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# STATEMENT

## ON THE EUROPEAN ENERGY REGULATION

### A BRIDGE TO 2025

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*The VKU represents 1,400 local utilities in the areas of energy, water and waste disposal. In the end-user segment they have a share of 54.2% in electricity, of 51.4% in natural gas, of 53.6% in provision of heating and of 77.5% in the provision of drinking water. The wide range of services provided by local utility companies is reliable, environmentally compatible and affordable for the consumer. They make a significant contribution to regional economic development. With over 240,000 employees the individual segments together generated revenue in excess of 90 billion euro in 2008. Investments amounted to 8 billion euro. The majority of these investments took the form of contracts placed with companies located in the region.*

VKU welcomes the ACER and CEER public consultation paper “European Energy Regulation: A Bridge to 2025”. The paper is seen as a necessary step towards an integrated approach to the regulatory framework of European energy policy in the coming decade. Such an integrated approach is vital to fully appreciate the increasing complexity in the energy mix and between production and demand in Europe. Anyway, VKU wants to underline that market-based approaches should be the first choice for a further integration of European electricity and gas markets. Regulation should only be taken as solution to solve or prevent market failures.

In the following you will find some remarks to the main questions in the consultation document:

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

VKU supports the creation of a transparent wholesale and retail market across Europe. Full market access across borders is important to achieve cost efficient investment signals. Coordination of different policy areas will be important to avoid conflicting regulation that undermines the overall objectives. The involvement of all stakeholders is a key to achieve good solutions.

The need for grid and production investments due to more renewable energy sources is getting urgent, and VKU supports regulatory incentives for an investment friendly climate. At the same time some arrangements have become too expensive, demanding higher than necessary costs for the consumers. We would like to encourage the promotion of the most cost efficient subsidy schemes, which comes with the lowest need for infrastructure upgrades. Regional auctioning of renewable energy concessions is one such scheme.

The last years showed that RES are driving changes in generation. The vast majority of RES is and will be connected to the distribution grids; therefore the role of DSOs is very important for the overall energy system. In today's system operation, DSOs have to manage constantly actively their distribution systems, due to the volatile feed in from RES. As more RES is going to be installed in upcoming years, managing the system will require new technologies and know-how. The fragile balance between supply and demand can partly be kept by flexibility services, like demand-side management. Also important is an infrastructure which will be able to function properly under these new circumstances.

VKU also sees the advantages of gas-fired plants in connection with the increasing amount of renewable energy. Especially in Germany, gas-fired plants suffer high losses due to the merit order effect. Therefore VKU wants to stress the importance of a market design, which brings gas-fired power plants into money. The market design or capacity mechanism question should be a national one. There should not be too much regulation from the EU as this would hinder to implement a suitable mechanism.

Due to high and increasing energy efficiency many DSOs, are facing uncertainties on the use of their grid capacity. The regulated volume-based tariff structure is likely to cause difficulties concerning the amortisation of past investments and uncertainty for

future investments. Nevertheless, the use of gas grid capacities underlies regional and temporal deviations. The peak use of gas therefore fosters the need for existing capacities. Biogas and power-to-gas are two innovative technologies which will need the existing gas grid infrastructure and are promising for the future. As biogas constantly feeding into the gas grid, or can be used as energy resource for generating electricity, it is a complementary source to volatile RES feed in.

Regarding the integration of gas wholesale markets, VKU wants to state that the exploration of shale gas reserves is seen very critically due to uncertain environmental consequences, especially its effect on drinking water supplies. Member States should remain free to ban the exploitation of certain forms of unconventional sources, especially in environmentally sensitive areas.

A further future item is the role of the aggregator. To gain from flexible devices in a large scale, they have to be bundled. This could be done e.g. by the balancing responsible party (balancing group manager). To offer attractive tariffs to the customer, the supplier has to know the given flexibility in the relevant balancing group. Therefore it would make sense if this role would be given to e.g. the balancing responsible party (balancing group manager) or the supplier.

When it comes to the discussion about bidding zones VKU wants to stress that there should not be made hasty decisions. Especially the bidding zone Germany-Austria is a well- functioning one and increases the liquidity in both markets. A separation of this zone will also have negative effects for the customer, as prices will rise. The present problem, i.e. loop flows via Poland and Czech Republic, can also be solved in another ways. Germany is hard working on the network development plan, which will help to reduce the present problems. A short-term approach, which could ease the present situation until a final solution was found, could also be a technical one by installing phase shifter at the cross border points. As this problem will be temporary, VKU does not see the need to question the German-Austrian bidding zone.

### **Have we identified an appropriate regulatory response?**

In general, the regulatory framework which already exists in the energy sector is very extensive. The rules for the regulatory framework ranges from the 3<sup>rd</sup> Package, which is, according to the monitoring report from the German NRA, fully implemented in Germany, and to financial regulation which applies to the energy sector as well.

The focus now should be not to increase complexity, especially when it comes to the end consumer. Smart metering, smart grid and demand response opportunities are very complex themes. VKU sees the task at the regulator / legislation to inform the customer and to give him the necessary trust in those technologies and possibilities. As each member state is different, this is seen as task of the national legislation. This is also the case with home automation. The more internet-connected devices one has (there are), the more transparent consumer behavior will become. This bears the risk of vulnerable private data.

Regarding the intervention in electricity markets, VKU believes that political interventions should generally be implemented through market-based measures, where possible and appropriate. Political interventions and public financial support for social and environmental measures that address market failures are embedded in the

energy sector, given its public service character. Mentioning only the market distorting effects of RES subsidies does not reflect the complete situation. While VKU agrees that support for RES should become more market-based and gradually be phased out when technologies have become competitive, competitiveness is hard to judge in a market that is influenced by (indirect) subsidies for even very mature technologies, such as fossil fuels or nuclear, with support to conventional generation being more than twice the RES support according to the European Commission's figures in the draft of communication on public intervention.

Especially when it comes to support mechanisms for RES as well as capacity remuneration mechanisms, we believe that the market-based approach is the right way to go. We suggest that additionally any capacity remuneration mechanism should also incentivize demand response in a market based instrument. Any flexibility option (flexible generation, energy storage, demand response) should be able to participate in a market for secure generation.

A reform of the ETS is both necessary and urgent and fully supported by VKU. The current low carbon price as a consequence of the large oversupply of certificates does not drive investments in innovative low-carbon technologies, such as renewable energy and energy efficiency. It also has to be said that in each Member State the usage of the money generated through ETS certificates is regulated on national level. VKU therefore supports the proposed market stability reserve but would like to see further reforms, such as a permanent retirement of allowances in order to unfold an immediate effect on the carbon price.

Any measures that Member States take toward ensuring generation adequacy should be compliant with the ultimate goal to complete the European Internal Energy market. Therefore, VKU agrees that if a capacity remuneration mechanism is to be implemented in one Member State – after careful evaluation of all other options and including a cross-border assessment of its generation adequacy, it should allow for the participation of capacity (demand and supply) from neighboring countries. All set-ups should be carefully monitored by regulators and be as market-based as possible to avoid further distortions.

The role of DSOs has already evidently evolved from a sole distributor of energy, into an active system manager who operates, maintains and develops the network. The competences of DSOs lie in the operation of a stable and reliable grid, taking care of efficient and reliable supplier switching process, allowing network access in a non-discriminatory way, distribution of data in a non-discriminatory way and therefore acting as a neutral market facilitator.

The DSO should also be allowed to execute tasks, such as load control, energy usage monitoring and electric vehicle charging points. As a matter of fact, excluding DSOs from taking over these tasks, or even taking tasks away from them, would hinder one major actor from developing smart grids. Restricting DSOs to natural monopoly activities, would forgo an important actor, who has long experience in managing, operating and developing energy networks.

As ACER outlines correctly, DSOs will need to intervene more often in the energy system, due to fluctuating supply and demand. The dramatic increase of redispatch activities is an indicator for the active management role the DSOs are holding.

Additionally, they will be facilitating effective, affordable and customer-friendly retail market, i.e. through effective data management and non-discriminatory data provision to market parties. Therefore, it is reasonable that they need access to consumption/injection data to ensure grid stability. As neutral and regulated entities, they are actually best placed to ensure this data is provided to all relevant parties in a non-discriminatory manner. A current VKU survey clearly shows that most DSOs are willing to take over new roles concerning the management of system-/metering data.

Regarding the data management relating to smart meter, it is important to say that a clear framework is necessary to define the rights and duties of the customer. There should be high safety and privacy standards regarding transmission of metering data to third parties – especially if third parties want to receive this data. The owner of metering data is the customer and only with the accord of the customer this data can be given to a third party. Therefore, if the consumer requires more service apart of the sole energy supply, he has to legitimate the relevant party (e.g. through a contract) to have access to the relevant data for this service.

With regard to data management, DSOs should indeed give non-discriminatory access to this data to all parties that have been entitled by the consumer to receive them. VKU has been actively promoting the DSO as market facilitator model, in which DSOs make the data available on (de-)centralized data hubs. As highly-regulated parties, DSOs are actually best placed to ensure the non-discriminatory access to data.

In general, to allow the customer to benefit from the smart world and from smart appliances it is crucial that the supplier has accurate and reliable consumption data. Therefore energy suppliers should have access to data which are necessary for offering various tariffs. Only if this is the case, appropriate offers can be made. When it comes to flexible devices it is important that the supplier can steer this flexibility to optimize his portfolio. Only if this is given in a wide range, the customer will profit from low prices. Therefore it is essential to leave demand response services to the market. As long as there are no grid restraints, markets participants should have the possibility to carry out demand response services in order to bring benefits to the customers.

VKU also appreciates the fact that the increase of energy efficiency is considered as an important part/brick for the future development of energy markets. However, it should be associated not only with demand response. It should be rather seen as a separate central instrument. Demand Response is highly focused on energy savings, load shift, peak shaving and valley filling. In connection with that, it is often disregarded that the market-based and competitive implementation of energy services can be a viable/sustainable tool for increasing energy efficiency across all customer groups and reduces network investments.

In Germany, the grid traffic light has been developed, which has been adopted by the EG 3 of Smart Grid Task Force. When the light is green, the grid is stable and everybody can act as he wants (switching on and off loads whenever they want). When it turns into yellow, the stability of the grid has to be regained by e.g. selective switching off some flexible loads. At present the German legislator is working on a respective act. In the yellow phase it is planned that the DSO will contact the supplier and the supplier can then tell the DSO which flexible load can be reduced, as the

supplier makes the respective contract with the customer. If the traffic light turns red, only the grid operator can decide which load will be switched off to regain a stable grid. This concept is also seen as suitable in the future market under the consideration of the smart world.

In general, also in a smart world the roles should be as follows:

- DSO: responsible for grid stability, distributor of metering data, load control, energy usage monitoring and electric vehicle charging points, offers network tariff reductions in a non-discriminating way for flexible loads Therefore a shift from volumetric (kWh) towards more capacity based (kW) network tariffs should be envisaged in is highly supported by VKU.)
- Supplier: optimizes his portfolio by using flexibilities, offer different tariffs (e.g. time-of-use) to the customer – prerequisite: accurate data received from the DSO (or gateway administrator)

There will be no major shift in the role of DSOs. They will remain the market facilitator and guarantee non-discrimination and neutrality with regard to market participants.

VKU sees certain synergies between the energy and telecom sectors with regard to communication in a smart grid environment. As DSOs will increasingly depend on data for the smooth functioning of their networks, the telecom sector can supply some interesting ICT solutions. However, it needs to be clear that data communication and management needs to be in the hands of the DSOs. They cannot rely on third parties for the delivery of necessary information. Common standards for content, format and exchange of customer metering data are a prerequisite for a functioning retail market. Only with the possibility to access and process the relevant data, service providers (which have the consumer's assent) are able to develop individual products and services. These standards however, should only be set on national level, as they are rather different across Member States. A European-wide harmonization would entail unnecessary major costs, especially for DSOs, which would then be passed on to consumers.

When it comes to infrastructure investment we agree with ACER's assessment, that there is a need for a more pan-European view on the infrastructure. However, we do think that regulators have to recognize all levels of energy transport and distribution as an integrated system. As already mentioned, the large number of RES installations, are causing volatile supply. There is a common understanding among member states and EU-bodies, that there is an urgent need for smart grid installations at distribution level. This should be reflected by ACER and national regulators.

This can be achieved through transition from a static to flexible energy system and demand-side-management. Smart distribution grids are highly suitable to enable more flexibility within network systems.

VKU welcomes and emphasizes that ACER has identified the need for a regulatory framework which incentivizes investments in infrastructure. To achieve the goal of investments, the regulatory framework should be clear and reliable.



Regarding infrastructure development a focus on future-proof enabling regulatory frameworks is very much appreciated. Traditional regulatory frameworks increasingly appear to be inappropriate to cope with the changes in the energy system. DSOs sometimes face returns on investments that are lower than their weighted average cost of capital (WACC). Often, the revenue caps of DSOs are only adapted with considerable time-delays, in Germany of up to seven years and hence lead to very late return on investments made and consequently financial difficulties for DSOs. Additionally, a general complexity of incentive schemes and benchmarking procedures make it very difficult for DSOs to develop innovative activities.

Another issue is the design of network tariffs. In many European countries, network tariffs are 100% volume-based, meaning network tariffs are charged for each kWh used. With an increasing share of prosumers and through successful energy efficiency measures, less electricity, gas and heat are transported through the networks. While this is contributing to the EU energy and climate objectives, it dramatically decreases the revenue for DSOs. At the same time, the network needs to be maintained, reinforced and extended and even consumers with (micro)generation facilities will continue to be dependent on the grid during certain time periods. Moreover, for DSOs the cost driver of the network is supply of (peak) capacity and not volume. Therefore, a tariff structure which sets a higher focus on the capacity of the connection, may constitute an interesting alternative, allowing network operators to recover their costs in a more balanced and consistent way. For an in-depth analysis of several tariffs design opinions, please refer to the recent position paper, which has been elaborated together with the European umbrella Association "CEDEC": [Distribution Grid Tariff Structures for Smart Grids and Smart Markets](#).

In order to incentivize the necessary investments for the deployment of smart grids in Europe, VKU advocates for cost-reflective regulatory frameworks that recognize investments in innovative technologies, adapt to changing CAPEX & OPEX structures and minimize the time-delay between investments and adaptation of revenue caps.

New technologies are needed to meet the requirements of a decentralized and flexible energy market. As a variety of technologies are available today, there is an urgent need for clear policymaking on regulatory aspects, so the technologies can be implemented. As the regulatory framework currently causes uncertainty about investments in these new technologies, such as controllable local power transformers, DSOs cannot fully engage system challenges. We are therefore stressing, that the deployment of new technologies mainly depends now on the recognition and incentives in the regulatory frameworks for DSOs.

VKU strongly disagrees that the most-effective model to ensure competitive markets is ownership unbundling for DSOs. In fact, with ownership unbundling retail markets might be less competitive due to a large number of especially smaller integrated companies, currently falling under the de-minimis rule, having to sell their supply branches, which would then be bought by the large incumbent players, considerably decreasing the variety of market actors and the level of competition in retail markets. Furthermore we stress that the DSOs are already neutral market facilitators and do not impede the development of the market in supply services including load control, energy usage monitoring or new activities ,like electric vehicles recharge points in public places.



The de-minimis rule, proved to be an appropriate instrument to allow DSOs with less than 100.000 customers to operate their network efficiently while maintaining a balance between benefits of further competition and costs.

VKU agrees with ACER, that before considering further measures on unbundling, the current provisions from the Third Energy Package need to be fully implemented and monitored in all member states. The current rules – if properly applied – already prescribe a clear separation of commercial and con-commercial activities with integrated companies and lead to a high level of competition in many countries. Considering the existing rules, DSOs cannot use access to data to gain commercial advantage.

The current VKU survey shows, that the number of third party suppliers within the respective network area is 120 on average. In contrary to ACER believing that there is no sufficient competition in network areas, this fact reveals, that the market competition is functioning.

All DSOs are, irrespectively its size, obliged to meet with strict unbundling rules according to 2nd and 3rd Energy Package, such as informational unbundling, unbundling of accounts and branding unbundling. Considering the existing and implemented rules, DSOs cannot use access to data to gain commercial advantage. The size of a DSO company or a network area has no indication regarding its efficiency or the possibilities for consumers participating in the energy market. This has been annually investigated and reported by the German NRA.

VKU underlines, that further regulatory intervention would be inefficient and costly and should therefore be avoided.

For an improved coordination VKU agrees that changes for DSO networks in the energy sector are probably to be considered as most fundamental. Coordination between TSOs and DSOs, but also between DSOs mutually plays already today and even stronger in the future, an important role to address this challenge.

Network codes in development already describe in different domains the roles of DSOs and cooperation between DSOs and TSOs, but mostly from a TSO perspective.

VKU wants to stress that TSOs need to recognize DSOs as 'full' system operators and that distribution networks differ fundamentally from transmission networks. Technical measures and procedures on transmission level are not necessarily fit to be also applied on the distribution level.

A lot of the cooperation between TSOs and DSOs will take place on the level of information exchange. It is important that DSOs are and stay master of what is happening on their grids. No interventions from other operators should be allowed without the DSOs knowledge, as they are the responsible party for stable and reliable distribution grids. Direct communications channels of TSOs to grid users connected to the distribution grid are endangering the safe operation of distribution grids.

Regarding the actions pointed out under 3.26 VKU wants to comment them as follows:

- Transparency: VKU supports transparency, but also wants to say that because of the extensive requirements from the 3<sup>rd</sup> package (especially regarding the information which has to be printed on the invoice) transparency is not always given.

Transparency can also suffer because of a discriminating behavior of price comparison tools, as it is the case in Germany. A very well-known and often used price comparison tool invented two separate listings – one, which is preset, with companies paying for the company's services, and another one containing also suppliers that are not paying for the company's services.

- VKU does not support the proposed reduction of the switching period from 3 weeks to 24 hours as we don't see any additional value for the customer there. In Germany, the switching period now is two weeks and this is already quite hard to keep because of the numerous processes which have to be followed. If the switch cannot be realized within the given time, the customer ends up automatically in the Auxiliary Supply which is quite expensive until the switching process is fulfilled. By reducing the switching period VKU sees the thread that nearly every switch will first end up in the Auxiliary Supply as the processes are too complex to realize them within 24 hours.
- VKU strongly supports the point regarding ensuring data privacy. The customer is the owner of the meter data and the meter operator is the only one allowed to use this data. Any third party is only allowed to use the data if the customer agrees on that. Therefore, VKU wants to point out, that in Germany, The Federal Office for Security of Information Technology (BSI) has developed detailed rules for data communication and data handling (protection profiles) which have to be applied whenever smart meter are implemented.
- The protection of vulnerable customers is also seen as necessary by VKU. But in general, this is seen as task of the social policy. Apart of that, many local utilities offer energy advice to this kind of customers. They also offer the possibility of payment by installments.
- VKU does not only see the customer's benefit through smart meter by a greater control of the energy use. The much higher benefit will come through easier processes (billing, meter reading, and so on). The big cost advantages are seen at these points.

For the fit for purpose processes for the implementation and enforcement of market rules, VKU agrees that implementation of network codes is important and should be monitored appropriately, but would like to warn about the use of the wordings 'quickly' and 'speedy' as it comes to implementation.

VKU asks for adequate transition periods in each of the codes, needed to facilitate the implementation for the DSOs and for all other stakeholders by providing them with the necessary time to adapt existing procedures, settings, contracts, arrangements, and so on and to put in place the new requirements as smoothly as possible.

Some of the electricity draft network codes include non-binding guidance and monitoring on implementation and a stakeholder committee. The creation of this stakeholder committee – in which VKU DSOs wish to take part - should also be envisaged in all the other network codes for electricity and for gas. It seems also useful to setup these committees as soon as possible, because early implementation will certainly shorten the learning curve for the involved stakeholders once the regulation enters into force.

Transparency throughout the whole development process, from the start with the ACER framework guidelines to the voting of the regulation in the Comitology committees at the end, will allow all stakeholders to follow up on the evolution of the legal text and permit them to help improve the quality of the network codes and to prepare implementation adequately, based on 'latest' available drafts.

Regarding future modifications to the network codes, we would like to refer to the process ACER describes in its “Guidance on the evaluation procedure for network code amendment proposals” under art. 7 of the “Electricity and Gas regulations”, which already provides in a rather detailed description on how the network codes can be amended.

While amendments will be needed, it should be taken into account that none of the network codes are implemented at this stage. It is very important to learn from implementation experiences before changing the rules (again). As a result VKU does not see the amendment of network codes as a priority to focus on.

### **Which regulatory actions are most important and should be prioritized?**

In general, VKU supports the key priorities defined in the paper (especially the ones under 3.5.). From our point of view, the following actions on regulatory issues are seen as the most important for European energy policy:

- Further development of interconnection points to enable a functioning cross-border electricity and gas market
- Further development of an integrated electricity market across Europe
- Further integration of renewable energy sources (RES) in the market
- Development of an European balancing market to enable that balancing can be undertaken in the most efficient way
- Full implementation of the Gas Target Model
- A competitive cross-border energy market, without regulated prices in wholesale or retail markets.

To create a competitive, reliable and future-prove energy market, regulatory rules should be designed in a way that investments can take place, in order to meet challenges and cope with changes of a new energy landscape. As most investments in energy infrastructure are naturally long term investments, there is a need for a certain degree of consistent regulation framework. Ownership rights should be respected and inappropriate regulatory steps must be avoided.

Nevertheless, as the energy landscape, especially the generation and distribution grid, is changing considerably, regulatory actions have to reflect this change.

VKU sees the change in incentive regulation as an out most important priority. As ACER has correctly identified, the most changes in the upcoming years are taking place at distribution level. The incentive regulation should therefore be adopted from a sole “cost reduction scheme” towards an investment incentivizing regulation, which allows to operate and develop smart grids.

DSOs should be acknowledged as an important actor for the implementation of smart grids and should be fully involved in drafting of regulatory and technical rules. This will guarantee an integrated approach and a driver for succeeding with realizing the single European energy market.

**Are there other areas where we should focus**

As ACER already stated, it has to be expected that the future energy market will be very complex. But even if it is understandable that ACER wants to prepare for the future, it is even more important to concentrate on the present. There are a number of regulations and network codes which have to be implemented but which do not run properly because of the complexity. One example is REMIT where the delegated acts are still not finished. Due to the complexity of the energy market, the implementation of a regulation takes time. Therefore VKU wants to state that ACER first should concentrate on a proper implementation of the existing regulations and then think about new regulations.



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