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EUGINE CONTRIBUTION TO THE EC PUBLIC CONSULTATION ON ELECTRICITY MARKET DESIGN

SHORT-TERM MARKETS

1) Would prices which reflect actual scarcity (in terms of time and location) be an important ingredient to the future market design? Would this also include the need for prices to reflect scarcity of available transmission capacity?

Any market reform should focus on supporting the goals of the European energy policy: achieving a power system that is secure, affordable, sustainable and increasingly integrating renewable energy sources. Two different market design options are currently under discussion at EU level: the establishment of Capacity Mechanisms (CM) or the further improvement of the Energy Only Markets (EOM), including prices which reflect actual scarcity. EUGINE would like to highlight that only the further improvement of the energy-only market is a suitable solution, providing the right investment signals and which is compatible with the internal energy market.
In a CM, the primary investment signal for new plants is the level and availability of the capacity payment on offer (either through a central procurement mechanism or through a decentralised capacity market). Capacity developers are incentivised to deliver generation technologies that are likely to be awarded a capacity contract, which may not have the flexibility characteristics requested by the market. With a CM in place, a pre-determined capacity "margin" is procured on a regular basis and investment cycles are thus absent from reading changes in the energy market price. Moreover, CM are often a highly-administrative, complex and costly option like in Spain where retail prices have been quickly and strongly increasing due to the system of capacity payments in place. Finally, CM established at a national level tend to focus only on the national capacity available and by this restrict cross-border trade in electricity and hinder the whole internal energy market.

In an EOM the marginal plant receives a contribution for recovery of its fixed and capital costs when supplies are scarce. Supplies can be scarce across different timeframes, including in the spot markets, which means that providers of energy in these markets should be able to offer prices above their short run marginal costs if there are few flexible providers of energy left in these timeframes. This acts as a signal for the new entry of flexible plants. In an EOM, expectations of average energy prices (affected by spikes in short term prices) would be to rise as capacity exits the market as part of the normal investment cycle. Of course, freely fluctuating prices on the wholesale market (no price caps, so higher prices in times of scarcity) send an economic signal to the market to develop new capacity, and so the cycle starts again. In addition to freely fluctuating prices on the wholesale market (which does not necessarily have an impact on the retail market), the EOM should empower market participants to reduce imbalances: balancing responsibility applying to them all, cost-reflective imbalance charges and marginal balancing energy prices would create very strong incentives for a balanced energy system with a very high level of security of supply.

The third energy package of the EU achieved a very successful liberalisation of the European energy market. We believe an improved EOM with prices reflecting actual scarcity and proper balancing arrangements is a further market-based reform of the electricity arrangements, required to prepare the market for the future generation portfolio, leading to a competitive and functioning energy market where any distorting effects are eliminated. However, if existing CM are kept in the system or new CM are set-up in the future, the European Union should adopt a set of minimum requirements minimising their potential negative impact on the internal energy market: any CM should be market-based, be open for cross-border participation, solve proven problems related to the security of supply, value flexibility solutions and be a temporary scheme.

2) Which challenges and opportunities could arise from prices which reflect actual scarcity? How can the challenges be addressed? Could these prices make capacity mechanisms redundant?

Prices which reflect actual scarcity on the wholesale market and proper balancing arrangements would definitely help fix the energy-only market, re-create incentives for investments and thus foster flexibility solutions in the EU power system. These measures are a prerequisite to a strong and sustainable EU energy system.

The “joint declaration for regional cooperation on security of electricity supply in the framework of the internal energy market”, 12 “electricity neighbours” (10 EU Member

States and 2 neighbouring countries) stated on 8 June 2015: “we will allow flexible prices; we will particularly not introduce legal price caps and we will avoid that national measures have the effect of indirect price caps.” This is a proof that prices which reflect actual scarcity are already becoming a reality and that decision-makers in member states are aware of the fact that advantages clearly outweigh potential disadvantages.

Prices which reflect actual scarcity and proper balancing arrangements would probably make capacity mechanisms useless because all market players would be incentivised to provide the right type and quantity of capacity for the system. The German government recently decided to further improve the Energy-Only Market (EOM 2.0), not to introduce a capacity market, but to set-up a less-distortive additional mechanism: a capacity reserve with specific capacities kept outside of the market. This move shows that a country with a high share of variable renewables in its energy-mix does not necessarily need a fully-fledge, complex and costly market mechanism to ensure security of supply: an improved EOM is the best way to create the right incentives and to strengthen the internal energy market.

If the EU wants to secure properly functioning electricity markets with clear price signals, electricity markets should be protected from distortive effects of often poorly designed national capacity remuneration mechanisms locking Europe into old and polluting power plants. The EU should rather adopt common standards for adequacy assessment and restrictive criteria for capacity remuneration mechanisms to avoid that diverging national mechanisms question the whole EU energy policy.

A solution might be to restrict the establishment of such state aid mechanisms to only so-called ‘strategic reserves’, for specific emergency cases and a limited time. As long as it is ensured that such capacities are kept outside the regular market, strategic reserves might be the less distortive option and a useful solution in case of sensible fears of market failure. As such strategic reserves are intended to be used as a measure of last resort, also the strategic reserve capacity needs to be flexible enough to react in a fast manner when required.

3) Progress in aligning the fragmented balancing markets remains slow; should the EU try to accelerate the process, if need be through legal measures?

The upcoming network code on electricity balancing should play a major role in developing and integrating balancing markets at regional and then EU level. In principle, EUGINE would like to see this network code adopted and implemented

rapidly. However, it is even more important that this regulation is perfectly drafted to ensure a proper functioning of the EU balancing system.

On the one hand EUGINE welcomes the relatively clear message contained in the draft network code on electricity balancing regarding the upcoming proposed pricing method which "shall be based on marginal pricing (pay-as-cleared), unless […]." (article 42 of the version recommended by ACER to the European Commission on 20 July 2015).

On the other hand, EUGINE regrets the confusing wording on price caps: "Balancing Energy prices shall not be capped. In case TSOs identify that caps are needed for consistency with other market timeframes, they may develop within a proposal for harmonised pricing method for Balancing Energy a proposal for harmonised maximum and minimum Balancing Energy prices to be applied in all control areas. […]" (article 42). Furthermore, EUGINE stresses that the key principles of 'balancing responsibility for all market participants' (including producers of electricity from renewable energy sources) and 'cost-reflective imbalance charges' should have been applied at EU level and be enshrined in this regulation to develop real incentives for flexibility investments and security of supply. EUGINE believes that the three aforementioned issues should still be solved by the European Commission before adopting the network code on electricity balancing.

To sum up, EUGINE pleads for both a correction and an acceleration of the integration process of balancing markets.

4) <u>What can be done to provide for the smooth implementation of the agreed EU-wide intraday platform</u>?

The cross-border intraday (XBID) solution will help market participants trade electricity across borders close to gate closure and balance their own positions. This will ease the integration of increasing shares of electricity generated from variable renewable energy sources. However, EUGINE would like to stress that cross-border interconnection capacities are a precondition to making the cross-border intraday project a reality. In this respect, EUGINE pleads for a balanced approach: in order to keep the costs to a minimum level, only cost-efficient interconnection projects should be financed, based on a solid cost-benefit analyses.

LONG-TERM MARKETS TO ENABLE INVESTMENTS

5) Are long-term contracts between generators and consumers required to provide investment certainty for new generation capacity? What barriers, if any, prevent such long-term hedging products from emerging? Is there any role for the public sector in enabling markets for long term contracts?

EUGINE would like to distinguish two different types of long-term contracts: simple hedging contracts on the one hand and compulsory long-term contracts between suppliers and generators on the other hand.

On the one hand, EUGINE fully supports hedging contracts as described in the consultative communication on the energy market design: “Market participants, including renewables producers, should be able to hedge against price volatilities and volume risks translating the uncertainties connected to price peaks into planned and secure revenue.” EUGINE believes that such hedging contracts (like the EEX hedging product named ‘Cap Futures’) are key to reduce uncertainties for the market players, to decrease imbalances in the system and to foster investments in flexibility solutions. They represent an essential building block of an improved EOM. However, market players should be free to make use or not of such contracts.

On the other hand, EUGINE has not been convinced so far by the Latin-American examples of markets for long-term contracts where suppliers are required to cover their forecasted demand through long-term contracts, as described in the recent document published by the European Commission on “investment perspectives in electricity markets”. For example the Brazilian system has not been very successful so far. For EUGINE, such markets seem to be quite similar to capacity markets and might have also the same drawbacks.

Therefore, EUGINE pleads for the quick development of simple long-term hedging products to be used by the market participants willing to do so. This principle should be supported and fostered by the European Commission and the national authorities concerned.

6) To what extent do you think that the divergence of taxes and charges[1] levied on electricity in different Member States creates distortions in terms of directing investments efficiently or hamper the free flow of energy?

[1] These may be part of general taxation (VAT, excise duties) or specific levies to support targeted energy and/or climate policies.

RENEWABLE GENERATION

7) What needs to be done to allow investment in renewables to be increasingly driven by market signals?

The 'Guidelines on State aid for environmental protection and energy 2014-2020' are an essential tool paving the way to the integration of renewables in the market. EUGINE highly supports the principle enshrined in these guidelines that for energy from renewable sources "subsidies and exemptions from balancing responsibilities should be phased out in a digressive way". It is of utmost importance to ensure as of 1 January 2016 the proper and harmonised application of the concrete provisions of these guidelines (premiums instead of feed-in tariffs, balancing responsibility for all, no electricity generation under negative prices).

In parallel, the EU emission trading scheme (ETS) needs to be further reinforced to deliver strong signals for investments in low-carbon technologies, including power production from renewable energy sources and gas technologies. The adoption of the Market Stability Reserve is a step forward. Now, EUGINE supports a very ambitious long-term reform for the post-2020 period. A strong ETS would foster investments in renewables on the long run and would progressively make costly national support schemes useless.

8) Which obstacles, if any, would you see to fully integrating renewable energy generators into the market, including into the balancing and intraday markets, as well as regarding dispatch based on the merit order?

EUGINE believes in a technology neutral approach of the European energy policy. As technologies using renewable energy sources are progressively becoming mature technologies, they should be gradually benefitting from the same rights and duties as the other technologies. For example, the principle of 'balancing responsibility for all market participants' (including RES producers) is already successfully applied in several EU Member States and should be extended to all EU countries. There is no reason to further exempt certain mature RES technologies from general rules applying to the other technologies.

9) Should there be a more coordinated approach across Member States for renewables support schemes? What are the main barriers to regional support schemes and how could these barriers be removed (e.g. through legislation)?

DEMAND RESPONSE

10) Where do you see the main obstacles that should be tackled to kick-start demand-response (e.g. insufficient flexible prices, (regulatory) barriers for aggregators / customers, lack of access to smart home technologies, no obligation to offer the possibility for end customers to participate in the balancing market through a demand response scheme, etc.)?

Apart from specific technical or financial problems, the main obstacle to the development of demand-response may be the same as for the other flexibility solutions: it is twofold, the lack of technology-neutral incentives to invest in flexibility solutions in the EU energy system on the one hand and the establishment of market-distortive Capacity Mechanisms in various EU Member States on the other hand.

As a consequence, the EU should rapidly adopt a legislation defining restrictive criteria for Capacity Mechanisms and empowering all market participants to reduce their imbalances and to directly or indirectly (contracts with other market participants) invest in flexibility solutions.

COOPERATION BETWEEN SYSTEM OPERATORS

11) While electricity markets are coupled within the EU and linked to its neighbours, system operation is still carried out by national Transmission System Operators (TSOs). Regional Security Coordination Initiatives ("RSCIs") such as CORESO or TSC have a purely advisory role today. Should the RSCIs be gradually strengthened also including decision making responsibilities when necessary? Is the current national responsibility for system security an obstacle to cross-border cooperation? Would a regional responsibility for system security be better suited to the realities of the integrated market?

ADAPTING THE REGULATORY FRAMEWORK

12) Fragmented national regulatory oversight seems to be inefficient for harmonised parts of the electricity system (e.g. market coupling). Would you see benefits in strengthening ACER's role?

13) Would you see benefits in strengthening the role of the ENTSOs? How could this best be achieved? What regulatory oversight is needed?

14) How should governance rules for distribution system operators and access to metering data be adapted (data handling and ensuring data privacy etc.) in light of market and technological developments? Are additional provisions on management of and access by the relevant parties (end-customers, distribution system operators, transmission system operators, suppliers, third party service providers and regulators) to the metering data required?

15) Shall there be a European approach to distribution tariffs? If yes, what aspects should be covered; for example framework, tariff components (fixed, capacity vs. energy, timely or locational differentiation) and treatment of own generation?

16) As power exchanges are an integral part of market coupling – should governance rules for power exchanges be considered?

EUROPEAN DIMENSION TO SECURITY OF SUPPLY

17) Is there a need for a harmonised methodology to assess power system adequacy?

Yes, the past has shown that EU Member States are considering diverse criteria and objectives when assessing the adequacy of their power systems. At a time when national energy policies are more and more interdependent on one side and interlinked with the overall EU energy policy on the other side, such moves should be coordinated through the adoption of a harmonised methodology.

This harmonised methodology should not only focus on the calculation method for available capacities but also on the definition of the required capacity, i.e. on the specific type of capacities which will be needed in the short-to-long term. As the share of variable renewable energy sources is growing in the EU energy mix, the EU and its Member States should focus on securing enough highly flexible back-up capacities (quick start-up and ramp-up times) rather than on relatively old-fashioned baseload capacities which will not be able to quickly react to sudden increases and decreases in electricity production by solar and wind power sources.

EUGINE is pleased that the 'joint declaration for regional cooperation on security of electricity supply in the framework of the internal energy market' of 8 June 2015 states that the twelve countries concerned "will develop a common methodology to assess generation adequacy" and "will work towards further harmonisation of security of supply indicators and a common understanding of security of supply as well as towards a joint regional generation adequacy assessment, to complement the work carried out at national level". This is a very important step in the right direction.

18) What would be the appropriate geographic scope of a harmonised adequacy methodology and assessment (e.g. EU-wide, regional or national as well as neighbouring countries)?

If the EU wants to increase the efficiency of its energy system, reduce costs and protect smaller Member States from the effects of national support schemes set-up by bigger Member States, a European approach may be the best option for a harmonised adequacy methodology and assessment. However, taking into account the existing diverging national adequacy systems, a two-steps approach may be considered as well: a regionalisation and then a Europeanisation of the existing adequacy systems.

19) Would an alignment of the currently different system adequacy standards across the EU be useful to build an efficient single market?

Yes, common system adequacy standards across the EU would be a more efficient solution because capacities installed behind the borders would be taken into account and distortive state aids may be considered as useless and be reduced within the internal energy market.

20) Would there be a benefit in a common European framework for cross-border participation in capacity mechanisms? If yes, what should be the elements of such a framework? Would there be benefit in providing reference models for capacity mechanisms? If so, what should they look like?

21) Should the decision to introduce capacity mechanisms be based on a harmonised methodology to assess power system adequacy?

Yes, EU Member States planning to establish a Capacity Mechanism should first demonstrate that there is an adequacy issue and that cross-border trade as well as the further improvement of the energy-only market could not solve this problem.

To avoid undistorted competition within the internal energy market, such a demonstration should be based on a harmonised methodology to assess power system adequacy. As aforementioned, this harmonised methodology, should not only focus on the capacity calculation methods but also on the capacity capabilities which should be available on the market to ensure a high level of electricity security of supply.