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Agder Energi – Response to the European Commission Consultation Paper on generation adequacy, capacity mechanisms and the internal market in electricity

Agder Energi welcomes the opportunity to comment on the Consultation Paper on generation adequacy, capacity mechanisms and the internal market in electricity.

Norway has around 28,000 MW hydropower and 50 % of Europe's reservoir capacity. There is also considerable potential for increasing power installations. Thus, Norway can make a substantial contribution to Europe's need for balancing power based on our flexible hydro power which has extraordinary large storage capacity and short response time.

Agder Energi is Norway's fourth-largest energy supplier measured by hydroelectric power generation with a mean annual production of 7.7 TWh. Installations, encompassing both river flows and storage capacity, exceed 1,700 MW of generation. Agder Energi's production facilities are situated in the very south of Norway, close to the European Continent and the UK.

General Comments

Agder Energi supports the development towards a functioning physically and financially integrated and harmonized European internal energy market. Agder Energi is of the opinion that the best way to meet the challenges of generation adequacy is to allow energy-only markets to function properly. Instead of introducing new regulations and subsidies one should rather develop the existing energy only markets. Hence, Agder Energi does not support the establishment of national capacity markets in Europe. However, if capacity markets nevertheless will be established, these markets should be open for demand responses and cross-border competition from production. Capacity markets should only be used as an option of last resort after exploiting all possibilities within the energy-only markets, and they should be constructed in a way that minimize market distortion.

Agder Energi will point to the ENTSO-E report "Scenario Outlook and Adequacy Forecast 2012 – 2030" (even though we are aware that the report has met some criticism) which indicates that there is no need for capacity markets by stating that:

"The report also notes that the generation adequacy is expected to be maintained during the whole forecasted period in each scenario and in each reference point,

even after the expected shut down of German (but also Swiss and Belgian) nuclear power plants after the Fukushima disaster.”

Replies to the questions in the consultation:

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

Currently there are distortions to the price formation in the energy only market such as price caps, priority access of certain technologies, subsidies on RES etc, which reduce electricity price peaks but increase the cost on the net, cost to consumers and the cost of balancing. Especially flexible power plants benefit from short-lived price peaks. Therefore investment becomes risky as there is no profit from the price peaks.

(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, any support scheme distorts price formation in an energy only market and thus to some extent reduces the incentives for efficient investments ensuring generation adequacy.

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?

Yes, Agder Energi think that market integration by establishing cross-border day ahead, intraday and balancing markets will contribute to ensuring security of supply, as resources from the whole area can be automatically used to cover a deficit in one of the areas.

Regarding the timeframe, Agder Energi is of the opinion that there already exists cross-border markets which can be utilized better to ensuring security of supply from today on. Further cross-border integration by building more interconnectors and strenghtening of national grids and regional market coupling projects will enhance the possibility of cross-border trade to ensuring security of supply even more.

(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?

Agder Energi is of the opinion that energy-only markets will ensure generation adequacy and security of supply.

The only additional step that should be taken at European level is to secure that the EU Emissions Trading Scheme (EU ETS) really becomes the key policy driver for carbon reduction in the market. Hence, Agder Energi suggest that other mechanisms and subsidies distorting prices should be removed so that all generation resources and demand response resources compete on equal terms, be dispatched based on the market prices. Furthermore, Agder Energi thinks that all producers, especially producers of intermittent energy, are made responsible for their imbalances and exposed for the balancing costs.

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

Agder Energi suggests that Member States (and Norway) should work for the full implementation of the 3rd energy package in their respective countries. The 3rd package incorporates important measures such as the removal of regulated prices and price caps. Other important topics are infrastructure development, market coupling, regional cooperation and roll out of smart meters which would enable wider demand response.

Agder Energi is of the opinion that existing capacity remuneration mechanisms should be phased out through more reliance on cross-border trade and on market-based demand response, as capacity mechanisms can distort markets and endanger generation adequacy for neighbouring Member States.

(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?

By developing market mechanisms for demand response and exposing producers and consumers to equal price signals the preferences of consumers in relation to security of supply can be reflected.

(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:

Agder Energi support that generation adequacy assessments should take into account cross border connections and become more regional than national. Through the coupling of day-ahead, intraday and balancing markets this contribution is becoming more reliable and should be fully acknowledged in the national assessments. Further, the TSOs should look beyond national geographical borders and include interconnectors. If there is adequate capacity between adjacent price areas their generation capacity should be assessed together.

a. National level

Agder Energi thinks that there are no reasons to differ between national and regional levels as cross border capacity needs to be taken into account.

b. Regional Level

Agder Energi thinks that there are no reasons to differ between national and regional levels as cross border capacity needs to be taken into account.

c. European Level

Agder Energi thinks that there is a need for in depth generation adequacy reviews at regional levels defined by existing cross border capacity within the European internal energy market.

(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?

Yes, there is a need for regional assessments of the availability of flexible capacity within the European internal energy market. Such assessments should also take into account possible closures of thermal power stations due to lack of operating hours and profitability, and the increasing production from intermittent renewable energy sources such as wind and solar power.

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

No comment.

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

No comment.

(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 comment.

(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?

No comment.

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

Yes, to enhance electricity markets' ability to deliver generation adequacy, governments and regulators must first of all allow energy-only markets to function properly. Therefore, introducing capacity mechanisms should clearly be the last resort option after all necessary actions to improve market functioning have failed or proved to be insufficient to guarantee security of supply in the given member state. A detailed justification should be required from the member state planning to introduce a CRM, and this justification should be done prior to implementing any measures. The CRM should also have a sunset clause.

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

a. to ensure that new flexible resources are delivered?

Integrated European energy and balancing markets and a well-functioning ETS based on long-term goals to meet the low-carbon economy in 2050 should be able to deliver the necessary price signals for new flexible resources to be delivered if authorities do not intervene in the market and accept price signals such as price spikes and price volatility. There is not necessarily a need for addressing new flexible resources. There should be sufficient flexibility in the system if drawing on both the flexibility on the production and the demand side, and at the same time increase the scope of the markets by establishing interconnectors to facilitate more cross-border trade.

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

In competitive power markets the peak-load balance can always be reached through the matching of price dependent supply and demand bids. This assumes that current regulation that prevents price signals from functioning such as price caps is removed, that market integration in the day ahead, intraday and balancing timeframe progresses and that other red tape preventing investment in generation and grid capacity is removed.

(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?

No. The transition from a fossil fuel based electricity system to a renewable electricity system should be done based on a well functioning ETS. A nuclear phase out should also be met by other means and solutions than strategic reserves. However, a strategic reserve is not an appropriate tool to steer targeted new investments for a low carbon generation and 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?

Agder Energi believes that as long as the strategic reserve is procured in a market based manner by the TSO, controlled by the TSO and used only as a last resort in real time to help supply meet demand, the interference with competition and price signals on the wholesale markets can be minimized.

There is however, always a risk that strategic reserves might be used for political targets such as to keep wholesale prices low. That risk should be prevented through very clear regulation concerning the sizing and the use of these 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?

Agder Energi is of the opinion that the best way to meet the challenges of generation adequacy is to allow energy-only markets to function properly. Instead of introducing new regulations and subsidies one should rather develop the markets in terms of shorter time periods (30 or 15 minutes), market clearing closer to the operational hour and/or fixing price for 12 instead of 24 hours in each auction. Hence, Agder Energi does not support the establishment of national capacity markets in Europe. However, if capacity markets nevertheless will be established, these markets should be open for cross-border competition on supply of capacity and they should not be based on subsidies to secure supply of capacity.

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?

Flexibility should be ensured through equal market-based participation for both supply and demand in the day-ahead, intraday and balancing markets, as well as in balancing reserves, and not by capacity markets.

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

Strategic reserves are easier to build down, as ideally they come into the wholesale market only in extreme situations and don't reward all capacity at all times. However, the design of the strategic reserve is important as mentioned in the questions above. Generally it should be tried to use the reserve only in extreme situations where there is no real time cross between supply and demand, the reserve should be purchased efficiently and the reserve capacity should be set as low as possible.

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

Agder Energi is of the opinion that least impact would be caused by market-based systems with non-discriminatory participation and a regional dimension instead of national systems.

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

Capacity mechanisms as such should not be introduced for encouraging flexibility. The existing balancing markets, with the on-going European balancing market integration, should instead be used and developed so that adequate balancing reserves are contracted by the TSOs (taking also into account the increased need for balancing power due to the growth of intermittent energy sources such as wind and solar generation). Balancing energy markets should be based on marginal pricing which will encourage increased flexibility based on the market needs. In addition, all generators including RES should be balancing responsible parties to set the correct incentives to be in balance.

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

No. There is no need to establish a European-wide capacity mechanism. The Commission should rather focus on the network code on balancing markets which could probably address many of the relevant questions regarding generation adequacy.

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

As pointed out earlier, Agder Energi is of the opinion that the best way to meet the challenges of generation adequacy is to allow energy-only markets to function properly. Agder Energi does not support the establishment of national capacity markets in Europe. If capacity markets nevertheless will be established, these markets should be open for competition on supply of capacity and they should not be based on subsidies to secure supply of capacity.

Thus, if capacity mechanisms will be established, then Agder Energi is of the opinion that, yes, the European Commission should develop detailed criteria to assess the compatibility of capacity mechanisms with the internal energy market.

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

Yes. Agder Energi considers the detailed criteria set out in the consultation paper to be appropriate.

a. Should any criteria be added to this list?

No comment.

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

Agder Energi thinks the following criteria should be given most weight:

- 1) The necessity for a capacity mechanisms should be clearly established in the context of:
 - a. The potential of the identified needs being met in the normal operation of the internal energy market, in particular:
 - increased interconnection and in particular the completion of identified projects of Common interest.
- 4) Any capacity mechanism should be open to electricity undertakings operating in other Member States, to the extent they are able to make the electricity available in markets to which the capacity mechanism is established.

- 5) Any capacity mechanism should not act as a barrier to cross border trade or competition in the internal market by:
- a. artificially altering trade flows or the location of production, in particular by:
 - restricting the ability of electricity undertakings in the Member State to sell their electricity to customers elsewhere in the internal market, (i.e. capacity physically located in a Member State should not be reserved for that Member State).

Yours faithfully



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