

**European Regulators Group
for Electricity and Gas**

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Brussels, 4 October 2007

Dear Madam,
Dear Sir,

EURELECTRIC strongly supports the development of regional markets in Europe and sees regional markets as a pragmatic and practical intermediary step towards the internal electricity market. In this respect, the ERGEG regional initiatives are an instrumental tool and should play a major role in fostering regional integration. EURELECTRIC welcomed the launch of this project and has provided concrete input on key issues such as market transparency, integration of intra-day and balancing markets, improved capacity calculation (flow-based calculation) and increased cooperation of TSOs.

Regional markets will pave the way for an integrated pan-European market provided that they do not diverge (see the EURELECTRIC Road Map published in June 2005). We welcome the initiative taken by ERGEG to analyse the convergence and coherence of its regional initiatives in the electricity sector and appreciate very much the opportunity to participate in this public consultation process.

Noticeable progress has been made since the launch of these initiatives but the first year of operation shows that the results vary from one region to another. The markets which were already rather advanced progressed even faster and further, in particular where the initiatives are backed by government support (see e.g. recently the Memorandum of Understanding signed by the ministers of the Pentalateral Energy Forum). Conversely, markets which were lagging behind the most developed regions did not speed up their development and therefore the gap between the regions increased.

For this reason, we believe that it is very important for ERGEG to coordinate their regional initiatives even more strongly and to speed up the process in those regions which are currently not considered the most developed in Europe. More **cross-regional coordination** should therefore take place within ERGEG in order to identify **best practice** as a basis for the development of compatible and sufficiently harmonised solutions for all regions, following discussions with all involved stakeholders. The present report on the direction of the policies on particular issues in the different regions is very important in this context.

The analysis of the convergence and coherence of different approaches and proposals should be made in even more depth and recommendations should be set out – following thorough consultation with all involved stakeholders – for how to best achieve an internal electricity market based on the solutions developed. The different regions should also be obliged to consider the impact of their actions on other regions before adopting new processes and rules. The degree of necessary harmonisation and the timing of the alignment should be determined according to its impact on the functioning of the market.

Not only is it necessary to have more cross-regional co-ordination, it is also a basic condition to harmonise the regulatory frameworks of countries belonging to the same regional market, in a way that markets participants can operate in a truly level playing field without discriminatory (legal) limitations among competitors. In addition, there is also a need to harmonise the roles and responsibilities of different market actors in a regional and ultimately European environment.

We urge ERGEG to increase the **dialogue with and the support by the Member States** as political will is necessary to make real progress towards regional and ultimately a European market. This would also be important in view of enforcing the decisions taken by the regional initiatives, in particular in cases where the regulators concerned do not have sufficient powers (yet) to do so. In addition and as set out in our discussion paper on the “Regional Independent Operator”, a more regional and European view of regulators would be needed to achieve market integration.

We also feel that further synergies could be reached with a stronger **involvement of market parties** based on the work and actions EURELECTRIC and its members have engaged in. We believe that we could make a positive contribution to the work of the Implementation Groups (IG) and that we should be more systematically and in an early phase associated with their work. This contribution could also help to monitor consistency since one of the issues we are looking at internally is the direction the different regional initiatives take. The full involvement of market parties is therefore important for the further development of the process. This should also apply for cross-regional issues. In order to find the most efficient solutions for market functioning of the regional markets on both sides of the interconnectors, all market parties from the involved regional markets should be invited to an open and transparent consultation. An example where such consultations did not take place sufficiently is the change of congestion management rules on the NorNed cable.

We believe that it might also be useful to review the geographical scope of the regions of the ERI from time to time in the light of market development and reality. It could for example be possible that congestions are “moving”, due to new infrastructure investments or to increased flows, which might have an impact on the determination of a region. As a first step, we would support the proposal made in the report to include an eighth region for South-East Europe (based on the structures already established within the Athens Forum process) into the ERI process despite not all involved countries being Member States of the European Union. In addition, we also agree that Switzerland should be more strongly involved in the regional process as it is situated in the centre of the (continental-)European electricity network and therefore Swiss agreement on a number of issues (e.g. market based allocation on all Swiss borders) is important for the further developments towards a pan-European market.

In addition to these general remarks, we are happy to provide you with some high level responses to the questions raised in paragraph 131 of the consultation paper, which can be found in Annex 1. In view of the important and extensive questions raised, we would be happy to provide further in-depth input to some of the issues in due course if this would be a useful contribution to your work.

We would also like to use this opportunity to set out in Annex 2 the key issues for the different regions which should be – in the view of the electricity industry – addressed as priorities.

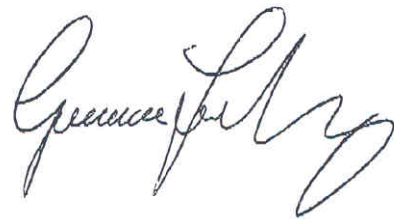
EURELECTRIC and its members remain strongly committed to the regional process and are happy to provide all necessary and relevant input for the further development.

We hope that our comments prove useful and look forward to our continued dialogue. We are at your disposal to discuss any points you may consider relevant in the follow-up of your work.

With best regards,



Eric van Vliet
Vice-Chairman, Markets Committee



Gunnar Lundberg
Chairman, Markets Committee

Attachments:

- *EURELECTRIC Position Paper on market transparency (as further to the request of the 12th Florence Forum) (February 2006)*
- *EURELECTRIC Position Paper “Towards European intra-day and balancing markets” (October 2006)*
- *EURELECTRIC Position Paper “Flow-Based Allocation of Transmission Capacity” (May 2007)*

Annex 1: Responses to specific questions set out in paragraph 131

– Capacity calculation

- *The level of transparency of the current and future capacity calculation methods applied by the different TSOs*

Commercial capacities should be determined by the precise physical realities of the grid but the existing discrepancies between NTC values and the actual flows on the grid lead to some concern. Improved transparency on the determination of capacities (notably on the calculation methods) would thus be much beneficial and would increase confidence of the market in the published capacity values.

If a flow-based method is implemented, it has to be ensured that the methodology and the input data for both the PTDF and the BC values are determined in the most transparent and neutral way. This means that they should not be set bilaterally by neighbouring TSOs but that they should be agreed regionally by a competent regional entity under effective supervision by the competent regulatory bodies. Also a high level of transparency to the market participants should be ensured. This appears to be the only way to ensure compliance with the agreed operational standards, guarantee the transparency and credibility of the grid calculations for all market participants and lead to optimal gains in economic welfare.

- *The need and the importance of long term (year, month) capacity rights (physical or financial) and the associated need for long term capacity calculation; and*
- *Which information should be published in the case of a flow (PTDF) based capacity allocation? Indeed, some implementation scheme may imply that ex-ante cross border day ahead capacity estimation should not be available anymore.*

In general, it is important to have full knowledge of the methodology applied as BCs and PTDFs are fundamental parameters that intervene in the allocation computations of a whole region and they thus unquestionably need to be published. In addition, the market needs publication of network capacity estimates on all time frames (Y-1, M-1, D-1) to be able to decide on its positions and determine which bids for capacity to place (for more details on the publication of relevant information on transmission and access to interconnectors see the EURELECTRIC Position Paper on market transparency (as further to the request of the 12th Florence Forum) (February 2006)).

- *Is there any added-value of implementing PTDF-based allocation method without an implicit allocation method or an explicit auction of obligations to nominate?*

With flow-based allocation, virtual netting of options is almost impossible. As this method gives full freedom to market participants to nominate flows in ways (directions and borders) that can not be pre-determined by TSOs, applying virtual netting would represent a great risk, which TSOs would likely manage by setting low BC values.

To overcome this problem, the most appropriate solution is to implement flow-based allocation either with implicit auctions or with explicit auctions of ‘obligations to nominate’. This would represent considerably less risk for TSOs and higher BC values could be set than if explicit auctions without obligations would be permitted. Market participants are however not in favour of the obligatory use of capacity rights for long-term (Y-1, M-1) allocation.

Therefore, EURELECTRIC recommends that flow-based allocation should only be used with implicit auctions for the day-ahead.

– ***Long and medium term capacity allocation***

- *Current auction procedures as well as the products auctioned are different in some aspects:*
 - a. *Can different auction procedures (where to go to acquire capacity, nominations, functioning of secondary markets, time frame....etc) on different interconnections hamper cross border trade where a market player wishes to or must trade over more than one interconnection?*
 - b. *Can different auction products (product profile, duration, degree of firmness etc) on different interconnections hamper cross border trade where a market player wishes to or must trade over more than one interconnection?*
 - c. *To what extent can the harmonisation of auction procedures and products contribute to a convergent development?*

Whilst having different auction procedures or products on different interconnectors might lead to a more complex situation than would be ideal, provided there is sufficient transparency and reciprocal access to markets, it should not prove a barrier to cross-border trade. However, the harmonisation of procedures and products for capacity allocation per region and where appropriate could contribute to the development of cross-border competition on a European level, and ultimately lead to lower transaction costs for the operator and thus increasing market liquidity.

- *Can the coexistence of PTRs and FTRs on different borders reduce the degree of hedging for a market player who wishes to or must trade over more than one interconnection? Can such coexistence on different borders cause any other obstacle to cross border trade where a market player wishes to or must trade over more than one interconnection?*

– ***Day ahead capacity allocation :***

- *Can day-ahead NTC based allocations and flow (PTDFs) based allocations coexist as such?*

NTC and flow based allocation cannot coexist on the same interconnection in the same timeframe and even should not coexist in the same regional market. However, as an interim solution, it should be possible to couple markets which use different allocation methods, e.g. to allocate long-term rights via an NTC-based model while on the D-1 allocation a PTDF flow-based allocation is applied. In such a case, the NTC-values should be the indicative value for the interconnectors between the regions. This question needs further in-depth analysis in order to avoid problems in trading with considerable financial impact.

- *Can day-ahead market coupling and market splitting coexist as such? Would you consider market splitting (a single power exchange) more efficient, in the longer run?*

Day-ahead market coupling and market splitting already coexist in the Nordic market. It might be the case that in some circumstances market splitting with sufficiently large price areas and with a single power exchange might be more efficient. However, the experience of the trilateral market coupling of France, Belgium and the Netherlands shows that several power exchanges can also provide very efficient solutions as long as the underlying contractual arrangements are sufficiently developed and there is sufficient transparency. The advantage of market coupling is that different but compatible market designs can remain. Nevertheless, a more sophisticated solution, e.g. with a central auction office, might be appropriate for larger regions, in particular in a highly meshed network.

- *Does the linking or merging regions using implicit auctions require a high degree of harmonization of “algorithms” and to some extent products and legal framework?*

Implicit auctions in a region necessitate full harmonisation of the algorithms and a high degree of harmonisation of the market frameworks (including products) to avoid inefficiencies. The harmonisation of procedures or of the gate closure is for example a necessity (see e.g. the problems the capacity allocation mechanism at the NorNed cable is currently experiencing due to the differences in gate closure on both sides of the cable).

- *Do you regard “volume coupling” (each PX participating in a joint auction office still calculating own prices, but based on auction office calculated volumes on interconnectors) as a flexible option in a transitional period towards a price coupling?*

– **Intra day :**

- *Should regions pursue the implementation of continuous trading platforms?*
- *What could or should be the geographical scope of such continuous trading platforms?*
- *Will the development of several competing intraday platforms in the same geographical area not be detrimental to the development of liquidity in intraday?*
- *If, for liquidity reasons, one single intraday platform appears to be relevant, who should offer this service? TSOs? PXs? Other? Should it be regulated, and how?*

In relation to these questions, we would like to refer you to the EURELECTRIC position on the integration of intra-day markets as set out in our October 2006 position paper “Towards European intra-day and balancing markets” (see attached). We believe that implementing continuous trading platforms as fast as possible in the regions is crucial for setting up intra-day markets by January 2008 as mandated by the Congestion Management Guidelines. In addition, in order to achieve the aforementioned goal continuously updated capacity allocation platforms should also be established as fast as possible by TSOs. We also would like to recall the importance of the firmness of available transmission capacity in the market, guaranteed by a high degree of coordination among TSOs and clear procedures and responsibilities.

The number of intra-day trading platforms and their geographical scope should be left to the market as it would lead to the most efficient handling of the issue. The questions were also raised when discussing the regional independent operator and whether such a regional entity could also provide a single regional capacity intra-day platform.

Intra-day markets are a way for market participants to trade and close their position to the largest extent on the market as close to delivery as possible. Therefore, the operation of intra-day markets should be provided by power exchanges or brokers and not by TSOs which should be responsible for balancing market operation only.

– **Balancing**

- *Is the harmonization of the remuneration schemes for balancing bids/ offers (pay-as-bid versus pay-as-cleared) a pre-requisite to the integration of balancing markets?*
- *Is the harmonization of the methods which determine the share of automatically activated reserves and manually activated reserves in the balancing reserves procurement a pre-requisite to the integration of balancing markets?*
- *To what extent a common intraday trading platform could be used for or interact with balancing trades?*
- *Could “TSO to TSO” balancing trades co-exist with “Actor to TSO” balancing trades? Could both processes co-exist and interact using a common balancing trade platform?*
- *To what degree should TSO to TSO coordination be enhanced or merged for national balancing markets to become properly integrated?*

The basic principles for the integration of balancing markets are also set out in the above mentioned position paper “Towards European intra-day and balancing markets” (October 2006). EURELECTRIC is currently developing a more in-depth position paper on how to integrate system reserves and balancing markets and how this could best be achieved. In addition, it might also be discussed whether the best solution for balancing markets becoming properly integrated on a regional scale could be to set-up a regional entity being also in charge of balancing the grid. In any case, we believe that cross-border balancing market integration is an issue which requires in-depth analysis and should only be done after intra-day markets are developed and integrated and following sufficient harmonisation of existing balancing markets across Europe.

– **Transparency :**

- *Is the described coordination of regions concerning the treatment of transparency sufficient?*

EURELECTRIC fully supports clear and harmonised rules for market transparency in the different regional markets. We believe that it is of crucial importance that the standard of transparency in the different regional markets should be at a similar level as wholesale trading markets are of European nature. Therefore, we consider it as a positive development that both the Northern and the Central-West European markets issued (broadly) the same transparency list for consultation in their respective regions – despite the need for further discussion on some open issues in the transparency lists. We encourage the lead regulators of the other regions to follow this example and to harmonise the requirements for their regions in order to create a level-playing field for market transparency in Europe.

- *What should be expected or required in terms of a harmonised level of transparency across the EU?*

As for the relevant level of transparency from the viewpoint of the electricity industry we refer to our February 2006 position paper on market transparency which also already called for a level-playing field on market transparency in Europe. For details see in particular the list provided in the Appendix of the “EURELECTRIC Position Paper on market transparency (as further to the request of the 12th Florence Forum)” (February 2006) which also constituted the basis for our input to the Transparency JWG set up by the 13th Florence Forum.

– ***Governance and regulation :***

- *Who should preferably be the owners of joint auction offices? How should “shares” (ownership and voting rights) be determined?*
- *Should auction offices, interconnectors operators and PXs disposing of all or part of interconnection capacity (disposing of an “essential facility”) be regulated?*
- *Which governance elements could ensure non discriminatory access of additional owners to a joint auction office?*
- *Could you mention other important governance requirements for PXs and auction offices*
 - a. providing “essential facilities”?*
 - b. undertaking purely competitive business?*

Annex 2: Regional priorities from the viewpoint of the electricity industry

Central-East

- Removing market barriers (technical, legal, etc.)
- Seamless cooperation of TSOs
- Congestion Management (cooperation of power exchanges)
- Removal of long-term contracts and price regulation
- Infrastructure investment based on regional planning

Central-South

- Regional action plan
- Clarification of the situation on market transparency
- Further improvement of congestion management methods
- Stronger involvement of Switzerland

Central-West

- Harmonised long-term auctions
- Market coupling by 1 January 2009
- Regional intra-day market + intra-day towards the Northern region
- Single regional auction office for transmission capacity
- Infrastructure investment based on regional planning, in particular for Interconnectors

Northern

- Proper implementation of market coupling on the NorNed cable (cross-regional issue) in cooperation with CWE region and on the DE-DK interconnector
- Market coupling on all interconnectors
- Implement transparency in the whole region
- Infrastructure investment to integrate wind power
- Extension of the existing intra-day market to the whole Northern region + extension towards the CWE region

– South-West

- Full implementation of MIBEL in order to further increase the market integration degree
- Inter-regional coordination with France following establishment of MIBEL

- Elimination of discriminatory limitations among market participants.
 - Increase of the cross-border capacity with France
 - Removal of price regulation
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- **UK & Ireland**
 - Regional intra-day market
 - Harmonisation of auctions, gate closure, etc.
 - Levelling-up on transparency
 - Regional balancing market