

Europeex Response to European Commission Public Consultation on New Energy Market Design

(As handed in on 8 October 2015)

1) Would prices which reflect actual scarcity (in terms of time and location) be an important ingredient to the future market design? Would this also include the need for prices to reflect scarcity of available transmission capacity?

Indeed, prices should reflect the underlying fundamentals, including over and under supply, in any well-functioning market. This includes the scarcity of available transmission capacity. With market coupling in place this is revealed as bidding zone price differences. Hence, the bidding zone prices reflect both the actual value of energy as well as (implicitly) the available cross border capacity.

2) Which challenges and opportunities could arise from prices which reflect actual scarcity? How can the challenges be addressed? Could these prices make capacity mechanisms redundant?

Scarcity prices could appear quite extreme versus “normal” price levels, and there can be issues of political and public acceptability, although theoretical foundations for price spikes in electricity markets have been known since the 1980s if not before. Therefore, it is important that market and other stakeholders, including political decision makers, accept the bidding zone prices and cross-border schedules in the organised markets, even in cases of very high or low prices. Otherwise, the incentive for more investments in flexibility both on the production and demand side will be severely hampered. Instances with extreme prices in situations of scarcity of supply or over-supply can trigger market-based responses. This includes demand side management, investments in production and demand flexibility as well as new market products to facilitate the trading and pricing of flexible capacity.

Well-functioning markets are crucial since they provide investment signals through prices. In this context, markets could indeed mitigate the need for capacity remuneration mechanisms. In particular, if it is flexibility that is required, a well-designed, short-term energy market is an efficient way to incentivise this. Furthermore, to make Demand Side Bidding a more natural part of the overall flexibility in the price formation it is key that regulated end consumer prices are removed in member states where such pricing regimes still exist.

3) Progress in aligning the fragmented balancing markets remains slow; should the EU try to accelerate the process, if need be through legal measures?

Lessons for aligning the fragmented balancing markets can be drawn from the achievements of the power exchanges (in cooperation with TSOs) in integrating wholesale electricity markets. This includes the following aspects:

- a. The approaches were initially developed at a more manageable regional level.
- b. The solutions sought to build on existing entities, methodologies and responsibilities, while recognising a pathway to a pan-European solution.
- c. Pragmatic solutions were seen as more useful than the pursuit of perfection.
- d. Harmonisation was done where necessary.
- e. Creation of natural incentives on the parties to make it work.
- f. The legal framework followed the process rather than the other way around. (Day-ahead market coupling was well established across most of Europe long before even draft network codes were written.)

Far more could be done to create the right incentives and promote semi-voluntary progress on integration. Additional legal measures (in addition to the network codes) should only be a last resort, and would essentially represent a failure. This is especially true since such measures will be very slow at making real changes, if they are not supported by most of the TSOs.

Regional solutions between TSOs sharing common balancing resources can be a way forward to achieve significant benefits within a reasonable timeframe. This could e.g. be done in a well-defined part of a multi country grid system. In this respect some good best practise models exist that could also be considered in other regional settings before a more pan-European approach gradually evolves. This process should be supported by the Balancing Network Code that is in its final stage of approval.

4) What can be done to provide for the smooth implementation of the agreed EU wide intraday platform?

CACM is now in force and the XBID project has been recognised as the vehicle to achieve the pan-European Intra Day Target Model of Continuous Implicit Trading via a Shared Order Book (SOB) and the Capacity Management Module (CMM) for the matching of orders based on all liquidity coming from all the power exchanges (PXs) connected to the XBID solution.

CACM will make it easier to gain the full support of all TSOs, NRAs and PXs (NEMOs). (The participation outside the NWE+ region in the XBID project is currently mixed.)

There should be mechanisms for active involvement in the XBID project by non-EU TSOs and PXs – including Norway and Switzerland.

XBID is a major project that requires strong project management and governance. Both can potentially be further enhanced under CACM, although improvements have already been made.

The implementation process for XBID, including the rollout at local/regional level, will benefit from the further involvement of market parties – a process that has already started.

5) Are long-term contracts between generators and consumers required to provide investment certainty for new generation capacity? What barriers, if any, prevent such long-term hedging products from emerging? Is there any role for the public sector in enabling markets for long term contracts?

Long-term contracts may be important in providing investment certainty, and such contracts are likely to develop if there is sufficient demand for this. However, we do not see that there is a role for the public sector to provide such products beyond securing that such contracting is allowed. Currently, we see no specific barriers preventing such contracts to emerge, and there is no need for implementing any new regulation or other measures to enable markets for long-term contracts.

6) To what extent do you think that the divergence of taxes and charges levied on electricity in different Member States creates distortions in terms of directing investments efficiently or hamper the free flow of energy?

Large differences exist between wholesale and retail energy prices, and the difference is increasing. This causes an ever growing burden for consumers. One reason for this is that some EU member states have put price regulation in place. Consumers are therefore disempowered as the real price of energy is obscured to them. National interventions in markets should be limited to advance efficient, transparent, competitive electricity markets with prices determined by the market.

Export cross-border charges, which still exist in the EU, constitute distortions at the wholesale market level and pose a direct obstacle to free trade and the Internal Energy Market. In addition, differences in the

proportions of C- and G-charges can also impact the competitiveness of producers, retailers and industrial end consumers in different markets. For example, producers in countries with low G-charges have a clear competitive advantage over imports.

Rising levels (in absolute terms but also proportionally) of different taxes and add-on charges reflect nevertheless more a symptom of other problems, rather than the problem itself. They are mostly due to various types of subsidy systems for renewables and varying level of taxes on pollutants and some production resources. Against this background, it needs to be pointed out that the market itself tend to encourage to the harmonisation of taxation and subsidy levels, provided that Member States react to these signals in the spirit of the single internal energy market. However, the harmonisation of taxation levels is a much wider issue and energy trading and markets only play a modest role in this.

The serious risk of VAT fraud in gas and electricity wholesale trading and the very different levels of protection in the individual member states against it, creates a non-level playing field with major consequences for competition and the further integration of the internal energy market. It is therefore important that all 28 EU member states make use of the existing derogation and apply the reverse charge mechanism (RCM) to gas and electricity wholesale transactions at national level. This should explicitly include the trading in Guarantees of Origin (GOs), following the Austrian example of classifying them as electricity certificates according to the amended VAT Directive.

7) What needs to be done to allow investment in renewables to be increasingly driven by market signals?

There is a need to integrate renewables further into the market. Europex welcomes the increasing introduction of market premium and quota systems for renewables support throughout Europe to achieve this, since they are at least better than feed-in schemes, although still creating market distortions. Tender mechanisms should be further encouraged as a means to determine competitive, market-based subsidy mechanisms for renewables.

Subsidies – if any – should have a clearly defined endpoint and purpose and should be administered in a way that distorts the energy market as little as possible. Subsidies based on energy (MWh) rather than capacity (MW) typically have a more detrimental effect on the market. The same applies to nationally focused support systems with important negative externalities, such as loop flows. The focus should therefore rather be on harmonised or at least compatible market-based incentives across the EU Internal Energy Market.

All power plants, independent of the technology used, should have obligations and opportunities towards the stability of the system (e.g. balancing services and obligations). All production technologies and “demand installations” that comply with the necessary technical requirements established by the TSOs should be allowed to participate in balancing services.

Even before considering subsidies, customers should have a more pronounced role in choosing the production mix. To be able to choose, a proper reliable mechanism should be put in place. The Guarantee of Origin system – further standardised and expanded to all sources – is the best option to achieve this.

8) Which obstacles, if any, would you see to fully integrating renewable energy generators into the market, including into the balancing and intraday markets, as well as regarding dispatch based on the merit order?

Most legal obstacles stem from the legacy status of exemptions as well as the instability of the regulatory framework. Any inability of RES power plants to adjust production levels can be technically solved provided that the right incentives are put in place. Several projects and initiatives from industry associations have proven that these units can and should play a role in ancillary services, not to mention the market.

In a decentralised production framework, where the ownership is diverse, there is an objective problem for small plants (owners) to take part in such markets individually (cost-wise) which requires the existence of

production aggregators. The role of aggregators as the “missing link” between decentralised production (and consumption!) and the wholesale market needs to be facilitated. Some technical obstacles can be mitigated by better forecasting, new technological means as well as aggregation in order to deliver better system services.

However, to secure efficient and fair competition it is key that also “aggregators” - regardless of if they are part of traditional distributors/retailers or vertically integrated suppliers or act as “new types” of entities – should be obliged to follow the existing Balance Responsibility obligations set by TSOs when they act in the markets.

If policy is steered towards subsidies, such as the FIT support schemes or net-metering approaches, which do not relate to market prices or system conditions, then investors will take the “easy way out”, although the technology can support other, better solutions.

RES should be fully integrated into the market. The basis for this is that RES bid their marginal cost, resulting in dispatch based on the merit order. This preserves the price signal even when RES sources are increasing.

9) Should there be a more coordinated approach across Member States for renewables support schemes? What are the main barriers to regional support schemes and how could these barriers be removed (e.g. through legislation)?

Harmonisation would lessen some of the problems, yet the aim should be a European solution, rather than harmonised national ones. Such a European solution should incentivise RES to be built where it is most efficient.

Furthermore, instead of thinking about how to harmonise support systems, the EU should focus on the fundamentals, for instance: extend the guidelines for environmental state aid as to allow only support types that do not distort the market (e.g. not distorting the merit order); focus on the customer – strengthen the guarantees of origin system to provide for a trust-worthy disclosure process.

To reap the benefits of the internal market, the vision should be that new RES capacity is built where it is most appropriate, irrespective of national boundaries or support structures. The common Swedish-Norwegian support scheme as the first cross-border system sets a great example. Member states should increasingly make use of the possibilities for cooperation under the RES Directive. An increasingly coordinated approach is also crucial for achieving the 2030 renewables target for the EU, in particular as only an EU target without national targets has been agreed. The ‘Governance Framework’ proposed for the 2030 framework needs to be used to the fullest as a means to coordinate support schemes. Making it merely a tool for reporting without binding action is not enough.

The key is that the support system should be perceived as finite, as a means for a goal, not as the goal in itself.

10) Where do you see the main obstacles that should be tackled to kick-start demand-response (e.g. insufficient flexible prices, (regulatory) barriers for aggregators / customers, lack of access to smart home technologies, no obligation to offer the possibility for end customers to participate in the balancing market through a demand response scheme, etc.)?

The answer to this question includes two main aspects: technical and economic.

Regarding the technical aspect, the key is to enable the required flow of data and the ability of customers to adjust load (either automatically or on demand).

In order for consumption to play a major role, more consumers should take part in the market. However, since the gains could be relatively small on an individual level, they might not be motivated to actively take

part. Therefore, an aggregation of this flexibility is needed – regardless of this is done via traditional suppliers or an aggregator (VPP) or via portfolio management companies. In addition, cost efficient and high quality technical solutions to track consumption patterns and do the billing linked to it should be put in place.

If we assume that there is a sole purchaser, e.g. a TSO or a DSO, of demand-response when designing markets for demand-response, we may be constraining its expansion. TSOs/DSOs should not be seen as natural market facilitators of demand response, but rather just as a segment of the market. Suppliers/retailers, aggregators, TSOs, DSOs, customers themselves and others may wish to buy and perhaps re-sell/buy back demand-response over different time periods and in different packages. All of them will have different interests, e.g. TSOs are likely to be more interested in larger blocks of demand-response and less interested in location, whereas other purchasers and sellers will have different needs.

Another obstacle is the fact that a relatively minor part of the total bill is related to the wholesale energy price – because of a rising share of add-on charges stemming from RES support schemes, energy taxes, grid related charges and soon maybe also from CRM and other energy policies.

Finally, demand should as much as possible be incentivised by the wholesale energy price itself (i.e., market-based), not just by administered mechanisms which are less transparent or less efficient.

11) While electricity markets are coupled within the EU and linked to its neighbours, system operation is still carried out by national Transmission System Operators (TSOs). Regional Security Coordination Initiatives ("RSCIs") such as CORESO or TSC have a purely advisory role today. Should the RSCIs be gradually strengthened also including decision making responsibilities when necessary? Is the current national responsibility for system security an obstacle to cross-border cooperation? Would a regional responsibility for system security be better suited to the realities of the integrated market?

Increasing regional coordination seems a pragmatic way forward to improve integration in a way that is compatible with the respective responsibilities of TSOs. A more radical change in the role of TSOs, such as the creation of RTOs or ISOs, would take a long time to achieve.

Nonetheless, the benchmark of how a single ISO/RTO might manage system planning, risk management and operations could help identify areas of potential improvement. This covers issues such as:

- How could a RSCI get closer to achieving the optimal calculation of coordinated capacities that a single ISO should be able to achieve?
- Should risk policies be more transparent and coordinated?
- What would a single balancing mechanism achieve?

12) Fragmented national regulatory oversight seems to be inefficient for harmonised parts of the electricity system (e.g. market coupling). Would you see benefits in strengthening ACER's role?

The question implies that fragmented regulatory oversight has been inefficient in market coupling. We challenge this: NRAs in the relevant regions have, in our experience, in general managed to co-ordinate adequately between them, facilitated by ACER in some cases.

ACER could, however, play an active role in the interconnected European electricity market for the benefit of all relevant stakeholders. This future part in providing a more adequate regulatory oversight should comprise of a range of key facets. This includes important aspects such as fostering harmonisation, addressing the potential threat of regulatory arbitrage and ending a fragmented national regulatory oversight landscape across Europe. Furthermore, double regulation, undue regulation and misleading decisions should be avoided.

ACER will receive new tasks under the CACM Guideline, NCs and REMIT, and we should see how this works before deciding on the need for any new powers.

The existing procedures and decisions of ACER should be more transparent and accountable, following a due process.

ACER will also require suitable resources – e.g. to fulfil its role under REMIT.

ACER should have greater influence (within the energy industry, including the area of renewables, and beyond – such as financial markets regulation and internationally) by providing objectivity – for example, by promoting objective, transparent, authoritative assessments of issues judged against the European public interest. It should be absolutely clear that its governance board is responsible (and accountable) for upholding this principle, and that it does not represent national interests.

13) Would you see benefits in strengthening the role of the ENTSOs? How could this best be achieved? What regulatory oversight is needed?

The ENTSOs have a number of roles of public interest, including policy development (such as drafting network codes, bidding zone reviews, etc.), and technical coordination between TSOs (e.g., Ten Year Network Development Plan). These are important functions that need to be done on behalf of all stakeholders in the broader public interest.

Unfortunately, however, ENTSO-E's ability to perform these functions is potentially impaired by any lack of independence from national TSO interests. At the very least this is an issue of perception. Hence, there should be a clear distinction between its stakeholder and its policy role.

The ENTSOs should play a stronger role in pursuing the goal of European integration, even if this may sometimes conflict with national interests. Therefore, it needs to improve its processes and independence.

We do not see the ENTSOs performing any operational function.

Rather than simply greater regulatory oversight, we would propose greater transparency and accountability to all stakeholders, including regulators. There is considerable expertise and knowledge spread around stakeholders, and this could be harnessed to monitor assist and improve the activities of the ENTSOs.

14) What should be the future role and governance rules for distribution system operators? How should access to metering data be adapted (data handling and ensuring data privacy etc.) in light of market and technological developments? Are additional provisions on management of and access by the relevant parties (end- customers, distribution system operators, transmission system operators, suppliers, third party service providers and regulators) to the metering data required?

With the growth of distributed energy resources (generation and demand), DSOs will play an increasingly important role in facilitating access to the wholesale market. It is vital that the regulation and governance of DSOs (and retail markets) is integrated with that of the wholesale market, and not (as in the U.S.) separated.

However, most of the issues relevant to DSOs and retail markets do not need to be harmonised at European level – and doing so could even hinder innovation and progress.

Metering data is a vital asset and access to it has commercial and privacy implications. If end users are to be able to protect their privacy and/or participate actively in demand side management, they need to have ultimate control over their own meter data and who can use it. If the Supplier or DSO controls this, they can limit the options available to the end user.

15) Shall there be a European approach to distribution tariffs? If yes, what aspects should be covered; for example, tariff structure and/or, tariff components (fixed, capacity vs. energy, timely or locational differentiation) and treatment of self-generation?

No answer

16) As power exchanges are an integral part of market coupling – should governance rules for power exchanges be considered?

Power exchange market coupling activities are regulated. Therefore, the question is misleading as it suggests that regulation and governance need to be introduced and would not already be in place. Existing regulation (e.g. CACM Guideline, NCs, local grid codes, regulatory supervision, etc.) should be checked first, and additional oversight shall only be considered, if shortcomings have been clearly identified.

Power exchanges or their functions are NOT natural monopolies. Even as far as the market coupling function is concerned, the existence of several PXs is possible.

The impact of CACM should be evaluated first. As the CACM guideline has just recently entered into force (i.e. on 14 August 2015) and is currently about to be implemented, the impact of this legislation should be evaluated first before further market interventions are decided. Moreover, CACM already provides rules for the governance of PXs, distinguishing between the NEMO role and the MCO functions and providing for two alternative setups to choose from: the competition system (cf. Articles 4.4-4.9 in CACM) and the legal monopoly (cf. Article 5).

As part of the CACM process, all NEMOs are required to produce an MCO Plan for NRA approval. We anticipate that this, and possibly other methodologies, will further elaborate the NEMO governance framework – including e.g. decision making, stakeholder involvement and operational responsibilities. This will be done based on tasks defined under Article 7 (NEMO tasks) and adoption of methodologies as defined under Art. 9, including a consultation with stakeholders.

17) Is there a need for a harmonised methodology to assess power system adequacy?

System adequacy is becoming more unpredictable due to the rapid growth of RES. Furthermore, the impact of changes made in the generation mix or the national policy in one country has an increasingly greater level of influence on other countries.

Therefore, it is vital that system planning is done in a rational way across regions/Europe. Adopting a harmonised methodology would furthermore improve transparency.

18) What would be the appropriate geographic scope of a harmonised adequacy methodology and assessment (e.g. EU-wide, regional or national as well as neighbouring countries)?

There needs to be consistency between the responsibility for system security and the mechanisms to evaluate adequacy as well as to determine when adequacy is being met.

Individual regions with a joint system security management could potentially emerge where there is a sufficient convergence of technical and political factors. In such regions, system adequacy and mechanisms to ensure adequacy (e.g. through capacity mechanisms, balancing mechanisms, etc.) would logically be organised at a regional level in a regional system security framework.

Less ambitiously, regional adequacy assessments could determine the national contributions that need to be made to ensure regional security. In this context, each country would need to put in place suitable mechanisms to ensure that it achieves its national contributions to the regional system adequacy system.

19) Would an alignment of the currently different system adequacy standards across the EU be useful to build an efficient single market?

See previous answer

20) Would there be a benefit in a common European framework for cross-border participation in capacity mechanisms? If yes, what should be the elements of such a framework? Would there be benefit in providing reference models for capacity mechanisms? If so, what should they look like?

Regional cross-border capacity mechanisms would only be appropriate in the context of a regional system security framework (see answer to question 18). However, cross-border capacity mechanisms in the absence of such a framework could either severely limit the effectiveness of the mechanism or lead to unintended consequences (such as incompatibility with the Internal Energy Market).

Market coupling already leads to power flowing to where it is most needed. Market coupling would lead to maximum imports irrespective of whether any generation capacity had been "secured" in another country. Equally, generation capacity secured in another country will not necessarily contribute to importing security where import capacity is congested. In the case where adjacent countries are also in stress it is vital that TSOs do not curtail cross-border capacity.

More important would be regional security assessments that determine the contribution each country needs to make, and for measures to be taken to achieve this at a national level. These mechanisms could be open to cross-border participation only if this is consistent with the regional security plan. Moreover, there must be measures in place to ensure that the cross-border capacity is managed appropriately.

Implementing various capacity mechanisms in different countries makes it challenging to market couple the solutions cross-border and might potentially distort the day-ahead and intraday market coupling.

Provided it operates within a well designed framework, regional CMs will be preferable to fragmented national solution.

21) Should the decision to introduce capacity mechanisms be based on a harmonised methodology to assess power system adequacy?

See previous answer