REPLIES OF THE EUROPEAN COMMISSION

TO THE EUROPEAN COURT OF AUDITORS' SPECIAL REPORT

Internal electricity market integration

Complex legal architecture, delays, weaknesses in governance and incomplete market surveillance hamper full achievement of the ambitious objective

Contents

This document presents the replies of the European Commission to observations of a Special Report of the European Court of Auditors, in line with Article 259 of the Financial Regulation and to be published together with the Special Report.

I. THE COMMISSION REPLIES IN BRIEF

Over the last decade, the major efforts undertaken by the European Union to further integrate electricity markets in Europe and boost cross-border trade have delivered significant benefits to EU citizens and consumers. These benefits are estimated by the Agency for the Cooperation of Energy Regulators (ACER) to amount to around EUR 34 billion a year, by enabling cross-border trade between Member States and improving security of supply across a larger geographical area[1]. While the current energy crisis has shown weaknesses of the electricity market design, it also made apparent that the existence of an integrated market helped to avoid electricity curtailment or blackouts in certain regions, since it allowed electricity produced across a large geographical area to flow to where it is needed.

Market coupling[2], which means that electricity and interconnector capacities to transport it can easily be traded on a common EU trading platform, has further improved, in both the day-ahead and the intraday markets. The Commission considers that as of 2022, the day-ahead market coupling has been successfully implemented to all borders between EU Member States. This has been made possible not least due to the network codes and guidelines, Commission Regulations adopted based on empowerments in the Electricity Regulation (EC) 714/2009 (now Regulation (EU) 2019/943) and developed in close cooperation with the organisation of the European electricity transmission system operators (ENTSO-E), and ACER. This close cooperation is not only crucial due to the need to make use of the expertise available in the sector, but also to achieve "ownership" of the rules by key stakeholders, since this facilitates implementation of the rules. For the same reasons ENTSO-E, Member States' regulatory authorities for energy and ACER are all involved in developing additional binding and detailed rules under certain electricity guidelines.

The objective set by the European Council to complete the integration of the internal energy market by 2014[3] has not been fully achieved yet. Despite this political agreement by Heads of State and Government of all EU Member States, national circumstances and interests diverge, making compromises necessary when trying to agree improvements to the EU regulatory framework. As an example, the recast Electricity Regulation (EU) 2019/943 could only be agreed by allowing Member States more time for adapting the structure of their markets (bidding zones) to physical realities (available network capacities).

Despite the major progress achieved so far, integrating[4] European electricity markets is therefore an ongoing process, also since new challenges like the current energy crisis ask for new answers. Efforts to optimise the functioning of the electricity market design should not slow down efforts to implement the existing framework. This includes improving consumer rights, working towards the target that in 2025 at least 70% of interconnector capacities are available for trade, structuring the market so that it provides the right signals to where investment is needed, as well as identifying and eliminating distortions and market failures. This is clearly evidenced in the State of the Energy Union 2022 report adopted on 18 October 2022.

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[1] See §'s executive summary and § 38 of the Observations of the ECA report.

[2] See §'s 34, 35, 37, 42 of the observations of the ECA report.

[3] See § 23 of the audit scope and approach and §'s 33 and 37 of the observations of the ECA report.

[4] See § 27 of the audit scope and approach and §'s 40 and 97 of the observations of the ECA report.

II. COMMISSION REPLIES TO MAIN OBSERVATIONS OF THE ECA

1. Regulatory framework for integrating EU electricity markets

European electricity markets are regulated at EU level by a comprehensive set of EU legislation, which has been progressively updated over more than 20 years. An important step was Regulation (EC) 714/2009 which introduced electricity network codes and guidelines, which are Commission Regulations, developed in cooperation with transmission system operators (TSOs) and ACER. These electricity network codes and guidelines set binding technical rules required for facilitating cross-border flows and trade in electricity, thereby complementing and strengthening the rules governing European electricity networks and markets.

The Commission believes that the legislative approach chosen contributed to improving the functioning of the EU electricity markets and to fostering market integration. The conclusions reached by ECA are based on indicators such as price convergence between bidding zone or the volume of cross-border trade. The Commission considers that price convergence is not an objective in itself as it would require overinvestment in network infrastructure[5].

The latest revision of the set of EU legislation took place from 2016 to 2019 resulting notably in recast Electricity Directive (EU) 2019/944, recast Electricity Regulation (EU) 2019/943 and recast ACER Regulation (EU) 2019/942. As a result of the interinstitutional negotiations with the European Parliament and Council, those recasts brought key provisions from network codes and guidelines (Commission Regulations) into EU secondary law (adopted by European Parliament and Council), for example core rules on making cross-border interconnector capacities available for trade. In this reply the Commission focuses on the four electricity guidelines[6], reflecting the scope of relevant EU rules taken by ECA.

However, the Commission emphasises that the implementation of EU rules needs to be seen as a whole, and not only as regards those four electricity guidelines. For example, in the interinstitutional negotiations on the Clean Energy Package the co-legislators decided to include key rules relevant for the review of the bidding zone configuration in the Electricity Regulation (EU) 2019/943[7]. Therefore, the process for the bidding zone review needs to be considered integrally together with the relevant rules on bidding zone configuration in the implementing Commission Regulation (EU) 2015/1222 establishing a guideline on capacity allocation and congestion management (CACM). The Commission considers that the main factor for not having price convergence between bidding zones is the lack of physical interconnector capacity. For example, price convergence is almost full between Spain and Portugal, but much lower between Spain and France. The reason is not the existence of market barriers which may result in interconnector capacity not being available for trade, but limited interconnectors capacity. The Commission notes that ECA uses inter alia the volume of cross-border trade as indicators. However, in the view of the Commission what is important is not the amount of

[5] See § 02 executive summary, findings section EU Regulatory Framework, § 51 observations and recommendation 1 of the ECA report.

[6] Commission Regulation (EU) 2015/1222 establishing a guideline on capacity allocation and congestion management (CACM), Commission Regulation (EU) 2017/1719 establishing a guideline on forward capacity allocation (FCA), Commission Regulation (EU) 2017/2195 establishing a guideline on electricity balancing (EB) and Commission Regulation (EU) 2017/1485 establishing a guideline on transmission system operation (SO).

[7] Articles 14 to 16

trade, but that trade of electricity increases social welfare for European customers and that it facilitates the integration of renewables.

The co-legislators established the process for adopting new network codes in Regulation (EC) 714/2009. New network codes are proposed by the transmission system operators cooperating in ENTSO-E, an entity set up as well by Regulation (EC) 714/2009. Therefore, the development of network codes obviously took some time, since ENTSO-E and ACER had first to be set up. While ENTSO-E was working on the proposals for binding network codes, there was nevertheless a parallel and voluntary implementation process steered by ACER. Thereby it was possible to reap some of the economic benefits of market integration, as mentioned by ECA[8], already prior to the adoption and implementation of the network codes and guidelines.

When ENTSO-E submitted its proposals for network codes, it turned out that in case of four of them, the level of detail and maturity was not sufficient and that it would not be possible to adopt them as such. It was also considered that the level of technical details would be so complex and high (e.g. with more detailed rules at pan-EU level, but also adapted to different regions within the EU) that setting such detailed rules would not be suitable for Commission Regulations. Hence, it was considered that the development of such technical details through terms and conditions or methodologies (TCMs) set out in electricity guidelines, subject to the approval of regulatory authorities, was a more efficient alternative. Thereby, rules set directly in the guidelines could already take effect and delays with developing more complex detailed rules would not delay progress with adopting other rules. The Commission stresses that TCMs, like network codes and guidelines, are binding and like ACER Decisions or decisions of the Member States' regulatory authorities can and need to be enforced by the latter. The approach of setting more detailed technical rules via TCMs has been confirmed by the legislator (cf. Regulations (EU) 2019/942 and 2019/943).

In conducting the impact assessment, the Commission considered that the timely adoption of the guidelines would be essential for further integrating existing national electricity markets. National markets had certain commonalities (e.g. using the marginal pricing method in day-ahead markets), but also their own specificities. The guidelines are an enabler to achieve a truly European-wide electricity market, taking into account this reality and building on the considerable preparatory work done by ENTSO-E and ACER. On the other hand, trying to design an "ideal" electricity market design quasi from scratch would not only have meant abandoning this preparatory work, but also would have hampered and delayed implementation and hence resulted in slower progress with market integration. The current electricity market design resulted in more choice for consumers and, for years, helped to ensure affordable electricity supplies. However, the current energy crisis indeed showed certain weaknesses of the regulatory framework and therefore the Commission intends to re-assess certain EU rules governing electricity wholesale markets with a view to put forward a proposal in 2023.

2. Implementing the regulatory framework

The fundamental governance system underpinning the EU electricity market was introduced with the third internal energy market package in 2009:

- Unbundled transmission and distribution system operators (TSOs and DSOs). This means that the operators of the electricity grid can act without being influenced by potentially conflicting interests as generators or suppliers of electricity. The TSOs cooperate in the European Network of Transmission System Operators for Electricity (ENTSO-E)[9]

[8] See § 39 and 42 of the observations of the ECA report.

[9] The recast Electricity Regulation (EU) 2019/943 introduced with the EU DSO entity a similar entity for DSOs.

- Independent regulatory authorities for energy at Member State level who are complemented at EU level by the European Union Agency for the Cooperation of Energy Regulators (ACER).

ACER's prerogative to adopt binding decisions, in cooperation with Member States' regulatory authorities for energy, is essential for integrating electricity markets. The politically most sensitive decisions cannot be adopted by the Director alone, but require approval by 2/3 of Member States' regulatory authorities represented in ACER's Board of Regulators. This limits the risk of a small number of regulators preventing ACER to take binding decisions. This is a key reason for the successes with electricity market integration achieved so far: In many other policy areas the added value of EU integration needs to be pursued by the "open method of coordination[10]", like reporting requirements and peer pressure. In contrast, EU electricity markets are regulated by a comprehensive set of binding rules at EU level. Those rules are developed in close cooperation with Member States' regulatory authorities, but without individual national interests having veto powers.

This governance system has been proven and tested and was, with some revisions, confirmed by the recast Electricity Directive (EU) 2019/944, recast Electricity Regulation (EU) 2019/943 and recasts ACER Regulation (EU) 2019/942 as well as a subsequent focused amendment of electricity guidelines[11]. Those revisions include:

- More precise rules on the right of Member States' regulatory authorities to impose penalties, or to propose that a competent court imposes such penalties, thereby strengthening their powers to enforce EU rules, including decisions by ACER.
- Rules on enforcement action by Member States' regulatory authorities, if necessary, with involvement of ACER, in case ENTSO-E or other entities set up under EU law do not comply with their obligations.
- Streamlining the process for developing network codes and guidelines, as well as terms and conditions or methodologies under guidelines, by giving ACER the right and duty to revise, if necessary, proposals submitted by ENTSO-E.

Pursuant to Article 45(1) of ACER Regulation 2019/942, by 5 July 2024, the Commission, with the assistance of an independent external expert, shall carry out an evaluation to assess ACER's performance in relation to its objectives, mandate and tasks. In this context the Commission will assess if ACER's role in the governance system for achieving and securing integrated electricity markets is still fit for purpose. The evaluation will, however, carefully consider the potential impacts on implementation and enforcement of EU rules, but also as regards financial impact. Currently regulatory authorities contribute significantly to the work of ACER. In case the work done by their representatives in ACER's 4 working groups and 14 task forces is to be taken over by staff employed by ACER, ACER may need significant additional human and financial resources.

3. Implementation of REMIT by ACER

The Commission is aware that ACER has been lacking human and financial resources for its task under REMIT[12]. The Commission has responded in two ways:

1. It has made use of the new option provided by Article 32 of ACER Regulation (EU) 2019/942 to introduce fees for ACER's tasks under REMIT. Commission Decision (EU) 2020/2152 of 17 December 2020 provides ACER with the needed additional revenues.
2. Commission Opinion of 5.10.2021 on the draft programming document of ACER for the period 2022 – 2024 and on the sufficiency of the financial and human resources available

[10] https://eur-lex.europa.eu/EN/legal-content/glossary/open-method-of-coordination.html

[11] Commission Implementing Regulation (EU) 2021/280 of 22 February 2021 amending Regulations (EU) 2015/1222, (EU) 2016/1719, (EU) 2017/2195 and (EU) 2017/1485 in order to align them with Regulation (EU) 2019/943.

[12] Regulation (EU) No 1227/2011 of 25 October 2011 on wholesale energy market integrity and transparency.

to the Agency was accompanied by a Legislative Financial Statement providing ACER with additional 15 post for implementing REMIT. Those new posts will be phased in until 2027, considering the challenge of recruiting staff with adequate expertise and the effort needed to onboard new staff in ACER's REMIT teams.

Starting in 2022, ACER will receive additional human resources amounting to 15 full-time equivalents in 2027[13]. However, addressing implementation challenges caused by understaffing takes time, given the need to find and recruit qualified staff and, if necessary, to train new staff. The Commission is nevertheless confident that the new fee revenues and the additional 15 posts will allow ACER to adequately fulfil its tasks under REMIT. The number of additional posts provided for in the Commission Opinion is based on the Commission's assessment of the agency's workload and sufficiency of resources. The Commission notes that the increase in posts is an exceptional step, taking into account the stable-staffing requirements on the Commission and the strong policy line that agencies' budget (annual EU Subsidy and establishment plan posts) can only be increased via a legislative proposal to extend the mandate of the agency.

The Commission however stresses that any regulatory changes leading to additional tasks and workload for ACER, e.g. related to possible improvements to the REMIT framework to increase market transparency, monitoring capacities as well as more efficient and effective surveillance of potential market abuse cases in the EU, would require the impact on ACER's human and financial resources to be properly assessed.

III.COMMISSION REPLIES TO THE RECOMMENDATIONS OF THE ECA

Recommendation 1 – Streamlining the implementation of the regulatory framework

The Commission should:

(a) When developing network codes and guidelines, systematically assess the costs versus benefits of setting out their further implementation via the adoption of terms and conditions or methodologies, in particular in light of the administrative burden they could entail for ACER, NRAs and other parties involved. (Target implementation date: as of 2023)

The Commission accepts recommendation 1(a).

(b) Re-assess the EU rules governing wholesale electricity price formation in view of the current energy crisis and the increase in renewable energy. (Target implementation date: 2023)

The Commission accepts recommendation 1(b).

In 2023 the Commission plans a targeted revision of key EU internal electricity market rules so that consumers benefit from secure and affordable supplies of electricity from renewable and low-carbon

[13] Commission Opinion of 5.10.2021 on the draft programming document of the European Union Agency for the Cooperation of Energy Regulators for the period 2022-2024 and on the sufficiency of the financial and human resources available to the Agency. COM(2021) 7024 final.

generation against the background of high energy prices observed in the context of the energy current crisis.

(c) Set out rules incentivising demand flexibility. (Target implementation date: 2025)

The Commission accepts recommendation 1(c).

By 2025 it will propose a Commission Regulation for a network code or a guideline on demand response.

Recommendation 2 – Enhancing the monitoring framework for network guidelines

(a) The Commission and ACER should clarify the strategy in respect of monitoring the implementation and effects of the network codes/guidelines and apply it consistently over time and across Member States. (Target implementation date: 2023)

The Commission accepts recommendation 2a.

ACER reports to the Commission regularly via different channels, not least via regular informal, bilateral contacts at working level. The Commission will consider how a more formalised approach could increase clarity while trying to minimize the impact additional workload of more formalised reporting could have on the substantial work directly relevant for implementing network codes and guidelines.

(b) The Commission should review the weaknesses of the transparency platform and the EU's energy data framework, with ACER's support, and, if required adopt corrective legislative measures. (Target implementation date: 2025)

The Commission accepts recommendation 2b.

Changing Commission Regulation (EU) No 543/2013 of 14 June 2013 on submission and publication of data in electricity markets requires adopting an Implementing Act under the examination procedure, with the process only starting after the review.

Recommendation 3 – Enhancing ACER's surveillance of wholesale markets integrity

(Target implementation date: 2025)

In order to improve the markets surveillance and prevent potential market distortions, ACER should fully implement the REMIT regulation, for example by completing the data coverage of REMIT market surveillance, enhancing the coverage of abusive behaviours it monitors, and fostering cross-border investigatory cooperation by setting up investigatory groups.

The Commission takes note that this recommendation is addressed to ACER.

Recommendation 4 – Speeding up the use of REMIT fees to address shortcomings in ACER's market surveillance

(Target implementation date: by the end of 2023)

ACER should speed up the use of additional financial resources received through REMIT fees to address shortcomings in its REMIT activities (for example, obsolete IT system, understaffing). ACER should improve the monitoring of staff needs across departments based on its established priorities.

The Commission takes note that this recommendation is addressed to ACER.

Recommendation 5 – Enhancing ACER's governance

(Target implementation date: 2025)

The Commission should evaluate and propose improvements to ACER's governance by enhancing independence from NRAs and national interests, enforcement powers, and convergence tools.

The Commission partially accepts recommendation 5 as it cannot commit to a legislative proposal prior to the evaluation as scheduled by the co-legislators. Pursuant to Article 45(1) of ACER Regulation 2019/942, by 5 July 2024, the Commission shall carry out an evaluation to assess ACER's performance in relation to its objectives, mandate and tasks. The evaluation shall, in particular, address the possible need to modify ACER's mandate, and the financial implications of any such modification.

Recommendation 6 – Improving ACER's transparency and accountability

(Target implementation date: By 2023)

ACER should improve the transparency and accountability of its work by facilitating public access to the documents and data contained on its website, ensuring full and timely publication of its decisions and data in accordance with legal requirements, and introducing a clearly defined transparency policy based on best practices.

The Commission takes note that this recommendation is addressed to ACER.

Recommendation 7 – Assessing the need of a framework for the consistent application of penalties

(Target implementation date: 2023)

To foster compliance with EU rules and prevent regulatory arbitrage, the Commission should:

(a) Assess whether penalties for breaches of EU rules are legislated and applied consistently across Member States.

The Commission partially accepts recommendation 7(a).

Enforcement action generally, and penalties in particular, very much depend on national administrative rules and culture. The Commission will assess if national regulatory authorities have the tools to enforce EU rules, hence whether Member States correctly transpose Article 59(3)(d) of Electricity Directive 2019/944.

(b) If warranted, develop a framework setting out minimum common requirements for penalties.

The Commission partially accepts recommendation 7(b).

It is not feasible to develop a "framework setting out minimum common requirements for penalties" for all possible penalties national regulators may impose given the many possible infringements of EU internal energy market rules legislation covered by Article 59(3)(d) of the Electricity Directive. In contrast, for the more definite area of REMIT, a more harmonized framework for penalties could be considered.