

1.1 Main developments in 2009

Wholesale market developments

Wholesale **electricity** prices were relatively stable throughout 2009: spot and futures prices in Austria and Germany peaked at the beginning of the year and then stabilised at a moderate level. To a certain extent, it could be the sharp drop in prices for emission certificates and natural gas that brought down electricity prices. This also led to an inversion of the spot-futures relation as compared to last year: 2009 saw spot prices below the futures level. Low spot prices also mean that the better option for suppliers was short-term procurement, while producers benefitted from long-term sales strategies.

The Austrian electricity wholesale market is integrated with the German one both regarding over-the-counter (OTC) trading and energy exchanges. Wholesale market developments depend on bilateral trading on the one hand and on trends at the power exchanges EPEX Spot/EEX Derivatives (Germany) and EXAA (Austria) on the other. Both exchanges offer electricity spot products for the integrated German-Austrian market. This means that the development of the German wholesale market is of direct relevance for Austrian traders and suppliers (fundamental data, marketing of renewable energy from Germany etc.). Apart from that, EEX Derivatives offers financial futures contracts.

2009 saw a growth in the electricity volumes traded at Austrian EXAA, which is mainly due to the greater number of (mostly foreign) traders active at the exchange. The volume traded on EXAA's spot market accounted for about 7.1% of domestic consumption, i.e. twice the 2008 volumes, which brought more liquidity to the market. Trading volumes for the German-Austrian spot market at the German EPEX Spot did not significantly increase during the same time but even so, amounted to approximately 17% of gross electricity consumption.

Apart from energy exchanges, wholesale trading happens also bilaterally, or 'over the counter' (OTC). Even at the very liquid German EEX the volumes cleared on the OTC market are about three times the volumes traded through the power exchange.

In the interest of increasing transparency on the wholesale market, EPEX/EEX put into practice a legal requirement by establishing a web-based platform through which relevant market information from the four German transmission system operators is provided. The platform realises the central concept of ex ante or real-time publication of generation data – even though only German producers with units > 100 MW are obliged to provide information.

Regarding **natural gas procurement**, buyers can use bilateral long-term contracts as well as OTC trades or energy exchanges. The latter

procurement options gained in attractiveness in the course of 2009: the supply interruption in January 2009, among other factors, caused also Austrian wholesalers to look to European hubs for their trades.

2009 also brought extensive changes for the Austrian trading points of CEGH Exchange (Baumgarten and Oberkappel), where the gas exchange was kicked off on 11 December 2009. For this purpose, two separate entities (CEGH Exchange and CEGH OTC) were established. ECC provides the clearing services for the gas exchange. Wiener Börse AG acquired a 20% stake in CEGH on 17 June 2010. The situation around Gazprom's participation in the company is still unclear.

Trading at CEGH Exchange increased during the six months following the start of activities, but then fell sharply. As a reaction, the minimum tradable unit for spot products was reduced from 30 MW to 10 MW on 28 June 2010, but this has not yet had the desired effect on trading activities.

Transparency at CEGH greatly benefitted from the introduction of an organised spot market (i.e. the exchange) in September 2009. Average OTC and exchange prices are published.

The year 2009 brought a marked increase in liquidity at other European hubs, particularly NCG and TTF. This testifies to the growing relevance of gas hubs for traders to optimise their purchasing portfolios. An analysis of gas suppliers' margins showed that a purchasing strategy that combines long and short-term options would have enabled decreasing consumer prices. Of course, procurement is only possible within the limits imposed by congestions or supply interruptions. But cross-border trade also plays an important role in strengthening the Austrian market. Developments abroad, e.g. in Germany or the Netherlands, indicate that liquidity benefits from combining all potential gas sources: transit, domestic production and balancing energy. The current separate treatment of transit and domestic transport greatly hampers trading options.

The growing importance of spot markets also impacted on the nature of long-term contracts. The traditional gas trading partners E.ON and Gazexport agreed in 2009 on coupling part of the gas purchases to spot prices; this agreement marked a milestone in the development of a competitive wholesale gas market in continental Europe.

Retail market developments

Electricity consumption declined by 3.8% in 2009. The energy-intensive industry (>20 GWh/year) registered the steepest drop at 14%, followed by medium-sized industry (2 – 20 GWh) with a 3.8% decline. All other groups increased consumption by 0.2 - 4.4%.

Not all consumer categories benefitted equally from the downwards trend of wholesale electricity prices in 2009. While the industry saw falling prices, small consumers even faced price increases.

However, neither these price increases nor the significant price differences between suppliers drove switching rates up – on the contrary, the rates declined. Continued high market concentration – due to only small movements in market shares - combined with the virtually nonexistent PR activity by suppliers, a lack of product innovation and the weak integration of retail markets, indicate that competition on these markets, especially regarding small consumers, did not pick up.

Natural gas consumption slightly declined (1.8%), which is mainly due to the drop in industrial consumption (3.4%) that outweighed a minor increase in household and other small consumption.

Developments of the wholesale gas price were not passed on to all consumer categories to the same extent. Price reductions for industrial consumers were much larger than for small consumers. Indicators such as switching rates show that competition increased in the industrial segment.

Austrian households, on the other hand, do not yet reap the full benefit of low wholesale prices. Competition in this consumer segment did not improve, as is also shown by the lack of product innovation on the market, low switching rates in spite of pronounced price increases in 2008 and considerable savings potentials from switching.

Access to gas storages

Directive 2009/73/EC¹, adopted as part of the Third Energy Package and amending its predecessor 2003/55/EC, retains in Article 33 sentence 1 the possibility for member states to choose between negotiated and regulated third-party access (TPA) to storage. It only requires member states/regulators to devise criteria for the purpose of assessing whether TPA to new storage capacity in their country is technically and/or economically necessary at all and if so, whether it should be regulated or negotiated.

Member states/regulators are not forced to overturn their current TPA system; the Directive rather requires that they review it regularly and improve transparency in choosing the access regime.

¹ Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC

Regarding the assessment criteria, the European Commission gives guidance in an interpretative note² that addresses among others Article 33 Directive 2009/73/EC. It contains the following indicative principles:

- Existence of a flexibility market. Does effective competition between facilities or between facilities and other flexibility services in the market area exist? Is there competitive pressure such that efficient tariffs, products, product variety and access to the services offered are a result of market mechanisms?
- Effective access to storage. Is there a high proportion of storage capacity booked long-term without having previously been allocated in a non-discriminatory manner, and is only a comparatively small amount of capacity offered to the market each year?
- Degree of dispersion of storage clients. Is capacity largely booked by one or very few large undertakings? Are storage pricing and the access regime distorted by such concentrated interest?

Besides these points, the European Commission proposes an investigation of technical, administrative and economic barriers to market entry as an assessment criterion.

In the view of E-Control, the indicators show a lack of competition on the Austrian storage market. This should be addressed by way of clear and binding access rules (capacity allocation and congestion management). As storage prices in Austria are largely competitive, regulation of the storage market should concentrate on a regulated access regime, capacity allocation mechanisms and congestion management procedures.

Progress in electricity market integration

Integration of Austria's electricity market with the wider European market is crucial. With Germany, integration has already been achieved to a large extent as there are no congestions at the border and no significant obstacles to cross-border electricity transports. However, facilitating cross-border transports on borders with other neighbouring countries continues to be a major concern. In this regard, the Third Energy Package aims to foster efficient usage of the existing capacity and eliminate obstacles to further capacity development.

The traditional split of the Austrian territory into three control areas has so far restricted the size of the markets and hindered trade. As a consequence of the Third Energy Package, all Austrian control areas will be managed by Verbund APG in the future, i.e. one more step towards the integration of the Austrian wholesale and balancing energy markets is

² Interpretative Note on Directive 2009/73/EC concerning common rules for the internal market in natural gas, Third-Party Access To Storage Facilities, Brussels, 22 January 2010; p 12

taken. This will enable suppliers to offer their services throughout Austria without facing administrative or financial barriers, traders will be able to procure energy for all of Austria at once, and the balancing energy market will gain in liquidity.

Regulation of networks

Incentive regulation for electricity distribution system operators (DSOs) was introduced on 1 January 2006. After the first four-year regulatory period, the second one started on 1 January 2010 and will again last four years.

The system charges for natural gas grids were adjusted as of 1 January 2010, mainly to take account of the high inflation, high fuel cost, increased transmission capacity and investment in the southern trunk line.

Unbundling

All nine Austrian provinces fulfilled the legal unbundling requirements and transposed the relevant provisions of the national Electricity Act into provincial law. The wording of the legal text leaves room for interpretation and most companies stretched this to the maximum by founding system operators that lack the human resources and financial independence necessary to properly carry out their tasks. In fact, the setup of most DSOs reduces their activities to the design and financial settlement in relation to service contracts.

Oversight of unbundling in the electricity sector is a difficult issue, as in E-Control's opinion, many problems reflect the experience already made in the gas sector. This includes:

- close ties in terms of organisation and personnel
- risk of non-compliance
- service contracts of staff across affiliated companies
- treatment of commercially sensitive data
- insufficient data protection and access concepts
- staff members working both in grid operation and retail

The Electricity Directive 2009/72/EC, to be transposed by 3 March 2011 as part of the Third Energy Package, also provides for unbundling improvements for DSOs. Even though the principles of corporate, organisational and accounting unbundling are maintained as before, there will be structural implications for the companies. They spring from the unbundling requirements in the Package, which now clarify that DSOs must have at their disposal the necessary resources including human, technical, physical and financial resources in order to fulfil their tasks (operation, maintenance and development of the network) efficiently;

they must have effective decision-making rights relating to the above, independent from the integrated undertaking.

Distribution system operators must also ensure, in their communication and branding, that no confusion arises in respect of the separate identity of the supply branch vs. the vertically integrated undertaking. The compliance officer must be fully independent and have access to all information of the DSO and any affiliated undertaking. Transposition of the Third Energy Package by the national legislators throughout Europe is under way.