- Consultation Response -

Public consultation on the ACER study on efficient price formation and easy market entry and participation for new players and smaller actors in electricity markets

Brussels, 1 November 2020 | The objective of this consultation is to gather views and information from stakeholders regarding the ongoing ACER study on efficient price formation and easy market entry and participation for new players and smaller actors in electricity markets, developed in accordance with Article 15 of Regulation (EU) 2019/942. Europex welcomes the opportunity to provide input to the process of identifying barriers and developing indicators. We provide below our responses to selected questions in the consultation.

Definitions

Please provide a definition of what you consider as "barrier to market entry and participation" in electricity markets. The definition should be generic. You will be invited to provide specific examples in the subsequent sections.

We understand barriers to market entry as preventing direct participation in electricity markets in any of the relevant market timeframes, including balancing and ancillary services, and therefore hampering the completion of the Internal Energy Market. The definition of barriers importantly goes beyond entry or licensing requirements. Barriers can also be regulatory in nature (e.g. market design, legal frameworks for participation, existence and design of subsidies, existence of regulated retail prices, or severe price caps in markets and regulated mechanisms across all timeframes, etc.) or related to more operational requirements (grid code requirements, tariff design, product design etc.) and can exist on both a national, regional or European level, including barriers to cross-border trading combined with local trading. A lack of transparency (including not being prompt and at the same time to all stakeholders) and standardisation (where deemed beneficial) can also prevent or hamper trading and should therefore also be included.

Power exchanges and electricity market operators have contributed to removing barriers to market entry and to efficient price formation over the past twenty-five years, accompanying the gradual liberalisation of the European energy markets. Exchanges are committed to processes which are fundamentally removing barriers to trading, including:

- facilitating efficient and secure trading based on transparent and timely dissemination of key input data and results (while protecting anonymity of individual market parties);
- increasing product standardisation;

- product innovation to meet market demands;
- centralised settlement and collateral (risk) management towards market participants by clearing houses within or linked to the exchange(s) operating a given market;
- advancing market integration via among others EU-wide market coupling projects for short term (spot) markets;
- facilitation of local and regional long-term hedging instruments for electricity, and related environmental products.

Please define: Efficient price formation of electricity (MWh) products.

Prices should reflect market fundamentals, and, where applicable, the real time value of energy. Ideally, they should accurately reflect the value of a given action to the electricity system and provide incentives for the efficient use of resources. Prices must be able to reflect the true value of scarcity, via price peaks and negative prices, during times of high demand and system constraints, as well as during times of deficit or surplus of inflexible generation. As part of that it is key that political interference in free price formation is avoided. Unless related to market surveillance actions in case of identified manipulations, there should be free price formation in all timeframes, including balancing. While technical max/min clearing limits may be in place, there needs to be a mechanism to adjust in case necessary.

Efficient price signals in the market are also fundamental for the achievement of policy objectives including incentivising general innovation and investments in generation assets, consumption flexibility, storage, etc. that contribute to decarbonisation and added security of supply. It is market-based mechanisms that should drive price formation on all markets (energy, capacity, flexibility etc). As examples, it is necessary to 1) establish a market for flexibility (e.g. local flexibility marketplaces) and 2) phase out RES subsidies to ensure full market integration.

On organised markets, (local) liquidity is one important factor in efficient price formation, but interactions with other factors, including levels of competition domestically and via availability of maximized cross-zonal transmission capacity within relevant security constraints, are also important to include. Liquidity depends on several factors, including inter alia bid-offer spreads, market depth, trading volume and churn rate as well as supportive elements such as the number of and diversity of types of market participants enabled to participate in given open markets or ancillary services.

Which aspects, among those included in your definition above may specifically prevent prices from reflecting actual scarcity? You may cover additional aspects that may be relevant for price formation at times of scarcity.

We identify in the below section several aspects which prevent prices from reflecting scarcity - we highlight here three which have high potential to distort price formation in the energy-only market: a) RES support: subsidy schemes which shield RES installations from participation or at least prevent them from being fully exposed to prices in the wholesale market while others are; b) Restrictions to participation in balancing/ancillary services markets for aggregators, DSR and storage; c) Regulated retail prices.

Section 2: Barriers to efficient price formation

Barrier: Presence of price caps, bidding limits[1] and/or price regulation in any market timeframe

Price caps/bidding limits are primarily a barrier in the retail market and ancillary services market. The presence of regulated limits to price formation can prevent the price from fully reflecting the real-time value of energy. Article 10 of the Electricity Regulation (2019/943) must be fully implemented – i.e. removal of bidding and clearing price caps in all timeframes, with the exception of technical limits on clearing prices.

Please rate the importance of this barrier: High **Medium** Low

Does this barrier specifically prevent prices from reflecting actual scarcity? Yes No

Examples/further detail: The most important price regulation barriers remain in the retail market and ancillary services/balancing market. Greater awareness of the longer-term electricity price for consumers as well as the role of forward markets and hedging may help to mitigate political and consumer protection concerns around price spikes. The CEER 2018 retail market report provides an overview of price regulation, including ex-ante, ex-post and social tariff interventions (e.g. in 2018, 14 countries reported a direct intervention in electricity retail household prices). The regulated tariffs in France for residential and small business customers are an example that prevents or at least limits the possibility for wholesale and retail prices to reflect actual scarcity, and also in effect may represent a barrier to entry for new suppliers.

Barrier: Restrictions to the amount of capacity available for cross-zonal trade

As a starting point, cross-zonal capacity should be maximised to the extent possible: making this available for commercial use is vital for cross-border trading, contributing to effective competition, additional liquidity and ultimately increasing in overall welfare. It is important to implement the 70% rule at a minimum. However, there are already numerous derogations/exceptions/action plans (e.g. see ENTSO-E analysis presented at the MESC 23 September), implemented for various reasons, and with subsequent negative impacts on capacity levels available to the market at least for the coming 4-5 years. ACER analysis also shows that there is significant room for improvement between the available margins on some borders and the 70% minimum cross zonal capacity required by the CEP from 1st January 2020.

Please rate the importance of this barrier: High Medium Low

Does this barrier specifically prevent prices from reflecting actual scarcity? Yes **No**

Examples/further detail: Grid reinforcements can be considered a long-term underlying driver/solution for this barrier. There have been clear examples of improvements on certain borders e.g. 2018 cross-border reinforcement of the northern interconnector between Poland and Germany resulted in a substantial increase in capacity available to the market.

[1] Article 10 of the recast Electricity Regulation.

Developments such as hybrid subsea interconnectors to integrate offshore wind, for example, the Combined Grid Solution (CGS) between Germany and Denmark, are also encouraging. Other 'pan-European' solutions for this barrier include improvements in the capacity calculation processes. Addressing a lack of transparency is also vital e.g. transparency is needed on the justifications for and progress made to as quick and efficiently as possible reach at least the 70% required minimum cross zonal capacity available to the free supply-demand markets, e.g. day ahead and intraday.

Barrier: Poorly designed or discriminatory network tariffs

The distribution of tariff components and overall tariff levels placed on either grid users that supply or grid users consuming electricity can impact the price formation in wholesale and retail markets since tariff components can affect the willingness to produce or consume electricity and, in some cases, work as a barrier to entry.

Please rate the importance of this barrier: High **Medium** Low

Barrier: Barriers to formation of balancing energy prices and/or related to the imbalance settlement mechanism

While there are provisions in the EB GL and technical projects underway for EU level integration of balancing mechanisms, e.g. aFRR, mFRR, and RR, the actual rules linked to that on national levels, including ISP rules, will seemingly remain different per Member State and that makes it burdensome for market stakeholders to cope with. This limits their ability to be active in several Member States due to different detailed ISP rules and level of access from given MS(s) to pan-EU balancing mechanisms. Apart from that, there are also many examples of both (a) special artificial max/min limits for settlement prices in national balancing markets, and (b) special artificially fixed price levels applied for specific situations, e.g. anticipated strained or even curtailed power supply.

Please rate the importance of this barrier: **High** Medium Low

Does this barrier specifically prevent prices from reflecting actual scarcity? Yes No

Barrier: Inefficient design of bidding zones

ACER Note: A design of bidding zones can be understood as inefficient if it does not meet the Article 14 of the recast Electricity Regulation that states that "Bidding zone borders shall be based on long-term, structural congestions in the transmission network. Bidding zones shall not contain such structural congestions unless they have no impact on neighbouring bidding zones, or, as a temporary exemption, their impact on neighbouring bidding zones is mitigated through the use of remedial actions and those structural congestions do not lead to reductions of cross-zonal trading capacity in accordance with the requirements of Article 16. The configuration of bidding zones in the Union shall be designed in such a way as to maximise economic efficiency and to maximise cross-zonal trading opportunities in accordance with Article 16, while maintaining security of supply."

We agree that bidding zone configuration should reflect long-term structural congestion and we note the clear objective in the CEP to maximise economic efficiency and cross-zonal trading opportunities. The configuration must support both operational security as well as efficient market outcomes. From an end-consumer perspective, an inefficient bidding zone design may result in reduced cross-border capacity and subsequent reduced welfare benefits, as well as high costs of remedial actions.

Please rate the importance of this barrier: High Medium Low

Does this barrier specifically prevent prices from reflecting actual scarcity? Yes **No**

Examples/further detail: Beyond the challenges associated with the technical implementation of the bidding zone review (e.g. TSO agreement on alternative configurations) or political challenges (e.g. lack of political acceptance to potentially reconfigure BZ borders away from Member State borders), we highlight two important aspects:

1) a comprehensive and balanced review of the CACM criteria is needed, including those related to market efficiency. Any loss of liquidity in short term physical or long term (derivatives) markets can result in a negative impact on socio-economic welfare. It is vital to look at liquidity impacts in all market timeframes - forward, day-ahead, intraday and balancing. a thorough analysis of the interaction between liquidity, competition and cross-zonal transmission capacity is needed.

2) A pan-European approach to the bidding zone review is important to ensure that the market functions efficiently and can fully deliver its benefits in terms of optimisation (maximisation) of market efficiency, competition, liquidity and overall welfare.

Barrier: Existence of capacity mechanisms

ACER Note: This barrier refers to all types of capacity mechanisms described in the chapter 3 of the Staff Working Document accompanying the EC Final Report of the Sector Inquiry on Capacity Mechanisms.

Capacity mechanisms are an acknowledged feature of the current energy landscape. However, there should be a clear commitment to the energy-only market in the longer-term, which is necessary to support security of supply. In this context, it is important to focus on regional/local market design to enhance system security and ensure efficient use of resources in the value chain, from generator to end user. Capacity mechanisms must be in line with the CEP requirements (competitive, non-discriminatory selection, open to participation from all resources, clear phase out plans etc.).

Please rate the importance of this barrier: High **Medium** Low

Does this barrier specifically prevent prices from reflecting actual scarcity? Yes No

Barrier: Existence of RES support schemes

The objective should be the full market integration of renewables, i.e. that in the long term, renewables act as any other generation source on the market and are subject to the same rules as all other generation assets. This ensure a cost-efficient integration of renewables to the benefit of the end consumer, as no subsidy payments are needed anymore. Power exchanges have successfully contributed to the market integration of renewables, for example through trading close to real time and finer product granularities.

Subsidies including the feed-in premium lead to short- and long-term market price distortions. To the extent support schemes are still needed for some years to secure sufficient investments and inclusion of intermittent RES in the markets, those support schemes shall be as least distortive as possible, market-based, compatible at a European level, and the subsidy amount should be determined by competitive mechanisms (such as auctions).

If support schemes remain widely used across Europe, they could have significant implications for the energy market, particularly if they prevent the transition towards market integration (e.g. market risk exposure fully covered by the state), and if the revenues obtained outside the energy market become a significant share of generators' revenues.

Please rate the importance of this barrier: High Medium Low

Does this barrier specifically prevent prices from reflecting actual scarcity? Yes No

Examples/further detail: Poorly designed contracts for difference or feed-in premiums. On the spot market, incentives for the most efficient commercialisation of renewables are comparable under CfD and under FiP scheme, given the parametrization is the same. Nonetheless, CfDs are a clear step backwards on the way to successful market integration. For the futures power market, CfDs (e.g. as currently being discussed in Germany), would have a considerable impact. The main difference between CfD and FiP is that the market price level risk is fully socialised under CfD, whereas under FiP a gradual assumption of this risk by the tenderers is allowed.

The 'socialisation' of the market price risk leads to the loss of incentives for renewable investors to hedge the risk on the market. However, there are already today suitable possibilities to hedge these risks on the market, so there is no need for a socialisation of these risks. Against this backdrop CfDs pose a clear risk to efficient price formation on the energy market. Instead of developing new support schemes, the focus should be on developing ways how to phase-out current subsidy schemes and achieve full market integration of renewables where renewables are remunerated fully on the energy-only market. In general, the lower the settlement period (i.e. daily), the lower the incentive to react to the market price signal.

Other barrier: Lack of harmonisation regarding market suspension rules, including a lack of rules regarding the setting of the imbalance settlement price in emergency state.

Today the majority of EU plus Norway is coupled within BZs and cross-border both in day ahead (SDAC) and Intraday (SIDC). Therefore, unilateral market suspension activations on MS level would cause direct negative impact on such coupled markets. The rules on market

suspension and restoration are set out in NC ER (currently national scope). We welcome current ENTSO-E efforts to assess the different areas for feasible harmonisation but remain concerned about the lack of coordination and harmonisation of these rules. Generally, organized market activities support system security. More information and justification is therefore needed on why and how suspension would help SoS and restoration. Detailed national rules (e.g. national grid code methodologies, system conditions), including specific market suspension rules create a further risk for market players and ability to secure efficient price formation, including allocation of CZ capacity.

Please rate the importance of this barrier: High Medium Low

Does this barrier specifically prevent prices from reflecting actual scarcity? Yes **No**

Examples/further detail: Some TSOs and regions have concluded in nationally approved NC ER Methodologies, that there is essentially no need at all to suspend market activities in emergency state. Contrary to that potentially uncoordinated and inadequately justified suspension and restoration measures in other countries being part of coupled markets renders significant risks to orderly markets and efficient price formations. Therefore, additional clarity is needed on exactly what activities will be suspended, justifications for it, and about the impact on SDAC and SIDC, forward and balancing markets as well as clarity on arrangements for economic responsibility following market suspension triggered by TSOs.

Other barrier: Capacity withholding (market manipulation under REMIT) or selling non-produced capacity

Please rate the importance of this barrier: High Medium Low

Does this barrier specifically prevent prices from reflecting actual scarcity? Yes No

Examples/further detail: Capacity withholding can cause significant distortion of the market and can also distort the formation of the balancing energy price. ACER REMIT guidance has been issued with a view to the correct implementation of the Electricity Regulation and REMIT. It is important to ensure a distinction between legitimate bidding behaviour and market manipulative practices.

Selling non-produced and/or non- purchased energy from third party (bilateral contracts etc) can also distort price formation.

Section 3: Barriers to market entry and participation for new entrants and small players

Barrier: Lack of a legal framework defining roles and responsibilities of flexibility resources

We believe local flexibility markets have significant potential to develop as distinct markets, building on the basis of the above principles, understanding that they must be complementing among others the wholesale coupled markets, and be based on market principles. The Clean Energy Package already contains valuable targets for demand-side flexibility and should be fully implemented.

There is however a need to further streamline and clarify the rules to achieve the following objectives:
a) ensure that CEP rules are clearly implemented, ensuring a market-based approach;
b) limit differences between national implementations, thereby allowing cross-border compatibility of solutions (e.g. common approaches regarding the inclusion of independent aggregators into the market, baselining and metering, information exchange);
c) effectively scale up demand-side flexibility services and markets, including local flexibility markets and allowing upstream integration into day-ahead and intraday organised markets.

Please rate the importance of this barrier: High Medium Low

Examples/further detail: Full implementation of the Electricity Regulation (EU) 2019/943 is necessary especially with regards to:

- the obligation for TSOs and DSOs to adopt market-based mechanisms for redispatching, open to all generation technologies, storage and demand response (Art 13 Electricity Regulation (EU) 2019/943);
- market-based procurement of non-frequency ancillary services (Article 31 Electricity Directive (EU) 2019/944);
- the implementation of incentive- and output-based regulatory frameworks for electricity distribution networks (incentives for the use of flexibility and non-wire alternatives);
- the participation of demand response in markets through aggregation, including through independent aggregators (Article 17 Electricity Directive (EU) 2019/944).

However, while a common taxonomy is needed, we believe that product standardisations for flexibility services are not yet needed. An overly prescriptive or premature network code on demand-side flexibility aiming to address any conceivable feature would run the risk of hampering further development of innovative solutions. Flexibility markets are a response to specific physical challenges in the grid and need to take into account local specificities.

The Electricity Directive (EU) 2019/944 leaves it up to Member States to choose the appropriate implementation model for independent aggregation. We recognise that there is no 'one-size-fits-all' solution - however, more detailed rules may be required in a number of areas in order to more effectively scale aggregation services and ensure that different business models can be implemented across the EU. Given the harmonisation in wholesale

and balancing markets, harmonisation of certain aspects of demand-side flexibility rules would contribute to the potential to trade volumes across borders and ultimately support Internal Energy Market objectives.

While there is debate about precisely what regulation is needed, there are a number of areas where more clarification is needed:

- Clarification of roles and responsibilities for the aggregator, supplier and consumer, for example determining the scope of the balancing responsibility and the relationships between these parties.
- Ensuring market access for aggregators, including to ancillary services, capacity markets and to wholesale markets. Flexibility markets should not be restricted only to ancillary services in the TSO and DSO domain. Some implementation models may not be in line with this or create barriers for aggregators to access the wholesale markets. Rules may be needed to help ensure aggregators have the possibility to extend their activity to all electricity markets, including the day-ahead and intraday.
- Common approaches should also be developed for other aspects necessary for demand-side response through aggregation, including baselining (i.e. finding the best approximation of the energy consumption or production that would have occurred if no demand-response event had been triggered), measurement and validation (e.g. approaches to quantify the delivered flexibility) and information exchange between the different market roles.

Barrier: Discriminatory licensing and tax arrangements for non-domestic actors

Legal requirements and licencing: specifics regarding a company from country A participating on country B's market; licencing requirements differences; differentiation between wholesale and retail; differentiation between intra- and extra-EU etc. Financial requirements, including the level and type of guarantees across the value-chain can also represent a barrier.

Please rate the importance of this barrier: High Medium Low

Barrier: Lack of transparency and availability of relevant information to entry and participate in all market timeframes

Lack of timely transparency from TSOs in the balancing and ancillary services markets, e.g. withholding of information about volumes and prices being settled during the delivery periods until 1 or more hours, or in some cases multiple days after delivery, both creates an uneven playing field between those being active providers to balancing mechanisms and those that cannot act in those mechanisms, and reduces the ability to promptly gain information about on-going imbalances that likely will also have an impact on supply/demand equilibrium in subsequent hours and days still open for trading in organized markets, e.g. intraday.

Please rate the importance of this barrier High Medium Low

Examples/further detail: The delay of price/volume information is existing in many EU Member States today. Information about it is available in national rules for balancing mechanisms and linked to how Transparency Regulation requirements are fulfilled.

Other barrier: Lack of harmonised rules regarding redispatching remuneration – e.g. cost-based vs market-based approaches

Please rate the importance of this barrier: High Medium Low

Examples/further detail: Market-based flexibility solutions are especially important when it comes to the integration of demand-side flexibility. Flexibility on the load side is urgently needed to ensure the energy transition is cost-efficient and thus more acceptable to European citizens. However, regulated, cost-based approaches to congestion management (e.g. Germany's derogation to the Clean Energy Package) struggle to integrate loads. This is because the definition of the cost of the load is based on the value of the electricity to the consumer, which varies between individual consumers as well as with time and location, making it very difficult to define meaningful costs for these load-side flexibilities. Market-based approaches with free bids, on the other hand, have the advantage of being able to integrate this flexibility and therefore unlock these resources.

Other barrier: Difficulty or disallowance of DSR participation in redispatch arrangements/balancing/ancillary services. Similarly, severe restrictions may also be imposed on specific generation sources e.g. intermittent RES

Please rate the importance of this barrier: High Medium Low

Conclusion

What are, in your view, the three most important barriers to market entry and participation for new players and small actors in the electricity markets, in your country and in the EU?

1. Lack of a legal framework defining roles and responsibilities of flexibility resources, including definition of roles and responsibilities for aggregation.

2. Lack of transparency and availability of relevant information to entry and participate in all market timeframes

3. Difficulty or disallowance of DSR participation in redispatch arrangements/balancing/ancillary services. Similarly, severe restrictions may also be imposed on specific generation sources e.g. intermittent RES.

What are, in your view, the three most important barriers to efficient price formation in the wholesale electricity markets, in your country and in the EU?

1. Existence of RES support schemes: subsidy schemes which shield RES installations from participation or at least prevent them from being fully exposed to prices in the wholesale market while others are. Non-market-based support mechanisms for RES render the deployment of RES more expensive for the end-consumer and more difficult to manage for grid operators. Market-based price formation is the key to a cost-efficient decarbonisation.

2. Barriers to formation of balancing energy prices and/or related to the imbalance settlement mechanism

3. Restrictions to the amount of capacity available for cross-zonal trade

About

Europex is a not-for-profit association of European energy exchanges with 29 members. It represents the interests of exchange-based wholesale electricity, gas and environmental markets, focuses on developments of the European regulatory framework for wholesale energy trading and provides a discussion platform at European level.

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