

COMMENTS ON

REGIONAL INITIATIVE PROGRESS REPORT

November 2009

23 December 2009

General considerations

Iberdrola welcomes ERGEG public consultation on Regional Initiative Progress Report. Iberdrola supports these initiatives as a tool for integration of national electricity markets.

The main points that should be taken into account have been identified by ERGEG: capacity calculation capacity allocation (long term, day ahead and intraday markets), balancing markets and transparency. Iberdrola has some comments that are exposed in point B.

But there are other issue that is relevant in the case of SW Region. This is the ban on imports of energy from any other EU country that has been approved in Spain, which effectively prohibits the main players of Spanish market from importing electricity from France and Portugal. Such a ban is an obstacle to the efficient use of the interconnections. Therefore, it contradicts the main objective pursued by Regulation 1228/2003.

As an exception to the equal access principle this Regulation provides in its annexe (article 2.10 of the Guidelines on management and allocation of available transfer capacity on interconnections, "Guidelines on congestion management") that National Regulators can impose, where appropriate, restrictions on the use of interconnectors by dominant firms to avoid abuses. Article 2.10 states that:

"In principle, all potential market participants shall be permitted to participate in the allocation process without restriction. To avoid creating or aggravating problems related to the potential use of dominant position of any market player, the relevant Regulatory and/or Competition Authorities, where appropriate, may impose restrictions in general or on an individual company on account of market dominance."

However, the prohibition foreseen in the Spanish legislation cannot constitute an appropriate use of such exceptional provision. Spanish legislation a) uses a threshold to identify "dominant operator" which is far more restrictive than that laid down by the EU competition rules¹; b) is not justified given that the Spanish

¹ Spanish regulation automatically identifies a company as "operador dominante" if it holds more than 10% of the ordinary regime installed capacity.

wholesale electricity market is already competitive and there is no risk of abusive use of market power; c) imposes a prohibition that is impeding efficient cross-border trade and preventing Spanish prices from falling, and d) is clearly disproportionate since there are less restrictive alternative means to increase the competitive pressure in the market.

For these reasons Iberdrola ask eliminate this ban as soon as possible, in order to remove the various obstacles it presents on cross-border trade and on the attainment of a single energy market.

B. Comments on ERGEG Electricity Regional Initiative

B.1. From your point of view, what is the main achievement of the Electricity Regional Initiatives process?

First, the Electricity Regional Initiatives has allowed to identify the main obstacles for the attainment of a single energy market and to increase the cooperation between PXs, TSOs, Regulators and Market Players. Also Regional Initiatives have allowed reaching agreements and developing proposals to promote the Regional Markets. The main achievements have been the implementation of Congestion Guidelines and the initiatives of Market Coupling in day a-head markets.

But there are still some cases in which Governments have approved new regulation without harmonization and without taking into account the works that are being done by Regional Initiatives. The Spanish Energy Ministry “Orden ITC/1549/2009” has change the previous agreement in “Orden ITC/843/2007” and the Regional Initiative has unfortunately not play any role. This has lead to a non-coordinated mechanism to allocate cross-border capacity between Spain and Portugal. Iberdrola urges to implement a coordinated and non-discriminatory mechanism based on the allocation of fully firm PTRs between Spain and Portugal as foreseen in previous regulation ITC/843/2007. For this reason, the participation of Governments should be reinforced in the Regional Initiatives and it should be compromises by Governments to consider the Regional Initiatives recommendations and explain why are not adopted.

Capacity calculation

B.2. What should be the framework conditions for having flow-based capacity calculation based on a common grid model implemented in practice?

First, a coordinated flow-based capacity calculation algorithm should be developed by TSOs.

In a second stage, both TSOs should interchange information to reply the calculation of the other TSO.

In a third stage, only one TSO has to be responsible of the calculation of capacity of each interconnector according to a common grid model.

The ATC-based approach should be changed towards a regionally-calculated flow-based approach. If a TSO consider ATC most appropriate the TSO should justify this decision.

B.3. What do you believe should be the short- and long-term goals for a regional approach to capacity allocation?

In the short term the goal is to increase transparency on calculation and process to determine capacity. This can allow knowing if the TSOs are working well and offering all the capacity to the market.

After this, in less than one year, the short-term goal is to reach an agreement on target capacity calculation model and the calendar to be implemented. Despite all the complexity involved in the models, we shouldn't forget the last aim of flow-based mechanism: further market integration through more capacity available to the market. Therefore, the whole process cannot be successful if less capacity is offered to market participants.

In the mid-term, in two or three years, Market Coupling, Continuous Intraday and TSO-BSP model for cross-border balancing should be implemented.

In the long term, less than five years, the development and implementation of a TSO-TSO cross-border balancing market.

B.4. Do you consider transparency requirements for capacity calculation sufficient? If not, what do you need additional data/information for?

There is not enough transparency on capacity calculation. Iberdrola has asked for the following data in other consultancies:

- Thermal capacity of interconnectors
- Commercial Capacity of interconnectors
- Reasons for the differences between Thermal and Commercial Capacity:
 - Security reserve and justification
 - Congestions: critical branches
 - Interconnectors availability
- Capacity Calculations by both TSOs in each interconnector

Transparency can prevent cases of abuse of dominant position on national electricity transmission markets by discriminating between domestic and export electricity transmission services and segmenting the Single Energy Market.

Capacity allocation

B.5. What practical steps should be taken at an interregional level to ensure an efficient and harmonised approach to capacity allocation in the 1) long-term; 2) day-ahead; and 3) intraday markets?

First of all, all regulatory restrictions that are hampering an efficient use in existing mechanisms should be removed. We refer particularly to the ban on imports that was stated previously. The removal of such measures will be a “quick-win” for creating a “level playing field” between all market participants thorough Europe.

In addition to this, Target Models defined at Project Coordination Group should be in some way implemented by ERIs. There is a high risk that Target Models are discarded by ERIs because “our region is different”. Any difference from the target model should be clearly motivated, and if possible, verified by an interregional organization (could it be ACER?).

Also real regulation-makers should participate in debates to avoid incongruence such as the abovementioned Orden ITC/1549/2009, that has created an specific product (contract for differences of the spread between Spain and Portugal) that is far from been harmonized with the current mechanism in place between Spain and France.

In the long term, all the available capacity should be offered in yearly and monthly PTR auctions by TSO in order to promote competition and the rule “Use It or Get paid for It” should be applied in day a-head auctions or day-ahead markets. Special care with fiscal issues (VAT) should be paid if FTRs are implemented as target model. PTRs are VAT exempted and do not enter into the prorate rule, however this might not be the case for FTRs.

In the day-ahead, governance issues should be clear since the beginning. We have seen disputes on governance in several regions that have provoked delays in Market Coupling projects. In our opinion, Power Exchanges must play an important role. However, TSOs should be leading market coupling initiatives.

For Intraday Markets, if Continuous Trading is the target model for EU, the regional models based on Intraday Auctions should move to Continuous Trading.

B.6. What are the future challenges in ensuring that allocation mechanisms across all timeframes can work together?

We advocate for maximization of capacity allocated in “correct” timeframes. In our opinion, correct timeframes are those that match forward products that currently are traded in the wholesale market and serve to hedge positions to suppliers and producers. So we consider that capacity rights allocated (annual and multiannual) in longer timeframes will be more helpful to market integration that those allocated in shorter timeframes (monthly and daily).

In certain occasions, some stakeholders, notably Power Exchanges, have asked for a reservation of capacity to be allocated in day-ahead if Market-Coupling is in place. In our opinion there is no need for any reservation of capacity for day-ahead timeframe when MC is available:

- If Transmission Rights are Financial (FTRs), there won't be any problem because all physical capacity will be available for the Market Coupling mechanism.
- If Transmission Rights are Physical (PTRs) and a use-it-or-get-paid-for-it mechanism is in place, traders will act efficiently and won't be nominate the capacity hold by them. Thus the majority of the capacity will be available for the Market Coupling mechanism.

Note that any reservation of capacity for the Market coupling day-ahead mechanism is, in some extent, hampering further competition across borders and not delivering better results in the day-ahead (traders will give this capacity back to get the congestion revenues).

B.7. Do you consider that achievements by different regions towards a harmonised set of rules at regional level for long-term capacity allocation merit further work or should there be more emphasis put on inter-regional harmonization (considering that this may impede short-term regional progress)?

In our opinion, ERIs have revealed as a very successful tool to harmonize wholesale markets in neighboring countries. However, some inter-regional harmonization is needed. In our opinion, Project Coordination Groups have achieved this quite well.

In any case, "quick-wins" for market integration should be implemented. Most of them can be implemented at a regional or even national level: Firmness of capacity or removal of current ban of imports in Spain are typical examples. Only when the identified quick-wins have been achieved, we should focus on the most complex issues such as flow-based interregional market-coupling

B.8. Do you think that extending the geographical scope of existing auction offices is advisable/feasible?

We advocate for the maximum harmonization if this leads to a more efficient use of resources. Auction Offices are on the direction of further harmonization. Nevertheless, they can be an expensive solution if we do not take advantage of the economies of scale. Therefore, a clear analysis of benefits and costs has to be done before extending the geographical scope of existing auction offices.

B.9. Do you agree with price market coupling as the target model for day-ahead capacity allocation?

Yes, but most of interconnection capacity should be reserved for PTRs, offered in annual and monthly auctions. A few amount of capacity and the rule “Use It or Get paid for It” can liberate enough capacity for market coupling.

Balancing

B.10. How important do you consider further development of cross-border balancing solutions? Which model do you consider appropriate and efficient?

The development of cross-border balancing can reduce the cost of deviation for customers and increase the amount of renewable power to be managed in a system.

An integrated balancing market is the optimal approach if congestions in interconnectors are not very often and a high level of integration exists as a market splitting solution for daily market.

If this is not the case and congestions are often and there is low level market integration, a model ‘TSO to TSO’ is a better solution. Iberdrola prefer a common merit order solution because of the economic benefits for systems and because it is objective, transparent and non-discriminatory. In this case, Iberdrola ask to improve the harmonisation of balancing markets and the technical characteristics of power plants to provide reserve or balancing energy.

The TSO-BSP model, can be implemented as a first step if the rest of models are not possible. In this case, we ask for an agreement between TSO to allow the generators of each system to send bids and offers to the other electric system. The generators, that could be interested in provide the cross-border balancing service, would be individually allow participating in the neighbouring balancing markets by TSO.

Full harmonisation is not a prerequisite under TSO-BSP model, but in the rest of the schemes the differences can make very difficult cross-border balancing.

Iberdrola agree that marginal pricing is the most efficient allocation of resources, and prefer this balancing services settlement scheme. For integrated balancing market model a common settlement scheme is needed and for ‘TSO to TSO’ model is the best solution.

Transparency

B.11. Do you share ERGEG's view that significant progress in transparency has been reached thanks to the ERGEG Regional Initiatives? What steps should be taken in order to enhance transparency further?

Some transparency improvements have been reached thanks to Regional Initiatives. However, there is still a huge way forward to reach the required transparency to have a level playing field across Europe. Differences of data available to the market are huge, not only between regions, but also between countries in the same region (e.g. Spain where unit-by-unit real-time information is available in a mandatory framework and France where these information is not available and the framework is voluntary).

We consider that there should be clear rules common in all MS to deliver transparency in the wholesale market. These rules should be the same across Europe and its implementation mandatory. In our opinion:

- Information having a reasonable probability of influencing prices should be made available for all market participants. For power markets, this shall include, but not limited to, availability and production in a plant-by-plant basis, as close as possible to real time. Unexpected unavailabilities should be disclosed to the market. We consider that the voluntary initiatives are not sufficient.
- Transparency regime should be EU-wide and ideally, information disclosed to the market should be the same in all Members States. We consider that a common implementation, application, supervision and enforcement among Regulators, TSOs, Power Exchanges and market participants will help in this issue.
- Transparency requirements should be mandatory and regulators should monitor compliance of all stakeholders (TSOs, Power Exchanges, Producers,...)
- As information disclosed may have an effect on price formation, reliability on the data is key. Therefore, a fall-back mechanism should be in place to avoid dissemination of inaccurate or incomplete data due to technical reasons (e.g. IT problems). Market players should be automatically informed when the information has not been updated and fall-back mechanism is in place.