ACER

Agency for the Cooperation of Energy Regulators

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# ACER Consultation on
# European Energy Regulation: A Bridge to 2025

## Contribution by Enel

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

We believe that ACER properly identified most of the issues and trends faced by the energy sector. We welcome ACER efforts in following a holistic cross-sectoral approach and we acknowledge that the consultation document captures a number of relevant issues to be addressed in order to shape the design of the electricity and gas markets of the future in a context of complete integration.

However, we consider that ACER does not appropriately recognize the importance of some issues or provide the right approach and solutions to solve them. In this respect, we particularly refer to the actions to be undertaken by the Agency related to the generation adequacy that should be achieved through proper instruments such as preferably long term contracts or, in an interim phase, capacity remuneration mechanisms which, if adequately designed and implemented, do not distort short term markets. Additionally we consider flexibility as an important element of electricity markets since it is linked to the capability of the power system to respond to variations in the supply/demand balance (see next section for further details).

Moreover, we would like to comment on some policy and regulatory concerns that we didn't find sufficiently or adequately addressed in the document.

Firstly, policy interventions, rather than being considered mostly national, should be contextualized in the European policy framework. This is essential for governments and regulators to design and implement the most efficient and effective tools to deploy ambitious policy goals (e.g. 2020 targets) while ensuring security, affordability and sustainability.

Secondly, we would like to emphasize the structural shift of the generation fleet towards higher fixed costs and lower or zero variable costs, thus calling for a robust reveal of the capacity value and the value of low emissions.

Thirdly, a fundamental issue concerns the structure and sustainability of electricity prices. The growing share of policy-induced charges not associated with the costs of generation, transmission, distribution and supply often leads to political pressure on the remuneration

of regulated activities and to confusion or lack of transparency over the real drivers of rising price trends.

## 2. Have we identified an appropriate regulatory response?

### a) Electricity Wholesale Markets

Although ACER correctly pointed out that there are growing concerns about generation adequacy, flexibility and the provisions of grid support, the actions highlighted by ACER seem mainly focused on addressing the flexibility issues, leaving the generation adequacy problem in the background. Notwithstanding the fact that both flexibility and adequacy are needed to ensure security of supply at short and long-term level, we believe that these aspects should be treated separately in order to avoid confusion about the functions that energy markets should deliver.

#### i. Flexibility

Current European market designs are already based on "bulk energy" and "flexibility" markets. Flexibility is bought and sold in the forward, intra-day, ancillary services and reserves markets. Increased penetration of RES generation requires some reforms in these markets. However, these markets usually do not present the same failures as "bulk energy" markets (e.g. maximum prices). Important improvements like removal of regulated prices, ensuring data availability to relevant market players, or enabling demand to react on prices are very welcome.

In our opinion, flexibility should be remunerated through market mechanisms that are able to adequately price all dispatching services (i.e. primary, secondary and tertiary reserve, voltage regulations, black start, etc…) needed by TSOs and DSOs.

Furthermore, we do agree with ACER on the need to speed up the integration of balancing markets in order to improve the efficiency and responsiveness of the EU energy system to balance demand and supply at short-term level. Indeed, the increasing volume of intermittent generation will require the availability of additional products to be pursued by targeted market adjustments. However, the full implementation of the current balancing target model will require an extensive work of coordination and harmonization among TSOs and Power Exchanges. Considering the complexity and peculiarities of national balancing markets, their integration will be even more challenging than the coupling of the day-ahead markets or the creation of a common platform for intra-day markets which encountered or are facing several obstacles in their development. Furthermore, the current draft of the Electricity Balancing network code foresees long lead times for the full implementation of the code's provisions. In this respect, we believe that ACER should facilitate the

implementation of interim BSP-TSO agreements in order to fully utilize the economic benefits related with market integration also in the short-run.

### ii. Generation adequacy

Most EU electricity markets are experiencing unprecedented variability of generation due to the increased volume of intermittent electricity. The growing share of renewable energy has the beneficial effects of reducing the dependency from fossil fuels imports and the pollutants emissions of the energy system. At the same time, it raises issues affecting the physical infrastructure (e.g. need for increased network investment) and the functioning of generation markets (e.g. absence of spinning capacity, loop flows).

In theory, energy-only markets provide optimal incentives for investment if several conditions are met. Operators should be able to freely enter and exit the market, regulation should be stable and adequate (including carbon and renewable policies), information should be perfect, and prices should be allowed to reach very high values in scarcity hours. Additionally, the network should be "smart" in order to allow for selective disconnection of customers valuing electricity the least (e.g. in terms of Value Of Lost Load - VOLL).

These conditions are not met. In fact, we live in a world characterized by strong regulatory uncertainty and price caps, and only few customers can be selectively disconnected. Moreover, the financing of RES facilities through administratively-set feed-in tariffs decouples RES investments decisions from expected market prices, generating a risk in terms of long-term equilibrium between demand and investment. All this has led to a system enjoying low wholesale energy prices but unable to adequately remunerate firm capacity, which is required as backup power.

Due to these market and regulatory failures, there appears to be a risk of insufficient investment, which, as a consequence of the long lead times of new generation facilities, might compromise adequacy and security, as well as the transition towards a low-carbon energy system.

A careful and sound reflection on the sustainability of the current energy-only model is crucial. A long term vision of a decarbonised energy system with a high share of renewables does not match with an electricity market structured and based only on short-run marginal cost. It is crucial that the future market design be able to provide adequate remuneration also to the renewable technologies that will be installed to compete on a level playing field with conventional technologies.

Market operators are presently reluctant to invest in new facilities or even to maintain, in some cases, the existing ones. In this regard, in the past 2 years around 50 GW of the assets of major power companies have been decommissioned or mothballed in the EU. This trend

is exacerbated by the ongoing stagnation of the EU economy and will not improve with the imminent implementation of EU environmental regulation (LCPD & IED Directives) which will impact mainly older conventional plants.

Taking into account the above-mentioned considerations, we agree with ACER about the necessity of reviewing and amending the current electricity target model. In particular we believe that more robust long-term signals should be provided, preferably in the form of long-term contracts, or, in an interim phase, through market-based capacity remuneration mechanisms (CRMs). To this end, the European market design should be re-thought including sound and coordinated (structures and approaches) market-based and technology-neutral CRMs across the EU. However, to avoid lock-in effects which would hamper EU efforts towards decarbonisation, the use of CRMs across Europe, within and beyond the time horizon analysed, should be designed not to provide distorsive incentives for investments in new capacity above the system back-up needs.

The European Commission and ACER have a major role to play in providing proper guidance to Member States in designing CRMs which are compatible with EU overall objectives, including completion of the internal energy market.

We would also like to stress the importance of enhanced and more liquid forward markets. From this perspective, we appreciate ACER commitment in pursuing its efforts in developing and harmonizing forward capacity allocation rules. At the same time, it is important to foster markets for long term energy contracts. In fact, price signals deriving from current forward products may not be sufficient for investments in new power plants which have an economic lifetime of at least 20 years.

### iii. Renewable energy support and market integration

The RES support mechanisms set at national level have been fundamental to increase the penetration of renewable energy in the market and reduce the generation cost gap with respect to conventional energy technologies. However, support schemes need to be reviewed to make them more sustainable and consistent with the fact that investment costs on deployed RES technologies (e.g. wind on-shore, PV) have declined drastically in recent years.

The great penetration of RES generation combined with the often poor design of national support mechanisms, unable to capture technology advances and mainly based on operating aid, substantially contributed to increase electricity bills for households and businesses.

Consequently, in a general climate of austerity and budget constraints, in several Member States RES players have been the target of abrupt and sometimes retroactive interventions to reduce or remove support to RES to limit costs surge or to mitigate the increasing debt

load of some EU countries. Such moves obviously undermined existing investments and investor's confidence.

In such a context, we welcome the adoption of the Guidelines on State aid for environmental protection and energy for 2014-2020, which foresee the gradual introduction of competitive bidding processes for allocating public support and the progressive exposure of renewable energy sources to market signals. Although we acknowledge that the move from feed-in tariffs to feed-in premiums is a significant first step toward market-based instruments, we also consider that this instrument won't remove all market distortions currently present in energy markets. For instance, market distortions will persist when operating aid is applied to technologies with relevant variable costs, such as CHP and biomass.

We believe that there is an urgent need to rethink renewable policies, in order to make them compatible with the decarbonisation, competiveness and security of supply objectives. In this respect, we are glad that ACER acknowledges the existence of major distortions caused by current RES subsidies and the need to design market-based, cost-efficient, least distortive support mechanisms.

More concretely, concerning deployed technologies, we believe that aid should be provided through bidding processes in order to avoid market distortions and to promote more competitiveness in the market. Aid should be progressively phased out, in a framework of markets evolving towards conditions which enable a level playing field among all participants and in which the $CO_2$ price signal is strengthened. A remuneration per MW could be considered to mitigate the failure of energy-only markets in remunerating investments, especially in a context of high RES penetration.

RES development requires a dynamic approach with regard to types of support as long as technologies become closer to maturity. The choice of the incentive mechanism should depend on the position of the target technology along the path to full market competitiveness and integration. Technologies in the demonstration phase should be supported by R&D schemes mainly financed by public budgets and in volumes such that the market is not significantly affected. Technologies that are beyond this phase should preferably be supported through tendering on capacity in order not to distort short-term market signals and to capture the learning curve of technologies.

In addition to the support schemes they should be entitled to any revenue that they can get from the markets, including those for flexibility (intra-day, reserve and balancing). Further integration of renewables into the market by giving them balancing responsibility should also provide them additional economic incentives to have better generation forecasts and thus reduce system imbalances and flexibility needs.

It should be stressed that RES are able to effectively participate in these markets (e.g. by providing reserve by reducing their output when the energy price is low and the flexibility price is high). Even limited obligations, such as nominating production and being subject to balancing payments, can be shown to lead to much improved operation, including but not limited to much better production forecasting. However, we consider as well that appropriate tools and market adjustments are needed to enable the full participation of renewable technologies in the above-mentioned market timeframes.

In any case, retroactive changes should be avoided as they deteriorate the profitability of existing projects and violate investors' legitimate expectations. Sound regulation should include clear and transparent review clauses or a contractual commitment that makes the policy framework transparent and predictable for investors.

**b) Downstream sector**

Within this document ACER puts great emphasis on the need of further regulatory measures in the distribution and retail segments in order to facilitate the introduction of new services and technologies that should enable the demand-side response.

However, with respect to the role of DSO we believe that the level of separation between the activities of the network operator and customer-facing energy retailers and service providers should not be re-evaluated. The European experience already shows that the current regulatory provisions are adequate to promote a competitive electricity market and the development of Distributed Energy Resources (DERs) and Distributed Energy Systems (DESs). For any further separation a cost-benefit analysis proving that benefits of the regulatory provisions outweigh the costs will be necessary.

Generally speaking we consider balancing a global task for TSOs. This should not be confused with what DSOs may be able to do at local level. At distribution level we understand "balancing" as the management of local network constraints within the distribution grid. Resources connected at DSO's level could participate in the management of local congestions or to balance the entire electrical system. In the latter case, it is important that local resources compete in a fair and equal way with all other resources through a so called global merit order.

Given this setup, regulation should empower DSOs to solve technical problems within the local grid (i.e. local congestions, voltage regulation), to support TSOs in balancing the system and to enable demand response.

Furthermore, unlike TSOs, DSOs are an heterogeneous set (in terms of number of customers, connected distributed generation, voltage served). Therefore we cannot see neither the need nor a solid justification for an EU-wide comprehensive harmonization of the regulation of DSOs' tasks. Moreover, many of the issues are already regulated in the EU legislation (e.g. 3rd Energy Package, RES Directive, Energy Efficiency Directive). However,

guidelines and good practices may be helpful to provide clarity and focus on certain basic principles and act as an incentive for some Member States to catch up on critical regulatory issues in which they may be lagging behind.

Finally, data management should be a DSO task. DSOs already act as data managers as they manage, use and need metering data to run their network. Validated metering data should be managed in a secure and cost-efficient manner and we believe DSOs are the best actor for such role. Distribution systems are already well regulated and provide very high levels of monitoring and security. Entrusting data management to some other actors may lead to lower levels of security and protection. Moreover, leveraging on DSOs as market facilitators allows for the best exploitation of economies of scale and scope. As already prescribed by the Energy Efficiency Directive, such data must be shared upon customer's request with entitled third parties, which need to be meant as "users" of those specific subsets of customers' data (and only in this broader setting, "managers"). In order to avoid taxonomical confusion, we'd distinguish on the one hand the management of data flows, which should be the DSOs responsibility, and on the other hand the commercial use of such data. In other words, the flow manager is a systemic role to be thus entrusted to DSOs for the sake of security and efficiency. Upon customers' request, other third parties may be allowed to manage (read: use) only that customers' data (or the data of all of the third parties' customers) for commercial activities on behalf of that customer.

**c) Gas Wholesale Markets**

Regarding gas wholesale markets, the Consultation Paper emphasizes the importance of achieving liquid gas markets describing the primary "tools" to reach such a target, including integration of markets and full implementation of network codes. In this context, Enel considers it important to underline that European reliance on long term import contracts is also – at least in part - enhancing liquidity on the hubs and wholesale markets. Long term contracts will probably be renewed at expiration, at least for a quota, but under different terms and conditions, aimed at reducing the risk for importers and increasing the diversification and security of supply of the systems, also in association with investment in new infrastructures such as LNG regasification plants.

**d) Governance**

We would generally favourably consider more powers for ACER.

More specifically, the experience from recent years shows that some new governance arrangements are needed.

First, it is of utmost importance that, in drafting Network Codes (NCs), ENTSO-E follows more closely the directives defined by ACER and that the outcomes of the consultation with market operators are better considered (e.g. by including experienced market stakeholders

in the ENTSOs' drafting teams). If ACER deems that a NC is not compliant with its Framework Guidelines (FGs), it should have the power to unilaterally modify the text before it is sent to Comitology.

Second, NCs should be assessed through a detailed cost benefit analysis before being finally approved with legislative acts.

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

### a) Removal of taxes and levies from the electricity bill

The first priority should be to remove from electricity tariffs all costs that arise from policy decisions and do not properly correspond to electricity supply. These include RES support, as well as social and industrial policies. The proliferation of these costs is damaging the competitiveness of electricity compared to other forms of energy (presently often exempted from a number of charges or levies) and is increasing the total cost of energy. Moreover, customers are incentivized to invest in distributed generation in order to save on inflated regulated tariffs, which makes this solution artificially attractive and favours inefficient outcomes from the societal point of view, because investments are made in more costly alternatives.

The competitiveness of electricity is relevant also to the fact that there is wide consensus that decarbonization goals are only feasible with a continued electrification of the energy system. Also some initiatives addressed to the transportation sector (as the hydrogen economy) rely on the massive use of electricity.

In order to ensure a level playing field it is also imperative that network costs are fairly distributed among all users.

### b) Ensuring necessary investments

Priority should also be put on the need of adapting the market design to the current and future challenges that power systems are going to face. In particular, the inadequacy of energy-only markets to deliver stable, predictable long-term price signals for investments requires a less dogmatic and more pragmatic approach regarding the current structure of energy markets. In this respect, we believe that the European electricity target model should be reviewed and appropriate mechanisms that incentivize investments in new capacity, such as long term contacts, should be integrated in the future market design. The lack of such instruments could be also compensated in an interim phase by market-based capacity remuneration mechanisms (CRMs) which are able to provide appropriate price

signals to investors. Therefore, we encourage ACER to move this issue on top of its priority agenda.

### c) Full implementation of the Third Energy Package

Finally, we urge regulators to take the necessary actions to push Member States to fully implement the Third Energy Package, as it is an imperative prerequisite to have a harmonized and coherent regulatory framework across the EU. In several Member States, some aspects still need to be addressed in wholesale and retail markets to improve cost-reflectivity of final prices. In particular, the removal of end-user regulated prices and of price caps in spot markets are crucial in order to promote greater competition in energy markets and to encourage market operators to invest in innovative technologies and provide new services to consumers. If Member States do not undertake the above-mentioned actions it will be impossible to send the right price signals to consumers for an efficient use of energy and consequently enable and develop demand side response.

## 4. Are there other areas where we should focus?

### a) Removal of taxes and levies from the electricity bill

We believe that in this document ACER has addressed most of the priority areas.

We would however highlight that final energy prices are a major concern, as they affect production costs of industries and services and the purchasing power of households. In recent years electricity prices rose for both households and industry, widening the gap between the EU and major competitors. Increasing taxes and levies are damaging competitiveness of electricity compared to other energy forms and of the EU compared to other geographical areas.

We would like to refer ACER to a recent EURELECTRIC report ("Analysis of European Power Price Increase Drivers", May 2014), showing that recent increases in electricity prices are largely a result of government add-ons, falling within the taxes & levies component.

For example, according to the EURELECTRIC report, between 2008 and 2012 household energy prices rose by 9%, mainly due a 31% increase of taxes & levies, while energy & supply costs decreased by 4% during the outlook period. In fact, between 2008-2012 policy support costs for household consumers grew by 141% on average across all reporting countries. Policy support costs increased the most in Spain, Germany and Italy.

On the basis of the above-mentioned facts, we consider that this aspect has not been thoroughly tackled in this consultation document and we deem ACER is the most suited technical organization to provide proper guidance to the European Commission and

Member States to identify direct and indirect subsidies that are major sources of distortions of energy markets in view of removing them from electricity bills.

**b) Ensure compliance with TSO unbundling rules**

As more variable renewable energy sources (RES) are being introduced into the electricity system, storage, along with other technologies, will play a growing role in stabilizing the system and reducing temporary imbalances between supply and demand. We believe that storage is a valuable mean to ensure flexibility on a market-based level and in competition with other sources. However, some Member States recently introduced measures which allow TSOs to have the right to own and operate storage facilities. In this respect, Member States should comply with the unbundling rules of the third energy package which establish the principle of separation of energy network activities from energy generation activities in order to avoid distortions in the wholesale market.

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