



BUSINESSEUROPE response to the public consultation on a new energy market design

Introduction

BUSINESSEUROPE supports the goal to establish a European wide electricity market, in order to facilitate unhindered flows of electricity across borders and thus reduce costs for consumers, both industry and households. A market-based approach should be a core element towards delivering this new power market design, aiming at stimulating industrial growth and job creation.

The top priority must be security of supply and affordable prices that ensures industrial competitiveness whilst aligning with a coherent and consistent climate and energy policy: absolutely essential are policy framework conditions which remain predictable and stable over the longer term, i.e. instruments and objectives whose interactions are understood and which correspondingly build on each other.

The benchmark of today's market design is the energy-only market attracting economically viable investments through price signals and competition. The Target Model along with the EU Emissions Trading System (ETS) could become an EU-wide model integrating national and regional power markets.

Regional power markets should play a key role as "stepping stones" in approaching an EU-wide electricity market, with the ultimate goal of an EU-wide solution. Regional approaches such as the German-Austrian common power market as well as the Nordic power market between Norway, Sweden, Finland, Estonia and Denmark or the Iberian power market shall be seen as examples in this regard.

Key messages

- A European wide electricity market can reduce costs for consumers, both industry and households, when opting for a market-based approach towards delivering it. The Target Model could become the EU-wide blue print for integrating national and regional power markets.
- Regional power markets can play a key role as "stepping stones" in approaching such an EU-wide electricity market, whereas the regional approach should not prevent the parallel development and ultimate goal of an EU solution.



- High investments are needed to reach the EU's emissions reduction goal and to maintain high standards of security of supply across Europe. Regulatory uncertainty should not hamper these investments. A functioning, competitive market should provide sufficient investment signals to bring forward economically viable investment necessary to deliver security of supply.
- A key objective is to have affordable energy prices for all. The market design must provide predictable framework conditions and thereby promoting industrial manufacturing, growth and investments. Reinforcing the competitiveness of European industry and securing international competitiveness is of paramount importance.
- The EU should focus on a single greenhouse gas emissions reduction target to incentivise investments in low-carbon and energy-efficient technologies. Support schemes for renewables should be progressively phased out to allow the market to determine energy choices.
- Capacity mechanisms, like any regulatory intervention, have risks associated and it is crucial that Member States and the European Commission work to ensure that other options are exhausted before capacity mechanisms are pursued. Though we have to recognise that capacity mechanisms do now exist in some Member states. The European Commission and Member States should ensure that existing capacity mechanisms can work with the internal energy market



Reply to the Commission questionnaire on a new Energy Market Design

PART 1 - DELIVERING THE NEW ELECTRICITY MARKET FOR THE EUROPEAN UNION

Question 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?

In order to provide correct price signals for new investments (both generation and consumption), and to provide security of supply, prices which reflect actual scarcity are an important ingredient in the future market design. In this framework, market interventions that weaken the price signal, should be removed. This includes the scarcity of transmission capacity. Scarcity of the latter is reflected in the fact that prices in one country, or one region in a country, might be higher or lower than neighbouring areas. A consumer who pays - and a producer who receives the power price for that specific region thus implicitly also pays for any scarce transmission capacity.

Because flexible power plants (and other providers of flexibility) rely on fewer running hours to recover capital costs, price peaks in situations of tight capacity margins are an important metric. Generally it can be expected that intraday markets are more peaked than the day-ahead. This is because the available supply of generation diminishes closer to the time of use: fewer plants are able to turn on in short-time frames (technical and economic restrictions) and others will have already committed their maximum generation. Those plants that remain available often have higher marginal generating costs (which is also the reason why they are still available). Negative prices are also observed, e.g. from excessive wind generation. The market design should ensure that electricity systems serve consumers' demand rather than the demand to serve the production. Prices that reflect scarcity of available transmission capacity can act as investment signals.

Question 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?

A potential challenge is a case where competition is not well functioning. This may result in too high market prices. Hence sufficient competition enforcing control mechanisms are necessary.

The opportunity arising from prices which reflect actual scarcity and oversupply is for power producers and consumers to locate their new production/consumption in areas which need additional production/consumption due to the price being higher/lower than in other areas. The challenge compared to a scheme with



regulated prices is price volatility. The latter can be negated through voluntary long term contracts or other means.

Through the signals mentioned above (see answer to question 1) market participants are incentivised to self-balance and thus contribute to system security. As a general principle, incentives for market participants to buy and sell flexibility are strongest when there is a known risk of high imbalance charges. This drives market participants to procure flexibility in the short-term markets close to the point of delivery, when generating capacity shortages or surpluses usually emerge as a result of forecasting errors or plant outages.

The forward market has to be improved and will gain much more relevance in terms of security of supply and investment incentives than it delivers today. Long-term investment incentives will be set if higher volatilities on the spot market (mainly driven by asynchronous feed-in and output and thus by higher uncertainty) will lead to a higher price level on the forward market. Hence, the forward market will serve both as an indicator and as a suitable instrument for setting investment incentives.

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

BUSINESSEUROPE strongly believes that higher levels of integration on a European level fosters efficiency and effectiveness in terms of security of supply. Aligning fragmented balancing markets can be one component to bring this forward. Increased coordination of energy policies among neighbouring countries is another step towards the achievement of a single European electricity and gas market.

We do believe that the development of the Electricity Balancing Network Code and the implementation of the regional pilot projects – when provided for a common Target Model - are the right instruments to progressively align European balancing markets. Before their full implementation and entry into force, it is hard to justify any additional legal intervention at this stage.

Currently, national balancing markets in Europe have significantly different market designs and are operated according to different principles as they are strongly linked to the local market context and network conditions. The presence of such different market designs makes it difficult to evolve towards a genuine European balancing market. From this perspective, it is crucial to ensure that further integration of balancing markets is smoothly implemented and is done carefully taking into account implementation costs. A solid and robust cost-benefit analysis (CBA) taking into account stakeholder input should be conducted, to assess the case for pan-European harmonisation of the various elements of balancing markets



The balancing price needs to reflect real time scarcity. This is important to create a level playing field between pre-contracted reserve by the Transmission System Operators (TSOs) and 'pure' balancing energy, but also from the point of view of reflecting the full marginal costs of system scarcity (especially when TSO's apply out-of-the-market emergency measures) and encouraging self-balancing ahead of gate closure.

To avoid distortions, the European imbalance settlement (cash-out) arrangements will need to be harmonised along with balancing energy markets. If differences in imbalance settlement remain, the incentives on market participants to offer balancing services to the common merit order may be distorted. This could lower the efficiency of cross-border trade.

Question 4: What can be done to provide for the smooth implementation of the agreed EU wide intraday platform?

BUSINESSEUROPE is supporting the establishment of an efficient cross-border intraday (XBID) platform based on a Common Management Module and a shared order book (SOB). While we do recognize the challenges to implement such a XBID platform in Europe, we are disappointed about the lengthy and burdensome process that has led to repeated delays in the delivery of the solution. We welcome the signing in early June this year of the contract between Deutsche Börse AG (DBAG) and each of the power exchange involved in the implementation of the European XBID platform. This was a significant step forward. It is now crucial that project parties' stick to the agreed timeline of Q3-2017 for the go-live date of the platform with all Local Implementation Projects (LIPs) attached.

While welcoming recent progresses made, BUSINESSEUROPE regrets that the development of intraday markets have been held captive of this project centric approach and the delay in the finalization of the SOB has led to the further postponement of necessary, no-regret market design improvements - the so-called "quick-wins" at local level - to facilitate cross-border access to interconnections (CMM component of the project). Those quick-wins were not a fall-back solution but rather a smart implementation plan, a way to improve the current situation and use the common XBID at its full potential once ready.

To smoothen the implementation of an XBID platform in Europe, BUSINESSEUROPE would therefore recommend:

- The implementation of the Local Implementation Plans (LIPs) by transmission system operators should be done in parallel of the platform development by power exchanges and a fallback should be foreseen in case LIPs are not ready on time for the go-live date.
- Stronger stakeholder involvement should be ensured throughout the process – the establishment of the XB ID User Group is a first step in the right direction to improve communication and transparency. It is crucial to have market participants at the centre of the discussion as they will be the



main users of the system. This should allow for quick improvements of XBID trading at regional level.

A regional approach would smoothen the implementation process of the EU-wide intraday platform. However, this regional approach should not prevent the parallel development of the more European approach: the development of the single order book by Power Exchanges.

Question 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?

The electricity price level and ability to enter into long term contracts are critical for the ability to operate and invest in generation and electro-intensive industries. Investments in both these industries (energy generation and industry) have very long life spans, and access to electricity contracts for at least 15 to 25 years are crucial in order to control costs, reduce risks and enable investments. The power price forecasts are highly influenced by CO2 price assumptions and other electricity regulated costs (RES support and electricity taxes). Uncertainty regarding future compensation schemes and other regulatory costs are major barriers for entering into long term contracts. For electro-intensive industries competing globally, predictable exemption for non-global levies should be incorporated in the market design.

Liquid forward markets are important as reference price for long term hedging contracts. Preferably there should be a “system price” (hub price) covering several price zones like in the Nordics. TSO must not be forced to issue transmission rights. These products have no value as hedging instruments for generators and consumers and will increase risk and costs for TSO that needs to be covered by grid customers.

Voluntary long term contracts are one of the appropriate tools to give sufficient incentives to investors. Competition rules should allow all players to conclude this type of contracts and all regulatory barriers should be removed. Long term contracts can be desirable in order to provide investment certainty and financing for new generation capacity (large scale projects).

Additionally, it is important to note that voluntary long-term contracts can just hedge costs. They do not ensure a targeted level of adequacy for the whole system nor secure supply for a specific customer.



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

Taxes and levies differ substantially among EU Member States. While taxes and levies constitute 57%¹ of the energy price in Denmark they only do 5% in Malta. In EU average energy prices comprise 32% taxes and levies.

The challenge of high energy prices should receive the necessary attention by implementing a coherent and targeted approach to remove policy-driven costs. Safe supply of energy at affordable price is crucial for businesses across Europe. European industry keeps facing high energy prices that affect its global competitiveness towards main industrial competitors. At the same time Europe witnesses investment leakage of energy intensive sectors. Action is needed to address the cumulative cost impact of policies such as carbon pricing, taxes and levies for energy intensive and trade exposed industries.

EU Member states are using electricity bills as a mean to fund energy policy costs, including renewable energy subsidies and efficiency policy. Electricity bills are therefore no longer driven primarily by the cost to generate and transport the electricity – but instead by taxes and levies which are added on top. As long as EU Member states deliberately increase the price of electricity, electrification will remain an uneconomic option for investors and competition. Furthermore, the benefits that well-functioning retail markets can bring to consumers are drastically reduced when the share retailers can compete on to deliver electricity at the lowest cost and in the most innovative way is rather small. They also represent a burden on consumers and damage industrial competitiveness.

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

Renewable and low carbon technologies offer interesting market perspectives for many European companies. However the energy price impact of current support schemes is not viable for the EU's economy.

The barrier to renewable energy is cost. Until renewables are cost effective (inclusive all additional imbalance costs and grid investments) industries competing globally have to be fully exempted for all direct and indirect related renewable energy support costs.

Support for the market deployment of renewable should be progressively phased out to allow the market to determine energy choices. In the long run low carbon investments should be driven by the carbon price, which is the most efficient signal - being conditional towards carbon and investment leakage protection.

¹ Reference is made to retail prices, see: COMMISSION STAFF WORKING DOCUMENT Energy prices and costs report /* SWD/2014/020 final */.



A transitional support structure should be designed taking into account the expected technological progress and decrease in production costs for different renewable technologies. As soon as possible, support should be focused on the early stages of technology development.

Question 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?

All types of resources should be subject to the same network connection rules and operational market responsibilities. Renewable energy generation should bear the same technical requirements and charges for balancing, grid connection and network use as other generators. The European Commission should further consider the impact of priority of dispatch on market prices.

Production in times of negative prices should not be economically viable for producers. Imbalance costs created by renewables must be borne by these assets.

Furthermore, since intermittent renewable electricity is becoming an important part of the electricity supply in most Member states, it is important that renewable electricity is integrated into the electricity market, i.e. that renewable energyE operators act like any other power producer as a market participant and responds to market signals and do not lead to market distortion.

Question 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)?

On the short to medium-term, and as a transitional phase, subsidies for those renewable energy technologies shall be based on mechanisms that try to avoid negative effects on the market. Such a transitional renewable support scheme should be coordinated EU wide, allowing for the most cost-effective deployment of varying renewable energy technologies across Europe. Any renewable support scheme must allow for full exemption towards any additional costs for energy intensive industry sectors that face international competition. EU state aid rules should reflect this as well.

Question 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.)?



We are deeply convinced that demand response will play a key role in the power system in the upcoming years. For this purpose, market rules should allow demand response to participate in all markets. As it should be the case for all technologies, demand response should only be triggered by market incentives.

Allowing suppliers to offer cost-reflective, flexible price signals that reward consumers' flexible consumption would be a key step forward. In order to ensure that customers can participate in demand response aggregation and do not face undue costs, a robust, transparent and equitable market design should be put in place. Demand response should be based on voluntary market participation.

Market design for demand response must be developed regionally, in close cooperation with stakeholders. Reward must reflect real value of flexibility, and incentivize use of existing capacity which in the long run will give the highest benefit at lowest cost. As seen from the consumer side, there are increased costs and increased risks that have to be compensated.

PART 2 - STEPPING UP REGIONAL COOPERATION IN AN INTEGRATED ELECTRICITY SYSTEM

Question 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?

BUSINESSEUROPE is supportive of the Commission's view for more integration of system operation (instead of just coordination of system operation) regarding cross-border issues. A more integrated approach to system operation will indeed become necessary given the transformation of the European electricity system, as well as the obligations stemming from the EU Network Codes. Establishing regional system operators, based on a costs-benefits analysis, could be a first step towards more operational coordination of TSOs in the future. This transition towards regional system operators should be a realistic, progressive, stepwise approach where system operators with similar system operation approach in a given regional market would gradually bring together all network related activities relevant for cross-border activities.



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

ACER should take an active role in the governance of the Energy Union and ensure seamless cooperation of NRAs regarding especially cross-border issues. The role of ACER should thus be strengthened, but not without greater clarity about what this means. The agency should be granted the appropriate resources and powers to carry out its mission and therefore enable faster and more efficient achievement of the EU objectives of completion of the European Internal Market. National operators should keep an active role within the organization of ACER, increasing the transparency of its governance and its powers on cross-border issues.

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

ENTSOs' role and governance should be clarified and in particular a clear delineation between the TSO lobbying entity and the tasks defined by European legislation is necessary. This intrinsic conflict of interest could be addressed through an increased supervision of ENTSOs' work and functioning by ACER. Clarifying the present missions and the role of ENTSO-E is a prerequisite to a strengthening of their role. BUSINESSSEUROPE believes that a closer regulatory oversight could help ensure that ENTSO-E does not promote mainly TSO's interest but acts in a real "neutral" way by promoting the interests of the European system (not just of the network).

Question 14: What should be the future role and governance rules for distribution system operators? How should 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?

Distribution system operators (DSO) will play a more and more important role in reaching targets concerning energy efficiency and renewable energy supply in the future. Together with electric utilities they will increasingly provide a platform for development and integration of new business models and promote a steadily investment friendly environment. To be able to fulfill this role, clear obstacles for the market entry of new players like access to metering data have to be solved by the DSOs in charge. European-wide distribution tariffs seem to be a vision but a systematical frame considering innovation incentives, the quality of distribution services, data management and addressing the "prosumer" topic could contribute to making national electricity distribution sectors more comparable for both consumers and investors while bringing an integrated market forward.



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

European wide distribution tariffs seem to be a vision only. A systematical frame considering innovation, distribution service and addressing the integration of “prosumer” into the market could contribute to bringing an integrated market forward.

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

Power exchanges will continue to play a significant role in market coupling and the further integration of the EU markets.

They have specific tasks and obligations stemming from the legally binding EU Network Codes – in particular the Capacity Allocation and Congestion Management Guideline - and other EU regulations (REMIT). For that reason, there should be appropriate regulatory oversight and transparency on governance rules.

PART 3 - A EUROPEAN DIMENSION TO SECURITY OF SUPPLY

Question 17: Is there a need for a harmonized methodology to assess power system adequacy?

Power system adequacy should be assessed at a regional level and not only at national level - while the regional approach should not prevent the parallel development and ultimate goal of an EU-wide solution. This raises the need for regional system adequacy studies which require close cooperation among involved TSOs and NRAs. As interconnection capacities across Europe are finite, the location of “firm capacity” is just as relevant as the total amount. This is also the case in some systems under the jurisdiction of a single System Operator. Analysing the practices of ensuring generation adequacy within those systems (e.g., the Italian case covering different bidding zones) may be helpful when conducting these regional adequacy assessments.

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

The methodology should be harmonised EU-wide. Adequacy assessments should evolve in its geographic scope at least to a regional level. The initial purpose of interconnections built in the “pre-liberalisation era” was to facilitate mutual support and energy sales between countries; performing purely national adequacy assessments would not be efficient. Regional assessments should be coordinated by ACER.



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

A common harmonized methodology to assess system adequacy should be developed. Although the metrics should be shared, Member states can decide for different system adequacy standards. To enforce those standards each Member state may take appropriate measures as long as they do not distort the integrated energy market.

Question 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?

First, there is the pledge for the energy-only-market, the market based approach, where ideally renewable support schemes are phased out. In this way the need for capacity mechanisms would be limited as much as possible. Volatility can only be provided in large and well interconnected regions. Such a redesigned energy only market should lead to a more “real” market that is also characterized by a bearable price risk for all stakeholders.

In order to safeguard security of supply in the form of sufficient generation capacities, the viability of conventional power stations which will still be necessary must be ensured. This should preferably be achieved by toughen up the energy-only market as well as by a growing-together of national markets in Europe. If sufficient reliable generation capacity cannot be ensured despite these measures and reformed support measures for renewable energies, top-up payments on the wholesale market may be permissible. These should only be maintained until it is ensured that an adequate provision of generation capacity can be made available on a durable basis. The condition is European involvement, especially within coupled markets.

Second, we see that national initiatives regarding capacity mechanisms are moving forward. Recently the European Commission approved the UK capacity market under the Guidelines on State aid for environmental protection and energy. These national capacity mechanism developments cannot be ignored. It should be carefully observed whether they do not disturb the internal energy market, going beyond national borders, and be brought in line with a harmonised approach.

Question 21: Should the decision to introduce capacity mechanisms be based on a harmonized methodology to assess power system adequacy?

Capacity mechanisms represent a significant regulatory intervention and, as with any intervention, there are risks associated. As such it is crucial that Member states and the European Commission work to ensure that other options are exhausted before capacity mechanisms are pursued.



However it is also important that we recognise that a number of Member states have pursued capacity mechanisms in order to address security of supply concerns.

A well designed transitional capacity mechanism – having achieved state aid approval – could be incorporated into the wider internal energy market. Key to this should be the focus on the provision of security of supply as its sole objective, be technology neutral, non-discriminatory, tied in a regional approach and open to cross-border competition.

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