# CLEAN ENERGY FOR ALL EUROPEANS: NEW EU RULES ON ELECTRICITY MARKETS

The EU has adopted a package of new legislation that comprehensively updates the EU electricity market rulebook to facilitate the energy transition through liberalised energy markets.

## Introduction

The final four legislative acts comprising the "Clean Energy for all Europeans" package (**CEP**)[1] were adopted by the EU on 22 May 2019. Among the significant changes introduced are new design principles for Capacity Mechanisms (**CM**), rules encouraging investment in storage facilities, and measures enabling fairer and more flexible balancing systems.

In this briefing, we highlight these and some of the other key measures introduced by the CEP.

## Electricity market design

The CEP is based on the principle of competitive energy markets and, at its core, has the following aims:

- achieving market-based prices in all organised electricity markets;
- requiring equal treatment of generation, demand response, storage and aggregators;
- the development of more flexible generation and demand; and
- enhancing national regulators' independence and cross-border collaboration between regulators.

## Market rules

A key area of reform in the CEP focuses on creating more efficient electricity markets where market participants bear more of the financial impact of their actions. This will be achieved through revised rules on balancing and dispatch, removal of dispatch priority for renewable energy generators and facilitation of greater flexibility within the system.

### Balance responsibility

Under the CEP, all energy market participants (except for certain small and certain innovative projects, as well as existing energy generators currently exempted) will be financially responsible for the imbalances they cause to the electricity system (representing the difference between the allocated volume and the final position in the market). For example, generators will be penalised for discharging energy to the grid when there is no demand. To this end, each market participant must be a "balance responsible party" (**BRP**) or delegate this responsibility contractually to a market participant taking on the role of a BRP.

In a similar fashion, to make the most of higher shares of intermittent renewable energy on the European grid, the CEP aims to foster further market liquidity by ensuring that electricity trading occurs as close as possible to 'real-time' (i.e. when the energy is delivered). This objective is reflected in measures such as the harmonisation of the imbalance settlement period to 15 minutes in all scheduling areas from 1 January 2021.

## Key issues

- New rules on the design of capacity markets
- Further liberalisation and harmonisation of EU power markets with a focus on flexibility
- Removal of priority dispatch for renewable energy generators
- New rules on the ownership of storage

### Removal of priority dispatch for renewable energy generators

Priority dispatch for renewable electricity generators and high-efficiency cogeneration has been an important part of the renewable energy policy of several Member States (including Germany and Belgium) but has also been contentious in the European Commission (**EC**) and among industry stakeholders. The CEP (in its move to more market-based principles) has removed this benefit for all but the smallest projects and the most innovative technologies, as well as existing generators currently benefiting from priority dispatch.

1 These are the recast Electricity Regulation, Electricity Directive, Risk Preparedness Regulation and ACER Regulation.

Some commentators have argued that the abolition of priority dispatch will impede the decarbonisation of the EU's electricity markets. The EC's position, however, has been that the benefits of transparent and market-based rules will outweigh any adverse short-term effects. The EC's position is supported by the fact that since the Third Energy Package was passed in 2009, renewable energy technology costs have come down sharply, and renewable power producers are therefore better able to compete against conventional generation without the need for priority dispatch.

### Level playing field for flexibility providers

Another key feature of the CEP is the focus on flexibility. The EC has recognised that flexible generation and demand (such as storage and demand response) are the ideal partner technologies to cost-effectively integrate intermittent renewable energy sources such as wind and solar onto the grid. The CEP therefore requires Member States to ensure a level playing field for all types of market participants in all organised electricity markets, including ancillary services markets, and to provide incentives to flexible generation and demand. For example, Member States must ensure that the different technical capabilities of generation sources, storage and demand response are taken into account when drafting eligibility rules for participating in balancing markets.

Similarly, the CEP aims to remove barriers to independent aggregation of generation and demand. For example, Members States must ensure that aggregators can participate directly in the retail energy market without having to obtain the consent of other market participants (such as suppliers) or to pay compensation to suppliers or generators.

### Treatment of electricity storage

The CEP has confirmed that storage should be treated as generation. This is a helpful and long-awaited clarification as Member States have to date taken different approaches to the regulatory classification of storage.


To ensure the uptake of flexible technologies such as electricity storage in a competitive, market-based manner, the CEP also contains rules on the unbundling of storage from Transmission System Operators (**TSO**) and Distribution System Operators (**DSO**). TSOs and DSOs will be prohibited from owning, managing and operating storage facilities, unless the storage facilities are fully integrated network components and the national regulatory authority has granted a derogation from the unbundling rules. The following conditions must also be met:

- no other party (following an open tendering procedure) was able to deliver the same services at a reasonable cost;
- the storage facilities are necessary for the DSO/TSO to meet its obligations under the Electricity Directive; and
- the regulatory authority is satisfied that a derogation is necessary and has assessed the tendering procedure.

This derogation from the unbundling rules will need to be transposed into domestic law by each Member State so we may see a non-homogenous application of the derogation across the EU (as has been the case with the existing unbundling rules).

In order to encourage further private investment in storage facilities, the CEP also provides that customers that own a storage facility will (i) have the right to a grid connection within a reasonable time after the request; (ii) not be subject to any double charges (such as network charges) for stored electricity not exported to the grid or when providing flexibility services to system operators, (iii) not be subject to disproportionate licensing requirements or fees; and (iv) be allowed to provide several services simultaneously, if technically feasible.

## Capacity Mechanisms

While recognising that some Member States may face genuine security of supply concerns, the EC is concerned about CMs having a distortive effect on electricity markets and continuing to prop up fossil fuel power plants. The CEP addresses these concerns by requiring Member States to satisfy a number of pre-conditions before introducing CMs. These include ensuring that any regulatory distortions (for example price caps) are removed, enabling scarcity pricing, and maximising interconnection capacity and flexibility solutions.

The EC will have an oversight role in judging the adequacy of Member States' plans and the subsequent market reforms enacted. The introduction of a CM will therefore be a measure of last resort once all other options have failed to address the resource adequacy concern. If adopted, a CM must be designed based on a number of key principles, including:

- ideally CMs should be designed as "strategic reserves" (slightly different rules apply to strategic reserve CMs and other CMs);
- CMs must be a temporary solution (10 year limit);
- CMs must be open to all types of resource, including demand response, and subject to a carbon emissions limit

of 550g CO2/kWh (immediately applicable for new CMs, and from 1 July 2025 to existing CMs); and

- CMs must be open to direct cross-border participation.

Importantly, existing CMs will need to comply with the above CM design principles by 31 December 2019, but this requirement is without prejudice to contracts or commitments already concluded by this date. This means that CM contracts awarded for 15 years (i.e. over the new 10 year limit), or contracts awarded to generators that do not meet the new carbon emission limits, prior to the relevant cut-off date should not be impacted by the CEP.

The new CM rules are perhaps the most pressing issue for many investors and Member States, given the number of new CMs that have been implemented across the EU and the short compliance timeframe. Stakeholders have also only recently been grappling with the effects of the successful Tempus Energy challenge of the CM in the UK before the European Court of Justice[2], which has temporarily suspended the CM[3], and has potentially opened the door to other legal challenges of CMs around Europe.

## New cooperation mechanisms

As part of its effort to further integrate national electricity markets, the CEP has introduced a new element of regional cooperation though the establishment of regional coordination centres (**RCOs**) for TSOs and a new European entity for DSO collaboration.

RCOs will complement the role of national TSOs. While their powers are not as ambitious as initially proposed by the EC (as all real-time operational tasks remain with the TSOs), RCOs will have significant responsibilities. These include the carrying out of coordinated capacity calculations, security analysis, regional outage planning coordination, regional sizing of reserve capacity and the creation of common grid models. All TSOs of a system operation region will be required to submit a proposal for the establishment of an RCO within 12 months following the entry into force of the relevant provisions under the CEP.

The CEP contains a similar procedure for the establishment of a new European entity for DSOs, albeit on a voluntary basis. The new entity's role includes the support of DSOs' digitalisation efforts, data management and protection, and the development of network codes. The CEP also specifies how DSOs and TSOs should cooperate with regard to the planning and operation of their networks.

While national energy regulators support the new rules, the European Network of TSOs for Electricity (**ENTSO-E**) fears that certain aspects of the new set-up will result in lower security of supply and less clarity on the split of responsibilities and allocation of liability between system operators, RCOs, ENTSO-E and the new DSO entity. While it remains to be seen how these new entities will interact with the existing DSO/TSO landscape, we expect that some of the overlap issues might be mitigated. For instance, the articles of association of the new DSO entity could include provisions to tackle any interface and liability issues and the RCOs could enter into appropriate cooperation agreements and protocols with other RCOs or TSOs/ENTSO-E to align governance and operations.

## Permitting rules for renewable energy plants

The recast Renewable Energy Directive contains new measures to encourage development of renewable energy projects. These include a new "one-stop shop" for permitting matters to streamline the consenting process for renewable energy projects (including the associated grid infrastructure). Member States must implement compliant consenting processes by 30 June 2021. The new measures are similar to the streamlined permitting process established under the EU Projects of Common Interest regime and are set out in the table below.

These timeframes do not, however, take into account timeframes under other legal regimes that may be relevant to the consenting process such as EIA and Habitats Regulations Assessment and do not include judicial and other appeal

| Type of project | Timeframe of consenting process |
|---|---|
| New projects | 2 years + 1 year extension due to "exceptional circumstances" |
| Re-powered projects and projects below 150kW | 1 year + 1 year extension due to "exceptional circumstances" |

2 See further our briefing on the Tempus Energy legal challenge here: https://www.cliffordchance.com/briefings/2018/11/standby_power_standstillcapacitymarke.html.

3 See further our briefing on the latest developments following the suspension of the UK CM here: https://www.cliffordchance.com/briefings/2019/04/uk_government_planstopupcapacitymarke.html.

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processes. The new consenting timeframes appear very ambitious, particularly for Member States with complex permitting requirements and a range of decentralised permitting authorities. These bodies may not have the resources to process permit applications quickly, especially where the project itself is highly complex or uses a novel technology. Meeting these deadlines may also require Member States to reduce the length of public consultation periods, something likely to meet some resistance.

## Next steps

Both the recast Electricity Directive and Electricity Regulation, adopted as part of the CEP, will enter into force 20 days after their publication in the *Official Journal of the European Union*. The Electricity Regulation will be directly applicable in all EU Member States and most of its provisions will apply from 1 January 2020. The Electricity Directive on the other hand will need to be transposed into domestic law by each Member State with the majority of provisions required to be implemented by 31 December 2020.

Both Member States and market participants will need to act fairly quickly to understand the new measures and ensure they are implemented before the compliance deadlines. Although the CEP may place additional compliance burdens on some market participants, it will also create significant scope for new players to enter the market and for existing participants to operate on a more competitive basis. This should go a long way to achieving a more efficient, cost-effective and greener European energy market.

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