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## ***Relations in regulated and non-regulated market segments and their impacts on retail prices***

High-level Policy Talks on the Electricity Market of Georgia

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# The European Electricity Acquis



- **Regulated segments of the market: Networks (transmission and distribution)**
- **Non-Regulated segments of the market: Generation and Supply (including balancing and AS procurement)**
- **Special Regime for “special type” of supply services: Universal Service and Supply of Last Resort**
  - prices for such services should be comparable and based on market mechanisms
  - where the sector undergoes a transitional period, prices can be regulated and for the universal service linked to regulated upstream arrangements

# Competition in retail tariffs and wholesale markets



***The ultimate goal: to decrease costs for consumers through competition in the retail tariffs***

- ***The conditions for true supply switching are met***
- ***Third Suppliers can go to different market places and compete on equal terms in purchasing electricity quantities***
- ***Such market places should be able to offer them products that meet all their needs from forward hedging, to bulk energy supplies, balancing needs and forecast errors***

# The link between retail and wholesale



- *Retail prices should be linked and reflect competitive wholesale generation prices: market based retail prices of the Clean Energy Package*
- *The European electricity markets have been designed on the basis of passing wholesale costs to retail tariffs on an unbiased way*
- *If there are distortions at the wholesale level, including non market based contracts, this will be transferred to part of the retail sector*
- *Competition in the supply business can be implemented progressively (e.g. de –regulation of prices for large consumers and exporters first)*
- *To allow competition in the prices large consumers and exports face, we need to create space where some part of the generation can truly compete*



# Why Large Consumers and Exports deregulated first?



- ***Cross subsidization among customer categories has to be eliminated and they are the first (usually) suffering from corresponding practices***
- ***Possibilities for direct negotiations on purely commercial arrangements***
- ***They do not benefit from Universal Service or SoLR supply services***
- ***They have means to adopt to price signals***
- ***Hourly metering***
- ***It is essential to secure that local consumers are not cross subsidizing exports and therefore exports should be purely based on price differential with prices freely set***

# Long term PPAs

- **Long Term PPAs: guarantee income for a long term period (10 or 15 years)**
- **This brings a degree of regulation to the generation- supply chain**
- **Incorporating such Contracts into the electricity market brings distortions in the way the total system operates and the final tariffs are calculated**
- **Two sources of distortion: regulated generation and PPAs**

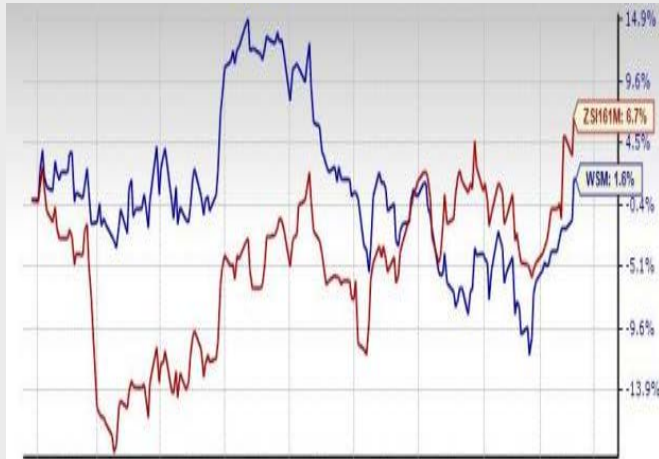


# Current tariffs regime in generation



- **Tariffs for HPP with seasonal storage are regulated by GNERC**
- **Some other HPP are receiving partially deregulated tariffs with ceiling caps**
- **Some HPPs constructed after 2008 as well as other under construction have agreed PPAs in place**
- **So more or less apart from a small portion of freely negotiated contracts with local distribution companies or consumers or exporters, the rest of the sector is non-market based**

# Space for wholesale competition



- **Forward arrangements allowing for physical contracts between generators and suppliers/consumers**
- **Trade through organized spot markets (Day-ahead and Intra-day markets)**
- **Physical forward contracts should be allowed as they facilitate even small generators to perform “simple” contractual arrangements without entering the risks and costs of participating to PXs**
- **Liquidity in to the spot markets, mainly the day-ahead market, can still be safeguarded through appropriate rules**





## How to deal with PPAs (1 of 3)

- *If PPAs are transformed to financial CfDs with obligatory participation to the spot DAM a certain degree of distortion is inherited to the new market*
- *Holders of the CfDs will have incentives to press prices low*
- *Indifferent in the market price outcome*
- *Exposing the central counterparty to some considerable financial risks*
- *The only positive argument is that the liquidity of the DAM is increased though in the shake of the fair costs reflectivity*



## How to deal with PPAs (2 of 3)

- *Investments have been made or are scheduled on the basis of corresponding contracts*
- *CfDs perfectly incorporate the volumes but not the income expectations and therefore there should be a plan to progressively move away from such “price guarantee schemes”*
- *Georgia needs to develop a plan on how progressively such generation could be incorporated into the energy market and start receiving from it the vast majority of the income expectations*



## How to deal with PPAs (3 of 3)



- *If overall the CfDs provide for prices lower than the market price then the PX does not face financial risks but surpluses*
- *CfD receivers will have an incentive to leave the contract and bid to the energy markets where prices are higher*
- *So eventually this will incorporate the PPAs (transformed to CfDs) both volume and cost wise into the market*
- *If the overall CfDs prices are higher than the market price then the PX was a deficit which needs to be fairly transferred to all*

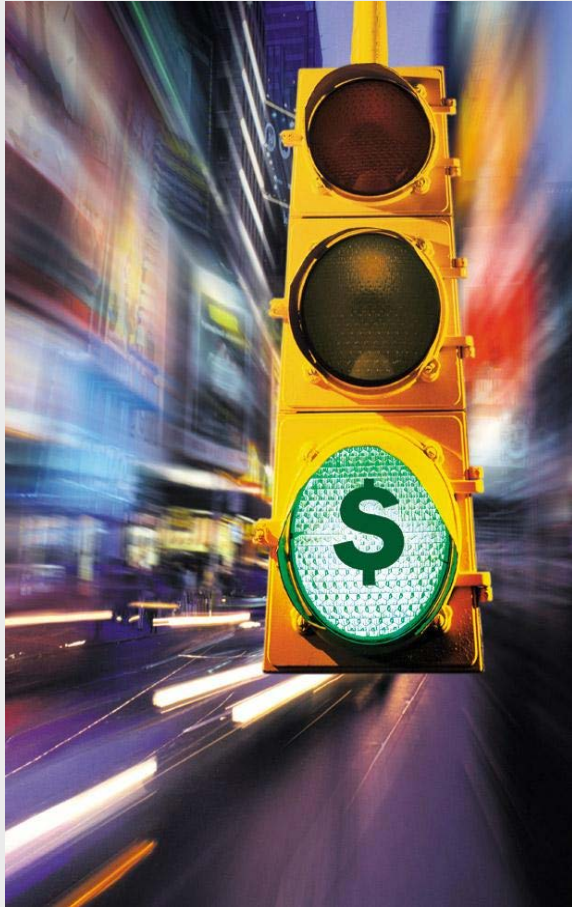


## *How the Universal Supply is involved in the process*



- *In case of surplus and for a transitional period such surplus to be passed to retail tariffs for household consumers and small businesses (through universal supply)*
- *A corresponding detailed methodology needs to be drafted and approved by GNERC*
- *In case of deficit the corresponding amount if only passed to universal services recipients: exports and large consumers are subsidized*

# Cross subsidies in retail tariffs need to be eliminated



- *Cross subsidies among customer consumers need to be eliminated in due time*
- *Depending on weather overall PPA prices are above or below the market price of the rest generation competition we might have either an easy and relatively automatic deregulation process or (2<sup>nd</sup> scenario) we might need to proceed with a more complex plan*
- *The deficit will need to be passed to all consumers (large, small and exports) i.e. there will be a Public Obligation imposed to the Central Counterparty of the CfDs to collect money not only from the Universal Supplier but from all consumers to reimburse the corresponding deficit*

# Progressively moving to free prices



- ***In both cases the move to free prices for consumers is done progressively***

***In the first case the market incentives will eliminate the CfDs***

***In the second case a plan needs to be agreed on how to progressively phase out the mechanism for deficit collection***

***The PSO imposition to the Counterparty (PX) and through it to all, on equal terms, does not directly affecting competition though is still distortive as the price at the spot market is not reflective***

# Electricity SoS

- *Any regulatory measures undertaken or adopted for the purpose of Security of Supply shall be non-discriminatory, **shall not distort conditions for competition and price signals on the electricity market** to the extent higher than the minimum level necessary, and **shall not place an unreasonable burden on electricity market participants, including new entrants and undertakings with small market shares**. Such measures shall be also justified on their economic and social effect to the final customers in Georgia, including their possible impact on electricity prices*





# Monitoring of electricity market performance

## ***GNERC should***

- ***Monitor the level of prices at the spot markets***
- ***Should further follow on an hourly basis the difference between the weighted average PPA price and the spot market price***
- ***Take measures to eliminate cross subsidies among categories to those retail tariffs that still remain regulated***
- ***Monitor whether the deficit is progressively decreasing***





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*Thank you  
for your attention!*

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