



# **Challenges creating market conditions (national and regional)**

## **Open questions of the transition in ERRA countries**

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## National Regulatory Authorities:

- Responding to all stakeholders' aspects → *optimising actions on regional market and cooperation on regional level*
- Committed to electricity market competition
- Believe in positive effects of efficient competition on economy → *forcing non discriminatory access, level playing field, market conditions*
- National Regulators have limited possibility to force regional harmonisation of legal/regulatory framework → *it is in the hand of politicians, governments (they are not active in this field)*



## Substantial developments in energy reform in the ERRA regions, like:

- Intensive, continuous regulatory cooperation (under the leadership of ERGEG, ERRA and ECRB) aiming legal and regulatory harmonisation with the Directives and relevant EC regulation and with the best European and US regional market building practices
- Energy Community Treaty is a legal obligation for SEE countries to meet EU Directives (extensive working groups dealing with issues)
- Treaty Observer countries: Ukraine, Moldova and Georgia (Ukraine is in discussions on becoming a full Contracting Party)
- Members of the Energy Regulators Regional Association (ERRA) have taken a common position regarding price increases and capacity shortage in some regions (December, 2007)
- Common intention for harmonised licensing procedure.
- There are functioning national Regulatory Authorities with adequate statutory power, authorisation and expertise.



## Substantial developments in energy reform in the ERRA regions, like(cont.):

- Functioning Russian competitive wholesale market, major foreign investment in generation (ENEL and E.ON) and abolishment of RAO UES
- The existence of a vigorous Kazak wholesale market (but with imperfections).
- A coordinated explicit cross-border capacity auction exists in the CEE region.
- The mechanism for transmission revenue allocation among the SEE TSOs was agreed upon.
- Non-regulated end-user price for industrial users – in several countries.
- Introduced mechanism supporting vulnerable consumers – in some countries.
- There are advanced methods for monitoring service quality.
- Based on price signals and relative comfort, an increasing number of investors are interested in new generations (several issued new licences).
- A memorandum of understanding on market coupling between Austria, Hungary and Romania is under way to be signed.
- The possibility of a regional power exchange is under development (CEEPEX concept) with the cooperation of the World Bank, E-Control and HEO.



Common intention of ERRA regulators (published common statement after the Bucharest meeting, 2007 December):

- not to disturb market tendencies, market forces,
- to maintain good level of security of supply in national and regional markets,
- to reduce market entry barriers and regulatory barriers to give more chance for new investments (analysing the possibilities to give the adequate comfort to the investors on new generation and transmission investments)
- to utilise more potential tools of demand response programmes

The regulators agree that special (non-avoidable, non market based) actions to secure the supply in the national market(s) and to avoid drastic price increases should be proportional, transient and can not endanger the neighbouring markets.



Main characteristic of environment in the late 1980s and '90s, when efficient competition was created in Great Britain and Scandinavia:

- Low energy prices
- Reserve capacities (no urgent need for new investment)
- Healthy general economic conditions
- Stable, competition oriented governments
- General (citizens and politicians) belief in positive effects of efficient competition on economy
- Environmental considerations had no serious effect on end-user prices



Main characteristic of environment in the 2000s, when most of the ERRA countries (some of them perimeter ones of EU) are in the process creating efficient competition:

- High and continuously increasing energy prices
- Diminishing reserve capacities (urgent need for new investment both in generation and in cross border network)
- Unstable financial and economic conditions
- Changing government orientations
- Citizens and politicians are afraid of the negative effects of transient period (not easy to convince them on the future positive effect of efficient competition)
- Environmental considerations have serious effect on end-user prices (CO<sub>2</sub> credit, renewable targets)

Some special characteristics of some ERRA countries:

- Low regulated household tariffs (as difficulty for retail market conditions)
- Starting point of the restructuring of energy industry on the relatively small national market: state owned integrated company

- National political aspects, priorities:
  - **Security of Supply (SoS)** on national market → *In case the level of SoS is endangered politicians urge interventions, like:*
    - postponing the market based solution („open” borders, new generation investment on investor risk)
    - priority access to cross border capacities; pressure on TSO reducing „export” possibilities; preference for state owned incumbent
  - **End-user price** (especially for households, Universal Service Provider (USP) clients) → *In case of pressure for drastic price increase politicians urge interventions, like:*
    - the market conditions could be hindered (high portion of regulated segment)
    - regulated household prices (i.e. the price of energy component is different from the market based one); enlarging the USP umbrella (less room for retail competition)
- EU aspects, priorities:
  - Implementing the Directives in all national markets (*no special rules for small markets; no short term solution for existing or foreseen SoS problems*)
  - Forcing cross border trade (price convergence, regional trade, common market)





Market structure issues during the transient period (from the state owned vertically integrated supply chain with regulated end-user prices to the restructured, unbundled industry under TPA rules with market-based energy prices):

- Regulators would like to dismantle or renegotiate (reduce the volume and time-period) the PPA structure signed by former state owned incumbent :
  - creating liquid multiplayer wholesale market (condition of competition)
  - mitigating market power
- Private investors and banks are reducing their risk, they argue strongly for long-term contracts (preferably with state owned company) or for feed in tariff comfort, saying:
  - no liquid wholesale markets
  - no indicative price signals
  - continuously changing rules

**Challenge: Finding the balance between the contradictory arguments**

**Open Questions: How to find the good balance? How to avoid rebuilding the monopoly structure without postponing new generation investment?**



## Security of Supply (SoS) issues during the transient period:

Net export position of certain national markets of the CEE and SEE region is diminishing and is turning into net import position:

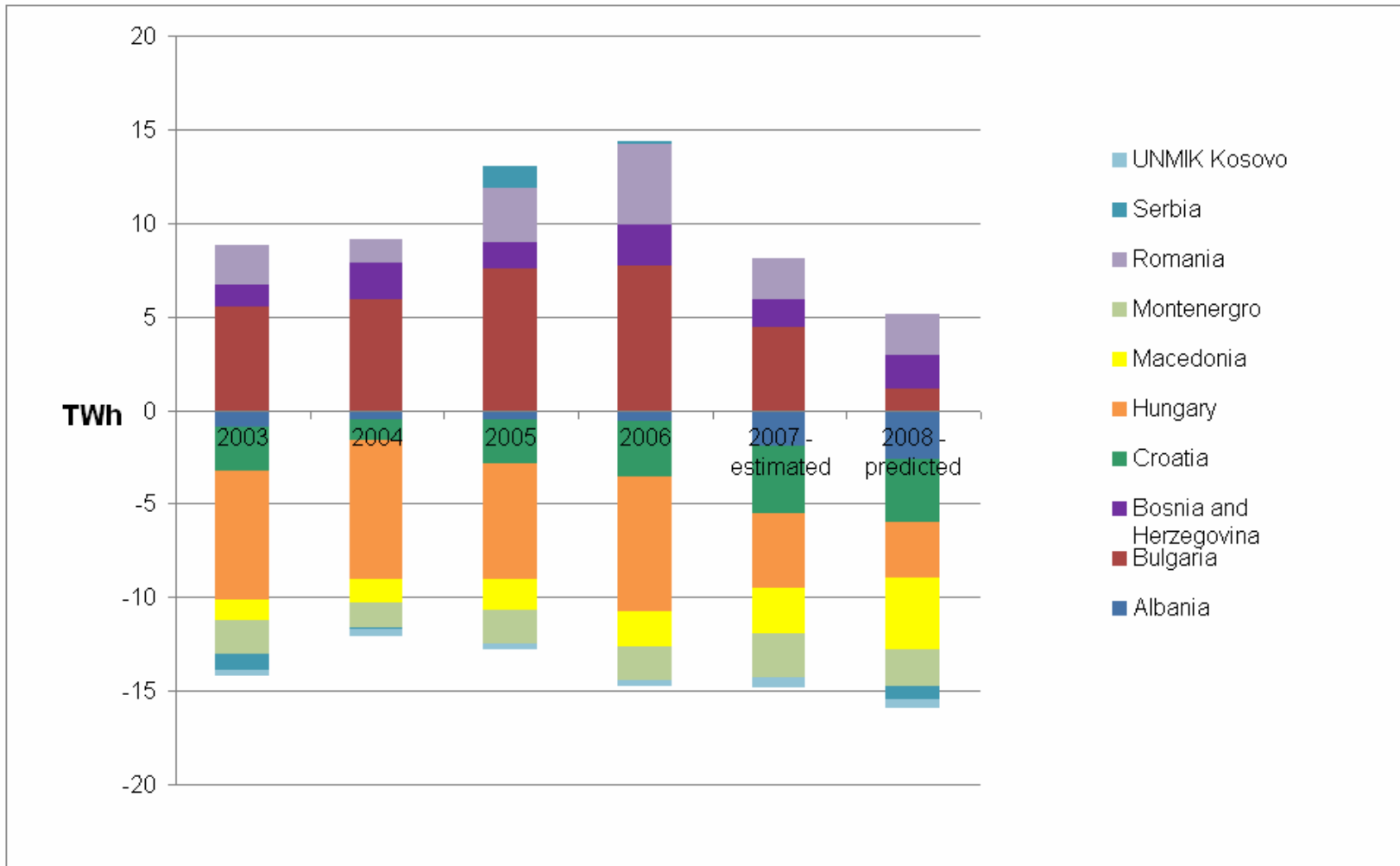
- If there is a threat of capacity shortage politicians may become concerned and the following arguments can become rather appealing:
  - the state-owned wholesaler (former Single Buyer) should enter into contracts with potential new capacities offering the comfort they need
  - the government should issue a tender for “guaranteed” new capacities
  - the state (through the state-owned incumbent) should build new capacity, securing the supply.
- If the SoS is seriously threatened, politicians could accept those proposals, which create temporary administrative barriers against new entries into the market and against cross-border trade, such as:
  - priority of AAC at borders,
  - export fee, and
  - zero capacity on annual and monthly cross-border capacity auction

**Challenge: How to avoid maintaining or re-creating isolated, relatively small national markets instead of establishing regional market conditions.**

**Open Question: How to save the adequate level of SoS in national markets until the new generation investments come on line (2-3 years), knowing that the lack of regional market and the potential discriminative, administrative measures discourage new private investments?**



## Net export position of some ERRA members



Source: *ERRA Database*



- The EC sector inquiry (2007) report highlights the phenomena of regulated end-user prices acting as a market distortion, especially for industrial users.
  - The new EU members understood this „message” and most governments and legislators eliminated the possibility of regulating energy prices at a wholesale and retail level (with the exception of special services for households, such as USPs).
  - At the same time, some former EU members, such as France, introduced regulated prices for industrial users.

## **Challenge: Convincing politicians not to „create” more robust USP umbrella**

- Some factors influencing industrial end-user prices:
  - Formerly regulated wholesale prices did not fully follow fuel prices
  - Capacity shortage in SEE: the traders, suppliers and importers (with “short position”) serving consumers on market, where capacity shortage occur, are ready to pay a higher price for energy in neighbouring markets → push up market price)
  - The monopoly rent (extra profit) of the dominant players
  - Controlled (reduced) USP prices raise the energy price for industrial users (cross subsidy)

**Open Questions: How to convince politicians to respond to industrial users’ tariff as well, beyond the household ones? How to convince them not to intervene any the less, the energy prices increase drastically?**

Thank you for your kind attention,  
please, reflect to the [Open Questions!](#)

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