



European Regulators' (EREG) Discussion Paper on Regional Markets

AEP¹ Comments

Summary

- The Association supports the general concept of regional markets as an interim step towards a single European market in electricity;
- ERGEG's paper provides a thorough analysis of the technical and practical issues involved in developing cross-border markets;
- Regulators should continue to press for the liberalisation of national markets and implementation of existing legislation;
- The Association would like to see more positive recommendations in the paper, and in particular the creation of an action plan, preferably with set timescales;
- ERGEG should focus more closely on the definition of regional markets and the overlap between them;
- ERGEG should consider not only the consistency of arrangements within regions but also between regions; a regional approach will not lead to a single European market unless markets move in the same direction;
- Most areas for priority action are correctly identified in the paper, but cooperation among regulators and transmission charging methodologies also need to be tackled;
- We believe that there are dangers in creating a further tier of regulation at regional level; greater emphasis needs to be placed on removing barriers to trade and achieving market convergence;
- ERGEG should carefully weigh the benefits of creating regional markets against any possible future costs when they might have to be adapted;
- Network users, as the main trans-national players, must be involved in discussions on regional markets, e.g. in the Mini-Fora.

General Comments

The Association welcomes ERGEG's discussion paper on regional markets. It is clear that it will take some time to achieve a fully integrated EU energy market and there is logic in seeking to make progress on a regional basis. It is important in this context to promote a similar stage of maturation in the various national markets to enhance regional trading opportunities. However,

¹ The Association of Electricity Producers (AEP) represents the interests of the electricity generation sector in the UK, with a membership of more than 100 companies. Between them, the members embrace virtually all of the fuels and technologies used for commercial electricity production, from coal, oil, gas and nuclear power to wind, wave and hydro and production from a wide range of waste products.

unless regional markets develop in the same direction, integration across the EU could be slowed down. Dissimilar regulatory decisions can distort trade between regions, and so an effort must be made to achieve regulatory convergence across the EU, not only within but also between regions. In our view, cooperation between regulators should be mentioned as a priority in para. 6.2 of the paper, alongside inter-TSO cooperation.

In the Association's view, the paper should focus more closely on the definition of a regional market. There is little consideration of the fact that the regions discussed at the Mini-fora overlap to a considerable extent. France, for example, has a key role to play in a number of regional markets because of its interconnections with Belgium, Italy, Germany, UK and France. This overlap is likely to be helpful if it ensures that development in different regions keeps in step, but this point should be explicitly addressed in the paper.

The paper provides a comprehensive coverage of the issues, but we think that it could take a more positive approach to integrating markets, both at regional and EU level. It is noticeable that ERGEG mentions no timescales, in contrast to similar papers by the European Commission and EURELECTRIC. Moreover the recommendations in Chapter 7 appear rather timid: the performance of more case studies, which will then be used to prepare further analysis. The Association accepts that complex issues are at stake, but believes that, without clear objectives and deadlines, progress towards a single European market is likely to be very slow. We would like to see ERGEG develop a bolder action plan for the future.

ERGEG appears to be generally negative towards further action at EU level. However, pan-European solutions clearly have a benefit in terms of creating a level playing field (the adoption of the two Electricity Directives has been an example of this) and should therefore be considered alongside national and regional solutions. A purely regional approach clearly cannot suffice, since certain issues would not be tackled at all, e.g. the promotion of infrastructure investment between regions. The Association takes the view that the choice of approaches is not "either/or": some issues will have to be solved on European and others on a regional level. If a single European market is to be achieved, it is clear that pan-European solutions *must* be considered.

Key Market Design Features

The ERGEG paper identifies most of the main market design features that need to be addressed for a regional market to develop. The Association particularly welcomes the focus on network access issues and transparency. The role of the TSO in providing access to transmission and in providing information in a transparent way is critical, and we agree with the statement (para 2.40) that TSOs could collaborate even more closely, e.g. over balancing in order to commercially remove physical restrictions. We also support the proposal that TSOs should have incentives to maximise available capacity. As the paper recognises (para 6.12), there are sometimes reasons why data should not be published; for instance, information on constraint location or outage plans can reveal distressed purchasers.

The paper's treatment of network access issues is unsatisfactory in one important area, that of transmission charging. Para 2.34 accepts that different charges can have a "significant" impact on users in adjacent networks, but then states (without any supporting justification) that in reality such differences are "unlikely to be so wide".

ERGEG should develop guidelines on the harmonisation of the G/D split and locational charges in a single European market. The Association believes that significant trade distortions will occur in the European market unless transmission charging approaches are harmonised to some degree. We are unaware of any regional markets which have not sought to address this. The Association favours a harmonisation of the percentage split between generation and demand rather than of charging levels. In the UK, the creation of a single GB market led to the harmonisation of the G/D split and the TSO has proposed reducing G average to zero, which would bring the UK in line with most of mainland Europe. While it would be difficult to harmonise absolute charging levels in the short term, there is no reason for not harmonising the split of charges. A uniform generation/demand split is fully compatible with the existence of locational signals, since charges can be varied above and below the average within the Member State.

The potential for market distortions between member states in a regional market is also very important. Such distortions can arise through differences in the incentives on market participants to use particular technologies, e.g. national support schemes for CHP, renewables and indigenous fuels. Differences in the way transmission access is charged for, different treatment of losses, or different balancing incentives can also have a significant impact.

The Association supports ERGEG's pragmatic approach to the integration of wholesale markets. Regulatory frameworks and trading rules will have to be harmonised to some extent, but this does not require a single model throughout Europe. For instance, we do not see the need to mandate over-the-counter or exchange trading within Member States. The Association endorses the conclusions of the EURELECTRIC Roadmap², which outlines how the process of integration could be undertaken.

One major obstacle to trade is the fact that balancing and wholesale market timetables are not harmonised across Europe. It will be essential to harmonise such timetables to facilitate greater cross-border trade and ensure a level playing field and we would like to see ERGEG place more emphasis on this issue.

Regional Frameworks/Role of Governments

The Association takes the view that an overarching regional framework is not necessary to allow a regional market to develop, as long as the basic principles are harmonised, and the regulatory approaches are similar. The

² Integrating Electricity Markets through Wholesale Markets: EURELECTRIC Road Map to a Pan-European Market; June 2005

case for an additional layer of regulation, at the European or Regional level, is certainly not made in the paper, and any increase in the burden of regulation would have to be measured against the potential benefits. We note that, in the Electricity Security Directive, EU governments decisively rejected the proposal to subject interconnection planning and investment to a further tier of regulation.

The European Commission currently has responsibility for cross-border trade and regulatory issues. A further difficulty of creating a regional regulatory framework is that it could lead to overlap between the European Commission and national regulators, resulting in duplicate regulation. Careful thought needs to be given to the respective role of the Commission and regulators, a topic which is not covered in any depth in the paper. A framework for cross-border issues already exists in the shape of the EU Electricity Regulation, which introduces a decision-making process relating to interconnection issues. It would be preferable to use this framework to develop the necessary principles, rather than creating additional mechanisms

The role of regulators and governments should primarily be to ensure a consistent approach and to seek continuously to remove barriers to free trade, rather than add regulation in an attempt to encourage it. As a matter of urgency, regulators should focus on developing closer cooperation, particularly with their counterparts in adjoining markets and should ensure that they give adequate prominence to the European dimension of their remit.

The Association agrees that government support for integrating national markets is important. Where governments do intervene in the market on public policy grounds, they should do so transparently and with a view to minimising the impact on competition.

Process for Future Work

Case Studies provide a useful tool to assess the potential problems involved with creating a regional market, but have limitations because of the special circumstances of any real case. It is debatable whether much more work should be done in studying existing regional markets in Europe or elsewhere.

The existing Mini-Fora regions provide a practical way forward for further debate. However, in the Association's view, the absence of market participants from the mini-forum discussions is a major drawback. ERGEG should invite market participants, who are most affected by the development of regional markets and those with the biggest influence on their success or failure, to join in the Mini-fora. Whereas regulators and TSOs operate predominantly on a national basis, network users increasingly trade across the Member States and are thus crucial to the process of cross-border integration. We would therefore strongly encourage ERGEG to revise its position that the Mini-Fora should continue to leave out network users.

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