To ERGEG

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Public Consultation on 2008 ERI Coherence and Convergence Report

Dear Ms. Geitona,

The European Energy Exchange AG and Powernext SA welcome the opportunity to provide comments to the ERGEG Public Consultation on the current ERI Coherence and Convergence Report about the implementation of congestion management and also on transparency and balancing issues.

Please find attached the mutual comments of both EEX and Powernext to the Consultation Paper. We hope that our annotations are helpful and are looking forward to a fruitful discussion in the future.

Kind regards

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2008 ERI Convergence and Coherence Report and related public consultation: contribution by EEX and Powernext

1. The improvement of market results and social welfare in spot markets

1.1. Integrating the markets through efficient day-ahead congestion management mechanisms

Spot markets have continuously grown in most European countries, especially through the development of organised markets run by power exchanges, improving the management of imbalances and establishing reference prices for electricity in their respective hubs.

It should be noted that individual markets are not necessarily independent from each other. The possibility to transmit power between different market areas creates mutual dependencies. A clear example of this matter of fact is the interdependency of the spot and derivatives markets in France and Germany, which results in strong price correlations. However, correlations between market areas are often limited due to constraints in transmission capacity, i.e. there are congestions between market areas. These congestions must be managed in the most efficient way in order to ensure the best possible outcome in terms of overall social welfare.

The improvement of congestion management mechanisms is therefore an important factor for improving the market results. Market-based mechanisms of capacity allocation (starting with explicit capacity auctions) help optimizing cross-border energy flows (in terms of amount and direction), and build more coherent reference prices. The most advanced congestion management mechanism for day-ahead markets are implicit capacity auctions. Such implicit auctions take into account the available transmission capacity between market areas, thus optimising capacity allocation in a way that maximises social welfare across all coupled areas. Therefore, they help building more reliable spot markets and are a prerequisite for market integration as long as congestions prevail. In addition, the design of long and short-term capacity allocation rules should ideally also include a flexible and efficient secondary market of capacity rights, allowing the “sliding and dicing” of capacity blocks of different maturity by market participants and a smooth integration of such products with spot energy markets.
Implicit congestion management mechanisms have to be carefully designed through a collaboration between the power exchanges operating the coupled market areas. It must be ensured that systems performing the implicit capacity allocation correctly reflect the market models of the coupled power exchanges, since poorly designed congestion management mechanisms can indeed disturb the mechanisms of local price formation, either through inappropriate economic signals or operational inefficiencies or risks. The assessment of the robustness of coupling mechanisms, both in terms of capacity allocation and price formation, together with the involvement of all concerned parties, are thus essential success factors for all initiatives aiming at implementing cross-border congestion management mechanisms.

1.2. Value-added of the involvement of PXs in congestion management projects: examples

Launched almost two years ago, the TLC between France, Belgium and the Netherlands, illustrates perfectly the ability of PXs, together with TSOs, to participate to market integration while ensuring a robust price formation system. The TLC is a decentralised price coupling mechanism, based on a non-sequential computation process, made at the level of a single algorithm owned and operated jointly by the involved PXs. Such a mechanism has so far ensured an optimal utilisation of existing day-ahead capacities, matching perfectly with local prices. Furthermore, the contractual approach of the project has allowed involved stakeholders to keep under control their core business activities, thus creating enough incentives for their participation to the initiative.

The CWE project aims at coupling the French, German, Belgian and Dutch day-ahead power markets through a price coupling mechanism. The merger of the French and German power spot activities by Powernext and EEX into EPEX Spot will lead to a harmonisation of both the market models and the trading system for the French and German market areas, bringing about a significant simplification for this regional coupling project, process-wise and in terms of governance. It also reduces the number of parties acting with one single voice and the related costs.

From the exchange side, the EPEX Spot initiative also opens the door to, for example, a smooth and easy inclusion of the Swiss market area into the CWE initiative very shortly after the launch of CWE.

In effect, the corporate and process merging of the French and German spot PXs will facilitate an effective market splitting mechanism of the French-German-Austrian hubs within the CWE area. Cooperation between PXs enhances the robustness standards of the market integration mechanism, and facilitates its operation, as a single entity operates spot markets in different market areas using an implicit capacity allocation mechanism, with the benefit of a single system and a single market model across all coupled areas.

More generally, PXs have a natural incentive to encourage the development of robust, liquid and simple (thus secure) coupling projects. Market coupling introduces extra complexity in the day-ahead price determination processes. As regards the design and operation of market infrastructure, it is a particular PX responsibility to make sure that this complexity does not impair the efficiency and the security of markets. As regards governance, as the number of parties increases, without gradual consolidation of power exchanges at the regional level (applicable to some TSO functions as well), it will become a real challenge to extend market coupling beyond isolated clusters of a few markets.

2. Consolidation of hubs at the regional level and the issue of interregional integration

2.1. Impacts of regional consolidation

The multiplicity of market coupling initiatives across Europe reveals a strong willingness from market stakeholders to ensure an efficient, price-reflective allocation of cross-border capacity, and possibly increase the liquidity of emerging, less mature markets.

Since coupling projects always require a certain degree of technical harmonisation and a close cooperation between implementing parties, they help regions consolidating into a more coherent market zone. Regional consolidation can in fact have to effects:

- On the one hand, this trend can reduce the degree of local divergence in terms of market standards, operational process, and improve the ability of stakeholders to coordinate their actions within common projects for further integration across Europe.
- On the other hand, if designed without taking into consideration the requirements of compatibility for further extension, regional initiatives may reveal to be difficult to integrate into a wider European framework.

2.2. Ways towards interregional integration

The CWE market coupling project will consolidate a major part of the continental electricity market and will lead to a harmonisation of market standards and the coordination of local process. The achievement of this continental coupling is crucial for the next steps of interregional integration in Europe.

The issue of interregional integration applies particularly to the CWE region, which shares all its borders with other regions, and whose coupling system often overlaps with existing integrated regions, or in process of consolidation. This is the case on the:

- French/Spanish border (Spain and Portugal being integrated in the MIBEL market splitting);
- German/Danish borders and the Dutch/Norwegian border (both Norway and Denmark being part of the Nord Pool Spot market splitting)
- UK/France border;
- France/Swiss and German/Swiss border;
- French/Italian border (Italy is run by an internal market splitting; furthermore, market coupling in the Central-South region is currently discussed within the ERGEG-ERI framework).

Cooperation between the main regional exchanges, and sharing of information on the functioning of the concerned coupling systems will facilitate the identification of the technical, legal and governance-related hurdles for interregional integration.

However beyond this "study phase", a more general "glidepath" approach could be of a helpful inspiration for improvement of the convergence and coherence of regional initiatives. ETSO and EuroPEX will present a more detailed report on this issue, on the basis of the Interim Report they have presented in April 2008 *("Development and implementation of a coordinated model for regional and interregional congestion management"*) and which final version will be presented at the 2009 Florence Forum. The "glidepath" approach presented in the Interim Report is declined into several alternatives of integration:

"Methodological" alternatives:

- gradual coupling
- overarching "dome coupling" institution

"Mechanism" alternatives:

- price-coupling based mechanisms
- "loose" or "tight" volume-coupling based mechanisms

The merits and drawbacks of those various alternatives will have to be assessed, from the legal, economic, operational, and technical viewpoints. EEX and Powernext are committed to take part of this work, taking also into consideration market participants' interest in gaining a reliable regional capacity allocation system, such as a non-sequential price coupling mechanism.

3. Transparency and market integration: the need to create a European level-playing field

We are strongly in favour of a harmonised improvement of the transparency level of the market, so as to ensure a level-playing field level across Europe, as it is in the focus of the Congestion Management Guidelines.

The efficiency and the confidence in the market is greatly dependent on the publication and monitoring of generation, load assets and consumption data. These information are indeed crucial to ensure a fair and efficient competition among energy market players.

In the French market, the local TSO RTE is in charge of collecting and publishing these fundamental market information.

Independent and neutral Power exchanges like Nord Pool Spot for Scandinavia, or EEX for Germany and Austria have also proved to be generally accepted by the market for the endorsement of this task. The current implementation of the Congestion Management Guidelines

shows that, for Germany, the EEX is seen as the preferable place of power plant operators to publish their data.

Irrespective of the place of publication, it is crucial that adequate monitoring and binding requirements ensure the accuracy and the timely sending of those data by supply undertakings. In addition to this, the aim is to further expand the range of data offered and to further improve the quality of the data. The Congestion Management Guidelines adopted by the EU provide the right framework for this.