

**EASTERN PARTNERSHIP PLATFORM 3: “Energy Security”
2nd WORKSHOP OF EASTERN PARTNERSHIP
ENERGY REGULATORY BODIES**

**REGULATORY TOOLS IN SUPPORT OF INFRASTRUCTURE DEVELOPMENT,
INTERCONNECTION AND DIVERSIFICATION OF SUPPLIES**

**Wholesale markets in the ERRA region
as driving force for market
integration and infrastructure
development**

**18-19 June 2013
Tbilisi, Georgia**

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Chairman of ERRA*

Voluntary association of national energy regulators

Objectives:

- Improve regulation
- Strengthen Regulators with exchange of information, training, and research
- Harmonized regulatory framework
- Stable investment climate



34 member regulators

1700 trained participants

80 trained Commissioners

4 training Videos

4 textbooks

Several issue papers, case studies

Some Characteristics of ERRA's energy markets (1)



- Very diverse market structures, operation models and very different market sizes;
 - Large energy markets with healthy power capacity balance and main gas supply status
 - Serious capacity shortage and high gas import dependency
 - Small national markets with lack of flexible generation capacity and lack of synchronous operation with the electricity markets of EU Members
 - In most cases concentrated markets with dominant players (former incumbents)
 - Limited cases with functioning wholesale competition
 - Very limited cases with efficient retail competition
- No common, binding legal/regulatory framework (except EU members and signatories of Energy Community).

Some Characteristics of ERRA's energy markets (2)

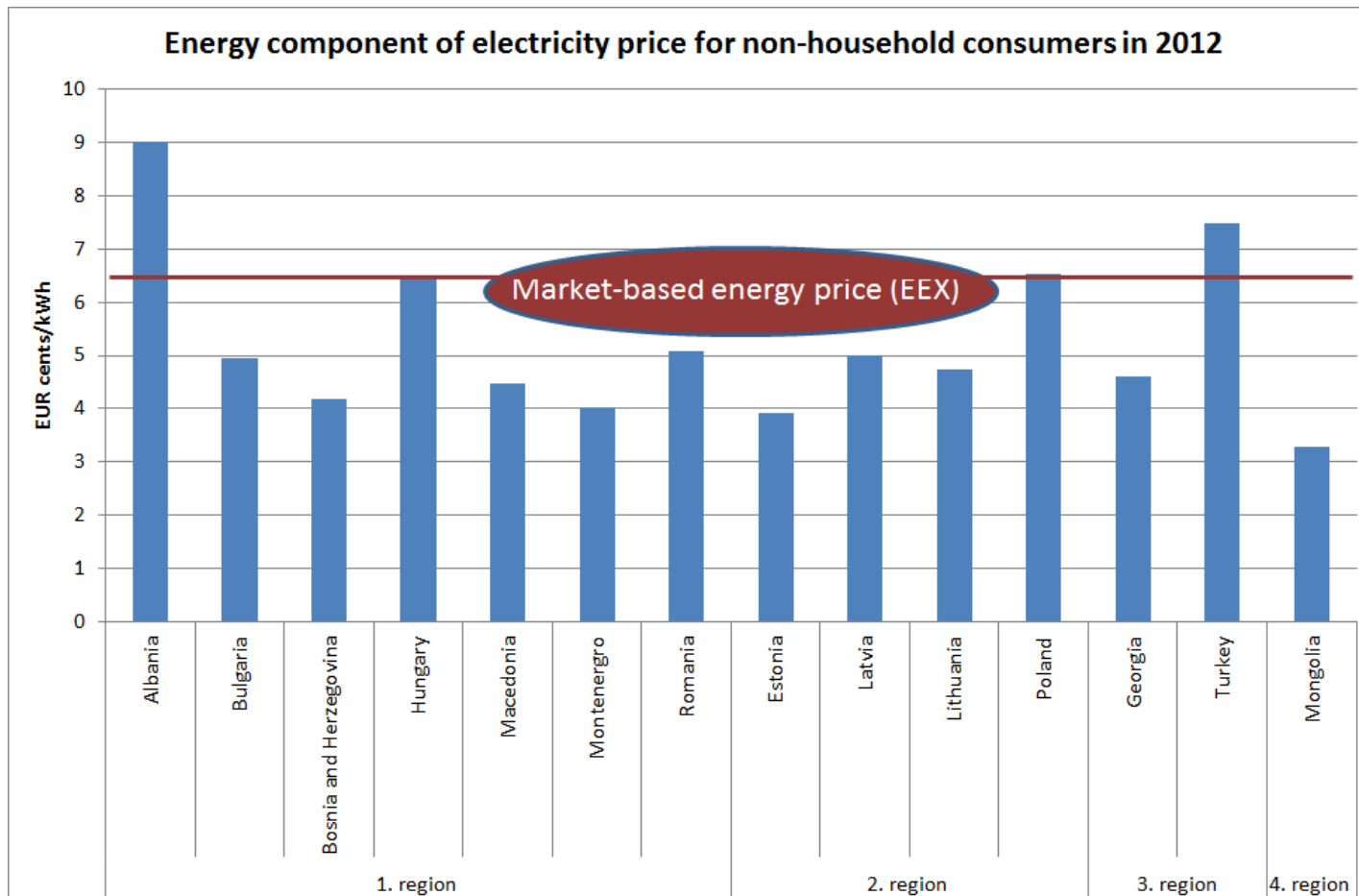
- The financial crisis strengthened the affordability problems. Politicians are more sensitive on end-user prices. In the ERRA region some countries slowed down the market building processes and put more focus on the household price setting.
- The reduced demand (less kWh delivery) reduces the income of the TSOs and DSOs on the same network charge level. Without substantial increase of the network/system charges the infrastructure development could be endangered.
- In some of the ERRA countries the social safety net is not strong enough and the identification and the support (subsidy) to the vulnerable customers (instead of low tariff for all households) is missing.

Consequences of Financial and Economic Crises

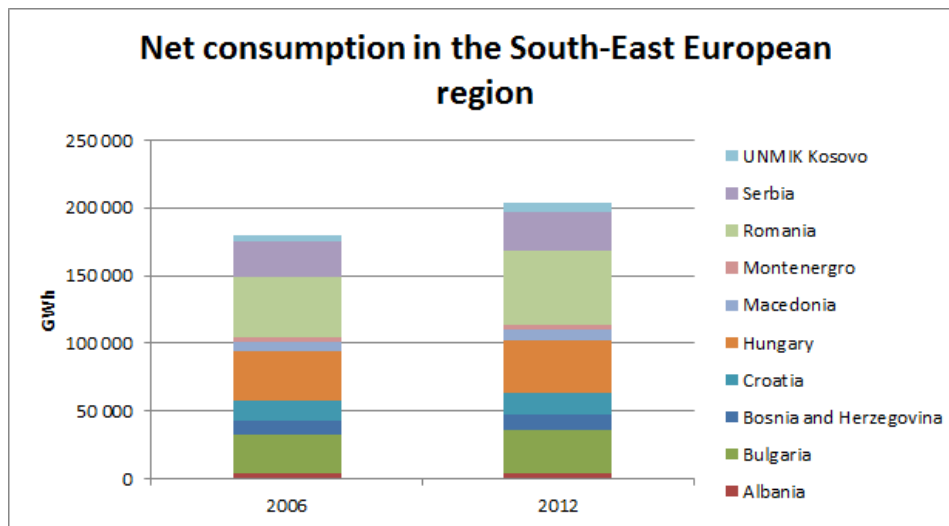
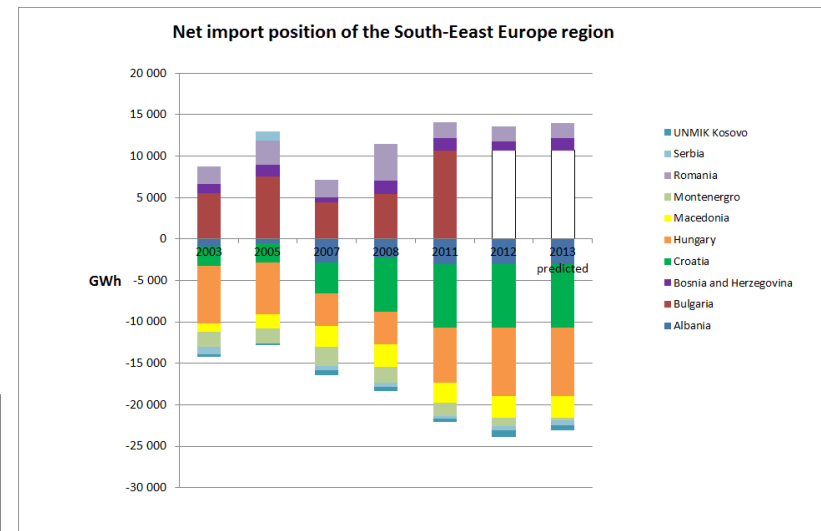
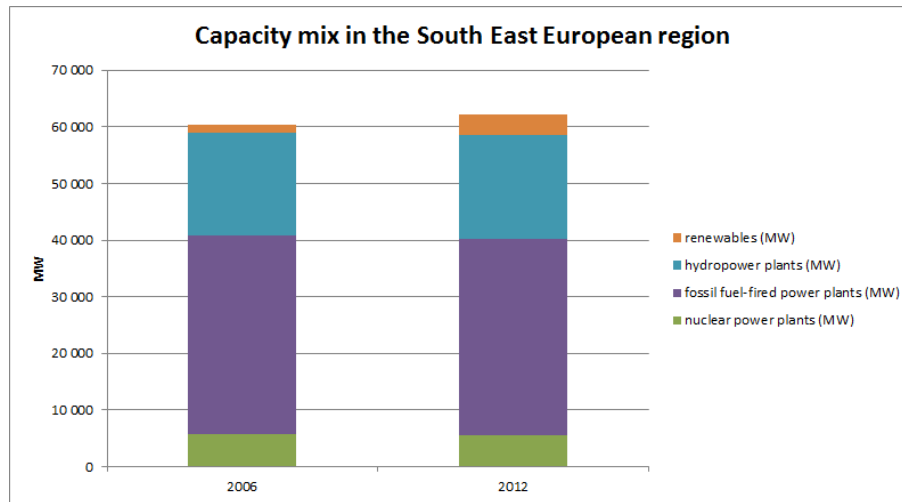
- Limited latitude (freedom) of local private commercial banks (affiliates) – limited availability of funding
- Long Term Debt market has shrunk
- Higher risk sensitivity of banks;
 - Country/political risk of transient economies
 - Regulatory risk of emerging energy markets (market building process + countries with transient economy → higher risk premium)
 - General energy industry related risk elements (CO₂ regulation, fuel prices, SoS, regional market tendencies)
 - Default-risk (banks asking for long term PPAs with state owned national incumbents → market building process hindered)
- Anxious hesitation → Investment programs postponed (newly calculated financial conditions)
- Limited availability of funding → Only the „best” projects will attract financing



Low wholesale (energy component „only”) prices in some ERRA countries do not allow private investment in generation

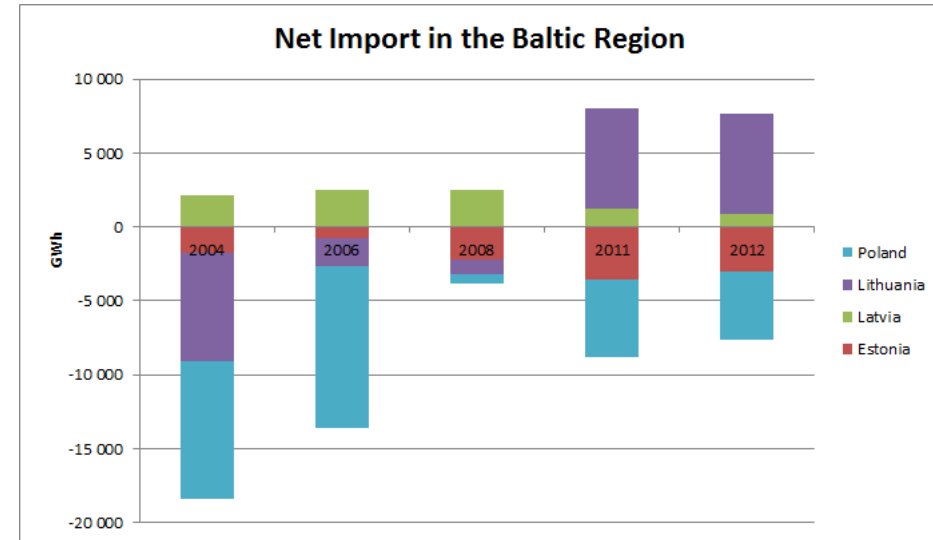
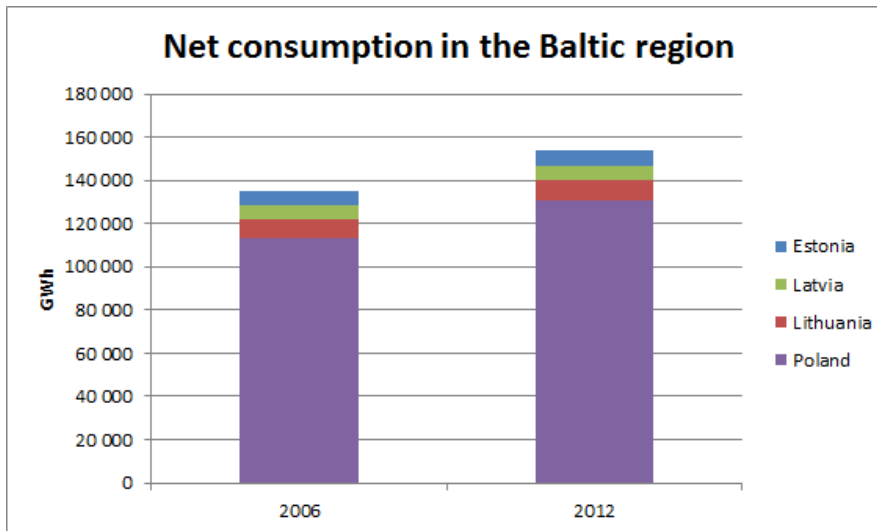
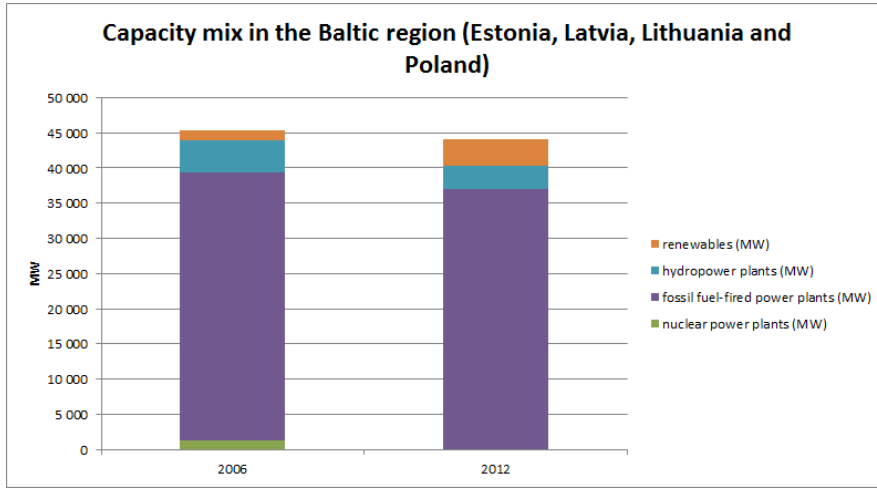


Capacity Balance in the CEE-SEE ERRA region



- Increasing regional cross border trade
- Turning to serious net import position
- New generation investment is needed

Capacity Balance in the Baltic ERRA region



- Export potential turns to import dependency without new investments

Driving forces on ERRA's energy markets

- Different capacity situation of neighbouring markets (capacity surplus and shortage) → the present practice of export/import with annual contracts could be developed (better utilization of existing cross border network capacities and building new ones) → good motivation for regional market creation
- Concentrated markets with dominant players → good motivation for regional market creation (reducing the possibility abusing market power)
- Lack of flexible generation capacity → less chance to build balancing market and efficient system-regulation without the utilisation of flexible capacities in the neighbouring markets → good motivation for regional market creation
- No common, binding legal/regulatory framework (except EU members and signatories of Energy Community) → voluntary harmonisation of good regulatory practice, if fit to the local circumstances

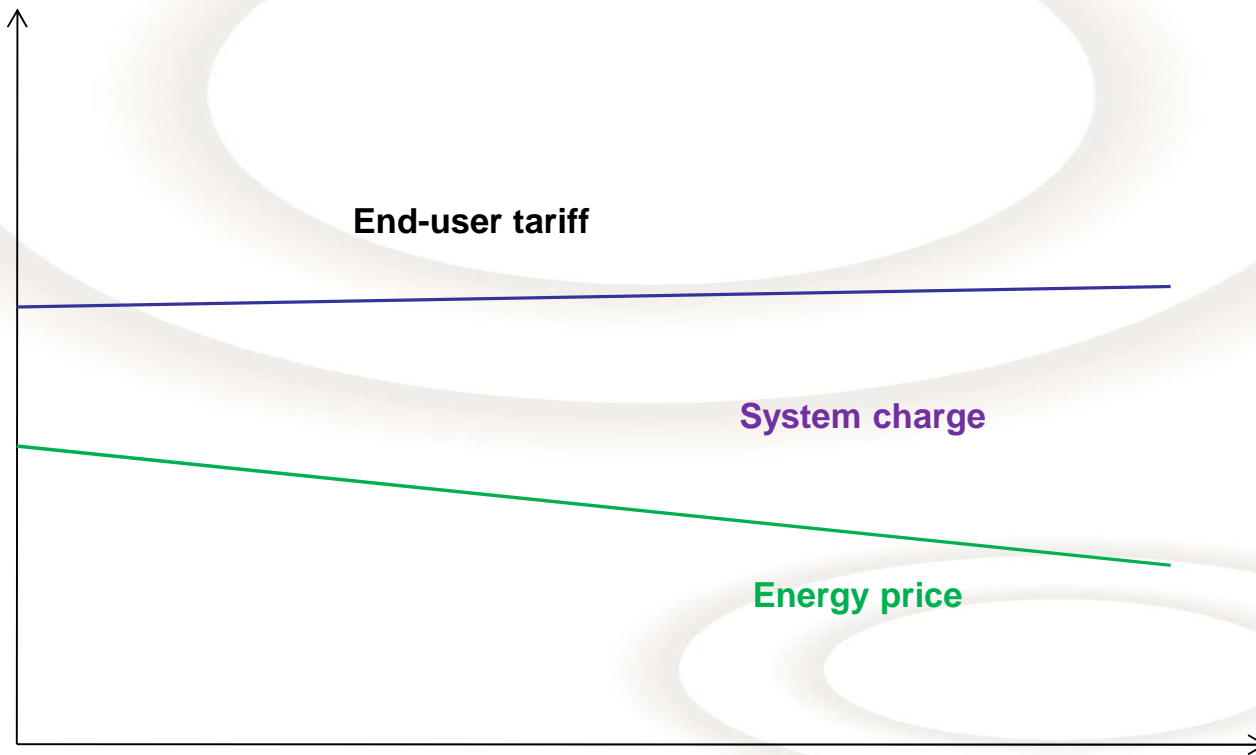


- Financial incentive is key (Regulatory „pressure“/ obligation for network development is not enough)
- Potential regulatory tools:
 - „Real“ evaluation of network asset (→ depreciation and cost of capital could increase among network costs → network charge↑)
 - Shorter amortisation period of network elements
 - Network charge adjustment during pricing period (activated new investment elements could be accepted)
 - Accepted return could be adjusted to new economic situation (Returns on Government bonds + risk premium)
- Cross border (inter-TSO) network → higher risk;
 - Higher accepted rate of return for new investment
 - Exemption from general TPA rules
- Negotiated tariff for gas storage facilities in competitive environment



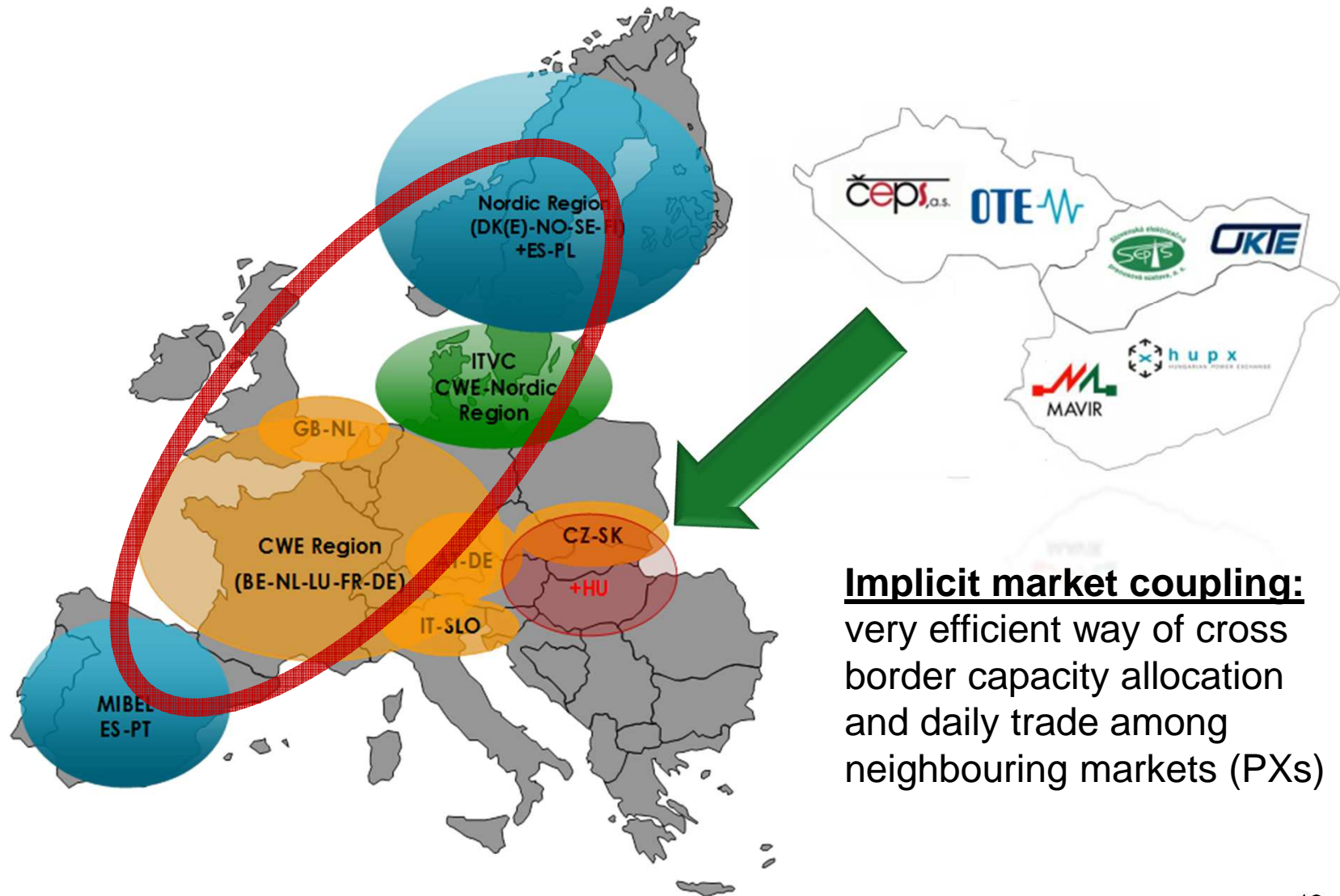
Potential regulatory actions:

Network charge increase has less influence on end-user tariff during low energy price time-period → time for adjustment



- In case of capacity shortage situation (foreseen SoS problem in gas supply) the market based solution („open” borders, new generation investment on investor risk) could be postponed
- In case of drastic energy price increase tendency (based on oil, gas, CO₂, power [commodity] prices and increased cost of capital) the market conditions could be hindered (result: supply with regulated price [USP] instead of market based price)
- Potential attitude of emerging markets with affordability problems on renewable supports
 - progress, but slowly with the support of the fast developing technologies (e.g. PV)
 - selective support schemes and predictable, transparent regulatory framework is key (as ERRA internal analysis showed)!

Major step in the process integrating national markets in Europe



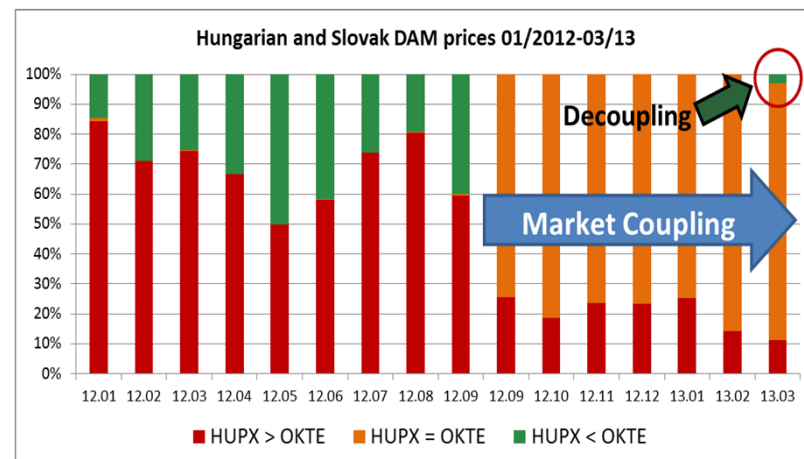
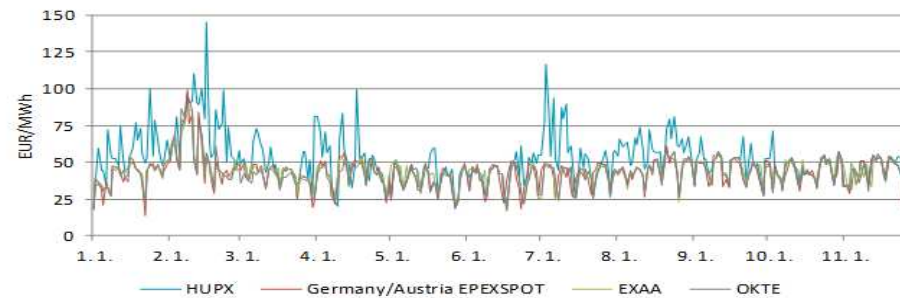
-The very close cooperation of the involved stakeholders, the dedicated hard work of the involved experts and managers and the continuous believe in the customers' benefit of the integrated market were necessary for this successful market coupling.

- Decreased volatility of prices

- Convergence to regional prices (the prices converged among the three PXs) → robust indicative price signal for investors

- The utilisation of cross-border capacities increased (limited days of congestion at borders) → potential benefit of traders to optimize portfolio (social welfare effect)

Hungarian and regional Day Ahead Market (DAM) prices in 2012 (before and after market coupling) → decreased volatility



Source: MAVIR

Integration of substantial ratio of renewable resources to the interconnected system creates new challenges for TSOs and NRAs!



Thank you for your kind attention!

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September 16-17, 2013
Tallinn,
Estonia

12th ERRA
**Energy Investment
and Regulation Conference**



The ERRA Energy Investment & Regulation Conference serves as a platform where you will not only hear the latest news on energy but where you can actively exchange ideas with more than 100 energy regulators of the ERRA region. Get actively involved in the discussion about the necessary improvements for the development of energy markets and for energy regulation for electricity, gas and sustainable development of the energy industry.

SESSION I: ENERGY MARKET IN THE BALTIC REGION: REGIONAL MARKET DEVELOPMENT, INVESTMENTS AND PERSPECTIVES

SESSION II: SUPPORTING COMPETITION ON ENERGY MARKETS

SESSION III: REGULATORY MEASURES SUPPORTING INVESTMENT (GENERATION, NETWORK) DURING ECONOMIC AND FINANCIAL CRISES

SESSION IV: EMERGING MARKET ISSUES

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