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White Paper

Answering the Energy Crisis – A Power Market Perspective

Throughout 2022 we have seen a great deal of speculation and debate among energy sector stakeholders and in the media about high electricity prices, their causes and the background to the energy crisis. High prices place a strain on both private customers and businesses alike, creating a situation which few in the sector could possibly see as either desirable or sustainable. Nord Pool operates the power market across 16 European countries, making us very well placed to constructively contribute to the discussion around energy markets, price formation and the underlying causes of the current crisis.

For us, the answer to the current energy crisis lies in addressing a combination of key factors – **lowering demand, increasing supply of renewable generation, strengthening the grid and further integrating European markets.**

Nord Pool acknowledges the political pressure on national governments and the European Commission to take action over today’s high energy prices. But in such a pressured environment it is all the more necessary to carefully assess any potential measures so as not to destroy a market that, despite the high prices is in fact functioning well.

We would like to caution European institutions and national governments **against adopting a revenue cap**, since it would be very challenging to implement and would deter investment in renewable generation. In effect, it would achieve the opposite of what it intended and be detrimental to the EU’s climate policy goals.

The Problems of a Revenue Cap

The European Commission has suggested a temporary revenue cap on electricity generated from production plants which have lower operating costs than gas-fired power plants. The intention is to limit the “excess” profits of, among others, renewable generators resulting from gas-fired plants setting a high marginal price in the “merit order”, due to the high gas prices currently being seen.

The challenge here is that such a temporary revenue cap on renewables **would be difficult to implement and hard to unwind once introduced.** Its implementation would raise complicated administrative and legal questions such as how to set the revenue cap in a non-arbitrary way, how to take into account various types of hedging, including PPAs, identifying the source of the electricity offered and discriminating between renewables generators benefiting from different subsidy schemes and protections against price volatility.

Such a revenue cap on renewables would also create more uncertainty for investors in renewable generation. Investors tend to shy away from investments with unpredictable rates of return. In

addition, such a cap would change the terms on which existing renewable generators have made their investments and expect their returns.

A revenue cap on renewable generation destroys both shareholder value and trust in markets being allowed to operate free from governmental interference. This can backfire severely in the long run, with investors in renewable generation either refraining from investing or expecting governments to guarantee them a fixed minimum price for their generation. The ultimate outfall from this is **a regulated renewables market which stymies competition and innovation.**

Nord Pool agrees with the European Commission that a possible **short-term measure to dampen the effect of high prices could be to set a price cap on natural gas imports from Russia.** Though such a measure would need to be coordinated throughout Europe and structured in such a way as not to increase demand for gas.

The Benefits of European Market Integration

At Nord Pool we have been driving European market integration for more than 25 years because we believe in its benefits. More than that, we are instrumental in the delivery of transparent and reliable daily prices for power across Europe. Electricity and capacity to transport electricity from generator to consumers are scarce resources which need to be used in the most efficient manner for the optimal benefit of society.

Matching supply and demand drawn from the widest possible liquidity pool and using every bit of available capacity to extend liquidity within and between bidding zones, is crucial for ensuring “minimal waste” and maximum carbon-efficiency. Market integration gives European electricity consumers access to the best available (least costly and least polluting) source of electricity and enhances overall security of supply.

Projects **expanding and reinforcing transmission and distribution grids,** in particular lines connecting regions with significant renewable electricity to those which are high on consumption but have a low share of renewables- based production, need to be prioritised and expedited.

Nord Pool believes the solution to the current crisis must lie in lowering demand, increasing supply of renewable generation, strengthening the grid and further integrating European markets.

To find out more about Nord Pool visit nordpoolgroup.com or email: support@nordpoolgroup.com