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E10-PC-48: Call for Evidence on Generation Adequacy Treatment in Electricity

We thank for the opportunity to respond to the Call for Evidence on Generation Adequacy Treatment in Electricity. The subject is of great importance. Please find below the answers to the questions and some other comments.

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

The first priority is that energy policy has a long-term perspective and that it aims to create a favourable operational environment for investments.

The licensing procedures must be rapid and functional. Unnecessary barriers for investments should not be formed. The legislation should give clear guidelines on which terms actors may invest in production capacity and let the investments take place.

A key-element is sufficient grid capacity with which local fluctuations in supply and demand even out over aggregated larger market and price areas. Transmission grid becomes even more important when considering investments in capacity based on renewable energy sources. The efficiency and profitability of these power plants is highly dependent on the location (wind speed, availability of biomass to give some examples).

There is a clear need to harmonize energy policy within Europe in order not to favour one region over another. Common policies also give more stability to the regulatory environment. This stability together with uniformity of regulation are among key-elements. Investments are made with a perspective of decades. It is important that energy policy has long-term goals and equally important is that the actors can trust these policy goals.

Last but not least we would like to highlight that the importance of different production technologies should be recognised. The policies should not channel investments in technologies that the market finds undesirable. If, for example, in the market there is a need for peak-capacity or flexible electricity generation, the subsidies or other elements should not guide to make other investments and thereby wreck the attractiveness of needed investments.

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

There are a number of national and European level barriers. Here we comment the most important barriers starting from some barriers noticed in Finland.

Different playing field with perimeter regions is an obstacle for investments. There are different investment environment and especially different environmental rules in some neighbouring regions than in EU. Therefore it is of great importance to have rules that enable investing in power production with European standards and in the same time enable fair competition with power producers in neighbouring regions. The lower standards must not lead to producing power on the other side of the border with worse environmental impact.

Legislation may create a barrier for investing in power generation. In Finland there is a need to build more flexible power generation capacity and investors are ready to invest in hydro power. However there are legislative barriers which hinder these investments.

Large penetration of politically driven RES, combined with mandatory priority of dispatch, alters the generation mix and the market equilibrium, making investment in power generation capacity generally riskier in Europe. National capacity or RES subsidies in one country create barrier for new investment in neighbouring country having no subsidies in place within the common market area.

In some parts of Europe there are price caps/floors in wholesale markets. Price is the key driver for investments and any caps/floors weaken the signal. The same applies to price spikes which signal what sort of capacity is needed and shouldn't therefore be artificially smoothed.

Differences in environmental regulation requirements, as well as power plants and grid authorisation procedures, create distortions and barriers to investments. Generally the licensing procedures take far too much time and the duration can also be unexpected.

There is uncertainty on how many emission allowances will be given to the market. The decision will affect the price of the allowances and any delay causes unnecessary uncertainty.

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

The issue of generation adequacy may be considered in different time-frames. For example in Finland in short-term there is a need for publicly funded solution such as reserve capacity systems, but on a longer term the issue should be handled by market-based investments.

When considering transient solutions such as reserve capacity system, it is of great importance that the effect of the system is minimal on the market, that is, the system affects as little as possible the attractiveness of market-based investments. Further it is important that the TSOs don't take part in the market as producers but let the actors to invest in reserve capacity.

It is important is that capacity will not be artificially thrown out of the market, by introducing ill-planned emission limits (based on IE-directive) to power plants. This is the case especially when considering power plants that typically are used only relatively short time in a year. Effective emission reduction would not occur but power balance could weaken significantly. The existing plants must be let to operate as long as they are profitable, subject to adequate regulation, of course.

National solutions lead to un-optimal solutions. EU should strive for common policies and competition between actors, not between member-states.

An important part of the generation adequacy is the elasticity of demand. This highlights also the importance of not to mess up with market prices. In addition to that prices give signals to invest in different types of production, they also give signals to lower electricity use during hours when power balance is strained. The market must be let to decide which is more efficient, to increase production or to lower consumption. It can be expected that new technology, especially smart-grids, will improve the demand response.

Equal balancing responsibility helps to ensure adequacy. System must not encourage to waste electricity which is the case currently with some renewable subsidy-schemes. Because of the subsidies some producers may find it profitable to push electricity into the market although prices would indicate not to do so. This inevitably leads to waste of electricity. Subsidy-schemes must be planned carefully. Balancing responsibility leads to improved power balance and encourages to find solutions how to develop for example means to move consumption to low-price hours or to store electricity.

Additional comments

The raised question of hedging needs is of lower importance than the stability of political environment. Investors are well capable to calculate whether investment is profitable in terms of consumption estimates and the price of emission rights. What is a lot harder to estimate are changes in legislation. To enable the investments, stability is needed, for example:

- emission allowances schemes must be clear as soon as possible
- no surprises are needed, eg. there must be no threats that the profitability of some technology will be on a later time-frame diminished

The need for more transparency seems from a Nordic perspective exaggerated. Market monitoring is a responsibility of authorities and they should have sufficient expertise to monitor market and estimate variable costs when necessary with the information they receive through different channels.

In the coming years technology will provide more possibilities. Legislation must not be developed to hamper development. For example ill-planned subsidies might lead to un-optimal technology-paths.

In academic discussion locational signals (nodal pricing) tends to get over-estimated. There are physical reasons having load center in different locations than production, and the soundest tool to work with this is sufficient transmission capacity. To aggravate it can't be desirable to build wind mills near load centers, if there is no wind. Locational pricing is also only a short-term solution, designed to optimize the use of existing transmission grid without giving notice to the functioning of market (the larger price area, the better) and to future development needs of transmission grid.

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Yours sincerely,

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The Finnish Energy Industries is power and district heating sectors' association for industrial policy and labour market policy.