

Tuesday 11 November 2008

**ERGEG consultation paper of 10 September 2008:**

**European Regional Initiative Coherence and Convergence Report (Ref: E08-ERI-13-03)**

**E.ON AG response**

E.ON remains strongly supportive of the regional initiative approach towards the integration of European power markets. We are actively contributing to the development of markets in six of the seven regions. The latest Coherence and Convergence Report issued by ERGEG provides a welcome opportunity to review progress. The Report itself provides a useful and impartial summary of both recent achievements and current obstacles.

Our main observations from the Report are:

1. Inter-regional harmonisation

We acknowledge that it would ultimately be inefficient if individual regions were to progress their projects in complete isolation. However we caution against premature efforts to draw up a detailed and fully-harmonious EU-wide market design. The separate regional initiatives still represent complex technical and commercial projects, meaning that opportunities to advance inter-regional convergence have necessarily to be focused on incremental steps in the short-term.

It would not be feasible to give some regions or specific projects priority status,<sup>1</sup> as to do so objectively would require that regions are scored against each other according to a set of criteria. Just setting such criteria would be both difficult and unduly time-consuming. We maintain that it would be highly undesirable for any viable market integration project to be delayed to give priority to another.

Our solution to accelerate progress is therefore to give priority, not to certain regions or interconnection projects, but to establishing those common inter-regional *market features* that will clearly promote greater flows of trade. In short, different market coupling or market splitting systems and algorithms can be set up alongside each other successfully, and at different rates of progress, if the basic market framework is made more standard and the big obstacles to cross-border trade are removed.

---

<sup>1</sup> Paras 7 & 176

## 2. Transparency and timing

Accepting that the individual regions can continue to be developed in parallel, inter-regional convergence can be achieved by selecting and standardising key market features. We consider these to be any feature of market design that potentially provides an arbitrage advantage to one trading party over another. High on our list are the provision of power market data (transparency), and the harmonisation of day-ahead gate closure times and generation plant scheduling deadlines (timing).

On transparency, fair trading and accurate price discovery would be advanced with an earnest push to make at least a minimal list of key generation data available to all. Some markets have already achieved an appropriate standard, the chief example being the Nordpool Rulebook. Progress towards an equivalent standard is important for the intensively interconnected markets like Central West and Northern; for data used to determine scarcity in markets such as available generation capacity; and for markets without power exchanges or accessible price data. We believe that a fairer disclosure of information will promote trade and could prove to be a ‘quick win’.

Many of the highlighted transparency measures are yet to produce real improvements. We therefore look forward to analysing the results as new data becomes available, for example from the new studies of internal congestions on cross-border transmission capacities mentioned in the Report.<sup>2</sup>

On timing, we concur with previous recommendations<sup>3</sup> that there needs to be more pressure to make the move to a standard 12:00 gate closure for day-ahead markets happen. Accompanying this should be an agreement to harmonise scheduling times.

To overcome both of these barriers to trade it is reasonable to suggest that a show of political will is required, where national markets are developing more slowly than anticipated. We recognise ERGEG’s perception that not all parties seem fully committed.<sup>4</sup> For example, we do not think it a convincing argument to suggest that where transparency rules differ, it is because the Congestion Management Guidelines are insufficiently specific. Where disagreements over transparency obligations have occurred, such as in the South West region, the solution whereby transparency requirements are referenced to the reports of other regions is to be applauded.<sup>5</sup>

---

<sup>2</sup> Report due for autumn release mentioned in para 192

<sup>3</sup> Frontier Economics for the Central Europe West regulators (August 2007), “Harmonisation of gate closure times”, London

<sup>4</sup> Para 175

<sup>5</sup> Paras 134 & 135

### 3. Auctioning

The establishment of central auction offices in each region encourages greater flows of trade and should continue to be pursued. We believe that the establishment of auction offices is an appropriate way to harmonise inter-regional markets. It is beneficial to trade to have in each region a common set of auction rules and a 'one-stop-shop' single office. This prevents the need for traders to have to register, provide bank guarantees and connect to IT systems many times in different countries in one region.

### 4. Intraday and balancing markets

New mechanisms for the intraday congestion management of interconnectors will promote trade and must be considered as a priority market feature. The Congestion Management Guidelines had required these mechanisms to be established by January 2008 at the latest.<sup>6</sup>

Intraday markets will also provide market participants with more tools with which to balance themselves. It should be expected that intraday trading will leave Transmission System Operators (TSOs) with smaller imbalances to manage. We therefore view balancing markets to be a residual feature to intraday markets and would not think it appropriate for interconnector capacities to be reserved for balancing.

### 5. Regulated retail tariffs

Regulated retail tariffs are a major barrier to developing cross-border trade and should be considered alongside wholesale market convergence activities. The persistence of this practice in large national power markets is detrimental to competition and to regional integration. With a properly functioning retail market, companies are forced, by competitive pressure, to procure wholesale energy at the lowest cost, which in turn guides efficient investment. Regulated prices are unlikely to be set at the appropriate level to encourage both investment and competition. Typically prices are set too low, preventing suppliers from funding adequate investment, or even from entering a new market at all if they are unable to cover their wholesale costs.

---

<sup>6</sup> Article 1.9

## 6. Capacity calculation

We accept the long-term market design consensus that concentrates on establishing day-ahead liquidity with, where it is feasible, implicitly auctioned capacity rights.

As there is much work to do before this can be achieved everywhere, all incremental improvements in the accuracy of capacity calculation are to be welcomed. For example we agree that in Central South, it would be a big step forward to have monthly, weekly or, ideally, daily Net Transfer Capacity (NTC) calculations instead of the annual process we have at present.<sup>7</sup> A further priority must be to achieve the netting of nominated long-term capacity applied on all borders, which is again an obligation under the Congestion Management Guidelines.<sup>8</sup>

With regard to Flow Based Market Coupling (FBMC), it is disappointing that the results of early studies suggest that what is an optimal capacity calculation method on paper may not produce sufficient commercial opportunities in practice.<sup>9</sup>

FBMC should not be brought to the market until it can be proved that it will provide at least as much capacity for sale as is available at present, and in a way that is sufficiently transparent for market parties to understand the methodology. Trading can continue with Available Transfer Capacity (ATC) or NTC calculation methods for as long as it takes to properly scrutinise flow based results. Here we would question the Report's observation that often progress is hindered by the presence of too many parties.

We would argue that too few parties have been involved in the work to develop better capacity calculation methods. Of course we recognise that the TSOs have the appropriate technical expertise for initial work on the inherently complex models and algorithms. However at the same time we would point out that such technical efforts would be wasted if they produced a market platform that is not conducive to trading.

It is for this reason that we emphasise that TSOs should have equal incentive to produce system security and optimal commercial capacity. Furthermore, solutions should be avoided that are technically efficient but fragment the market by basing capacities on nodal generation points.

In terms of previously set target dates, even at this late stage the market has little understanding of the components of flow based algorithms and, crucially, what the effect will be on prices. ERGEG is the

---

<sup>7</sup> Para 77

<sup>8</sup> Article 2.6b

<sup>9</sup> Para 11

appropriate organisation to ensure that commercial trading parties are given access to example capacity models on which they can base their own tests and contribute to the work.<sup>10</sup>

In summary, it may be sensible to acknowledge and accept delays in challenging market coupling initiatives and, while work continues, focus in the short-term on setting up common market features such as standard auction procedures. The issue of optimal capacity calculation highlights that convergence is a challenging task and is unlikely to be accelerated by mandating a rigid master design.

#### 7. Dome Coupling

We suspect that too much significance is given to the problems potentially created by the existence of overlapping regions.<sup>11</sup> The different regions have different characteristics: the degree to which networks are meshed, the predominant use of OTC trading or a central power exchange, and whether there is a merit order and central dispatch or self dispatch. It is essential that the inter-regional market integration process can tolerate some differences in market design.

Where countries participate in more than one regional initiative – and where different border characteristics mean that a country has to be a component in more than one algorithm – the capacity allocation problem can potentially be resolved through a central coordinating office. This so called Dome Coupler solution has the potential to address many of the perceived inter-regional convergence questions. We believe that serious development work on it should be given status above suggestions that convergence can only happen if one project is sacrificed for another.

#### 8. Accountability

European power market integration is of central importance to E.ON and we have taken ambitious steps to encourage free trading in those national markets where we are a significant player. ERGEG's suggestion of a region-by-region review<sup>12</sup> could be an appropriate method of ensuring that all parties are serious about tackling the obstacles over which they have control. The success of such reviews would be subject to having explicit and very short terms of reference, where each identified barrier to trade is designated to an 'owner' to which direct responsibility is given for addressing a solution. Timetables are always likely to be subject to change but these reviews could at least provide an unambiguous record of the main barriers to trade.

---

<sup>10</sup> Para 208

<sup>11</sup> Para 213

<sup>12</sup> Cover note

## 9. Governance

We agree that a governance body with legal authority is required wherever an implicit allocation area is created.<sup>13</sup> Such a body need not be overly bureaucratic. The essential functions will be to uphold a set of clearly defined rules for capacity calculation and allocation, and to allow the market to continue to develop with an efficient change process. Any party registered to the governance body should be able to propose operational changes, providing proposals are thoroughly prepared and perhaps subject to a threshold level of support from other parties. Such a system would ensure that integrated markets remain fit for their primary purpose, which is to encourage cross-border flows of trade.

The Coherence and Convergence Report has provided both a useful summary of the current status of the Regional Initiatives and an opportunity to clarify our own ideas on how to accelerate progress. In conclusion, the original reason for having Regional Initiatives is still valid: power market integration is complex and will be achieved more quickly through incremental steps; with each achieved among a smaller number of parties. We believe a detailed and fully-harmonious EU-wide market design would be unworkable at this stage and that there is no fair or reliable way of giving preferential attention to certain regions or projects. If such priority status were given, it is quite possible that a good project could end up being sacrificed to focus on an ultimately unsuccessful one.

However as it is important that inter-regional coherence is considered, our suggestion is to draw up a list detailing the key market features that should be standardised. Crucially, such a guiding plan should allow work to continue at regional level. We emphasise that further progress will best be achieved if all regions work on establishing common market features, such as transparency standards, timing, auction systems, auctions rules and intraday trading mechanisms. These measures promote cross-border trade and still allow for a degree of tolerance of the different market designs found in each country. It goes too far, and risks creating an unmanageable super-project, to say that the all but one market coupling proposal should be stopped; particularly before a potential solution to couple the regions has been properly explored.

---

<sup>13</sup> Para 177