

“Clean Energy for All Europeans” Package: security of supply at all times

Introduction

The European Energy Exchange (EEX) and DONG Energy are calling for EU institutions to support the strengthening of the Energy-Only Market in the Clean Energy Package. This will help to achieve Europe's Energy Union strategy aiming to ensure a secure, clean and affordable energy supply for European consumers.

A strengthened energy market can form the basis for long-term investments in both renewable energy and flexibility, with the help of forward and futures markets. And while the European Commission's proposal for the Clean Energy Package is a step in the right direction, further legislative efforts are needed.

The Energy-Only Market can deliver the right price signals for investments

The energy-only market can deliver meaningful price signals showing market participants the real balance between demand and supply. Recently, we have seen successful zero-subsidy bids in the German offshore wind energy tender¹. Market participants, including DONG Energy, could bid at zero because of a range of factors lowering the costs of offshore wind, but also due to trust in the regulatory framework, and particularly in the energy-only market based on free and undistorted pricing. Market participants have taken up significant commitments and risks through these tenders, as non-delivery would result in substantial penalties². However, the commitments in these bids will not be executed until the beginning of the 2020s. The ability of policy makers to re-enforce the trust in the regulatory framework, the commitment to a meaningful CO₂ price and the capability to deliver the necessary transmission infrastructure will lay the foundation for the bidders' ability to execute. If Europe wants more zero-subsidy projects, we must now enact all relevant policies supporting this market model.

Distortions, such as Capacity Remuneration Mechanisms (CRMs), present a risk to the electricity market in delivering meaningful prices and could lead to prolonged system overcapacity. This, in turn, makes investments in flexibility and renewable energy difficult. The introduction of capacity market schemes should, therefore, always be a remedy of last resort and subject to strict conditions.

Strategic capacity reserves outside the market, such as those planned in Germany, are acceptable. However, continuous checks and a clear exit strategy must be put in place to avoid any negative effects on the wholesale market. Such a capacity reserve is a transitory measure until market reforms take effect.

¹ The economic drivers in the projects will deliver costs below forecast wholesale prices. There is no guaranteed minimum price; the wind farm will operate fully on market conditions.

² While it is theoretically possible to choose to forego an investment in 2021, this would come at a penalty cost of € 100 million per GW not built.

Futures markets are an essential part of the Energy-Only Market

The changing generation mix increases power price volatility, which in turn will grow market actors' interest in long-term hedging against such volatility risk. Markets deliver new products to support the transition of the energy system by enabling such hedging opportunities, and will continue to innovate and offer the products needed by market participants. Examples of this include the EEX German Intraday Cap/Floor Futures allowing hedging of price peaks on the intraday market³ and the EEX Wind Power Future which enables dedicated hedging of wind risk in power generation⁴.

The energy sector increasingly relies on the close interplay between physical and financial – forward and futures – markets. Futures and forwards are contracts that allow hedging against price risks. They represent over two thirds of the wholesale power transaction volume on the electricity market in Europe and have grown by a factor of 32 since 2002 showing the increasing demand for such contracts. We see the undistorted development of these markets and similar bilateral contract markets as an essential component in the future market, and the way forward to avoid capacity mechanisms.

Europe needs stable and liquid bidding zones

The European – and especially the German – electricity market is out of balance and subject to overcapacity, low CO₂ prices and lack of transmission infrastructure. Over the next 10 years, Germany plans to improve market balance, for instance through grid expansion and the exit from nuclear energy scheduled by the government. While it is neither sufficient nor perfect, the route towards a more balanced electricity market seems to have been set.

The stability of wholesale market bidding zones is essential to ensure the investors' trust in the rebalancing process. Moreover, benefits of large bidding zones through liquidity and competition should be recognised. Risks related to the unpredictable size of bidding zones will translate into higher cost of capital and, subsequently, increase costs of the decarbonisation of the European energy sector. Any review of bidding zones, therefore, needs to be predictable and involve all affected stakeholders.

With a cost-efficient build-out of transmission, the corresponding large bidding zones allow the most efficient management of demand and supply in the power market, leading to an economically efficient outcome on the dispatch of power plants and demand side response.

Emissions trading to be strengthened

The EU Emissions Trading Scheme (ETS) is Europe's overarching market-based tool for the achievement of climate policy objectives. However, due to several different factors, there is an oversupply of allowances in the EU ETS. Unless it is re-balanced, e.g. through member states' cancellation of surplus allowances (which is for instance inspired by the Swedish buy-back programme), the ETS is unlikely to play any significant role in meeting 2030 targets and drive investments in low carbon technologies.

³ More information on German Intraday Cap/Floor Futures [at this link](#)

⁴ More information on the Wind Power Future [at this link](#)

Strengthening markets for ancillary services

The changing generation mix impacts electricity prices and, hence, the question of which assets are profitable and investable. Many of the old assets have been delivering grid services necessary for the TSOs - and often without compensation- as such services are mostly produced at no costs to large electricity generators. With a decline in the number of large electricity generators, such services are becoming scarce.

In the Clean Energy Package, ancillary services are referred to as frequency and non-frequency ancillary services. There are established markets for frequency ancillary services, but it is important that TSOs also begin to increasingly procure non-frequency ancillary services from the market- through either market-based processes where there is competition or regulated processes where competition is inadequate. This will help to determine the necessary volume, and create incentives for currently installed and new power plants, storage capacity etc. to offer such services. The proposal to establish network codes for non-frequency ancillary services is an important step in the right direction.

Ancillary services should only be provided in a market-based manner regulated by a contract. The starting point should be for such services to be offered by market participants instead of those being provided through assets owned by TSOs.

About

The **European Energy Exchange (EEX)** is the leading energy exchange in Europe. It develops, operates and connects secure, liquid and transparent markets for energy and commodity products. At EEX, contracts on Power, Coal and Emission Allowances as well as Freight and Agricultural Products are traded or registered for clearing. Alongside EEX, EPEX SPOT, Powernext, Cleartrade Exchange (CLTX), Gaspoint Nordic, Power Exchange Central Europe (PXE) and the US-based Nodal Exchange are also part of EEX Group. Clearing and settlement of trading transactions are provided by the clearing house European Commodity Clearing (ECC). More information: www.eex.com

DONG Energy is a global leader in renewable energy. Since DONG Energy was formed in 2006, it successfully transitioned away from being one of the most coal-intensive utilities in Europe to being the world leader in deploying offshore wind. DONG Energy's mission is to develop and enable energy systems that are green, independent and economically viable. Our vision is to lead the energy transformation. More information: www.dongenergy.com

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