

## **E.ON proposals to review**

### **ERGEG's Regional Initiatives Progress Report**

The E.ON Group welcomes ERGEG's report that summarizes achievements made in 2009 and issues which are still pending.

Although we see progress in the development of gas and electricity regional markets, we perceive the report as too optimistic and find it in single chapters even misleading. Furthermore, we miss a reflection of why certain issues in electricity are still open, even if they obviously breach applicable European law such as Regulation 1228/2003 and affiliated Congestion Management Guidelines. This applies particularly to the pending implementation of cross-border intra-day markets for electricity.

Our comments reflect the wish to promote an efficient internal market for gas and electricity by applying market-acknowledged best practice. We furthermore want to stress the need to focus on urgent priorities in order to comply with current legal requirements or to realize quick wins such as the dispensable licensing of wholesale trading companies. Afterwards other topics might have the attention of regulators and/or TSOs.

In chapter I we will highlight our main objectives on the Gas Regional Initiative. In the subsequent chapter II we will briefly review ERGEG's view of the state of play in the regional electricity markets. This is followed by an in-depth discussion of the questions raised in the consultation paper on electricity and an explanation why we come to the conclusion as mentioned above.

#### **I Gas Regional Initiative (GRI)**

E.ON appreciates the existence of Gas Regional Initiatives (GRI) and believes that main achievement of the process is the "step by step" approach towards the creation of a single European energy market. Nevertheless, there are also some side effects; in making a comparison between GRIs E.ON observes the different speed in the integration process. This is can be most likely due to the starting point at the moment of the establishment of the GRIs and the heterogeneity of countries within a region and between regions. The voluntary basis of the entire process leads moreover to various approaches, depending on the resources and priorities assigned by lead regulators.

##### **Investment in new infrastructure**

Further gas infrastructure investments will be necessary to finalize the Single European Energy Market, to overcome cross-border congestions and to address the deteriorating European gas production / demand balance over the same period of time, as well as to promote competition between different sources. This can be applied also to geographical areas within member states where the gas infrastructure can be further developed and expanded.

The investment conditions differ across the EU but in most countries the allowed cost of capital is not sufficient to attract enough capital for the necessary investments. Furthermore, quite often the regulatory rules make it impossible to actually reach a

return for new investments that matches the headline allowed cost of capital (CoC). One of the main reasons why the actually achievable return for new investment is sometimes far below the headline allowed cost of capital (even for 100% efficient network investment) is a time lag of several years after start of operation of new networks assets until new investment leads to revenue. Also critical is that in several countries unachievable efficiency targets on capital costs further reduce returns.

### **Capacity allocation and congestion management**

Harmonized capacity products and procedures within the EU facilitate trading across Europe. Similarly, a toolbox allowing Member States to 'pick-and-choose' should be avoided. The rules should clearly ensure harmonization between Member States. Currently, there are in place very different approaches for capacity allocation: FCFS, auctions or even lotteries. E.ON believes that this variety of methods constitutes itself an obstacle to achieve integrated energy markets. E.ON thinks that an enhanced cooperation between regulators, TSOs and stakeholders will lead to more harmonized outcomes.

### **Transparency**

As a European company E.ON supports the vision of creating a single European energy market. One core aspect of this vision is the creation of enhanced transparency in order to allow all market participants to better understand the supply and demand fundamentals. E.ON therefore reckons that transparency is considered a high-priority issue in all energy sectors (electricity, gas, CO<sub>2</sub>). But by introducing enhanced transparency requirements double efforts on this issue between ERGEG and the COM should be avoided, an efficient proceeding and an appropriate implementation period should be ensured. In the light of this, the role of GRIs for transparency development might be to track and report developments in specific transparency requirements within each region.

### **Interoperability and hub development**

The development of European hubs as central transfer and trading points within grids is nearly completely depending on the development in other areas which are partly already mentioned in the Progress Report e.g. such as transparency, improved capacity allocation and congestion management procedures, investment conditions, rules for security of supply. Any improvement and harmonization in one of these areas will support the hub development.

### **Security of supply**

E.ON supports the enhanced transparency requirements (e.g. introduced by GTE and GSE) on infrastructure. However, by strengthening the security of supply the proposed mechanisms should integrate the markets by more market-orientated approaches instead of further market regulation.

## II Electricity Regional Initiative (ERI)

### II.1 Review of progress in each regional market

#### a) *Baltic States*

We welcome the political agreement on a Baltic Energy Market Interconnection Plan (BEMIP) which will result in a better interconnection level of Baltic States towards Poland and the Nordic market. Additionally, BEMIP tends to anticipate upcoming grid operation challenges when it comes to an intensive cross-border trade and an expansion of renewable energy in-feed and could therefore avoid potential bottlenecks in the Baltic transmission grid.

However, we remain disappointed that despite several announcements no real progress on the day-ahead market integration towards the Nordic market is visible. As the integration of the Baltic market into the Nordic market is envisaged, we would additionally recommend to trust on the Regional Transparency Report of the Nordic region and to refrain from a separate Baltic version.

Although we acknowledge the value of common regional balancing rules for all Baltic TSOs, the impact is assumed to be low due to the lack of interconnection capacity, the missing market integration and limited potential for balancing service providers from abroad.

#### b) *Central Europe East*

The steps in Central Europe East in 2009 have created a lot of doubts how serious concerns and proposals of market participants are taken by regional regulators, TSOs and the common auction office CAO. Even if the European Trader Association EFET as well as E.ON repeatedly stressed the need of a thorough documentation of the method and of all changes required in IT processes, the results were by far disappointing. We furthermore again and again raised our concerns that information is only provided partly and on short notice. However, traders are expected to change their IT and their processes within short and insufficient time spans.

We also find it misleading if regional regulators outline in favour of the flow based allocation mechanism that “an initial testing phase ... demonstrated that the envisaged benefits can be achieved”. In the first dry run phase held by CAO, participants could only make them acquainted with the system. The paper “Technical Parameters” explaining the PTDF matrix and flow-based calculation parameters as well as the Auctions Rules explaining the allocation method in the Annex 5 were only published after the dry run. Thus the dry run was of no value at all to the participant and neither bids sent cannot be taken as serious input by CAO nor can regulators take these dry run as a basis to justify benefits of the flow-based allocation. Indeed, when looking at the allocation function, bids are not awarded as announced according to price differences but according to their cost efficiency.

ERGEG states that “The flow-based approach **should** deliver correct signals to the market and gives a high incentive towards harmonization, ensuring higher security of network operation, more transparency and more efficient use of existing infrastructure.” We agree that this **should** be the outcome. But when it comes to delivering correct signals and more transparency we wonder how this can be achieved when

- no capacities are published but matrixes with about 50,000 figures per hour. The information can only be evaluated and understood by each participant, programming its own analyses tools.
- capacity is not only allocated according to price differences but primary according to the expected physical flow.
- TSOs introduce in a non transparent manner export and import limits (e.g. Poland)
- TSOs still have not come up with a proposal on how in a flow-based world article 5.5. of Congestion Management Guidelines will be fulfilled. The availability of cross-border lines is a very important price forming information, similarly to the availability of power plants and has the substantial influence to national merit orders.

Taking into account the size of the region and the huge dimension of the PDTF matrix, we assume that it will put an obstacle to trade especially for smaller traders.

We strongly advice regulators to investigate in detail how the flow-based allocation really works and recommend an adjustment in the bid selection process. It has to be secured that the basic promise of the flow based methodology: higher security in grid operation and maximisation of capacities for trading can be kept (see article 6 para 3 of Regulation 1228/2003). This should be implemented given the right balance between an efficient and applicable system for traders and the comprehensive representation of the grid situation.

When it comes to the agreed interim period we are very unsatisfied that regulators and TSOs did not keep their promise that nothing will change for market participants. Moreover, the partial hand over to CAO resulted even in more work for participants as for example guarantees could not be prolonged but needed to be renewed. CAO often communicated other deadlines as the Auction Office at APG for example and participants needed to confirm and cross check with different counterparties to get clarity.

Overall, we evaluate the progress in the region with countable results for the market as low with a huge gap in cooperation and coordination between and within the group of regional TSOs and regional regulators. Information from TSOs and CAO is only provided piece wise and sometimes even contradicting. Different national interests still seem to be dominant and a regional view of regulators is most often not visible. We hope that with the political grouping following the Memorandum of Understanding of the regional governments the progress is more aligned with market participants' needs.

#### *c) Central South*

In 2009, we have experienced again a consultation process of the auction rules which shows again how little serious concerns of market participants are treated. Auction dates for the upcoming yearly explicit auctions were published late on 19 December, thus for one border only two working days in advance. Annual auctions, taking place usually mid November, are held 22, 23 and 28 December! Moreover the annual auctions will be held under auction rules that are not approved by 21 December 2009, 6 pm. Such delays and unstructured process put a lot of unnecessary uncertainty on market participants that could be easily avoided by a sufficient planning by regulators and TSOs.

Nevertheless, we very much welcome the envisaged target that all long-term explicit auctions in the region should be operated by CASC-CWE. Hereby, we hope for a

more Central Western like consultation process which allows a proper preparation for all parties involved. Against this backdrop, we call upon Central Western and Southern regulators to strongly focus on an identical set of auction rules for both regions.

Additionally, it needs to be stressed that many Italian market features such as day-ahead market's gate closure time and the auction-based intra-day market do not fit what is identified as European target model within the Florence Forum framework or what is widely acknowledged as best practice across Europe. Therefore, we strongly recommend to make best use of reform initiative such as the Italian Anti-Crisis-Decree or the planned Slovenian-Italian market coupling and to revise current incompatible arrangements.

*d) Central West*

We are aware that a project with such a broad agenda as in the regional action plan of February 2007 is very ambitious in realisation of the different issues. Therefore, we appreciate and highlight the full implementation of CASC-CWE and the operation of all explicit auctions under a single set of auction rules in the region. However, we still see potentials for improvements in terms of compensation at market spread in case of curtailments and a Europe-wide applicable definition of force majeure. There might be a chance to work on that when it comes to an integration of Central Southern auction activities.

With regard to the ongoing development of a regional market coupling solution, we understand that such a project is complex and challenging especially with such a large amount of stakeholders involved. However, we do not understand the several postponements without real argumentation and hope now for implementation in May 2010 as announced. We are satisfied with the improvements in regional cooperation of TSOs, especially with regard to capacity calculation. Nevertheless, we regret that in the regionally harmonised methodology there is no increase of capacities but only reductions. We also regret that available capacities in the new methodology are not published until now.

With regard to the planned implementation of the flow-based methodology we regret that no details on the design and especially consequences for capacities have been made public yet. We ask regional TSOs and regulators to pay attention to the lessons learnt from the implementation of a flow-based concept in CEE. We are prepared to explain in more detail where we see inconsistencies in the method which will put an obstacle to trade, particularly for smaller traders.

With the regional integration and market coupling we expect stronger interdependencies of markets and a further convergence of wholesale prices. Due to highly fluctuating wind power in-feed, which impacts cross-border grid capacities as well as power exchanges' prices, we strongly advocate a quick and smooth implementation of a cross-border intra-day market according to an ELBAS-like model. This should even have a much higher priority than any advanced cross-border balancing concept.

*e) France-UK-Ireland*

The progress on the IFA interconnector is welcomed and appreciated. However, we remain depreciative on the variety of products and the auction-based intra-day allocation. We strongly favour a simple set of financially firm products with annual, monthly, daily and intra-day allocation. Annual and monthly allocations should be

explicit and it should be investigated whether bi- or tri-annual explicit products could be additionally offered. Existing seasonal, quarterly or weekly products should be suspended. These changes would allow concentrating available capacities to just a few products. Seasonal, quarterly and weekly products could be sliced from the annual and monthly products and non-used parts either sold on the secondary market or given back to IFA as part of subsequent explicit or implicit auctions. Daily capacities could be allocated implicit as soon as possible along with an implicit continuous intra-day trading.

These aspects also apply to product and auction designs on the BritNed interconnector and any further capacity enhancements in the region.

*f) Nordic countries*

We welcome the recent re-start of EMCC and acknowledge its effort to optimize the use of Nordic-German interconnectors (DK 1/2). With the envisaged integration of Baltic Cable into EMCC market coupling services, we value this market link between Scandinavia and Germany even more important. When looking to other Nordic-‘continental’ interconnectors such as SwePol and NorNed as well as to the upcoming market coupling project in Central West, we would also see further potentials and therefore ask regional power exchanges, TSOs and regulators to develop a smart interregional price coupling solution as soon as possible. For an interim period an interregional connection of Central West and Nordic, based on a tight volume coupling, is a sensible solution.

On the side of drawbacks, we still find it unsatisfying that neither firm financial nor physical transmission rights exist in the Nordic market and Nordic TSOs are reluctant to introduce them. Additionally, we would like to see progress on the implementation of an ELBAS-like intra-day solution allowing continuous trading from the Nordic countries to Central West and vice versa making best use of *all* available interconnectors. Further we regret that the UIOSI principle at the German-Danish interconnector will not be introduced before 2011. We strongly recommend that monthly and yearly explicit auctions at this border are handed over to CASC-CWE.

Any work on cross-border balancing market should be postponed until day-ahead and intra-day solutions are available and fully implemented.

*g) South West*

We appreciate the progress made to plan and construct a new French-Spanish interconnector by 2014. However, for the time being, the management of scarce capacities is of utmost importance.

Therefore, we urge regulators, TSOs and power exchanges in the region to accelerate the investigation of a Price Coupling of the Regions with Central West and Nordic countries and the revise Spanish-Portuguese auction-based intra-day market. The European target model for cross-border intra-day trading is a continuous trading model which finally aims to trade power from the national market of one country to the domestic market of another. The auction-based OMEL system is therefore an obstacle because the continuously executed cross-border trade has to wait for the next intra-day auctions. Other opportunities to sell the power do not exist due the strange obligations to sell power only through OMEL.

## **II.2 Review of progress in each regional market**

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

From 2006 until today, we would judge the implementation of explicit auctions on all ERI borders as the main achievement which have replaced previous non-market based methodologies. We also think that the regional transparency reports should be considered as an achievement.

On the side of drawbacks, we are still concerned on the compliance level with all these regional transparency reports. Furthermore, we wonder how less pro-active the implementation of cross-border intra-day markets is taken up by the relevant entities against the backdrop of the overdue legal obligations in the Congestion Management Guidelines. We would stress to review the priorities as set by regulators and focus less on the not legally required cross-border balancing compared to legally required cross-border intra-day market implementation. Moreover, we think that ERGEG should focus as well on national rules in place that put obstacles on cross-border integration. As the most urgent issue we see the abolishment of all wholesale licensing requirements (with or without the requirement of establishing a branch). Licensing requirements lead to less competition (as particularly smaller companies are discouraged from market entry), are discriminatory towards foreign companies, put high administrative work on businesses and are time consuming.

### **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?*

A flow-based capacity calculation should provide benefits in terms of a more secure grid operation and maximal cross-border capacities as promised. Both targets are laid down in article 6 para 3 of Regulation 1228/2003 and should therefore be the only guiding framework conditions for having a flow-based method. It is unnecessary to say that such a method should prove real benefits for both targets.

We furthermore have to highlight the need to choose a bid selection process which starts with the most valuable bid without weighting it with any sensitivity factor as in CEE. Real benefits could be expected if the most valuable bid in the region would be accepted first, afterwards the second highest bid etc. until the physical impact of the accepted bids fully load the regionally critical grid element.

We do not see advantages of a flow-based method in the Nordic countries and between France and the Iberian peninsula. However, where grids are highly meshed, we support the establishment of a common grid model with harmonised methodology and assumptions of grid usage and security margins for identification of critical branches. The base case for capacity calculation should be developed on best estimated 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 or, where reasonable, a more European level. 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.

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

*i) We assume that 'capacity calculation' is meant here.*

Capacity calculation is at 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, where reasonable, a more European capacity calculation.

A further short-term goal should be, without any doubt, the adjustment of the CEE flow-based method according to our statement to B.2. This should be done in cooperation and coordination with market participants and finally lead to an identical approach in CWE and CEE which can prove the benefits as mentioned under B.2.

The long-term target should be the **definition of borderlines** where widely coordinated capacity calculations reached their limits. According to our view, it will not be beneficial to coordinate capacity calculation in CEE with those between Spain and Portugal. Therefore, regional coordination might have its limits.

*ii) Short-term goals for the purpose of 'capacity allocation'*

Transmission System Operators should organise **explicit transmission capacity auctions** to sell yearly, monthly and daily cross-border capacities. Ideally, capacities for two or three years ahead should also be made available through auctions. *Particularly* for cases where markets are liquid enough, market coupling should be introduced for day-ahead trading (D-1), replacing existing daily explicit capacity auctions.

**Intra-day congestion management procedures** should be established by TSOs and/or power exchanges (PXs). E.ON's preferred solution is for continuous intraday power trading platforms (ELBAS-like but with the added capability to trade OTC). In cases where implicit intra-day trading platforms cannot yet be established, an acceptable interim solution would be to set up explicit capacity platforms that offer a continuous reservation of cross border capacity. **TSOs shall not reserve cross border capacity for intraday trading** but make available all unused D-1 capacity and released capacity after netting off all the D-1 nominations and relevant changes in network capacity availability.

**Allocated capacity shall be offered as financially firm.** This means that in cases where already allocated capacity is curtailed, and where this is not due to a reason of clearly-defined Force Majeure, TSOs must compensate capacity holders at the current full market spread.

Capacity allocated for terms longer than D-1 shall be subject to either the **use-it-or-sell-it** (UIOSI) or the **use-it-or-get-paid-for-it** principles (UIOGPFI). This means that unscheduled cross border capacity is automatically re-allocated through a D-1 auction or made available for **market coupling** trades. The original capacity owner then gets paid the market price difference. UIOGPFI is a first step towards **financial transmission rights** (FTR). The appliance of UIOGPFI allows non-physical traders to enter cross-border markets creating more liquidity.

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



First of all, we need to stress that TSOs and auction offices should release information on their capacity calculation methods completely and as early as possible and not piece wise as experienced in CEE.

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. Therefore, information systems designed in an appropriate customer-friendly manner should be established.

When it comes to a flow-based mechanism with the identification of critical grid elements and branches, we request a single and non-changeable code for each grid element which let us estimate physical impacts and derive sensible auction bids.

### **Capacity allocation**

*B.5. What practical steps should be taken at an inter-regional level to ensure an efficient and harmonised approach to capacity allocation in the 1) long-term; 2) day-ahead; and 3) intraday market?*

As stated under B.3 ii), we expect regulators to safeguard that at all borders only annual, monthly, daily, and intra-day allocations of financially firm products take place. As a practical step we assume that a definition of such only eligible products needs to be done as part of a congestion management framework guideline. The same applies to the allocation method which should be explicit for annual and monthly time frames and implicit for day-ahead and implicit continuous for intra-day time horizons.

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

We see financial firmness and the application of an automatic Use-it-or-get-paid-for-it (UIOGPFI) as the main driver for a proper integration across all time frames.

*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)?*

We think, all regions experienced strong reviews of their auction rules which provide the market with some kind of harmonization. The next step should be to elaborate an identical set of long-term auction rules with respect to definitions such as force majeure, products, bank guarantees, payment conditions, compensation in case of curtailments etc. for all regions.

As stated under II.1 for the Central Western, Nordic and Central Southern region, we see the integration of the Central Southern and Nordic auction activities into CASC-CWE as a main driver to draft and implement the European model.

Furthermore there should be identical rules in place when it comes to consultation and deadlines. Regulators should consult auction rules well in advance, preferably over summer. Further with regard to the annual auction available capacity, auction rules und information about the registration procedure should be published at least with two weeks prior notice.

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

As stated under II.1 for the Central Western, Nordic and Central Southern region, we see an opportunity to do that if regional TSOs really want it. However, it might not serve as a general short-term model although further integrations are possible.

However, we are fully aware that some national regulations may set a restriction to an identical set of auction rules. At this stage we would request more flexible arrangements in the national markets in order not to block any further integration progress. It is also worth noting that the pure focus on an extension of geographical scope should not hinder further bottom-up driven progress in any region.

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

Yes, we fully agree and ask all power exchanges involved to come up as soon as possible with the first insights of their Price Coupling of the Regions approach and state what kind of means are necessary to achieve that goal. However, the requirements in harmonisation of products, time planning and governance are still not clear.

## **Balancing**

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

Cross-border balancing is without any doubt an important issue and could drive balancing costs down. We recommend to start with the development of a common understanding and finally a common definition what balancing should comprise and which products should be eligible. Furthermore, a market based approach to procure balancing service needs to be developed all over Europe.

Where congestions exist we consider the TSO-to-TSO model as most appropriate. Where no bottlenecks exist the TSO-BSP model is most efficient as a common market could be established as of today for Germany and Austria.

## **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 to enhance transparency further?*

Yes, we agree that progress has been achieved with the elaboration of regional transparency reports. However, we emphasize that further harmonization over time should not be forgotten in the future.

For the time being, we see a lack of implementation of those regional transparency reports, inter alia, as stated by ERGEG for the South Western market.

On the contrary, we acknowledge the efforts made for the EEX Transparency Platform in Germany which could serve as model. 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 in the CWE regional market. The next step should be to build on this pilot project and expand its reach beyond national

borders. The EEX initiative is open to data from Austria, CH or in cooperation with EPEX Spot even to France. The experience gained in these projects can be easily employed for other markets and they can lay the ground for a more regional transparency platform, providing the same level of transparency for a single market coupling system across Europe.