



CHAIRE EUROPEAN
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Electricity market reform in the EU: ***Disruptive reforms or incremental transformation***

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CRISIS: THE WAYS FORWARD “

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1. The EU ecosystem

- No hierarchisation of the EU objectives
 - Competition for market integration and for competitiveness
 - Decarbonation (RES-E, low carbon technologies) : overlapping of ETS, RES , energy efficiency
 - Security of supply (while RES-E are creating a new
 - Strong beliefs in the virtue of markets to harmonise these objectives

***Hypothesis* : We can change European energy policy priorities:
decarbonization and security of supply first
before market competition (for integration & competitiveness)**

Institutional « footprint »

- **UE : double niveau de prescription et de création de règles juridiques**
 - Prééminence de la législation européenne en matière de concurrence (contrainte forte pour sortir des solutions market-based)
 - Mais subsidiarité
- **Les règles européennes de décision ne sont pas propices à des décisions tranchées:**
 - Besoin de consensus en cas de réformes radicales (conflit d'intérêts et de valeurs, différences de croyances):jeu à 27 sans solution
 - L'Europe n'avance qu'à petits pas après crise
 - (exemple crise financière et concession tardive de l'Allemagne sur refinancement des banques)
- **Importance des contextes institutionnels de chaque pays au moment du choc réglementaire :**
 - compromis sectoriel propre et Path dependency : culture politique ne change pas ainsi
 - Etat garant de la « sécurité de fourniture »
 - Difficulté de délégation de sa souveraineté?

Subsidiarity, a fact which cannot be dissolved so easily

- EU = set of delegations of sovereignty
- Lisbon agreement: sovereignty on technology mix and security of supply (art. 194)
 - 20% ENR binding targets : transitory concession to this principle by MS
 - Reminder : disagreement about acceptance of one major technology
- No obligation of adopting the same instruments for pursuing the same goal in particular in matter of supply security
 - provided that it does not alter integrated market functioning

2. What would imply a radical disruption ?

- Exemple of the British electricity reform :
 - CfDs and FIT for low carbon and RES-E
 - Capacity mechanism for fossil technologies (with stable revenues on 10-20 years)
 - Risk shifting + subsidization

Other ideal type:

- Brazilian mechanism regroups all contracts in the same mechanism
 - but techno specific for renewables
- Priority to public policy objectives: decarbonation and supply security
 - Observation that the market coordination for long term is definitively altered by support to RES-E and low carbon technology
 - Transition to a combination of planning and competition for markets (auctioning for long term contracts)

Barriers to radical transformation

- Difficult recognition of the central role of planning to reach public policy objectives in the context of market regime
- Treaty provisions (state aids, antitrust) and jurisprudence will constrain any radical change decided by member states
- Incremental changes for correcting effects of preceding policies

But also no legitimacy to reduce subsidiarity which constrains the other way of market liberalisation

- Admission of sovereignty in matter of technology
- Admission of sovereignty in matter of control of the security of supply
- To let each MS define the priority of objectives

Part 3.

Incremental change in the EU context

- A process of change by steps:
 - Change could be decided after clear dysfunctions
 - Example of « one thing at a time » attitude:
 - disinterest for market design reform needed if large scale development of FIT and Long term contracts for RES-E:

First step

Correction of ETS at the basis of the market solution

Could carbon price-signal be credible soon?

- If so, the other instruments or arrangements to promote small-sized RES-E
- Three ways are not structural remedies
 - (backloading, reduction of CDM certificates, eventual price of reservation at discretion in the auction)
- Present Proposal of the Commission is insufficient
 - Credibility of carbon price will only be reached :
 - if price floor/price cap
 - if independent authority to monitor the level of quotas with transparent rules.

When to admit that it would not be sufficient ?

First step

Correction of RES-E support instruments

Critics of the FIT and priority dispatch:

- not market-oriented: no incentive to efficiency by the market,
- rent (?)
- Under the CJUE and DG Comp scrutiny for State Aids
- Recently : they alter the price setting on the whole sale market

Proposals

- FIT Premium,
- Auctioning for long term contracts ,
- Europeanisation (crossborder exchange) ,
- Suppression of any support

FIT premium:

- no improvement of incentives to operational efficiency, by sales on wholesale markets and risk exposure
- Only incentives to cut wind generation when negative prices
- But more risks for developers, higher risk premium, less investment and higher cost of the policy per MW.

Auctioning for long term contracts for every RES-E unit whatever their size :

- Pressure of long term competition for contracts ?
- Important administrative costs and risks relative to small-sized projects
- no scale effects

Any RES-E support is a problem for the market, not only FIT

When a RES-E technology is mature, suppression of any support is not the solution

Supposition: Revenue on wholesale market sufficient if carbon price

It is supposed to increase variable cost of fossil equipment

- **But in fact very important market risk (hourly revenue)**
- Large scale deployment of RES-E make annual average wholesale price decrease
 - Negative correlation between windpower production and wholesale price

In fact **Self –enforcement of RES-E support mechanism**

We do need long term arrangements for RES-E:

Function of FIT : not only subsidisation but also risk-shifting

To fix FITs

- Just a problem of flexible design and monitoring
 - review clause and sunset clause,
 - to addition of quantity cap

Relevant correction of instrument :

- Economic responsabilisation of variable generators for system costs
 - Balancing responsibility
 - Demand for flexibility services

Second step: Capacity mechanisms

- **Capacity pricing becomes a necessity because variable RES-E entries « out-of-market »:**
 - it is an answer to distortive effects of RES-E policies on LT coordination by markets
 - However it would have been needed for adequacy with new investment cycle
 - **Present debates around rationale of CRMs are related to market norms:**
 - **Beliefs in Energy Only** and virtue of market integration:
 - So question on State aid,
 - But in fact effects of temporary **overcapacity on beliefs** about necessity of CRM
 - Time to learn
 - **Debates related to distortions on integrated markets**
(but a curiosity: no problem with distortions by different RES-E policies)
 - **Debates on harmonisation**, but no way for the CE to impose harmonised CRMs
- To admit third best solution:** different CRMs but for the same outage criterium

Third step

Need of long term arrangements for every low carbon technologies

For new nuclear, large-sized RES-E and CCS in the future,

- as for small sized RES-E,
 - need of risk shifting arrangements (combined with subsidization in the first step) in a long term agreement in a public agency

In parallel observation of extension of missing problem to fossil technologies: CCGTs, peaking units

1. Issue of a new reform of capacity mechanism design:

Presently CRM only gives an annual forward payment per kW :
Capacity to be in place and reliable during critical periods at the delivery date

Extension of capacity contracts to recovery capital cost period

Third step

At this final step, EU should admit the need for

- 1. planning/programming
- 2. central buyer for auctioning
- 3. long term arrangements with the central buyer
- 4. not technology-neutral in the first step of the decarbonation process

Need of a new directive

Need to change the guidelines and the jurisprudence in matter of state aid and competition policy

How to find efficient articulation between EU long term climate/ energy policy and own MS policies

How long will it take to reach agreement for smart architecture market/policies ?

Should we wait for dysfunctioning to decide some incremental change?

How to build new European compromise beyond diverging representations which are behind conflicting interests?