

Energy UK Response to the ACER Consultation on a “Bridge to 2025”

17th December 2013

About Energy UK

Energy UK is the Trade Association for the energy industry. Energy UK has over 80 companies as members that together cover the broad range of energy providers and suppliers and include companies of all sizes working in all forms of gas and electricity supply and energy networks. Energy UK members generate more than 90% of UK electricity, provide light and heat to some 26 million homes and in 2011 invested over £10 billion in the British economy. Energy UK is listed in the EU Transparency Register under ID no. 13457582538-68.

Main Points

- Energy UK welcomes ACER’s consultation, which provides a useful starting point for discussion of longer-term energy market issues;
- More emphasis needs to be placed on affordability and cost effectiveness as policy drivers;
- The scale of the investment challenge in power generation appears to be underplayed; ACER needs to look more closely at the market framework for investment;
- Some statements appear over-optimistic about the rate of progress towards an integrated European market; work on developing the Network Codes should remain a key priority and the evolution of the Target Models should be considered in the light of experience so far;
- ACER needs to give greater consideration to regional and national differences within the EU market, given the relative lack of interconnection in many parts of Europe
- The electricity paper is too narrowly focussed on the issue of flexibility and demand-side response;
- Energy UK favours a market-based approach to flexibility, which promotes a level playing field between different options and fosters innovation;
- Capacity mechanisms should not be seen purely from the viewpoint of a competitive distortion but also in terms of contribution to system adequacy;
- Energy UK would urge caution about any interventions to promote gas market liquidity, given the unintended consequences this could have for well-functioning hubs;
- The priority in relation to retail markets should be full implementation of the Third Package, including the removal of retail price regulation, rather than new policy measures.

1. General

Energy UK welcomes the fact that ACER has issued this consultation on “A Bridge to 2025”. European energy markets are increasingly affected by broader energy policy considerations and it is important that regulators look at the wider picture and take into account longer-term goals when undertaking their functions under the Third Package.

ACER’s four papers provide a useful starting point for the debate and highlight a number of relevant issues for future electricity and gas markets, e.g. flexibility, renewables integration, gas market liquidity, smart grids etc. However, we think that the analysis misses some important points and appears in some respects over-optimistic about the future of energy markets, given the increased level of public intervention in many Member States. There are also some differences of approach between the three papers on electricity, gas and consumer issues.

ACER’s overarching paper identifies a large number of policy drivers, but makes little reference to the increasing concern about affordability and competitiveness which is now emerging in many Member States. In this light, the assumption that EU policies will continue largely as at present is open to question. The picture is complicated by overlapping and sometimes conflicting policies at national level. ACER calls in the Overarching paper for “stronger EU-wide coordination of national energy policies”, but this is not followed up and little is said about the problems which arise from conflicts between EU objectives.

The consultation says little about the issue of future investment in generation. Regulatory and political risk has become an increasing concern across Europe and is a major factor in the fall-off in investment in recent years. At present there is little investment in new generation plant in most Member States, other than in renewables, which are being developed on the basis of national support schemes. In response, some Member States which need new capacity are undertaking reform initiatives to improve the investment framework, e.g. EMR in the UK. In the medium and longer term there are considerable question marks over a market which does not provide adequate incentives for the construction of new plant. Moreover, there is currently no market signal to move towards the low-carbon electricity mix required by the EU’s longer-term greenhouse gas targets. ACER in our view needs to place more emphasis on the issue of market-based investment in new capacity (not simply on the current difficulties of gas-fired plant – which is correctly identified as an important issue).

ACER states at the outset that its priority will remain to progress the Network Codes, while noting that the Target Models “may need to be enhanced”. However, while the Gas paper looks at possible improvements to the gas market, the Electricity paper is largely silent on the Target Model and Network Code framework. Progress in agreeing the Codes has been more difficult and time-consuming than had been expected and we would expect some analysis of the lessons learned so far and possibilities for improvement. This is true both in relation to the substance of market design and the process of agreeing the Codes.

In general, ACER seems to underplay the challenge of integrating European markets:

- “While recognising the value of current framework guidelines and network codes, there is still scope to improve the functioning and efficiency of European wholesale and retail energy markets” – this seems to be something of an understatement, given that only two Codes have so far even been agreed, let alone implemented;
- “In the mid-term we expect to have an adequate, integrated and reliable energy network which can deal with intermittency ...” – this is in our view not an inevitable outcome.

ACER understandably takes a European perspective on energy, but it is surprising that no reference is made to regional differences within the EU. While parts of the continental network are well-interconnected, this is not the case for island systems such as the UK and Ireland, as well as some other regions such as Iberia, the Baltic States and Italy. It will take some time to integrate these “energy islands” into the wider European market, both in physical and commercial terms, and in the meantime some differences in regulatory approach are likely to be necessary. This is particularly relevant to the discussion on flexibility – access to flexible generation, storage and interconnection varies across Europe.

In relation to network infrastructure, Energy UK agrees with ACER’s comment that investment should take place in a cost-effective way. Regulated interconnection is likely to remain the main option for connecting national markets, but ACER should not lose sight of the merchant route and this should remain an option.

It appears increasingly likely that some energy players will be brought within the scope of EU financial regulation. This potentially has large implications both for the framework of energy regulation and for future trading arrangements. We think that ACER should at least bear this factor in mind in framing its analysis.

2. Electricity Paper

The Electricity paper focusses particularly on flexibility and demand-side response, but does not tackle some other very important issues, e.g. whether any changes to the Target Model are needed or whether greater European harmonisation is needed to secure market integration.

The paper tends to treat the European electricity system as a “copperplate” and does not acknowledge any regional differences, other than making the comment that “governments and regulators in several European countries “appear concerned” about generation adequacy. In the period to 2025 there will need to be a continuing emphasis on the need to integrate market arrangements and build interconnection and other infrastructure, and we would expect ACER to reflect on these issues as part of this project.

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?

This question appears to imply that system adequacy is likely to be a short-term problem – something which in our view cannot safely be assumed at this stage. In general, the paper appears rather negative about capacity mechanisms, seeing ACER’s role as being to ensure that CRMs do not distort cross-border trade and market arrangements. These are important issues, but ACER should also look at the case for CRMs in the broader context of ensuring security of supply.

Energy UK agrees that flexibility will become increasingly important as more intermittent capacity comes on to the system. We support a level playing field for different sources of flexibility, e.g. flexible generation, demand side response, storage and interconnection. The regulatory approach will probably need further consideration, as technologies develop.

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?

Energy UK agrees with ACER's general analysis of the impact of renewable generation on wholesale markets, though the forecasting problems should not be over-emphasised: the accuracy of wind forecasts, for instance, has increased considerably in recent years.

The priority at European level should be to continue the integration of day-ahead, intra-day and balancing markets, and to ensure that flexibility is properly rewarded in all these timeframes. Early progress towards an intra-day platform is of particular importance, given the need for market players to adjust their positions close to real-time as more intermittent capacity comes on stream.

ACER rightly highlights the need to remove barriers to renewables while also integrating renewables into the market. A further point to be considered is the impact of renewables on the business case for conventional generation, which is leading several Member States to consider capacity mechanisms and other measures to maintain low-load-factor plant on the system.

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?

Much of the new renewable capacity is likely to connect to the distribution system and, as such, closer coordination between TSOs and DSOs will be required.

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

Energy UK takes the view that demand-side participation should develop within an open, competitive market which allows and enables DNOs, suppliers and other new entrant, third party organisations to bring forward innovative DSR propositions. It is important that there is a level playing field in which all participants are able to participate should they wish to offer DSR products, within an open, competitive market place to encourage customer choice and innovation.

It should be noted that energy markets are undergoing considerable change, as is customer behaviour, e.g. increased use of the internet. Regulatory policy will therefore need to be flexible and ensure that short-term decisions are in line with longer-term objectives. As a first step it may be helpful to map the opportunities for demand-side participation across the supply chain. For example, the roll-out of smart meters along with time of use tariffs will help consumers manage their consumption and reduce overall demand; for DNOs there is value in DSR to help reduce network reinforcement costs; and for suppliers there is benefit in reducing exposure to network charges and losses.

Energy UK believes it is important that DSR is not considered in isolation but alongside other measures that can be used to manage energy on the system, including storage and interconnection, as well as demand reduction and demand shifting.

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?

No comment.

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

Regulators should take an active role in the energy policy debate, particularly in relation to measures such as price regulation, which will drastically impair the operation of markets.

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?

Any consideration of the interaction of the two markets should carefully assess the risks of the costs and the benefits being misaligned, i.e. being paid and received by different parties. Detailed scrutiny of this would be required. However, where there are well-functioning gas markets, intervention to support the flexibility requirements of the electricity market should not be necessary.

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

Regulators should make the case for technology-neutral policies which promote a diversity of energy sources. They should also highlight the risks of unnecessary regulation of electricity generation, e.g. measures to impose emission performance standards on installations covered by the EU Emissions Trading Scheme.

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

The key priority should be to make progress with the Network Codes under the Third Package and to keep the target model under review to ensure that it is adapted to changing policies and circumstances. Market integration of renewables is also a priority.

3. Gas Paper

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.**

Energy UK agrees with this analysis. Although the extent and pace of change remain uncertain, the general direction of change is clear.

We very much agree with the concern over the ‘vicious circle’ of declining demand: network costs are spread over less volume so charges increase, potentially leading to further demand loss and higher costs.

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?

We agree that greater liquidity would be likely to bring improvements in competition; a virtual point would help with this. We also agree that the contracting framework is a factor here. However, it is important that any intervention should not have a detrimental effect on hubs where there is already good liquidity and churn

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?

Increased integration could help, but connectivity between zones and risks of constraints and associated costs would need very careful assessment

G4. Would efficient use of existing infrastructure and the building of efficient new infrastructure facilitate competition between gas producers?

We agree that efficient use of existing infrastructure should be facilitated by CAM and CMP implementation. These measures should be given time before assessment of their effectiveness is determined

We also agree that some redundancy in infrastructure may assist competition – but need to be mindful of costs passed on to customers given long asset lives and projections of declining demand overall

G5. Can upstream competition be improved with physical infrastructure redundancy or is it an issue of market structure (oligopoly)?

Possibly but it is not simple to draw general conclusions here. Any benefits would depend on the physical location of the specific market in relation to potential gas sources.

G6. Should regulatory incentives be placed on TSOs to improve the efficient use of existing gas infrastructure?

Yes – TSOs should be incentivised to ensure that maximum capacity is made available to the market, that system costs are minimised and that accurate information is provided to market participants in a timely manner.

G7. What are your views on the future investment climate for new gas infrastructure in Europe? What are the major challenges ahead?

The major challenges are to establish a needs case and allocate costs.

G8. Should regulatory frameworks recognise externalities in order to improve investment decision making?

Yes. Regulators should take into account externalities when supporting network investment. However, as externalities are by definition difficult to measure, the effect of externalities should not be directly integrated into quantitative cost-benefit analyses (CBAs) but rather used as a complement.

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

Yes, in theory if practical challenges can be overcome, e.g. roles of TSO(s) balancing and congestion.

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

Liquidity is well established at the NBP and TTF, and prices seem to be well correlated across the NW European hubs, which account for the greatest proportion of EU demand. Energy UK would caution against intervention to promote increased liquidity in other markets because of concerns about the unintended consequences on well-functioning markets. As other markets mature and the Network codes for CAM and balancing and the CMP guidelines are implemented, liquidity may well improve at other European hubs as well.

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

Ideally such steps should be driven by the market rather than driven in a top-down fashion, particularly given that the cost-benefit ratio may be uncertain.

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

The impact is likely to vary according to the market and the mix of renewables deployed. The accuracy of wind generation forecasts has been improving, which reduces imbalance risks, but solar output is less easily predicted. This issue can be tackled through the implementation of the

Network Codes; at present the Gas Balancing Code seems to imply that the TSO has discretion over accepting re-nominations at <2 hours' notice. The following approach could be used:

- Push forward the deadline for gas re-nomination to H-1 whenever it is technically feasible (TSOs are allowed to do this by Art. 17.1 of the Balancing Network Code)
- Avoid the application of within-day obligations and charges unless this is duly justified by network safety or system stability concerns. When absolutely necessary, these constraints should be applied for a larger period, such as four-hour blocks rather than hourly

We have concerns with the following statement in para 5.1:

“Gas-fired generators have no way to make re-nominations 2 hours or less before real time”. The Balancing Code seems to allow discretion to the TSO to accept nominations with a shorter lead time Article 17.1 says “**may** reject”

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

An implementation of the Network Codes in line with the principles set out above should be sufficient to reduce risks and imbalance costs faced by gas-fired power generators.

However, the situation should be kept under review, depending on market developments and decisions taken by NRAs and TSOs.

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

The best way for TSOs to support interactions between the gas and electricity markets is for the networks to be capable of responding to customers' offtake requirements such that requests for changes at short notice (< 2 hours lead time) can be met. If such requests are unlikely to be met then the TSO should inform market participants of this in advance.

Unduly onerous within day obligations or limitations on ramping should be avoided. Access to within day entry and exit capacity products may also be important

The TSO is best placed to manage the overall gas system cost effectively on a physical basis. Disaggregation and commercialisation of 'flexibility' products could result in sub-optimal system utilisation and potentially artificial scarcity of 'flexibility' and additional costs to customers.

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

Gas-fired generation plant will be capable of providing demand response so long as there are alternative sources of generation available to meet electricity demand. Larger industrial customers may also be price responsive to some extent but their business focus will not be stopping production in order to sell gas.

4. Consumers and Distribution Paper

C1 - Do you think that further European level measures should be taken to enhance the operation of retail markets to the benefit of consumers?

The Third Package provides a basis for establishing competitive retail markets in electricity and gas, though progress has been limited in some Member States. Energy UK believes that the priority should be to ensure full implementation of the Package. In particular, regulated retail tariffs should be removed as soon as possible, as they are incompatible with the development of a competitive retail market. If prices are capped below market levels, new players in energy retail will not emerge. ACER should therefore work towards phase-out timetables for regulated prices.

National energy retail markets are currently rather diverse, reflecting different stages of development and political priorities. Moreover, European consumers are not homogenous and different consumers engage in different ways. Some consumers find the market difficult to navigate while others may be more sophisticated in how they manage their energy. Consequently, Energy UK believes that a “one-size-fits-all” approach is not feasible and would run the risk of inhibiting innovation in some markets.

Regulatory authorities need to strike a balance between simplicity and choice in retail markets; whilst it is important for consumers to find it easy to choose between products, innovation should also be encouraged, particularly in the context of the role that Time of Use tariffs will play in demand-side response.

Smart meters increase the amount of data available to consumers. This data needs to be managed securely and we welcome the Commission’s recognition that consumption data should only be provided to third parties with the consumer’s express permission, e.g. via a Letter of Authority.

C2 - Can you suggest ways in which we could enhance the voice of consumers in the development of Europe’s energy market?

European consumers are well-represented through events such as the London Forum and through ongoing engagement between ACER/CEER and European associations such as BEUC and national organisations such as Consumer Futures.

ACER should continue to seek contributions from as disparate a group of organisations as possible. Energy suppliers engage with customers on a daily basis and, through regular interaction and consumer research, have a good understanding of what motivates and interests energy consumers. Therefore, to maximise the information available to ACER, it is important that suppliers and energy trade associations are also involved in the decision-making process.

C3 - What are the main questions that you consider the proposed CEER review should address with regard to the future role of DSOs and also to ensure that the regulation of distribution networks remains fit for purpose in 2025?

Any review by CEER, or any other European body, should recognise that some Member States employ a supplier-led market structure in which DSOs do not hold a direct relationship with consumers. As a result, the DSR regulatory framework should facilitate the participation of suppliers and third parties.

We believe it would be inappropriate if DSOs were allowed to use any regulated returns to invest in DSR. We would also recommend that either the provider of DSR or the final consumer be required to inform the supplier that they are taking DSR. This will help suppliers manage predictable changes in demand.

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