

ACER pre-consultation on the “Energy Regulation: A bridge to 2025” position papers



EFET comments – 17 December 2013

The European Federation of Energy Traders (EFET¹) welcomes the publication of the consultation papers on ACER’s long term approach to energy market regulation and the opportunity to provide its views on the subject. Following our remarks on the overarching paper in the first part of this document, you will find our comments on the electricity and gas discussion papers.

1. Comments on the overarching paper “Energy Regulation: A bridge to 2025”

Question 1: Do you agree with this overall approach? Would your emphasis be any different?

The ACER “bridge to 2025” strategic policy initiative ties into the parallel review process of the wholesale gas market Target Model, in which energy trading is one of the main building blocks. The timeline is also suitable for the purpose of a prospective revision of the electricity market Target Model, in that we would expect most of the network codes to be completed and implemented by that time.

However, the reform at EU level of financial support and dispatch/ access privileges given to RES-E output is much more urgent as it already has detrimental consequences on existing markets. A more market oriented structure to renewable and low carbon generation should be in place at a European level well before 2025 to avoid counterproductive measures being enacted at a national level.

EFET actively contributes to the development of open, transparent and liquid wholesale power and gas markets throughout Europe. Traded energy markets are an essential aspect of effective competition in power and gas 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 supply and transportation capacity, storage, and location of large consumer loads.

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

Established trading activity indicates that the adequate elements are present and that the market is sufficiently open and transparent to work efficiently. Traders are continually incentivised to discover new ways of improving efficiency. The absence of traders is a strong sign that the market is not working effectively and that the efficiency benefits of liberalisation might not materialise for energy consumers.

We agree with the implication that further primary legislation is probably not necessary and the focus should be on ensuring the implementation of the Third Package and the development and modification, where necessary, of the network codes and RES directive. In fact our view is that 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 flexible trading mechanisms and intraday markets, 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.

We therefore agree with the importance of continued implementation of the existing legislative framework, namely the Third Energy Package and associated network codes as a priority. **Implementation must involve consistency between the treatment of transactions within hubs or bidding zones and transactions crossing borders. Thus the objective, transparent and non-discriminatory management by TSOs of congestion and capacity allocation at inter-connection points remains paramount, as well as the timely publication of fundamental data or variations of such data, especially for transport capacities.** 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 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 storage, 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 this context, we would like to see the powers and resources of ACER strengthened, whilst network users must be allowed a stronger voice, including equal rights with TSOs to amend network rules. Most specifically, 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 an ENTSO 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.

Question 2: Do you agree with this broad analysis and/or do you have further suggestions?

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. 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 be sought to cope with the challenges and costs involved in the intermittency of renewable electricity generation. **The EU ETS needs overhaul and revival to make it useful as an instrument to steer low carbon investment, yet this imperative is nowhere mentioned in**

the ACER paper. That is a strange omission, even if ACER has no statutory competence in relation to EU climate change policy.

In the context of the ACER bridge policy debate, it is unwise in our view to devise a strategy predicated on a particular fuel mix. . ACER should avoid second guessing outcomes that are, indeed, very uncertain. In this context, the analysis in section 2 focuses too much on current market conditions that will probably change several times between now and 2025. For example, global coal prices were much higher 2-3 years ago and this may be the case again. Likewise we would hope and expect the RES subsidy approach to become more stable, predictable and European-oriented in the period to 2025.

Policy instruments should be designed to preserve the benefits of the integrated market, be market based, cost effective, and protect industry competitiveness so that they are effective over a range of scenarios. Greater effort is required by the national authorities in Europe to harmonise market operations in practice and improve gas and electricity cross-border trading prospects within Europe, even though in theory many authorities claim that this is already the case.

There are possibly too many assumptions made in the document. For example it may be that new technologies emerge that can provide new sources of flexibility. Likewise the assumption throughout the document that renewables are, by definition, non-programmable is also not appropriate for an analysis running to 2025: the flexibility of such generation could be managed at the injection point rather than borrowing the flexibility of the complete system or requiring all other assets to adapt. There are also several technologies under development that could address this issue over time, if the market was allowed to give the correct signals.

The role of consumers certainly needs to be strengthened both in terms of their rights and responsibilities. Consumer cannot any longer be seen as passive. There needs to be a much greater range of possible products - “season ticket”, “pay as you go” etc. - with a good explanation of the features of these products. It is regrettable that some regulators and governments persist with price controls, simplification initiatives etc. that constrain this process.

Question 3: Do you think the list of suggested measures is complete or do you have further suggestions?

Do you think that the requirements for infrastructure investment in gas are the same as in electricity?

What further ideas do you have on the future role of consumers?

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, any long-term framework 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. There certainly is a need to encourage greater harmonisation of market design and remove obstacles to cross border competition. In some ways the current electricity network codes process, most notably, has been a missed opportunity since many of these allow for diverse national arrangements to continue.

One of the highest priorities of the next EU climate and energy policy, to which ACER ought to contribute to a large extent, 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. Particularly, any long-term framework must fully integrate renewable

energy producers into the market by requiring from them to comply with balancing obligations and must harmonise 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.

Beyond the necessary short-term measures (such as the back-loading of EU ETS phase 3 supply), one of the priorities for 2025 should be to reform the carbon market in order to ensure that the pressure of the CO₂ market is maintained on a steady slope, thus ensuring that adequate price signals are maintained in the power industry. Any regulatory uncertainty with respect to the greenhouse gas reduction targets between 2020 and 2050 will affect negatively CO₂ prices and dilute signals for private investments in low-carbon technology².

Use of both gas and electricity infrastructure can also be significantly improved. Competitiveness and the efficient operation of network assets and existing infrastructure must be ensured as the first step, before any new investment decisions are taken. The document sometimes gives the wrong message that regulators also have some role in, for example, forecasting demand or deciding on storage investments. These are decisions that must be largely for market participants.

Energy policy should aim to facilitate a market-based investment approach rather than centralised planning. The development of trading hubs is essential to help inform investment decisions as well as providing short-medium term risk management tools.

We agree that there is clearly a necessity to better signal the value of flexibility. The key to this are cost reflective signals from the balancing and imbalance arrangements and ensuring that all market participants are balance responsible. Flexibility signals will largely emerge from well-functioning day-ahead and intraday markets rather than from any substantial market design changes. This will require that balancing prices are not unduly capped or constrained.

In terms of encouraging competition (section 3.2), EFET agrees with most of the points identified. We would also add that market participants need to have access to a range of transmission products that meet their contractual needs including forward access rights. However we would expect this question to be resolved well before 2025.

Finally, the document could be more ambitious with respect to developing smarter solutions. By 2025 we would expect that more than 50% of electricity and gas consumption to be metered on a smart basis (i.e. hourly, or more frequent, data collection). This will allow for a large range of additional market based solutions.

² For additional information, please refer to the *EFET response to the European Commission Green Paper consultation on a 2030 Framework for Energy and Climate Policies*, July 2013, available at: http://www.efet.org/Cms_Data/Contents/EFET/Folders/Documents/EnergyMarkets/RE/~contents/89G29HRG4MHMFDEN/EFE-T-response_EC-GP-energy-and-climate-2030.pdf.

2. Comments on the ACER Discussion Paper on Energy Regulation: A Bridge to 2025 – GAS

G1. Do stakeholders agree with our view of the gas specific strategic context and in particular with our views on:

- Declining demand for gas, and in which sectors such decline is seen;***
- Increasing role of imported gas and uncertainty surrounding unconventional gas supplies in Europe; and***
- Increasing role for a flexible gas supply to support growth of renewable electricity generation.***

The strategic context for gas in Europe is indeed characterized by demand that peaked in 2005, a trend of increasing imported gas volumes, uncertainty in Europe's unconventional gas production potential and an apparent need for greater flexibility in gas supply. In part because demand has fallen, but also because reverse-flow investments and new infrastructure links have improved connections within the market, Europe is arguably in a better position to cope with supply disruptions than in, say, 2006 or 2009. Current short and long-term prospects for gas demand in Europe remain uncertain, particularly given the wide range of global fuel prices and the prevailing economic challenges facing industrial gas users and gas-fired power station operators and prospective investors. The regulatory approach needs to recognize these uncertainties and ensure that the framework is not predicated only on one scenario.

G2. Are concerns about competition in gas markets and concerns that liquidity at most hubs is insufficient to achieve functioning wholesale markets sufficient to warrant some form of intervention?

G3. Should increased market integration be sought to address issues of non-competitive markets and a lack of liquidity? Are there other more effective measures to be sought in this respect?

Transparent and liquid gas hubs have been established in Great Britain and The Netherlands, providing a dual focus for the wholesale gas market in North West Europe. Further East and South, greater regulatory and political impetus needs to be established, including through enforcement action, in cases where the development of the traded market has stalled or where there are barriers to trade between different parts of Europe.

Barriers to competition still remain within the internal market in natural gas. Open, liquid, and transparent gas markets are not only essential for delivering the Third EU Energy Package, but they also go hand in hand with fundamental EU energy policy goals such as security of supply. Moreover, provided that regulatory and technical barriers to trading and market entry are removed, economic fundamentals in mature markets will ensure that gas flows to those consumers who value it most.

To counteract this dysfunction the development of binding pan-European network codes for cross-border issues sets out a complex and evolving framework which defines the architecture of the EU gas market. The EC intends for the European network codes to help develop an integrated and harmonised European Energy market, through facilitating competition and eliminating trade barrier deriving from different national rules. Unfortunately, we continue to see national regulators and national TSOs making decisions that ignore the importance of striving for a consistent approach with their neighbours. This is

particularly worrying, not only because most gas crosses at least one border in Europe but also regards to the dual role that national regulators play in ACER, who is supposed to resolve differences at national borders.

The interdependence of the network codes is key but inconsistencies are already appearing limiting the potential gains. It is vital that any concerns are understood at an early stage allowing adequate input from all stakeholders at all stages in the process in helping produce coherent and viable network codes.

- G4. Would efficient use of existing infrastructure and the building of efficient new infrastructure facilitate competition between gas producers?***
- G5. Can upstream competition be improved with physical infrastructure redundancy or is it an issue of market structure (oligopoly)?***
- G6. Should regulatory incentives be placed on TSOs to improve the efficient use of existing gas infrastructure?***
- G7. What are your views on the future investment climate for new gas infrastructure in Europe? What are the major challenges ahead?***
- G8. Should regulatory frameworks recognise externalities in order to improve investment decision making?***

The efficient import, storage and transmission of natural gas are crucial to meeting energy needs in Europe during the transition to a low carbon economy. 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. 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. Most operators have improved the level of information that they provide on the physical use and availability of gas infrastructure, but this is rarely available on the 'near-real time' basis as required by the Gas Regulation EU/715/2009. Full compliance is essential, with a consistent and coherent approach taken to information provision across Europe. Greater consistency and transparent presentation of data for the existing transmission pipelines in Europe is a fundamental pre-requisite that must be addressed as a higher priority than data collection and analysis for future projects.

Priority access used to be a problem at almost every high-pressure pipeline interface in Europe, but the new EU Capacity Allocation network code should ensure that all primary capacity is made available to the market through auctions. Ensuring that the market is involved in the decision-making process for new (incremental) capacity remains a missing element, but there is a commitment from Regulators to address this.

G9. Are cross-border market zones or regional trading zones practical ways to integrate market zones?

G10. Are there other ways one may envisage to enhance the liquidity of European markets?

G11. What actions could be taken to further integrate market zones, given the uncertainty regarding costs and benefits of integrating market zones?

If Europe moves towards combined grid operation with larger market areas then gas flows could be more streamlined as capacity allocation should be less complex, provided there is no substantial internal congestion. Capacity provision must also ensure that all reasonable demands for primary capacity are met where it is economic, and efficient to do so. This implies that the existing system should be used to its maximum physical capacity and that demands are met with timely additional investment. The provision of any investment must be done in a way that ensures a TSO can earn a reasonable return on assets for a given level of risk.

A key problem on many networks has been the existence of contractual congestion even though there is no physical congestion, i.e. new shippers are unable to book capacity because it is already booked, but actual physical flows of gas are well within the levels of technical available capacity. Contractual differences, particularly those that affect firmness, at IPs need to be resolved before contracts are bundled together.

The way tariffs at Interconnection Points will be set in future might help or hinder the process of merging zones. Regulators will need to ensure that, whatever approach is taken, consideration is given to how the regulated tariffs would need to change once it becomes evident that the technical, operational and political considerations would allow the merger of certain zones.

In the longer term, proper bundled capacity products might also help integrate the market, including the merger of zones where that would be the best economic option. 'Proper' bundling would involve the shipper contracting for capacity (from one trading point in one system to the next) with a single counterparty rather than with two TSOs each of which has their own terms and conditions for the capacity on different sides of the border.

G12. Does a lack of coordination between intra-day gas and electricity markets expose gas-fired generators to significant imbalance risks?

G13. Does the level of risk exposure create sufficient concern that it could hamper efficient market operation to warrant intervention?

G14. How should coordination of intra-day / balancing gas and electricity markets be improved?

G15. What concrete possibilities for demand response in gas do you envisage?

EFET believes that in order to develop effective regional European gas markets and ultimately a common, pan European gas market two basic prerequisites have to be met:

- Transmission system operators shall harmonise balancing regimes and streamline structures (in particular the balancing period and the basis for calculating balancing charges, but also the

calculation of line-pack and time, frequency and format of information provision) in order to facilitate cross border gas trade;

- 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, 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.

The gas balancing network code is an important step in the direction of implementing consistent market-based balancing across Europe. Ensuring that it is just as easy for large gas users to access Virtual Trading Points as it is for gas producers or importers is important for the development of the competitive market.

It would be sensible to review the changing interaction between gas and electricity markets. Issues include the ability of the gas market 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 that are not addressed in the gas target model. Clear guidance from the Target Model could inform a consideration of the trade-offs arising from this issue in respect of both tariff and balancing rules.

3. Comments on the ACER Discussion Paper on Energy Regulation: A Bridge to 2025 – ELECTRICITY

E1. *Although adequacy issues are not likely to disappear completely, do you agree that the current primary focus on levels of adequacy will likely be expanded to emphasise a later priority focus on flexibility?*

We generally agree that flexibility will rapidly become equally important to adequacy as a concept in the electricity sector. This is why there is a clear need not to undermine or duplicate the flexibility signals that should come from the energy (MWh) market if capacity remuneration mechanisms are implemented.

E2. *Should we seek to further define, measure and develop flexibility in addition to the initiatives that are underway? If so, how could this best be done and in which market time periods?*

E3. *What are the market-based routes for flexible ‘tools’ to participate?*

E4. *What measures may be required to ensure that the market receives the most appropriate signal for the value of flexibility?*

E5. *Do you think that other, for example institutional arrangements should be considered? Is greater TSO and DSO coordination required? If so, what should NRAs do to facilitate this?*

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 strong 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.

We do not see the need for significant changes in institutional arrangements. There is already plenty of scope for TSO\DSO cooperation and nothing to prevent this.

E6. *How should regulators facilitate demand side participation (including demand side response and electricity storage)?*

E7. *How can NRAs support, or incentivise TSOs and DSOs to invest in ‘smart networks’. What actions are needed, in particular from regulators, to promote more active distribution networks? Do we sufficiently reward avoiding ‘dumb’ investments?*

Demand side participation is best implemented through liquid day-ahead and intraday markets. Regulators should ensure full demand side participation 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 market can deal with 90% of the issues on demand side participation.

E8. How should NRAs influence the competition debate, for example on support schemes, regulated tariffs, capacity remuneration mechanisms, etc?

E9. To what extent should the relationship between competition in electricity and gas markets influence regulators' activities? Could regulatory action on the gas market, help solving the flexibility problem of the electricity market?

E10. How should regulators remove barriers to entry for new supply sources?

E11. What actions, identified in these papers, should regulators prioritise?

We would expect that by 2025, issues such as RES support schemes, regulated tariffs, or capacity remuneration mechanisms, would have been resolved by the application of European wide rules and guidelines, and the full implementation of the Third Package.

Regulators should be less prescriptive in terms of competition in electricity and gas markets and should not try to second guess where particular solutions might emerge. As long as both gas and electricity markets have the freedom to function well, then the most efficient outcomes should emerge without heavy regulatory involvement.

New generators should be encouraged to participate fully in wholesale markets and thereby increase liquidity and reduce concentration. Other than non-discriminatory third-party access, we do not see the need for specific additional action to support new entrants.

Reform and harmonisation of balancing arrangements are the key to well-functioning markets in all timeframes. The key elements to work towards are full balancing responsibility and marginal imbalance prices. Minimising TSO actions before gate closure would also be helpful. We would expect these issues to all be dealt with well before 2025.