

# EREG DRAFT STRATEGY FOR DELIVERING A MORE INTEGRATED EUROPEAN ENERGY MARKET: THE ROLE OF THE REGIONAL INITIATIVES

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A EURELECTRIC Response Paper

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# EURELECTRIC RESPONSE TO THE EREGG CONSULTATION "DRAFT STRATEGY FOR DELIVERING A MORE INTEGRATED EUROPEAN ENERGY MARKET: THE ROLE OF THE REGIONAL INITIATIVES"

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With contribution from the WG Regional Implementation and the WG Gas

## **EURELECTRIC response paper to the ERGEG consultation “ Draft Strategy for delivering a more integrated European energy market: The role of the Regional Initiatives**

### **Introductory remark**

EURELECTRIC welcomes the effort to re-evaluate and possibly re-calibrate the strategy to achieve EU-wide market integration by improving the ERGEG Regional Initiatives process and, for electricity, by determining (possibly fewer) well defined regions in the light of the ongoing integration of markets. The most important question should be which lessons can be learned after some years of experience with regional markets development and the related ERI.

EURELECTRIC points out that ERGEG consultation comes at the right moment as the 17<sup>th</sup> Florence Forum on 10-11 December 2009 agreed upon a European target model for electricity market and related tentative roadmaps. We believe this model is a positive development and should be used as basis to make further progress.

More work is, however, needed to further develop a thorough design of the target model and the related roadmaps. In our view, this work can be done within the three implementation projects that will be launched in 2010 in accordance with the decision of the Florence Forum in December 2009.

As far as gas is concerned, the regional initiatives have helped foster progress with due respect to regional features and have contributed positively to the overall objective of creating the European gas market. At this stage, we welcome the intent of engaging in a forward-looking discussion as it will provide the GRI with further guidance on a long term strategic vision. It could be advisable starting a process similar in goals, scope of work and composition as in electricity whilst at the same time paying due consideration to the gas specificities.

In a nutshell, the strategy to drive integration forward should consist of:

- Finalising as soon as possible the target models and roadmaps for electricity
- Identifying where appropriate target model and roadmap for gas, with particular focus on cross-border market design features
- Assessing what role ERGEG Regional Initiatives can play in the implementation of the target models
- Making progress – in the case of electricity - on the three concrete implementation projects (as agreed and launched by the recent Florence Forum), ie. day-ahead market coupling governance model, a European intra-day trading platform and a common grid model
- Recalibrating functioning and possibly – in the case of electricity - geographic remit of the existing regional initiatives.

EURELECTRIC is willing to contribute to this exercise with its expertise and its constructive approach in finding agreement with all stakeholders and policy makers.

## 1. Questions - set 1

*There is no 'blueprint' for achieving a single energy market, and yet activity towards that goal is taking place across a number of levels. Do you consider that a high level / strategic vision is needed to set the overall direction of market integration?*

### Combining a top-down strategy with bottom-up pragmatic best practices

Regional approaches match current reality of energy markets integration and in many cases reflect the appropriate geographical scope of an issue. EURELECTRIC believes that regional markets are the main stepping stone to market integration as greater regional cooperation will facilitate pilot testing, development and benchmarking of best practices. To enhance the pivotal role of regional markets we deem it therefore necessary to strengthen the mechanisms surrounding regional cooperation and improve the ERI as a way to achieve quicker integration.

At the same time we recognise that a top-down strategy is needed to ensure coherence and convergence. Up till now, coordination and streamlining of regional integration at European level has shown room for considerable improvements. We believe that rather than a high-level vision of how to achieve a single energy market, there should be a concrete roadmap towards agreed target models to which regions can refer to orientate their next steps.

In this context, it is crucial to use the momentum created with the European target model for electricity markets as adopted at the recent Florence Forum by all stakeholders and policy makers. This model should be taken up as a basis for further elaboration on a more detailed level within the framework of the implementation projects and drafting of the Framework Guidelines and Network Codes. We believe that this work will allow moving forward with the implementation rather than re-opening time consuming debates or duplicating similar exercises.

EURELECTRIC recognises the value of **bottom-up initiatives and interim solutions provided that they develop in a consistent manner with the relevant target model** and accelerate and simplify, rather than slow down and complicate the integration process.

This requires that these local/regional initiatives are closely coordinated and monitored in order to make them compliant with the target model. For those initiatives that will prove to be inconsistent with the target model, pragmatic steps will have to be identified and planned to align them up with the target model. Therefore, the top-down guidance and the bottom-up implementation should be part of the same strategy and converging together towards the same goal. Besides, we think a stronger political will is required to set up the legal and regulatory basis for market integration.

In addition to that, we consider implementation of the target model as an urgent task in order to eliminate existing inefficiencies in cross-border trade between or within the regions. In some regions, removal of export/import limitations, increasing transparency in capacity calculation and allocation process as well as defining incentive schemes for maximising available cross-border capacity are among issues that should be tackled.

In the "top-down" context, EURELECTRIC welcomes the Florence Forum decision to continue this work within the ERGEG Ad Hoc Advisory Group (AHAG) and to entrust it with a task of

coordinating different implementation projects. We also believe that AHAG should have a role in coordinating the existing regional initiatives as well as advising new bottom-up initiatives on their consistency and appropriateness in relation to the target model. Care should be taken to avoid (new or additional) inconsistencies in the cross-border projects<sup>1</sup> that might result in delaying the overall end goal. We are also concerned about the parallel existence of competing<sup>2</sup> projects, which aim in principle to achieve quick market integration on a scale smaller than regional, but at the end might result in less harmonised products for the markets and rather be used for fulfilling the economic interests of some particular stakeholders.

EURELECTRIC also strongly supports the need to reach agreement between all major stakeholders on a roadmap with clear milestones and deadlines. The roadmap should be based on a realistic view reflecting a possible natural path of market integration, in which most advanced regions join together (or expand their geographic dimension) first and the less developed regions join them in later phases. This “natural” horizontal expansion process has been proven most successful in the past, e.g. the creation of Nord Pool, the stepwise implementation of market coupling in CWE (via an intermediate TLC step between three of its markets). Such a horizontal expansion model has the advantage that fast progress can be made where the necessary conditions are fulfilled. However, it has the drawback that the used technical tools might need to be updated or changed from time to time,<sup>3</sup> but this should not be insurmountable: waiting until the final optimal technology is found would have definitively withheld more social welfare.

We propose a three-fold approach:

1. Develop EU-wide target models: as some of them already have been provided by the PCG work, to set the overall direction of market integration – knowing that during the design phase many delaying factors are still out of sight but they do exist. In case such target models have been already sufficiently agreed, implementation should start at regional level with no delays. As progress is achieved on the ground, tools for reaching the target models may have to be updated accordingly to reflect the experience of the regions and most pragmatic way to implement the overall EU market design. By and large the same is true for best practice that can be shared between regions.
2. Best practice Triple A implementation, Where Triple A stands for:
  - Assessment of existing market design best practices and eventually incorporation of those features into a target model (on several aspects of

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<sup>1</sup> Germany and the Netherlands are the markets currently involved in 2 market coupling projects (EMCC vs. CWE, Britned vs. NorNed cables), although the early position from the Europex ETSO report was that such developments should not happen.

<sup>2</sup> Eurelectric is currently aware of 2 initiatives to implement continuous trading, one between the Netherlands and Belgium, a second one between the Northern Region, Germany and France; while both projects are welcomed and should be encouraged, they leave a gap on Dutch/German border and French/Belgian border, therefore not complete and potentially not consistent to cover the whole CWE region. At the same time, the NorNed cable is also not included, leaving a gap between CWE and NE region

<sup>3</sup> For instance, though both in NE and in CWE day-ahead capacities are allocated via an implicit allocation, further integration between both regions will require that either one or either both algorithms are replaced by another one.

congestion management this stage has already been achieved by the PCG together with consultation of the regions)

- Possible adaptation of the needed tools to reach the target model to the specific needs of the regions, provided an adequate level of harmonisation is ensured
  - Application of agreed target model in all the regions consistently based on pragmatic spread of “best practices” and taking into account progress achieved so far
3. Put in place an appropriate body overseeing and supervising the different implementation steps and giving advice on the appropriateness of each step while having in mind the roadmap to achieve the target, and while being flexible in order to review or update the roadmap if developments are faster or slower than initially planned. ERGEG together with the AHAG could take up this role in a first phase, later on, ACER, preferably supported with the input of a further elaborated AHAG group could continue this “top-down” guidance.

#### *Should this vision be the same in gas and in electricity?*

Principally yes. At this stage there is not yet a clear vision for the gas sector regarding the final goal. Therefore, a target model could be analysed as a way to establish the priorities and the necessary harmonization and coordination of the whole process. Specificities due to geography and of course due to the product have to be assessed issue by issue and may have their impact on the target model and on the roadmap.

It is very important to achieve a well functioning and integrated gas market as well, because it is an important underlying market for the electricity market.

The reasons to differentiate between gas and electricity are various and include among others the following:

- Gas is to a large extent imported into EU-27.
- Gas has all in all a limited number of “entry” points to the continent.
- Gas has a limited continental sourcing, most of it is “produced” globally in the world, and still here, there is a kind of “oligopoly” of gas producers world wide
- Electricity can only be stored to a very low extent in other energy sources (mechanical energy like pump storage, chemical energy like batteries).
- Most of the gas costs are infrastructure related
- Gas regulation in producing and transit countries can deeply affect gas availability conditions in the final destination market.

Nonetheless, the differences mentioned are not of principal nature. They give rise not to copy paste every detail.

*How do you think it should be formed, and who should be involved? Which sort of forum do you think would be appropriate for the development of such a strategic vision?*

On several occasions (outside of the PCG process) experience has shown that the input of market parties has been sought either insufficiently, non-transparently or in a non-structured way (the recent EC Review of the Regional Initiatives confirms this). This could be overcome best by an open dialogue stakeholder platform similar to the one of the Project Coordination Group (PCG). Whilst such a platform is well-suited to coordinate progress and discuss solutions, it is not intended and should not have as an effect to replace formal consultation.

*Do you see a risk that developing a strategic vision may delay implementation in the regions under current structures, or that it could facilitate progress?*

Yes, there are risks. However, as suggested above, if consistency and coordination between the top-down guidance and the bottom-up implementation are ensured, progress will be significantly facilitated. Coordination, giving guidance and monitoring will be key for success. In our view, this could be done efficiently by ERGEG/ACER in conjunction with the recently established AHAG (in line with the conclusions of the 17<sup>th</sup> Florence Forum).

## **2. Questions - set 2**

*Member States have an important role in establishing a legally binding cross-border regulatory framework, as well as in relation to their own Member State's interests. Work in the Regional Initiatives will be very relevant. Do you agree that Member States should be more closely involved in the work of the Regional Initiatives? If so, how should this happen?*

We agree that Member States should be more closely involved in the ERI in order to provide stronger political support for the market integration process. Active participation of Member States could facilitate full enforcement of the rules and decisions agreed and ensure constant cooperation among all the Member States of the Region.

We recognise that in a number of regions political support reflected in signing memorandums of understanding ( in CWE in 2006 and most recently in CEE) or engaging in creating a regional spot market (Nordic, Iberia) gave a strong impetus to making progress in market coupling projects. This governmental involvement has been able to provide useful guidance with regard to overall strategic direction and help take the necessary steps to overcome incompatibilities in national legislations and regulatory frameworks.

With regard to the organisational aspects of Member States' involvement into the work of ERI, it is important to ensure efficient representation of Member States. In order to avoid the risk of "overloading" the consultation process with too many actors Member States representation could be initially organised with one official per member state and evolve to one single (rotating) official per region that would take charge to report to all the other Member States of the region, or to the Council of Ministers as a whole. For certain stages of

the process, it may be sufficient to have the Member States as “observers” or simply ensure that they have constant access to the information flow and the status of the progress<sup>4</sup>.

There should also be a distinction between the discussions of “technical issues” (to which government officials may not be necessarily involved due to lack of specific competence), like for example the work carried out in the past by the “work streams” of the PCG, and the discussions of “high level issues”, where government involvement, understanding and commitment is essential to speed up the integration process.

Member States’ involvement in the ERI could improve dialogue between governments and other stakeholders and increase mutual understanding about legislative or regulatory changes on the national basis needed to make further progress in establishing regional market design solutions and well functioning electricity market.

### **3. Questions - set 3**

*There are currently 7 electricity regions in the ERGEG Regional Initiative, and 3 in gas whereas the overall target is to create a single region – the Single European market. How should the number of regions in the ERGEG Electricity Regional Initiative evolve towards a single market? Should the number of regions be reduced?*

*And/or should specific topics firstly be merged across the regions? Which regions do you think should be merged or topic areas reconfigured, and what criteria should be used in reaching a view? How many regions should result initially, and what topics might be reconfigured?*

As for gas, the number and geographical scope of regions seem to be appropriate at the current state of play. However, as gas crosses several EU countries before getting to its final market destination, the interdependency among EU countries is very strong. Thus, with the improvement of physical gas exchanges between gas markets, it should be considered if some countries (i.e. Italy, Germany) should participate in more than one GRI.

The same logics applies to electricity where experience has shown that the automatic overlapping nature of regions has consumed huge resources in countries engaged simultaneously in several regions (as it does for the overlapping market coupling projects in CWE, SWE, FUI, CSE). The problem of “overlapping” regions might even increase when additional borders are created. At the same time, we recognise that none of the Member States should be forced to exit the neighbouring regions that have direct impact on its market and national grid. In other words, overlapping of regions should not be used as the main underlying principle, but can be employed where necessary. Moreover, we see a strong need for a horizontal structure (like ERGEG + AHAG) to have a larger role in observing, coordinating and monitoring consistent development of projects between regions.

EURELECTRIC also wishes to point out that electricity market developments and integration across regions has been very inhomogeneous: the ERI, in our view, have had an unintended effect of widening the gap between the less and more advanced regions. Therefore,

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<sup>4</sup> On the same issue, please see for more detail EURELECTRIC response to the Everis Mercados report « ‘From Regional Markets to a Single European Market’ ».

EURELECTRIC urges policy makers to build up a comprehensive strategy – underpinned by a concrete roadmap - aimed at increasing convergence and bridging the gap so as to develop more mature and consistent markets across the EU.

The cornerstone of this strategy should be defining the market fundamentals necessary to develop liquid wholesale markets in the CEE, CSE and SEE. Increasing liquidity of wholesale markets is one of the main prerequisites for implementing the target model for congestion management agreed at the last Florence Forum in December 2009.

One could say that a “birth defect” of the regional concept has been that it does not differentiate between :

- a geographic core and
- countries linking this geographic core to other regions.

However, for the sake of pragmatic progress the degree of homogeneity for the core countries (e.g. Iberian market or Nordic market) ideally has to be much higher than the degree for countries building a bridge to bordering regional markets.

Depending on the degree of maturity of regions it should be promoted that advanced regions combine their efforts in certain projects. This may for instance be true for the Northern, the Central-Western and the South-Western Region for:

- day-ahead market coupling
- intraday market design.

However a single market goes beyond the mere integration of wholesale markets but also encompasses retail (e.g. switching procedures, connection rules for new generation units etc.). So it seems to be premature to completely merge regions. Secondly, there is a danger that the process of redesigning the regions might take too much time and diverts the focus from practical implementation to procedural questions. Thirdly, there is a risk of creating super-regions which might develop much slower due to the number of parties involved.

In some cases regions do not cover all relevant members as bridging countries are not part of the region (e.g. Austria in Central West). Also the role of Switzerland has to be clarified. Given its central position and its high interconnection capacities, Switzerland should play an active role in ERGEG Regional Initiatives. EURELECTRIC would advice to bring Austria and Switzerland (subject to their adhesion to the market integration rules) into, at least, the CWE region.

As for gas, a first step could be to identify a proper target model and road map. Given that local specificities could seriously affect the speed and even the mere possibility to implement regulatory reforms, convergence should be pursued through a step-by step approach.

## Questions - set 4

*Not all regional market projects are part of the ERGEG Regional initiative, and yet the achievement of a single European energy market is the goal of all such regional projects. Do you agree that the regional market initiatives which are outside of the ERGEG Regional Initiative should be incorporated in some way in the overall approach to achieving a single European energy market? How do you think this should happen? If you disagree, what role do you think these initiatives should have and how do you think convergence of European markets should be achieved?*

see comments to question 2

## 5. Question 5

*Could ACER improve co-ordination across the regions in a better way than is proposed in this paper?*

We believe that an open dialogue and coordination of policies, projects and initiatives between ACER and other major stakeholders will be the key to achieve timely progress in regional market integration. In our view, a very strong impetus should be given by the work of AHAG – an open stakeholder platform – that will start functioning in the end of January 2010. As mentioned earlier in the response, in our view the primary role of AHAG will be to agree on the target model (to serve as guidance to the ERI), coordinate the agreed EU implementation projects and play a strong role in coordinating and monitoring the activities of ERI.

Further improvements could be achieved through more intensive consultations between ACER, ENTSO and the Commission during elaboration of priorities and their respective Work Programs.



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