



The market design initiative: Towards better governance of EU energy markets

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We welcome the Commission's commitment to transform Europe's energy system into one that prioritises decarbonisation and decentralisation, facilitates entry of new market actors, and places consumers at the centre. We also applaud efforts to redesign the Internal Energy Market (IEM) to effectively integrate renewable generation and to prioritise demand reduction in line with the efficiency first principle.

The achievement of important Energy Union policy objectives (i.e. energy security, IEM completion, and decarbonisation of the energy system by 2050) will depend on the EU's ability to develop a new and coherent set of rules that better align market and climate objectives and facilitate collaboration and resource sharing between Member States. Moreover, transforming the Energy Union from vision to reality will require not only a re-set of the policy framework but also changes to improve the governance of EU energy markets.

Getting governance right means having in place a robust institutional and regulatory framework that better aligns the IEM and decarbonisation agendas and ensuring it is based on the key principles of good governance, namely transparency, accountability and legitimacy.

In the context of the Market Design Initiative (MDI), governance refers to the legal, procedural and institutional arrangements put in place at EU and national levels, to ensure delivery of IEM/Energy Union objectives. These include:

- a fully functioning and sustainable energy market that integrates energy efficiency first;
- optimised deployment of decentralised renewables and other flexible energy resources;

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- the efficient sharing of resources across borders to ensure security of supply for all at a reasonable cost; and
- the promotion of a more open energy system that attracts a diverse range of new players and business models.

1 The need for policy coherence

Despite the clear link between energy and climate issues, as well as a Treaty mandate,² the IEM's legal arrangements currently do not adequately incorporate environmental protection objectives. The IEM, since its inception, has largely been concerned with the creation of a single market and the free movement of gas and electricity. Meanwhile, climate-related energy policy (e.g. energy efficiency and renewable energy) has been developed primarily through separate standalone legislation, leading to potential inconsistencies with the market framework. In addition, the interventions undertaken by Member States, often to address perceived security of supply challenges, lack coherency and are increasing market distortions at a cost to consumers. This is exacerbated by the lack of developed institutions or market mechanisms that are capable of facilitating more cost-effective resource sharing between Member States.

Moving forward, the IEM will need to develop in a way that sufficiently integrates protection of the environment and sustainability. The Commission has acknowledged this, stating that the 2030 targets agreed by the October 2014 European Council mean that changes to the electricity system in favour of decarbonisation will have to continue and intensify.³ However, to date, the targets have not been a topic within the MDI discussions, instead primarily being debated in talks over the Energy Union Governance System.

It is, therefore, necessary to ensure that IEM governance arrangements embed the delivery of EU-level climate objectives. Specifically, institutional actors need to have a stronger link to the Energy Union Governance System and legal duties to ensure they fulfill their tasks consistent with the effective delivery of the 2030 climate and energy targets.

ENTSO-E should be required to ensure that the Community-wide ten-year network development plan and the European generation adequacy outlook, as well as in the development, implementation and reform of Network Codes, are consistent with EU policy and targets. In particular, ENTSO-E's methodology for conducting Scenario Outlook & Adequacy Forecasts (SO&AF) needs to be revised to ensure that not just renewable energy sources but also flexibility and efficiency are more explicitly accounted for. In addition, links should be made between the SO&AF and the Energy Union Governance system, particularly within the regional dimension of planning and reporting.

There is also a need to strengthen the regulatory framework to ensure Distribution System Operators (DSOs) and Transmission System Operators (TSOs) are further required and/or incentivised to develop flexibility and efficiency potential, and to invest in smarter networks, sufficiently to achieve policy objectives. The Infrastructure and Security of Supply Regulations should be revised to require Member States to take demand response and interconnection contribution fully into account in their resource adequacy assessments and network development plans. This will ensure the system is sufficiently flexible to cope with growing shares of renewables, and lead to improved common methodologies for assessing power

² Treaty on the Functioning of the EU (TFEU), Articles 7 and 11.

³ European Commission, Launching a public consultation process on a new energy market design, SWD(2015) 142 final, p 3.



system adequacy and security that will not discriminate against demand-side measures, variable renewable and interconnections.

ACER should also play a more significant role in ensuring that the 2030 targets are met. It should be required to ensure that the Community-wide ten-year network development plan, the European generation adequacy outlook and EU Network Codes support delivery of the 2030 targets. In addition, ACER should be required to ensure that regional cooperation between National Regulatory Authorities (NRAs) and TSOs promotes effective target delivery. Together with ENTSO-E, ACER should also play a role in overseeing Member State planning and reporting under the Energy Union Governance System through its monitoring of markets and its contribution to reporting on indicators.

Furthermore, it is necessary to reinforce the role of NRAs so they can play a role in promoting target achievement. Specifically, they will need a stronger legal mandate to enforce enhanced market rules so that actors generating and supplying renewables and providing new services to promote grid flexibility and participation by prosumers (e.g. aggregators) are able to enter and participate on a level playing field with incumbents.

Above all, institutions that are independent of governments are a fundamental condition to ensure market confidence. Therefore, existing EU requirements for NRAs to achieve full independence from national governments must be reinforced. More robust arrangements for overseeing and ensuring independence of NRAs, either through a stronger ACER role, increased requirements on the Commission to ensure implementation, or alternative market oversight arrangements (see suggestion for an RISO below), should be considered. Beyond the role of NRAs, there is also enormous value in an independent expert body (e.g. a Climate and Energy Observatory) capable of advising EU Institutions and Member States on the implementation of national delivery plans, as proposed under the 2030 governance discussions.⁴

2 A more robust institutional framework to promote regional cooperation and the role of consumers

The Third Energy Package made substantial progress in establishing an institutional framework that promotes cooperation between market actors within a consistent EU level framework. Indeed, there is broad political support for increasing the level of inter-state transmission connection and targets for the minimum level of interconnection have been introduced. Moreover, EU-level network codes are being developed to ensure the optimal use of interconnection capacity to meet short term system balancing requirements⁵ – so-called ‘market coupling’. Therefore, increases in interconnection capacity, along with implementation of market coupling provisions, should go some way to improve the efficiency of the power system operation.

However, we are far from achieving the ideal level of market integration, where resources can be exploited from a wide geographic footprint such that consumer needs and policy objectives are met at least overall cost. This would require consistent policy goals and institutions capable of planning networks and deploying resources such that cost efficiencies can be delivered. In practise, Member States have different objectives with regard to energy mix and security of

⁴ See E3G (2015). Market Design for the Energy Union: the institutional structure for a flexible and integrated energy market. Briefing Note (October 2015).

⁵ Although the trading of balancing services such as frequency response and reserves is still restricted to bilateral agreements between TSOs.



supply, and it is common for governments to aim for self-sufficiency in delivery of key policy objectives. Additionally, there are no institutions within the IEM that are designed to deliver outcomes across borders or a generally agreed basis for allocating costs between Member States and/or consumer classes. In effect, Member States wishing to share resources (e.g. to meet a common reliability standard) need to work from scratch and apply arrangements on a bespoke basis.

While Member States remain attached to voluntary approaches towards regional cooperation, the MDI can still improve IEM institutional structures to facilitate better resource sharing between Member States. The most effective way to address this issue would be through the creation of a new independent regional institution (IRSO) charged with least cost delivery of system balance and other policy objectives. This institutional structure has already proved effective in many international markets in promoting regional co-operation as well as exploiting the benefits of demand side resources, and its independent nature and market monitoring capacity is helpful in improving investor confidence and market integrity.

Furthermore, DSOs are largely untouched at EU level given that they have traditionally had a limited impact on market integration. However, it is widely recognised that the energy transition will result in major changes for local network operators as they aim to safely and efficiently integrate increasing shares of renewable energy, storage and demand response locally, and to coordinate operation with TSOs. In this regard, a patchwork of multi-speed progress across the EU would be highly undesirable. Not only should all EU citizens have the right to actively participate in energy markets and reap the benefits, but international competitiveness for many industries will depend on effective grid modernisation.

It is, therefore, important to ensure that the role of DSOs is fully addressed when considering market design and the EU should undertake a thorough review of the future operation of markets at a local level. In particular, this review should focus on improving the role of consumers in energy markets (e.g. through enhanced rights and /or potential reform of rules on tariff design) and ensuring efficient and coherent investment in local infrastructure (electricity, heat and energy efficiency). This, in turn, requires a critical review of the role of DSOs and how they are regulated and governed.

3 Sufficient regulatory oversight

Finally, arrangements for overseeing the proper functioning of the IEM are incomplete and not sufficiently effective. The Commission currently fails to make full use of its enforcement powers and ACER is limited in the instances it is allowed to use its (non-binding) decision-making authority. However,

A reinforced regulatory framework will be needed in order to cope with further enhancement of the roles and responsibilities of other institutional actors such as ENTSO-E and regional groupings of TSOs. Furthermore, along with new market rules that prioritise efficiency, enhance the role of consumers, and promote flexibility and renewable and interconnections, corresponding arrangements to ensure transparency and accountability are needed.

In the context of enhanced regional cooperation between TSOs (e.g. the creation of IRSOs), as well as between Member States in the development and implementation of their national plans, ACER needs to be enabled to exercise appropriate oversight to ensure the independence of institutional actors and a level playing field for market participants. Specifically, ACER should be



provided with enhanced decision-making authority for cross-border infrastructure issues. The Commission should also consider whether to provide for regulatory oversight on a regional level, for instance through regional groupings of NRAs within, or overseen by, ACER. Again, such responsibilities would need to be coupled with enhanced arrangements for overseeing and ensuring independence of NRAs, either through a stronger ACER role or increased requirements on the Commission to ensure implementation.

In order to improve confidence in markets for investors, consumers and regulators, there is also a need for improved real-time market monitoring. At present, ACER is under-resourced and does not have access to all the data it needs. Compared to best practice market monitoring in other jurisdictions, there is plenty of room for improvement for what is monitored, how frequently data is collected, adequate access to data, the resources available for data collection, and analysis and independence of the market monitor. Until NRAs meet requisite standards for independence and/or ACER is sufficiently resourced, real-time market monitoring should be carried out by an independent non-governmental entity tasked by the Commission, or collectively within regional groupings of Member States.

Recommendations

In order to ensure delivery of Energy Union objectives, the MDI should result in enhanced institutional arrangements that:

1. Align the development of the IEM with meeting EU climate and energy goals. This will be most effectively achieved through introducing duties on IEM actors such as ENTSO-E, TSOs and DSOs, ACER and NRAs to promote the effective delivery of the 2030 and 2050 climate and energy targets. The confidence of market actors and investors depends critically on institutional independence – particularly of NRAs – and this must be reinforced either through a stronger role for ACER, increased requirements on the Commission, or alternative market oversight arrangements.
2. Establish a new independent regional institution charged with least cost delivery of system balance and other policy objectives (IRSO), jointly owned by Member State governments and regulated by a collective of independent NRAs (or ACER). The IRSO should be specifically responsible for promoting the optimal use of resources through operating pan-national markets by regularly assessing resource adequacy on a regional level applying a solid methodology that looks at demand, supply and infrastructure on equal terms.
3. Initiate a review of local energy markets including the role of DSOs, the rights and roles of consumers, and the efficient delivery of energy infrastructure (electricity, heat and energy efficiency).
4. Continue to pursue better implementation of energy regulation through use of Commission enforcement powers, and a stronger role for regulatory oversight over regionalised institutions, as well as better real-time market monitoring.