

## **EFET reaction to the CREG interim report on measures to improve access to demand-side flexibility in Belgium**



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The European Federation of Energy Traders (EFET)<sup>1</sup> thanks CREG for the opportunity to provide feedback on its Interim Report on Demand Response. The report gives some structure to the on-going discussions on how independent demand response aggregators can be best integrated in the market. As a European trading association, EFET cannot comment on all points that are touched upon in the Interim Report as they concern topics that are beyond the trading role of market participants. Nonetheless, EFET sees important elements in the Interim Report that may impact proper market functioning and would like to react those.

Fundamentally, EFET believes that the best way to get full value out of the market is to ensure the optimal functioning of the market with as little constraints as possible. All parties that can bring liquidity and value to the market should be allowed to participate freely and on a level-playing field. As such, if aggregators can bring value to the market, they should be welcomed. However, the promotion of their role should be based on actual added value, and not introduce new, restrictive market regulation for the purpose of artificially creating room for them.

EFET is worried about several proposals brought forward by CREG in the Interim Report as they may impact such proper market functioning. As a good and sustainable integration of independent third party aggregators can only be within the market framework, we ask CREG to carefully weigh the impact on the market of any measures it considers.

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<sup>1</sup> The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent, sustainable and liquid wholesale markets, unhindered by national borders or other undue obstacles. We currently represent more than 100 energy trading companies, active in over 28 European countries. For more information, visit our website at [www.efet.org](http://www.efet.org).

## **1. Flexibility should be understood as a characteristic of capacity**

A first element that should be clarified is the concept of flexibility: Flexibility is often defined as “the capability of a system to balance rapid changes, for example caused by intermittent renewable generation.” Such a definition would not be sufficiently precise. Flexibility is not just the capability to respond to *rapid* changes. The system must be able to respond to situations of scarcity for several days in a row (e.g. caused by low wind, low reservoirs, high demand, etc.). EFET therefore defines flexibility *as the capability to use capacity with few or insignificant limitations, and capacity is the option to take (consumer) or deliver (generate) electricity*. The wholesale market consists of different segments (forward, day-ahead, intraday and balancing) and each of these segments is an integral part of the market. Flexibility (or better put: flexible capacity) can be of specific value in each of these segments.

Flexibility is not a product that can be traded or valued separately from the wholesale market. Instead flexibility is a characteristic of capacity, and flexible capacity can only be valued and exploited on all segments of the wholesale market.

## **2. Free contracting should be preserved save for cases of abuse of dominant position**

A second, key element in the Interim Report is the issue of financial settlement of the energy that is rerouted away from the end-user. As explained above, flexibility can only be properly valued by having a view on the wholesale market as a whole. The value of flexibility is continuously changing based on varying prices in all segments of the wholesale market and depends on the specific aspects of each individual case. Therefore EFET strongly supports the preference of CREG for a bilateral arrangement between the parties involved. The result of such free negotiations are the best assurance that the energy is valued correctly, market participants are not adversely impacted by the actions of the independent demand response aggregator and market prices are not distorted by a regulated price. An agreement between two parties on the price of the energy that is to be exchanged is a cornerstone of the market and from which policy makers should not deviate.

This is why EFET is worried that CREG considers in the Interim Report that a standardised formula could be used in case the parties do not agree on the price of the energy that is to be exchanged. Irrespective of how such a regulated price would be determined, it would introduce distortions in the market. Part of the market would no longer be linked to the actual forces of demand and supply that normally shape the market outcome. As CREG correctly mentions in paragraph 86, a regulated price would quickly function as a reference price, as all market participants involved in such negotiations would opt for the fallback solution if the bilateral negotiations fall below or above the regulated reference price. As a result, in practice the fallback solution would become the sole means of establishing the price at which the energy is exchanged, indirectly introducing a regulated price into the market.

EFET believes that retail competition should be the basic driver to ensure that demand-side flexibility is being exploited (in those cases where demand-side flexibility has a value). A business model, where an independent aggregator is exploiting flexibility on behalf of a consumer (or a generator) and in parallel to a retail supplier supplying electrical energy to that consumer (respectively to an off-taker taking the electrical energy from the generator), does not need to be ruled out. In that case however, it is important that retail suppliers (off-takers) and independent aggregators enter into bilateral arrangements and in particular arrangements on financial compensation need to be the result of free negotiations. If bilateral negotiations between the parties fail because of bad faith from one of the parties involved, this should be dealt with on an individual basis by competition authorities, and not be a cause for the wholesale regulation of part of the market.

In theory, if a retail supplier does not allow end-consumer to value their flexibility correctly through an independent demand response aggregator, end-consumers can switch supplier. It is however patent that the current level of energy prices (and hence the limited valuation of flexible capacity on the market), combined with a sub-optimal level of competition in retail markets in most parts of Europe, do not currently set the conditions that facilitate end-customers' ability to leverage their power of choice or incentivise retail suppliers to either enter the business of demand-response management or contract such services from independent demand aggregators. The root cause of the present situation, which CREG may not be satisfied with, therefore does not lie in the negotiations between retail suppliers and independent demand aggregators. Rather, CREG should focus on sharpening energy price signals at wholesale level and improve the conditions of retail competition. And if a market participant behaves in bad faith on a structural basis, this could be ground for a regulatory intervention, especially in cases where market dominance is present.

### **3. The regulatory framework should be kept simple and avoid creating market distortions**

A third element of concern is the overly complex frameworks currently proposed in the Interim Report to deal with issues that could be dealt with in a more straightforward manner. Complex frameworks inhibit the good functioning of the market as they create additional entry barriers for new participants, reduce transparency required for correct pricing and increase transaction costs in the market. EFET is a strong advocate of simple designs that foster trust in market functioning and facilitate contracting between counterparties. An example of this are the EFET Standard Contracts that are designed to reduce transaction costs and risks by creating a standardised framework within which two parties can securely contract with each other.

A complex framework proposed by CREG in the Interim Report is one of the fallback solutions for the pricing of the financial settlement between market participants, of which others have been discussed in the previous point. The proposed solution implies a correction of the metering data of the end-user to include the diverted energy. In addition to concerns already mentioned by CREG regarding this framework – with the end-user becoming a broker and the risk of double payment of taxes including VAT – it also calls into

question how this will impact the trading positions of the market participants, including the balancing perimeter. The adjustment of the metering data should not move the imbalance risk back into the perimeter of the Balancing Responsible Party (BRP) of the end-user.

Another source of complexity is the conclusion in the Interim Report that the client list of the independent demand response aggregator is commercially sensitive data. We agree with CREG on the numerous arguments it lists against the fact that such data is commercially sensitive or can be even kept confidential given that both retail supplier and BRP need access to data to perform their duties, and that such data would allow them to identify end-users with a flexibility contract anyway, even for smaller end-users. EFET is surprised that despite the more extensive argumentation, CREG in the end considers it justifiable to keep the data confidential on the basis of limited, concise and vague arguments such as market share targets or favouring production. As a result, a neutral third-party becomes necessary to exchange the required data, complicating any possible market design.

EFET is thus worried that in the end - and for doubtful reasons - a complex market design will be implemented, confronting market participants with new data requirements, balancing adjustments and third-party interventions. EFET considers that the current market design and competition regulations are sufficient to accommodate independent demand response aggregators through simple contractual exchanges – as is already the case for all other market participants. As EFET has consistently argued, many of the current challenges arising in the market do not originate from a lack of regulatory framework, but more often from an overregulated market. As such, the introduction of further, complex market interventions should be avoided.

#### **4. The key role of the Balance Responsible Parties should be maintained**

A final element, somewhat related to the previous point, is the proposal for a separate market role for independent demand response aggregators. As CREG correctly points out under principle 3, an independent demand response aggregator should be a BRP, or be associated with a BRP. As the role of a BRP is the corner stone of the market design that incorporates all the requirements and obligations to the market, it is questionable whether an additional market role on top of this should be developed.

After all, aggregating or bundling different energy sources and marketing them on the wholesale market is not a new activity or role at all, but a rather common element of the daily activities of market participants. It is also important to recall that all resources (generation, storage and demand side options) must compete on a level playing field. The owner of an individual resource can market its flexibility - or rather flexible capacity - either by becoming an active market participant itself or by outsourcing this to a third party. The second option is the default solution for smaller entities and in particular for consumers. All this is already possible within the current market design.

We nonetheless acknowledge the need to ensure that all market participants benefit from equal treatment in all segments of the wholesale market. This includes the possibility for all, including independent demand aggregators, to access the ancillary services business and bid for balancing products proposed by the TSO. Regulatory and technical requirements preventing the participation of independent demand aggregators should therefore be removed to ensure non-discrimination. Conversely, no balancing product should be designed for the sole provision of reserves by independent demand aggregators. We refer to the study currently performed by the ENTSO-E Balancing Pilot Project on standard balancing products where specific efforts are being undertaken to open the access of all market participants to balancing markets in the future.

## **5. EFET recommendations**

EFET thus calls on CREG to avoid introducing new complexity and regulatory interventions in the current market design. This means that the free establishment of prices should be safeguarded or rather further enhanced by removing – instead of adding – distortive interventions. The market should be allowed to freely signal moments of oversupply or scarcity and offer a maximum of opportunities to market participants to bring the required capacity where and when it is most valuable. The appropriate valuation of flexible capacity relies on a number of rather simple elements:

- Decision-makers should not be scared of scarcity and increased price volatility; trading of more sophisticated forwards and options will only flourish after volatility is seen to transpire in the market
- Efforts to harmonise wholesale market arrangements across borders in all timeframes (balancing and intraday, but also day-ahead and forward) should be pursued to ensure that market entry is facilitated for all, including smaller participants
- The integrity of the OTC market alongside power exchanges should be preserved to ensure that a vast array of options remains to market participants to value flexible capacity in the market
- Smaller market participants should not be driven out of markets through the imposition of inappropriate regulation, be it in the energy or financial sphere
- The wholesale price needs to represent a significant share of the end consumers electricity bill as otherwise the incentive is steered towards tax/levy optimisation

In this way, demand response could be best supported, together with all other resources that offer similar products and can become a sustainable part of the market.

The market entry of independent demand response aggregators can indeed require a standard framework to resolve a number of administrative and legal hurdles. EFET has experience with fostering confidence through Standard Contracts that define a contractual framework that clarify the necessary points. If independent demand response aggregators can bring added value and foster increased liquidity in the market, EFET would welcome this. However, their integration should not come with the introduction of an overly regulated framework or with regulated prices. Therefore, EFET stresses the importance of the following principles:

- Flexibility should be understood as an attribute of delivered energy and should as such be correctly integrated into the energy market, on a level playing field with other market participants that also offer energy with an implied level of flexibility.
- The market design should safeguard the free establishment of prices and not introduce or impose any regulated price on the energy that market participants bring to the market. Competition concerns should be dealt with at the appropriate level, and not lead to the imposition of further restrictions affecting the wholesale market.
- Transparency through a simple market design should be pursued to ensure proper market functioning and price formation, while removing regulatory and technical barriers that de facto exclude certain participants from the market. Overly complex market designs with a proliferation of new market roles, additional intermediaries and ex-post adjustments should be avoided.

Finally, CREG should bear in mind that demand response is just one of the pieces needed to make the system more flexible. Other improvements in that direction include, amongst others, the development of storage, grid usage enhancements, and more flexible use of conventional and renewable generation. A market-oriented approach is needed to find the most economically efficient solution and to select which of these solutions is best suited to meet the needed flexibility requirements.