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To:
European Regulators Group
for Electricity and Gas
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Nordenergi Comments on ERI Convergence and coherence report

Nordenergi welcomes the opportunity to give comments on the ERI Convergence and Coherence Report. The report addresses important issues vital in order to integrate electricity markets. In general, Nordenergi supports the ERGEG ambitions of a well functioning and further integrated European power market. Experience has shown that market integration is most efficient when based on market driven processes, and it is vital that regulators enable and foster this development.

It is very important that convergence between regional initiatives is enhanced. In order to pursue the most efficient solutions from a market functioning point of view and in order to increase transparency of development in transmission and trading systems, we propose that a consultation process is initiated involving relevant regulators, TSOs, power exchanges and market participants in cases dealing with inter-regional integration.

In order to create a level playing field within and between regions, a balanced and coordinated development is important. If one issue is left out or is not addressed from the beginning, it is important that the process has a flexibility to include upcoming issues that are crucial for a successful development.

Economic theory and practice suggests that the use of implicit auctioning is the most efficient regime for congestion management and the best approach to optimise NTC, securing transparent and liquid spot markets and thus trust in the price formation. Within the Nordic region, the use of implicit auctioning is successfully implemented on all interconnectors. There has been no discussion or doubt among the Nordic market players on the efficiency benefits related to the use of implicit auctions. Generally, the use of explicit auctions should be considered as a second best solution, as efficiency losses affect the consumers directly. Nordenergi believes that many of the problems addressed in the ERGEG report would be solved by introducing implicit auctions. We would like to stress that any mixed or "hybrid" solutions should only be considered as intermediate steps towards full market coupling using implicit auctions.

Nordenergi also wants to point out the problems with different gate closure times between different interconnected regional power exchanges. This causes difficulties for further integration and efficient trade between the regional markets. We recommend that this topic is included in the further proceedings.

Capacity calculation

Methods for capacity calculations should reflect the need for transparency and harmonisation. Nordenergi recognises many of the advantages related to flow based allocation methods. We are, however, somewhat sceptical since there are many important prerequisites that must be in place in order for it to be implemented successfully, cf. Eurelectric report. In any case, it is important that the process of developing capacity calculations methods does not delay other developments in e.g. capacity allocation.

Long term and medium term capacity allocation

Nordenergi does not see the need for long term capacity rights (physical or financial) in a well developed power market. However, there is a need for financial instruments e.g. contracts for differences (CfD), enabling market players to hedge potential price differences between markets (basis risk). In our opinion, risk management by use of long term capacity rights will undermine the liquidity in the financial markets on CfDs or other suitable instruments, and reduce transmission capacity utilisation.

As already mentioned, Nordenergi considers the use of explicit auctions to be an intermediate step towards full market coupling (implicit auctioning). In that sense, Nordenergi believes that long term capacity allocation (multi-yearly auctions) may cause a delay in future abolishment of explicit auctions for congestion management, undermine liquidity in the Day-ahead markets (spot), in the financial hedging instruments and reduce transmission capacity utilisation. Should explicit auctions be applied, the weight of the allocation should primarily be set on a daily basis or at least restricted to a monthly or quarterly basis. Also, the principle of “use it or lose it” must be effectively implemented.

Day-ahead capacity allocation

Different procedures and gate closure times between interconnected regional power exchanges have proven to be an obstacle for efficient trading between the regional markets. Inconsistencies also prevent efficient use of implicit auctions for inter-regional trade. The need for harmonising gate closure times should therefore be addressed in more detail.

Nordenergi does not believe that day-ahead NTC based allocations and flow (PTDFs) based allocations can coexist as such. However, day-ahead market coupling and market splitting may coexist as a step towards developing integrated European electricity markets. Market coupling is a methodology to couple exchange areas (e.g. Nord Pool and APX)). In addition we would also stress that “market splitting” should be supported with counter trade as an additional methodology to handle temporary congestions within a market area.

In our experience, the use of implicit auctions (market coupling) presupposes some, but not a substantial degree of harmonisation between the markets. Some vital issues must be harmonised, i.e. gate closures.

Nordenergi considers “volume coupling” to be an intermediate solution towards price coupling. In any case, it needs to be an iterative process. We would prefer a solution where the PXs exchange data during the price calculations in an iterative process to achieve an efficient allocation of the transmission capacities.

Day-ahead capacity allocation is closely linked to TSO functions, facilitating vital infrastructure for electricity trading. Day-ahead markets (as well as intra-day and balancing markets) must therefore be organised in close cooperation with the TSOs. However, other financial and derivative markets are considered as pure competitive businesses.

Intra day

Nordenergi agrees that regions should pursue the implementation of (cross-border) continuous trading platforms. We believe that this will increase the overall efficiency of the market. The geographical scope of such platforms should be as broad as the system can handle. The scope should at least include each country (or region of the country) on both sides of the exchange capacity.

The development of several competing intraday platforms in the same geographical area may be detrimental to the development of liquidity in intraday trading. Preferably, only one intraday platform should be implemented. If there are several platforms in the same geographical area, they should work together as one platform.

The TSOs have to be involved in the process of developing one single intraday platform. The service may be offered by a third party through a mandate from the TSOs. Nordenergi believes that the platform probably should be regulated, at least to some degree.

Balancing

Integrated balancing markets require a high degree of harmonisation in order to function efficiently. This includes the harmonisation of remuneration schemes for balancing bids/offers and the share of automatically activated reserves and manually activated reserves in the balancing reserves procurement.

Nordenergi does not believe that “TSO to TSO” balancing trades should co-exist with “Actor to TSO” balancing trades. Open, efficient and liquid balancing markets should be established enabling market participants (including TSOs) to trade balancing services on equal terms.

A high degree of integration and coordination between the TSOs contributes to increased efficiency of the power markets. Possible gains may however be limited by transmission constraints.

Transparency

Nordenergi would like to stress that transparency is of the utmost importance in order to create a level playing field and to promote efficient trade. In our opinion, lack of transparency is a serious threat to the development of both regional markets and further integration of the common European market. Therefore, Nordenergi recommends that this issue is pursued in all regions. The transparency solution that has been reached at Northern ERI provides a good basis for a European standard.

Governance and regulation

Nordenergi believes, as long as explicit auctioning solutions exist, that power exchanges should be the owners of joint auctioning offices, perhaps with TSOs as a secondary solution. The owners should in any case not be players with strong commercial interest in the results from the auctions. Nordenergi also believes that participants disposing interconnection capacity should be regulated to some extent.

Final remarks

In general, Nordenergi fully supports the process towards creating one single European market. This process is vital to creating a secure, efficient and sustainable energy supply for the future on both national and regional levels. The development of a framework and regulation should therefore be developed on the basis of business driven processes that contributes to efficient market solutions.

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