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Reply to the European Commission's consultation on generation adequacy, capacity mechanisms and the internal market in electricity

Introductory remarks

BEE welcomes the European Commission's consultation on generation adequacy, capacity mechanisms and the internal market in electricity. It provides us with the opportunity to express our views on the topic. BEE shares the concerns expressed by the European Commission in regard to the necessity and introduction of capacity mechanisms. We believe that there is no urgency for such mechanisms and that their establishment would only lead to jeopardizing the EU's decarbonization objectives, the lock-in of inflexible conventional energy sources to the detriment of renewable energy, the interference with cross-border trade and competition and finally higher energy costs for all consumers of the EU Member States.

Consultation questions

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

A prerequisite for investment decisions are clear signals of a functional market. The actual state and the "missing money" problem are rooted in the fact that market prices do not speak the truth. In view of non-internalization of externalities, conventional energy sources such as coal and nuclear have never been viable economic options. Historic development is based on subsidies for these technologies and has led to a generation overcapacity, which affects current prices. To date, new capacities are being built and are expected to come into operation in the near future, leading to a further increase in capacity.

Furthermore, the imminent collapse – in view of the non-action of both the European Parliament and the Member States – of the instrument designed to reflect the real costs of conventional power generation, the EU-ETS, will further negatively affect market prices.

Above all, the "missing money" problem has to be considered from a European perspective: Member States have either not transposed or not fully implemented the provisions of the market liberalization packages. National markets are therefore still highly concentrated – with incumbents dictating, not yet unbundled and not open to competition. This situation, together with the still existing subsidies for conventional power plants and a carbon price of 2.81 Euro/ton CO_2 (a record low), hinder the existence of a "truthful" market which could set the right price signals.

Likewise, the price formation on the market is obstructed by hidden subsidies for nuclear power plants. For these, private coverage against potential damage is much too low and should be revised, as was suggested by the European Commissioner for Energy in the wake of the nuclear stress tests. If an adequate insurance premium would be introduced, the price for nuclear energy would soar and truly reflect the risks and costs associated with this technology.

(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?

Support for renewable energy – financial support, as well as priority grid access and dispatch – is in place in order to provide financial certainty and stimulate the investments a flawed market cannot provide for and only until the market will be functional. The need for renewable energy support is a consequence of historic development of generation capacity. It has proven its effectiveness in helping lower the costs for new power generation technologies and deploying them on a large scale. In view of a system based solely on renewables, a stimulus for investment has to be secured in the future, while the integration in the current market should not be attempted.

On the other hand, historic subsidies for conventional power generation have led to an overcapacity and continue existing, despite the fact that the technologies have long reached maturity and most power plants have been long paid-off. Support given to inflexible power plant fleets, incompatible with a full renewable generation, should be considered a market distortion and addressed accordingly.

(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?

No opinion.

(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?

The most important market-based instrument at European level, the EU-ETS, has not proven effective in internalizing the carbon costs. The all-time low reached by the certificates at the beginning of 2013 is a clear signal that action is long due and that the efforts to put this instrument back on track have to be stepped up – first by agreeing on the proposed “back-loading” and second by means of structural medium-term changes.

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

- To speed up grid reinforcement and extension
- To improve demand-side management
- To boost the development of cross-border interconnectors
- To increase the flexibility of renewable energy generation (bioenergy)
- To improve the framework for CHP and biomethane
- To introduce a CO_2 tax for the areas excluded from the EU-ETS

(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?

No opinion.

(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:

a. National level
b. Regional Level
c. European Level

No opinion.

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

No opinion.

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

No opinion.

(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?

No opinion.

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

No opinion.

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

Capacity mechanisms are not a panacea for dysfunctional markets. Before calling for the introduction of capacity mechanisms, the national markets have to be opened to competition and made transparent, the power of the incumbents reduced, the subsidies for the conventional power plants removed and the carbon costs internalized. Furthermore, many Member States currently experience overcapacities. The introduction of capacity mechanisms should therefore follow a thorough assessment of the existing generation capacity and be put in place only if clear evidence of the need for such an

instrument has been provided.

More generally, the question should be what other options lead to a more flexible generation, capable of putting the intermittent renewables at the center of the market. A number of flexibility options are available in the short term – such as demand-side management, reinforcement of the grid, development of cross-border interconnections – and in the medium term, such as energy storage for when renewables will have reached a certain share of the total generation capacity. Capacity mechanisms involve significant regulatory risks and might take a long time before they operate effectively. Moreover, the approach taken to ensure flexibility should not lead to carbon lock-in or to unintended adverse consequences for renewable investment and therefore lead to the EU not meeting its 2020 decarbonization goals.

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

a. to ensure that new flexible resources are delivered?
b. to ensure sufficient capacity is available to meet demand on the system at times of highest system stress?

See (12).

(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?
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?

A strategic reserve is the simplest and most in line with the market solution. Nonetheless, its introduction should be considered in relation to the national market in question, seeing that a "one-size-fits-all" approach would be inefficient and costly. In Germany, a strategic reserve could include very flexible and efficient power plants, both old and new, with the new power plants operating mostly on biogas and biomethane. As for the costs, they would be recovered through grid charges – as is already the case with the cold reserve. Such a solution would be complemented by additional flexibility measures, among which demand-side management and storage, and would not lead to a continuation of the status quo, where most power plants are inefficient and polluting.

It is nevertheless important to keep in mind that the strategic reserve cannot and will not replace a functional market. Without fully internalizing the external costs, fair competition among energy sources is not possible. The EU-ETS has to reflect the true carbon costs of power generation, but the current all-time low of 2.81 Euro/ton CO_2 is very far from the 80 Euro/ton CO_2[1] that would be required for internalizing them. We believe the focus has to lie on the structural revision of this instrument and on providing the right stable framework for the development of flexibility and of renewable energy sources more than on a framework for capacity mechanisms.

(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

[1] According to BMU, Erneuerbare Energien in Zahlen. Nationale und internationale Entwicklung, July 2012

functioning of the internal market, and why?

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

See (12).

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

See (12).

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

See (12).

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

See (12).

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

See (12).

(20) Do you consider the detailed criteria set out above to be appropriate?

a. Should any criteria be added to this list?
b. Which, if any, criteria should be given most weight?

See (12).