ACER

Agency for the Cooperation of Energy Regulators

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Energy UK Response to the ACER Consultation "European Energy Regulation: a Bridge to 2025"

16th June 2014

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 2012 invested over £11 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 framework for discussion of longer-term energy market issues;
- ACER's major function is to assist in the development and implementation of Network Codes and this should be maintained as the key priority, with a view to completing the single energy market; in light of this challenging agenda, ACER should retain its focus on the Codes rather than looking to extend its role into other areas;
- Energy UK welcomes ACER's focus on affordability and cost effectiveness as policy drivers;
- Energy UK recognises the increasing importance of flexibility in wholesale markets but believes that ACER also needs to play greater attention to generation adequacy and the scale of the investment challenge in power generation;
- ACER appears to have an equivocal view on capacity mechanisms; Energy UK believes that in much of Europe a value will need to be placed on capacity, given the changed market conditions;
- Energy UK favours a market-based approach to flexibility, which promotes a level playing field between different options and fosters innovation;
- 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 and different approaches to the fuel mix;
- 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;
- Energy UK does not regard further unbundling of distribution as a priority;
- Energy UK recognises the importance of further interconnection but stresses the need to ensure that projects are fully cost-justified and that the merchant route remains open;
- ACER needs to pay greater attention to the involvement of stakeholders in establishing processes to amend Network Codes;
- The Network Code consultation process has so far worked better in respect of gas than electricity and lessons need to be learned from this.

1. General

Energy UK welcomes ACER's consultation "European Energy Regulation: 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 highlights 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.

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 are correctly identified as an important issue).

ACER understandably takes a European perspective on energy, but in our view regional differences within the EU also need to be taken into account. This is acknowledged in the section on gas, which recognises that a "one-size-fits-all" policy for gas markets is not feasible, but not elsewhere in the document. While parts of the continental electricity 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.

ACER's pre-consultation referred to overlapping and sometimes conflicting policies at national level and called for "stronger EU-wide coordination of national energy policies". This issue is not followed up in the current consultation document, other than some comments on capacity mechanisms. It is nevertheless an important factor to be borne in mind, particularly in view of the current concerns about Europe's energy security.

Energy UK is encouraged to note the emphasis placed on affordability of energy for consumers and the need for cost-effective policies (these issues are covered in paras 1.1 and 2.23). It is essential that ACER takes full account of these concerns in all its work and ensures that all its outputs are based on robust impact assessment.

2. Electricity Wholesale Markets

Energy UK agrees with ACER's assessment that wholesale markets are undergoing major changes and also recognises the key importance of full implementation of the Network Codes. We also agree that market-based approaches should be used and that it is sensible to keep the Target Model under review. However, given the delays in adopting the Codes and the challenges faced by wholesale markets (see our comments in the "General" section above), ACER should not underestimate the difficulty of moving to a fully integrated market. We therefore emphasise that ACER should redouble its efforts to help ensure prompt adoption of the Network Codes and should not be distracted by other issues.

Energy UK agrees with ACER's general line on renewable support schemes and on the need to integrate renewables into the energy market. We would even go further in stating that priority dispatch and access issues should not just be reviewed but should be phased out. Renewables should operate on a level playing field with other generation technologies in terms of balancing and network responsibilities. We also accept that there may be some benefits in bringing about a convergence of national support schemes, but would stress that this must be done in a way which does not damage investor confidence.

ACER's stance on capacity mechanisms (CMs) appears to be equivocal. Whereas the paper asserts that more flexibility is needed to accommodate renewables, measures to ensure generation adequacy are viewed as responding to governmental "concerns" and ACER expresses worries about a lack of coordination. It is then stated that CMs "may or may not be needed" and it is implied that rewarding flexibility may be a more appropriate measure.

Energy UK takes the view that CMs are likely to be needed as a response to the "missing money" problem in wholesale electricity markets. Given the rapid expansion of intermittent renewable generation, the value of conventional plant will increasingly be in capacity and the provision of backup rather than the supply of energy. Energy UK nevertheless agrees with ACER that CMs should be designed to minimise market distortion, should avoid discrimination and should be open to cross-border participation.

Energy UK believes that NRAs and ACER can helpfully provide advice on the preparation and design of CMs. It should be noted, however, that Member States should retain primary responsibility for security of supply, including their fuel mix and questions of generation adequacy. Regulators or ACER should not therefore call into question decisions by national governments to implement CMs, though they have a legitimate interest in seeing that distortions of the single market are avoided as far as possible.

3. Gas Wholesale Markets

Energy UK agrees that ACER has identified the key issues and trends affecting the wholesale gas market, namely: integration of markets, uncertainty in future supply and demand and interactions with the electricity market as gas-fired generation plays an increasing role in providing backup for intermittent renewable generation.

Energy UK also agrees that the full and effective implementation of the Third Package's Network Codes is a priority and we consider this should be ACER's main focus. It may be that implementation of the Codes is sufficient to facilitate liquidity in wholesale markets and cross-border trade, thus ensuring that price differences between markets are reasonable and that customers benefit from competitive forces. The introduction of a virtual trading point and market-based balancing as required by the balancing code will be key factors here. However, fully liquid, deep markets in every Member State may be an unrealistic expectation. Rather it is more likely that liquidity across a range of product durations will evolve at a small number of hubs across the EU, with local trading points being focussed on shorter-term markets for supply / demand matching and system balancing purposes. We believe that ACER should not take a prescriptive top-down approach to market integration to try to drive liquidity, since this could produce unintended consequences. Rather it should encourage and monitor progress towards that goal, with support where necessary for market participants, NRAs and TSOs to enable markets to evolve. ACER can also have a role in ensuring that the regulatory framework does not hinder or prevent the merging of trading or balancing zones.

The future gas supply / demand outlook across the EU is uncertain; domestic production is largely in decline but may be partially offset by shale gas developments and there is the potential for new supply sources and routes. Energy efficiency measures and the increasing penetration of renewable generation may lead to declining demand. In any scenario arrangements which facilitate cross-border trade will help to ensure that gas security of supply is not compromised. The Capacity Allocation and Congestion Management Guidelines will be important here and their timely and full implementation will support the internal energy market objectives. Greater co-ordination between TSOs at the regional level and early identification of projects to address physical congestion will assist this and initiatives are in hand in this respect, although cost allocation for projects spanning borders will continue to be a challenging issue that needs ACER's attention. In a declining gas demand scenario we also share concerns over network charges becoming an increasing burden to the remaining demand and consider this issue requires further attention, albeit we recognise this is not an easy issue to resolve.

Energy UK welcomes ACER's recognition of the increased importance of interactions between the gas and electricity markets and networks, as flexible gas generation provides a greater role in back-up for intermittent renewable generation. Important issues include:

- Access to liquid markets, forward and shorter term
- Access to capacity products; at point of offtake and bundled at interconnection points
- Access to flexible gas storage services
- Flexible nomination and re-nomination rules in both gas and electricity markets
- Minimisation of within-day obligations
- Avoidance of ex ante linepack products that could create perception of false scarcity
- Appropriate information provision to TSOs and market participants

- Consideration by TSOs of network requirements for both gas and electricity to support flexible generation
- Consideration of gas and electricity security of supply in a joined-up manner.

The basis for considering many of these issues exists within the current Network Code framework, which simply reinforces the point that consistent and timely implementation of these Codes should be ACER's priority.

In the context of all the issues above, Energy UK agrees that if ACER considers intervention is necessary, then it should be targeted, and assessed on a case by case basis for costs, risks and benefits to customers. A one-size-fits-all approach would risk there being potential for detrimental effects on existing markets that are functioning well or are on that development pathway.

4. Infrastructure Investment

Energy UK agrees that greater interconnection is needed if Europe is to reap the benefits of a single market in energy and supports measures to speed up investment. However, it must be stressed that interconnection is not a panacea and that all projects should be subject to rigorous cost-benefit analysis. We therefore support ACER's view that infrastructure development should be market-driven. Energy UK acknowledges that interconnectors can have security and other benefits, but it is still important that the costs are primarily met by the beneficiaries. Regulated interconnection is likely to remain the main option for connecting national markets but ACER should not lose sight of the merchant route and should explicitly recognise that merchant interconnection is an acceptable option.

Network access charges are mentioned in this section and this is one area where ACER needs to step up its work. The Agency has recently published an opinion on the range of transmission charges paid by generators in the EU. Although the opinion recognises that differing charges can be a source of market distortion, ACER's recommendation does nothing to bring about a convergence of charging approaches, and indeed could even be used as a basis for increasing differentials. Energy UK believes that efforts should be made to harmonise transmission charging methodologies (though not necessarily the charges themselves) and to reduce the differentials between Member States where these are not based on costs.

5. Consumers, Retail Markets and the Role of DSOs

Energy UK broadly agrees with ACER's assessment of the main trends shaping retail markets. Nevertheless, it is important that ACER and NRAs should recognise that national energy retail markets are currently rather diverse, reflecting different stages of development, political priorities and commercial realities. 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.

Energy UK takes the view that competitive retail markets are key to ensuring that consumers can better control their energy consumption and costs. The Third Package provides a basis for establishing such competitive markets in electricity and gas, though progress has been limited in some Member States. Energy UK believes that priority should be given to ensuring 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 with the Commission and NRAs towards phase-out timetables for regulated prices.

We note with interest ACER's proposals to reduce switching to 24 hours by 2025 to improve customer experience (para 3.26). Energy UK supports the objective of quicker switching, but not at the expense of reliability. If we are to avoid unintended consequences and protect consumers' interests, it is vital that the customer benefits of quicker switching outweigh the costs. Consequently, a thorough impact assessment should be undertaken before any such switching target is adopted.

With regards to removing barriers in Europe's retail markets (para 3.27), NRAs should be focused on identifying and reducing barriers to entry at the national level to encourage competitive retail markets generally. Energy UK takes the view that this is the best approach in order to encourage a supplier's entry into another Member States' retail market.

The impact of taxes and levies on energy bills and the broader issue of affordability are briefly considered in para 2.23. As we have seen in recent weeks and months, the affordability of energy is likely to remain a key driver of future developments in European energy markets. It is important that all parties recognise that legislation and its implementation have costs, which are ultimately reflected in the bills of all consumers. An open and honest debate is needed as to where these costs should lie.

ACER states in para 3.33 that ownership unbundling is the most effective model to deliver a neutral market facilitator role for DSOs, but does not provide any justification for this statement. In the UK, comprehensive business separation overseen by an independent national regulator ensures effective separation and actively promotes competition. Energy UK takes the view that further unbundling of distribution is not a priority and that ACER's experience and insight would be extremely beneficial on other issues related to the Network Codes.

Finally, Energy UK supports NRAs and ACER working with DSOs and TSOs to assist them in more clearly defining their respective roles and responsibilities so that DSOs may manage their evolving networks in a transparent and reliable way, whilst at the same time supplying system services to TSOs.

6. Implications for Governance

Energy UK agrees with ACER about the need for robust governance mechanisms and for consistent approaches to regulation. It is important that lessons are learned from the operation of the Third Package so far. Energy UK's main concern is that the ENTSOs are responsible both for drafting Codes in a neutral fashion on behalf of all stakeholders and for representing the interests of TSOs. This results in a potential conflict of interest, which needs to be carefully monitored by ACER, particularly in respect of ENTSO-E, as most problems appear to have occurred on the electricity side.

One area in which ACER's work so far has been a disappointment has been the development of a Network Code modification process. In the GB market the early years of the industry codes have seen several hundred modifications across electricity and gas, and, given that EU Codes must cover 28 Member States, it could be assumed that even more regular modifications would be required. In this light it is extremely surprising that ACER has not consulted on this important issue. Energy UK takes the view that market players must be considerably more involved in the process once the initial Codes are established and should be able to put forward modifications (as envisaged by the Third Package).

ACER mentions the possibility of extending regulation to some new entities. Regulation of monopolies, e.g. TSOs is necessary, but a light-touch approach should be taken to regulating activities which are potentially competitive.

Gwyn Dolben/Dan Alchin/Julie Cox
Energy UK
Charles House
5-11 Regent Street
London SW1Y 4LR

Tel: 020 79309390
gwyn.dolben@energy-uk.org.uk
daniel.alchin@energy-uk.org.uk
julie.cox@energy-uk.org.uk

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