

## **Comments on the interim report and working document of the sector inquiry on capacity mechanisms from the Nordic countries Denmark, Finland, Norway and Sweden**

### **Key points**

- The overall aim for the European internal market must be to eliminate the need for capacity mechanisms through a well-functioning energy-only market that sends efficient short and long-term price signals. Possible adequacy problems may be dealt with by amending the existing market design.
- Developing harmonised principles for transparent regional adequacy assessments should be prioritised and must be the starting point in the decision whether to intervene in the market.
- Capacity mechanisms should be a measure of last resort. If introduced, capacity mechanisms must be proportional to the problem at hand and coordinated regionally.
- The introduction of capacity mechanisms should be accompanied by a roadmap for removing existing electricity market design failures including a deadline for a phase out of the mechanism.
- Harmonised principles for capacity mechanisms are desirable. The mechanisms should be time-limited, technology neutral, allow for cross-border participation and demand response, and minimise overall market distortions including cross-border effects.

The report lacks:

- A description of the process for Member States to perform transparent adequacy assessments leading to a roadmap for rectifying possible market failures.
- A discussion and differentiation between different types of capacity mechanisms in order to minimise distortions in the electricity market.

### **General**

The Nordic countries welcome the interim report and working document of the sector inquiry. The overall aim for the European internal market must be to eliminate the need for capacity mechanisms through a well-functioning energy-only market that sends appropriate short and long-term price signals to invest in new and existing capacity and infrastructure. Member States should improve the functioning of their markets as far as possible, fulfil all obligations in the third energy package, and address the underlying causes that create adequacy concerns. Any distortions preventing the market from delivering the right incentives for investments (e.g. inefficient congestion management or regulated end user prices) have to be removed. The result is a more efficient utilisation and development of the

electricity system. A market design that facilitates efficient price formation can alleviate many adequacy issues.

We agree with the Commission that there is a strong case for developing harmonised methodologies to define and assess system adequacy and that these should form the basis for assessing the need for capacity mechanisms.

### **Harmonised principles for transparent adequacy assessments are needed**

Before capacity mechanisms are introduced, capacity adequacy should be assessed and underlying market failures identified. Based on this, a roadmap for rectifying market failures should be developed. We believe that this must be the starting point and should be further described in the Commission's final report.

The interim report identifies that the methods for assessing capacity adequacy vary significantly between countries. Priority should be given to developing harmonised principles for transparent adequacy assessments. Any bias towards thermal, domestic generating capacity must be eliminated. Hence, capacity adequacy assessments should be performed on a regional level and consider conditions in neighbouring countries, taking into account cross-border capacity. Scenarios where connections to neighbouring countries are excluded should not be considered as the basis for establishing capacity mechanisms.

Harmonised principles for adequacy assessments must take into account that different countries and regions face different challenges. For example, the Nordic countries have a large share of hydropower and can be vulnerable to seasonal variations in inflow, while other countries that have a large share of wind- and/or solar-based production can be vulnerable to daily variations in weather conditions. Adequacy assessments should therefore be based on probabilistic statistical methods. A probabilistic method ensures that all contributors to security of supply are included, including wind- and solar-based production, demand side response, transmission lines as well as interconnectors.

### **Capacity mechanisms should be a measure of last resort**

The use of capacity mechanisms should be limited as far as possible. All capacity mechanisms distort market behaviour and investment decisions across the internal market. Capacity mechanisms should not be considered as an alternative to a well-functioning energy-only market.

Capacity mechanisms should be a measure of last resort and only be introduced once efforts to rectify existing market failures and barriers have been exhausted. If introduced, the mechanisms should be seen as a temporary solution and must be designed to efficiently address the problem identified in the adequacy assessment. The introduction of capacity mechanisms should be accompanied by a roadmap for removing existing electricity market design failures including a deadline for a phase out of the mechanism.

The introduction of a capacity mechanism can have a great impact on the electricity markets in neighbouring countries. Consequently, it is important that the effects on electricity

markets in neighbouring countries are taken into account before introducing a capacity mechanism.

### **Harmonised principles for capacity mechanisms should be developed**

Harmonised principles for capacity mechanisms are desirable. In general, a capacity mechanism must be time-limited and minimise overall distortions in the market, including distortion of cross-border trade and competition between different capacity providers. Capacity mechanisms must be open to all technologies and allow for cross-border participation as well as demand response.

The Commission should develop cross-border solutions for capacity mechanisms. An important part of this is on which conditions interconnectors and/or foreign capacity could be included in the mechanisms.

In the interim report, we see no differentiation regarding the impact on the electricity market between different types of capacity mechanisms. Smaller schemes such as strategic reserves that are kept outside the market and are contracted by TSO's are less distortionary than wider capacity mechanisms driving investments. The final report should describe the implications of introducing capacity mechanisms with different scope and design.

We agree with the Commission's differentiation between ancillary services and capacity mechanisms. We find it important that the harmonised principles for capacity mechanisms do not affect the ancillary services acquired by the TSO's for system operation.