GEODE COMMENTS ON ACER-CEER "EUROPEAN ENERGY REGULATION: A BRIDGE TO 2025"

GEODE - the Voice of local energy distributors across Europe - welcomes the ACER-CEER paper on the "European energy regulation: A bridge to 2025" and is grateful for the opportunity to comment.

In principle **GEODE** agrees with the issues and trends identified by ACER-CEER in this Paper, electricity and gas wholesale markets, infrastructure investment and consumers, retail markets and the role of DSOs. However, it is very important to highlight that these energy sector trends are very much interlinked with each other and although they are analyzed separately, considering the overall picture is crucial to achieve a fully integrated European energy market.

GEODE, representing energy distributors across Europe, will focus principally on infrastructure investments, retail markets and consumers and the role of DSOs. We will also elaborate on the development of DSO's tariff structures, an issue that is, in **GEODE**'s view, not clearly expressed in the paper.

I) Infrastructure investments

GEODE welcomes ACER identifying infrastructure investments **at distribution level** – and not only at transmission level- as the backbone of efficient European energy markets.

DSOs are absolutely critical to meet the energy challenges of the future. **GEODE** believes that investments in the distribution networks are therefore essential. Once the required infrastructure is in place, an efficient RES integration and market flexibility will more easily be achieved.

As DSOs are the prime movers in the deployment of Smart Grids, it is essential they are empowered by **an adequate regulatory framework** to take an active role in this deployment. Therefore, **GEODE** supports ACER's initiative *"to explore how best to deploy incentive mechanisms, to encourage efficient operations and investments of DSOs and TSOs."*

❖ **Adequate incentives for DSOs investments**

In **GEODE**'s view current incentive based regulation models used to set grid tariffs in most Member States focus on short term cost reductions, and give almost no incentives for innovation and investments for the future. In order to fully take advantage of the new technology related to the smart grid, the regulatory models have to be updated.

GEODE believes that the following criteria should be taken into account by Regulators when setting DSO grid tariffs:

- Sustainable, future-oriented and long-term perspectives are all essential as the DSO business has a planning horizon of decades, and the challenges are changing in line with the development of European energy policy to achieve the decarbonisation of the energy market. In the current regulatory framework, comparatively short regulatory periods constitute the standard practice in many Member States, with the regulatory scheme changing every 4-5 years. This prevents DSOs from taking long-term decisions based on current regulatory schemes. However infrastructure investments in the grid are often long-term.

- Investment and innovation friendliness:
    - To support investments in technical equipment and ICT infrastructure enabling the implementation of intelligent solutions

    - To support the necessary reinvestments in the "conventional" components of the grids (transformers, cables).These investments are crucial to maintain security of supply.

    - To support DSOs to strongly commit to R&D and Demonstration projects to build the electricity networks of the future in good time.

The regulatory framework must enable these essential investments. The networks for both, gas and for electricity, need a stable, predictable and appropriate regulatory

regime, supported by sufficient incentives for investors, to fund the necessary networks updating, with a clear "direction of travel" signposted to reduce the levels of uncertainty.

❖ **Incentives for Research and development**

As DSOs are essential in the deployment of Smart Grids, it is necessary that all DSOs (small, medium and large) are able to participate in R&D projects. More ambitious and more numerous R&D funding programmes than the currently existing ones are needed both at national and European level. The funding should be accessible by all network operators, regardless of their size. Innovation will be the key.

An example of good regulation incentivising R&D work within the DSOs exists in Great Britain (GB). In 2009, the GB energy regulator Ofgem launched the £500m Low Carbon Networks Fund (LCNF) for electricity DSOs to help drive innovation and promote new technologies to deliver the intelligent grids of the future. The LCNF is one of the most significant investments in network innovation in Europe. And now the Network Innovation Allowance (NIA) and Network Innovation Competition (NIC) are incentivising increased levels of innovation in both electricity and gas distribution, and also transmission.

II) Consumers and retail markets

GEODE agrees with ACER-CEER that a smart energy market principally needs customer engagement.

Smart meters, market flexibility and demand response will bring a lot of changes to the retail energy market and in particular for consumers, as stated in the consultation paper. In the future, smart meters and special consumption or load orientated tariffs will play an important role in developing a flexible market and changing consumption behaviour. Moreover, home automation and smart appliances will be essential to contribute to consumers actively participating in the market. This may also bring a lot of uncertainties, especially for consumers and some may be concerned by these changes.

Therefore, to gain consumer trust and to encourage everyone to participate, it will be important to provide consumers with comprehensive information about the reasoning, outcomes and benefits of energy market flexibility and demand response. This information should be provided to consumers not only by DSOs or other market players

but also, by national and local regulatory authorities, as well as by consumer organisations in the respective Member States. In this respect, **GEODE** would like to see an action included in the regulatory actions for domestic consumers in the consultation paper (section 3.26).

GEODE supports ACER-CEER view that "*policymakers will need to ensure that the impacts of their policy changes are applied as cost-effectively as possible*" (2.23) as taxes and levies are now and have been previously the main drivers for the increases in energy prices in recent years, and not network charges.

With taxes in some countries such as Germany and Denmark close to 50% of the bill, it is impossible to create sufficient incentives for consumers to actively participate in energy markets by only making changes to the electricity price and to the network tariffs. According to Eurostat, an average of 30 % of the retail electricity bill paid by consumers relates to the different taxes, levies and other governmental fees payable in the EU. This reality reduces the impact of customer incentives to engage, for example, in Demand Side Flexibility (DSF).

GEODE agrees with ACER-CEER on the upcoming technological changes listed in section 2.29, including smart grids, smart meters, smart load controls, micro-grids and gas developments. **GEODE** is actively working on all these issues that significantly impact the distribution networks. In that respect, we have published a series of reports covering DSOs approach on "Bringing Intelligence to the Grids"- May 2013, "Gas Works- the future role of gas distribution networks" April 2014 and the most recent one "Flexibility in tomorrow's energy system" -May 2014 (http://www.geode-eu.org/home/publications/geodereports).

In relation to gas developments, **GEODE** supports new and unconventional sources of domestic EU gas production, such as biomethane injection to the grid and shale gas. The consultation paper also outlines among other issues "the production and injection of biogas in the distribution system". **GEODE** supports ACER-CEER view that an optimal sharing of system access costs should be established compensating DSOs for the connection of biogas plants by the grid. **GEODE** would like to see a specific proposal included in the possible regulatory actions summary in the Annex (page 33).

GEODE disagrees with the Council of European Energy Regulators (CEER) intention to set minimum standards at European level on certain issues such as connections, disconnections and maintenance or in the area of format and exchange of customer metering data (section 3.30). Also the supplier switching period according to ACER – CEER paper should reduce from the current maximum period of three weeks to only 24 hours (section 3.26). **GEODE** sees this as problematic as 24 hours does not respect e.g. the notice period which in many countries is longer (14 days in Finland). For the DSO and depending on the data exchange model such a short period could be difficult to fulfil. If the DSO needs to control who supplies to whom, a 24 hours maximum switching period may be impossible (e.g. during weekends). **GEODE** believes that ACER has not recognised the difference between the supplier switching process and the data exchange process as a part of the supplier switching process. There is no real customer need, nor benefit to shorten the whole supplier switching process to 24 hours. The data exchange process is different.

While we support some degree of harmonisation at regional or national level, it is not necessary or helpful to impose European wide harmonisation.

It is a fact in many Member States that DSOs already work to rigorous levels of guaranteed standards of service set by NRAs. The question is whether it is appropriate to establish another set of standards at the European level, when so many differences exist in terms of market models and legal frameworks and in particular when the key is to get the right balance between the standards and their associated costs to the consumer.

GEODE believes that each Member State should be allowed to choose which market model suits its market best, taking into account local circumstances. A pan-European approach and legal mandates risk being over-prescriptive - rather than supporting and invigorating progress – and could have the opposite effect. It is clear that a system change due to standardisation introduces additional costs that have to be analysed beforehand through cost-benefit analysis. Only if the benefits outweigh the costs is the change then advisable. This applies also to billing. The differences among all Members Sates should be respected if the market is well-functioning.

In that respect, we would like to underline that this is the opinion also endorsed by the recently published final Ecorys-ECN study on the role of DSOs, April 2014 that supports

the approach that due to national differences policy implementation will require tailoring at the level of the Member States and that 'one-size-doesn´t-fit-all'.

Regarding the proposal for customer offers as a "projected unit price" (3.26) to enable the comparison to be easier and more transparent, **GEODE** disagrees. There will always be inaccuracies and limitations (no possibility to present the full costs of dynamic market-based products – e.g. hourly wholesale market price + margin-, special discounts, etc…)

We welcome ACER-CEER's new approach towards a customer-centric model, thus **GEODE** does not support the supplier centric model. There are issues like switching where the supplier is the main point of contact. There are also grid related issues when the DSO is the point of contact and the link between DSO-customer must be maintained.

II) The role of DSOs

❖ Definition of roles and responsibilities

GEODE agrees there is a need for clear market rules and **definition of roles and responsibilities** of different market players (i.e. suppliers, DSOs, aggregators, ESCOs, others …).

When defining the role of the DSO, **GEODE** supports the following principles:

- The DSO is the neutral market facilitator that ensures the reliability and stability of the system while facilitating the commercial activities of other market actors and above all safeguarding the interests of customers. This principle is supported by ACER-CEER.

- DSO should as well retain responsibility for metering as the meter is the logical end point of the DSOs' network (exceptions in the UK and Germany).

- To create further market opportunities, all Smart Meters should be equipped with a standardized open interface. The customer as the owner of the data will have access to their consumption information via a standardized open interface in the Smart Meter.

- Meter data should be provided to other market actors authorised by the customer, using the above mentioned standardized open interface in the Smart Meter. With this in place, existing unbundling requirements are sufficient to ensure new market services to develop by new actors (aggregators, ESCOs, others) for customers. Then the principle underlined by ACER-CEER "*the DSOs should not impede the development of the market in supply services …/ not be able to use advance access to data to gain commercial advantage*" (page 26) will be guaranteed.

- DSOs must without restriction be allowed to use information from the Smart Meters in order to fulfil their regulated duties such as grid operation and billing.

- As a neutral regulated entity, with no commercial interest in consumers' data, the DSO is best positioned to be market facilitator (data hub) for managing and gathering grid data while providing third-parties with non-discriminatory access to customer data. At the same time, the DSO can ensure consumer privacy and data protection in order to increase consumer confidence.

- DSOs' priority access to relevant flexibility services is crucial to fulfil their core tasks as the party responsible for grid stability and secure grid operation. In all other situations market actors can act freely as long as the distribution grid is not put at risk - e.g. the traffic light grid status is green. A prerequisite necessity for the DSO to fulfil its role as market facilitator and for the introduction of a traffic light scheme, is to increase the real-time monitoring ability and controllability in the medium and low voltage distribution grid. The next step would be to include decentralized generators, the re-charging processes of electric vehicles and consumers in real-time smart grid operations.

- DSO is the central point of contact for customers in grid-related issues and the link between DSOs and the customer must be maintained. As regards market flexibility, DSOs should not be excluded from direct contract with customers required in case the market does not provide sufficient flexibility. Transparency should be assured in these circumstances.

- In order to fulfil these emerging data responsibilities in a smart grid environment, DSOs need to be equipped with the right tools, to manage the increasing quantity and the quality of the data collected.

- In addition, DSOs will be confronted with additional tasks in order to ensure a smooth grid and market functioning due mainly to upcoming changes in the generation such as re-charging stations for electric vehicles or ancillary services, etc.

❖ **Unbundling**

GEODE fully disagrees with ACER-CEER's opinion regarding **unbundling. Neither ownership unbundling, nor a revision of the unbundling exemption** (review of the minimis limit) for those DSOs with less than 100.000 customers, is required. There is no evidence that such actions will bring a consequential increase in energy market competition and/or any customer benefits.

❖ **Implementation of existing legislation**

GEODE would like to stress out that according to the rules already established under the Second Energy Package in 2003, vertically integrated undertakings, regardless of their size, are obliged to meet substantial unbundling requirements. As part of these requirements, DSOs have to handle commercially sensitive information, e.g. meter data obtained in the course of carrying out its business, confidentially ("informational unbundling"). Regarding sensitive information, more or less identical rules apply to TSOs and DSOs. There is no exception for a small DSO. Besides, all electricity and gas undertakings are obliged to keep separate accounts for their transmission and distribution activities ("unbundling of accounts", Article 31 of the Electricity and Gas Directives, respectively).

GEODE believes that before considering ownership unbundling at the distribution level, full implementation of the Second and Third Energy Package provisions has to take place. **GEODE** recommends the regulators take account of commercial concerns related to the issue of ownership unbundling since in those countries where DSOs are in private and not public ownership (as in the UK, Spain, Italy, others …), this would raise significant concerns around property rights and the value of deployed equity. In

particular, this could put at risk important investments, and also constrain the future development of the DSO role.

- **Stricter Unbundling**

With regard to small DSOs that benefit from the unbundling provisions' exemption, their activities are already strictly monitored by the regulatory authorities, so that they are prevented from taking advantage of their vertical integration under the Electricity and Gas Directives, and any infringement of the legislation will be penalised. Many small companies are, due to their small size, able to work efficiently, in a cost-saving and very customer-focused way. Thanks to their local dimension they have a much closer relationship with the customer.

For these companies stricter unbundling, in particular, imposing a functional unbundling obligation would represent a loss of synergies in terms of human resources and management. This will lead to higher costs for small companies which must be paid for by the customer, or, additionally it could make the company no longer economically viable, thereby reducing competition in the energy market.

Stricter unbundling could also introduce disadvantages that do not exist now. There is no proof that non unbundled small energy companies are hampering other market actors or that they are in a worse position to meet the criteria for providing flexibility services to the market. Those companies that make use of synergies should be supported. Furthermore, the market share of the total number of DSOs under the threshold of 100.000 customers is around 2 - 300 DSOs across the EU ie it- is a very small number. The smallest DSOs in many cases only hold a market share of around 2% to 5% in their own countries, so they cannot realistically represent a threat to market competition.

In addition, **GEODE** would like to highlight that, with accordance to the preliminary analysis taken by the Commission based on replies received with regard to the Public Consultation on the retail energy market, a majority of the respondents do not see any need for further unbundling regulation at the DSOs level. EU stakeholders across the board do not see the current DSO unbundling arrangements as unsatisfactory or as a barrier to the operation of the internal energy market.

GEODE strongly disagrees with ACER-CEER on the point that "*customers connected to small distribution networks may not benefit to the same extent as those connected to larger systems*". There is no evidence provided by ACER to justify such statement, rather opposite in terms of customer satisfaction it is in many cases the smaller local DSOs with the higher satisfaction rates. Customers really value much the closeness to their energy company that is assured by the local energy distribution companies.

Technically speaking market rules and obligations of grid use and connection to the grid are the same, regardless of the network operator´s size. Neither are there exemptions on the basis of the de minimis-rule. For that reason, we reject the ACER –CEER argument that there is a relation between the size of a DSO and the fact whether it is connected to a TSO and the opportunities of the DSO's customers to benefit as active grid users from different options on the energy market.

Since a high degree of compulsory automation of workflow processes, like supplier switching and data handling, effectively and efficiently assures non-discrimination and provides a functioning market, any further regulatory intervention that would lead to the restructuring of businesses would be costly and inefficient.

Therefore, **GEODE**'s view is that the existing unbundling rules from the 2nd and 3rd energy packages are comprehensive, in force, and being actively monitored by national regulators to ensure the non-discriminatory behaviour of the DSOs as neutral market facilitators. The main focus for regulators and the Commission should therefore be on the full implementation of these rules, across Europe, before any decisions are made towards the introduction of new business separation requirements, with the risk of 'unintended consequences'.

IV) Improved coordination TSO-DSO

GEODE supports the ACER/CEER statement regarding the TSO-DSO interface. It is becoming obvious that there is a significant increase of intermittent RES mainly connected to distribution networks that creates a need for more complex IT systems, communication and coordination between TSOs and DSOs, and also with major producers, customers and aggregators, offering DSF balancing services. The communication needs to include both measuring/monitoring data and control signals.

The DSO will have an even bigger role in system operation and grid management while keeping his traditional role of managing the distribution grid. It's priority that DSOs have the appropriate new tools to fulfil these tasks and regulation has to make this possible.

V) DSOs tariff structure

In **GEODE**'s view, re-thinking the **DSO's tariff structure** is crucial. The current tariff structure has to be developed further in order to address the absence of adequate cost reflectivity and to improve customer incentives for network optimisation, customer savings and the necessary investments by DSOs.

GEODE recommends the following general principles for the future development of DSO tariffs.

- Tariffs should be cost reflective, easily understood and transparent.
- Tariffs should promote peak demand management and aim to reduce infrastructure costs purely for peak demand.
- Tariff structure should encourage distributed generation, demand response, and efficient energy consumption [from the distribution system perspective].
- Tariff structure should enable sufficient and predictable revenues for DSOs investments now and also in the future.
- Tariffs should be technically feasible to implement (metering and control).
- Tariffs should promote well-functioning electricity markets.
- Tariffs should support the European Union and national energy and climate policies.
- Tariff structure should not conflict with the overaching regulation and legislation.

GEODE proposes a DSO power based tariff approach as one tariff scheme, among others, that better suits the requirements DSO's tariff structure should fulfil, encouraging efficiencies in the energy system. Network costs are capacity-driven. Capacity-based grid tariffs would encourage consumers to reduce their contracted demand and will incentivise the shift of energy use from peak times to hours with lower demand.

Regulation must not prevent DSOs from developing better functioning and more cost-reflective tariff structures keeping the overall efficiency of their networks as the main guideline[1].

[1] *See the GEODE Report on the Development of the DSO's Tariff Structure* at: http://www.geodeeu.org/uploads/GEODE%20Position%20Paper%20Tariff%20Structure.pdf

As a consequence **GEODE** disagrees with the ACER Paper proposing "time-of-use or locational distribution network tariffs" and dynamic network tariffs (3. 37) to encourage efficiency in the use of the network. Taking into account that the distribution grid is mostly based on fixed costs – over 90%, a power based network tariff as described above would be more suitable for all future needs, both from the network, but also from generation and supply/demand perspective. Furthermore time-of–use tariffs are not god for flexibility and too complex for consumers to understand.

A pricing structure with time of use pricing in retail prices and power based network tariffs could provide the end user with the proper cost reflectiveness of the electricity market and network charges. For instance, it has to be taken into consideration that there is a significant risk of energy prices being low at the same time the DSO price is high, and the other way around. If cost reflectiveness reaches the customer, the benefits of participating in DSF become visible.

VI) Implications for governance

❖ Flexibility and competition

The ACER document identifies a need for more flexibility and more competition. We agree that flexibility has gained importance and will remain essential during the next decades based on the increased amount of RES being connected to DSOs' networks. However, on the other hand, system capacity has been left out of the energy equation.
Capacity and flexibility adequacy are both necessary to deliver, through market mechanisms, the level of security of supply to allow a stable and well-functioning market. Flexibility is needed to match shifts in both supply and demand and overall capacity is needed to meet peak demand with reduced risk.

Each generation plant or demand-response installation has a maximum generation capacity and an expected performance at peak load. Sufficient capacity is needed in a system to control the risk of supply-demand imbalance within minimum security standards. However, unlike flexibility, total capacity is usually used only a few hours each year, even though it contributes to lowering the risk every day.

Therefore, this security of supply provided through adequate flexibility and capacity should both be economically valued by energy markets. Currently, markets do not

provide signals to attract investments in new capacity and encourage existing capacity to leave the market. In fact, there is currently a lack of purely market based investments, either in conventional or in RES plants.

Uncertainties and needs for both capacity and flexibility may differ from one country to another but each Member State is facing or may face both issues in the future. Therefore regulatory decision-makers should develop regulatory frameworks and schemes in order to promote economically and efficient decisions.

The key objective of regulation is to improve economic efficiency. It is essential to define a clear and stable policy framework with non-conflicting objectives. Regulatory tools cannot solve the confusion resulting from the conflict of political objectives. Governance still has many structural issues to deal with, for example, the RES support schemes and capacity mechanism schemes. A successful regulatory framework should promote economically efficient decisions.

❖ **Network Codes**

GEODE wants to highlight that regarding Network Codes, assuring the right involvement of DSOs in the code drafting process is crucial, and therefore especially welcomes the ACER-CEER proposal *"to ensure an appropriate role for consumers and stakeholders*". Network Codes will significantly affect the operations of Distribution System Operators and **GEODE** would like to see the significant involvement of stakeholders in the pre-comitology and comitology stages for the adoption of NCs by making updated versions of the codes readily available to all stakeholders as well as by explaining the amendments introduced. This will provide increased transparency into the process.

GEODE wants to underline that Networks Codes can dramatically affect the operation of Distribution System Operators, causing in some cases important costs to rise, e.g. the CAM code change of the gas day, when implementing certain provisions contained in different Network Codes.

Thus **GEODE** would like to point out the importance of carrying out the corresponding Cost Benefit Analysis regarding the fulfillment of new requirements that a Network Code might introduce. These CBA should be submitted to public consultation, justifying the need for modifying existing operational rules. No CBAs have been made for those requirements of NCs that are currently in comitology, even though the economic effects

can be substantial as DSOs associations have previously made clear. ACER could play a key role in this process.

GEODE would also like to underline that the requirements between different Network Codes need to be consistent. Therefore the coordination among the drafting teams of the respective codes needs to be assured in order to avoid misunderstandings. Network Codes should also be consistent with EU energy policy in general, to avoid unintentionally creating barriers. Here again **GEODE** sees a role for ACER to play.

And finally, **GEODE** would like to underline once more that Network Codes should be limited to setting minimum common standards in order to prevent situations that could have a negative impact exclusively on cross-border trade, and on the European system operation and security of supply, respecting the subsidiarity principle. The Network Codes should not go too deeply into detailed technical provisions nor go beyond cross-border issues. The principle “one-size-fits-all is not applicable; technical conditions and operations vary considerably amongst distribution networks and their users across Europe.

Brussels 16 June 2014