



Draft Strategy for delivering a more integrated European energy market: The role of the Regional Initiatives

An ERGEG Public Consultation Document

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Executive Summary

The introduction of the 3rd Energy Package¹ creates a new context for the achievement of a single European energy market with the result that the overall approach to achieving a single market must be refreshed.

The measures in the 3rd Energy Package have the potential to accelerate progress towards a single European energy market through the establishment of new European institutions which will foster cooperation between regulators (i.e. the Agency for the Cooperation of Energy Regulators - ACER) and between TSOs (i.e. the European Network of Transmission System Operators - ENTSOs), the development of Framework Guidelines and the adoption of network codes through comitology which will establish a binding cross-border regulatory framework. The enhancement of regulators' powers in respect of cross-border issues will allow them to enforce their decisions. These measures, when implemented, will transform the context within which the Regional Initiatives (RIs) operate from an essentially voluntary one, to one with binding and enforceable rules.

The present paper examines the role of the Regional Initiatives (both those of ERGEG and other region-based initiatives outside of ERGEG's responsibility, such as the Pentilateral Group) in the context of the achievement of a single European energy market. Necessarily, the paper also addresses the question of the overall approach for achieving a single European energy market, although European energy regulators recognise that this is primarily the responsibility of other Institutions, such as the Energy Council, the European Commission (Commission) and the European Parliament (EP). Nevertheless, we hope that the ideas in this paper will encourage debate.

In the present paper European energy regulators propose, for consultation, that:

- An overarching strategic vision of the route to a single European energy market goes beyond this paper's scope, but one should be developed and maintained to provide a clear direction for the technical reforms which must be undertaken, in a way which involves Member States, the European Parliament and stakeholders as well as regulators. This vision could take the form of an ongoing dialogue on relevant issues which should assist with the timely and focussed development of Framework Guidelines and network codes, and with implementation at regional level. The Commission should consider establishing an appropriate forum to achieve this taking into account the need for quick progress on implementation, including in the regions;
- The framework within which the Regional Initiatives operate is significantly adapted to the new context so that they continue to complement the work towards a single European energy market. This includes:
 - the Regional Initiatives should be co-ordinated by ACER, and the utilisation of the Regional Initiatives to progress market integration should be an integral part of its work;
 - a deeper role for Member States and the Commission should be developed. When relevant, they should be invited to Implementation Group (IG) meetings in addition to Stakeholder Group (SG) meetings;
 - including Member States' representatives in each region on the circulation list for Regional Initiative projects relevant to that region;

¹ Ref: ACER Regulation (EC) No 713/2009; Electricity Cross-Border Regulation (EC) No 714/2009; Gas Cross-Border Regulation (EC) No 715/2009; Electricity Directive 2009/72/EC; and Gas Directive 2009/73/EC.

- feedback from Regional Initiatives into Framework Guideline and network code development;
 - regulators offering support to Member States' representatives in preparation for key discussions organised by the Commission, including the Florence and Madrid Fora;
 - reporting on progress by the ACER Board of Regulators to the European Parliament;
- The number of electricity Regional Initiatives should evolve towards the achievement of a single market. This could be achieved by reducing the number of geographic regions or by converging individual topic areas (such as capacity allocation) across a number of geographic regions² through common working arrangements - or both. We would welcome views on the right number of regions and on the question which regions should merge, or which topics might be reconfigured, as a result;
 - The Commission should consider how other regional market reform initiatives such as the Pentalateral Group, Gasplatform, MIBEL, the Single Electricity Market in Ireland, and Nordic Market could be incorporated into the single market project in a structured way.

Responding to the Public Consultation

ERGEG invites all interested parties to respond to this consultation paper, and in particular to the questions set out below. Responses should be sent by email to the following e-mail address: [Regional Initiatives Strategy Paper@erggeg.org](mailto:Regional_Initiatives_Strategy_Paper@erggeg.org). The closing date for responses is 31 January 2010.

Any questions relating to this document should in first instance be directed to:

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ERGEG welcomes respondents' views on our suggested approach; in particular responses to the following questions are sought:

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

² In electricity regional initiatives, common meetings are organised between two regions on specific topics for example on market coupling between Northern and Central-West.

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?

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?

4. 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?

5. Question 5

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

1. Introduction

- 1.1. The present paper fulfils a commitment given in the paper 'Implementing the 3rd Package: Next Steps' published by European energy regulators in June 2009³ which stated that:

"European energy regulators will, in the coming months, develop a detailed paper to define the role of the Regional Initiatives in relation to the 3rd Package for presentation at the Annual Conference on the Regional Initiatives which is planned for November 2009."

- 1.2. The commitment was included in the published ERGEG work programme for 2009⁴ in relation to its Regional Initiatives Group (RIG).
- 1.3. Of course, the Regional Initiatives are not, and were not intended as, a substitute for comprehensive legislation which would fill the regulatory gap identified by the European energy regulators in 2005⁵. The 7 electricity Regional Initiatives, and 3 gas Regional Initiatives were launched by ERGEG in 2006⁶ against a background where there was no immediate prospect of new legislation to accelerate progress towards a single European energy market. There are also regional projects which have developed outside of ERGEG's Regional Initiative programme, such as Nordic Market, MIBEL, MIB-GAS, Pentilateral Forum, and Gasplatform. In order to ensure convergence towards a single market, the ERGEG Regional Initiatives are coordinated through an ERGEG Working Group (RIG) established for the purpose and report on developments to the Florence and Madrid Fora. No such co-ordination arrangements exist for the non-ERGEG regional projects. The absence of a comprehensive cross-border regulatory framework gave rise to the 'bottom-up' approach inherent in the ERGEG Regional Initiatives as well as other regional initiatives, where progress would be made region by region on the basis of voluntary cooperation between the relevant actors, so that European consumers could benefit from incremental advances in competition and market integration.
- 1.4. Up to now, the Regional Initiatives have shown they can play a significant role in two main ways: firstly, they have acted as a facilitator of projects, being able to bring together all the different actors involved, encouraging dialogue for a common understanding on goals and priorities in the regions, and gathering the needed effort for carrying out this work; and, secondly, the Regional Initiatives have shown that they can help solve particular problems in the regions "on the ground", often dealing with disagreements and removing concrete obstacles that have arisen.
- 1.5. It is right, therefore, that all Regional Initiatives and regional projects be re-examined now that a comprehensive regulatory framework has been made possible through the adoption of the 3rd Energy Package. European energy regulators consulted on their initial considerations on the role of the Regional Initiatives in their consultation on the implementation of the 3rd Energy Package⁷. As recorded in the ERGEG conclusions

³ Ref: C09-GA-52-06a, June 2009.

⁴ European Energy Regulators' Work Programme 2009, Ref: C08-WPDC-16-03.

⁵ 'The Creation of Regional Electricity Markets', ERGEG, 8 June 2005, Ref: E05-PC-04-01.

⁶ ERGEG Fact Sheets, Ref: EO6-GMI-02-03d, PR-06-05.

⁷ Implementing the third energy package – an initial consultation paper by the European Energy Regulators, Ref: E08-PC-33.

paper⁸, the response to the consultation was that all stakeholders who responded on this point supported the continuation of the Regional Initiatives. The 3rd Package has since been adopted and contains explicit and important provisions for the development of regional markets in relation, for example, to the new objectives of national regulatory authorities, network codes, and the responsibilities of Member States and Transmission System Operators. This is welcome as, in the view of European energy regulators, European cross-border measures will inevitably be implemented in a regional manner because integrating markets is always a regional challenge: the need for physical interconnection in the case of energy markets means that neighbouring states have to work together on their local (regional) issues if they are to contribute to the creation of the single European energy market.

- 1.6. The present paper addresses the role the Regional Initiatives should play in achieving a single European energy market in the new context established by the 3rd Package which brings with it the prospect of a comprehensive, binding cross-border regulatory framework. Having identified a continuing need for both 'bottom-up' and 'top-down' approaches which are managed actively in a way that each complements the other, the paper identifies further steps which should be taken by the Commission and Member States to set the strategic direction of market integration. These steps are necessary to ensure that the wide range of market integration activities are well directed and convergent, that they are consistent with stakeholder ambitions, and are consistent with the new regulatory framework to be established progressively through the comitology process.

⁸ Implementing the Third Package – A conclusion paper, 11 March 2009, Ref: C09-ADG-04-03.

2. Future development of the single European energy market: 3rd Package measures

- 2.1. The 3rd Energy Package has the potential to accelerate progress towards a single European energy market through the establishment of new European institutions which will foster cooperation between regulators (i.e. ACER) and between TSOs (i.e. the ENTSOs), the development of Framework Guidelines and the adoption of network codes which, after adoption through the comitology process, will establish a binding cross-border regulatory framework, and the enhancement of regulators' powers which will enable them to enforce the legislation relevant to the internal energy market. These measures, when implemented, will transform the context within which the Regional Initiatives operate from an essentially voluntary one, to one with binding and enforceable rules.
- 2.2. Among the measures contained in the 3rd Package which are likely to accelerate regional market development there are:
 - (i) the introduction of Framework Guidelines and network codes which create cross-border regulatory rules facilitating trade between national markets, and ultimately their integration;
 - (ii) related to the previous point is the ability of the Commission to propose network codes for the comitology procedure which would make each relevant network code binding;
 - (iii) the enhancement of the powers and independence of national regulatory authorities (NRAs), together with the extension of their objectives to include the promotion of a single European electricity and gas market, and as part of that, the promotion of regional markets;
 - (iv) specific consideration of regional cooperation and regional market development as a complement to 'top-down' measures.
- 2.3. The 3rd Package places responsibility on specific bodies in respect of the measures envisaged, for example: Agency to prepare Framework Guidelines and provide an opinion on draft network codes; the two ENTSOs to prepare network codes and the 10-year network development plans; the Commission to make proposals to the comitology process; and Member States and the European Parliament in respect of the comitology procedure itself.
- 2.4. No formal institutional role is given to customers, network users, energy traders, DSOs and other stakeholders in the 3rd Package. We consider that stakeholders, as the recipients of the outcome of the single market process, should be closely involved in an appropriate way in determining the overall path towards a single market, in addition to their involvement in the various consultations relating to implementation issues. In devising the arrangements for the Regional Initiatives, European energy regulators have sought to ensure that stakeholders are closely involved in the development of regulatory proposals at both European and regional levels through formal consultation processes, the establishment of stakeholder groups, the sharing of information on developments and progress through the European Energy Regulators' website, and more recently through the possibility of establishing ad hoc expert working groups on specific issues related to the Framework Guidelines. The involvement of stakeholders as central participants in the development of reform proposals is a major success of the Regional Initiatives.

2.5. The section below considers the main 3rd Package measures which interact with regional market developments.

(i) *Framework Guidelines and network codes*

2.6. Framework Guidelines and network codes can be considered as ‘top-down’ measures. The overall intention is that the network codes apply across all Member States with the ultimate aim of establishing a single market (although some regional differences are explicitly provided for). The 3rd Package specifies 12 areas each in electricity and gas where Framework Guidelines and network codes may be adopted. These areas together comprise a comprehensive list of cross-border network interactions and so their potential as a tool for market integration is immense.

(ii) *Importance of comitology*

2.7. If network codes are to become binding rules, the Commission must propose the draft code for the comitology procedure. If the code is adopted through the comitology process with or without amendments, then it will become binding. Member State representatives and the European Parliament therefore have an important role in the overall process as they will have the power to amend, accept or refuse proposals for network codes. It is clear that political agreement by Member States at national and European level is an essential prerequisite for making progress and this must be taken account of in the development of single energy market proposals.

2.8. It is inevitable that progressive development of regional markets and of a single European market will mean change to existing national market arrangements. The adoption of network codes as binding instruments through the comitology process will commit each Member State to implementing these changes. A careful understanding of the proposals and the impacts they will have (which could be different in different Member States) will be essential during the comitology procedure. In order to fulfil their role in the comitology stage it is important that Member State representatives have an appropriate place in the development of Framework Guidelines and network codes.

2.9. The interests of Member State representatives in the comitology procedure would also seem to point towards an ambitious and realistic step-by-step approach to establishing a single market. It is acknowledged that regional differences could be unavoidable for a transitional period because of the widely different state of development of Europe’s markets. Experience in the Regional Initiatives suggests that if Member States are to be open to beneficial change in market rules, then they need to be closely involved.

2.10. These factors suggest that Member States, the European Parliament, and the Commission must have a strong role in the development of the steps needed to achieve a single European energy market. It also suggests that the Regional Initiatives should have a role in relation to pan-European Framework Guidelines and network codes, both in a practical way in their implementation and in a consultative capacity in their development.

(iii) *The enhancement of the objectives, powers and independence of NRAs*

2.11. The 3rd Package establishes a minimum set of regulatory powers which must be available to each NRA, which European energy regulators consider to be consistent

with the minimum set of competencies needed for them to undertake their functions, including the ones relating to monitoring, enforcement and fixing or approving network tariffs or their methodologies. The independence of NRAs is also reinforced through requirements relating to the independence of NRAs decision making from the influence on industry participants and from that of Member State governments, and for the security of tenure of the management board of NRAs. This is important as the enhancement of regulatory independence is central to the establishment of a sound regulatory framework. The 3rd Package also extends the objectives of NRAs so that they are required, when undertaking their functions, to take into account issues which reach beyond their national market and national consumers. This is because the 3rd Package included requirements on Member States to extend the duties of NRAs to include promoting a competitive, secure and environmentally sustainable internal electricity and natural gas market within the Community. As part of fulfilling that objective, NRAs are also given a further objective of developing competitive and properly functioning regional markets within the Community. It is therefore clear that, whilst measures in the 3rd Package could be considered to be 'top-down', 'bottom-up' processes will continue to be an important route towards market integration.

(iv) *Comparison of European 'top-down' and regional 'bottom-up' approaches*

2.12. Both the 'top-down' and 'bottom-up' approaches to achieving a single European market have a place in enabling future development. The use of top-down, centrally mandated measures is a powerful tool to require the establishment of harmonised rules applied uniformly across the Union's markets. Bottom-up measures, which are developed by those involved on the ground within a regional approach, enable to take into account local specificities, where needed, and what is achievable in reality. This approach therefore manages risks and enables practical and speedy progress to be made in a step-by-step manner, and for the approach to be tested within a single region before being applied more widely. It can therefore be a powerful complement to a top-down approach.

2.13. It seems that both approaches are essential for the achievement of a single European market, but that both need to be managed in such a manner that they work together in a focussed way where the goal is clearly set towards a single market outcome.

3. Regional cooperation and regional markets in the 3rd Package

3.1. The 3rd Package explicitly envisages the development of regional markets as a stepping stone to a single European energy market. This is a major change from the past situation. In addition to the inclusion of a specific objective for NRAs to promote the development of regional markets as a means of achieving a single European market, the 3rd Package also:

- requires NRAs to cooperate at least on a regional level (which may be facilitated by ACER);
- provides for network codes to take account of regional specificities, where needed;
- provides for regional cooperation between Transmission System Operators (which may be facilitated by the ENTSOs);
- requires, in coordination with an EU-wide 10-year network development plan, the development of regional network development plans;
- aims for congestion management methods which are applicable in the whole EU in the future but may also be suitable for regional application;
- requires the Rules of Procedure for the Board of Regulators of the ACER to provide for specific working methods for the consideration of issues arising in the context of regional cooperation;
- provides for regional solidarity between Member States in relation to gas security of supply;
- requires Member States as well as the regulatory authorities to cooperate among themselves for the purpose of integrating their national markets at one or more regional levels, as a first step towards a fully liberalised internal market; and
- requires the Agency to cooperate with NRAs and Transmission System Operators to ensure the compatibility of regulatory frameworks between the regions.

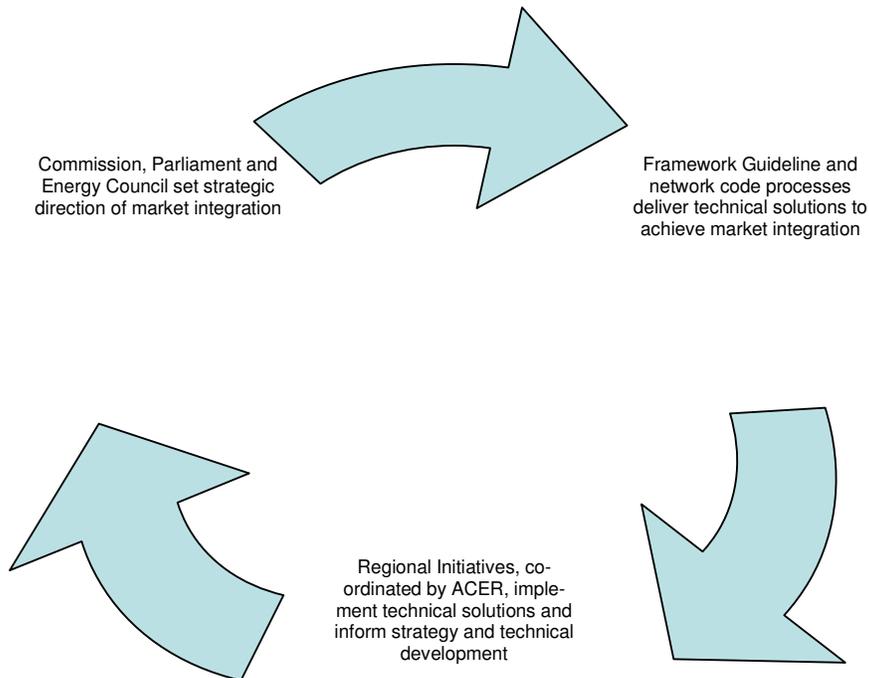
3.2. It is therefore clear that there is a challenge to define how the Regional Initiatives will contribute to the achievement of a single European market. In the view of European energy regulators the Regional Initiatives will have a major role. In particular they will:

- assist in the implementation of network codes;
- contribute to the development of Framework Guidelines and network codes, including specific regional knowledge;
- identify where a specific regional issue may need specific treatment;
- assist with monitoring compliance with network codes and guidelines provided for in the 3rd Package;
- develop and trial, on a regional basis, regulatory approaches which might have wider European application;
- prepare, as far as possible, for implementation of proposals contained in Framework Guidelines in order to accelerate the process of implementation.

4. Integrating the Regional Initiatives into the new strategy towards a more integrated European energy market

Organising the Regional Initiatives

- 4.1. The formal process and roles established in the 3rd Package raises a challenge. The 'top-down' Europe-wide measures established in the 3rd Package have defined procedures which must be undertaken by specific institutions. The process for the preparation of Framework Guidelines and the resulting binding network codes requires specific actions at various stages by the Agency, the ENTSOs, the Commission, the Member States and the European Parliament. The 'bottom-up' processes in the Regional Initiatives have different processes which were designed on the basis of voluntary cooperation rather than the more formal legal processes foreseen in the 3rd Package.
- 4.2. However, the issues (both in terms of the overall aim and the technical challenges) are substantially the same in respect of both the 'top-down' and 'bottom-up' approaches and at some point must interrelate. There is little benefit in work being undertaken on a Framework Guideline and network code on, for example, capacity allocation whilst exactly parallel work is underway on the same topic in one or more of the regions, and if the various strands are undertaken without co-ordination. The result could be that the outcome of the work on, for example, congestion management in one region proves to be incompatible with proposals for a congestion management Framework Guideline, thus resulting in wasted effort. This applies to all regional initiatives – both ERGEG-led ones and others (such as those mentioned in paragraph 4.6). There are synergies between 'top-down' measures and the more practical 'bottom-up' approach. These relate to the drive for harmonisation and market integration that top-down network codes can bring, and the detailed understanding of cross-border issues and the capacity for local implementation which are strengths of the bottom-up approach. Co-ordination of these strengths could offer real opportunities to make rapid progress.
- 4.3. Similarly, the involvement of Member States and the European Parliament in the formal adoption of network codes in the comitology process will result in binding codes which will bring about real change to the way national markets work and interrelate. The fact that codes allow, where appropriate, for regional specificities will have a direct effect on developments within the Regional Initiatives where, in most cases, Member States have not played a significant role in the past.



Role of Regional Initiatives in the process of market integration

Options for change

Developing the roles of Member States and the Commission in the regions

- 4.4. The analysis in this paper suggests that, in the new context of the 3rd Package, which has the possibility of creating legally binding cross-border rules, Member States should have a greater role in relation to the Regional Initiatives (both ERGEG and non-ERGEG) than has been the case in the past. In summary, this results from the future role of the Regional Initiatives as mechanisms complementing the 3rd Package measures in achieving a single European market, as well as the legislative responsibilities of the Commission, the Member States and the European Parliament in the comitology procedure for adopting network codes (which may have regional aspects) into binding legal instruments. It is not the role of European energy regulators to determine precisely what role Member States (and the Commission) should play, but we do note that there is a strong argument for them taking more significant roles and for greater coordination in view of their position in the comitology process which will establish the binding cross-border regulatory framework. European energy regulators would welcome such a development.
- 4.5. Examples of 'leadership' roles aimed at promoting the reforms needed to integrate markets (not relating specifically to the Commission or Member States) can be found in existing regional markets. In the gas Regional Initiative North-West a 'Programme Co-ordination Board' has been established which is constituted of senior industry repre-

sentatives and regulators. The Programme Coordination Board⁹ (PCB) provides a leadership body which can give high-level direction across all of the participating organisations. The PCB is, of course, constituted to address the specifics of a voluntary initiative before the 3rd Package was agreed. Such a group provides direction, agrees the annual work programme and monitors progress. It could also encourage the allocation of resources by participating organisations.

- 4.6. Some other regional market developments already have significant involvement of Member States, such as the Pentalateral Group and the Gasplatform, both in North Western Europe, which are electricity and gas market initiatives respectively. Other initiatives also have significant direct government involvement, including Nordic Market, the Single Electricity Market in Ireland, MIBEL and MIBGAS.
- 4.7. It is often more efficient to build on existing structures than to create new ones and this paper does not suggest the creation of new structures. One way of increasing the involvement and high level influence of the Commission and Member States in the Regional Initiatives, as well as to appreciate the purpose of related technical changes, would be to extend where relevant the membership of the current Regional Initiative Implementation Groups to include them. This would mean that the Commission and Member States would have a direct say in Regional Initiative developments.
- 4.8. It is important that the 'bottom-up' work in the Regional Initiatives is not progressed in isolation from the parallel (and related) work on implementing 3rd Package measures, and in particular the introduction of binding network codes. It will therefore be important that Member State representatives have the opportunity to be closely involved in the Regional Initiatives relevant to them, and that they are also closely involved in the consideration of Commission proposals for the comitology procedure relating to network codes in related areas.

Consolidating the Regions towards a single market

- 4.9. The purpose of the Regional Initiatives has always been to act as a stepping stone towards a single European energy market. Ultimately, the success of the Regional Initiative will be that the regions disappear altogether when a single market is achieved. European energy regulators consider that it is possible to make a first step in that direction immediately. This can be achieved by either merging some regions or by encouraging inter-regional cooperation as regards specific topics. We would welcome views on the best way to reduce the number of electricity regions from the current seven.
- 4.10. Alternatively and on the basis of experience already made, regions may be technically merged by cooperation on specific topics. Under this approach a topic might be treated in a common way across a number of geographic regions which allows for a flexible system of inter-regional cooperation. For example, congestion management was treated in a common way across a number of different regions. We would welcome views on this proposal as well.

⁹ The gas RI NW created a Programme Coordination Board in 2008 in order to provide leadership for the organisations centrally involved in promoting change in the region. The PCB is chaired by the Dutch Regulator and has a membership of senior representatives of TSOs, regulators, and market participants.

Clarity in the strategic direction to align bottom-up and top-down approaches

4.11. A real challenge for the progressive achievement of the single European energy market is that there is no overall 'blueprint' to be followed by those designing individual market reforms. Ultimately we need to arrive at the situation where a single European market emerges from a long series of complementary market reforms underpinned by well structured and co-ordinated network codes. The lack of clear direction to guide the necessary technical reforms affects:

- the development of the various Framework Guidelines and network codes which will have to tackle many problems over a fairly long period of time;
- co-ordination of 'bottom-up' initiatives across the regions;
- the co-ordination of initiatives in the regions; and
- the management of future modifications to established network codes.

4.12. These challenges suggest that the step-by-step approach currently used in European single market reforms will continue to be taken as the route to achieving a single market, and that a single step to a fully harmonised market is unlikely, and perhaps even impossible. These considerations must be accounted for in the drafting of Framework Guidelines and network codes and in their implementation so that the steps to market integration happen in a smooth and managed way.

4.13. It will therefore be important to have a clear view of the overall direction of European market integration.

4.14. This suggests that some form of strategic vision is needed to ensure that the various strands of activity are properly focussed and directed over time. The form of such a vision is not entirely clear but the framework and principles are set out in European internal energy market legislation. The strategic vision could take the form of an overall detailed market design which would form the benchmark and target. However, the US experience of attempting a comprehensive blueprint, or 'standard market design' (SMD), is not encouraging. In that case the SMD was proposed by FERC (US Federal Energy Regulatory Commission), but in the end FERC was unable to obtain sufficient political support for the proposal and it was subsequently dropped. It is also quite different from the 'step-by-step' approach that has been adopted up to now in the European Union. A development of the 'strategic vision' could take the form of the progressive development of papers which describe the objectives for each major area against which the different strands of activity could be assessed. The objectives could be revised and refined over time to fine tune the direction of market integration. Clearly, the debate on the strategic vision would need to be structured in such a way that the outcome results in a clear and broadly based remit for detailed work on each major element of the necessary single market reforms to proceed to implementation. However, it is also important to consider whether the risk that debating a strategic vision could create additional uncertainty to ongoing implementation and impede the timely implementation of reforms at regional level and so delays ongoing activities. Therefore, such exercises should be limited to issues where added value can be expected and any arrangement should balance the proposed clear view of the overall direction of market integration with the need not to slow down progress in the regions.

4.15. A further challenge stems from the fact that the changes we must make to markets to integrate them must be made during their live operation (energy markets cannot simply be 'switched off' whilst changes are made and tested). This makes the management of

change very important if security of supply is to be maintained and network users are to be protected from the unnecessary commercial risks resulting from poor implementation. It will therefore be a central part of the development of Framework Guidelines and network codes that the specificities of national and regional markets are considered, where appropriate, when deciding on the best approach to achieving a single European energy market and the changes that this will entail. This suggests that, where justified by regional issues, the Regional Initiatives should contribute to the consultation process when Framework Guidelines and network codes are developed.

The role of Member States, the European Parliament and the Commission in setting the overall direction

- 4.16. The above analysis of the role of the Regional Initiative in achieving a single European energy market indicates a strengthened role for Member States, the European Parliament and the Commission, both in relation to determining the overall pace and direction of market integration, and in the legal processes of implementation.
- 4.17. It would seem worth considering that there is a formal opportunity for the Commission and Member States to come together to discuss these aspects. European energy regulators currently use the CEER and ERGEG structures for their discussions (and in due course the Agency), and TSOs have their own bodies.
- 4.18. As has already been stressed, the organisation of meetings to enable discussion by Member States is the responsibility of the Commission and not that of regulators.
- 4.19. Whatever approach is decided upon, European energy regulators would respond positively to an invitation to provide any technical support which might be necessary to assist constructive discussion at such meetings.

The involvement of stakeholders in setting the overall direction

- 4.20. Stakeholders, as the users of the energy markets, must have a significant influence over the shape of the reforms needed to achieve a single European energy market, and on the overall direction of change. The enhancement of the role of the Florence and Madrid Fora would enable stakeholders to be engaged, particularly in relation to helping to establish the overall strategic direction of market integration, and on specific planned reforms. This more strategic role for the Florence and Madrid Fora would not substitute formal consultations on specific regulatory proposals. European energy regulators have already set out the way in which stakeholders will be engaged in respect of specific regulatory proposals¹⁰.

The engagement of the European Parliament

- 4.21. Progress against the strategy would be reported by the Agency in its annual report and this would provide a basis for discussion with the European Parliament (EP) and the relevant Parliamentary Committees on the strategy for market integration. The views of the EP could be reflected in the further development of the strategy. European energy regulators are ready to provide technical assistance to members of the European Parliament during their consideration of comitology proposals.

¹⁰ Implementing the 3rd Package: The next steps, 18 June 2009, Ref: C09-GA-52-06a.

5. Enhancing the Regional Initiatives for the future – practical issues

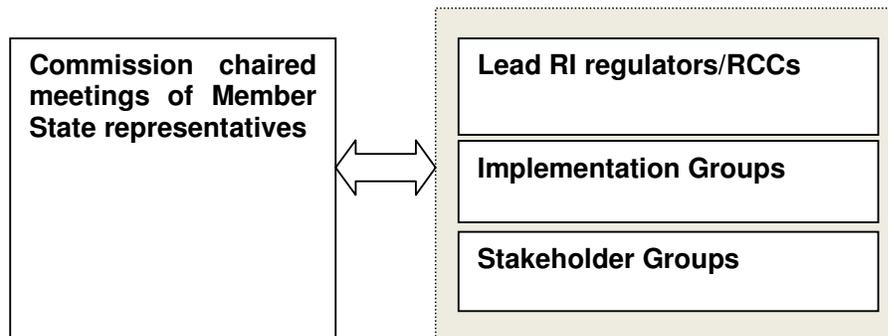
- 5.1. The current governance structures on the Regional Initiatives are explained in Annex A. This structure now needs to be enhanced to:
- Facilitate greater interaction with the Commission and Member State representatives;
 - Provide greater transparency to the European Parliament and Energy Council on current and future developments;
 - Enhance co-ordination between regions and with developing European regulatory policies;
 - Enhance further co-ordination between the regions.
- 5.2. ERGEG has already created a new Working Group to oversee this process and we hope that the Agency will also implement similar co-ordination arrangements.

Engaging Member States and the European Institutions

- 5.3. The intention is to create arrangements whereby the Regional Initiative can act not only as a mechanism to implement European single market reforms, but also as a test bed for approaches to market integration, and also as a source of information on the detailed issues and circumstances which must be addressed or accounted for in each local region. In addition, Regional Initiatives can continue to facilitate progress in the regions, and operate as a forum to identify and tackle particular obstacles that have arisen within regions. To these ends, regulators can continue to play their role in fostering market integration through tangible initiatives. They should also continue to provide solutions to cross-border issues through working in a cooperative manner and where agreement is not possible to seek consensus by mediation by the RCC.
- 5.4. European energy regulators will enhance dialogue with Member State representatives by building, where possible, on existing structures:
- including Member State representatives in each region on the circulation list for Regional Initiative projects relevant to that region;
 - where relevant, extending invitations to Member State representatives to attend meetings of the Regional Initiative Implementation Groups;
 - continuing to invite Member State representatives to Stakeholder Group meetings, and offering a speaking position when that is relevant to the agenda;
 - offering a bilateral discussion on progress and obstacles to progress in advance of key events, such as the Energy Council, the Florence Forum and the Madrid Forum.

Enhanced support for Member State representatives

Agency Co-ordination



- 5.5. European energy regulators will increase the level of information provided on the Regional Initiatives to the EP and the Energy Council by:
- Sending a copy of the annual report on the Regional Initiatives to the EP and to the Energy Council;
 - Offering to appear before the relevant Committee of the EP; and
 - Providing technical assistance to Member State representatives and members of the EP through the provision of factual material to assist with the preparation of key discussions organised by the Commission.

Enhancing co-ordination and integration between the regions

- 5.6. In all the phases of the transition between the current legislation until the single European energy market is fully achieved, it is crucial to allow regions to make progress whilst ensuring that regional markets converge as they develop, and that the work under the framework of the Regional Initiative within individual regions is tied firmly to wider European objectives.
- 5.7. The 3rd Package contains measures which extend the objectives of national regulators beyond national boundaries, including in relation to regional cooperation. Moreover the Commission is empowered to propose potentially binding guidelines to extend duties of the regulatory authorities to cooperate with each other and the Agency. To this end the Agency may make recommendations to the Commission. TSOs are required to cooperate at a regional level within the framework of the ENTSOs. This means that 'regional decisions' will, in reality, be a series of co-ordinated decisions taken by national bodies.
- 5.8. This implies that arrangements are needed to co-ordinate developments within a region (even where these are subject to a European level endorsement). To ensure that regional developments, over time, converge towards a single European market there must be strong links between these regional arrangements and those of the Agency, and possibly the ENTSOs. Rather than create new regional governance structures, we consider that it would be better to build on the existing Regional Initiative arrangements. The basic Regional Initiative structure consists of:

- a Regulatory Coordination Committee (RCC) which is composed of regulators in the region and the Commission;
- an Implementation Group (IG) composed of regulators, TSOs and, in some cases, exchanges;
- a Stakeholder Group (SG) which is a forum of all stakeholders and regulators.

The proposed approach to coordination between regions

- 5.9. The basic model which has been followed in respect of the ERGEG Regional Initiatives and which will continue following the implementation of the 3rd Package is that common principles, and sometimes detailed and binding obligations, are established at European level (through legal instruments and both binding and non-binding guidelines by the Commission and the European energy regulators) and that the role of the Regional Initiatives is to implement these requirements. However, regional ambitions may mean that regional developments may overtake those at European level in some areas, and in such cases it is necessary to ensure that the overall direction remains consistent with the achievement of a single European market.
- 5.10. The challenge is to ensure that arrangements are put in place so that there is a sufficient level of oversight of European and regional activity so that the two layers are properly coordinated (and national rules will need to fit within this overarching framework). This suggests that the solution lies in ensuring sufficient coordination between the European and regional governance structures of ERGEG/Agency, the ENTSOs, and Member States, and that the oversight arrangements are adequate to ensure consistency of approach. The governance structures of the Regional Initiatives may need to be adapted as a result of these considerations and the consultation arrangements at the regional and European level should be developed to recognise the interaction between the two levels. To this end, it is the intention of European energy regulators that Member State representatives should be invited, where relevant, to Implementation Group meetings so that they are fully involved in implementation issues, and that they are included in the relevant circulation lists for working documents as outlined above.
- 5.11. A new aspect introduced by the 3rd Package relates to enforcement actions. Although the 3rd Package extends the duties of national regulators so that they extend beyond national boundaries, only national regulators have enforcement powers (other than the Commission) as jurisdictions remain national. Coordination arrangements at regional and, if necessary, European level are needed to ensure that the relevant national regulator is in a position to take action where the problem manifests itself in another Member State. The Agency has a role in determining disputes between regulators in such cases¹¹. The Agency may also recommend to the Commission that binding rules on cooperation between NRAs are required¹².

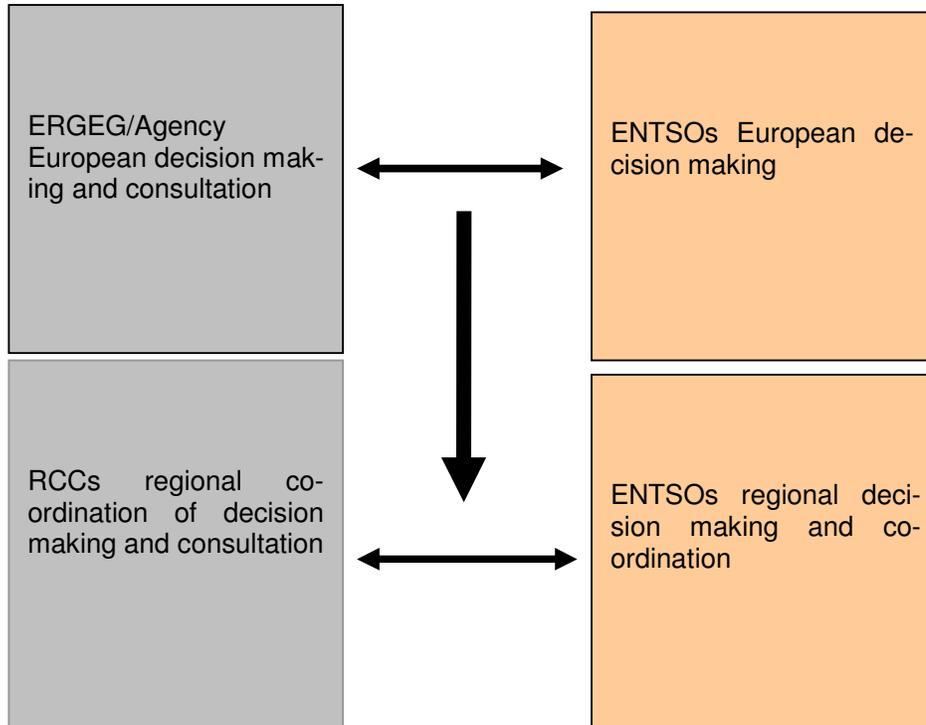
The decision-making process

- 5.12. There are vertical and horizontal aspects to ensuring proper coordination of decisions at the regional level, and regional activity, with European policy development. Vertically there will be interactions between ERGEG/Agency and the RCCs of the Regional Initiatives. Horizontally there will be interaction between ERGEG/Agency and the RCCs

¹¹ Article 8 (1) Regulation (EC) No 713/2009.

¹² Article 7 (3) Regulation (EC) No 713/2009.

with the ENTSOs and their regional decision-making and coordination structures. The following diagram describes the relationships between the Agency and the ENTSOs:



Vertical and horizontal aspects of European and regional decision making

5.13. There is substantial and growing interaction between European policy decisions and regionally coordinated decisions, both in respect of the issues and the timing of policy development. Horizontal interaction is also a substantial issue. It is clear that there must be significant interaction between ERGEG/Agency and the ENTSOs (and ENTSO-E/GTE+ before the ENTSOs are formally in place). This interaction is already beginning at the European level. As the 3rd Package is implemented, and as the Regional Initiatives progress, we can expect more interaction at the regional level also. This suggests that the governance structures of the ENTSOs in electricity and gas must be fully compatible (but not necessarily identical) with the governance arrangements in the Agency (and in ERGEG in the interim). The processes of engaging with stakeholders must also be coordinated to ensure that stakeholders understand the overall process and that their resources devoted to reacting to consultations are used effectively.

5.14. Coordination of congestion management is an example of an issue where there could be widespread application across the Union but where, as today, there could (at least in the medium-term) be detailed differences of approach between regions. In cases like this, the question arises whether the regional developments are consistent with overall European regulatory policy or have to be adapted, whether the European regulatory policy needs to be developed to reflect regional experience, and whether the proposals in the region have implications for other regions (for example, whether there is an ad-

vance in best practice). Such an issue would involve regulators and TSOs at all levels, as well as the Commission.

5.15. In undertaking monitoring and oversight it is important to ensure that any new procedures:

- do not impose a significant burden;
- are consistent with, and if possible build upon, existing structures;
- ensure that there is a compatible approach applied by the European regulators and the TSO bodies;
- do not seek to over harmonise or control issues which can be left to subsidiarity, either on a national or regional basis.

Practical co-ordination arrangements

5.16. To achieve adequate coordination and oversight of European and regional decisions, a number of enhancements to the existing coordination arrangements established by European energy regulators are proposed.

5.17. The proposed enhancements are:

- Improved coordination of forward work programmes at European level with those of the Regional Initiatives;
- Increased proactive in-year oversight of developments in the regions to ensure coherent development of regulatory policy at regional and European levels;
- Regions to be included in the development and consultation arrangements for Framework Guidelines and network codes;
- Coordination of enforcement issues by the regulators directly concerned, with a report to the relevant RCC;
- In cases where the Agency is fulfilling its responsibilities to resolve issues relating to terms and conditions for access to, and operational security of cross-border infrastructure, the Agency might choose to seek advice from the relevant RCC before reaching a view;
- The development of annual work plans of the Agency and the ENTSOs will establish an efficient and coordinated allocation of work between the Agency and the ENTSOs, and with the regions;
- Specific processes for the development and regulatory oversight of the 10-year network development plans at regional and European levels.

5.18. The engagement of stakeholders in the process will be very important. It is expected that the consultation procedures for the Agency will specify that formal consultation should happen on regional proposals and on European proposals. Where it is anticipated that a regional proposal may be developed further for European application this will be stated clearly in any regional consultation. A regional consultation in these circumstances will not be an acceptable substitute for a European consultation when the proposal is further developed for that purpose. The existing consultation arrangements used for the Regional Initiatives will continue to form the basis for regional consultations.

Annex 1 ERGEG Regional Initiatives - History and Background

Summary

The ERGEG Regional Initiatives were initially based on the so-called electricity “mini-fora” which were set up by the XIth Florence Forum (September 2004). The Commission’s intention was to hold a series of “mini-fora” which should “provide a plan and detailed timetable for the introduction of at least day-ahead co-ordinated market-based mechanisms”. The idea was to facilitate the implementation of the Congestion Management Guidelines¹³. One of the main advantages of this bottom-up regional approach was (and still is) that it enabled to involve the relevant stakeholders more than is usually possible on a European level. In addition, the regional approach could also better take account of regional specificities where divergences from the European standards are needed on an exceptional basis. At the same time, the regional approach enables a step-by-step development towards an integrated European energy market.

The experience with the mini-fora was a positive one and the regional implementation of European legislation considered a good way forward towards an internal energy market. However, the Commission only held one round of mini-fora under the Florence Forum process. ERGEG decided to adopt the regional idea and to develop it further. Therefore, the ERGEG Regional Initiatives were set up, first for electricity only, but shortly after also for gas. In electricity, the regions remained the same as defined for the mini-fora, i.e. seven electricity regions covering the whole of Europe were set up¹⁴. In gas, regulators are working in three regions towards a better integration of the European gas market. In order to further improve the internal coordination of the Regional Initiatives (between electricity and gas and between the regions) ERGEG set up in 2009 a Regional Implementation Group (RIG).

In June 2005 ERGEG published its conclusion of the consultation paper *The Creation of Regional Electricity Market* proposing that ERGEG and regulators, in cooperation with relevant stakeholders, take forward the work of setting up regional initiatives.

The consultation paper on *The Creation of Regional Electricity Market* highlighted that stakeholders and institutions were needed in the process for change to occur and suggested that regulators, the Commission, Member State governments, TSOs and other market operators, market participants and other interested parties comprised the overall set of parties necessary to identify and effect change. The Florence Forum should still play an important role.

Regional cooperation (such as the All-Island market for the Republic of Ireland and Northern Ireland, the Iberian market, and the Nordic market, the plans for linking wholesale markets in Belgium, France, Luxembourg, the Netherlands, and Germany) was already a fact when ERGEG proposed to set up the Regional Initiatives. However, it was underlined in the proposal that Regional Initiatives had to be framed in a way that existing initiatives were complemented. Also, the need for flexibility in the arrangements adopted in each region was recognised in order to avoid unwieldy bureaucratic measures. Furthermore, the fact that a

¹³ Guidelines on the management and allocation of available transfer capacity of interconnectors between national systems, Annex to Regulation (EC) 1228/2003 of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity.

¹⁴ An eighth further region is operating under the Energy Community, but outside the ERGEG RI process.

number of countries potentially belonging to more than one region was recognised implying that regulators and other stakeholders in these countries had to combine and / or target resources to the proposed regional initiatives. Stakeholders widely support the Regional Initiatives process as a useful initiative to develop the energy markets further and to implement European issues on a regional level. They welcome the faster pace possible on the regional level, although some still consider the pace as too slow. Another recurring comment is that diverging regional solutions might develop without sufficient cross-regional coordination. This issue is taken care of with the creation of the RIG and by the 3rd Package where a more European steer should come from the Agency. Some stakeholders recently also started to raise the possibility of merging regions as overlaps become more frequent and issues could be better dealt with in larger regions. Stakeholders also encouraged ERGEG to carry on with their work in the Regional Initiatives and to implement similar structures within the future structure of the Agency.

In November 2005 ERGEG issued a further consultation on a Roadmap to a Competitive gas market in Europe. The result of this public consultation was the launch by ERGEG (with the backing of the European Commission) of the Gas Regional Initiative in Spring 2006 which set up 3 regional gas markets in Europe, as a first step to creating a single-EU gas market.

The ERGEG proposal for Regional Initiatives

The aim of setting up the Regional Initiatives was to initiate a process to make concrete progress in integrating national markets and facilitate further the creation of regional markets, the final aim being one single energy market. For each regional market, problems, impediments and distortions to trade had to be identified and practical improvements that would contribute to removing barriers to trade had to be determined. Furthermore, the Regional Initiatives should enable local stakeholders to identify, and plan solutions for, the priority areas for which action is needed to deliver integrated markets.

Each regional initiative had to:

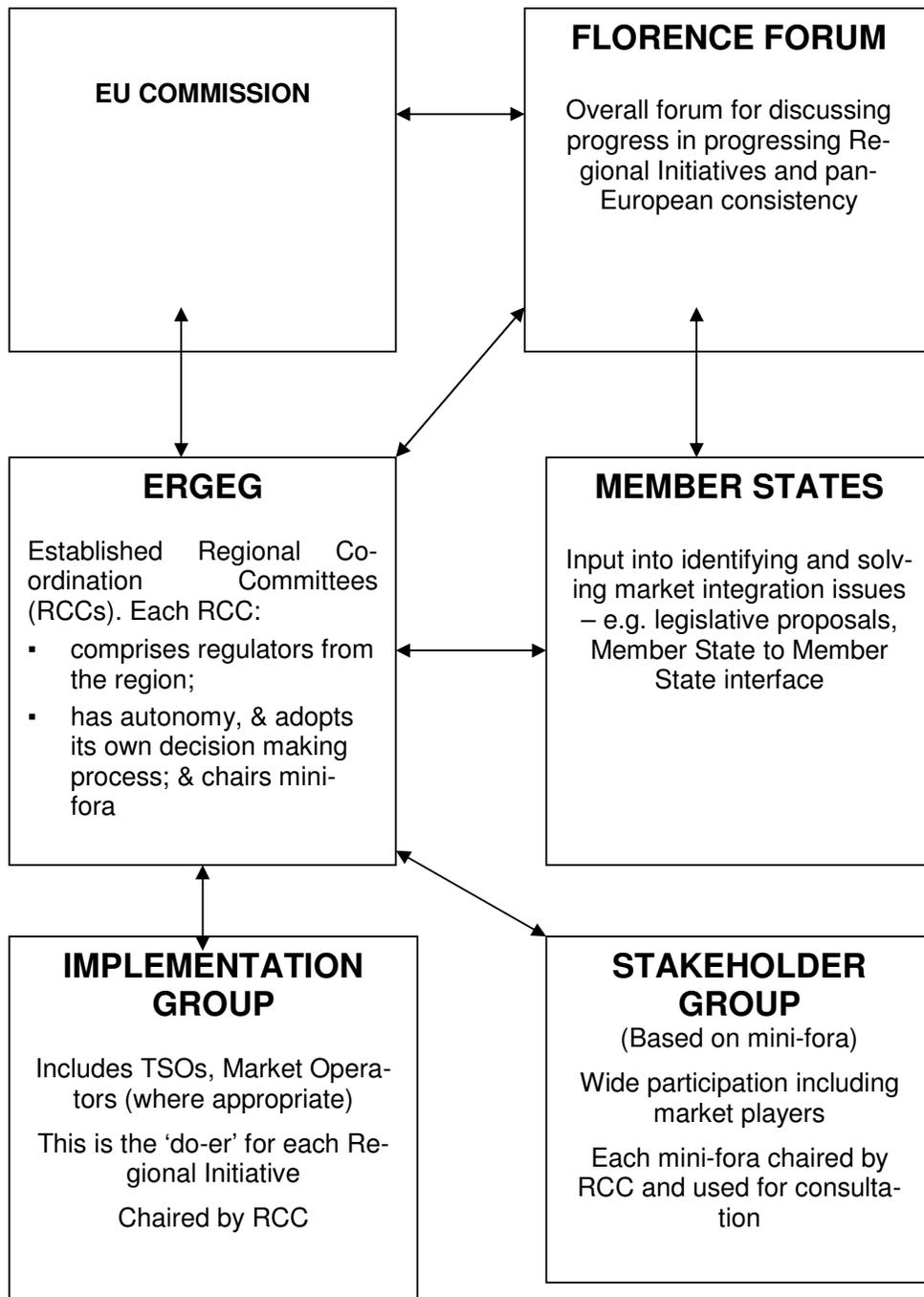
- Identify and publish, through open consultation with market participants, the priority areas to be addressed in the region;
- Establish and publish a timetable for the technical work required to address these areas, including allocating responsibility for the tasks to the stakeholders most able to accomplish the relevant work;
- Take forward and oversee that this work is done in line with a set timetable;
- Monitor and report progress;
- Note any reasons for any delay.

For the purpose of creating finally single electricity and gas markets it was considered of utmost importance that each Regional Initiative considered the need for compatibility of the established processes with those in connected regions, although progress in one region should not be contingent on progress in another.

Overall compliance with the EU legislation had to be ensured in all the activities and deliverables of the Regional Initiatives or in cooperation with other ERGEG Working Groups.

The organisational structure of the Regional Initiatives is illustrated in the following figure:

Regional Initiatives – Elements of an Organisational Framework



EREGEG anticipated some flexibility in tailoring each of the Regional Initiatives - given local circumstances, institutions, and already existing initiatives - however, the general framework had to achieve results in accordance with the objectives above, and to monitor and report on progress.

At the core of the framework, Regional Coordination Committees (RCCs) which comprised the regulators for each region had to be set up. Each of the RCCs had the responsibility and authority of driving forward the work in their region. The RCC was to act as overall co-ordinator of the tasks facing the region and providing leadership, strategy and decisions. Each RCC had to consult stakeholders. The duties of the RCC's were to establish and lead the regional projects and activities such as stakeholder meetings (mini fora), defining the way of work, involving stakeholders and setting up priorities, milestones and deliverables in line with the general EU/EREGEG objectives, in suitable collaboration with Member States and the Commission. Each RCC was also to ensure compliance with the relevant EU legislation and for reporting on the progress of their regional initiative through ERGEG to the Florence and Madrid Fora.

Given that the characteristics of each region and its institutions, issues and existing initiatives differ, each RCC was allowed some autonomy and flexibility regarding the governance procedures. However, this autonomy had to occur within the boundaries of the given overall objectives of each region. In addition, for pragmatic reasons and in order to foster a transparent, accountable and consistent approach, the organisational procedures, decision making and conflict resolution in each RCC may be drafted in accordance with ERGEG statutes and principles. Each of the RCCs had to report to ERGEG on progress and ERGEG would inform the Commission as well as the Florence and Madrid Fora periodically on the progress of work in the regions, including all the issues of importance and relevance for each region and for the European electricity and gas market more widely. An important task for each RCC will be to specify detailed roadmaps, milestones and deliverables in each region. These roadmaps shall cover key milestones for 2-3 years, with a detailed project plan for the first year and a general plan for successive years.

The organisational framework also anticipated that each RCC would establish and chair an Implementation Group (IG) or equivalent body, comprising regulators, TSOs, exchanges and market operators, as appropriate. Each RCC would liaise closely with the IG and could for example request the IG to make proposals for action to deal with the priority issues identified by the RCC. The RCC was expected to meet with the IG on a regular and reasonably frequent basis in order to set out the issues that the IG will need to deal with in coming forward with proposals.

Proposals by the IG had to be subject to consultation with stakeholders. Thus stakeholder groups had to be established. Consultation should formally be with stakeholders, and this may include written consultation exercises, public hearings, and workshops. Stakeholders should have an opportunity here to express how solutions to market integration problems affect them and market functioning, and how solutions might best be conceived and implemented.

It was expected to involve fully the Commission in each of the Regional Initiatives, particularly to help deliver some of the objectives in some regions. However, final decision on how to involve the Commission was left to each Regional Initiative.

Clear political support for identifying and solving impediments to market integration was considered particularly important for the Regional Initiatives. Indeed in many regions, some cross-border problems had been addressed as a result of government to government agreements and/or government commitment to bring forth the necessary legislation. It was

considered likely also to be the case that regulators lack a full legal basis to address issues outside national borders and so they may not be able to mandate fully all efforts concerning cross-border market integration. Member State's support was considered particularly important in this regard.

Each RCC had to establish a governance structure for itself and identify priority actions. Following this each RCC had to liaise with stakeholders in order to set in place the Implementation and Stakeholder Groups.

Other Regional Developments

In parallel to the ERGEG Regional Initiatives, other regional projects developed. The first market which was developed on a regional basis, long before the idea took hold on the European level, was the Nordic electricity market which was considered a prototype for regional integration of electricity markets. As this paper focuses strongly also on the future role of Member States in the regional process, it is important to point at initiatives which were started by governments. A good example for this is the Pentalateral Energy Forum which was originally set up by Belgium, Luxemburg and the Netherlands, but quickly also included France and Germany. With the political support of the governments, an ambitious agenda for the integration of the electricity markets of the five countries was set. With the success experienced in the electricity market, in particular in relation to the Trilateral Market Coupling between the Netherlands, Belgium and France, the initiative was later on also extended to gas. Another example which is developing based on a government initiative is the MIBEL market which integrated the Portuguese and the Spanish electricity markets. Similar processes are also in place for the gas market (MIBGAS).

Annex 2 Listing of Abbreviations

Term	Definition
ACER	Agency for the Cooperation of Energy Regulators
DSO	Distribution System Operator
ENTSO	European Network of Transmission System Operators
EP	European Parliament
EREGEG	European Regulators Group for Electricity and Gas
FERC	Federal Energy Regulatory Commission, USA
IG	Implementation Group
MIBEL	Mercado Ibérico de Electricidad (Iberian Electricity Market)
MIBGAS	Mercado Ibérico del Gas Natural (Iberian Gas Market)
NRA	National Regulatory Authority
PCB	Project Coordination Board
RCC	Regional Coordination Committee
RI	Regional Initiative
RIG	Regional Initiatives Group
SG	Stakeholder Group
TSO	Transmission System Operator
WG	Working Group

Annex 3 ERGEG

The European Regulators for Electricity and Gas (ERGEG) was set up by the European Commission in 2003 as its advisory group on internal energy market issues. Its members are the energy regulatory authorities of Europe. The work of the CEER and ERGEG is structured according to a number of working groups, composed of staff members of the national energy regulatory authorities. These working groups deal with different topics, according to their members' fields of expertise.

This report was prepared by the Regional Initiatives Working Group.