

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

EFET Response to the ERGEG Public Consultation Document  
**Ref: E09-RIG-04-03**

**ERGEG questions for public consultation**

**Introduction**

We believe that the role of Regional Initiatives has been instrumental for improving European energy market integration. Wholesale energy markets are more liquid than ever before and important steps have been helped by the Regional Initiatives on the way to full integration. Lessons should also be learned from the Regional Initiatives experience and improvements introduced to fine-tune the way forward.

Electricity

The Project Coordination Group (PCG), launched for calendar year 2009 under ERGEG chairmanship and the auspices of the Florence Forum, has been a success according to its own terms of reference. Now the work of the successor Ad Hoc Advisory Group of Stakeholders (AHAG) will begin. The AHAG can fill a gap, pending the establishment of ACER, and the readiness of ENTSO-E to address codes related to market design, in addition to codes related to technical, investment and security issues.

The three chosen work-streams for the AHAG are capacity calculation, intra-day trading and governance for market coupling. The forward market is just important as, if not more important than, the spot market intraday or day-ahead, for price and investment signals and evaluation of pricing risk by large energy purchasers. Therefore, regulatory and grid access improvements which help the forward market should go hand in hand with any day-ahead measures.

So, while welcoming the planned work programme of the AHAG, and recognising the progress made during 2007 and 2008 on cross border congestion management and

transparency in some Regional Initiatives, EFET believes it is now also high time to implement some critical steps necessary for the development and strengthening of forward markets in power and the creation of greater transparency of fundamental power sector data.

EFET is therefore calling for more effort to establish:

- A common TSO calculation model for assessing available capacity
- Uniform regional and inter-regional transmission capacity auction rules
- Common auction platforms across regions
- Fully financially firm transmission rights (at least on a “pilot” basis in key regions)
- Standard arrangements for day-ahead nomination or cash-out of all longer maturity transmission rights
- Uniform electronic transfer processes and registries for assigned transmission rights.

## Gas

On the back of the success of the PCG initiative under the auspices of the Florence Forum, would a similar initiative under the Madrid Forum have merit for gas market development?

The current work being done on pilot framework guidelines might suggest that there is a need for a target wholesale market model for the European gas sector. Some EFET member companies see a “gas PCG” process as a useful addition to current means for grid users and market entrants to debate market design. But they think any such process probably should neither limit nor replace public consultations by regulators and TSOs, in which individual companies can participate, as well as associations.

EFET would be well prepared for a PCG-type debate for gas. We already have task forces and project groups, which could serve as “shadow groups” to support EFET delegates in designated work-streams. The idea of developing a target model is a good one as long as the target model allows for more competition, non-discriminatory network access and harmonised rules and procedures.

Others of our member companies caution that, although top-down guidance is important to organise progress efficiently, clear guidance will probably be much harder to achieve with respect to the gas markets. In contrast to the electricity sector there is not

even yet a common, Europe-wide understanding that deep, liquid traded markets are needed for successful gas market liberalisation. In this case would feasible EU-level compromise solutions provide enough market-oriented light, to relieve the darkness prevailing in some corners of the supposed internal gas market?

## **1. Questions - set 1**

*Do you consider that a high level/strategic vision is needed to set the overall direction of market integration?*

A high level strategic vision would be a useful document to underline the overall direction of market integration and set out the key features of the electricity and gas market that we would expect to see develop. Of course, this is already embodied in the details of the 3<sup>rd</sup> IEM package, but a short “vision” document, accessible to non-experts would give a higher degree of transparency in this respect and would facilitate progress. It is unlikely that this would delay implementation since it would be expected that the strategic vision would largely reflect progress already being made in the Regional Initiatives.

The vision should be in the form of a document that is agreed at the highest level possible. The new Lisbon Treaty institutions are a good opportunity to give some more political drive to energy market integration. Obviously, it should be the subject of an open consultation process with the main market participants. The document should contain clear objectives and deadlines and set out a clear action plan with responsibilities assigned.

Separate documents would be appropriate for gas and electricity although they should share a number of common features. We note that, other than the concepts in the 3<sup>rd</sup> IEM package, there is as yet no “target model” for gas and this is a necessary first step.

We would, for electricity, expect that a high level vision document would largely be based on the target model as set out by the PCG and endorsed by the Florence Forum. But it should in addition take a long view on the integration of renewable sources in the wholesale power market across the EU and on the interplay of markets in power and in emissions allowances under the EU ETS.

This will also help the various network codes to be consistent. However, it would be useful to combine a top-down approach represented by such a high level vision and the bottom-up approach, typical for the Regional Initiatives, in a consistent way. This should also help avoiding overlaps in between.

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

Yes in principle, but practical implementation may well differ.

Considering Regional Initiatives experience we can observe that electricity and gas differed in some sense: in the electricity sector there has emerged a target/reference model on major aspects related to congestion management foreseeing explicit auctions for yearly and monthly transmission capacity allocation, implicit allocations through market coupling for day-ahead / and a continuous allocation platform for intraday trade.

As for gas, there has emerged a partial shared vision on main beliefs: to increase transparency, to adopt market-based rules for balancing and to manage congestion to make it easier to move gas between hubs and/or regions. However, some bottom-up work is still needed before the less homogenous approaches by TSOs, shippers and regulators in different Member States allow a common model on capacity allocation mechanisms (CAM) and congestion management principles (CMP) to be implemented in every Member State.

*How do you think it should be formed, and who should be involved?*

The vision should be a European one drafted by ERGEG/ACER and the European Commission and driven primarily by the needs of infrastructure users. The output should not be more than a few hundred words and should be widely consulted upon. One possibility is that it could be agreed in the form of a Memorandum of Understanding between the Energy Commissioner and the Director General of ACER.

At working group level it should leave sufficient freedom to pick and choose pilot projects and reach harmonised solutions on specific issues in all/some Member States or regions and to move forward at different speeds towards the same goal.

In general, we support the idea that *“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”* as stated in the consultation paper. As no formal institutional role is given to market participants in the 3<sup>rd</sup> IEM package, we consider essential their involvement in developing a strategy and in monitoring its implementation. Considering the experience of the Regional Initiatives, market participants have often been consulted late, regional Action Plans are frequently not met and not all regions had strong leadership.

We therefore call for a better involvement of market participants and thus the recognition of them influencing “the overall direction of change”. They have a crucial role in suggesting the direction of market integration and giving feedback on implementation. Market participants have also the possibility to verify the practical

consistency between plans, actions, results and principles and can exert pressure on responsible bodies in case of incoherent regulation and/or undue delay.

*Which sort of forum do you think would be appropriate for the development of such a strategic vision?*

Ideas could be submitted from the existing “regions” but a small group, chaired by the European Commission and/or ERGEG, with EU-wide representatives of market participants should prepare the draft vision statements for approval by the next Madrid and Florence Forums in 2010. On the electricity side the AHAG seems fit for this purpose.

*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?*

There is always a risk of delay, but the risk will be limited if the strategic vision is agreed to be a very concise statement (perhaps with a small number of explanatory diagrams if necessary). Strict controls will be essential to stop the strategic vision expanding into a lengthy guideline.

Developing such a strategic vision would facilitate progress since it would set the basis towards integration by means of a common vision, with agreed minimum requirements on which regions and Member States can base their future action plans. The risk of holding up progress in Regional Initiatives in the meantime is diminished by virtue of the fact that several Regional Initiatives have lost momentum in the last year or so or become less relevant to real market integration projects.

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

*Do you agree that Member States should be more closely involved in the work of the Regional Initiatives?*

Given their role in the comitology process, which is required for the official enactment into EU law of some market integration measures, we agree that Member States should be more closely involved in the Regional Initiatives. One of the reasons to have a vision document would be to assist Member States in increasing their engagement with the process. In this context, it should be underlined that an effective, legally binding cross border regulatory framework is ultimately in the interests of all Member States.

The involvement of Member States is essential for the effective resolution of many cross-border issues. Legislative changes can be needed to ensure that undue

regulatory, operational or commercial discontinuities are removed and supra-national trading locations can develop. Greater Member State involvement will be welcome whether or not it is via the existing Regional Initiatives.

In the past the progress of different regions towards integration may depend also on the respective regulatory powers of national authorities involved. Those different powers can probably explain the slight commitment in some Regional Initiatives. Therefore we welcome the strengthening of national regulators' role, under the 3<sup>rd</sup> IEM package, with the extension of their duties to achieve the promotion of a competitive, secure and environmentally sustainable internal electricity and natural gas market *within the EU* and not only in each reference country. This is fundamental to allow them to adopt concrete actions towards the objective.

Nevertheless, national governments should cooperate in the overall process to facilitate the removal of barriers to fully competitive markets. The role of governments is generally to set policy and to change primary legislation; in many EU Member States governments still have a high influence on the development of the regulation of the energy sector and their influence has in some cases reduced the relevance of the market integration objective. Often national governments' intervention is limited to verify the formal consistency between provisions in place and the EU legislation principles, even if in practice we observe a considerable distance between principles and practical impediments to market entry (i.e. varying national licensing rules, reporting requirements, declarations of origin.). Thus, since under the 3<sup>rd</sup> IEM package jurisdictions remain national, the involvement of Member States in the work of Regional Initiatives is essential to ensure consistency between national regulatory bodies' role, their commitment in the Regional Initiatives and the policies set by Member States through their governments.

More generally, we believe Member States should have a prominent role in harmonisation. Their legislation concerning electricity and gas markets should move from a predominantly national approach towards the approach of establishing a single EU energy market. Namely the objective of integration should prevail over national perspectives that, in some cases, hinder the possibility to integrate markets and thus to reach wide competition and efficiency.

*If so, how should this happen?*

We believe that the involvement of national governments is helpful to achieve better understanding of the ongoing initiatives and to ensure that legislative changes, that can be needed, are adopted. Nevertheless national governments' role should mainly be to share the strategy and the design and to take the necessary actions through national legislation. Government support is fundamental for independent regulators, as the institutions practically responsible for implementing technically the overall design, and in pursuing the objective of market integration on regional and

European scale. Practically national governments' representatives should participate, under the actual Regional Initiatives organization, in the Implementation Group (IG) meetings.

There may also be benefit in ACER adopting an "Account Management" approach where capable representatives are assigned to proactively engage and inform each Member State and the European Parliament of developments in the Regional Initiatives.

### **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?*

For gas, there needs to be better clarity when talking about regions of Europe for administrative convenience (the existing three gas regions) and the eventual number of balancing zones that could be operated on a regional basis.

Currently there are three gas regions, but there are more than 20 different balancing zones. The optimum solution for the single European gas market is almost certain to be more than three and less than twenty regional balancing zones.

To find a way forward for gas, a new focus and analysis is needed on how contiguous pipeline systems could be optimally operated (multi-system operation) bearing in mind their differing technical characteristics and topography. That said, we do not at this point see merit in changing the number of gas Regional Initiatives currently in force, but some work may need to focus on smaller multi-system projects within these larger regions.

As far as electricity is concerned, we note that there are already initiatives that would lead to a reduction in the number of areas – in particular the Europex initiative "Price Coupling of Regions". We believe this should serve as a vehicle for the progressive integration of almost all Member States' electricity markets. So rather than reconfiguring the regions, we consider it is the right time to identify a core region in the European Union (which would be the Nordpool, CWE, OMEL block) with respect to the electricity market. Other regions could then progressively adhere to the core region once basic criteria were met such that market coupling could sensibly take place. The UK could be incorporated relatively quickly into this core grouping.

*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?*

We suggest that some electricity regions could be merged or, at least, a better coordination between regions should be established. It would be wise to discuss specific topics across the regions. We mainly believe that there's a need to allow the design agreed on major topics (i.e. congestion management) to be implemented in a coordinated way on wider regions and therefore.

In this sense, each country should be involved only in a Regional Initiative, so that it can be easier identify clear commitments and focus on regional and cross-regional integration issues.

Practically we don't suggest an on-off approach, rather a step-by-step approach starting with cross-regional alignment concerning topics on which there's already a common view because further developments towards integration could be reached mainly in this way. We support a pragmatic approach allowing variable composition of cross-regional coordination, depending on the subject.

This is the case of market coupling, single auction offices, flow-based capacity calculation and intraday trading. With regard to auction offices, the geographical scope should be extended improving asking for coordination of tasks between existing auction offices. Concerning market coupling a wider coordination should be considered in the view of PCG conclusions (Florence forum). Namely Nordic and CWE should be first merged, later to be joined by SWE and FUI. The same approach could be adopted for intraday. Concerning topics like cross border balancing integration could start with pilot projects at (actual) regional level.

However, along this process coordination and converge between regions is fundamental and such discussions could take place similar to the process of the PCG where for example the principle of continuous implicit cross-border intraday trading up to real time was agreed. Actual regions should be left to develop practical "local" issues, concerning a few countries within a wider region. Additionally, we suggest that EU countries not included in any region should be included and that clear management of Swiss issues shall be addressed as Swiss TSOs are practically part of the market, but not submitted to EU law.

Meanwhile, as regions start to overlap and new interconnections and/or market couplings get completed, we are contemplating in EFET a future elision of the work of the Regional Initiatives (many of which already ran out of steam) with the PCG follow-up work being started by the AHAG. We foresee the possibility, for example, of some inter/intra-regional projects concentrating on less tractable market design disparities. We have conceived the idea of projects involving CWE-CEE, Central -Nordic, the Swiss



roof, CWE-UK-Ireland, CWE-Iberia and Italy–borders to the north. It would be unnecessary for each project to comprise the panoply of elements originally involved in each Regional Initiatives. It would suffice to work on specific market design or grid management disparities (e.g. in capacity calculation, day-ahead auction design and timing, transmission rights auctioning) blocking harmonisation and standardization.

Our concept has led us furthermore to discuss inside EFET the merits of allowing some Regional Initiatives to die a natural death, but there could be others to replace them or variations. We are inclined to leave the Baltic and Balkan states to somewhat different processes (already constituted). We would like to discuss the overall concept and the merits with ERGEG, the Commission and other industry groups in due course.

We would also like to point out the need to approach a dimension hitherto missing from both Regional Initiatives and the PCG: integration of RES in the wholesale power market across borders.

Finally, for the gas Regional Initiatives, as we have explained above, the underlying problem is that connected pipeline systems are not operated optimally. This lack of consistency across systems is difficult to tackle in a large region, and further effort is needed by the gas TSOs, with support of regulators and governments, to develop more practical implementation of optimum multi-system operation within parts of each region in the interests of the users of the gas networks.

#### **4. Questions - set 4**

*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?*

Yes, if substantial for the European market, as there needs to be a consistent approach.

*How do you think this should happen?*

By ensuring that there is a shared vision, communication of all main activities to stakeholders and duplication with other initiatives is avoided.

*If you disagree, what role do you think these initiatives should have and how do you think convergence of European markets should be achieved?*

We do not necessarily believe that all initiatives must take place under the auspices of the Regional Initiatives. At least some of the progress that has already been made has

been the result of spontaneous co-operation between TSOs and/or Power Exchanges and indeed EFET. The regional initiative structure should allow such activity to continue unhindered. One possible way to achieve this would be for the regional initiative governance process to somehow endorse or sponsor efforts at integration being undertaken by other groupings provided they are consistent with the overall strategic vision.

## **5. Question 5**

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

The primary focus of the Regional Initiatives should be the practical implementation of the EU vision of a single energy market through the development, adoption and effective implementation of cross border network codes. ACER will be able to improve co-ordination in the sense that it has the role of settling differences between regulators on cross border issues. The involvement of ACER in setting the strategic direction of market integration will help give a signal to regulators on the principles it will adopt in resolving any issues that arise. ACER could take on responsibility for overall oversight of the progress being made in the Regional Initiatives with a team being appointed to achieve this. In the meantime, the ERGEG-AHAG grouping would be a good means for continuing to monitor progress for electricity, and a similar approach could be considered for gas.

Working structures should also be aligned to those projects that require international support and regulatory harmonization. Not all countries or TSOs within a “region” need to be involved in such projects, but the information about how the issues are tackled and the problems are overcome could be usefully shared in Regional Initiatives SGs’ meetings.

In general, greater coordination across regions is necessary. The creation of regions allowed different groups to work at various speed; this encouraged integration within some regions. But, on the other hand, gaps between regions have been increased and there’s a high risk that an overall harmonized framework could be more difficult to achieve. To ensure convergence between regions while following a step by step approach, we see the need to have a wider cross-regional discussion. ACER involvement is necessary for top-down (3<sup>rd</sup> IEM package) and bottom-up (Regional Initiatives) approaches to be complementary, avoiding inefficient overlaps and to solve possible disputes between regulators.

Finally, we believe that a concise strategy - made of a few and clear points - is needed to set the overall direction of market integration and, within this, the future role of Regional Initiatives. In this light, we propose:

- The improvement of governance in the Regional Initiatives. In order to increase national regulators' commitment it is fundamental that Member States are asked to contribute to regional cooperation, through the involvement of national governments in the Implementation Groups.
- A better involvement of market participants is necessary to ensure feedback on practical implementation and to highlight issues that still remain on the way to an integrated European gas and electricity markets.
- Operational and organizational improvements, in respect of the two above-mentioned suggestions, establishing effective internal working arrangements within the regions to ensure that the overall aims of legislation are implemented consistently and in a cost-effective way.
- Concerning electricity, merging regions could be useful to avoid overlaps and increase effectiveness even if coordination across regions should be even more important to ensure convergence on specific topics and thus strengthened. In this view each country should belong only to a Regional Initiative.
- Concerning gas, trading areas involving small numbers of TSO systems must be allowed to develop across national borders within the regions. To begin with, not all countries or TSOs in a region may need to be involved in such projects, but the experience should be shared with all.
- We suggest a pragmatic project approach to ensure further developments in market integration. Most developed Regional Initiatives should work on how to integrate with other regions/countries, also on specific aspects; less developed regions should concentrate on solving internal obstacles in the light of the best practices adopted in most developed regions in order to ensure convergence towards integration.