

Enel-Endesa response to the Call for Evidence by CEER on **Generation Adequacy Treatment in Electricity**

(C09-ESS-05-03)

Introduction

Enel and Endesa substantially agree with the contents of the document.

We believe that generation adequacy should be primarily sought through an increased market efficiency. In this context, and as the CEER document also recognises, it is “urgent to implement all the necessary regulatory measures to facilitate the creation of efficient liquid markets”. In order to achieve this goal, some crucial prerequisite must be satisfied:

- creating a stable and sufficiently harmonised legislative and regulatory framework aimed at reducing regulatory uncertainties and promoting a friendly environment for investments;
- removing regulated energy prices and other national protectionist behaviours which discourage potential investors to invest in new generation capacity;
- ensuring the existence of correct price signals also to encourage customers to adjust their consumption according to prices, therefore smoothing demand peaks
- implementing efficient and harmonised congestion management methods;
- facilitating and speeding up authorisation procedures for new power plants and interconnections

Specific comments to the Call for Evidence

Pg 10, first bullet Market monitoring should be aimed at avoiding anti-competitive behaviours and check market efficiency. It should not be intended as an instrument to fix a kind of “reference” prices, which sound very similar to “regulated” prices.

Pg 14, first § The occurrence of prices spikes not necessarily implies lack of capacity in the system, but it is a physiological characteristic even of an efficient and balanced market. Price spikes allow the system to recover all the costs, which, on the contrary, cannot be covered (“missing money”) in case price spikes are hampered (e.g. setting a price cap).

Pg 15, third § “Furthermore, any additional measures for generation adequacy shall be market oriented and non-discriminatory (Directive 89/2005/EC)”. Then instrument like VPP are contrary to the market and to the EU legislation spirit. These measures are, in principle, distortive of the market. In case they should exceptionally be taken, they would have to be based on market prices.

Answers to the questions of the Call for Evidence

1) What are the key elements for ensuring generation adequacy in the competitive electricity market in EU MS and the EU as a whole?

- We believe that an efficient market, without any regulatory distortion (e.g. distortions deriving from certain measures taken by regulators/governments oriented to achieve certain results/goals in the electricity market), would always deliver an appropriate level of generation adequacy.
 - A well designed and efficient competitive market will provide the most efficient price to the customer considering the available capacity, the fuel costs, the level of competitiveness, etc. This price should indicate the scarcity of capacity and should send the adequate price signal to new investments.
 - When the aim of the Government or regulators differs from this, because of environmental goals or social or political reasons, we will face different market distortions which ultimately will lead to a change in the investments opportunities/decisions: there will be more investments in the supported technologies that will imply a change in the generation mix. Then regulatory intervention may be necessary to guarantee the security of supply.
- Other distortions, such as price caps/floors in wholesale markets, import bans, or VPPs, also alter the generation mix by artificially limiting price signals for investments. These distortions should be removed.
- Liberalization levels, market rules, TSOs operation criteria (e.g. balancing responsibility) and support schemes should be harmonised among the different Member States.
- An adequate level of interconnections is a main driver to get competitive electricity markets. Increased investments in interconnections are necessary to allow neighbouring countries benefiting from energy sources with lower marginal cost.
- Finally we would like to remark that in the case of renewables target, and in order to favour the development renewable energy sources, all support schemes have forced a rebalance of the generation mix, leading to higher penetration of RES. For this reason support levels for renewables must be carefully set to be consistent with the expected objectives and the progress of the MS in achieving those targets¹. Inefficiencies or miscalculations of certain regulatory schemes can lead to generation mix inadequate to preserve generation adequacy.

2) Do you observe any barriers for investing in new generation capacity? If yes, please list and explain them

- To invest in new generation, the regulatory framework should be clear, consistent and stable in time since a variable regulatory framework does not help to take consistent decisions.

¹ As an example, the Spanish photovoltaic capacity target for 2010 is 482 MW, which compared to the 3.200 MW of installed PV capacity in 2008 (as a consequence of a very generous Feed in Tariff), gives a magnitude of how the development of certain generation technologies can follow inconsistent trends if inefficient or miscalculated support schemes are in place.

- The increasing share of intermittent RES generation is progressively reducing the number of running hours for conventional plants (therefore, market equilibrium is altered), making investments in these technologies less attractive. Furthermore this situation will probably lead to more frequent price spikes. However, it is uncertain if these spikes will be sufficient in number and in magnitude to cover the fixed costs of the plants (in particular peak plants) needed for generation adequacy. If not, CCGT plants would not longer be built.
- Differences in environmental regulation requirements, as well as power plants and grid authorisation procedures, create distortions and barrier to investments. Grids and power plants authorisation procedures should be harmonised at European level.

3) In case of additional measures for ensuring generation adequacy, what would be the key issues to take into account?

- If sufficient revenues cannot be recovered in the energy market to achieve generation adequacy, a fall back solution such as capacity remuneration mechanisms may be required. These mechanisms allow (depending on its design) the energy market to operate undisturbed while recovering the ‘missing money’ needed to support investments through capacity remuneration schemes (these may assume the form of competitive capacity mechanisms or auctions).
- On the medium-term, for the EU, we think that capacity adequacy concerns will mainly regard lack of flexibility, rather than lack of capacity in quantitative terms.
- As a matter of facts, the achievement of the Climate Package targets will imply an increasing recourse to renewable sources on one side and to nuclear plants and other CO₂-free technologies (e.g. CCS) on the other. These technologies present characteristics that will make the generation system less flexible: both renewables, due to their unpredictability and intermittent nature, and large base-load power plants, due to their intrinsic difficulty to modulate their capacity, will reduce the overall flexibility of the system. At the same time, the expected entry into operation of these new plants will dramatically reduce the number of hours during which traditional mid-merit/modulation fossil fuel plants are running, making new investments in these latter less profitable and even prejudicing the operation of the existing ones. This effect could be extremely dangerous for the stability of the system, putting at risk, on the short term, the availability of thermal units as a back-up for renewables, and on the longer term the investments needed to guarantee a sufficient capacity adequacy level and a diversified generation portfolio. Therefore, we think it is necessary that additional capacity remuneration mechanisms are put in place first of all to ensure the maintaining into service of the existing “flexible” units and, secondarily, to create a friendly environment for new investments.
- Different capacity remuneration models might be considered. Careful analysis is required to assess in which cases, under which conditions and at what geographical scale it may be advisable to introduce such models
- Electricity prices should be fully passed-through to consumers and the remaining tariffs should be removed, especially those which are set below market price. Furthermore, support schemes increase electricity bill in a quantity that should be transparent and published for every Member State.