

13 February 2013

Public consultation on generation adequacy, capacity mechanisms and the internal market in energy

KEY MESSAGES

- 1** European industry calls to prioritise a well-functioning internal energy market. Its completion is decisive to support Europe's competitiveness and ensure security of supply at European level.
- 2** If Member States implement capacity mechanisms, interests of all market participants have to be properly balanced. Investment challenges, cost-effectiveness and impacts on costs to final energy consumers need to be taken into consideration.
- 3** A coherent and coordinated approach at European level is required providing Member States the flexibility to implement capacity mechanisms which fit in best with existing market structures.

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A well-functioning fully integrated energy market is decisive to ensure Europe's competitiveness and security of supply and is a major issue for the effective integration of renewable energies. Although progress on the completion of the internal energy market has been made in the last years, obstacles still remain.

The further development of the internal energy market needs to be put into a wider context to ensure it truly helps to tackle EU's triple challenge of energy competitiveness, security of supply and climate objectives in the most cost-effective way. The considerations around the implementation of capacity mechanisms in different European Union Member States are important components of this wider debate and must be assessed from a European perspective.

If implementation of capacity mechanisms is considered by EU Member States and EEA countries, such mechanisms should provide long-term security of supply and a well functioning internal energy market. Capacity mechanisms could counteract both existing market failures introduced by regulatory interventions and significant long-term uncertainties on the future energy policy. Given their possible far-reaching impacts, their design requires a careful impact assessment, including of existing generation, grid and storage capacities, to avoid unintended consequences on distortion of trade, production and investment decisions for instance.

Investment for future electricity capacities

Investment decisions are based on their expected return on investment. This includes that investors closely monitor signals given by the market and his participants, in particular public authorities. In some European countries energy-only markets do not deliver these adequate long-term investment signals to provide the confidence needed, due for example to large scale introduction of subsidised renewable electricity production with low marginal costs or insufficient participation of demand in the market. Furthermore, conventional generation capacity and investments in new capacity are also subject to a number of significant obstacles, such as public subsidies schemes of certain power technologies, slow and cumbersome permitting procedures as well as unstable regulation in the fields of energy and the environment. In addition, investors closely monitor Europe struggling with the crisis and possible ways out.

Removing those obstacles and providing a stable and predictable regulatory framework could contribute to increasing investment in existing and new capacity. The implementation of market-based capacity mechanisms could solve problems with energy-only markets and could raise confidence of market operators and investors to invest in new and refurbish existing capacities. Hence, ensuring system generation adequacy, and stabilizing prices to address concerns also from customers and

regulators. Where mechanisms are required they should be complementary to energy-only markets until being fully implemented at European level and able to deliver investment signals on the long term.

What is more, the increasing share of renewable energy sources and its connection to the grid represents a major challenge in most European countries. Investment is not only required in capacity but also in modernizing and extending grid infrastructure. In this sense, smart grids should also be main contributors to flexibility, including features related to distributed generation and reliable integration of renewable energy sources. The increase of investment in interconnections can contribute to cope with volatility through expanded access to flexible power generation and flexible storage facilities.

Design of cost-effective and coordinated capacity mechanisms

Capacity mechanism measures taken by European countries must be non-discriminatory and must not place an unreasonable extra burden on energy consumers. In particular, capacity mechanisms must not damage the competitiveness of energy intensive industries by increasing the price of energy. It remains unclear, how energy markets will react to the implementation of capacity mechanisms. Especially with regard to the necessity of energy competitiveness of European industries, measures taken at European and national level should be cost effective and avoid market distortions.

If capacity mechanisms are going to be implemented within European countries, a coherent and coordinated approach at European level, based on a set of indicative criteria as proposed by the European Commission, is required to ensure security of supply purposes at European level and the compliance with energy, climate and competition policy. Criteria should address, in particular, impacts of capacity mechanisms on the market in a temporal dimension, to avoid lock-in effects, which in the long run would harm the completion of the internal energy market. It should also allow the demand/supply balance to be managed either by encouraging new generation capacity or by facilitating reduction in demand.

Whilst moving towards the completion of the single energy market, sufficient flexibility should be given to Member States to implement a capacity mechanism in the way best fitting to its own market structure.

Generation adequacy

Currently, the assessment of generation adequacy at European level is lacking attention to the flexibility of the system to cope with swings to feed in renewable energy generation. Yet, this flexibility of the electricity system is indeed crucial to the increasing penetration of renewable energy sources. Therefore, an integrated approach, including assessing the availability of flexible capacity, is required at EU and national level which indeed contributes to the security of supply in all Member States.

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