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WHAT PRICE IS A FAIR PRICE?

Fixed feed-in tariffs have produced heavy increases in the volume of electricity generated via renewables, but their continued existence diminishes the strength of market signals in European power markets. **Steffen Köhler** puts forward a different approach

All participants on an electricity exchange share something in common – an interest in power, or in prices in general. At the same time, many of these companies come from different backgrounds. An exchange involves thousands of people from all walks of life – be they financial traders, power marketers, producers or consumers – and all these people have access to various pools of information that they individually interpret.

What else but an exchange is able to incorporate and manage all this information on a continual basis? With regards to the fundamental question of how to determine the price of a certain good, I truly believe that an exchange is the perfect example of two-way price

1. Position paper of EEX and Epex Spot: Further development of the renewable support schemes in Germany, February 5, 2014. Available online at: www.eex.com/dl/en/about/newsroom/opinions-and-expert-reports/68104/file

formation. The result of this process is consolidated in an order book, in which buy and sell offers are listed in a manner that is transparent and equally accessible for all market participants.

Nonetheless, the process of collective price determination has often been replaced by the alternative of a body decreeing that ‘for the next 20 years, the price should be x’. In recent years, this has happened particularly frequently when it comes to government schemes designed to incentivise the use of greener renewable energy.

Personally, I think the solution lies in using elements of both approaches. In the past few years, we have seen a strong commitment by various governments to promote renewable

energy. But at times, this has come at the expense of market mechanics, creating a distortion of wholesale power prices, and not just the price of renewables. In Germany, where renewables have taken hold rapidly in recent years, the component of household electricity costs that is determined competitively is less than 24%, according to a recent position paper produced by my employer, the Leipzig-based European Energy Exchange (EEX), and Paris-based power exchange Epex Spot.¹ There are alternatives, however.

Governments will continue to promote renewable electricity. The question is not whether they should do it, but how. Fixed feed-in tariffs have worked very well to get renewables started. Yet we have

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to realise that in places such as Germany, they have outgrown this role. No-one expected just how quickly technology would develop and costs fall. Today, renewables have evolved enough to be integrated into the market, just like any other source of power.

In a world of guaranteed absolute returns, there is no incentive to react to supply and demand conditions. Renewable energy production has continued, even at times when there is no demand for additional energy. This increases the cost to society, leading to a heated debate about the sheer expense of supporting renewables.

My opinion is that we have created this issue because we structured the market in such a way that renewables and wholesale electricity prices became totally independent. The price of wholesale power is determined every second, while the price of electricity paid to renewable generators is set for 20 years. The solution is a combination of the two – define the price as market price plus ‘x’, where ‘x’ is determined through a competitive process.

This top-up above market prices guarantees a relatively high return for renewables, while the wholesale electricity price is determined in the context of continuously changing market conditions. This is one of the core elements in our position paper, in which we analyse the merits of renewables support in more detail. We argue that a comprehensive revision of the funding mechanism for renewables is necessary to make sure that the market and competition are safeguarded, especially as the share of energy generated by renewables continues to grow.

First, renewables must be integrated into the market. Producers of renewable power should offer their

electricity at marginal cost. Where this is zero, as in the case of wind, this can lead to bids at a price of zero. But production should not continue when there is oversupply, as indicated by negative power prices. Again, support for renewables is not the issue here, but support must aim to minimise market distortion.

Second, competition is important to make sure support levels are as high as necessary, but also as low as possible. This is why we call for the competitive auctioning of renewables support. Energy producers should bid for the level of support they need, with support paid as a premium over market prices. This premium should be capacity-based, with renewables plants being compensated for the capacity they provide, rather than for the megawatt-hours being fed into the grid. This is comparatively simpler than the current system, while it also



minimises market distortion and leads to a level of production more in line with market prices.

What about the need for certainty? Obviously, a return on investment is one of the most fundamental requirements for investors in renewables. Rather than guaranteed absolute returns, it’s probably enough to create an agreeable level of certainty that you will see a return on investment. In our proposals, the relative return is guaranteed, but not the absolute return. And if you compare renewables to other investments that are just as risky, then you will still be rewarded with better returns. ■

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