EOS/EMA/TP

MEMORANDUM
6.2.2013

FINLAND'S REPLY TO THE EUROPEAN COMMISSION CONSULTATION PAPER ON GENERATION ADEQUACY, CAPACITY MECHANISMS AND THE INTERNAL MARKET IN ELECTRICITY, 11/15/2012.

General comments

Finland welcomes Commission's efforts in speeding up the integration process of the internal energy markets. We are also delighted to see Commission taking up the important topic of capacity mechanisms as there is an apparent risk of deterioration of the energy-only target model of the electricity markets if uncoordinated national capacity remuneration schemes appear.

Capacity mechanisms should be used to address security of supply concerns, not to add flexible capacity to the markets. Emphasis should be placed on market based solutions taking into account resources available in neighbouring countries. The non-binding 10 years network development plan by ENTSO-E should be developed as a tool to address security of supply issues as well as non-binding recommendations to member states and market players.

It has to be noted that certain amount of reserves is needed for the normal operation and frequency control of the transmission system and for disturbance recovery. These resources are considered to be outside the scope of this consultation.

Consultation questions

1 Do you consider that the current market prices prevent investments in needed generation capacity?

In a sense yes as most of the investors are reluctant to make investments with the current market prices even though there is a lack of capacity in some areas. The market price is in many cases distorted by state interventions (price regulation, subsidized production etc.) giving wrong signals to the markets leading to this situation. It should also be noted that the risk level for the industry has risen because of these interventions and this might also raise the barrier to invest in new capacity.

2 Do you consider that support (e.g. direct financial support, priority dispatch or special network fees) for specific energy sources (renewables, coal, nuclear) undermines investments needed to ensure generation adequacy? If yes, how and to what extent?

Yes. Excessive support for specific energy sources will distort the price signals on energy only markets and thus undermine the role of the market price as the basis for new investments. The problem is emphasized as the share of supported energy sources increase in the system. Some support schemes are usually needed for new forms of technology to enter the market, but these schemes should be kept provisional.

3 Do you consider that work on the establishment of cross-border day ahead, intraday and balancing markets will contribute to ensuring security of supply? Within what timeframe do you see this happening?

Cross-border trade on all timeframes greatly improves the security of supply as can be seen in the Nordic power market.

4 What additional steps, if any, should be taken at European level to ensure that internal market rules fully contribute to ensuring generation adequacy and security of supply?

Cross-border transfer capacity is the key in making the system more flexible. This would help to see the security of supply issue on regional level rather than focusing on one country only. Cross-border exchange and resources in other countries should also be taken into account when assessing national capacity remuneration mechanisms. But at the end of the day it is each member state which has to decide the preferred target for adequacy.

5 What additional steps could Member States take to support the effectiveness of the internal market in delivering generation adequacy?

Promoting demand side response through e.g. smart metering and unregulated prices could help to shave off peak demand and thus promoting generation adequacy. In development of RES subsidy schemes market based solutions should be promoted. Also the processes to grant construction licenses have to be developed and speeded.

6 How should public authorities reflect the preferences of consumers in relation to security of supply? How can they reflect preferences for lower standards on the part of some consumers?

Security of supply is important for most of the consumers. Nevertheless, there is a growing number of customers willing to accept restrictions to their consuming patterns in exchange for compensation. This is one part of the flexible consumption. This would also help to guarantee security of supply.

7 Do you consider that there is a need for review of how generation adequacy assessments are carried out in the internal market? In particular, is there a need for more in depth generation adequacy reviews at:

In order to have a clear picture of generation adequacy at the EU and regional level, more coherent approach would be helpful. This would give a good comparison point for the national policy makers to assess their generation adequacy criteria.

The assessments should focus on regional level taking into account cross-border capacity.

8 Looking forward, is the generation adequacy outlook produced by ENTSO-E sufficiently detailed? In particular,

a. Is there a need for a regional or European assessment of the availability of flexible capacity?

Assessment of flexible capacity is not necessary. Transparency on how much balancing reserves have been contracted should be increased.

b. Are there other areas where this generation adequacy assessment should be made more detailed?

The rules and methodology of the assessment should be made more uniform.

9 Do you consider the Electricity Security of Supply Directive to be adequate? If it should be revised, on which points?

The directive should be reviewed in order to take into account the rapid increase of problems caused by intermittent RES-based energy.

10 Would you support the introduction of mandatory risk assessments or generation adequacy plans at national and regional level similar to those required under the Gas Security of Supply Regulation?

There is no need for such mandatory assessment as the non-binding 10 years network development plan by ENTSO-E covers this topic sufficiently.

11 Should generation adequacy standards be harmonised across the EU? What should be that standard or how could it be developed taking into account potentially diverging preference regarding security of supply?

There is no need to harmonise the standards as national needs vary. A non-binding recommendation could be useful tool for the policy makers to review their evaluation methods.

12 Do you consider that capacity mechanisms should be introduced only if and when steps to improve market functioning are clearly insufficient?

Yes. The main emphasis should be given to remove obstacles from the functioning of the energy-only market. Capacity mechanisms should be considered only if other steps prove to be insufficient.

13 Under what circumstances would you consider market functioning to be insufficient:

a. to ensure that new flexible resources are delivered?

Flexible resources should be introduced through market-based pricing (eg. intra-day and balancing markets). Incentivized production capacity decreases the profitability of existing peak capacity and can deteriorate the market.

b. to ensure sufficient capacity is available to meet demand on the system at times of highest system stress?

In well-functioning energy-only markets supply-demand balance can always be found. Price caps, regulated prices, prioritised production, and other regulatory measures may distort the outcome of the markets. If the markets can be considered to function well and still the generation adequacy is endangered capacity remuneration mechanisms could be considered.

14 In relation to strategic reserves:

a. Do you consider that the introduction of a strategic reserve can support the transition from a fossil fuel based electricity system or during a nuclear phase out?

Strategic reserves with a clear phasing out criteria are a good tool during transitional periods. It is important that these reserves are kept outside the market and they are used only after all other commercial resources have been used.

Finland has used strategic reserves since 2008 to address peak load capacity deficit. The latest act on the peak load capacity which secures the balance between electricity production and consumption (117/2011) entered into force on 1 March 2011. The capacity is procured through auctioning procedure and the level of contracted capacity is assessed at least every four years by the Energy Market Authority. The contracted capacity is reserved entirely to the reserve purposes and is kept outside the markets. Contracted capacity for the period of 2011-2013 is 600 MW in three power plants. For the next period also consumption can attend to the reserve capacity auction.

b. What risks, if any, to effective competition and the functioning of the internal market do you consider being associated with the introduction of strategic reserves?

The most obvious risk with the strategic reserves is if they are taken into use before all commercially available capacity has been utilized and thus introducing a price ceiling for the markets. Also if the reserves are too big, there is a risk that this capacity is taken from the markets.

In Finland only generation capacity which has been under the threat of closure has been contracted to the reserves.

15 In relation to capacity markets and/or payments:

a. Which models of capacity market and /or payments do you consider to be most and least distortionary and most compatible with the effective competition and the functioning of the internal market, and why?

In principle, all capacity mechanisms will cause distortions to the markets. Most distortionary would be fixed payments for only selected generation forms. This can easily lead to over investments and on the other hand premature closure of other generation capacity. It can also prevent or diminish market based demand response.

To keep the distortions at minimum key principles and criteria of the capacity mechanisms should be harmonized at EU level and they should be regional in character. The capacity mechanisms should let the markets (day-ahead, intra-day, balancing) clear without setting any price caps. The mechanisms should also be of temporary nature with defined time period and phase out criteria.

b. Which models of capacity market and /or payments do you consider to be most compatible with ensuring flexibility in a low carbon electricity system?

Capacity mechanisms should not be used to add flexible capacity as the markets should be able to find encourage such investments.

c. Are there any models of capacity mechanism the introduction of which would be irreversible, or reversible only with great difficulty?

All capacity mechanisms cause distortions and add uncertainty to the markets. Strategic reserves should be preferred as they do not interfere with the markets in normal situations.

16 Which models of capacity mechanisms do you consider to have the least impact on costs for final consumers?

Least cost solution would be market-based system with non-discriminatory participation and regional character.

17 To what extent do you consider capacity mechanisms could build on balancing market regimes to encourage flexibility in all its forms?

Balancing markets' price should give indication whether new flexible capacity is needed. Balancing market integration should therefore be developed to add flexible capacity at the least cost. Using capacity mechanisms to add flexible capacity should not be introduced.

18 Should the Commission set out to provide the blueprint for an EU-wide capacity mechanism?

The Commission should not set up EU-wide capacity mechanisms, but it should provide clear compatibility and assessment criteria for the use of these mechanisms.

19 Do you consider that the European Commission should develop detailed criteria to assess the compatibility of capacity mechanisms with the internal energy market?

It is essential to develop common criteria for the assessment. The initial criteria set presented in the questionnaire is a good starting point for further discussions.

20 Do you consider the detailed criteria set out above (p. 12 - 14) to be appropriate?

a. Should any criteria be added to this list?

For the criteria 1, subcriteria a, a new point should be added to address the integration of European markets (day-ahead, intraday and balancing).

For criteria 1, new subcriteria should be added which would address establishment of functioning intraday market.

References to energy efficiency should be removed as this cannot be considered as capacity capable of bidding in the markets.

b. Which, if any, criteria should be given most weight?

Criteria 5 concerning cross-border trade can be considered most important as badly designed national capacity mechanism can induce security of supply concerns in the neighbouring countries as well.

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