

Position Paper

ERGEG Draft Strategy for delivering a more integrated European Energy Market: The Role of the Regional Initiatives

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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 “Draft Strategy for delivering a more integrated European Energy Market: The Role of the Regional Initiatives.”

Introductory remark

BDEW welcomes the effort to re-evaluate and eventually to re-calibrate the role of the regional Initiatives in its strategy to seek EU-wide market integration via a set of well defined regions for electricity and gas. The most important question should be which lessons can be learned in the light of some years experience with these regional markets and how the framework is changing with the beginning of implantation of the *3rd energy package*.

BDEW points out that ERGEG’s consultation comes at the right moment as - concerning the power sector - the Florence Forum has already asked for a target model beyond the current status of regional integration (MIDP) and set up the Project Coordination Group (PCG). Results have been on the whole quite positive, even if some more time to thoroughly design the target structures and to discuss with regions would have been preferable. The working results obtained via the PCG-process should now be implemented as already started with the new AHAG process..

As far as gas is concerned it might be good to set up a process for definition of a strategic vision something similar to the PCG-process. But such a process should require more time for deliberation.

So the strategy may consist of

- refining and implementing the PCG-results for electricity
- identify in the mid term appropriate target models for the main X- border market design features for gas
- leave ample room for pragmatic interim steps both in electricity and gas
- assessing the role regional initiatives can play on the way to the target model
- recalibrating functioning of the existing regional initiatives and eventually – in the case of electricity – slightly adjust the geographic remit

BDEW is happy to constructively contribute to this exercise.

In the context of this consultation BDEW would like to concentrate on 5 key areas:

- interaction of bottom-up and top-down approach
- role of governments
- structure and geography of the regions
- market parties and DSO involvement
- same vision for gas and electricity?

Questions - set 1 (interaction of bottom-up and top-down approach)

There is no 'blueprint' for achieving a single energy market, and yet activity towards that goal is taking place across a number of levels. Do you consider that a high level / strategic vision is needed to set the overall direction of market integration? How do you think it should be formed, and who should be involved? Which sort of forum do you think would be appropriate for the development of such a strategic vision? Do you see a risk that developing a strategic vision may delay implementation in the regions under current structures, or that it could facilitate progress?

“Combining high level vision with a pragmatic best practice strategy”

Regional Markets are highly contributing to the integration of the European energy market the benefits from greater regional cooperation, *facilitating pilot testing, benchmarking and spread of best practices*. A regional approach reflects the reality of energy market integration as in many cases it is clear that the most appropriate geographical scope of an issue is neither bilateral in nature, nor European wide. We are convinced that regional markets can make a strong contribution to a fully integrated European energy market.

The regional approach is working bottom up. In order to reach the goal of achieving a single energy market it has to be accompanied with

- top down guidance
- incentives to take up positive examples from advanced regions (horizontal)

Top down guidance should come from

- EU-wide target models
- network codes and framework guidelines

EU-wide target models: Develop a strategic vision to set the overall direction of market integration – knowing that during the design phase many delaying factors are still out of sight but they do exist. It is of utmost importance that ongoing progress – provided that it is not detrimental to further integration - is not hampered by the long term strategic vision. As soon as such a strategic vision is developed and agreed there will be a need for some kind of clearing mechanism which helps to decide whether short term action / process is a no regret measure

or whether it at least allows for an evolution towards an EU-wide solution. The appointment of the AHAG has been a good step in this direction.

Network codes and framework guidelines: With the 3rd Package a much more developed framework for establishment of competitive markets and market integration has been set. The regulations on electricity and gas foresee the establishment of framework guidelines and network codes for a well defined set of issues. BDEW welcomes that ENTSO-E and ENTSO-G are set to start the process with pilot codes before the official deadline is reached in 2011.

At the same time the approach described above should leave enough room for regional projects to develop. It is important to ensure that feasible short term regional progress should not be slowed down but rather accelerated by a mid to long term EU-wide target model. Requiring a "one size fits all" approach cannot work, as it does not reflect for instance the different starting points of the various Member States and regions. Conversely, the ultimate goal of a true internal market for electricity and gas as much as a EU-wide level playing field demand that coherence is ensured. BDEW agrees that policy guidance is not restricted to a top down context. By and large the same is true for best practice that can be shared between regions.

The interaction of top down or horizontal guidance can be described by Triple A implementation, where Triple A stands for:

- Assessment of existing market design best practices and eventually incorporation of those features into a target model
- Adaptation of the needed tools to reach the target model to the specific needs of a given region or various regions (provided an adequate level of harmonisation is ensured)
- Application of best practice ("oil spread") or eventually an agreed target model in all the regions consistently based on progress achieved so far

Entrust an appropriate body with overseeing and supervising the different implementation steps and giving advice on the appropriateness of each step. ERGEG together with the relevant stakeholders could, within a structure such as AHAG, take up this role in a first phase, while later on ACER, preferably supported with the input of a further elaborated group for representation of stakeholders could continue this "top-down" guidance. Certainly, this should not replace the formal consultation procedure of stakeholders (market participants/ grid users).

We consider participation of market parties as key for achieving practical solutions in line with the overall European political strategy.

2. Questions - set 2 (“role of governments”)

Member States have an important role in establishing a legally binding cross-border regulatory framework, as well as in relation to their own Member State’s interests. Work in the Regional Initiatives will be very relevant. Do you agree that Member States should be more closely involved in the work of the Regional Initiatives? If so, how should this happen?

The EVERIS-MERCADOS study rightly mentions the role for governments of a certain region quoting the PLEF and the equivalent Gas platform.

Yes, we fully agree with a closer involvement of Member States in all regions where this is not the case till now (Nordic energy council and PLEF and are well functioning bodies in our perception. It’s fundamental that Member States give their support to the regional co-operation of regulators and TSOs as it is their task with the 3rd package. Practically, national governments representatives should participate, adequately under the actual Regional Initiatives organization. But Member States should be not involved in regulatory details on the market design such as the discussion of auction rules, products etc, while they should heavily be involved when it comes to energy policy issues.

3. Questions - set 3 (“structure and geography of the regions”)

There are currently 7 electricity regions in the ERGEG Regional Initiative, and 3 in gas whereas the overall target is to create a single region – the Single European market. How should the number of regions in the ERGEG Electricity Regional Initiative evolve towards a single market? Should the number of regions be reduced? And/or should specific topics firstly be merged across the regions? Which regions do you think should be merged or topic areas reconfigured, and what criteria should be used in reaching a view? How many regions should result initially, and what topics might be reconfigured?

As for gas, the number and geographical scope of regions seem to be appropriate at the current state of play. Concerning the North-West gas region no enlargement should be considered currently.

As for electricity, the overlapping nature of regions is consuming huge resources in countries engaged simultaneously in several regions (as it does for the overlapping market coupling projects in CWE, CEE, SWE, FUI, CSE) and sometimes the different ideas are really conflicting and reducing speed of integration. While the downside is evident, the upside is that countries in overlaps have a natural interest that regional progress is not diverging too much. Therefore the advantage of a more coherent composition of regions has to be weighed against the effect of slowing down ongoing integration within existing regions.

Against this background, BDEW

- warns against deep changes in the structure of regions. It clearly rejects the idea that one Member State could only be full member in one region during the integration process.
- calls for a recalibrating functioning of the existing regional initiatives and - in the case of electricity – slightly adjusting the geographic remit:
 - There is a danger that the process of redesigning the regions might take too much time and diverts the focus from practical implementation to procedural questions.
 - There is a risk of creating super-regions which might develop much slower due to the number of parties involved.

As for electricity it should be promoted that depending on the degree of maturity of regions two advanced regions combine their efforts in certain projects. For example this may for instance be true and is already under development for the Northern and the Central-Western Region for

- day-ahead market coupling
- intraday market design.

On the other hand, a single market goes beyond the mere integration of wholesale markets but also encompasses retail (e.g. switching procedures, connection rules for new generation units etc.). So it seems to be premature to completely merge regions. Secondly, there is a danger that the process of redesigning the regions might take too much time and diverts the focus from practical implementation projects to procedural questions.

In some cases regions may currently not be complete as bridging countries are not part of the region (e.g. Austria in Central West). Also the role of Switzerland has to be clarified. Eurelectric would advice to bring Austria and Switzerland (subject to their adhesion to the market integration rules) into the CWE region.

One could say that another “birth defect” of the regional concept has been that in some cases it does not differentiate between

- a geographic core and
- countries linking this geographic core to other regions.

However, these regions can be maintained for the sake of pragmatic progress if the degree of homogeneity for the countries building a bridge to core countries maybe much lower. (e.g. high degree of homogeneity within the Iberian market or within the Nordic market and lower degree for France as a bridge to the Iberian Market or Germany as a bridge to the Nordic market).

4. Market parties and DSO-involvement

On some occasions experience has shown that the input of market parties has been sought for too little. Stakeholder groups which had been implemented successfully at the beginning of the ERI process have been more or less abandoned. This could be overcome best by a dialogue structure similar to the one of the Project Co-ordination Group (PCG).

This is also true for the regional level, especially for the ERIs and to a much lower extent to the PLEF and the NW GRI. So far in practice those who will make use of the grid i.e. market parties and DSOs do have few occasions to give input. The EVERIS-MERCADOS study therefore rightly recommends an improvement of consultation mechanisms to stakeholders.

Every stakeholder should be integrated in this process. BDEW appreciates that market parties and DSOs as relevant stakeholder will be closely involved in the way in determining the path towards the single European market. On the other hand, the 3rd package has a clear focus on TSOs and gives national regulation for market parties and DSOs a distinct priority. Part of the 3rd package are the regulations of cross border electricity and gas infrastructure. One of the main elements of these two regulations is the establishment of network codes and framework guidelines. The involvement of market parties and DSOs in this process should be carefully defined considering this context. In this sense DSOs, too, should be consulted in their capacity as grid users.

5. “Same vision for gas and electricity”

Principally yes, for both we need a target model and a roadmap to reach that target model. Specificities due to geography and of course due to the product have to be assessed issue by issue and may have their impact on the target model and on the roadmap.

The reasons to differentiate between gas and electricity are various and include among others the following:

- Gas is to a large extent imported into EU-27.
- Gas has all in all a limited number of “entry” points to the continent.
- Gas has a limited continental sourcing, most of it is “produced” globally in the world, and still here, there is a kind of “oligopoly”¹ of gas producers world wide
- Electricity energy can only be stored to a very low extent in other energy sources (mechanical energy like pump storage, chemical energy like batteries).
- Most of the gas costs are infrastructure related.

Nonetheless the differences mentioned are not of principal nature. As far as gas is concerned it might be good to set up something similar to the PCG- (now AHAG-) process. But such a process should require more time for deliberation.

¹ Russia, Norway, Algeria and Qatar seem to possibly ensure 85% of the World gas production.

Some comments on ongoing regional initiatives:

- strengthen Regional Initiatives / bottom up approach and accommodate them to new framework as set by 3d package
- Put focus on important, manageable projects
- Keep market based/ competitive solutions as principle where possible, regulatory involvement only where necessary
- Keep processes lean

BDEW strongly appreciates that stakeholders are to be involved intensively.