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EFET Response to ACER Public Consultation on “European Energy Regulation: A Bridge to 2025”

1. Have we identified correctly the issues and trends within each area of the energy sector?

Current short and long-term prospects for gas demand in Europe remain uncertain, particularly given the wide range of global fuel prices, risk of stranded assets and the prevailing economic challenges facing industrial gas users and gas-fired power station operators and prospective investors.

The European Federation of Energy Traders¹ considers, however, that the energy sector trends – as were rightly captured in ACER Green Paper – should not dictate how regulation should develop at the moment. The regulatory approach needs to recognise these uncertainties and ensure that the framework is not predicated only on one scenario, a particular fuel mix or demand/supply assumption. Set of regulatory rules should envisage **a flexible approach and framework** to allow for different market outcomes, and not otherwise becoming a self-fulfilling prophecy.

¹ 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. EFET currently represents more than 100 energy trading companies, active in over 27 European countries. For more information visit our website at : www.efet.org

That said, gas should not be discriminated against by support for other fuels (i.e. no undue subsidies), and a **market-based level-playing field** needs to be established for all fuels and technologies so that all energies can be integrated into the European energy market.

For gas this means that **further development of traded markets** across Europe is essential so that they can cope adequately with changing gas demand patterns and uncertainties. Energy policy should aim to facilitate a market-based investment approach rather than centralised planning; development of trading hubs is essential to help inform investment decisions as well as providing short-term risk management tools. EFET recommends to develop clear, non-discriminatory (non-binding) guidelines for regulators that help establish cross-border hub governance to facilitate a hub merger (if the market indicates such a merger would be desirable/beneficial). We are helping this process move forward with our work on establishing Virtual Trading Points (see EFET guide) that can develop into robust and liquid hubs.

Market-based solutions should also be sought to cope with other challenges and costs, such as carbon emissions and the intermittency of renewable energy.

Gas trading as such faces new challenges, including:

- Political and economic support for RES and nuclear has impacted demand for gas, as has currently low price of coal and carbon.
- Overcapacity in transportation and storage and in generation in some member states has reduced price volatility, with exiting of market players. A consequent loss of liquidity could have adverse consequences for competition and reliability of price indexes.
- Cost of trading (compliance, clearing, regulatory capital) may further reduce the number of active traders and the level of trading activity.
- Reduced profitability and increasing costs of compliance put pressure on time/resource on regulatory matters.
- Competitiveness of the European gas market vis-à-vis other global regions.

On the electricity side, the integrated European market will only manage to provide greater opportunities for cross-border trade and enhanced competition if the **existing regulatory framework is fully used and implemented**. Then greater competition, transcending currently divided geographical markets and reinforced by new market entry, really will result in a wide variety of benefits for market participants, investors and, most importantly, consumers.

While the continued implementation of the existing legislative framework should be a priority for ACER, the European Commission and ENTSO-E should focus on RES-E integration related reforms urgently. **Implementation must improve efficiency of congestion management within bidding zones and across bidding zones borders**. Thus the objective, transparent and non-discriminatory management by TSOs of congestion affecting inter-connection points is axiomatic. Maximisation of transmission capacity allocation in all timeframes across zonal borders must remain paramount. Also still of great importance is the timely publication of fundamental data about the availability and use of electricity infrastructure.

In short, electricity trading still faces challenges, including:

- Integrating renewable energy into the power market design (wholesale market and network infrastructures).
- Developing and improving intraday markets by moving gate closure to H-1 and facilitating cross border exchanges to make the maximum use of interconnector capacity.
- Developing and improving balancing mechanisms, also on a cross border basis.
- Allowing free price formation in wholesale markets and remove explicit and implicit caps/floors.
- Extending real-time metering to enable demand response.
- Removing unnecessary operational requirements and restrictions on generation companies.
- Ensuring a stable and consistent energy policy framework for decarbonisation based on ETS.

The development and implementation of the electricity and gas target models need to continue. Some questions remain unresolved e.g. on how to fit demand response into market arrangements or how to ensure that the market can deliver the flexibility that is needed. And even where we know what the solutions are, these have not yet all been implemented in all Member States.

All in all, policy intervention should not create windfall winners and losers, and should work with the market to deliver policy intent in most efficient way.

2. Have we identified an appropriate regulatory response?

EFET urges ACER that the list of regulatory actions annexed to the Green Paper (some of which are more detailed than the other) should not be overly prescriptive but rather allow for a flexible approach as being most pragmatic.

EFET reiterates the need for **a greater focus on continued implementation of the existing legislative framework, namely the 3rd Energy Package and associated network codes**. Interdependence of the network codes is key but inconsistencies are appearing limiting potential gains. Implementation must, however, take account of the need for a consistency at major interconnection points. EFET supports and encourages regulatory initiatives that tackle the current problems in the market and remove barriers to trade, and more activity from ACER **in the area of inconsistencies across borders** that are causing additional risks for traders and shippers. Each TSO/NRA must have **a clear implementation plan** for how they are going to put in place by the end of 2014 the essential elements that are already required by EU instruments.

Removing distortions that stifle the traded energy markets should remain an absolute priority, including addressing price caps or regulated tariffs imposed by national governments or regulators, national failures to implement EU Directives, improper or insufficient or non-firm allocation of transmission capacity, mergers and protection of

national champions, lack of transparency about the use of infrastructure, discriminatory access to transmission and storage. However, we do not necessarily need regulators working on new **policy** initiatives.

EFET aims to establish a 'single' energy market in Europe, or at least a consistent approach to market design throughout Europe. All European gas network codes strongly depend on this cross-border cooperation, but currently do not foresee a mandatory regulatory convergence and compatibility. The Network Codes leave some discretion for NRAs to select from various implementation options recognising the physical differences between the markets. However, we believe it is crucial that neighbouring markets align their choices and provide market participants with an assessment of the possible impact of the use of different models and mechanisms on two sides of a border, as well as a market consultation on the best solution for possible problems. There needs to be a pragmatic approach to achieving a fully open energy market across Europe. There may well be essential transitional measures (which are correctly identified, managed sensibly and eventually phased out on a sensible timescale) and different timing for regional areas in Europe, but they should all lead to the same overall market design.

The Gas Balancing Network Code is an important step in the direction of implementing consistent market-based balancing across Europe. EFET encourages the EC to monitor and analyse national/ regional implementation, and engage with TSOs and NRAs where necessary, to ensure standardisation of balancing rules throughout EU.

We also consider it is important for the development of a single European gas market that, prior to the entry into force of the **Tariff Network Code**, there is some form of **Capacity Reset Mechanism allowing a one-off right for network users to reset their existing capacity contracts at IPs** with a certain notice period, either wholly or partially, thereby providing existing capacity holders with a one-off way of mitigating their perceived exposure or discrimination. All network users will then be operating on a level playing field. In its joint statement to the 25th European Gas Regulatory Forum, EFET, Eurogas, OGP and Eurelectric urged ENTSOG to consider including the Capacity Reset Mechanism in the EU Tariff Network Code.

EFET calls on the EU **TSO's compliance the transparency obligations** included within the Gas Regulation 715/09, namely the publication of actual physical flows at relevant entry/exit points updated in "near real time"; and the publication of the linepack or system imbalance information updated on an hourly basis throughout the day. The TSOs' provision of real-time information on all aspects of their regulated infrastructure (flows into and out of each VTP, amount of gas in the system etc...) would enable the users of the network to help optimise supply and demand thus reducing the cost of maintaining system stability and delivering security of supply more efficiently.

One of the core principles that would help guide implementation of Network Codes is that **each entry/exit systems should provide firm capacity rights that allow market participants direct access to a single VTP where (inter alia) market-based balancing takes place.** EFET is keen to follow up the points from the DNV-KEMA entry-exit study through continuous dialogue with ACER and the existing NRA workgroups.

As far as electricity matters are concerned, we advocate for a swift implementation of the following points, in accordance with the fundamentals of the internal electricity market:

- **Implementation of the Framework Guidelines** and further design developments should be pursued:
 - Firm forward transmission rights issued by TSOs in both directions between all bidding zones.
 - Day-ahead market coupling on a pan-European basis, accompanied by an extension of flow-based day-ahead market coupling if this can be done in a fully transparent way allowing market participants to assess the impact of flow-based market coupling on forward prices.
 - Implicit allocation of Intraday cross-border capacity with continuous trading, not hindering OTC intraday trading.
 - Harmonised and linked national balancing markets and arrangements for the procurement of reserve.
- **Full integration of RES-E generation in the wholesale power market.** National support schemes should be coordinated/harmonised to allow unimpeded cross-border tradability of RES attributes. Addressing the core issue of priority dispatch for renewable generation would expose renewable generation to market prices and terms, including the cost of balancing intermittency, and would create more efficient competition and more efficient utilisation of the resources in the power system.
- **Need for stable and robust bidding zones over time** to foster investment confidence and avoid welfare losses brought about by changes in their delineation. Changing bidding zones configuration defines a basis risk that can only be hedged with great difficulty by market participants. Bidding zones need to be large enough to promote liquidity in forward markets and other timeframes and to allow for competitive retail markets.
- **More attention to regulated tariffs**, where a clear road map should be developed to phase-out such regulations. Without fully liberalised markets, consumer will not be able to benefit from competitive pressure leading to low costs, improved services and innovative products, and the incentives for the development of demand response services will be limited.

3. Which regulatory actions are most important and should be prioritised?

ACER should give priority to sorting out the current cross-border problems, and each TSO/NRA must have a plan for how they are going to put in place the essential elements that are already required by EU instruments (e.g. near-real-time information provision on gas flows, entry/exit systems with single VTP, market-based balancing in line with the now approved Network Code, fully consistent firm capacity products at Interconnection Points, etc.).

The Conclusion of the recent Madrid Gas Forum supports EFET view (2nd paragraph of conclusion 01.C):

*"The Forum also takes note of ACER's work on the review of the Gas Target Model. **The Forum highlights the need to develop specific implementation plans** to build on existing work on the completion of the internal market in gas in order to achieve the objective that all European gas consumers can benefit from better functioning wholesale and retail markets as soon as possible."*

Even if all the current problems can't be resolved this year, at the very least the TSOs and NRAs should have an agreed plan by the end of 2014 to show how they are going to tackle the essential requirements.

Greater effort is required by the national authorities in Europe to harmonise market operations in practice and improve gas cross-border trading prospects within Europe, even though in theory many authorities claim that this is already the case.

We strongly believe that ACER could help facilitate market liquidity by removing remaining barriers to enter markets, such as storage obligations or restrictions concerning end-user supply, regulation and TSO terms & conditions published only in the local language and certain rules to obtain shippers or trading licences. We believe that solving these barriers will allow European market parties to become more active in all EU markets and will increase possibilities for new entrants to contribute to market competition and liquidity. Market integration as a properly implemented entry-exit system with a virtual hub and transparent information regarding system and portfolio balance will in fact allow trading and the flow of gas between markets as if they were a single market. These improvements, in our view, will follow largely from the implementation of the European Network Codes. Only with regards to the specific barriers mentioned above, additional action could be required and should be consulted upon.

4. Are there other areas where we should focus?

See response to Q2.

ANNEX: EFET comments on separate thematic issues elaborated in the ACER's Green Paper

GAS

- **Security of supply**

We urge ACER and the European Commission to consult industry stakeholders on the necessity and mandate of any Security Coordination Centre planned on regional or European level.

Undue intervention could have devastating consequences for the traded market, adverse impact on the commercial freedom of shippers and jeopardise security of supply. In those parts of the EU energy market where liberalisation is well advanced, gas prices respond to supply and demand and help to maintain flows to where gas is most needed. Ensuring that nothing unduly prevents the proper market response is the most efficient way to maintain supply security. The market needs gas price formation to be based on knowledge of gas supply and demand.

Regarding mandatory gas stocks, whilst there might be a justification for these in extreme circumstances if it has been shown that the market is not able to deliver the specific political or social objectives, the costs have been properly analysed and it has been decided how these costs will be recovered. EFET, however, remains convinced that the first step should be to encourage properly functioning markets throughout Europe, including a contestable storage market to be established wherever possible. Stress tests are a good idea, but they need to include the interaction between connected TSO systems.

- **Infrastructure Investment**

Consistency of regulatory and market regimes across borders will encourage investment in interregional pipeline infrastructure and facilitate trade and competition. Improving access to interconnections within Europe, thus widening and deepening the traded market, is the preferred route for mitigating regional upstream dominance.

At a basic level, both market opening and security of supply require well-connected physical infrastructure to be put in place. The limited connections between the Western pipeline network and the Eastern infrastructure, technical issues relating to gas transmission, those related to reverse flow, energy efficiency and different standards persist today. Uncertainty over forward tariffs has reduced shippers' willingness to underwrite larger TSO investments through long term capacity commitments.

Whilst market integration may progress thanks to new internal infrastructure projects, TSOs should be optimising the existing infrastructure already in place by investing when it is economic to equalise capacity on both sides of a border. Indeed, the operation of multiple gas networks by a single operator may well show that improved efficiency can be achieved or increased firm capacity can be offered without the need for additional investment.

Measures to improve information about infrastructure use and availability are still needed.

- **Implications for governance**

Overambitious regulatory change has created instability and discouraged investment, reduced quality of legislation, and has unintended effects on the interaction between initiatives. Greater focus should be laid on implementation and proper impact assessments.

The institutional processes and the time required to establish and implementing an EU Network Code in gas or electricity creates major difficulties for the functioning of the internal energy market. We have varied experience of the effectiveness of asking TSOs, through the ENTSOs, to write EU Network Code. The process has worked better for gas than for electricity and this raises separate questions about the internal governance and working practices of ENTSOG and ENTSOE as well as the role and level of involvement by ACER.

Concerning the involvement of stakeholders into ACER activities, it is pointed out that suggestions have been made, but it is not perceived that these are taken into account. If stakeholders suggest something which is out of the standard course of action, they are rarely taken into consideration (e.g. ACER refusing to discuss or reopen issues in workshops on Incremental Capacity and Tariffs because they consider the matter closed). We encourage ACER to provide a better capacity to understand the market requirements, foreseeing some proper analysis before making proposals in order to achieve better results. The Agency should be more involved in the network code development process, and we recognise ACER is trying to improve this issue.

Expectations should be raised on NRA performance – participation in discussions and resolution of regulatory issues (such as achievement of common capacity product definitions, clear definition of problem to be solved with tariff harmonisation).

Greater cooperation between ACER and NRAs is also desirable: e.g. failure of Germany to consult with its neighbours about implementing FDA UIOLI (as highlighted by DG Energy at the 24th Gas Regulatory Forum in Madrid last October); failure of NRAs and ACER to perform proper analysis of potential impacts of tariff reform (according to the ACER justification document, NRAs failed to provide sufficient information to ACER making it difficult for ACER to say clearly what the NRAs and TSOs currently have as their tariff methodologies); lack of information in ACER CMP report.

One common observation is that political imperatives and market conditions can shift during the development of a Network Code, so that interaction with other network codes or EU rules becomes problematic. Furthermore, we risk being locked into operational EU market rules for which there is no clear process for timely amendments in line with the needs of market participants. An investigation and proposal on how to address the issue of improved Governance and Network Code amendment would be a useful regulatory action.

Clearer governance is essential – how to bring about improvements and ad hoc solutions to individual TSO issues, and to allow European Network Codes to evolve.

- **Gas market's role in providing flexibility**

Network users must have market-based access to, and not unduly constrained use of, sources of flexible gas. This includes non-discriminatory access to and use of gas storage, the ability to re-nominate contracted gas at short notice to enable a rapid commercial response to changing operational conditions, thus recognising the value of fast-response infrastructure, as well as simple and responsive TSO rules and procedures that facilitate cross border gas transport intraday to be able to adjust supply-demand imbalances efficiently. The aim should be to make storage part of a contestable flexibility market. Intervention to 'administer' access to flexibility should only be done on a transitional basis when this is necessary to promote a competitive market.

In terms of the changing interaction between gas and electricity markets, the gas market has the ability to respond to short term changes resulting from the intermittency of Renewable Energy Sources in the context of the search for a relevant energy mix with low carbon emission. This inter-dependency in the electricity and gas markets leads to increasing needs of a liquid and functioning short-term market and access to flexibility offers and consequences on balancing.

ELECTRICITY:

Established trading activity since the beginning of the European liberalisation process in 1999 indicates that the adequate basic elements of the energy market are present. The market is sufficiently open, transparent and liquid in many European countries to work efficiently, and traders are continually incentivised to discover new ways of improving efficiency. The absence of traders is a strong sign that the market lacks liquidity and depth, and is hence not working effectively, preventing energy consumers to reap the efficiency benefits of liberalisation.

1. The need to complete the internal electricity market

As ACER correctly states, *the purpose of energy regulation is to deliver a level playing field in which competition can flourish and provide a sound investment climate that is based upon a stable and predictable regulatory framework.* However, the integrated European market will only manage to provide greater opportunities for cross-border trade and enhanced competition if the existing regulatory framework is fully used and implemented. Then greater competition, transcending currently divided geographical markets and reinforced by new market entry, really will result in a wide variety of benefits for market participants, investors and, most importantly, consumers.

Further primary legislation is probably not necessary to complete the internal electricity market, and the focus of all actors should be on ensuring the implementation of the Third IEM Package and the development and modification, where necessary, of guidelines and network codes. However, the RES Directive of 2009 needs fundamental amendment. Subject to reform of the national compartmentalisation of financial support given to RES generators and of the network and dispatch privileges they often enjoy, we believe the market design framework is generally robust enough to deal with the expected share of renewable generation. Indeed the target model, with its emphasis on a portfolio rather than individual unit approach, and open markets in all timeframes, is well suited to this developing picture. A higher level of consistency between regulators in implementing the target model and in ensuring the compatibility of the gas and electricity target models is, however, necessary. Meanwhile we advocate for a reasonable approach concerning the expansion of grids. While infrastructure developments are needed in several geographic areas, market reform and market design improvements can deliver faster benefits at a lower cost in most parts of Europe.

We therefore agree with the importance of continued implementation of the existing legislative framework, namely the Third IEM Package, and of further improvement of associated guidelines and network codes. For ACER this should be seen as a priority, whereas for the Commission and ENTSO-E we see RES-E related reforms as more urgent. **Implementation must improve efficiency of congestion management within bidding zones and across bidding zones borders. Thus the objective, transparent and non-discriminatory management by TSOs of congestion affecting inter-connection points is axiomatic. Maximisation of transmission capacity allocation in all timeframes across zonal borders must remain paramount. Also**

still of great importance is the timely publication of fundamental data about the availability and use of electricity infrastructure.

Removing distortions that stifle the traded energy markets should remain an absolute priority of ACER and the EC, including addressing price caps or regulated tariffs and prohibitions to close generation capacity imposed by national governments or regulators, national failures to implement EU Directives, and improper or insufficient or non-firm allocation of transmission capacity. Vigilance must further involve a critical review of mergers and other measures favouring specific technologies or preventing challengers to enter the market, any lack of transparency on the use of infrastructure, potentially discriminatory access to transmission, and ineffective or insufficient unbundling. Specific care should be taken in order to ensure a level playing field rather than accepting a patchwork of exemptions when these cannot be objectively justified.

In particular, we advocate for a swift implementation of the following points, in accordance with the fundamentals of the internal electricity market:

- **Implementation of the Framework Guidelines** and further design developments should be pursued:
 - Firm forward transmission rights issued by TSOs in both directions between all bidding zones
 - Day-ahead market coupling on a pan-European basis, accompanied by an extension of flow-based day-ahead market coupling if this can be done in a fully transparent way allowing market participants to assess the impact of flow-based market coupling on forward prices
 - Implicit allocation of Intraday cross-border capacity with continuous trading, not hindering OTC intraday trading
 - Harmonised and linked national balancing markets and arrangements for the procurement of reserve

- **Full integration of RES-E generation in the wholesale power market.** National support schemes should be coordinated/harmonised to allow unimpeded cross-border tradability of RES attributes. Addressing the core issue of priority dispatch for renewable generation would expose renewable generation to market prices and terms, including the cost of balancing intermittency, and would create more efficient competition and more efficient utilisation of the resources in the power system.

We would also like to point out the need for stable and robust bidding zones over time to foster investment confidence and avoid welfare losses brought about by changes in their delineation. Changing bidding zones configuration defines a basis risk that can only be hedged with great difficulty by market participants. Bidding zones need to be large enough to promote liquidity in forward markets and other timeframes and to allow for competitive retail markets.

Further there are still a large number of Member States applying regulated tariffs for all or most consumers. In most of the cases, the energy price is kept at an artificially low level, well below the actual market price. As ACER rightfully stated, this type of regulation hampers competition and options for consumers to actively take part in the

market. More attention should be paid to this issue and a road map should be developed to phase-out such regulated tariffs. Without fully liberalised markets, consumer will not be able to benefit from competitive pressure leading to low costs, improved services and innovative products, and the incentives for the development of demand response services will be limited.

2. Forward transmission rights

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. Bidders for rights are enabled to take a view on the transmission basis risks they need to hedge and to time and pitch their bids (or their secondary market purchases) accordingly. The availability of these hedging 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 forward transmission rights on all bidding zone borders, independently of the existence (or not) of other local hedging instruments (such as price spreads or CfDs towards the concerned bidding zones).

Indeed, forward transmission rights issued by TSOs provide an open and non-discriminatory access to hedging solutions against congestion costs (and the day-ahead congestion pricing), with no additional transaction costs. On the contrary, two opposite CfDs are needed on each border for market participants to be able to hedge against congestion costs and pricing. The issuance of forward transmission rights is therefore important for competition to develop in all bidding zones and not only in virtual zones.

It is also essential for TSOs and/or cable owners to offer to the market all the available volumes of cross-border hedging instruments provided by AC or DC interconnection lines. The issuance by all TSOs of forward transmission rights is all the more necessary that no evidence has ever been developed that the “non-issuance” of transmission rights would bring any benefit to the internal energy market, nor that the issuance of transmission rights could in any measure be harmful to existing, alternative arrangements for forward hedging.

3. Day-ahead markets

a. From CWE to SWE and beyond

The progress of ATC day-ahead market coupling in Europe is admittedly one of the great successes of the internal electricity market. The go-live of market coupling in North West Europe (NWE) in February 2014 and in South West Europe (SWE) in May 2014 had allowed coupling 17 European markets.

Day-ahead market coupling improves the liquidity of the market and increases cross-border hedging opportunities in forward timeframes at all borders.

EFET calls for the prompt extension of the day-ahead market coupling project to Switzerland notwithstanding prolonged discussions about governance, to Italy and to the countries in the Central Eastern and South Eastern Europe regions.

A Stakeholder Committee representing the interests of wholesale market participants as network users should be set up to contribute to and monitor these important developments and the functioning of day-ahead market coupling. For that purpose, this Stakeholder Committee should be given sufficient powers so that it can base its opinions on detailed and precise information.

b. Flow-based market coupling

The TSOs and PXs of the CWE region plan to couple their markets following the flow-based capacity allocation methodology by the end of 2014. While the theoretical benefits of flow-based market coupling are clear, the practical consequences/impacts for market participants are still rather uncertain.

Market participants need to be able to forecast market prices in order to take efficient decisions (including investments, maintenance scheduling, operational scheduling, building order books from non-coupled countries, ability to be dispatched for thermal units). Such efficient decisions and efficient integration of the flow-based process in the previous, subsequent or neighbouring processes can have significant impacts in welfare gains (for example, the bad quality order books will result in sub-optimised dispatch, even if the coupling algorithm is more efficient).

As a consequence, the beneficial effects should not be limited to the day-ahead stage, but also for the week-, month- and years-ahead stages, as well as for intraday. An inadequate integration of the flow-based process in the overall trading environment may result in a decrease of welfare in other timeframes. It is therefore important to ensure a sufficient visibility and understanding of the flow-based process and not to decrease the time available for market participants to analyse and run other processes.

The need for market parties to “model the TSO calculations of cross-border capacities” will not decrease with the introduction of flow-based, but will be much different. With an NTC approach, this was a relatively easy task but it becomes a much more complex process in the flow-based approach. A direct consequence of this is that market parties will also need much more detailed information on network elements. The parallel run in place since the spring of 2013 is a very useful step in order for all market participants to start preparing for flow-based market coupling. However, market participants need more detailed network information in order to perform proper market analysis and price forecasting. Such information is not provided as part of the external parallel run.

Fundamentally, all network information needs to be published. This includes the Common Grid Model (with all electrical characteristics of all network elements, allowing for load flow calculations), but also the GSK, FRMs, the list of critical branches and the base case assumptions. All the data that determines the PTDF matrices needs to be published preferably as early as the evening before (D-2), and in any case before 8:00 am D-1 (well before the 10:30 am deadline that was in use for ATC values).

Market participants' readiness for the switch to flow-based capacity allocation should in any case be tested before go-live. Full-member testing should be organised a few weeks or months before the go-live date and once the flow-based process has demonstrated its robustness and ability to bring value on a daily basis.

4. Intraday and balancing markets

a. Intraday markets

Contrary to the rather well-developed day-ahead markets, intraday market and their liquidity still need to be built and developed. This requires a favourable environment, so that companies can find the justification and interest for the development of their intraday activities and teams across Europe. The achievement of market integration for intraday requires additional efforts. In particular, there now needs to be parallel work on the TSOs' side, for which increased coordination and flexibility is also needed, as a preliminary condition for intraday markets to develop.

At present, many countries do not have the operational and regulatory environment allowing intraday trading during the last hours before real time (some borders can still not be accessed in intraday and many borders require nominations 5 to 8 hours ahead of real time). These operational constraints prevent market participants from efficiently rebalancing their positions between zones, or benefiting from the liquidity of neighbouring markets. It is important to note that most volumes in intraday are bound to occur close to real time, when all conditions are known. It is therefore now an important priority for TSOs to move gate closure times to a maximum of one hour ahead of real time in order for intraday trading to develop properly.

This also means that national TSOs are charging market participants for imbalances and using balancing resources, when the participants themselves could rebalance their positions at a lower cost. TSOs should resolve this issue well ahead of the development and implementation of the interim intraday platform by implementing an interim model, which allows for explicit access in parallel to the progressive pooling of liquidity on implicit platforms. Likewise, TSOs should allow the market to take over its balancing responsibilities as soon as possible, after TSOs have resolved any trouble in real time operation.

It is important to note that such improvements can be made on the basis of the existing (or available) allocation mechanisms. This will separate short-term improvement of cross-border intraday access, which will allow the development of intraday markets, from the inevitably lengthy development and implementation of the common open European intraday platform for the progressive implicit pooling of liquidity (or "Shared Order Book", SOB).

b. Cross-border intraday platform

EFET is a long-time supporter of a cross-border intraday platform based on the SOB. While we have deplored the delays in the setup of the platform, we welcome the recent news from the PXs that the project is going forward.

On point of concern is the option foreseen in the CACM network code that continuous trading could be suspended at intervals in the intraday timeframe, in order for a power exchange to perform a complementary regional auction inside and/or between bidding zones. This goes against the general objective of European harmonisation and the option chosen in the target model of continuous intraday model, with regional auctions as an exception, provided that they do not interfere in the normal functioning of the continuous intraday market. The proposed consultation process would not include market participants from Member States adjacent to those where the regional auctions are considered.

This approach would leave the door open for geographically isolated auctions, which do not take into account bids and offers available in the SOB, which should normally be matched. Despite efforts to clarify the timescale for regional auctions (“for a limited period of time, which shall not exceed the minimum time required to perform the auction”), continuous intraday trading risks being suspended regionally well ahead of real time. Continuous intraday trading must not be interrupted in any case, and the complementary regional auctions must be an additional possibility for market participants, never an obligation.

c. Balancing markets

A clear design for harmonised balancing markets still needs to be developed at a European level. So far, there has been little success in developing common rules in that respect.

While TSOs are admittedly at very different starting points and harmonisation will not happen overnight, clear goals should be established and some common general references should be set out, including:

- . roles and requirements on BRPs, BSPs, and TSOs (maintenance of a TSO-BSP model until a CMO is developed)
- . procurement process and timetable
- . format for standard products description
- . target timetable for gate closure, including for the intraday market, and settlement (leaving the maximum possible opportunity for market parties to resolve their own imbalances although without unduly compelling TSOs to act inefficiently)
- . general rules regarding the merit-order based activation of all types of reserve
- . imbalance principles and price calculation methodology

Without these basic arrangements in place it will be difficult to ensure proper integration at EU level. Currently, there are a number of different balancing arrangements in place in Europe, each one adapted to the technical and legal requirements of the corresponding area. Already, several successful pilot projects (e.g.

IGCC) have been implemented which demonstrate that significant benefits can be achieved easily through cooperation, even between different balancing regimes sharing common basic principles. The potential benefit of any change to an existing system needs to outweigh the implementation costs and risks. Therefore, we propose a gradual implementation of balancing integration, based on cost-benefit analysis (including how balancing arrangements modifications may affect the outcome of market coupling and intraday market integration).

Any harmonised framework for balancing needs to facilitate and maintain the integrity of intraday electricity markets.

d. Flexibility

The market should be largely responsible for providing signals for flexible generation. It is not a role for regulators who should concentrate on ensuring that the balancing and imbalance incentives are sufficient.

Flexible generation should be rewarded in day-ahead and intraday markets as well as in the balancing mechanism. Once market rules are improved through balance responsibility for all and better imbalance pricing (marginal), further products such as flexibility options may develop as their value is revealed.

Market participants must be given proper incentives to balance their positions and/or contribute to the residual needs of the system operator in balancing. Balancing and imbalance prices should move to more marginal pricing methodologies.

5. RES-E integration

The current framework for the development of RES-E has promoted the rapid growth of power generation from renewable energy sources. However, for the most part, this advancement has developed separately from the operation of the wholesale energy market 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. The severe deficiencies of the current methods of subsidised RES-E production involving the injection of physical volumes into the grid on a fragmented national basis is not a sustainable or efficient approach for the longer term. The serious negative impact of this process on the functioning of the European wholesale power markets in various timeframes, combined with the slow progress in international negotiations to reduce greenhouse gas emissions, indicate a fundamental need to re-think EU legislation.

An open debate on the appropriate mechanisms for meeting the EU policy goals of competitiveness, sustainability, and security of supply through the completion of the internal energy market in the run-up to 2030 is of paramount importance. That debate must be followed by credible and timely policy commitments made well before 2020. In helping to reduce uncertainty, such commitments would give new momentum to the internal market in electricity at the wholesale level and would ensure that strategic investment decisions are made in the next few years.

We believe that ACER has a role to take in contributing to the European Commission's efforts to reform the RES-E promotion framework and take a stronger role in coordinating and supervising the compatibility and side effects of climate policies in Member States. In view of achieving future harmonisation and greater efficiency of resource allocation for energy and climate policies, EFET believes that the European energy and climate policy developed by the European Commission should follow the principles listed below:

- . centre the climate policies around greenhouse gas reduction targets (2030, 2040, 2050), to be delivered by a well-functioning carbon market (reformed EU ETS)
- . include all sectors in the carbon market to allow the most cost-effective investment decisions for decarbonisation in a non-discriminatory manner
- . if needed, set up RES targets through an EU wide scheme
- . move away from operating aid for RES-E towards investment aid through European tenders or "take or pay" support arrangements
- . progressively remove financial support for mature or maturing RES-E technologies, and channel support for nascent technologies through R&D funding
- . revise priority access and dispatch rules for RES-E and require RES-E producers to the same balancing rules as other generators

a. Uncoordinated RES-E frameworks

EU Member States have had 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. The absence of coordination between national renewable energy support schemes 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.

Furthermore, renewable electricity is not necessarily produced at sites with the best natural conditions or the most optimal customer base. In contrast, sites which offer the best economic or commercial conditions the investor (e.g. by reference to high tariffs) are preferred, this leading to unnecessarily elevated socialised costs.

Finally, there is also no distinction with respect to the different degree of maturity of technology. In many areas, it is common understanding that mature technologies are ready for large-scale deployment, whereas immature technologies still need R&D support.

b. Priority Dispatch and Access for RES-E

In order for the energy market to contribute to a least-cost solution for RES-E deployment it is crucial that that all generation (RES and non-RES) is competing on a

level-playing field. This entails, for example, equal treatment in grid access and grid charging.

Priority dispatch of renewable production, often combined with fixed feed-in tariffs, means that RES-E producers always produce to the highest possible capacity with a right to full remuneration, even when the produced power is not needed due to low demand and overcapacity of other renewable sources. Therefore, priority dispatch does 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 or Italy for instance), which further erode the overall income from the market leading to further intervention. Alternatively, such operations are often carried out at the direction of the system operator without proper remuneration.

Although RES-E producers are currently assured of either priority or guaranteed access and priority 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. Likewise, in the future subsidy regimes should rather be based on incentives that do not distort dispatch decisions and do not involve the TSO in buying and selling electricity, which is contrary to the unbundling requirements in the Electricity Directive.

Particular attention must be given to small-scale generation currently connected at the consumers' sites behind the connection point. At present, approaches with respect to network charges and taxation rules allow for uneconomic decision, based on avoiding different charges or taxes that are to the detriment of total system costs.

c. RES-E financial support schemes

Most existing support schemes have explicit or implicit trade barriers which distort the internal market. The direct effect on competition depends on the design of the support scheme, e.g. arrangements for grid access or dispatch. Generally, feed-in tariffs are more distorting because they exclude RES-E from the power market and therefore, limit liquidity and competition in power markets and are usually, by definition, exclusively national with a ban on import and export of the renewable production or the renewable element of supported production. These are, arguably, quantitative restrictions on cross-border trade.

At present, we see various structures, e.g. in funding schemes for financial support systems, ranging from tax-funded systems to tax relieves and to levies on fossil fuels or power. Inevitably, such variation will create distortions, impede competition between renewable energies and between producers, and create barriers for cross-border trade and competition.

In our view, the 2030 framework should contain provisions for a reform allowing the EU as a whole to reach renewable energy consumption goals in a sustainable manner at an acceptable cost for society. Such a reform should include:

- . improving cross-border congestion management operationally
- . addressing the question of dispatch in a way consistent with the EU target model
- . market based RES support schemes where support schemes do not constitute a barrier to cross border exchanges

6. Capacity remuneration mechanisms

EFET believes that policy makers should avoid disturbing price signals in the energy (MWh) market if and when designing capacity mechanisms. The integration of EU electricity markets through the market coupling process relies on well-functioning day-ahead spot prices. Likewise, effective competition in the retail sector relies on efficient and liquid forward markets. Therefore, where capacity mechanisms could affect these, they are also likely to have an impact on the EU internal market. Price signals set incentives to invest in reliable and flexible power generation means. These characteristics are increasingly important as the European market moves towards decarbonisation with larger proportions of renewable capacity.

Therefore, policy makers need to be mindful of a certain number of elements which capacity mechanisms should ideally fulfil in order to the functioning of the energy market. Capacity mechanisms should:

- . demonstrably enhance adequacy and reliability;
- . avoid distortion or dilution of price signals from markets;
- . be transitory in nature, with a natural dynamic and process towards phase-out of their price signals as generation adequacy improves;
- . focus on time periods far enough ahead to limit overlap and interference with forward and future markets in electricity;
- . facilitate an active demand side and promote wide consumer engagement through willingness to pay for reliability and/or price stability;
- . be non-discriminatory, by taking into account the contribution of non-national generation through interconnection which may decrease local needs;
- . be non-discriminatory between new and existing facilities and between different technologies
- . minimise centralised management processes and maximise the scope for independent decisions by market participants about their off-take and delivery obligations, so that market dynamics have a chance to function;
- . minimise risk of regulatory failure and of need for redesign (e.g. by avoiding overly complicated mechanisms)
- . use market-based remuneration mechanisms (e.g. by means of auctions, tenders, or subscription obligations) where full competition determines the capacity prices
- . avoid regulation of capacity prices such a price caps;
- . be suitable for EU wide / harmonised application.

The existence of separate revenue streams to reward capacity may arise, but these must remain subordinate to the energy market in order to avoid any major distortion of the

role of markets. The EU is currently in the process of integrating national electricity markets through the development of network codes. Badly designed capacity mechanisms could distort the outcome of this process and reduce the significant benefits of integration.

In this context, the development of continuous intraday trading across interconnectors and consistent and linked national balancing markets and arrangements for procurement of reserve are also a necessary step to improve European security of supply and successfully integrate higher shares of renewable production. We refer to the contributions of EFET in that regard².

7. TSO cooperation, TSO-DSO cooperation

a. Governance

All parties to the IEM 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.

Discussions on the review of bidding zones delineation or the drafting of certain network codes has however showed the need for some reflection around the role and power of all parties involved in the development of the IEM. 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.

Specifically, 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 IEM. ENTSO-E should 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.

New challenges also expect ENTSO-E, 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.

² For additional information, please refer to the *EFET letter to DG Energy on the timely implementation of market opening and integration for intraday markets*, May 2012, available at: http://www.efet.org/Cms_Data/Contents/EFET/Folders/Documents/EnergyMarkets/ElectPosPapers/~contents/WQH2XHGPUYBMA47U/EFET-Letter-on-Intraday_21-05-2012.pdf and the *EFET Position Paper on Efficient Electricity Balancing Market Design and Integration*, March 2012, available at: http://www.efet.org/Cms_Data/Contents/EFET/Media/Documents/Public%20-%20Position%20Papers/1203%20EFET%20Position%20Paper%20-%20Efficient%20Electricity%20Balancing%20Market%20Design%20and%20Integration.pdf.

As far as ACER is concerned, the Agency was 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. We consider that this role should be further extended and strengthened, also considering the need for network codes to be fully compliant with framework guidelines and to take full account of best practices. In this perspective, 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.

While the mandated publication of official documents is welcome and arguably takes up a vast amount of time and resources, the completion and monitoring of cross border roadmaps and delivery planning up to completion of the Target Model will therefore remain of paramount importance for achieving the IEM.

b. Role of DSOs and TSO-DSO cooperation

We do not see the need for significant changes in institutional arrangements in the short term. Nonetheless, assuming that distributed systems will become increasingly important, the role of DSOs will be more prominent. Appropriate reflections should then be launched with regard to the need for full DSO unbundling.

There is already a vast scope for TSO\DSO cooperation and nothing to prevent this. We encourage them to use existing possibilities to their fullest extent.

8. Demand-side management, consumers

Demand side participation is best implemented through liquid day-ahead and intraday markets. Regulators should ensure full demand side participation on equal terms with generation in those markets and remove distortions such as tariffs and price controls. Regulators should also encourage innovative tariff structures and not over-regulate the retail businesses.

We don't think there should be too much emphasis on TSO and DSO investment in Smart networks other than metering. The roles of TSOs and DSOs should remain clear and limited to the regulated domain of network development and operation. All other activities like aggregation of prosumers, demand side participation, development and operation of decentralised generation and storage should be fully left to the market domain. Obviously, DSOs and TSOs should be allowed to contract services from market parties including consumers and prosumers e.g. for congestion management purposes. This also means that the methodologies for network tariffs regulation should incentive DSOs and TSOs to make a proper choice between procuring such services and investing in network assets.

9. Infrastructure

Fundamentally, EFET believes that infrastructure improvement has a greater meaning than solely building more infrastructure. Congestion needs to be addressed by TSOs by making sure that enough existing transmission capacity is made available to the market in the first place. The lowest cost option to do so is to make sure that existing transmission assets have been used to their maximum extent. Most particularly, the development of capacity calculation and allocation rules thanks to the Capacity Allocation and Congestion Management (CACM) and Forward Capacity Allocation (FCA) network codes – a common grid model for flow based calculations in day ahead and intraday and intra-zonal ATC calculations for forward capacity allocation – should be used to maximise available capacity on existing assets. The allocation of the maximum possible of anticipated available capacity through PTRs or FTRs in forward timeframes is also key to improving infrastructure use, as well as the utilisation of coordinated redispatch and countertrading tools to guarantee allocated capacity when necessary.

The expansion of the transmission grid with the objective to avoid structural congestions is nonetheless important for a well-functioning market, and therefore for the efficient integration of renewables. For instance, increasing interconnection capacity between markets with large amounts of base load capacity and markets with significant peak load capacity may offer benefits and would be used by market participants. Following a careful analysis of structural congestions which cannot be solved by improving the use of currently existing infrastructure, TSOs should propose new infrastructure projects to relieve structural congestions, ideally using accumulated congestion revenues to finance those projects. Regulators should ensure that an appropriate framework is established to incentivise the use of congestion revenue for the new investments.



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