



Dear,

Brussels 2/12/2017

Ahead of the upcoming COREPER negotiations on the reformed electricity market design, we would like to draw your attention to **two problematic proposals to change the Council text** on the revised electricity directive – article 54 and article 40.

In the Council text 14625/17 from the 29<sup>th</sup> of November, it is proposed to delete the part of article 54 dealing with provision of ancillary services.

**We would strongly urge the members of COREPER to maintain the text highlighted in red below, thereby supporting the market based provision of ancillary services, proposed by the European Commission.**

For reasons which are elaborated below, market based provision of ancillary services<sup>1</sup>) would, 1) be in line with the system operation guideline, 2) be in line with the general principles of an open, free and liberalized electricity market and 3) underpin innovation to lead the decarbonization of the European electricity mix.

**Article 54: Ownership of energy storage facilities [and provision of ancillary services]**

**by transmission system operators**

1. Transmission system operators shall not be allowed to own, **develop**, manage or operate energy storage facilities [and shall not own directly or indirectly control assets that provide ancillary services].
2. By way of derogation from paragraph 1, Member States may allow transmission system operators to own, **develop**, manage or operate energy storage facilities which are fully integrated network components and the regulatory authority has granted its approval ~~or~~ [or assets providing ancillary services, excluding balancing], if all of the following conditions are fulfilled:

Providing unconditional rights for TSOs to own facilities, which could be delivered by the market is in breach with the general ideas of a free and liberalized electricity market. The original proposal by the European Commission provides sufficient safeguards for member states to allow (not entitle) TSOs to own such facilities, **if** the market cannot deliver them. Such an approach would be in line with the general principles of the European electricity market.

Additionally, in article 54, the insertion of an “or” in second paragraph is problematic and should be **deleted**. The “or” removes the conditions for the exemption, while at the same time removes the role of the NRA if the conditions are met (unclear who would approve in such a case).

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<sup>1</sup> i.e. having as a starting point that TSOs should not own facilities delivering these services; unless the asset delivering is an “integrated network component”

Finally, a proposal in article 40 of the revised Council text, limits the principle of transparent, non-discriminating and market based procurement to only a sub-set of ancillary services, potentially allowing TSOs to discriminate against other market players capable of delivering such services.

***We would therefore also urge the members of Coreper to delete the words “those” and “non-frequency” in article 40 (5a). Transparent, non-discriminating and market based procurement principles should apply to procurement of all types of ancillary services.***

#### Article 40: Tasks of Transmission System Operators

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5.a. The requirements of paragraph 4 shall apply to the provision of ~~those non-frequency~~ ancillary services by transmission system operators, unless the regulatory authority has assessed that the market-based provision of non-frequency ancillary services is economically not efficient and has granted a derogation

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#### **JUSTIFICATION – WHY ARE ANCILLARY SERVICES IMPORTANT?**

Discussions of wholesale electricity market design normally focus on the functioning of the “energy only market” (EOM), the importance of energy scarcity prices and whether a well-functioning EOM brings forward sufficient and socio-economic investment. However, to bring forward sufficient and socio-economic investments, the electricity market should include more products than only energy.

In addition to energy, the ancillary services (frequency (balancing) and non-frequency) are of significant importance to the system, but subject to much less attention in the market design debate:

*Non-frequency related ancillary services* are additional services delivered for reasons of stability and handling of faults from assets connected to the grid (voltage control, inertia, black start etc.). These services are to a large extent delivered via obligations and not (at least not fully) paid for.

To ensure cost efficient procurement of these services, it is essential that their delivery is open to all interested market players. Creating a market place for ancillary services would both ensure the necessary competition to drive down costs, and – equally important – send the right investment signals to future owners of generation capacity, demand response and storage facilities.

The benefits of commercialisation of ancillary services is confirmed by existing secondary legislation at EU level. The Requirement for Generators network code distinguishes between the capability to deliver and the actual delivery of various system services. ***The Guideline on System Operation states that TSOs must use market-based mechanisms as far as possible to ensure network security and stability.***

#### **Implications for cost-efficient decarbonisation**

As an unavoidable consequence of the decarbonisation of the European electricity sector, the capacity mix is changing. Dispatchable thermal capacities are leaving the system and less dispatchable renewables like

wind turbines and solar power are coming in. Decarbonization is further strengthened with increasing investments in energy storage and investments in making demand responsive to price signals

These renewable electricity facilities can deliver ancillary services e.g. down regulation and combined with storage solutions even essential frequency response directly supporting the frequency of the system. In fact, this can become an important source of revenue for renewable electricity producers, who are facing a market with decreasing wholesale market prices and calls for lower subsidy costs.

However, such capabilities will only be developed further, if the market provides an investment signal. This will not be the case if TSOs can themselves freely invest, own and operate facilities which deliver ancillary services. Ancillary service markets are crucial for further development of demand response and storage solutions. To foreclose non-TSO market actors from this high-value market would slow down innovation and development of necessary complementary technologies to renewables. Instead TSOs are likely to invest in inefficient dedicated grid units such as synchronous condensers serving only one purpose and, hence, increase cost to society (as these units would not be able to be used in the whole-sale markets).

***Thus, having as a general principle, that TSOs cannot own facilities which deliver ancillary services, will send a strong investment signal to renewable energy developers, storage and demand response developers encouraging them to take part in this market, and widen their potential revenue streams.***

### **Market based provision of ancillary services is in line with general market principles**

In the past, system services have played a marginal role in total economics of power plants. In the future, however, system services will be more important for the individual plant and the value (balance of supply and demand of these services) to the system are likely to be markedly higher.

In this process, remaining necessary thermal plants are struggling to find sustainable business cases for their continued operation and the electricity system is losing services vital for system security/stability once supplied by thermal generators (mainly as by-product of the energy supplied).

However, with a shrinking share of thermal production, such services are becoming scarce<sup>2</sup>. This is part of the background that has led to the discussion/introduction of capacity mechanisms in most member states and to an increased use of “out-of-market measures” from TSOs to “keep the lights on”.

Out-of-market measures include; forcing generators to run and deliver system stability services and TSO investments in assets like synchronous condensers capable of delivering certain system stability services.

Both measures entail inefficiencies; when subject to forced operation, generators have fewer long term optimization possibilities. When TSOs invest in own assets, in effect in competition with other suppliers of system services, they may favor own assets over assets already in place or new technologies, but owned by market participants.

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<sup>2</sup> In the past system stability services like inertia, voltage control, short-circuit, black-start capabilities, and island operation were imbedded in the electricity system and came for free as a by-product to the generation of electricity. For several reasons this is not the case today. Firstly, thermal power units are closing and to some extent being substituted by RES units delivering fewer system stability services unless equipped with power electronics. Secondly, being residual providers remaining thermal plants continuously seek to reduce costs and risks. The supply of reactive power brings an efficiency loss in the generation of electricity. Island operation capability comes with additional costs for equipment and emergency back-up procedures. Fault-ride-through requirements increase risk of asset damage. Thirdly, new suppliers like consumers (large individual or aggregates) and batteries/storage are slowly entering the market, but are not yet enabled to provide system stability services.