

EFET response to European Commission consultative Communication on Electricity Market Design



8 October 2015

Introductory Comments

The European Federation of Energy Traders (EFET)¹ welcomes the consultative Communication of the European Commission on a new energy market design (COM (2015) 340). In particular, EFET appreciates the aspiration of the Commission to move towards an integrated market-oriented model to deliver the Energy Union objectives of reliable, sustainable and affordable electricity supply.

Traded energy markets are an essential aspect of effective competition in electricity supply. They facilitate price transparency, risk management, and market entry and exit. Supply competition provides customer choice, product innovation and variety, and improved efficiency. Accurate price signals also promote efficient investment in generation and transmission capacity, as well as the emergence of storage and demand-response solutions.

EFET agrees with the Commission that the electricity system in Europe is at a turning point. Collectively, we have reached an **unprecedented level of sophistication and integration of the electricity markets in Europe**. Regulatory hurdles to trading are gradually disappearing, and markets are being coupled throughout the continent. Information transparency is being ensured and market manipulations risks are being prevented thanks to REMIT and the Transparency Regulation. Through its support of such initiatives and the development of standardised electricity trading agreements, EFET has actively contributed to the development of open, transparent and liquid wholesale power markets throughout Europe.

¹ EFET promotes and facilitates European energy trading in open, transparent and liquid wholesale markets, unhindered by national borders or other undue obstacles. EFET currently represents more than 100 energy trading companies, active in over 27 European countries. For more information: www.efet.org.

At the very same time, **significant challenges remain in the design of the internal electricity market.** The emergence of renewable power generation has largely developed separately from the operation of the wholesale energy market and has undermined the efficiency of the European carbon market, the current national framework in many Member States detracting from, rather than contributing to, the completion of a single European market in electricity. The drafting of network codes and binding guidelines has proved a difficult process with rather disappointing, TSO-centric outcomes even before implementation has started. And the impact of financial regulation such as MiFID II, EMIR and CRD IV on energy markets, for which they were not tailored, is likely to be significant and drive many market participants out of traded energy markets.

Like many sectors in the world economy, the European energy markets have suffered from the economic downturn since 2007. To make sure that the sector survives this difficult time and the efforts to complete the internal electricity market have not been in vain, serious reform is needed. **The time has come to do away with privileges, old and new, and to guarantee a level-playing field to all market participants,** irrespective of their location, the technology they use, and the type of product or service they provide.

To reach this objective, we do not believe that further primary legislation is necessary. The focus of the Commission should rather be on ensuring the implementation of the Third Package and the development and modification, where necessary, of the network codes/guidelines and the RES directive. Full implementation of the letter and spirit of the Third Energy Package and associated network codes and guidelines is a priority. **Implementation must involve consistency between the treatment of transactions within bidding zones and transactions across borders. Thus the objective, transparent and non-discriminatory management by TSOs of congestion and capacity allocation at interconnection points remains paramount, as well as the timely publication of fundamental data or variations of such data, especially concerning the availability and use of transmission capacity.** Removing distortions that stifle the traded energy markets should remain an absolute priority of the Commission, with the help of ACER. This means reviewing artificial price caps, removing regulated tariffs imposed by national governments, exchanges or regulators, rectifying national failures to implement EU Directives, and challenging TSOs which fail to allocate sufficient and financially firm transmission capacity across borders. Vigilance must further involve a critical review of measures favouring specific technologies or preventing challengers – including on the demand side – to enter the market. Any lack of transparency concerning the availability and use of infrastructure, potentially discriminatory access to transmission and storage, and ineffective or insufficient unbundling should also be eradicated.

Our responses to the consultative Communication below are all framed around the objective of **restoring the level playing field,** which each stage of the internal energy market legislation has been designed to create. At a time of unmatched challenges for the functioning of the electricity market at wholesale level, the Commission must identify those privileges of certain generators and suppliers, which need to be removed and those dimensions of freedom to participate in the market, which need to be re-established. Any future IEM policy and legislative initiatives should be tested against that desired outcome.

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?*

In our answer to this question, we have differentiated the question of prices reflecting any scarcity of generation/demand capacity from the question of the management of transmission scarcity. We believe these matters are quite different and require distinctive responses.

Price signals reflecting generation scarcity, a fundamental element of market design

EFET believes that prices should reflect the reality of supply and demand of electricity in a transparent manner, both in terms of time and location. In this perspective, the European Commission, governments, regulators and TSOs need to fully implement the target model and improve market design to allow a free formation of prices where offer meets demand. Increasing the efficiency of the market will improve price signals in wholesale markets during episodes of scarcity. This will ensure that all types of capacity (generation, demand and storage) can properly be used and valued based on a level-playing field. Making the market more efficient will result in a more efficient use of capacities and therefore translate into lower prices overall, which better reflect the match between supply and demand.

Temporary price spikes will be absorbed thanks to better usage of resources across borders and market participants' hedging of their market risks. But they will allow the energy market to provide the adequate signals for the use of and need for each type of product and/or asset (see our answer to Q2 for more details on this point).

It is indeed important to note that not only short-term markets, but also forward markets, can play an important role in the emergence of price signals reflective of actual scarcity. Products of shorter duration and more precise profiles are emerging. They should gradually assume importance in the forward timeframe alongside the traditional calendar month and calendar year base and peak products, as variations in prospective value become more easily observable in the market. Such products can become more widely traded across Europe and even standardised. One prerequisite is that price variations between bidding zones become more visible in the intraday and balancing timeframes and that there is real freedom of price formation in those timeframes. Another prerequisite is that there will be increased participation in the forward market in those countries where forwards and futures are not so liquid currently. This be facilitated by a European market design which requires true self-dispatch of generation units in each market timeframe, decentralised merit orders and non-discriminatory access for shedders of load in all countries, free from national interference.

Attention should not only be paid to market rules, but also to operational rules developed by TSOs in the connection and operational network codes: establishing restrictive standards in terms of ramping constraints on cross-border flows in the LFC&R Code, requirements on generators in the RfG network code, or excessive flexibility standards in the Demand Connection network code reduces the room for manoeuvre of the market to provide and be compensated to provide

flexibility. Such proposals prevent scarcity pricing from arising naturally in the market in tense market conditions.

Wholesale energy prices as a reflection of scarcity of available transmission capacity

As mentioned above, it is the wholesale market that will most efficiently signal times of scarcity and the need for capacity. In terms of location, the foundation for these signals is the bidding zones, with price divergences signalling in part scarcity of available transmission capacity. EFET favours stability in the configuration of bidding zones along the lines of long-standing structural congestions. This certainty and continuity are essential to underpin liquidity, investments and competition in all bidding zones, including in the crucial forward timeframe. This is also the reason why we favour larger bidding zones, as they allow for more liquidity and competition – at wholesale and retail levels – over smaller, inevitably less liquid zones.

Wholesale energy prices will only truly reflect scarcity of transmission capacity if TSOs truly maximise the allocation of transmission capacity across interconnections in all timeframes between all bidding zones, as foreseen in Article 16.3 of Regulation (EC) No. 713/2009. A transparent capacity calculation process by TSOs is paramount for this – this applies to the capacity calculation algorithms, the methodologies, and the integration of operational day-to-day network constraints – especially in a flow-based environment and subsequently the consequences of intraday scarcity of transmission capacity. Transmission capacity then needs to be allocated to the maximum volume technically possible, and as much in advance as possible in the form of financially firm forward transmission rights (either PTRs or FTRs).

Respecting this process of transparent transmission capacity calculation and maximised transmission capacity allocation as far from real time as possible will improve visibility of the value of the output from capacity and allow for a true reflection of transmission capacity scarcity. Applying these principles, i.e. making the most of the existing infrastructure, will enable market participants to better understand, predict and react to price spreads between zones, and they will provide a sounder basis for discussions on the delineation of bidding zones, as well on the need or not for further investments in the grid (including interconnections).

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?

Opportunities arising from prices reflecting power generation scarcity

Prices that reflect short-term generation scarcity provide incentives and opportunities for all market participants, and incentivises for new entrants. At the moment, the general situation of over-supply in Europe is reflected in wholesale power prices, which show rare episodes of scarcity. However, and as mentioned in our answer to Q1, products of shorter duration – in short-term markets but also in the forward timeframe – are emerging and should gradually assume a greater role as variations in prospective value become more easily observable in the market, thus improving the valuation of flexible capacity in the market. Given the rise of intermittent electricity generation, the additional flexibility garnered by such products will improve the functioning of the market and the system overall.

Scarcity-reflective prices are also necessary indicators for investments in generation and demand-response management. Without price spikes, it is unlikely that the value of demand-side response will be appropriately valued in the market. Likewise, high-running cost power generation plants such as CCGT are unlikely to be kept in the market if prices do not signal the few hours of scarcity that would allow them to remain profitable.

Decision-makers should not be scared of scarcity and increased price volatility. As already mentioned in our answer to Q1, prices should be allowed to reflect the value of scarcity during times of system stress and high demand for power; similarly, when energy is in abundance prices should be allowed to reflect the value of displacing that generation and even go negative – which would give signals for storage operators/investments if they are not caused by out of the market reasons, such as ill-designed support schemes. Likewise, the volatility of energy prices, when not induced by flows in the market design – e.g. lack of transparency, excessive reserve margins, or any other distortion to price formation – are a sign that the market reacts appropriately and fast to demand and supply signals. Natural volatility of the markets does not lead to higher risks for the system of higher prices for end consumers, provided that these customers are fully aware of market risks and are able to use the appropriate hedging instruments available, or to outsource these activities.

Political and regulatory challenges arising from prices reflecting power generation scarcity

Three elements often frighten decision makers when discussing scarcity pricing, i.e. the risk of market abuse, the impact of price spikes, and the risk of brownouts.

First, Europe is equipped with market oversight legislation to ensure the transparency of the energy market and **prevent market abuse**: REMIT and MAD/MAR mitigate risks related to the market abuse by any market participant.

Second, it is important to note the **complementary role of future/forward products and hedging practices** (including of optional products, already available with the existing market design as any other type of energy products) for limiting the impact of price spikes manifesting themselves in the short-term markets. Meanwhile, most electricity is bought and sold in forward markets and we would normally expect projections of tighter supply-demand conditions to incentivise more forward contracting. Trading of more sophisticated forwards and options will flourish after volatility is seen to transpire in the market. In any case, only a very small proportion of total demand is affected by price spikes and these costs are faced by supply businesses rather than being seen by customers themselves.

The firm forward cross-border capacity rights provide an important hedge from price spikes which would be reflected in the price spreads between bidding zones. Other hedging instruments are also available in the market so market participants should be able to proactively hedge and mitigate the impact of the price spikes reflecting short-term scarcity.

The political acceptability of price spikes is therefore rather an issue of serious analysis of the problem in the media and in political circles if all participants learn how to hedge their risks or contract services to help them to do so. The reality is that average bills over the whole year are the most important point for consumers. The fact that market participants may financially benefit from tight peak periods should not hide the fact that they do operate at a loss in other periods. As long as customer prices over the year remain stable, and system security and generation (and load) adequacy are preserved, there should be no undue public intervention on the standard functioning of the market.

Third, the occurrence of high prices however might come with a somewhat **higher risk of brownouts** in periods of severe scarcity. The political and societal acceptance of such a risk remains a sensitive issue that has yet to be debated. Also the actual settlement of the market during emergency situations and brownout situations in particular needs attention. Scarcity prices will only materialise if scarcity prices will also occur during such extreme events. At European level, the current draft of the Emergency and Restoration network code allows individual TSOs to suspend market activities (such as market coupling or import/exports) at any time in case of “Emergency Situation” – a concept that still lacks a harmonised definition in European legislation. Especially in periods of brownouts caused by scarcity, capacities that are available should be able to obtain scarcity revenues.

Challenges for market participants arising from prices reflecting power generation scarcity– and proposed improvements

Finally, besides the regulatory and political risks linked to the appearance of short-term price spikes, it must be noted that market participants also currently face a number of challenges due to the slow progress in the development of the internal energy market. Current delays in the implementation of various projects, discriminatory practices on the side of TSOs or the lack of harmonisation of short-term markets slow the emergence of scarcity prices and hamper market

participants' ability to appropriately react to them. Direct, no-regret measures to improve the situation include:

- the adaptation and harmonisation of price caps and floors at a level that does not interfere with market forces in setting the price
- the guarantee that market participants will not be unduly constrained to bid in the market at high prices in times of scarcity - while competition law should be fully implemented to avoid abuse of market power, market parties should not feel unduly restricted to offer at high prices in times of scarcity
- the removal of exit and entry barriers – such as licensing requirements and licensing or supervisory fees based on the volume/value traded in Central and Eastern Europe (entry barriers) or measures preventing free exit of the Spanish, Belgian or German markets (“Winterreserve”, “grid relevant plants”, etc.)
- the promotion of market-based congestion management practices by TSOs, without discrimination between national and foreign market participants
- the swift entry into force of more efficient transmission capacity allocation solutions – such as the issuance of fully firm forward transmission rights at every bidding zone border in Europe in both directions or the implementation of flow-based capacity calculation in day-ahead throughout Europe in a fully transparent manner and the recalculation of intraday capacity post day-ahead flow-based clearing
- the open access to explicit and implicit cross-border intraday trading, with intraday gate closures times closer to delivery and allocation methods allowing market participants to book the necessary capacity to trade across borders and to match their needs – with gate closure time not more than one hour before real time and first-come first-served explicit access until the full target model coupling the various bidding zones and allowing for both standard and non-standard products is in place
- the integration of RES into market mechanisms including full exposure to imbalances – decision-makers should ensure that existing contract holders commercialise their power on the market and face imbalance prices as any asset owners
- the end of discriminatory congestion management practices which favour national transactions – such as over-cautious cross-border capacity availability calculations, conservative allocation of forward transmission rights and lack of firmness of these rights – or national feed-in arrangements over equivalent transactions arranged across borders
- the harmonisation of balancing products, such as replacement reserves and automatic frequency restoration reserves, and balancing arrangements articulated around the safeguard of intraday markets, the efficient functioning of balancing markets, and the preservation and promotion of the self-dispatch model
- the improvement of clarity in the rights and duties of TSOs in times of scarcity especially in case of scarcity situations in several markets – reduction of import/export capacities shall never be allowed for reasons of balancing demand and supply
- the eradication of all regulated end-user energy prices, except in cases of fuel poverty – otherwise decision-makers cannot expect consumers to understand the value of demand

- the elaboration of settlement rules in times of emergency / market suspension and the clarification when market suspension can or cannot be announced by TSOs

Most of these measures are part of European legislation – notably Regulation 714/2009/EC and its annexed Guideline on Congestion Management – or have been promoted by the European Commission in various Recommendations on the internal energy market – including Communications 2012/663 and 2013/7243 of the Commission, as well as the draft amendments proposed by the European Commission on the Forward Capacity Allocation network code in June 2015. Such measures will encourage better liquidity and greater competition in order to deal with both price risk and market power. We encourage the European Commission to strictly oversee their swift implementation in the different Member States.

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

EFET believes that considerable work is still required from to complete the drafting of the balancing network code to ensure that the code complies with the Framework Guidelines and fulfils the basic principles of efficient functioning and harmonisation of balancing markets and safeguard of the intraday timeframe. We welcome the improvements that the ACER Recommendation No 03/2015 of 20 July aims to introduce in the draft balancing network code. In particular, we welcome the insistence on the integration of balancing markets, the preservation of the intraday market, and the consolidation of the conditions for standard and specific products. But we believe there are a number of fundamental flaws that need to be addressed:

- The balancing market design should preserve the integrity of intraday market activities: market participants should be given the option to adjust their position as close as possible to real time, by means of liquid intraday markets and attractive intraday markets. This must not be sacrificed by the balancing market design for the sake of economic optimisation of TSO actions;
- The door remains open for different balancing market models that are potentially not compatible with each other. As a result, TSOs are reluctant to further integrate without a final decision on the target model. As a result, TSOs still retain the right to question potentially fundamental parts of the target model during the long lasting implementation phase;
- Procurement for reserves should be market based. An obligation with a secondary market should not be accepted as a market based procurement by the TSO. A primary market will allow for a level playing field for all market participants. Furthermore, whilst TSOs/DSOs are responsible for procurement of ancillary services (including flexible products) they must never be the suppliers of these services competing with market players;
- There should be no reservation of cross-zonal capacity for balancing purposes between the TSOs. All volumes of available capacity should be allocated to the market as far in advance

of real time as possible, to allow for correct price formation and let participants the possibility to balance their positions and participate in cross-border balancing;

- Price caps and floors should be reviewed to ensure they do not impede the incentives for market parties to balance their positions;
- TSOs should not be obliged to move the intraday Gate closure time away from real time to avoid overlap with the balancing market. Participants should be allowed to self-balance their positions as close to real time as possible. Likewise TSOs' responsibilities to balance the system should be for periods as short as possible, assuming that market participants will balance individual positions in the market.
- Restrictive regulatory requirements to provide a balanced schedule should be removed: market participants should strive, not be forced to be balanced after the last intraday gate closure and should only be subject to imbalance prices in case of imbalance.

When it comes to speeding up the integration of balancing markets in Europe, the balancing pilot projects launched by TSOs in 2014 are likely to pave the way for the future balancing target model. ENTSO-E and ACER have so far exercised limited scrutiny on these voluntary projects led by groups of individual TSOs. EFET, together with other market participants, has called on TSOs and ENTSO-E to improve transparency and engagement with market participants in this domain². We invite the European Commission to pay close attention to the developments in this domain, and to actively take part in these discussions which sometimes lack the presence of a “neutral referee”.

On a final note, we would also like to mention that harmonisation is not a goal in itself. Appropriate and differentiated implementation timelines per control area may be foreseen if required. The impacts, costs and potential side effects should be carefully assessed. Also, liquid intraday and forward markets (OTC as well as exchange based) are equally important in the drive to value very short-duration products correctly. The design of harmonised balancing markets in Europe also needs to fit in the overall electricity market design, so as to ensure coherence and continuity between the different markets and timeframes.

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

EFET believes that the cross-border intraday platform based on a Common Management Module (CMM) and a shared order book (SOB) is the right way forward to integrate intraday markets throughout Europe. However, while we congratulate the Project Parties on the signature of the contract with the service provider, we cannot fail to be disappointed with the lengthy and burdensome process that has led to repeated delays in the contracting of the XBID platform. This

² See EFET letter to ENTSO-E on stakeholder engagement in the balancing pilot projects of 26 June 2015, available at:

http://www.efet.org/Cms_Data/Contents/EFET/Folders/Documents/EnergyMarkets/ElectPosPapers/~contents/GBG2HD83V23SL8AF/joint-Associations_BPP-engagement_26062015.pdf.

experience raises questions on the governance of the market coupling function (see our response to Q16 for more details).

Intraday markets have been held captive of this “project-centric” approach and the delay in the finalisation of the common EU intraday platform has led to the postponement of necessary, no-regret market design improvements to facilitate cross-border intraday access to interconnections (CMM component of the project). The achievement of market integration for intraday in a timely manner requires additional efforts. In particular, there now needs to be parallel work on the side of TSOs and cable operators, for which increased coordination and flexibility is needed, as a preliminary condition for intraday markets to develop. This includes:

- TSOs should allow market participants to trade intraday products across borders with nomination rules compatible with national balancing periods, at every bidding zone border;
- Intraday transmission capacity should be allocated on continuous basis and therefore should be free of charge;
- Cross-border gate closure time should not be further than one hour away from real time, and coordinated with local intraday gate closure time;
- Access to cross-border intraday capacity allocation must follow the obligatory use principle in order to allow continuous netting.

On this last point, we welcome the announcement made by the concerned TSOs at the last XBID User Group meeting to quickly progress on the FR-BE-NL borders. Progress is urgently required at these borders to improve cross-border intraday market access, i.e. by granting first-come first-served explicit access at these borders with 24 gates at least until the go-live of the XBID platform, and to unlock the remaining barriers to trading in standard and non-standard products in the CWE region. We also invite the European Commission to take note of the gap analysis performed by EFET to identify where urgent implementation measures should be taken³.

Given the increased use of transmission capacities in day-ahead since the introduction of flow-based market coupling, and the corresponding decrease of the available transmission capacity available for intraday⁴, there should be a clear roadmap for a swift transition toward flow-based calculation for intraday capacities. As an interim short-term solution, we urgently request a recalculation of the flow-based domain after day-ahead clearing and a review of the possible intraday domain based on this outcome.

³ See Five principles for efficient cross-border intraday trading and the annexed gap analysis, available at: http://www.efet.org/Cms_Data/Contents/EFET/Folders/Documents/EnergyMarkets/ElectPosPapers/~contents/3JZ26LNH2QGNA663/Five-Principles-for-efficient-XB-ID-trading.zip.

⁴ A general analysis shows that the market coupling algorithm finds an optimal solution in a “corner” of the flow based (capacity) domain during more than 20% of the time. As a consequence, the possible cross-border exchanges during the intraday timeframe are limited, especially for the smaller bidding zones (Belgium, the Netherlands). As an interim short-term solution, we urgently request a recalculation of the flow-based domain after day-ahead clearing and a review of the possible intraday domain based on this outcome.

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?

With significant changes in power generation patterns – notably increased penetration of renewable energy – the viability of investments in power generation is being increasingly questioned. While some investment decisions in new power generation capacity may have proved unsuccessful over the past decade due to the economic downturn and regulatory interventions impacting the market, decision makers should not give up on the market’s ability to deliver the necessary investments.

First of all, we believe that forward markets, provided that they correctly anticipate market fundamentals in the various bidding zones and once they show sufficiently large spreads, help signalling a few years ahead the need for new-build. This also requires that they be left to function properly – see our answer to question 1 and 2 for more details on this.

Forwards and futures not only allow market participants to hedge their long term positions, they are also used by market participants as a way to secure positions and physical capacity at a border far in advance of real time. One of the vital elements to allow forward markets to function across borders is forward capacity allocation. Forward transmission rights have underpinned the development of cross-border liquidity in the continental wholesale power market since the early years of liberalisation at the start of the millennium. The availability of these instruments correspondingly promotes competition in electricity supply across national and control area boundaries at the wholesale level. As a general principle we consider that all TSOs should issue fully firm forward transmission rights at all bidding zone borders, independently of the existence (or not) of other local hedging tools. These principles need to be reaffirmed in the Forward Capacity Allocation network code.

Second, we believe that bilateral long-term contracts have a role to play in the current and future electricity market design. These contracts help provide more certainty to investors beyond the timespan of the forward market. Entering into bilateral long-term contracts should remain a voluntary exercise. The contracts should be strictly unbundled, i.e. they should not be linked to any kind of transmission capacity reservation. A careful application of antitrust rules at EU and national levels will contribute to avoiding any abuse of dominant position. Also, it is worth noting that market participants that have entered into a bilateral long-term contract may continue to be active on the market and optimise their (long or short) position in the contract when approaching real time.

Third, on the role of the public sector, we believe that public authorities should refrain from intervening in contractual relationships between market participants. If one does not find a counterparty (buy side) to secure one’s new-build investment, it is probably a sign that it should not be built, and governments should refrain from intervening to underpin the price. In the case of

government-backed PPAs, there should be no retroactive regulation that would undermine the conditions of the agreement

As a conclusion, we see that different instruments are and should remain at the disposal of market participants. How far in advance and how secure a deal needs to be depends on the risk appetite of each market participant. But how diverse those instruments may be, they are all at risk of being severely affected by legislation such as MiFID II and EMIR. Specific commitments have been made by the European Commission to accommodate the needs of energy market participants with regard to legislation pieces that were designed for financial markets, and to avoid redundancies with REMIT. The Commission should see to the appropriate fulfilment of these commitments. We see a risk that ESMA's proposed ways of implementing MiFID II could have a seriously detrimental impact on competitiveness, energy security, affordability and sustainability. Adverse impacts on the degree of liquidity and on the cost of participation in wholesale markets would tend to increase energy prices across Europe. Such outcomes are in stark contrast to the policy pillars underpinning the European Commission's stated ambitions for an EU Energy Union⁵. Whichever instruments market participants would like to use to secure investments or hedge positions should remain a choice, without undue public obligation or limitation, and in accordance with antitrust rules.

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?*

Taxes and charges levied on electricity are decided and collected by Member states, and European institutions have so far exercised limited scrutiny over them. First, taxes and charges are applied very differently in the energy markets: inter alia, they can apply directly to electricity, indirectly to the primary fuel to produce electricity, or via grid tariffs. Second, a distinction should be made between energy (€/MWh), capacity (€/MW) and fixed (€) charges. Finally, another important distinction is whether the charges apply at the wholesale level or at the retail level.

At wholesale level, taxes and levies designed at national level without taking into consideration interconnections between countries and competition in terms of dispatch could create distortions:

- Additional carbon taxes, such as e.g. in the UK, are giving advantage to the dispatch of plants not facing this tax or facing taxes at different levels;
- Charging power plants with ancillary costs in a specific market may create market distortions in neighbouring markets by modifying dispatch outcomes;
- Some Member States impose taxes or levies on energy products used for power generation (gas, coal and even on hydro and nuclear power generation). Such taxes lead to competition distortion and hamper market integration;

⁵ For more information on the potential impact of MiFID II on energy markets, visit the dedicated page on the EFET website at:
http://www.efet.org/dev~EFET/EnergyMarkets/Market_Supervision_Integrity_and_Transparency_MAIN/MiFIDIIRTS.

- Auto-generators are dispatched to avoid paying levies and taxes charged to consumption even at times of very low or even negative wholesale market prices;
- Further on, power plants might be charged with different grid injection charges (€/MW) both between and within Member States (like e.g. locational signals)
- Export fees paid to the TSO may apply, such as in Bulgaria, where the fee restricts cross-border trading even when there are clear market signals to export from Bulgaria as the export is so high that it reverses the market spread;
- The annual license fees levied on every MWh traded in Italy, Hungary, Poland, Bulgaria, Romania and Croatia have a significant impact on liquidity and are discriminatory.

These selected examples of “out of the market” decisions will lead to different dispatch results (for charges related to production - €/MWh) and impact investment decisions (for charges related to capacity - €/MW).

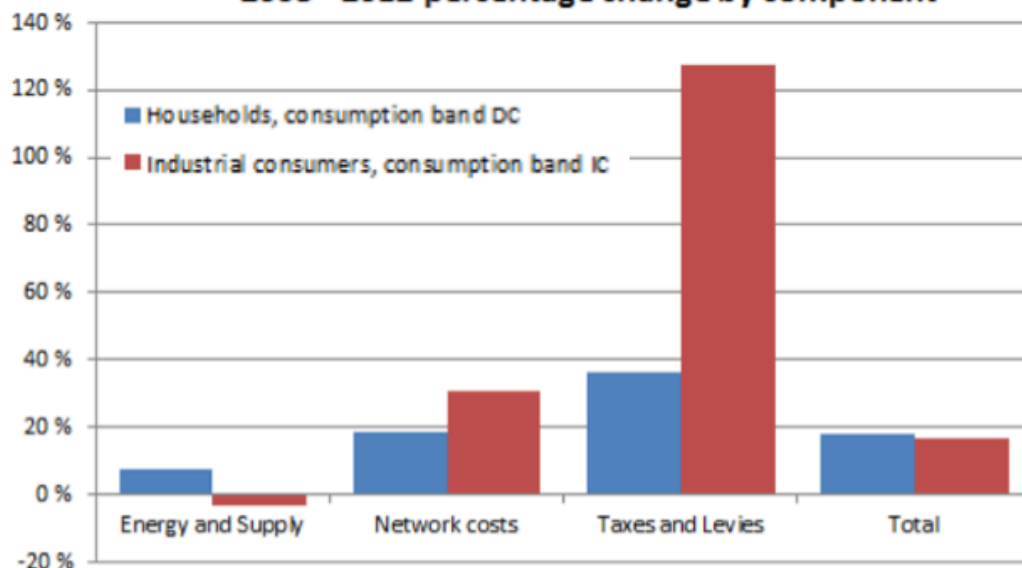
Power plants are located in a regionally interconnected electricity markets, but are subject to different national taxes. This might result for instance in the dispatch of less carbon-efficient plants and therefore lead to dispatch decisions that are not only market-distortive, but also contradict the EU environmental objectives. This situation is likely to deteriorate with the further integration of the European electricity markets (both energy and capacity). The more interconnected markets are (both physically and operationally), the more sensitive they become to distortions in cost structure and pricing. As the further integration of electricity markets is a key European objective, the removal of these distortions should be a parallel priority.

At retail level, the amount of taxes, levies and network charges has risen rapidly (see graph below), is generally above 50% of the bill in most Member States and is expected to increase further in the coming years⁶. This has some negative consequences like:

- There is a strong incentive to invest in “behind the meter” solutions (generation or storage) if this results in avoiding paying these taxes and levies. Such investments are then not market based, weaken the market, result in welfare losses and shift costs to other grid users.
- As the energy component of the final consumer bill decreases in share compared to taxes and levies, interest in demand response services dwindles, especially for smaller consumers.
- Increasing the credit risk exposure of retail suppliers: suppliers collect grid fees, taxes and charges on behalf of third parties and – in most EU countries – carry the related credit risks. They have to pay grid operators and authorities irrespective of whether their customers pay their bills or not. France and Italy recently ruled a more balanced repartition of risks between DSO and suppliers: EFET would welcome an enlargement of such rules to other Member states.

⁶ The European Commission Report on Tax Reforms in the EU Members States released last year shows that continuing the trend from the previous year, a significant proportion of Member States increased excise duties on energy.

**EU 28 wtd avg retail electricity prices,
2008 - 2012 percentage change by component**



Source: European Commission and Eurostat

As a conclusion, we believe that the European Commission should take a guiding role in coordinating and possibly harmonising the way taxes, levies and charges are collected throughout Europe to limit distortions between Member States. Besides, the explosion of taxes and levies deserves a serious discussion as to the acceptability of such costs – primarily linked to the development of power generation from renewable energy sources – for end-consumers.

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

We believe that the central instrument to encourage support in investment in low-carbon technology should be **the EU Emissions Trading System (ETS). It promotes the most cost-efficient form of abatement and does not distort the internal energy market.** The fact that the price signal in the EU ETS has been weak has only served to support the proliferation of a wide range of national renewable support schemes. Therefore, the focus should be on structural reform of the EU ETS to ensure it regains relevance as the primary means for supporting low-carbon technology. On this point, see our contribution to the reflexion on the need for further reform of the ETS Directive, together with our support for the Market Stability Reserve proposal⁷.

A fundamental reflexion on the viability of RES-E support as it exists nowadays should be launched. The diversity of renewable support schemes currently in place in many Member States is no longer

⁷ See the EFET comments to the ETS Directive review proposal of 15 July 2015, available at: http://www.efet.org/Cms_Data/Contents/EFET/Folders/Documents/EnergyMarkets/RE/~contents/DSX25ZBLUJMPUCUQ/EFET-comments-ETS-directive-review-proposal.pdf.

compatible with the completion of the single electricity market if they come in conflict with the EU ETS price signal. Therefore, new EU legislation in this field is needed to make that clear.

Specifically, we believe that **operational and connection privileges** should be reviewed:

- Balancing responsibility needs to apply to all types of generation, including renewables;
- Priority dispatch and priority grid access for renewables need to be abandoned where they still exist:
 - flows should follow prices and not be prioritised based on feed-in of specific technologies, and
 - RES generators should be subject to the same connection procedures and costs as other generators.

Beyond these operational aspects, a thorough review of **the financial support** enjoyed by RES producers needs to be launched. This includes:

- Phasing out of fixed feed-in tariffs, as they effectively segregate renewable generators from participating in the market;
- Ensuring the cross-border validity of renewable electricity attributes, for entitlement to financial support when imported / exported across borders. Furthermore, we believe that more needs to be done to allow the use of Guarantees of Origin as a mechanism for trading renewable electricity across borders;
- Lifting the financing of renewable support schemes, as well as other climate action policies, taxes and levies from the electricity bills to the state budget, so as to align private incentives and socially optimal investment signals and reduce the cost for RES and DSR development and “behind the meter” investments – all this being also valid for support for electricity generation from nuclear and fossil fuels;

Finally, a **clear strategy for the phase-out of direct financial support for renewables**, based on the maturity and economics of technologies, facilitated through a move to more competitive allocation of support should be sketched for the horizon 2030:

- There should be more focus on enhancing and strengthening the carbon price signal in the EU ETS as the most effective and efficient way of incentivising investment in low-carbon electricity and on decreasing the cost of support schemes, thus allowing for a truly market-driven energy transition;
- More awareness should be raised on the transfer effects between the carbon price and the RES support scheme – as a stronger carbon price will be largely passed through the wholesale power price (in most cases set by the marginal cost of carbon-intensive thermal unit), renewables could then get sufficient remuneration through this price signal as they would not have to surrender emission allowances for their production. The net effect of this shift on final consumers will be neutral or even positive due to efficiency gains and lower administrative costs.

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?

We believe there is an important and necessary role for the Commission to provide firm guidance – in the form of new legislation – to Member States to facilitate better coordination and harmonisation of renewables across Europe. There needs to be a ‘culture shift’ whereby renewables policy is no longer a ‘national’ matter but something that is cultivated on a pan-European basis. This will ultimately lead to better outcomes for all consumers.

Exposing RES generators to the market

The integration of renewables into the market has to be promoted by an appropriate design of support schemes. Exposing RES-E generators to the market (even if financial support of some sort is provided) as opposed to guaranteeing them a fixed price would be beneficial in this respect. We therefore believe that fixed FiTs should be phased out.

Regardless of whether support is in the form of investment or operating aid, provided that generators are not wholly insulated from the wholesale market, the focus should be on ensuring the allocation of support is competitive. An increasing number of EU Member States are heading in that direction. Moving to more competitive allocation ensures that support is necessary and proportionate, provided that ‘overcompensation’ is avoided and the schemes allow for RES-E imports. As such, we believe that more competitive allocation is complementary to a clear strategy to phase-out all financial support for renewables, based on the maturity and economics of technologies.

There is a question as to how to integrate existing renewable generation that remains excluded from the wholesale market on the basis of legacy contracts (for example, 10- or 20-year FiT contract). We believe that policy makers should find an approach that is mutually beneficial for both generators and consumers. Generators should be incentivised to participate in the market, up to the value that their participation brings to the system as a whole. The German model of offering generators the opportunity to choose ‘Direct Marketing’ instead of a feed-in tariff is an example of how existing generation can be ‘brought into’ the market.

Reviewing priority dispatch and priority access

On the specific topic of the merit order, the current priority dispatch arrangements, where they still exist, do not incentivise RES-E producers to moderate their own output efficiently. This leads conventional generation operators to perform multiple stop-start operations which, in addition to being unnecessary costly, makes the overall environmental benefit in terms of GHG suspicious. Besides, such operations may artificially lead to negative prices (in Germany for instance), which further erode the overall income from the market leading to further intervention.

Although RES-E producers are currently assured of certain privileges in terms of access and dispatch according to the Renewables Directive, this should not prevent the provision of market-based or TSO-designed incentives to RES-E producers to moderate their own output in response to price signals or to contribute to the management of network congestion and system imbalances. Future versions of the Renewables Directive should clarify this in more detail and should be consistent with European market design whereby generators of all types are largely responsible for their own dispatch decisions.

Rationalising financial support for low-carbon investments across the board

Particular attention must be given to small-scale generation currently connected at the consumers' sites behind the connection point. At present, the exponential rise in network charges, taxes and levies encourages consumers to invest in "behind the meter" solutions to bypass the electricity bill. These private initiatives, often financed by public funds, lead to uneconomic decisions when total system costs are considered. In order to promote a sane developments of new clean technologies at the lowest possible cost for the whole system, a review all financial aid and how it is pass through onto end-customers is needed.

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)?

RES promotion today: a patchwork of uncoordinated, largely non market-based initiatives

The current framework of the Renewable Energy Directive has promoted the rapid growth of power generation from renewable energy sources (RES-E), and we share the European institutions' satisfaction to see that the level of greenhouse gas (GHG) emissions were estimated well below 1990 levels. However, for the most part, this advancement has developed separately from the operation of the wholesale energy market, has come at an unnecessarily high cost to the consumer and has undermined the efficiency of the European carbon market. Furthermore, the current framework detracts from, rather than contributes to the completion of a single European market in electricity, as in reality it largely relies on uncoordinated national schemes to support renewable generation.

The operation of those schemes has had a number of negative effects on other policy objectives, especially the completion of the single electricity market in a cost-efficient way. Some of the negative side effects include:

- An erosion of the energy and carbon markets caused by the current policy architecture, leading to unnecessary costs for the energy transition and negative effects on competitiveness and investments

- High costs to consumers and distortion of the retail market through allocation of costs only to ‘non-privileged customers’
- Limited development of the cooperation mechanisms or joint schemes provided for in the Directive due to an excessive reliance on individual Member State initiatives and deficient development of a proper standard for the Guarantee of Origin (GOs), hindering the implementation of a proper voluntary market for renewable energy generation attributes
- Reduced effectiveness of the emission allowances market, and, arguably, little additional savings in CO₂ emissions beyond what would have happened naturally with the phasing-out of coal-fired generating plants, the recession, and the reductions forced through ‘command & control’ instruments to support RES-E and energy efficiency, increasing the cost of decarbonising the EU compared to what an efficient EU ETS would have delivered
- Inefficient dispatch of generation plants and artificially volatile prices
- Decreasing liquidity of wholesale electricity markets through the exclusion of RES-E output from normal contracting processes in many countries
- Unpredictable physical network flows leading to restrictions in the availability of cross-border transmission capacity, distortions in cross-border trade and restriction of cross-border competition due to insufficient contribution of RES-E generators to
- the planning of network operations, insufficient information exchange between RES-E generators, DSOs and TSOs, and between TSOs themselves, as well as insufficient procedures for coordinated cross-border congestion management (transmission rights buyback, redispatch, countertrading).

Our vision for 2020 and beyond: a coherent European framework for climate action

In our view, the current framework as detailed above is not a sustainable approach for the medium to long term. An important lesson from the 2020 framework and the present state of the EU energy system concerns the interactions among the different targets, policies and instruments. To yield the desired benefits, the framework going forward should contribute to creating a secure, liquid and well-functioning energy market through the full harmonisation and integration of regulatory measures introduced in the past years. One of the highest priorities of EU climate and energy policy is to provide greater coherence between the EU ETS and other EU climate policies, such as energy efficiency and renewable energy promotion, and to ensure minimum distortion of the internal energy market. Unfortunately, we observe this is not happening at the moment, as the EU is likely to implement once again three separate targets. The cap reduction trajectory leading to a 40% reduction across the economy (equivalent to 42% in EU ETS sectors) appears to be oblivious of out-of-market emission reductions linked to national RES development and energy efficiency policies will trigger.

Despite repeated pledges by Member States to develop cooperation mechanisms or joint schemes provided for in the Directive, only one such scheme has emerged in twelve years, namely between Sweden and Norway. The lack of willingness on the side of individual Member States to advance this important feature of the Directive has exhausted market participants’ patience to see improvements in Member State cooperation in that regard. EU Member States have enjoyed too

much room for manoeuvre in relation to the implementation of EU legislation for renewable energy, which has had detrimental effects on the functioning of the internal electricity market. Indeed, renewable power generation has been deployed on sites offering the best economic or commercial conditions the investor (e.g. by reference to high tariffs) rather than the most productive sites or where such generation capacity is needed, leading to unnecessarily elevated socialised costs. The absence of coordination between national renewable energy support schemes also leads to a degree of variety and incompatibility, which is certainly not in the spirit of an EU-wide internal market. Increasing the share of renewable energy in the consumption mix without at the same time ensuring the harmonisation and tradability of renewable attributes makes the integration of large volumes of electricity from renewable sources into the wholesale market impossible, which is in clear contradiction with the goal of a competitive internal energy market.

The European Commission needs to take the lead in coordinating Member States climate action initiatives

We believe that the European Commission needs to take a stronger role in coordinating and supervising the compatibility and side effects of climate policies in Member States. It can achieve this through stronger scrutiny of Public Service Obligations imposed by Member States under Article 3 of the Directive 2009/72, through the state aid guidelines for environmental protection, and by ensuring that support schemes do not infringe the Treaty by restricting trade between Member States. Further legislative steps could be envisaged to enforce a European approach to the deployment of renewable energy in Europe at sites with the best natural conditions or close to the most optimal customer base. In this perspective, a review of the RES Directive in line with the recommendations of Advocate General Bot in the Ålands Vindkraft case would be relevant. In particular, the European Commission should analyse a situation when an RES-E project investor in one Member State wants to apply for a support in a second Member State, but assuring that the project RES production counts against the commitments of the second (supporting) Member State.

Particularly, the European Commission should seek to fully integrate renewable energy generation into the market by requiring RES-E producers to comply with balancing obligations and by harmonising efficient support schemes for renewable energy across the EU. Likewise, any mechanisms to promote renewable generation (beyond the ETS) must be closely controlled to deliver a level-playing field for investment in renewable energy production, to deploy renewable energies in a cost-efficient manner, and to preserve the European internal electricity market and the EU ETS. The establishment of sustainable energy markets throughout Europe for the overall long-term benefit of the economy and of society must be retained as a key part of the EU energy policy and strategy. Well-functioning energy markets have the capacity to provide clear wholesale price signals, which allows the optimisation of supply and demand and enhances security of supply. It is our strong belief that market fundamentals should continue to form the backbone of EU energy policy and that the new framework should be designed with a view to ensuring the functioning of the internal market. This will provide for a cost-efficient realisation of the EU climate objectives, improve the security of European energy supply and offer an efficient model for others to follow.

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 roll-out of demand response has so far been limited in most EU countries, probably because of low wholesale electricity prices. Undoubtedly, more market volatility and significant price peaks in hours of scarce supply will have to be seen before many more consumers – from large industrial to business and domestic customers – are attracted to true participation in the market. At the margin the removal of regulatory and grid access barriers facing industrial users of electricity, together with better access to intraday purchasing arrangements, may help.

All market participants – generation, demand and storage – should compete on a level-playing field. The proper valuation in the market of flexible capacity is the key. Policymakers should resist the temptation to create special privileges, regulated or otherwise. Meanwhile the functional and financial unbundling of the transmission businesses of integrated energy companies remains paramount. Policy makers should focus on improving the market design instead of promoting certain types of flexibility.

Decision makers need to keep in mind that the emergence 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 (especially intraday and forward) should be pursued
- 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 financial sector regulation
- 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 any case, demand response is just one of the pieces needed to make the system more flexible. Other improvements in that direction include the development of storage, grid usage enhancements, 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.

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?

While we believe certain elements of inter-TSO cooperation are more easily managed at regional level and RSCIs have proved their added value, the priority should continue to be the harmonisation of market rules and market functioning.

Whilst there may be efficiency benefits in moving decision-making powers to a more central body, this is not strictly necessary. Nevertheless, there is much room for progress in terms of inter-TSO cooperation, for example through streamlining the financial arrangements between TSOs (e.g. we would not need the existing, inefficient ITC arrangement if we had a harmonised system in place for charging or not charging G and L tariffs for transmission access, possibly with locational charging signals built into the harmonisation on a pan-continental basis). Also the failure to draft certain EU network codes with precise and harmonised rules shows that progress based on voluntary cooperation between TSOs is not to be taken for granted.

The more integrated the management and operation of HV grids across Europe, the better it will be for both power price and generation investment signals. We would hope integrated system management will make it less likely that a TSO withholds transmission capacity between bidding zones out of undue caution or lack of willingness to take on commercial risk. That in turn means it should eventually be easier to eliminate the blockage of interconnection capacity by non-commercial flows of RES-E supported financially on a purely national basis.

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?

All parties to the Internal Energy Market can congratulate themselves for the rapid expansion of the internal electricity market since the start of the liberalisation process in 1999. European institutions, NRAs, TSOs, PXs and all market participants can be proud of their role in ensuring concrete cross-border developments and implementation initiatives before (and probably still after) network codes are in force.

However, we observe that progress on the advancement of the Internal Energy Market is too often slowed down by the lack of ambition of individual TSOs – through individual actions or via their influence in ENTSO-E – and regulators or by the difficulty for individual TSOs to agree on a common and clear position.

ACER is instrumental in ensuring compliance of network codes with framework guidelines, while promoting the development of best practices and ensuring Project Parties effectively work together in delivering concrete results through the early implementation projects. EFET believes that despite its limited statutory powers, ACER has had a positive influence as far as the progress towards the completion of the Internal Energy Market is concerned.

We believe that the Agency should make full use of its powers and role as they stand in the Third Energy Package, with a clear mandate to ensure delivery and achievement of the Internal Energy Market. This includes its dispute resolution mandate, which has so far been used in a very limited fashion. Also, the role of ACER should also be recognised in the wording of the network codes: provisions of the network codes foreseeing a role for all European national regulatory authorities collectively should fall in the realm of ACER, as the Agency should remain the guardian of the energy markets harmonisation process.

We also consider that the role of ACER should be further extended and strengthened vis-a-vis the national regulators, considering the need for network codes to be fully compliant with framework guidelines and to take full account of best practices. This would allow for a more coordinated European approach, rather than a regulatory process dominated by different national regulatory perspectives. The influence of certain NRAs over ACER decisions may be strongly felt at times, which leads ACER to take less ambitious roads and compromises instead of pushing for an ambitious completion of the Internal Energy Market. It is therefore also necessary to adapt the internal governance of ACER to ensure its independence and its ability to take a truly European, and not national, stance on market integration issues.

In the past, ACER has shown outstanding steering capabilities in spite of many obstacles with regard to the electricity market integration agenda, notably through AESAG. All European Stakeholder Committees and subject-specific expert groups proposed to be set up by ACER should be established as soon as possible. It is important that the role of the European Stakeholder Committees and expert groups should not be restricted to sharing views on guidelines implementation and monitoring. The committees and expert groups should take concrete and motivated actions based on a fair and well-balanced consideration of all stakeholder interests. Information and exchange of ideas is fruitful and necessary, but experience of the drafting of network codes has shown to market participants that their input was rarely followed up by concrete, motivated decisions. Any conflict arising at expert group level should be reported to the European Stakeholder Committees.

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

Discussions on the review of bidding zones delineation or the drafting of certain network codes has showed the need for some reflection around the role and power of ENTSO-E and its member TSOs. While we are moving towards the implementing phase of the target model through the application of network code rules, the roles and responsibilities of each party should be clarified, with a careful attention to conflicts of interests and clear accountability of all.

We believe that a large part of the difficulties in the electricity network codes drafting process is attributable to the reluctance of TSOs to depart from existing arrangements and their lack of understanding of the benefits coming from truly pan-European arrangements. This has also been observed in the different early implementation projects (EU HAR, CWE Flow Based Market Coupling, BPP) where the solution chosen often results in a lowest-common-denominator option. For instance, implementing flow-based market coupling in CWE using non-harmonised methodologies for grid topology (such as the Generation Shift Keys) leads to the necessity for the TSOs to take higher security margins on the commercial capacities. EFET believes that counting on good will and cooperation between the different TSOs will not be sufficient to guarantee the implementation of the Third Package. Tasks, processes and methods should be integrated to guarantee a full integration of energy markets, allowing non-discriminatory access to the grid and a significant reduction of capacity calculation and allocation margins.

Greater attention should be paid to the discharge by ENTSO-E of its duties under the Third Energy Package without interference of individual TSO interests going against ENTSO-E's efforts to build the internal energy market. ENTSO-E's role and independence vis-à-vis its members should be strengthened, so that the organisation can be fully dedicated to its core roles and responsibilities of ensuring system and network security at European and local levels. This should be done through increased TSO coordination and cooperation, while dedicating its efforts to facilitating market efficiency so that markets can work in a safe environment at any point in time, based on "fit for purpose" and reliable market and network infrastructures.

In this context, we would like to see the governance of ENTSO-E reformed so that the direction and content of draft electricity network codes is not subject to voting within a general assembly of an association; electricity market related network codes (and probably all other codes which bind third parties other than TSOs) should preferably in future be handled by a foundation bound by a much stricter and narrower statement of purpose; such a foundation should be separate from pursuit by ENTSO-E as an association of business, infrastructure development, security and financial interests on behalf of its members.

This should help ENTSO-E tackle the new challenges that expect the organisation, including reflections on how best to address flexibility at a European level, to which extent local systems can accommodate any type and volume of flexibility, and whether part of these variations could or should be more efficiently managed at the injection.

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?

EFET recognises that DSOs will assume a more important role in a system with increasing decentralised generation. Clear priority rules should be established when it comes to providing services to the DSO, the TSO or participating in the wholesale market. DSOs can play an important role in this as a facilitator for the market integration of decentralised capacity and a consumer of some of the services these can provide. This should be done along the following lines:

- Regulated parties (grid operators) should be neutral market facilitators and should not engage in commercial activities. In line with the principles of unbundling, services offered by decentralised generation and storage or related to flexibility, energy efficiency, sub-metering, consumption information, etc. should be based on fair competition provided by commercial parties. It will allow the emergence of better solutions in terms of quality, cost-efficiency and customer orientation than what could be achieved by regulated monopolies;
- Regulation of DSOs should incentivise them to search for the economic optimum taking into account all relevant options including investment as well as procurement of services from commercial parties. Current regulation often results in a bias of DSOs in favour of investment-based solutions instead of alternative service-based solutions – e.g. DSOs should procure flexibility services from commercial parties in order to avoid unnecessary grid investment as long as this proves to be the most cost-efficient solution;
- Clear principles for access and management of consumption data as well as for privacy and security are needed to protect customers’ interests and foster innovative services. As customers own the raw data, non-discriminatory access to raw data should be based on the customer’s explicit consent. Any treatment of raw data is then owned by the party who carried out the processing and sustained its cost. The owner can valorise the data with the consent of the customer and in line with privacy requirements. The DSO should be a neutral market facilitator and should not propose commercial services based on data (e.g. sell processed data to other parties).

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?

It is necessary that all users of the interconnected network see the cost they impose on the system (even though in specific locations those costs could be negative). Cost reflectivity is important in giving correct pricing signals and preventing discrimination.

As mentioned in our response to Q14, and in line with section 3.3 of the European Commission proposal, we believe that DSOs should remain neutral market facilitators. As such, it is questionable whether DSOs should be allowed to change the market outcome by setting tariffs irrespective of market prices, and by doing so, influence market behaviour and market outcome. Indeed, this would mean that they become an indirect market participant. DSOs can do this by adding other parameters, such as time of use tariff signals. Time of use signals (both for peak and volume tariff components) create additional incentives to change customer behaviour. Changing customer behaviour influences market outcomes. Taken to its extreme, time of use signals that would strongly discourage energy consumption would as a consequence lead to very low prices on the wholesale market, not reflecting the actual state of demand and supply. It shows a possible conflict between “grid tariff signals” and “market price signals”.

Flexibility market platforms, where DSOs are allowed to “buy” services (ramp down, or even ramp up) from customers (via their suppliers/aggregators) are in our view a more appropriate tool to let markets and tariffs interact. DSOs receive from such platforms appropriate signals to compare whether customers’ flexibility is cheaper compared to additional grid investments. Where grid tariffs lead to the imposition of a certain customer behaviour, demand side response platforms give the customer an opportunity to value its contribution to system control, which is a much more market-based approach. Such types of solution are economically efficient solution, reduce socialised costs, and are best suited to meet the needed flexibility requirements.

Self-generation should ideally be treated as any other type of generation. This would require separate metering and settlement of self-generation (as well as of self-storage) without netting consumption and generation.

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

A fundamental distinction needs to be drawn between power exchanges’ dual role, namely:

- their fully contestable and competitive function as providers of trade execution and settlement services; and
- their natural monopoly function as a participant in the coordinated management of network congestion and capacity allocation.

As per the provisions of the CACM binding guideline, power exchanges' role in the expansion and functioning of market coupling are now enshrined in regulation. Power exchanges therefore bear special responsibilities, and the governance rules of how they discharge these duties must be clear and transparent. Market coupling, capacity allocation and congestion management are natural monopoly functions in the sense that they are most efficiently performed by a single entity over an interconnected region rather than isolated local or national calculations of capacity. Only then can the full range of network externalities be identified and internalised into the most efficient allocation of capacity and network flows that are consistent with network capacities and constraints. Both the Euphemia algorithm and flow-based market coupling are natural monopoly functions that cannot and should not be left solely to commercial businesses without appropriate oversight.

Indeed, these conflicting roles of power exchanges were a significant hurdle and factor for delays when developing the common tools for operating the single electricity market:

- delays to the provision of intraday market coupling are precisely due to the lack of trust and difficulty of the power exchanges to agree on the correct commercial platform to host the coupling while vying for their own platforms to become the preferred choice-
- The Euphemia algorithm is under strain from the need to accommodate many different market designs (e.g., the auction based systems in North-West Europe and the pool based systems in Iberia). This both limits the ability of individual power exchanges to change and innovate on their execution product offerings (e.g., trade types) and the ability to streamline and improve the efficiency of the coupling algorithm.
- There is still a lack of transparency for market participants in many areas over the operation of markets or the Euphemia algorithm such as the publication of block bids in all bidding zones, the selection of critical branches, the publication of flow-based calculation factors (including GSK methodologies and values, separate CB and CO identification in fixed ID format, fixed ID publication in D-1 morning, breakdown of RAM into Fmax, Fref, Frm and Fav) and the calculation of transmission capacity. The result is a “black box” effect, which leaves market participants unable to derive, verify or forecast the link between the respective order books and the resulting prices.

One solution to these issues is to establish an overarching system of governance for market coupling – a “Market Coupling Coordination Body” – to manage the design, implementation and operations of market coupling with the power exchanges becoming “Market Coupling Delivery Agents” who are feeding their individual order books into the centrally governed processes and disseminating the ensuing results to their users. The Market Coupling Coordination Body would inter alia perform the following functions:

- Determination of market coupling rules including the central Euphemia algorithm;
- Design of interfaces to the central market coupling algorithm including acceptable product types and designs;

- Working with TSOs to publish details of transmission capacities, transfer factors and capacity calculations;
- Design, development and maintenance of the flow-based market coupling architecture;
- Provision of the flow-based model, assumptions and data to all market participants;
- Operation of market coupling and the dissemination of results via the participating power exchanges.

We believe that **power exchanges are well equipped to organise and run this “Market Coupling Coordination Body” and that there is no need for a formally regulated body.** To ensure that decisions are taken in the interest of the market and avoid potential deadlocks linked to conflicting business interests of the different power exchange, the governing arm of this Body could include ACER representatives and participants representatives. The Body would perform its functions according to the following principles:

- A primary objective to promote effective competition in the single electricity market through the provision of efficient and coordinated congestion management and capacity allocation; and
- A duty to ensure that its activities are transparent, accountable, proportionate, consistent and targeted only at cases where coordinated action is required.

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

Adequacy planning, system operations and security of supply questions are highly interlinked and need to be tightly coordinated across borders. A common approach to assessing system adequacy will contribute to a more ‘collective’ approach to ensuring security across borders. Moreover, the methodology should not only be based on static or ‘expected’ generation parks (like the current ENTSO-E methodology), but also include an economic assessment whether the plants are economically viable.

But first and foremost, there needs to be greater clarity and ‘firmness’ with regards to what happens in a situation where there is a period of simultaneous scarcity across bidding zones:

- CACM and FCA codes must ensure that forward rights and day-ahead markets are fully firm;
- Preventative cross-zonal capacity curtailments by the TSOs should be prohibited;
- TSOs wanting to hedge their system risks (or congestion risks) should buy back transmission rights.

For further elements on a harmonised methodology, see our answer to question 18.

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)?

We call for an adequacy assessment to be completed at regional and pan-European level. The current ‘national approach’ potentially leads to an over procurement of capacity as Member States do not appropriately take into account what capacity is available outside of their borders. As a medium step, regional assessments based on clusters of countries that are highly interconnected can be efficient, as they will effectively pool resources over a wider area.

The ENTSO-E Security Outlook and Adequacy Forecast reports are a first step in the direction of such a European approach to adequacy assessment. However, the reports so far only consolidate the analysis of individual TSOs for their respective control area/country. Market participants still expect a truly European adequacy assessment from ENTSO-E, and national regulators should support the requests of ACER and the European Commission in that regard.

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

EFET believes that the most important reforms when it comes to building an efficient single market is to ensure that prices are allowed to move freely, and without impediment so that existing capacity is properly valued and signals for additional capacity emerge when it is needed. In particular, explicit and implicit price caps and floors should be reviewed to a level that does not interfere with market forces in setting the price. During times of system stress, prices should be allowed to rise to reflect the value of scarcity; similarly, when energy is in abundance prices should be allowed to fall (and even go negative) to reflect the value of displacing that generation.

Meanwhile, the harmonisation of system adequacy standards could contribute to making sure that, e.g. “diverging preferences” regarding security of supply on the part of national governments do not overlook the contribution of neighbouring markets and lead to an over-assessment of generation adequacy needs. The Commission should challenge policies implementing national preferences that interfere with the functioning of the internal electricity market.

In the current context where EU Member States seem to be pushing ahead with the adoption of capacity remuneration mechanisms (CRMs), we would welcome an initiative of the Commission to develop rules for coordination of capacity mechanisms and suggest that capacity mechanisms should remain under its scrutiny as part of the state aid and/or public service obligation monitoring processes.

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?

National capacity remuneration mechanisms, if implemented, should be market-based in the sense of market with full competition between all capacity providers with no regulation of capacity prices. This also means that national CRMs should take account of the availability of capacity in all bidding zones. As things stand so far, Member States who have implemented capacity remuneration mechanisms have done so in an uncoordinated manner, which makes the contribution of foreign capacity difficult to integrate in national mechanisms.

Interconnected capacity should be able to participate in national CRMs in order for it to be consistent with internal market legislation. As requested by the Commission, Member States with a CRM need to explicitly take into account the contribution of foreign capacities. This will likely require advanced TSO-TSO cooperation, and will require more complex arrangement at EU or regional level. EFET therefore supports the establishment of EU rules in this domain, or, possibly as a first step, bilateral or multilateral agreements between the concerned Member States and their TSOs. One note of caution though: in no case should the cross-border participation to national CRMs result in any reservation of cross-border transmission capacity or alteration of cross-border flows from the market outcome.

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

See answers to Q17 and 18.