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Position Paper

ERGEG Regional Initiative Progress Report

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General Remarks

The German Association of Energy and Water Industries (BDEW) represents 1,800 members of the electricity, gas and water industry. In the energy sector, we represent companies active in generation, trading, transmission, distribution and retail.

We welcome the opportunity to comment on the ERGEG Regional Initiatives Progress Report "Safeguarding the move to a single EU energy market - ERGEG Regional Initiatives Progress Report - November 2009". The Report allows evaluating the achievements made in the different regions and makes the various work streams and projects transparent throughout the regions.

BDEW strongly supports the regional approach and actively contributes to the development in the relevant electricity and gas regions. The regional approach allows a high flexibility in tackling practical issues on a bottom-up basis, while facilitating a high level of participation of market parties close to their geographical focus.

The advantage of the regional approach to provide a framework for development of flexible and quick solutions should be maintained, even while acknowledging an increasing necessity for European-wide guidance. The necessary coordination of the regional initiatives and orientation for common European-wide solutions can be achieved by processes for development of common target models. The Market Integration Design Project (MIDP) which has been launched for the electricity market in the context of the Florence Forum is a good example. Within this project, the work of the Project Coordination Group (PCG) has developed target models and road maps which help to coordinate the respective regional developments. In a medium term perspective these processes may serve as a guidance also for gas issues.

In any case, it is necessary that the market parties are involved adequately and in a timely manner, in order to achieve workable results and to include the operational experience and practical feasibility.

A. ERGEG Gas Regional Initiative

A.1. From your point of view, what is the main achievement of the Gas Regional Initiative process?

The Gas Regional Initiative Process has provided a forum for regulators, TSOs and market parties of different nations to discuss concrete issues of cross-border gas transport and trading and to start pilot projects to improve the market conditions. These discussions gave a better understanding of the nature of the impediments to cross-border trade and allowed to find suitable solutions on a regional basis. In addition, the Gas Regional Initiative has helped

to understand the different legal systems and the impact of these legal differences on integration of the gas markets. Finally, the projects led to closer cooperation of TSOs.

Investment in new infrastructure

A.2. Do you consider that Gas Regional Initiative (GRI) projects have effectively contributed to cross-border investment process? What kind of improvement would you expect?

The GRI projects have contributed to a better understanding of the issues connected with cross-border investments. In some cases, as in the French-Spanish Open Season Project, the GRI projects have facilitated cross-border investment.

However, in our view a major impediment to cross-border investment projects are inconsistent national legal regimes, which make it difficult to coordinate investment projects. These obstacles can only be overcome by legislative actions of Member States. We would expect to see more emphasis on cross-border investment in future.

Capacity allocation and congestion management

A.3. What lessons do you draw from GRI projects in the area of access to cross-border capacity? Do the current GRI projects on capacity allocation harmonization meet your expectations?

In particular the GRI NW has been able to launch interesting pilots, like the secondary capacity pilot. However, other projects on capacity allocation become very difficult to pursue, as the national legal regimes (in particular with regard to network tariffs) do not always allow the flexibility needed for a pilot. As rightly stated in the Progress Report, in some cases amendments to national law are necessary in order to go on with a project. However, such national legislative measures are not easily implemented.

Capacity allocation has been chosen by the Madrid Forum as the topic of the Pilot Framework Guideline in the gas sector. The Framework Guidelines will facilitate further projects.

A.4. Would there be real benefits if, at this stage, the GRI tried to seek better coordination at a cross-regional level? How do you value the experience acquired with the capacity projects in the regions? What type of projects should be developed in the future?

As the ultimate goal is the single European gas market, cross-regional coordination is an important issue. For the time being, however, it seems more important to coordinate cross-border initiatives within the respective region.

The Regional Initiatives should continue to focus on projects that are essentially market-driven, in order to provide the highest benefits for the markets.

Transparency

A.5. What would you expect to be the contribution of the GRI to transparency going forward?

Do the current projects in the three regions meet your expectations?

The transparency project in the NW region has contributed to progress on transparency and constitutes a good example of cooperation between the stakeholders in the Regional Initiative. The experiences with this project have set the framework for the EU approach with regard to the revision of the transparency guidelines in Reg. 1775/2005.

A.6. How could this work help to ensure that the requirements of the 3rd Package are met in a consistent way across the three gas regions?

It is important that the transparency requirements of the 3rd package and the amended transparency guidelines in Reg. 1775/2005 are applied consistently throughout Europe. The Regional Initiatives can provide a framework within which such consistent application can be ensured. In this respect, however, some cross-regional coordination is necessary.

Interoperability and Hub development

A.7. What further actions would you expect from the GRI in this area in order to contribute to interoperability and hub development?

Interoperability covers different working areas, not all of which are dealt with within the GRI. However, the work of the GRI with regard to cross-border investment, capacity allocation, transparency and balancing contribute to more interoperability. It seems essential that market-based solutions are found for these issues.

Hub development is currently not in the focus of Regional Initiatives. The GRI could include in its work the concept of regional hub(s) which could help to support the market-driven development of gas hubs in Europe.

A.8. From your experience with the Regional Initiatives, what are the main obstacles to reach harmonization regarding interoperability at a regional level?

As set out above, national legislation which may require amendment before progress can be made is one obstacle to further progress. In addition, early and intensive involvement of the market parties in the decision project is crucial, in order to ensure that solutions are found that meet market demand.

Security of Supply

A.9. Should security of supply be more clearly considered as a main driver within the GRI? Should specific actions be developed in this area?

A.10. How can the regions of the GRI take into account and develop measures contained in the European Commission's proposal for a Regulation concerning measures to safeguard security of gas supply?

The main objective of the GRI process is to contribute to a single European gas market. However, measures which improve the cross-border transport and trade of gas will also be beneficial for security of supply objectives. Naturally, the GRI process has to be coherent and consistent with the EU policy on security of supply.

With regard to specific security of supply projects, the relevant regions have to be defined according to the necessities of the specific security of supply interest. Therefore a different regional configuration is necessary.

B. ERGEG Electricity Regional Initiative

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

BDEW strongly supports the development of regional markets. The regional integration process, which has its origin in DG TREN's Medium Term Vision (2003), and the foundation of the 7 Mini-Fora by the European Commission have certainly accelerated the development of cross-border trade. The Regional Initiatives have set road maps and provided the framework for various ambitious projects, which have shaped or are about to shape the European energy markets. For example the implementation of fully competitive allocation of long term capacities at all borders and the establishment of transparency reports for all regions are major achievements. In the Central-West (CWE) region the establishment of the common auction office (CASC), the well advanced work on a common market coupling system and the increased co-operation of TSOs are positive achievements as well as the latter with positive support from the Pentalateral Energy Forum (PLEF). Without the regional process, only relying on national implementation of European provisions, the integration of national electricity markets would have been much slower. The Regional Initiatives provide flexibility and the possibility of feasible short-term progress, while the final goal stays the single EU electricity market.

Although the question of cross-regional development and coherence and convergence becomes more pressing, the advantages of the regional approach should still be employed.

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?

The starting point and rationale for the implementation of a flow-based capacity calculation methodology is that this methodology could provide higher security in grid operation and higher capacities for trading. As the methodology is still under development there is no evaluation of the achievement of these potential benefits yet possible for market parties. How-

ever, it is already clear that this methodology is linked with increased complexity. Thus, it has to be secured that this complexity in operation and the costs for implementation and future operation at TSOs and market parties are balanced with this mentioned advantages. BDEW supports the establishment of a European wide common grid model with a harmonised methodology and common assumptions of grid usage and security margins.

The common grid model and the flow-based method require a high level of cooperation between TSOs. The base case for capacity calculation should be developed on best estimate information provided by generators to the TSOs. Based on their own assumptions and the generators' input, TSOs should calculate the available capacities on a regional/ European-wide level while the goal should always be to maximise these capacities (taking into account security of supply restrictions). Certainly, in a competitive market environment generators must be free to adjust their dispatch decisions according to changing conditions.

It is of very high importance that market parties get a maximum of information on the algorithm and the values in order to understand the outcome of the calculation.

The development of a common grid model and the methodology has to be closely monitored by the competent regulatory authorities.

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

We assume that the question also addresses capacity **calculation** and base our answer on this.

Capacity calculation is the basis for capacity allocation and therefore of crucial importance for functioning markets. A clear target to be achieved in the short run is to develop a sound and transparent methodology for regional and subsequent European-wide capacity calculation with increased level of TSO coordination and to provide a suitable regulatory framework for such coordination and cooperation. Also creating incentives for investments in new grid elements where necessary and beneficial on a sound cost-benefit-analysis will be important.

Short term goals in allocation should then focus on implementing the already advanced systems for market coupling in day-ahead market on the intra-regional (CWE) and inter-regional (CWE-Nordic) level, based on a common view on a target model for the EU capacity allocation and congestion management framework. Shortly afterwards further regions should join this system.

Particularly, intra- and inter-regional intra-day trading should not be left behind and be developed with high engagement with regard to the crucial role functioning intra-day trading will play in the management of intermittent power generation like wind.

Last but not least, there are also further developments necessary in the systems for allocation of long term capacities e.g. the establishment of secondary markets and with securing firmness for allocated capacities. Also a clear and harmonised definition for force majeure is necessary.

The main issues are the common grid model and common assessment of capacity. These should be based on common databases, reliability assessments and security analyses. Redispatch measures should be taken in consideration where necessary to secure adequate available capacities for the market. It is of utmost importance that regional and later European-wide capacity calculation is done on a common model, based on common definitions and whenever possible at one place to use all possible up-sides.

As described above, flow-based methodology is highly complex and should therefore only be used where a real benefit in operational security and maximisation of capacities has been established. Such benefit can probably be expected more in highly meshed grid areas than where inter regional connection is based on only some direct lines or cables.

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

In general, capacity calculation is not very transparent at the moment. More information on the methods employed, the relevant input data and the outcome on capacities available for the market would allow the market to understand the capacity situation and use the result for evaluation of power market thus creating the necessary trust as basis for functioning markets.

Consideration of reflections on grid security should be balanced in an appropriate manner with the well funded interests of markets parties. Also, information systems designed in an appropriate manner should be established.

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?

With regard to an efficient and harmonised approach to capacity allocation in the long-term, day-ahead; and intraday markets, the following practical steps seem advisable. We refer in particular in our remarks below to the situation in the CWE and Nordic market which can also

provide guidance for the integration of other regions e.g. the CEE Regional Market which is marked by a highly meshed grid with the CWE Regional Market.

Some of the basic features of an EU wide target model have been already agreed within the PCG work and should serve as guiding principles in the design of methodologies and systems within and between the regions.

Long-term: Regarding the allocation mechanism in and **between** the two regions we see the following important principles:

1. The allocation congestion management mechanism should lead to an efficient use of the existing interconnections between the 2 regions.
2. Market parties should be able to financially hedge their forward price difference risk between two price areas.
3. In the final implementation of the market coupling (assuming liquid and mature markets on all coupled price areas) we prefer a completely financial solution where capacity holders get a payout in cash and all capacity enters the market coupling. In a transitional period a hybrid solution with a use it or sell it (UIOSI) mechanism where only unsold or unused capacity enters the market coupling could be acceptable.
4. The physical transmission risk should be handled and the financial consequences borne by the entities with the best ability to mitigate the risk. These are the TSOs that sell financial firm capacity rights on the different interconnectors between the regions save under force majeure condition. This will lead to the lowest risk profile in the market (and therefore highest welfare).
5. A significant[1] amount of this capacity should be sold (financially) firm on a longer term basis to allow efficient price forming of the capacity rights. For this an efficient and appropriate administration platform for a region to facilitate secondary trade of capacity rights is essential.

Day-ahead: In the Nordic and Central Western Region three individual coupling projects are currently under development/implementation. EMCC (coupling of Nordic via Denmark) with Germany), NorNed (coupling of TLC with Nordic via Norway) and CWE market coupling (coupling of the markets in the CWE region). These projects can also offer an inter-regional coupling between CWE and Nordic Regional market in the very near future. At the same time it has to be said that for a well functioning integration between regions great efforts for coordination and harmonisation need to be made especially regarding a consistent methodology, involved parties, time planning and technical aspects. (see further in B 9)

Intraday: The intra-day market is an important part of the electricity market enabling market participants to adjust their positions in order to respond to changes to their day-ahead programmes. This includes the coverage of interruptions of generation units or significant changes in consumption. Furthermore, the establishment of cross-border intra-day markets

[1] This amount is not fixed, but should be adjusted to the needs and development of the market.

will support an efficient response of power generation to an increasing share of intermittent wind power sources. Generally, the majority of optimisation activities are performed until the day-ahead gate closure; thus volumes in intra-day markets are anticipated to remain comparably low. The real value of the intra-day market is the risk management aspect for close to real time adjustments

Regulation EC 1228/2003 requests the compulsory implementation of market-based cross border intra-day trading as of January 1st 2008; so far there is only partial compliance.

In order to keep the confidence in the liberalised market, we support that efficiency gains should be made and the key should be a fast implementation (without necessitating significant changes e.g. on the regulatory side or in the link with capacities) of a trading platform However, existing platforms should be made open for other trading platforms to hook up. Precondition is that the full range of trading possibilities of the integrated region should be visible on any of these platforms (central order book concept) Furthermore it should be open to be further extended to other adjacent markets and regions in a later phase.

Regarding the *implementation* of cross border intraday there are two important issues:

priority: Intraday trading should be implemented independently of the implementation of day-ahead market coupling. It should also not wait for an ultimate capacity calculation regime.

allocation: The intraday capacity allocation should continuously take into account updated day-ahead capacities.

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

The main step is to reach overall consensus on the target model for the EU-wide capacity allocation and congestion management for the different time frames. In this area, PCG has provided valuable input. All further design of allocation methodologies should be based on this target model. A consistent break down of capacities on the time axis and implementation of an appropriate UIOSI- or UIOGPFI-methodology before the start of the day-ahead allocation are basic requirements.

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 harmonisation (considering that this may impede short-term regional progress)?

At present, there is merit in further improving rules at regional level for long-term capacity allocation however this work should be clearly based on a common target model to ensure that the development does not go against the inter-regional integration. Also it has to be ensured that for countries which are part of several regional markets methodologies are practicable and consistent. There has to be a monitoring that regional solutions do not impede pan-European solutions.

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

Expanding the regional scope of existing auction offices may be an efficient solution for pan-European harmonisation and allowing finally allocation of long term capacities at one place based on a set of harmonised rules. However, there are a lot of questions still to be solved like design of auction rules (normally based on national law), issues of governance. Extending the geographical scope should not hinder further progress in harmonisation within a region.

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

We support price coupling as the target model for day-ahead capacity calculation. A project for price coupling on the regional level is well under way in the CWE regional market. There is also a project for inter regional price coupling between the regions CWE, Nordic and CSE which we actively support.

At the same time we like to point out that the specificities regarding the requirements in harmonisation of products, time planning and governance are not clear which makes it very difficult to implement full price coupling in a timely manner. Against this background we see a tight volume coupling as a possible pragmatic intermediate step towards price coupling which should be seriously evaluated.

Balancing

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

Further development of cross-border balancing is important for the integration of the European electricity markets. It is crucial that market based schemes are applied in an appropriate manner before cross border exchange can be started.

We support the main principles outlined in the ERGEG Finalised Revised GGP on Cross-Border Balancing, including no reservation of capacity and no charges on access to interconnection capacity for balancing.

We advocate for a pragmatic approach in implementation, starting with defining and further development of pilot projects, harmonisation of gate closures and technical characteristics. More advanced projects / areas can start directly with development of multiple TSO cooperation (ending in coordinated system operation) without going through all the intermediate steps.

We do, however, not believe that the TSO-TSO model is the only conceivable solution. The merit of TSO-BSP models, at least as an intermediate step and in one price area where no bottlenecks exist, should be further explored.

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?

The Transparency Reports of the Regions have provided momentum for the further development of transparency of fundamental data. However the level of implementation of these reports is still very different across Europe. On the basis of the report for CWE pilot projects like the 2nd step of the EEX Transparency Platform in Germany have been developed. In fact up to our knowledge this project is the first that does implement the requirements from the ERI Transparency report regarding generation and consumption. The next step should be to build on these pilot projects and expand their reach beyond national borders (the EEX initiative is already open to data from Austria).

The experience gained in these projects can be easily employed for other markets and they can be the basis for a regional transparency platform as same level of transparency is a key requirement for integration of markets in one market coupling system.