



**Federal Ministry for Economic Affairs and Energy (BMWi)**

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Your reference  
Our reference           MPP-2015-00165  
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Date                      28 February 2015

Subject                    Response to the consultation on “An electricity market for  
Germany’s energy transition Green Book”

Dear Madam, Sir,

The Market Parties Platform (MPP) is a cooperation of the CWE+ energy associations in Austria, the Benelux, France, Germany and Switzerland. We represent the commercial value chain of the power industry in these countries and have been contributing to the integration of the CWE market for many years. The MPP therefore appreciates the opportunity to comment on the “An electricity market for Germany’s energy transition Green Book”. In this response we will make first some general comments, then short comments on every chapter and finally draw our conclusions.

**General comments**

The Green Book is a worthwhile attempt to assess the current and future situation in the power market. Last year, France Stratégie - a French governmental agency - has led a similar project. We would recommend both papers, as relevant discussion papers in the Pentalateral context. These two papers reflect the growing concern of European governments regarding the issue of security of supply. They are mentioning almost all relevant issues linked to the situation of power markets and they provide contrasted views on these topics.

The part II of the Green Book generally reflects our insights of our 2013 position paper “View on next steps in enhancing electricity market functioning in the CWE region” that has been submitted to the Pentalateral Energy Forum (PLEF). Indeed an integrated, stable and well-functioning energy market, where the price is freely established by the matching of demand and supply, is essential for achieving



a secure, sustainable and competitive energy system. However, currently we have more or less regulatory interventions in every PLEF electricity market, which distorts the functioning and the results of the market itself. We strongly recommend eliminating existing regulatory intervention that causes market distortions. Furthermore we have seen that the market integration process is still challenging and the difficult issues are still to be addressed (e.g. balancing, price zones and even intra-day trade). It is important that the market integration process is pushed forward avoiding delays and that a regional approach (including Switzerland) is pursued, when developing integrated market and when working to ensure system security. The Green Book touches upon these integration issues, but is not very specific on the end goal. All members would promote most of the no-regret measures related to market integration that are listed in the Green Book.

The crucial question is whether the sophisticated energy market will permit to all assets required for the required security of supply to recover their costs. As it was expressed in the previous MPP paper "Pricing the right product in a sustainable electricity market", a competitive electricity market framework "shall allow the recovery of all (but not more) costs of efficient and necessary capacity". Such a competitive electricity market framework must enable the financing of needed investments, without subsidies and without supporting any kind of technology. This market framework must seek for cost efficiency. To ensure that, in addition to the energy market, a capacity market may need to be part of this market framework.

#### Chapter 1: How the electricity market operates

This provides a good description of the functioning of the market. Nevertheless, we have some remarks:

- The Green Book seems to conclude that a sophisticated and well-functioning energy only market will be sufficient to provide security of supply. Important here is that rather speaking of an energy only market it would be better to talk about an energy market with freedom of contract. Even in today's energy market other contracts than only for energy exist and should be possible. The crucial question is whether a market with no interventions is able to deliver the required level of security of supply. Here we have different perceptions in our membership<sup>1</sup>. There are arguments against the ability of the market to deliver the required security of supply levels, but there are also arguments leading to another conclusion. This will be further discussed under Chapter 9.
- The forward market is a bit underestimated in this description. By physical volume, the amount of trading in the forward market is by far the largest. The importance of a deep and liquid forward market should be emphasized. This is related to the bidding zone issue. The bigger the bidding zone the deeper the market.

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<sup>1</sup> UFE, BDEW and FEBEG believe that, in the short or longer term, the introduction of a capacity obligation will be necessary to ensure security of supply.



## Chapter 2: Challenges

Most of the challenges listed in chapter 2 are relevant. For most countries, in the short term, energy is the only relevant scarce product in the market. Given the transition towards a sustainable energy system with another (cost) structure and intermittency security of supply may also become scarce. For this however it is needed that energy prices can move freely also to very high levels and the risk of curtailment in case of scarcity would be acceptable. In the past this has already led to political and social concerns leading to interventions. But even with the absence of price caps part of our members have doubts whether the required security of supply level can be met. According to the adequacy assessment, performed in 2014 at the PLEF level, security of supply in France and Belgium will be at risk during the 2015-2016 winter. Fact is that in these countries haven taken measures in addition to the energy only market.

Besides the enumerated challenges in chapter 2, we have some additional points:

- With renewable sources getting more dominant the cost structure in generation will change to a more fixed cost oriented structure.
- In a mostly renewable system the question becomes what will be the trigger for reinvestment/replacement of renewable sources. Here the change from a subsidy-oriented system to a market oriented system (ETS) is a big challenge.
- The complexity and manifold of the challenges for the future electricity market requests that fundamental actions, like the one approached currently in Germany, are very carefully assessed, given their impact on the whole European electricity market. In any case, those actions should aim at ensuring that all aspects/products in an energy market function well across borders.

## Chapter 3: Flexibility is an answer

Indeed flexibility is a key aspect that has to be further improved. It comes down to intensify the interaction between demand and supply as in any market and across borders. A well-designed regional balancing and intra-day market is essential for that. In that case the necessary means will be triggered when needed. This may not be in the short run, as there is ample flexibility at the moment.

## Chapter 4: Strengthening market price signals for producers and consumers

Here we generally agree with the proposed measures. Indeed the market coupling and the harmonization of the balancing markets should be further promoted on a PLEF++ level. The coupling of the markets contributes to increased liquidity and to minimize market abuse opportunities, by potential market power. However, care should be taken with some of the mentioned measures:

- Using grid tariffs to strengthen the incentives may have a counterproductive effect as it mixes regulated costs with market prices.
- State imposed components in tariffs are a distortion and should be avoided.
- Another important issue is transparency. System position and balancing energy pricing should be real time available and settlement should be done preferably the next day after the ex post trading period. This will reduce the threshold for many small players.



- Benchmarking and consequently coordination and harmonization of underlying policies and market rules is important in order to ensure a level playing between the market actors in the different countries.

#### Chapter 5: Expanding and optimising the power grids

A supranational coordination of the grid developments within PLEF++ region, especially on the high voltage grid, remains a key factor for a well functioning and integrated energy market and more efficient grid investment decisions. We are convinced that the international/regional cooperation in balancing markets would lead to a more efficient reserve procurement and balancing energy exchange, therefore this is a topic which should be strongly promoted by trying to see the regional benefit and by involving market parties. Moreover, we reiterate the need to enhance the intra-day market, which would lead to a decreasing need of balancing services.

The suggestions on grid expansion and operation are a good way forward. Our remarks are:

- Grid reserve and redispatch are related to grid adequacy. Measures and costs for that should not interfere with price formation on the market.
- This also is valid for other ancillary services than balancing reserves. Voltage control e.g. is a congestion issue and should be treated in the framework of redispatch.
- The concept of market-based redispatch should be further developed also on an international level. We see a lot of room for improvement in TSO cooperation. Still the lines between control areas are treated differently from lines inside a control area. This is inefficient.

#### Chapter 6: Maintaining a single price zone

The German/Austrian price zone is the deepest and most liquid market (although it can be improved) and is therefore very important for the stability of the market in surrounding countries that the review of bidding zone structure does not undermine the liquidity of this “reference” market. In our view the zones should be discussed, given its aim on providing better price signals and grid investments incentives, but this discussion should be based on a deep impact analysis which considers liquidity as a key factor on the market side and TSOs acting as one on the other. As mentioned earlier this will require real regional optimisation of redispatch by TSOs (as required by the new CACM guideline) as a starting point.

#### Chapter 7: Intensifying European co-operation

As mentioned before the German market is important for the surrounding countries. Also the surrounding countries provide benefits to the German Energiewende as they absorb volatility. We already made steps in cross border trading, but this process is far to slow. Day ahead coupling is only the beginning. The first CWE adequacy assessment has shown that looking at a regional perspective leads to better insights and better solutions. Important now is to make next steps. Our priority suggestions are:

- Implement an effective cross border intra day market. This is not only the implementation of the target model, but also the improvement and alignment of e.g. cross border gate closures with national gate closures.



- Harmonise and integrate the balancing market. The German, Dutch, Swiss, Austrian and Belgian TSOs already started this process.
- Define a common criterion for adequacy for the region. Given the uncertainties in the assumptions of the models used the difference between a LOLE of 3 or 4 hours is not that big. We suggest to select a LOLE of 3.
- Progress towards a regional approach to define adequacy assessment and security of supply.

#### Chapter 8: Delivering on climate protection goals

Perhaps this is the most challenging action point. Making the ETS work is essential to have a real foundation under a future energy market. It will take the political courage to lower the cap to a level an effective and stable price emerges.

#### Chapter 9: Fundamental policy decision: Electricity market 2.0 or capacity market

This is another key issue. Though it is not yet very clear what are the main features of an Electricity market 2.0, the MPP has always promoted the no-regret measures described here and we still do. It is essential, for the well functioning of the market, that scarcity prices can emerge and that there is a strong political will to not cap those prices. In order to allow an efficient price setting, allowing scarcity prices, and a non-discriminated use of flexibility within the EOM 2.0 it is necessary to have highly liquid interconnected markets so that market power abuses can be avoided. In an integrated market it is easier to provide flexibility across border and by that mean limit price peaks and increase security of supply. This will require a strong political will not to interfere in the market. However, the confidence that political intervention will be marginal is in fact low. So far the track record of governments have not been very good.

Customising balancing mechanisms and removing price caps may not be sufficient measure to ensure security of supply. As we stated in our previous position paper: To maintain the required level of security of supply the scarcity of capacity should be revealed in the market. Therefore capacity needs to be adequately rewarded as well. To ensure this a capacity market, preferably on a multilateral cross border basis, should be developed. This is urgent given a lead time of several years to develop and implement such an international market.”

Final German decision on this topic will not be known before May. In the meantime, France, Belgium and the UK have chosen to introduce such a mechanism. In years to come, we believe that convergence of national initiatives on security of supply will be a major issue. A first step towards this convergence will be to ensure efficient cross border participation.

Furthermore there is another issue worth mentioning. Security of supply may become a product in the market when customers would like to have a different service level from the system. Some large consumers with e.g. CHP already have these kinds of arrangements. Especially with local generation and smart metering this may become more common. The market should be ready to cope with these kinds of developments as well.



#### Chapter 10: Collaboration with neighbouring countries

MPP strongly supports the cooperation approach with neighbouring countries taken by Germany on the topic of security of supply and CRM, and encourages to proceed with that. The PLEF++ region provides a very well established basis for that. Many market players operate on an international level on the supply side, but also on the demand side. The ultimate goal would be to evolve to borderless market. As the power system is one machine cross border solution will always include inefficiencies. Some TSOs may be conservative which leads to double counting and different treatment of grid elements that are technically identical. We strongly recommend that the CWE countries investigate the further integration of system operation in order to get rid of these inefficiencies.

#### Chapter 11: Capacity reserve as safeguard

The need of a capacity reserve, which backups the EOM, is in our view not clear yet. Depending on design features the establishment of a capacity reserve might have impact on existing markets, and the effects on the balancing markets are not clear yet. Those elements should be assessed, when discussing on capacity reserves. Should the introduction of a capacity reserve be considered necessary, the reserve procurement should be based on transparent, non-discriminatory methods. In the long run a capacity reserve should be transferred in market-based mechanism.

#### Conclusion and recommendations

The Green Book is a worthwhile attempt to analyse the situation and the proposed no-regret improvements are certainly worth implementing. It would be a positive step forward in reforming the European electricity market. Nevertheless, it is highly probable that market adaptations will be needed in a RES dominated market. This includes the introduction of a market price for security of supply. It is not clear at what point such a market is needed. Therefore the work on the design should start now. Key factors for the design are the level of interventions that remain and the level of market integration that has been achieved. But even then there is some doubt whether the required level of security of supply can be achieved. If the conclusion is that this is the case a good way of revealing a market price for security of supply would be to enforce an obligation for capacity products. This obligation should be market-based, technology neutral and it shall not rely on public subsidies to trigger investments. Moreover, as it was stated in a previous Eurelectric paper on CRM (Eurelectric contribution to a reference model for European capacity Market), cross-border participation in capacity markets should be quickly established and should be viewed a stepping-stone towards regional capacity markets.”

We recommend the following:

- Implement the proposed changes to enhance the market on at least PLEF++ level to create a truly integrated market
- At the PLEF level, progress towards a deeper coordination of national policies on security of supply
- Integrate system operation on at least PLEF++ level
- Establish a clear path to phase out subsidies and emerging of an effective Carbon price



- Work with the market on the implementation future changes in the electricity market (security of supply as a product, reflection of the changed cost base of the market)

Obviously this subject needs further discussion in an international context and as MPP we would like to contribute to that process in a constructive way. To elaborate on our input we would like propose to organise a workshop with your ministry or the ministries of the Pentalateral Energy Forum.

Yours Sincerely,

A handwritten signature in blue ink, appearing to read 'R. Otter', is positioned below the text 'Yours Sincerely,'. The signature is fluid and cursive, with a long horizontal stroke at the end.

Ruud Otter

Chairman Market Parties Platform

A copy of this letter has been sent to:

- Pentalateral Energy Forum
- European Commission, DG Energy
- ACER
- ENTSO-E

Annexes

- MPP position paper "View on next steps in enhancing electricity market functioning in the CWE region"
- Eurelectric background paper: "Options for coordinating different capacity mechanisms"