

## **European Energy Regulators' Overview Paper**

### **Initial Reactions to the European Commission's proposals on Clean Energy**

#### **Introduction**

1. Over the past decade, Europe's energy regulators have played a critical role in helping to create a competitive Internal Energy Market (IEM). We broadly welcome the European Commission's ambitious proposals in the "Clean Energy for all Europeans" Package. As the proposals evolve, we shall continue to work towards our shared goal of creating liberalised, integrated, sustainable and secure energy markets which benefit all energy consumers.
2. Energy markets are facing unprecedented changes as they adapt to meet the challenge of decarbonisation, whilst safeguarding security of supply and ensuring affordability. Electricity consumers can now actively participate in the system through self-generation and demand response and we are pleased to see that they have been placed at the heart of the European Commission's proposals.
3. This paper presents the joint feedback of the Agency for the Cooperation of Energy Regulators (the "Agency") and of National Regulatory Authorities (NRAs) in the Council of European Energy Regulators (CEER) on key elements of the European Commission's proposals. We shall continue to explore them in greater detail – considering both the individual proposals themselves and their interrelationship with each other and, later, with the gas sector. Our joint conference of 23/24 January "Towards a future proofed Energy Market Design" gives us the opportunity to hear the views of the Institutions and stakeholders and allow us to enrich those analyses.

#### **Fundamental principles for a well-functioning Energy Union**

4. In outlining our initial reactions below, regulators have drawn on a set of core principles against which we have assessed the proposals included in the Package. Our core principles are:
  - i. Maintaining and enhancing security of supply.
  - ii. Promoting competition and avoiding cross-subsidies between consumers and between market actors.
  - iii. Promoting cost efficiency and effectiveness in delivering the appropriate benefits to consumers.
  - iv. Ensuring that, at European level, legislation is proportionate, allowing flexibility for local, national and regional development and innovation.
  - v. Delivering coherence and consistency with the ongoing implementation of the Third Package, European Network Codes and other measures.
  - vi. Avoiding over-regulation and overly-prescriptive measures which could stifle markets and overwhelm consumers.
  - vii. Ensuring that the European regulatory system is underpinned by a reasonable and proper system of checks and balances.

## **Flexible regulations for a fast evolving market**

5. The creation of the IEM has been successful in fostering greater competition and in delivering benefits to consumers. Competitive markets offer the best opportunity for producers and consumers to come together and trade at competitive and fair prices and barriers to the efficient functioning of markets must continue to be broken down. Recent legislation (notably the Third Package and the subsequent Guidelines and Network Codes) are being successfully implemented by the regulatory community and other involved parties. It is crucial that no inconsistencies emerge between that ongoing implementation work and the new legislation. Any risk of undermining the progress made to date, along with any associated delays to market integration, must be avoided. Implementation should be prioritised and improvements in the energy market design should be built on those existing provisions.
6. The way consumers use energy and interact with markets is undergoing a profound transformation and will further transform as a result of wider developments such as the “Internet of Things” and the greater number of “prosumers”. Markets must evolve to supply the products that consumers need. Therefore, regulators support speedier and more agile switching of suppliers to allow consumers access to a wider variety of energy products to meet their needs.
7. The European Commission’s proposals that enable consumers to access dynamic pricing are sensible. However, we need to ensure that these obligations do not themselves create barriers to entry or, in some cases, risk imposing unduly higher costs on consumers. Consumers increasingly self-generate their energy and need to face prices which truly reflect costs. Any risk that self-generation is being subsidised by other users must be minimised and, hence, net metering should be critically reviewed to avoid inefficient behaviour by prosumers.

## **Balancing innovation and regulation**

8. Consumers are increasingly active and many other new participants are entering the energy market. Regulation must enable this change and we must be alive to the risk that overly detailed legislation or prescriptive rules could adversely inhibit new market developments. The case for detailed rules in nascent and fast evolving segments of the market must be critically assessed and pursued only where less prescriptive measures have proven inadequate.
9. That said, there are areas where the challenges are clear and action is needed. These include provisions that set a framework for storage, electric vehicle charging and demand-side response (DSR). Similarly, provisions are needed to safeguard the separation between Distribution System Operators (DSO) (who need to be neutral market facilitators) and storage operators. Storage and DSR act, with other technologies, as part of a broader energy market: they must compete on a level playing field with generation and consumption. Thus, we welcome the European Commission’s proposals to remove priority dispatch (though we have concerns about the volume of proposed exemptions); to bring renewables into the market; and to ensure that all relevant market players are responsible for balancing.

## **Making markets work**

10. The real-time value of energy should be the basis of the price signals that all participants face. Therefore, we support the European Commission's proposals with regard to price caps and to ensure prices are able to reflect scarcity. These aspects will be crucial in order to stimulate innovation, unlock the demand side of the market and encourage flexibility. Volatility in short-term market signals must be accompanied by a market framework that: enables robust and effective competition; ensures transparency; provides sufficient regulatory oversight; and allows participants to hedge their risks in a variety of ways. We are also supportive of the drive to maximise the amount of cross-border capacity available to the market.

## **Securing our supplies**

11. Notwithstanding Member States' responsibilities for security of supply, we welcome the European Commission's initiative to avoid overcapacity across the continent by coordinating the assessment of resource adequacy. That said, greater transparency and regulatory involvement are needed to ensure that consumers, industry and politicians can trust that markets are functioning well. Our initial analysis suggests that the proposals regarding capacity remuneration mechanisms (CRMs) appear broadly to strike an appropriate balance: While well-functioning energy-only markets can provide the best outcomes for consumers, well designed CRMs must not be a barrier to that objective. However, more refined arrangements on cross border participation of CRMs are needed and the Agency is ready to work further in this area.

## **Smarter system operation**

12. With ever more interconnection, our system must be operated in a smarter way. As smaller, more local generation emerges alongside centrally located, larger-scale generation, the distinction between transmission and distribution is becoming increasingly blurred. We welcome a proportionate and focused approach to both Transmission System Operators' (TSO) cooperation and to future cooperation between TSOs and DSOs.
13. While the diversity of DSOs must be recognised, DSOs should be sufficiently unbundled (e.g. by excluding them from owning or operating storage assets), so that they can perform the tasks assigned to them. The creation of the EU DSO body is welcomed: it highlights the increasing role that DSOs will play and ensures they can be involved in developing markets and legislation.
14. However, in this fast evolving area, we must be careful not to be over-prescriptive unless there is a clear problem to address. The European Commission should concentrate its proposals where the benefits for consumers are greatest and where action at European level is most efficient. NRAs consider that to harmonise transmission and distribution tariff structures is not merited. Similar policy proposals in other areas, including the use of congestion income, could have costs that outweigh the benefits.

## Regional markets

15. The European Commission's focus on regionalisation is a realistic recognition of the different challenges faced across the Union. This is a highly challenging area and we intend to work through the proposals in detail to ensure they are sensible as well as practicable. Regions must be flexible enough to evolve over time towards a fully integrated IEM, whilst individual regions will be different for different products and services (as well as differing, in all probability, across gas and electricity).
16. Crucial to the success of this approach will be the development of the appropriate, clearly defined oversight and governance to ensure compatibility within, and between, regions. The rules to create regional substructures of the ACER Board of Regulators (BoR) and to assess whether issues should be considered regionally or EU-wide should streamline decision taking. That said, the new framework will need robust stress testing and a thorough assessment to ensure its coherence with broader decision making at European level and the need to avoid excessive bureaucracy.

## A clear and effective framework for regulatory oversight

17. Appropriate regulation underpins effective markets and we need to ensure that the roles and responsibilities at both national and European level are clear and that proper checks and balances are in place. The European Commission's proposals introduce changes in a number of key building blocks of independent regulation and could alter a carefully conceived system of checks and balances which is in place today. The areas below would benefit from further consideration to ensure that the Energy Union is underpinned by a persuasive and legitimate set of decision making processes that deliver for consumers.
18. **Clarity of roles:** The Agency must continue to facilitate the effective cooperation between NRAs as enshrined in its name. Enhancing the Agency's responsibilities makes good sense where market integration calls for a more robust EU-wide regulatory approach. We also appreciate that the Agency is well placed to oversee the conduct of existing and new organisations at EU level – including ENTSOs, NEMOs and the new EU DSO body. Such oversight is needed to ensure that there is confidence that Europe's markets function efficiently. However, concerns remain as to whether the Agency will be properly equipped (in terms of resources) to fulfil its new and existing responsibilities.
19. **Independence of ACER:** Regulation needs to operate independently of national governments; of the European Commission, of any public or private entity and, of course, of industry. We have serious reservations regarding the European Commission's proposal to reallocate significant managerial responsibilities within the Agency, including the recruitment and appointment of staff, from the Director to the Administrative Board which is no longer shielded from political interference.
20. **Internal Regulatory Governance:** We welcome the European Commission's trust in the Agency and recognition to the important contribution that the Board of Regulators has made to its work and its decision-making process. Complementarity of regulatory action at national and European level will be even more vital in a more integrated market. Regulatory decision-making at European level, where subject to the Board of

Regulators' scrutiny, reflects this fundamental principle of complementarity and has supported the Agency's effectiveness over the last 6 years. Therefore, NRAs believe that it should be maintained and that the proposal to change the presently required majority rule in the Board of Regulators - from two thirds to a simple majority - would profoundly, and negatively, affect the checks and balances within the Board itself and, possibly, within the Agency.

21. **Resources:** ACER has suffered throughout its existence from inadequate resources (as, indeed, have many NRAs). Despite a relatively small proposed increase to cover its new tasks, this under-resourced situation looks set to continue. Insufficient regulatory resource has a much greater cost than the cost of providing the required resource and is a false economy. It is vital that the regulatory regime which establishes the foundation of the IEM is not compromised, leading to an erosion of confidence that will inevitably follow, ultimately costing consumers. Providing adequate funding from the EU budget would represent the best option. However, partial funding via cost-reflective fees for some activities could provide more flexibility for the Agency to fulfil its legislative mandate, without burdening an already stretched EU budget.

### Next steps

22. As regulators, we are proud of the contribution that we have made to the creation of a European market over the past years through the work of the Agency and CEER. While there is clearly much to do, we must not lose sight of the progress that has been achieved to date, nor let our attention be diverted from the important projects which are currently underway. Agreed network codes and guidelines will need to be fully implemented as a matter of priority. Regulators will continue to work together to push for better planning of cross-border infrastructure and better usage of cross-border capacity. We shall monitor markets and act where behaviour goes against the interest of consumers. Against this background we will continue our detailed analysis of the European Commission's proposals in a positive and constructive contribution to developing a proportionate and effective regulatory framework which can empower and protect consumers across the continent. In practical terms, we shall issue a series of short regulatory white papers in the coming months with the intention of providing a clear understanding of these often complexed issues.