

## A NordREG reaction to the European Commission's "Clean Energy for all Europeans"

### Aggregation services and demand response

*The Nordic energy regulators (NordREG) welcomes the "Clean energy for all Europeans" package and the Commission's intention to improve demand response in the internal electricity market.*

*This paper provides NordREG's views, aiming at assisting Member States and EU institutions on improving the proposals related to demand response and aggregation, in order to better reach the important objectives of efficient demand response for all Europeans.*

#### Key messages and recommendations

- ❖ NordREG believes market based solutions should prevail before regulated models, when possible, and allow competition and innovation enable demand response. Regulatory interventions should be carefully justified and aimed at removing barriers
- ❖ NordREG urges for MS' discretion to decide if, and in which situations, the regulated framework for independent aggregation may be efficient to implement. Further, NordREG recommends that the legal framework also provides the MSs or regulators with some flexibility to set the details of the regulated framework, if chosen in specific parts of the market
- ❖ NordREG is concerned that the EU-wide one-size-fits-all approach to demand response, based on independent aggregation, could lead to system-wide inefficiencies because:
  - It could lead to incorrect allocation of costs and benefits between market participants and distort the efficient price formation in the electricity markets
  - It disregards the differences between MSs' retail markets' level of maturity, and therefore also whether there is a need for a regulatory intervention as the model for independent aggregation implies
  - It disregards the increased administrative costs related to the establishment of the regulated framework for independent aggregation, which in the end will be borne by all customers
  - It disregards implications on balance responsibility and the potential influence on incentives for balance responsible parties to be balanced
- ❖ NordREG believes the provisions in the Electricity Directive should focus on the *service* "aggregation" and on guaranteeing the rights for all customers to efficiently take part in all market timeframes, both individually and through aggregation, instead of prescribing strict roles and relationship between the *entities* "suppliers", "aggregators" and "independent aggregators". This calls for MS' discretion on defining the details on how aggregation could be most efficiently facilitated

## **A need for a holistic approach and MS' freedom to set the details on aggregation**

Efficient provision of demand response, individually and through aggregation, are highly important objectives for NordREG. We believe efficient demand response would benefit Nordic consumers, and we therefore support the EC's intention to improve demand response and aggregation for all Europeans.

NordREG would at the same time like to express its deep concerns regarding the one-size-fits-all approach taken on aggregation, prescribed by the proposed Article 13 and 17 of the Electricity Directive. The proposals can be interpreted as a mandatory introduction of a regulated framework for independent aggregators in all EU Member States and across all market timeframes. Further, it is unclear whether independent aggregators should have balance responsibility.

Instead of focusing on "aggregation" as a service which can help facilitate efficient demand response, the Electricity Directive proposals focus on the roles of the entities potentially providing aggregation services, the contractual relationship between the customers and the entities, and conflict resolution mechanisms and potential compensation schemes between the entities. By this it creates an artificial separation between the roles "suppliers" and "aggregators".

NordREG would like to underline that the distinctions between these roles are in most cases not definite with respect to responsibility throughout the market timeframes. Thus, by applying this one-size-fits-all approach, the proposals are likely to cause unintentional inefficiencies and additional costs that in the end will be borne by the same customers the Electricity Directive is intending to support.

NordREG instead believes that in order to facilitate efficient demand response, the key legal prerequisites that needs to be fulfilled by each MS is the customers' right to market access, both individually and through aggregation, in order to provide demand response.

NordREG therefore urges for a regulation that gives MSs the freedom to define the details on how the customers are most efficiently secured the right to provide demand response, both individually and through aggregation, by also taking into account the characteristics and needs of each MS' retail market.

## **Competitive and well-functioning markets are prerequisites for efficient demand response**

The Nordic wholesale and retail electricity markets are in the forefront of the development. There is a high degree of competitiveness and the markets are well-functioning and efficient. This may be explained both by the underlying organisational structure, with low market concentration, as well as by the fact that the markets have had sufficient time to develop since the deregulation already in the 1990s.

The Nordic customers can therefore take advantage of a variety of offered services from a wide scale of suppliers according to their own choice<sup>1</sup>. In such a competitive environment, NordREG believes that competition is able to ensure the development of efficient and competitive services demanded by the customers, including through aggregation. This would allow all customers to take an active part in the market and to provide their demand response.

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<sup>1</sup> Norway has approximately 140 active suppliers, Sweden has around 120, Finland has around 75, and Denmark around 50. Further, the annual supplier switching rates in the Nordic countries have been ranging between 8 % to 12.5 % per annum, depending on the country.

While we support the EC's intention to improve demand response, we justifiably believe it could be achieved without the need for mandatory regulatory interventions, such as the regulated model for "independent aggregation". Further, we strongly believe that regulatory interventions should be carefully justified and be aimed at correcting identified market distortions.

At the same time, NordREG recognises that the situation may be different in other retail markets throughout Europe, and that this may call for regulatory interventions. The regulated model of "independent aggregation" could therefore be one of several tools to ensure the rights for customers to provide demand response and to take part in the market through aggregation. It should however not be the standard tool for all MS.

In the following sections we explain three of the main disadvantages we see with the regulated models for independent aggregation, which we believe may out-rule the benefits in the Nordic markets: The need to estimate values and regulate compensation; the increase of administrative costs; and the potential distortion to balance responsibility.

### **Estimated energy volumes and regulated compensation may create distortions**

The introduction of an independent aggregator, as a separate entity from suppliers, will in many cases require an administrative split of balance responsibility between several and independent entities related to the customer and its meter. This further requires TSOs, or another appointed entity, to estimate energy volumes based on a base-line method, divide the energy volumes based on these estimations, and correct the positions for the involved entities.

As with all estimations, they have a risk of not being correct. If the energy volumes are not correctly allocated between the entities, the independent aggregator's demand response bids may be set at a price that does not reflect the true costs of demand response. This may again lead to distorted price formation and inefficiencies seen from a system perspective.

To implement the regulated model, it may also be necessary to regulate a price for which a financial compensation between the different entities should be based on. This regulated price may also have a risk of not being correct and may further distort the price formation and lead to system inefficiencies.

Based on these concerns, NordREG urges for MS' discretion to decide in which circumstances a regulated framework for independent aggregators may be merited. To find the most efficient solutions, aggregation and demand response may require different solutions for different market timeframes.

### **The administrative costs of a framework for independent aggregators would eventually be borne by all customers**

The establishment and operation of unnecessary and complex models to estimate and correct energy volumes, and to facilitate compensation between independent entities, creates administrative costs. These administrative costs will in the end be borne by all customers through increased tariffs or fees.

Within well-functioning and competitive retail markets, such as within the Nordic region, the prerequisites to develop aggregation services through competition already exists without the need to introduce a separation of entities, based on unnecessary and complex models to estimate and correct the energy volumes.

Based on these concerns as well, NordREG urges for MS discretion to decide in which circumstances a regulated framework for independent aggregators may be efficient.