Mrs Fay Geitona
CEER Secretary General
Rue le Titien 28
1000 Brussels
Belgium

29 December 2009

Dear Mrs Geitona

**Safeguarding the move to a single EU energy market - ERGEG Regional Initiatives Progress Report - November 2009**

EDF Energy is pleased to provide the following views and answers to the open questions posed within the above report.

We welcome the format of the new report, especially the fact that progress is now being reported firstly by region and then by topic. This provides a more comprehensive and useful picture of the progress of all the current initiatives, which will make it easier for all stakeholders to assimilate.

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. We fully support the moves to create well-functioning EU energy markets which should facilitate the objectives of providing secure, sustainable and affordable energy supplies for all EU citizens and businesses into the future. We also support the regional initiatives as necessary stepping stones to that ultimate goal.

As regards electricity, the island nature of the British electrical power system, with its limited interconnection facilities all being HVDC links, separates it from many of the issues that exist regarding the power systems of other EU Member State. Having said that, EDF Energy welcomes the progress that has been made in both the gas and electricity regional initiatives, particularly considering they are voluntary, and specifically the progress on electricity within the FUI region in which we operate. We support ERGEG's approach of addressing the regional cross border issues first.

To make further progress on the regional initiatives, we believe that solutions should not be adopted, either in the regional initiatives themselves or in national markets, that create barriers towards the ultimate goal of a more unified market. One example of that might be the recent moves in the GB market to charge for transmission costs on an increasing zonally differentiated basis, which is completely out of step with the charging regime in the other FUI markets, as well as in the wider EU generally.

We are also conscious that the step from the regional initiatives to the single Energy Market will be a major change and must not in any way be under-estimated. As such, it is vital in our view that the overall objective should be to achieve fully functioning and integrated wholesale trading arrangements between markets, rather than trying to achieve any theoretical idealised solution. As such, we believe that the costs and benefits of moving to fully unified energy markets need to be properly considered before any attempt is made to

integrate the regional markets with each other. For example, if it were shown that the costs of this actually outweigh the benefits and where other options exist to ensure transparent, fair cross-border trade, then there must be flexibility to include those models and change tack accordingly.

For example, it could well be the case that a well functioning and interconnected set of regional markets could be just as efficient and effective in promoting competition and maintaining security of supply as a single EU energy market. Combining markets to create one could have an adverse impact on consumer prices and service levels if there are fundamental physical and technical differences between markets, as was the case with the amalgamation of the wholesale market in England & Wales with Scotland under BETTA. Indeed, we believe there is value in referencing and learning the lessons from the UK gas and electricity model since privatisation as one of the most liberalised energy markets in the world.

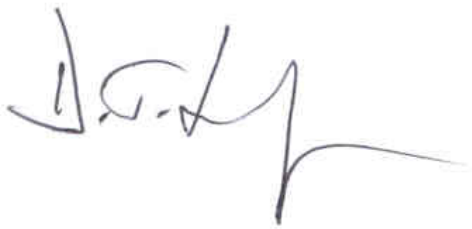
EDF Energy believes the Regional Initiatives will still have a role to play forwarding future in designing and implementing the framework guidelines that will form the legally binding unified codes. There then has to be a period in which the trading arrangements and systems that have been adopted within each region are fully analysed and compared, to assess whether:

- any are worthy of being transposed into other regional markets;
- they can be transposed practically; and
- there is an overall benefit for that market or the overall EU market.

In addition, the regulations must not be so prescriptive that they become limiting, to the extent that they themselves form a barrier to trade or investment. In this context, EDF Energy believes it is essential that merchant interconnectors are allowed not just to exist but that they should be encouraged. TSOs often do not have the same commercial drivers as other parties and there is no reason why only TSOs, who have a different risk/reward balance, should own and operate interconnectors.

Our detailed responses to the open questions are contained in the attachment to this letter. If you have any queries regarding this response, please contact my colleague Michel Tocher on +44 20 7752 2167, or myself.

Yours sincerely



Denis Linford
Corporate Policy and Regulation Director

Attachment

**Safeguarding the move to a single EU energy market - ERGEG Regional Initiatives Progress Report - November 2009**

**EDF Energy's detailed response**

## A. ERGEG Gas Regional Initiative

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

We believe that the main achievements of the Gas Regional Initiative are:

- the ability to bring together all the main Gas Transporters, Producers, Shippers and Suppliers in a room together with Regulators to discuss how the EU gas market can be opened up, liberalised and made more transparent and competitive to create a single EU energy market transcending national market arrangements;
- the harmonisation of certain rules and trading arrangements between adjacent countries leading towards better interoperability and increased hub liquidity;
- the development of Information Transparency programs phase 1 and phase 2;
- the establishment of voluntary cooperation and commitments by stakeholders ahead of legally binding EU regulations designed to create and encourage competition and market transparency ahead of the implementation of the 3rd Package, and
- helping resolve the security of supply crisis created by the Russia/Ukraine dispute.

## Investment in new infrastructure

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

We believe the GRI has been effective in highlighting the issues that are preventing cross-border trade and investment and in identifying the crucial pinch points such as the lack of interconnection between Spain and France. The Southern RI has been successful in designing legislation and a capacity auction mechanism to openly and fairly allocate capacity. However we note that this type of progress is still lacking at some of the NWRI hubs.

Investment in infrastructure will only take place where there are significant demand or investment signals and a manageable level of risk. From discussions at the Regional Initiative meetings it is evident that TSOs may be unwilling to invest without investment certainty and remuneration. This could be provided by appropriate regulatory measures and confidence that costs can be recovered. For these reasons we do not believe lots of progress has been made to create or release extra capacity in the NWRI as the incentives are not yet there for the TSOs. More could be done to facilitate this by:

1. Establishing and making public the maximum physical capacity that can be made available at the major Transmission Entry and Exit system points, and
2. Requiring TSOs, once this is done, to release this amount of capacity as firm and any extra capacities interruptible through a combination of short to medium term allocation mechanisms.
3. Developing appropriate incentive schemes and price controls.

We would expect NRAs to apply immediate pressure on the first 2 points above and start to develop a regulatory framework for point 3 that guarantees extra investment where needed to open up and facilitate greater cross border trade.

## 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?**

We believe that the GRI projects have been a good first step in discussing the issues around capacity allocation and constraints, and ensuring there is more transparency. However, it is evident that there is a lack of firm capacity at many major Entry/ Exit system points and that its release is still being unnecessarily restricted, sometimes up to 50%, which is hindering competition and trade. We believe that national regulators should put greater pressure on TSOs to ensure firm capacity is made available as this could be easily realised without much work.

**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?**

Projects that link Member States to ensure the free flow of gas especially from Member States where there are bottlenecks such as from Spain into France and from Western to Eastern EU should be prioritised.

## 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?**

We believe the information transparency projects have been working well, especially in the North-West region with phase one having been implemented and phase two currently in the process of being implemented.

**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?**

We believe that the better coordination of rules and requirements from one region to the other should ensure that the requirements of the3rd package are met in a consistent way across the three gas regions. We see no reason why there should be differences in the type and level of information being made available in different markets across the EU. The UK Gas market is a good example of effective information provision.

## 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?**

Maximum firm and interruptible capacity release is paramount for the development of well functioning and liquid hubs in Europe. TSOs need to be encouraged to release as much

capacity as possible and if not they need to be incentivised as it will be good for competition, consumers and the EU economy as a whole.

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

- the lack of firm capacity being made available at major Entry/ Exit system points;
- the lack of short-term capacity release mechanisms at cross-border points and hubs;
- the difference in gas quality levels and the inability of certain \member States to accept gas from all sources and gas type;
- the lack of effective investment signals for long-term capacity build;
- greater transparency from TSOs and market operators.

## 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?**

Not necessarily. When all the conditions under the 2nd and 3rd Energy packages are implemented then security of supply risks for the whole EU would be minimised; interventions should not undermine what the market can deliver.

**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?**

This question will depend on how the 3rd Energy package is to be legally implemented. MSs should ensure that the conditions of any regulation, including security of supply regulation, are translated and implemented into their own set of national legislation and codes where applicable.

## B. ERGEG Electricity Regional Initiative

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

EDF Energy fully supports the development of regional markets in Europe and sees them as an initial and realistic approach towards achieving the ideal of a single EU electricity market.

The initiative has initially focussed the attention of the regions' participants on their cross border trading arrangements and the differences that exist across their own boundaries, as well as addressing and implementing the requirements of the Congestion Management Guidelines.

Once this has been achieved, there will be the opportunity to analyse properly the differing methodologies and systems that each Regional Market has used to harmonise its own arrangements or, indeed, the problems that have prevented it doing so. This will enable any best practices to be identified and to work towards identifying what could become an idealised model for each Region and thereby for the whole EU market as well.

However, EDF Energy believes it vital that full cognisance is given to whether such changes will bring tangible benefits and especially whether these exceed their consequent costs.

Great Britain is an island, separated by at least 35km of water from its neighbours, so the GB electricity market is interconnected by means of limited HVDC links only. These are high cost facilities which have to be fully justified commercially and on a different basis from that used to make other transmission investment decisions, whose investment drivers are to respond either to generation or demand development and to maintain security standards. The merchant Interconnector model must be allowed to co-exist alongside any TSO led model to cater for the different drivers and incentives that each might have.

## 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?**

For technical reasons, all interconnections with the GB electricity market will be via HVDC facilities. These have the advantage of definable capability and flow direction, unlike HVAC interconnections, which are heavily influenced by nearby generation or demand. HVDC capacity is limited only by the design and availability of the equipment itself.

The capacity and availability figures for the GB interconnections would therefore form an input into any flow-based calculation for those systems that are AC interconnected. EDF Energy cannot at this stage see the need to impose Flow Based techniques on the GB and Irish systems. Furthermore, EDF Energy has yet to be convinced that the flow-based methodology offers benefits over other tried and tested load flow study techniques. It therefore eagerly awaits the outcome of the studies currently underway.

EDF Energy is concerned that were flow-based calculation to be adopted within the British and Irish systems and integrated with the rest of Europe, would this require the current security standards to change in GB from double circuit security to single circuit security.

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

We believe that the short and long term goals for a regional approach should be to:

*Short-term*

- reach consensus within the region on the methodologies and procedures for its interconnections that will deliver the requirements of the EU capacity allocation and congestion management framework;
- fully identify what worked well and what prevented other methodologies and procedures from working;
- consider whether other Regional initiatives could be adopted and whether there would be any advantages in doing so.

*Long-term*

- incorporate Market Coupling or other techniques that deliver fully flexible trading arrangements and capture all the potential benefits offered by having an interconnection i.e. pseudo-generation, trading and ancillary service benefits.

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

EDF Energy wishes complete transparency on the way in which interconnection capacities are calculated. Clearly for HVDC interconnections, any restrictions would be due to some problem with the interconnection facility itself; to a large extent it is not affected by pre- or post-fault load flows on the nearby system. This is not the case with HVAC interconnections, which can often bring about differing import and export limits, but with transparency comes the understanding by others as to why those limits have been placed.

## 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?**

*Long-term*

National regulatory authorities should ensure that appropriate and consistent systems and methodologies are in place on the interconnections within their jurisdiction (be it a TSO or merchant interconnection). These systems and methodologies must provide the maximum opportunity for all parties wishing to participate to trade energy products with the neighbouring power system in either direction. Given that the trades could be in either direction, TSOs should determine the consequences of full imports and exports and what would be best for their network, minimising constraints and maintaining system security. These consequences would be the basis for any trading the TSOs might seek to do to balance the system or to alleviate or to minimise constraints. It is EDF Energy's view that TSOs should only be allowed to trade with each other (for energy or system balancing) after gate closure, which in turn should be no more than one or two hours ahead of real time.

If a dispute arises over the determination of interconnection arrangements between affected TSOs/Owners that can not be resolved with the aid of the National regulators, then the services of ACER could be called upon. This in turn may then impact on the arrangements of other interconnections.

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

Each power system has developed largely separate from its neighbour. There has been an element of picking out best practice and, of course, the UCPTE and since 1999 the UCTE have set common technical rules and standards under which the Continental European countries have operated their power systems. Market rules have been adopted more on a country-by-country basis. So the achievement of having just one common set of trading and technical operating rules will be extremely challenging.

It will be vital, if success is to be achieved in moving closer to a single fully integrated European electricity market, for there to be full understanding and acceptance of both the costs and the benefits. There has to be full transparency in this process as well.

The different regional approaches will allow appropriate comparisons to be made to identify those methodologies that might be more robust than others or lend themselves to be transferred into other regional systems, thereby leading to an ideal pan-European market model.

**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)?**

EDF Energy considers that there has to be harmonisation for all contract durations for any particular interconnection and that this is also compared with the arrangements and products on other interconnections for consistency and harmonisation. The prime objective should be to facilitate trade between national markets by supporting flexible regulation, enabling existing capacity optimisation and interconnection development.

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

EDF Energy sees no reason why the geographic reach of the auction offices should not be extended or, indeed, ultimately combined into just one, providing that there is no loss of efficiency and that there is a cost benefit. The argument is the same as for all the EU countries adopting the same rules and procedures, if there is a net benefit then it should be adopted.

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

EDF Energy accepts that price market coupling has been chosen as the target model for day-ahead capacity allocation, which currently implies day-ahead nomination. EDF Energy reserves its opinion on whether this is the best method for all interconnections or indeed what its adoption will do to the value of the longer term capacity auctions and hence the returns to the interconnection owner.

## Balancing

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

The full benefit of having an interconnection is only realised if there are opportunities to trade and arbitrage between interconnected markets for all timescales right up to real time. In today's market regime, this can be done by various means of explicit and implicit auctions, together with a secondary market for unwanted/unused capacity, superposition and Use-It-Or-Sell-It rules. These should enable market participants and traders to trade and balance their own books up to gate closure, which in EDF Energy's view should be no greater than two hours ahead of real time. Following this, and only then, the TSOs should be allowed to trade and balance the physical system, selling and/or buying back energy as required as system conditions change or to potentially help resolve any transmission constraints. All previous contracts (nominations) are considered financially firm, but the TSO transactions act as a further overlay.

This inter-TSO-TSO activity provides real benefits to the two power systems, allowing fine tuning of the two wholesale and generation markets to enable customer demand to be met at least cost. However, it should not be forgotten that this benefit has been provided by means of the physical interconnection and that the arrangements for paying for capacity on such links must not inhibit potential cross-border trading.

## 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?**

EDF Energy considers that the Regional Initiatives have encouraged close cooperation and working to produce a common set of methodologies that comply with the Congestion Management Guidelines. This has encouraged further transparency of working procedures amongst parties as well as bringing about further changes to market rules that will deliver greater reporting of cross-border activities. If more information is required or sought by market participants then efforts should be made to provide it, unless justification for not doing so can be made to the regulatory authorities.

**EDF Energy**
**December 2009**