

Contribution to the consultation on

PROPOSALS FOR THE MARKET
FRAMEWORK IN ESTONIA FOR
DEMAND RESPONSE THROUGH
INDEPENDENT AGGREGATION

The Competition Authority and the Ministry of Economic Affairs and Communications of Estonia, together with Elering AS, published a Concept Paper (CP) to set forth proposals to open electricity markets to demand response, including through aggregation. In particular, the CP raises a number of questions (in § 17) that are open to contribution from stakeholders.

DR4EU is a network of aggregators operating altogether in more than 20 countries¹ in Europe.

DR4EU is thankful to the drafters of the CP for the very detailed analysis provided therein, and for the opportunity to share views through this consultation process.

DR4EU fully supports the goals defined in the CP, whereby DR should be allowed to develop by participating in all electricity markets, as set forth by the Clean energy package (CEP).

DR4EU is concerned that one aspect of the provisions from the CEP may not have been fully taken into account in the CP. The consequence is that **the proposed market model (model II) would in fact create a radical barrier to demand response participation** - a situation that is prohibited by the CEP (cf art.17-4 of the Electricity Directive, as quoted in the CP).

The barrier comes from the fact that the spread between day ahead price and reference price (RP) that would be used for compensation, would be so tiny that revenues for DR would be very limited and no significant investment can be made on this basis.

The French experience showed this, where a "model II" approach was implemented, leading to basically no participation in the market for DR, which could develop only thanks to subsidies. This is precisely why the European negotiation lead to include in the directive this sentence prohibiting to adopt a compensation mechanism that would create a barrier to DR.

Hence **the simplest solution could be to choose "model III", also generally referred to as an "uncorrected model"**. The CP is concerned that, in the (only) case where DR would be used for balancing, model III may not fully comply with the EBGL (art.49) which may be ambiguous. It is not clear at this stage whether this is really an obstacle (because it is not clear what the "BRP" mentioned there are actually referring to, knowing that the DR aggregator is now due to be or have a BRP of his own, as per art.5 of the Electricity regulation, further clarified by its recital 15). Conversely, it is very clear from the Electricity directive that *"Member States shall be free to choose the appropriate implementation model (...) for independent aggregation (...)*

¹ Main contacts regarding Estonia are: Fusebox (tarvo@fusebox.ee) and Voltalis (pierre.bivas@voltalis.com).

such as models where imbalances are settled of where perimeter correction are introduced". Hence it should be possible to use an "uncorrected model" in Estonia too, such as model III.

However, if Estonia is to prefer a "corrected model", this is allowed too, *"while respecting the general principles set out in (the) Directive"*. In particular, any compensation mechanism *"shall not create a barrier to (...) aggregation or (...) to flexibility"*. This means that a corrected model such as model II may be used, but with an important change regarding compensation costs.

To this end, the Directive provides a very effective solution that has not been taken into account in the CP yet. Indeed, in art.17-4 of the electricity directive (ED), a vital notion has been introduced: the distinction between

- the amount of compensation paid to suppliers (/BRPs) of participating consumers; and
- who pays it, i.e. how should this burden be shared among market parties.

Indeed, the CP suggests that suppliers may wish to receive a compensation at spot price (day ahead market price). Starting from this point, the discussion should then move on to the second issue: who should pay for this.

The CP seems to take for granted that any payment should be charged to DR, thus leading to concerns whether this would *"facilitate the growth of DR in markets without discriminatory treatment or creation of entry barriers"* (as mentioned in the first question of §17 of the CP).

Indeed, such compensation approach would mean both creating a radical barrier to DR (as already mentioned) and a huge bias versus generation, as opposed to the non-discrimination rule set forth in art.17-1 of the ED.

The solution is provided by art.17-4, the first sentence of which says that Member States may require a compensation be paid by various market parties, not particularly by DR aggregator. Indeed:

- charging the full burden to DR would create a barrier to DR
- there is no reason to charge DR.

This last point should be highlighted too. In the CP, the description of market model II begins (§ 7.2.1) on the assumption that there would be a need for *"accounting of the energy exchange between the aggregator and the consumer's electricity supplier/BRP"*.

Such an accounting rule lead to the total failure observed in France. But it can be avoided (and must be, according the new ED). Indeed, although widespread, this assumption is erroneous.

The key aspect here is that there is no energy to be exchanged, because DR is not based on energy generation: it is an *alternative* to generation, and is based on reducing consumption.

De facto the more DR is used, the less generation is, and not the more. DR is not based on reselling energy generated by others, but on avoiding energy being generated and consumed.

Hence the solution is straightforward: should Estonia wish to compensate suppliers at spot price, there needs to be a rule to share the burden among parties. More precisely, **the burden should be shared among all electricity suppliers**, because these are the market parties who benefit directly from DR (as rightfully mentioned in the CP, trading DR on the markets will reduce market prices, and thus reduce sourcing costs for electricity suppliers). Then the simplest rule is to **share the costs among suppliers pro rata their market share, so that they end up sharing evenly these costs exactly as they share the benefits of DR (via the market).**

There would be only one case where DR would also contribute to compensation costs, and this would be if it were established that the benefits of DR to suppliers² would not exceed the costs. Until this is proven, no compensation costs should be charged to DR, thus ensuring no discrimination versus generation, and no barrier created that would impede DR.

To summarize, choosing "model II" could be an effective approach to foster DR in Estonia and properly transpose the directive regarding DR, **provided the following vital change is made: compensation cost should be shared among suppliers (via a 'neutral' entity), just as benefits are (automatically via the market).**

DR4EU would be happy to provide further insight on how to implement such model II-s, in a consistent approach with the other provisions of the directive, and with the other aspects mentioned in the CP, whether analyzed therein or suggested for further analysis later on.

Besides, DR4EU would also be happy to share views and methodologies, based on experience from various countries, on the determination of the benefits of DR (as set forth in the ED).

Should the drafters of the CP agree, DR4EU would be more than willing to participate in any (e-)meeting they would wish to organize to cover any of those aspects.

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² The benefits of DR mentioned in the Directive are not vague 'socio-economic' benefits, but precisely the benefits to all suppliers, and, insofar as suppliers pass them on to their clients, the benefits to all consumers.