

Bailouts are not the key to energy security

A BEE consultation response
to the
European Commission's Interim Report
of the
Sector Inquiry on Capacity Mechanisms

July 2016



Assessment of the sector inquiry

Not long ago, in its communication on the new energy market design, the European Commission expressed its desire to make the markets fit for renewables, as well as its pertinent scepticism about capacity markets, as these are costly, distort the market and contradict the Euro-pean objective of phasing out environmentally harmful subsidies for conventional power plants. Unfortunately, in its recent inquiry on capacity mechanisms, the Commission is now close to backing capacity markets as being the way to trigger new investments, instead of tackling market design failures.

In the view of the German Renewable Energy Federation (BEE), the interim report of the Commission is based on weak arguments, and does not map a way forward to transforming our energy system. Capacity markets hinder the achievement of a functioning internal energy market and are by no means necessary to ensure security of supply. The interim assessment of the Commission is a rather backward-looking bailout for certain companies that have stranded assets – as the auctions for coal-fired plants in the UK duly prove; it will set us back from developing a renewable-energy-driven world; it will interfere with investor certainty and will limit the market options for new intelligent and flexible technologies.

The discussion on the need for capacity markets fails to touch upon key issues in the current debate, such as conventional power overcapacity in Europe or the transitional phase we are currently going through. In addition, the sector inquiry fails to look into details of the British capacity market, the design and implications of which should be taken into account when analysing the need for capacity mechanisms altogether. What is more, the British example seems to be taken as the ‘role model’ in the design of capacity mechanisms.

Moreover, the entire assessment reads as a dismissal of the need for well-functioning markets and thus in opposition to the ongoing legislative process on a new energy market design: “The ability of the ‘energy-only’ market model to do so in practice [provide the price signals necessary to trigger the necessary investments] is currently debated [...]”, “In addition, liquid and competitive short term markets that can better contribute to security of supply cannot be developed across Europe overnight.”¹ It is also worthy to note that the paper casts doubt on the possibilities for further development of the ‘energy-only market’, while concealing the fact that capacity markets can also be poorly designed. It is regulatory instruments, however, that risk being inefficient, as these can be distorted by political decisions.

There is no mention of the distorting effect of capacity markets, of their negative impact upon competition, upon developing innovative solutions such as storage and demand side management, or upon increasing interconnection between countries. Capacity markets are not a panacea, and are more a safety net for the incumbent conventional industry rather than an instrument that will ensure security of supply in the long run.

According to EWEA, Europe currently has an overcapacity of around 100 GW over peak load², which is putting pressure on power prices. If capacity markets were to be introduced, it could lead to an increase in overcapacity, rather than a reduction. We believe that a well-designed ‘energy-only market’ is sufficient to guarantee security of supply via peak prices, consequently acting as trigger for

¹ European Commission, “Interim Report of the Sector Inquiry on Capacity Mechanisms”, Brussels 2016.

² EWEA, “Market Design. A position paper from the European Wind Energy Industry”, June 2015

investments in generation capacity, demand side management solutions and storage. Key conditions for the functioning of the market are – aside from avoidance of politically-motivated public intervention – an elastic demand and the existence of price peaks. Price peaks only minimally affect final consumers, while providing an important trigger for all generators and consumers to adapt their decisions to best fit a market featuring high shares of renewables. Moreover, the ‘energy-only market’ should not be viewed only through the prism of prices: assuming balancing responsibility means that balancing group managers are using long-term contracts to ensure themselves against price hikes in case scarcities were to arise, in turn signalling the need for generation capacities or other balancing options.

Strategic reserve – is it an option?

Instead of addressing the issue of continuous subsidies for the conventional power plants, which amount to around \$490 billion per year only for fossil fuels³ – four times more than is received by the renewable energy sector – the European Commission is creating a ‘vehicle’ for regulatory bailout, without calling for Member States to provide evidence that their markets work well or require improvement. We encourage the Commission to include this issue as an additional condition in its forthcoming market design initiative, along with the alignment of the methods used to define generation adequacy and reliability standards.

In terms of ensuring security of supply during this transitional period, Germany has opted for a strategic reserve. The concept behind the strategic reserve involves centrally auctioning a predetermined generation capacity, which is disqualified from participating within the ‘energy-only market’. This capacity is available in addition to current market capacities and thus increases supply security. The capacity is used only when the market does not clear and has no impact on the ‘energy-only market’. It is important to note that the introduction of a strategic reserve is not a relevant change, but a useful supplement to the existing market. The price finding mechanisms and the efficient signals of the ‘energy-only market’ remain untouched, with the market thus retaining its signal function for investments in both generation and demand. The strategic reserve only functions as an additional safety net ensuring security of supply.

Moreover, the assessment criticizes poorly designed strategic reserves, while only citing the best-designed capacity markets. This view does not provide a balanced representation of the policy instrument landscape and should be revised.

Key points on moving forward

In the quest for almost full decarbonisation of our energy system by 2050, with the pledge made to the entire world in Paris, as well as the need for sustainable and secure energy systems based on renewables and efficiency, we now need to devise and implement clear exit strategies for coal, gas and nuclear power for both the EU as a whole and for Member States’ energy policies. As we move towards an energy system that features high shares of renewable energy, the assessment of generation adequacy should take a number of factors into account, instead of focusing on inflexible conventional generation capacity. Member States should, with encouragement from the European Commission, be given the right to preserve and further develop their energy market. Last but not least, the introduction of capacity markets must be avoided due to their negative impact on other European objectives, such as the binding climate change goals for 2030 and beyond.

³ International Energy Agency, „World Energy Outlook 2015“, 2015

**German Renewable Energy Federation
Bundesverband Erneuerbare Energie e.V. (BEE)**

Invalidenstraße 91
10115 Berlin
Germany

Tel: +49 30 275 81 70 0
Fax: +49 30 275 81 70 20

www.bee-ev.de