

Future-Oriented Market Design

A BEE consultation response

October 2015



Introduction

The German Renewable Energy Federation (BEE) welcomes the Commission's communication launching the public consultation process on a new energy market design¹, notably its aim of setting the necessary framework conditions for a flexible and efficient market that can fully integrate increasing shares of renewables. A new market design that puts renewable energy at its core will guarantee security of supply, minimize costs and enable innovation and sustainability.

The European energy system is undergoing significant changes. A new market design presents an opportunity to set the foundations for a future-oriented system, one based on high shares of renewable energy and energy efficiency, as well as to incentivize much-needed investments in flexible capacity and interconnections and to spur innovation and competition between different flexibility options.

In its framework strategy for a resilient Energy Union with a forward-looking climate change policy², the Commission stressed the need to transform the existing centralized and conventionally-fuelled energy system into one "fit for renewables". It is therefore essential that the Commission maintain its strong position against the creation of national capacity markets and support the reduction of inflexible fossil-nuclear generation capacity, which distorts the market and hampers the integration of renewable energy and the development of flexibility. In our view, the new market design should serve as an opportunity for the Commission and member states to eliminate the barriers preventing implementation of the internal energy market and thus increase integration and regional cooperation.

BEE welcomes the strong emphasis put on the regional coordination of member states' policy making. Cooperations such as within the Pentilateral Forum or the consultation preceding the publication of the German Federal Ministry for Economic Affairs and Energy's White Paper³, in which foreign stakeholders were invited to participate, pave the way to cost-effective achievement of European and national climate and energy targets while strengthening security of energy supply. Furthermore, it is especially important to concentrate on both the short and long-term development of markets, a balance well struck by the Commission's communication.

This paper focuses on the German Renewable Federation's views on the design of the future energy market, following the questions included in the consultation document.

1. Would prices which reflect actual scarcity (in terms of time and location) be an important ingredient to the future market design? Would this also include the need for prices to reflect scarcity of available transmission capacity?

BEE strongly supports the Commission in its view that scarcity pricing is a vital component of a future market design. The price quoted on the power exchange is the point where supply and demand intersect and therefore should be the main impetus for investments, competition and innovation.

A market-driven investment environment is the best means to provide long-term price signals together with the necessary stability needed to trigger investment and lower the cost of capital, while meeting all system needs and increasing the share of renewable energy in the power mix. In this context, price peaks are crucial in signalling scarcity of adequate generation capacity and demand management, or of other sources of flexibility to potential investors and are therefore a desired market outcome under these circumstances to incentivise investments. Market prices should therefore be allowed to shape freely and, in particular, undistorted by regulatory or other types of caps. Investment decisions based on a certain expectation of price peaks will only be made if investors sufficiently trust decision-makers not to interfere with price formation on the market, e.g. by introducing price caps.

¹ COM(2015) 340 final.

² COM(2015)080 final.

³ Ein Strommarkt für die Energiewende. Ergebnispapier des Bundesministeriums für Wirtschaft und Energie (Weißbuch).

With high shares of renewable energy at its core, the future energy system will require a high degree of flexibility. Prices reflecting scarcity are a necessary precondition for the development and the competition of the technologies intended to provide this flexibility, such as demand response, storage or flexible generation. A large number of flexibility options are now already available and economically viable, or will become so through continuous technological development. Price signals on the power market stimulate the use of existent cost-efficient flexibility options in the short-run and stimulate investment and their innovation in the long run.

However, current overcapacity on the German and European power markets neither allows for refinancing investments, nor provides incentives for flexibility options. One of the main challenges is to reduce the fossil-nuclear overcapacity in order that power market prices can fulfil their role of balancing generation and consumption and thus guarantee security of supply. An optimised power market that allows undistorted price signals (including price peaks) to reach market participants will incentivize the necessary investments, drive development of flexibility options and strengthen supply security at the lowest cost for consumers.

As our energy system evolves towards high shares of renewable energy and the need for security of supply increases, a holistic approach of all sectors – power, heating and cooling, and transport – becomes paramount. As the power sector represents only a part of the energy system, system thinking and sectoral integration will have to play a key role. The technological options are available already today; it is just a question of the right legal and regulatory framework.

In addition to their role of balancing generation and consumption, price signals should also reflect the scarcity of available transmission generation. When considering a higher degree of market coupling and increased energy trading, the Commission and member states should strive for a stronger connection between transmission capacity and power trading. Unfortunately, existent information on allocation of transmission capacity is not transparent enough to enable an in-depth assessment of the situation.

2. Which challenges and opportunities could arise from prices which reflect actual scarcity? How can the challenges be addressed? Could these prices make capacity mechanisms redundant?

An optimized power market that allows scarcity pricing is sufficient for delivering security of supply, as peak prices incentivize investments in generation capacity and flexibility options. By introducing “Energiewendeprodukte” (e.g. cap products that trigger capacity trading), the energy market has already proven its capability for timely adaptation. This is an additional indication of capacity markets being redundant.

The new market design should allow the energy market to address existing challenges in a secure and cost-effective manner. It should not create artificial and over-regulated instruments, such as capacity markets, which would counteract desired developments by increasing overcapacity, hindering the development of innovative, future-oriented solutions, and preventing the full implementation of the internal energy market, especially by limiting the use of cost-effective cross-border balancing potential. A temporary instrument outside the energy market, such as the capacity reserve in Germany, can guarantee security of supply in the transitional phase, and can be gradually phased-out along with the further development of the energy market.

3. Progress in aligning the fragmented balancing markets remains slow; should the EU try to accelerate the process, if need be through legal measures?

Well-designed and transparent balancing markets are the key counterparts of a new power market based on high shares of renewable energy. They provide a cost-efficient means to integrate renewables into the market and incentivize capacity refinancing via scarcity pricing. Aligning and transforming the balancing markets is a complex process, as their redesign poses additional challenges when compared with intraday and day-ahead markets.

It is crucial that the transformation process focuses on setting up reliable and inclusive quality criteria that facilitate the integration of renewables, allowing sufficient time to develop them. As regards balancing markets, compromises for a quick transformation bear the risk of adversely impacting the required quality. In addition, the transformation process should go hand in hand with reduction of both fossil-nuclear overcapacity and minimum generation of conventional power plants.

The design of balancing markets needs to be tailored to enable competition between flexibility options and for renewables' and new flexibility technologies' (such as storage), participation in the market. Barriers to this, such as long tendering periods or minimum bid sizes, need to be reviewed and adapted to prevent discrimination amongst players.

While it is true that European balancing markets are currently very fragmented, focus should be placed on member states optimizing their markets to enable competition among flexibility options and the inclusion of renewables, with market coupling as a future step. We encourage member states to accelerate redesign of their balancing markets taking available interconnection capacity into account, as balancing over greater areas reduces costs and the need to introduce distortive national instruments such as capacity markets.

4. What can be done to provide for the smooth implementation of the agreed EU wide intraday platform?

The renewable energy industry welcomes the coupling of intraday markets. Electricity trading makes the electricity system more efficient and reduces the need for power generation capacities. Additionally, it requires security of supply to be considered within the European context, and not as a national issue. It is essential that the process continues and that required information such as forecasts and deviations is available in a timely manner, so that the market can react quickly.

As the Capacity Allocation Congestion Management Guideline (CACM) will enter into force, current voluntary best practice projects of the European power exchanges and various transmission system operators are likely to become the basis for the European Commission's implementation of the Intraday Target Model. It is therefore expected that these projects will have to be gradually extended to more parties in Europe.

5. Are long-term contracts between generators and consumers required to provide investment certainty for new generation capacity? What barriers, if any, prevent such long-term hedging products from emerging? Is there any role for the public sector in enabling markets for long-term contracts?

Due to the current fossil-nuclear overcapacity and the lack of price peaks, market players do not significantly seek long-term contracts. As the power market transforms and enables scarcity pricing, the electricity exchange will increasingly develop these products, particularly since they offer additional revenues to flexible consumers. Moreover, long-term products have the potential to act as complementary hedging tools against short-term market risks, thus mitigating volume risks.

BEE advocates against state intervention in the creation and development of long-term contracts, as this bears the risk of strengthening already existing oligopolies and distorting the market. Long-term contracts should be left open to the market. Their prices reflect the players' willingness to pay and their assessment of price peaks' frequency. The resulting prices are cost-efficient, and allow refinancing of generation capacity at the lowest possible price for consumers.

6. To what extent do you think that the divergence of taxes and charges levied on electricity in different Member States creates distortions in terms of directing investments efficiently or hamper the free flow of energy?

The wholesale price constitutes just one part of the electricity cost for end users, as these bear additional costs such as grid charges, value-added tax and electricity tax. These state-imposed price com-

ponents weaken or neutralize the effect of the wholesale price, leaving consumers disinterested in increasing their own flexibility and therefore, in turn, increasing overall system costs.

In a future-oriented energy system, one based on renewable energy, flexibility will be key to strengthening energy security. Tapping into the potential of various flexibility options requires a swift and thorough revision of state-imposed price components, so that the price signals of the energy market reach all players, thereby facilitating innovation and competition. As the energy systems of member states are different, and the existence of state-imposed price components are justified for varying reasons, we encourage addressing these obstacles at national level. An example of how this might be addressed is the German Federal Ministry for Economic Affairs and Energy's initiative to reassess the grid charges regime.

7. What needs to be done to allow investment in renewables to be increasingly driven by market signals?

BEE is in favour of a transformation towards an energy system featuring high shares of renewable energy and highly competitive flexibility options, and in order to do this one should employ as few additional instruments as possible. This can only be achieved by creating stable and reliable framework conditions that ensure integration of renewables. This includes reducing the minimum generation of inflexible conventional power plants, fully internalising the negative external costs of fossil-nuclear generation capacity, and removing the direct and indirect subsidies these technologies still receive.

The integration of renewable energy would be facilitated by the existence of a level playing field with conventional generation. Renewables are domestic energy sources and their use not only reduces dependence on fossil fuels, particularly from politically unstable regions, but also contributes to strengthening security of supply. Their deployment must be incentivized by specific measures targeted at their inclusion within balancing markets, strengthening the role of CHP or incentivizing self-consumption.

We would also like to point out that well-designed national support for renewables has no negative impact on energy markets. Aside from this, it derives its legitimacy from the Renewable Energy Directive with the binding European goal of reaching 20% renewable energy in gross final consumption by 2020 and the binding national goals that support it. Furthermore, it is anchored in the need to reach our long-term European climate objectives of 80-95% reduction of greenhouse gas emissions by 2050 compared to 1990 levels. Therefore, supporting renewables is not a question of selfish national policy, but national implementation of a European directive and of overall European objectives. In addition, it is motivated by the need to create a level playing field to balance the historic and current subsidies for existing fossil-nuclear overcapacity.

National support should continue to be part of the EU climate and renewable energy policy as we move towards 2030. Steady and continuous RE deployment requires stable and credible framework conditions that build on a robust governance mechanism.

However, many member states still lack crucial awareness: By subsidizing nuclear power, (for example the Hinkley Point C project), countries like Great Britain are continuing to bet on expensive and dangerous technologies, which despite having had decades to prove their competitiveness on the market have completely failed to do so. Renewables, on the other hand, are increasingly driven by market signals. The German market premium and dynamic degeneration are already now contributing to the market-based cost reduction of renewables and their market integration.

It is essential that the European Commission and EU member states continue to support this integration by revising and optimizing their energy market design and creating the necessary framework conditions to develop flexibility options. In this context, the Guidelines on State aid for environmental protection and energy 2014-2020 present a big hurdle. The introduction of mandatory auctions and the lack of remuneration for renewable energy in the case of negative prices represent a massive interference with the market and favours polluting technologies with higher marginal costs, which is both economically and ecologically imprudent.

BEE would like to point out that the combination of an intelligent flexible ceiling, a market premium allowing market signals to reach renewable energy producers, and also dynamic depression, is the way forward to financing and integrating renewables into the market, until they reach a level playing field with conventional power generation and the market has been fully optimized.

8. Which obstacles, if any, would you see to fully integrating renewable energy generators into the market, including into the balancing and intraday markets, as well as regarding dispatch based on the merit order?

Full integration of renewable energy within the market should be based on the existence of the aforementioned level playing field, where all stakeholders and technologies have equal opportunities. Unfortunately, and because of multiple distortions, this level playing field is not yet available. There would be no nuclear power plant running today, were it required to take out appropriate insurance policies, nor would there be any lignite-fired power plant running if greenhouse gas costs were fully internalized. Furthermore, new power plants compete with ones already paid-off, and technologies already far ahead on the learning curve challenge those that still have a long way to go before market readiness.

We strongly believe that the first step towards integrating renewables into the market is removing market distortions. Reforming the European emissions trading system to reflect the true costs of greenhouse gas emissions and reducing the fossil-nuclear overcapacity and the minimum generation of conventional power plants are prerequisites for renewables' integration and for the completion of a fully-functioning internal energy market. In addition, balancing markets should be reshaped to enable the participation of renewables and new flexibility technologies; obstacles, such as long tendering periods or minimum bid sizes, need to be reviewed as soon as possible and adapted so that they do not discriminate among players.

Priority dispatch also plays an important role in facilitating the integration of renewable energy into the power system. The lack of transparency in curtailment rules applying to generators makes priority dispatch a policy-driven solution, one that ensures that renewables' intrinsic characteristics are not a barrier to their deployment. Given that the current market was never designed with these features in mind, priority dispatch is an enabler to the power system to adapt to signals based on the availability of fluctuating sources. This in fact makes the "market fit for renewables" in systems that have not yet developed rules for operation for variable energy sources.

In some member states renewables are already now competing on the market. In Germany, the market premium encourages a market-based generation pattern, where market signals reach generators and determine their behaviour. This has, amongst other things, led to a significant decrease in the occurrence of negative prices and, if they did occur, these were down from those in previous years. As more flexibility options develop and become part of the market, this will continue to incentivize renewables' integration.

9. Should there be a more coordinated approach across Member States for renewables support schemes? What are the main barriers to regional support schemes and how could these barriers be removed (e.g. through legislation)?

A sustainable approach needs to include similar renewables' expansion targets at regional level and the adaptation of support schemes and investment conditions towards a more uniform framework. It is essential, however, that this adaptation be made subject to high quality standards, and not member states agreeing on the lowest common denominator. Regional cooperation could be very beneficial in identifying and removing administrative barriers (for example in France, where foreign investors are sometimes discriminated against) or preventing damaging stop-and-go policies and retroactive changes (as in Spain or various Eastern European countries) thus removing market distortions.

Increased coordination should not invariably result in the cross-border opening of national support schemes, especially if there is no physical import of electricity. Renewables are predominantly domestic energy sources and their use reduces dependence on fossil fuel imports, particularly from politically

unstable regions, and contributes to strengthening security of supply, thus having a real impact on the energy system and the Energiewende.

Whereas some member states have recognized the need to reduce the minimum generation of conventional power plants and fossil-nuclear overcapacity, others are continuing to subsidize this form of generation and introduce capacity mechanisms that will distort the market and lead to the lock-in of inflexible generation for decades to come. In this context, coordination should include working towards creating a level playing field for renewables and creating a stable and reliable framework, so that member states can reach their binding 2020 goals and advance towards their 2030 targets and beyond.

A well-designed and functioning market with high shares of renewable energy and abundant and competitive flexibility options can guarantee security of supply. For this, we need to reduce investment uncertainty stemming from the lack of binding national targets for 2030. A new Governance Framework is needed, which guarantees investor certainty by providing a clear and timely indication of Member States' contributions to meet the overall European goal and also ensures achievement of the renewable energy target of at least 27% by 2030.

10. Where do you see the main obstacles that should be tackled to kick-start demand response (e.g. insufficient flexible prices, (regulatory) barriers for aggregators / customers, lack of access to smart home technologies, no obligation to offer the possibility for end customers to participate in the balancing market through a demand response scheme, etc.)?

In the future energy market, the role of demand side management (DSM) as a flexibility option will increase. An optimized market design should incentivize industry, commerce and households to reduce their power demand in times of high residual load and shift their demand to times of low residual load if this allows them to increase their profitability (by, for example, storing heat or cold or adapting production processes). Large consumers already perform demand side management to different degrees. Nevertheless, the structure of grid charges does not make DSM attractive for some industrial businesses, and should be revised. Furthermore, the participation of aggregators (which pool flexible consumers) to the balancing markets should be simplified.

At the same time, obstacles such as the current fossil-nuclear overcapacity should be reduced to allow for peak prices that incentivize the development and competition of flexibility options. In addition, artificial price ceilings, as created by the lack of remuneration for renewables in the case of negative prices, should be removed.

11. While electricity markets are coupled within the EU and linked to its neighbours, system operation is still carried out by national Transmission System Operators (TSOs). Regional Security Coordination Initiatives ("RSCIs") such as CORESO or TSC have a purely advisory role today. Should the RSCIs be gradually strengthened also including decision-making responsibilities when necessary? Is the current national responsibility for system security an obstacle to cross-border cooperation? Would a regional responsibility for system security be better suited to the realities of the integrated market?

Security of supply should be considered in the European context, and not as a national issue. This means that Regional Coordination Initiatives can play an important role in strengthening its regional dimension through transnational contracts, which would in turn render the introduction of capacity markets obsolete. Current national responsibility for system security is not an obstacle, and institutions such as ACER and ENTSO-E are already contributing to increased cooperation. A reform of the role of RSCIs should take into account the need for a multinational supervisory authority as well as multi-stakeholder participation.

12. Fragmented national regulatory oversight seems to be inefficient for harmonised parts of the electricity system (e.g. market coupling). Would you see benefits in strengthening ACER's role?

BEE supports a strong ACER, as some standards require European harmonization. ACER's capacities should be strengthened so it can easily fulfil its current tasks. It is crucial, however, to consider the risks of making decisions without participation of multiple national stakeholders. We therefore advise considering the need for solid multinational supervision and transparent coordination, so as not to increase the bureaucratic burden and thus discriminate against SMEs in favour of large companies.

13. Would you see benefits in strengthening the role of the ENTSOs? How could this best be achieved? What regulatory oversight is needed?

BEE would like to emphasize that strengthening the ENTSOs should go hand in hand with increasing transparency and including multiple stakeholders in the decision-making processes, so as not to increase the bureaucratic burden and thus discriminate against SMEs in favour of large companies. As regards regulatory oversight, ACER is already playing an important role in this today. It is paramount that political decisions, such as setting the right framework for the development of flexibility options, allow for multi-stakeholder consultation processes and that they are not only made by technical bodies. This bears the risk of technical bodies delaying the market transformation process by, for example, tightening prequalification standards for balancing market participation in favour of incumbent market participants.

It is also essential that ENTSOs' governance arrangements be reviewed, as it is necessary to ensure that the EU-dimension of their responsibilities prevails over the specific interests of their individual members. As a technical body in charge of coordinating the companies responsible for power supply security, it needs to ensure that innovative solutions are discussed and agreed upon by its members, rather than putting forward approaches that represent the lowest common denominator for TSOs.

14. What should be the future role and governance rules for distribution system operators? How should access to metering data be adapted (data handling and ensuring data privacy etc.) in light of market and technological developments? Are additional provisions on management of and access by the relevant parties (end customers, distribution system operators, transmission system operators, suppliers, third party service providers and regulators) to the metering data required?

The renewable energy industry believes that the future role of distribution system operators (DSOs) is to enable the swift and competitive development of flexibility options. The "border" between market and grid is to be drawn according to the overall design of the system (e.g. regional flexibility markets and the intelligent regional link to the heating and cooling and the transport sector). Furthermore, we encourage strengthening competition, without sacrificing it to technological developments.

In a future energy system featuring high shares of distributed renewable energy, the role of DSOs will and has to change: Secure system operation will have to be supported by the distribution system, and important ancillary services, such as balancing, frequency response and reactive power, will have to be provided by their grids. This means a fundamental redefinition of the responsibilities and tasks of DSOs, as well as changes in coordination with the TSOs. To ensure a coordinated and secure system operation, a reassessment of the TSO-DSO interaction must be considered.

As regards metering data, we encourage keeping the data transfer down to the necessary minimum (e.g. collecting end consumer data on a quarterly or yearly basis), and aggregating the most important data as to prevent conclusions on individual consumer behaviour. Individual agreements between consumers and energy providers should continue to be made possible. Data relevant to the secure operation of the system should still be provided as often as is necessary, but aggregated at substation level so as to ensure protection of individual rights.

In our view, data sovereignty should be in the hands of the user: Consumers should decide whether and which data they make available.

15. Shall there be a European approach to distribution tariffs? If yes, what aspects should be covered; for example tariff structure and/or, tariff components (fixed, capacity vs. energy, timely or locational differentiation) and treatment of self-generation?

BEE welcomes the fundamental revision of the distribution grid charges regime with a view to incentivizing self-consumption, increasing system flexibility and removing adverse incentives for operation that does not serve the system.

We support a careful national tariff structure assessment that takes into account criteria such as relevant system operation and accurate power forecasting as a first step towards a more European approach. Regional cooperation should also play an important role, as member states can learn from each other about how to optimize the system for increased flexibility and better integration of renewable energy.

16. As power exchanges are an integral part of market coupling – should governance rules for power exchanges be considered?

Power exchanges should only be subject to governance rules that ensure the proper functioning of the market. An optimized power market allows for prices where supply and demand intersect or peak pricing, making power exchanges the main venue for investments, competition and innovation, as more and more transactions will be conducted here. Power exchanges are capable of self-regulation and in accordance with existing competition law, rules are in place that allow participants to make complaints.

We would also like to stress that power exchanges are not the only drivers of competition and innovation. In the future energy market, bilateral contracts agreed upon outside the market will continue to play an important role.

17. Is there a need for a harmonised methodology to assess power system adequacy?

BEE welcomes a harmonised methodology to assess regional power system adequacy as a tool to increase transparency. These assessments should though not serve as a pretext for introducing capacity markets, as harmonised criteria tend to pave the way for introduction. Assessments resulting in the identification of any new generation capacity lacking should rather take the long-term perspective of the transformation process into account, as lack of capacity can be a temporary issue. To this end, BEE agrees with the Commission that a more standardised EU-assessment would have to properly take into account the contribution of interconnections, generation across borders, variable renewables' production, and demand response and storage possibilities amongst other things. Dynamic consideration of the energy system requires increasing overall system efficiency and identifying and addressing the existing obstacles to development of flexibility options and their removal – not locking-in inflexible capacities via capacity markets. The latter would only distort the transformation process, as these would render market mechanisms null and void.

18. What would be the appropriate geographic scope of a harmonised adequacy methodology and assessment (e.g. EU-wide, regional or national as well as neighbouring countries)?

BEE supports the development of a harmonised methodology to assess regional power system adequacy, which includes all currently coupled markets. A next step could be the inclusion of future coupled markets, so as to be able to forecast and evaluate possible interactions.

19. Would an alignment of the currently different system adequacy standards across the EU be useful to build an efficient single market?

A well-designed and efficient single market is a cost-effective way to achieve European and national climate and energy targets, while also strengthening security of energy supply. As we are working towards market completion, the alignment of different system adequacy standards can play a signifi-

cant role. It is, however, essential that the development of common standards does not serve as a pretext to introduce capacity markets, leading to a lock-in of inflexible fossil-nuclear capacity and thus distorting the flexibilisation of markets and, therefore, of the single market as such. In addition, the focus should lie in removing barriers that block development of flexibility options, by implementing 'no regret measures': This might include reducing the minimum generation of conventional power plants, reassessing the grid charges regime or optimizing the balancing markets.

20. Would there be a benefit in a common European framework for cross-border participation in capacity mechanisms? If yes, what should be the elements of such a framework? Would there be benefit in providing reference models for capacity mechanisms? If so, what should they look like?

BEE strongly opposes the introduction of capacity markets and agrees with the Commission's assessment that they are costly, distort the market and lead to the lock-in of inflexible and polluting power generation. Furthermore, they interfere with the full implementation of the internal energy market and hinder the development of innovative solutions, such as flexibility options that facilitate the transformation of the energy system. In a well-designed and fully functioning energy market, capacity markets are redundant; high shares of renewable energy are at the heart of the system, and they are complemented by flexible generation and demand as well as balancing markets where RES and flexibility options compete on a level playing field.

It is possible that member states considering the introduction of capacity markets have not yet fully liberalised their markets or have not introduced policies that incentivize flexibility. In the past, member states have also not sufficiently assessed the distortive impact of their national capacity markets on neighbouring markets. We encourage these countries to increase cooperation with other member states and profit from the information available regarding transformation of their energy system. We welcome the Commission's focus on promoting flexibility and cooperation and believe it is the right approach to changing our inflexible, old-fashioned system and achieving our decarbonisation targets.

The renewable energy industry believes that a common European framework for cross-border participation should not serve as a pretext for introducing capacity markets, as reference models tend to pave the way for their introduction. Nonetheless, we acknowledge the need for a common set of indicators and criteria for stakeholders' cross-border participation in these markets, as this is *conditio sine qua non* for their existence. Their development should be carefully considered and open for discussion with all relevant stakeholders.

In our view, the necessary steps have already been outlined in the Commission's communication. Further development of balancing markets – revisiting the prequalification criteria, the long tendering periods or minimum bid sizes – is one of the first steps needing to be taken towards transforming our energy system and strengthening supply security. Furthermore, the introduction of a transitional instrument, such as the capacity reserve in Germany, can be taken into account as an additional tool that enables the development of flexibility options and does not distort the market.

21. Should the decision to introduce capacity mechanisms be based on a harmonised methodology to assess power system adequacy?

Capacity markets are distortive and hamper the cost-effective integration of renewable energy. They furthermore hinder development and competition between flexibility options. Capacity markets interfere with the full implementation of the internal energy market, not only at national level, but also at European level, especially by limiting the use of cost-effective balancing potential available as European markets continue to converge.

A harmonised methodology for assessing power system adequacy bears the risk of creating the problems it seeks to solve. Participants wanting capacity markets will strive for their introduction and might use the methodology as a means to enforce them. We therefore suggest assessing which obstacles to increasing flexibility still need to be addressed, rather than introducing harmonised criteria.

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