Nordenergi Response to: An Electricity Market for Germany's Energy Transition – Discussion Paper of the Federal Ministry for Economic Affairs and Energy

Nordenergi, the joint collaboration between the Nordic associations for electricity producers, suppliers and distributors, welcomes the opportunity to comment consultation of the Ministry for Economic Affairs and Energy on the future design of the German electricity markets. We especially welcome the German interest for views from their European neighbours, which takes into account the growth of the cross border interconnection and the importance of European integration.

We support the option of the ElectricityMarket 2.0., as an efficient starting point to incentivize investment in flexible production and demand. In addition, it is an efficient design to include the benefits of cross border electricity exchange and gives correct incentives to investment in interconnectors. In our view, there are two main preconditions for the success of the described reforms and improvements to the electricity market: investment in electricity transmission within Germany and cross border and the acceptance of peak prices, both on electricity spot and intraday market as well as on balancing market. For the transition period we support the establishment of limited capacity reserves. Experience in Sweden and Finland shows that if handled responsibly the cost is limited and the influence on the function of the electricity markets and investment signals is minimal. Strategic reserves can also give a signal for finding out if a capacity market might be needed: if strategic reserves start to cover a significant amount of capacity and are no longer a residual, a switch to capacity markets could be considered.

Developing the spot and balancing markets further

Nordenergi supports for stronger European market integration on the spot, intraday and balancing markets to provide the necessary flexibility to respond to fluctuating renewables production. Developing intraday markets and moving the gate closure closer to the operational hour and thereby allowing to trade closer to real time will allow producers and consumers to put a value on their flexibility and will increase investment in flexibility. We see potential to extend these solutions also to cross border connections and support that ambition. These solutions require a close cooperation between the European TSOs to make the maximum of capacity available to the market close to real time. We think that the current work on the Network Codes is a good first step in that direction which should be followed by more cooperation and coordination.

The close cooperation and integration between the TSOs should also extend to the balancing markets where the European integration needs to make further progress. This measure should be seen in connection to a strengthened balance responsibility for renewable generation. Only when all actors bear the imbalance cost they cause, will they have enough incentive to reduce imbalances and to become active in the balancing markets.
We support the aims for developing balancing markets (modification of prequalification standards, uniform pricing procedure and separate bids for positive and negative balancing) in order to enable broader participation on the market. This development should also include the use of cross border resources for balancing.

 expansions the power grids

Nordenergi fully agrees with the need to expand the power grid as identified in the report. A functioning grid is a precondition for a functioning power market. Various German and European grid development plans deliver a good analysis of where there is congestion and where new grid investment is needed - on the list are also the interconnector projects between Nordic countries and Germany.

The report also rightly recognises the internal congestion within Germany, which leads to periodic calls for reviewing and possibly splitting the German price area. In addition to re-dispatch costs identified in report, the internal congestions have been a reason for limiting the transmission capacity between Germany and neighbouring countries. These limitations cause inefficiency on the European power market, are costly for German consumers and limit the possibilities for benefiting cross border resources on the spot market, on the intraday market as well as on the balancing market. As the report points out, Germany has benefited from cross border exchange and this must not be endangered by restrictions in cross border capacity. Nordenergi calls the German Ministry to duly consider the effects of these grid limitations and to guide TSOs stopping this behaviour.

While investments in the power grid are a long term measure, relief could be found in the short term in either re-dispatch/countertrade or the reconfiguration of bidding zones. This would expose market participants to the correct price signals for both supply and demand of electricity, hence lead to more efficient use of current production and transmission capacity. Experiences from Sweden of the introduction of internal bidding zones show a more efficient use of the power grid, without negative effects concerning market power, transaction costs and loss of liquidity in the spot market. Furthermore, market splitting also gives transparent signals for investments in production as well as demand response and the power grid. The latter is otherwise only known to the TSOs by their costs for re-dispatch and the likely outcome would be higher costs for the customers.

Regarding re-dispatch/countertrade the discussion paper argues in the first section on p. 29, that the current German generation management (redispatch) prevents distortion of electricity trading and avoids congestion having negative effects on the electricity market. It is important to note that this is only valid within the single price zone. The Germany-only re-dispatch of the existing grid congestion is indeed distorting the cross-border trade with the Nordic countries.

Intensifying European cooperation

Nordenergi fully supports the idea to intensify European cooperation beyond the market integration and the establishment of the Internal Electricity Market mentioned above. In our view security of supply can only be assessed in a regional context, taking into account the contribution generation from neighbouring countries can make via the interconnectors. Relying partly on interconnectors to meet generation adequacy is also less costly than aiming for generation adequacy by purely national resources. Current European work on the Energy Union but also concretely on the common generation adequacy assessments and on network codes regulating TSO cooperation in emergencies are steps in the right direction.

If Germany implements all the no-regret measures mentioned in the report, Nordenergi thinks, that the energy market will develop to offer sufficient incentives through the exposure of all actors to peak- and
imbalance prices to invest in new flexible capacity and demand flexibility. We also agree with report, that the electricity market 2.0 is a viable outset for the following reasons:

- First it is important to consider trade via interconnectors before deciding to finance a marginal power station in Germany.

- Second, it is easier to include demand flexibility within an energy only market, where demand is directly exposed to power prices. In a capacity market, where more capacity is on the grid, electricity prices fall and there is therefore less incentive for demand to react. Demand could participate in the capacity market, but lacking peak prices that would requires payments as an incentive, which is less efficient than avoided cost. Furthermore, flexible demand and energy efficiency are important resources to include also from an environmental point of view.

- Third a capacity market risks discriminating intermittent renewables, since they can’t as easily qualify for capacity payments as regulated thermal generation.

Other remarks
The report also discusses the potential effects of volatile prices. As the report concludes, they are needed as they give the needed signals for demand and generation. Also the report discusses the need for hedging. Here the experiences from the Nordic market could provide benefits for the German market. In addition to long-term power supply contracts, the industrial consumers and generators have access to financial forward electricity market. The hedging is done with financial products and the electricity purchase from the spot market. With financial hedges the hedging has no effect on the motivation to react on spot prices which enhances spot markets’ liquidity as well as incentivises demand response. Financial products having an index price as reference are an efficient hedging tool also when bidding zones are relatively small.

The installation of smart meters would enable for even households to purchase electricity with hourly based price contracts and thereby enabling demand response resources to the market, with respect to the rules of balance responsibility.

Nordenergi therefore supports all no-regret measures and thinks that these will be a suitable starting point to strengthen security of supply. We thank again for the opportunity to contribute in this interesting debate and will follow the developments with interest. If you have any questions or comments, don’t hesitate to contact us.

In addition Nordenergi warmly welcomes Germany’s commitment to enhance European emission trading system, which we find the most important tool in decarbonisation.

Yours sincerely,

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