 is justified.

(81) Article 21(7) of Regulation (EU) 2019/943 sets forth the requirement for an efficient administrative phase-out of the capacity mechanism where no new contracts are concluded during three consecutive years, whereas Article 21(8) of Regulation (EU) 2019/943 sets out requirements related to the temporary nature of capacity mechanisms. Based on Spain's explanations, the current regulated remuneration mechanism in Royal Decree 738/2015 for generation in the NPT (which does not have a temporary nature) could be considered equivalent to a capacity mechanism. To ensure the feasibility of this mechanism, which was approved under Commission's State Aid decision in case SA.42270, and the attainment of the objectives pursued (inter alia, to encourage power plant maintenance and replacement of inefficient power plant and promote renewable energy sources in Spain), the Commission considers that a derogation from Article 21(7) for the Canary Islands is justified.

(82) With regards to the request to derogate from Article 21(8) of Regulation (EU) 2019/943, the Commission considers however that this derogation is not justified given that it is not possible to predict the evolution of the electricity systems of the Canary Islands over time. Accordingly, the duration of the regulated remuneration mechanism set out in Royal Decree 738/2015 should be limited to the period up to 31 December 2029 as approved under State Aid decision in case SA. 42270.

(83) Article 22 of Regulation (EU) 2019/943 sets out the design principles applicable to capacity mechanisms. The Commission considers that a derogation from Article 22(1), points (f) and (h), of Regulation (EU) 2019/943 applicable after the expiration date of the regulated remuneration mechanism set out under the State Aid decision in case SA. 42270 would hinder the transition towards renewable energy, increased flexibility, energy storage, electromobility and demand response as these provisions aim to allow the participation by all technologies on a competitive basis. Therefore, the Commission considers that a derogation from Article 22(1), points (f) and (h) is not justified. This should be without prejudice to commitments and contracts concluded with regards to the Canary Islands under the remuneration mechanism in Royal Decree 738/2015 as approved under the State Aid decision in case SA. 42270.

(84) Based on the information provided by Spain (recital 77), the Commission considers that a derogation from the requirements in Article 22(2) and (3) of Regulation (EU) 2019/943 are justified.

(85) With regards to the request for derogation from Article 22(5) of Regulation (EU) 2019/943, the Commission considers that a derogation is not justified given that Article 22(5) of that Regulation is not applicable to capacity mechanisms approved after 4 July 2019.

(86) Regarding Article 22(4) of Regulation (EU) 2019/943 which sets out the CO_2 emission limit requirements on capacity mechanisms, the Commission considers that the CO_2 emission limit requirements are not applicable to the current regulated remuneration mechanism approved under State Aid decision in case SA. 42270, in light of the small size of the electricity systems of the Canary Islands, the constraints linked to obtaining the necessary environmental permits for new generation capacity and of the higher need for dispatchable generation to ensure the integration of renewables in the electricity systems of the Canary Islands and guarantee security of supply. The Commission considers that a derogation from Article 22(4) of Regulation (EU) 2019/943 applicable after the expiration date of the regulated remuneration mechanism set out under the State Aid decision in case SA. 42270 would hinder the transition towards renewable energy, increased flexibility, energy storage, electromobility and demand response as these provisions aim to allow the participation by all technologies on a competitive basis. Therefore, the Commission considers that a derogation from Article 22(4) of Regulation (EU) 2019/943 is not justified. This should be without prejudice to commitments and contracts concluded with regards to the Canary Islands under the remuneration mechanism in Royal Decree 738/2015 as approved under the State Aid decision in case SA. 42270.

(87) In the Commission's view, based on the explanations provided by Spain (see recital 78) a derogation from Article 25(2) to 25(4) of Regulation (EU) 2019/943 for the operation of the electricity systems in the Canary Islands is justified.

5.2.6. *Derogation from Articles 14 to 17, 19 to 27, 35 to 47 of the Regulation (EU) 2019/943 for the mechanism in Royal Decree 738/2015*

(88) In its application, as amended by the second set of clarifications sent by Spain on 17 January 2022, Spain stated that for the existing mechanism in Royal Decree 738/2015 a derogation from Articles 14 to 17, 19 to 27, 35 to 47 of the Regulation (EU) 2019/943 is needed. The Commission deems that such an ample derogation is not necessary to ensure its application. The Commission view is that only the derogations stated in the sections above are justified.

5.3. **No obstruction to the transition towards renewable energy, increased flexibility, energy storage, electro-mobility and demand response**

(89) Pursuant to Article 64(1), fifth subparagraph, of Regulation (EU) 2019/943 and Article 66(2) of Directive (EU) 2019/944, a derogation decision is to ensure that it does not obstruct the transition towards renewable energy, increased flexibility, energy storage, electro-mobility and demand response.

(90) As regards the transition towards renewable energy and increased flexibility (including demand response) and energy storage, it is important to note that well-functioning forward, day-ahead, intraday and balancing markets, in line with the requirements set in Regulation (EU) 2019/943 and Directive (EU) 2019/944, should provide the necessary dispatch and investment signals to maximise the potential development of those technologies. By way of example, the development of demand response that can be activated in periods when the electricity systems of the Canary Islands are under stress in principle would be achieved more easily in a system where the demand prices reflect the hourly situation of generation in the Canary Islands, instead of that of the mainland generation. This does not automatically prevent developments of demand response or other forms of flexibility in the current regulatory setting. However, it cannot be excluded that the derogation decision may have a negative impact on such potential developments.

(91) On the other hand, Article 64 of Regulation (EU) 2019/943 does not require that derogation decisions maximise the potential for flexibility or energy storage. A derogation under Article 64 of that Regulation only aims to ensure that it 'does not obstruct' such transition. In other words, the derogation must not prevent developments which, without the derogation, would occur naturally. It is unlikely that, absent the derogation, well-functioning forward, day-ahead, intraday and balancing markets would develop in each of the electricity systems in the Canary Islands. This is due to the challenges linked to the operation of the small and isolated electricity systems, the very low levels of competition in the generation segment, and the lack of connection to the mainland market described in section 2.

(92) Regarding energy storage in particular, the Commission acknowledges the importance of this technology for the integration of variable energy sources, such as renewables, especially in small and isolated systems like the Canary Islands. However, the Commission considers that market-based investments in those technologies should be promoted whenever possible. ([12]) For this reason, the Commission considers that a derogation from Article 54 of Directive (EU) 2019/944 pursuant to Article 66 of that Directive is justified only as regards hydropower pumped storage facilities.

(93) The derogation does not appear to have noticeable impact on electromobility.

5.4. **Duration of the derogation**

(94) Article 64 of Regulation (EU) 2019/943 and Article 66 of Directive (EU) 2019/944 expressly set out that the only instance where the Commission may provide for an unlimited derogation concerns outermost regions within the meaning of Article 349 TFEU which cannot be interconnected with the Union's energy market for evident physical reasons. This is easily understandable as those regions do not have any impact on the internal market for electricity.

(95) As mentioned in recital 42, the Canary Islands constitute one of the outermost regions recognised under Article 349 TFEU and they cannot be interconnected with the Union's energy market for evident physical reasons. Hence, the derogation should be granted for an unlimited duration,

HAS ADOPTED THIS DECISION:

Article 1

A derogation is granted to the Kingdom of Spain from the provisions of Article 3, first paragraph, points (a), (b), (e), (k), (o) and (p), Article 6, Articles 7(1) and 8(1) and (4), Articles 9, 10, 11, Articles 20(3) to (8), 21(7), 22(2) and (3) and 25(2) to (4) of Regulation (EU) 2019/943 and of Article 40(4) to (7) and from the provisions of, insofar pumped hydropower storage facilities are concerned, Article 54 of the Directive (EU) 2019/944 as regards the Canary Islands.

Article 2

The derogation granted under Article 1 shall apply for an unlimited duration.

Article 3

This Decision is addressed to the Kingdom of Spain.

Done at Brussels, 8 December 2023.

For the Commission
Kadri SIMSON
Member of the Commission

([12]) See recital 62 of Directive (EU) 2019/944.