

Will a piecemeal regional approach slowdown the pace of market liberalisation?

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Introduction

The development of the European electricity and gas markets are in a decisive phase. On 1 July 2007 we are supposed to have fully integrated internal electricity and gas markets in the European Union. In theory and on paper this will probably be the case. In practice not at all. On 1 July 2007 we will have a patchwork of 27 national markets. The progress report on the development on the internal market by commissioner Piebalgs and the results of the sector inquiry done by commissioner Kroes have shown that despite enormous efforts a lot has to be done.

Development of regional markets

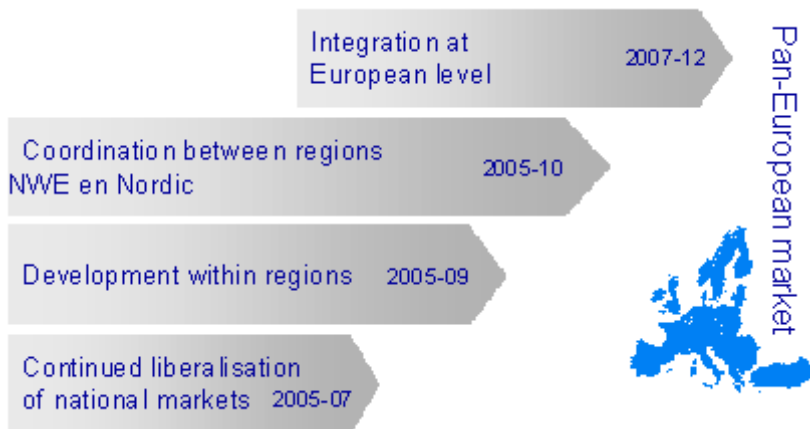
Within the electricity industry we are closely following these developments and have taken action to help achieving a pan European internal energy market through the development of regional markets as an intermediary step to a pan-European market. We are aiming to achieve this by using the expansion of liquid wholesale markets as a driver for market integration and through close cooperation between regulators, TSOs and market participants. As EnergieNed we have taken the initiative to set up a market parties platform for the North West European region, comprising the Dutch, Belgium, Luxemburg, German and French associations. Our goal is to create a competitive electricity market that creates a trustworthy basis for energy prices. In the past year important steps have been set to increase the liquidity on the wholesale markets. An important mile stone in November 2006 was the coupling of the Dutch APX to its counterparts in Belgium and France. As positive result of the coupling we see a more or less single price on the spot market in the three countries. Also transmission capacity is being used more efficiently.

The positive effects of the NWE regional market are also recognized by the European Commission and the European regulators ERGEG. Recently, explaining how the Regional Initiatives fit in with the Commission's Strategic Energy Review proposals and the findings of the Sector Inquiry, Commissioner Piebalgs described the Regional Initiatives as "a practical vehicle for progress towards a single energy market". ERGEG chairman Sir John Mogg stated "The Regional Initiatives are not a substitute for the establishment of the right legal and institutional framework but they have the potential to deliver real benefits now if all stakeholders engage effectively." Energy Commissioner Piebalgs confirmed "There is already evidence of enhanced market integration in the regions. We all have a strong interest in ensuring this continued success." ¹

The development of regional markets can be illustrated by the following figure²:

¹ ERGEG press release PR-07-05, The Regional Initiatives: Progress and Prospects, Joint Conference by the European Commission and ERGEG

² EURELECTRIC report "Integrating Electricity Markets through Wholesale Markets: EURELECTRIC Road Map to a Pan-European Market" (June 2005)



The enlargement of wholesale markets has a lot of benefits. It will enhance price efficient price forming, increase the number of market players, alleviate concerns of market concentration, stimulate liquidity on the markets, stimulate the need for common rules on transparency and reinforce trust in price formation and markets' abilities to deliver.

Drivers for market integration

To drive the process of market integration, to reduce congestion and improve cross border trading actions have to be taken. For this we need:

1. Integrated liquid and transparent wholesale markets with trustworthy prices. Transparent price forming and trust will lead to stability which is good for both supply and demand side.
2. Increased demand side participation in the wholesale market which can lead to more liquidity when demand side parties will start trading directly through an exchange.
3. Integrated retail markets and development of a common generic model for customer switching at pan European level. Currently there are many different switching models throughout the EU. This increases the cost to serve which is a barrier for new entrants or for instance for UK companies that want to open up a business in Germany. They can not copy there administrative an technical procedures because of the major differences in the switching model. A generic model overcomes this problem.
4. The success of the internal market depends on the successful establishment of an internal gas market. In EnergieNed's opinion, implementation – according to the letter and spirit – of the second gas directive is a prerequisite for a proper functioning internal gas and electricity market. This is necessary for the establishment of a level playing field for all market parties in the EU member states. The European Commission has justifiably introduced infringement procedures and must use its authority in competition law efficiently. If this authority proves to be insufficient, then the current guidelines must be made more explicit by imposing a split of ownership on Transmission System Operators (TSOs) and tightening rules of transparency. Furthermore, regulatory measures should stimulate and not discourage investment (among other things, in relation to gas storage and LNG installations). Although the complete unbundling of ownership of TSO's , as is the case in the Netherlands, is to be preferred, but it is not the solution for market integration. TSO unbundling is an important part of market integration. It can provide a solution to many problems related to independence/conflict of interest and transparency. Moreover, the TSO is then better able to fulfill its responsibility as a market facilitator.
5. Market integration means cross border trade. Therefore coordinated market-based congestion management mechanisms and coordinated planning processes among TSO's are necessary. Security of supply is in part dependant on the degree to which

cross-border transport is possible. Harmonization of international regulations for TSOs is a prerequisite for cross-border transport.

6. Last but not least we need a more efficient regulatory process at European level capable of rising to European challenges. Meaning harmonising powers, rules tasks and obligations of regulators at national level and a European regulator to deal with all cross border issues.

On December 1st 2006 the new Congestion Management Guidelines took effect which was an important step forward for (regional)market integration. But for the further development of the regional markets we have to focus on quick wins. For this we need to:

- Create a level playing field for generation transparency through voluntary disclosure and on a coordinated basis with ERGEG and ETSO by using the following price determinants: installed generation capacity by fuel type; day-, week-, month- and year-ahead information on available generation capacity, expressed in MW by fuel type; ex-post actual hourly aggregated generation (in MWh) by fuel type, including actual hourly injections (in MWh) of wind power.³ Same steps have to be taken for transmission transparency.
- Allow cross border intra-day trading and balancing markets which leads to more efficient use of the infrastructure and reduces market risks for balancing responsible parties.
- Remove regulated tariffs for end-consumers to create an efficient market with fair pricing.
- Implement a European customer switching model, which I explained before.

Conclusions

Will a piecemeal regional approach slowdown the pace of market liberalisation? No, it will drive market integration, reduce congestion and improve cross border trading. Nevertheless, progress is needed in the form of dialogue/ cooperation between regulators, TSO's and the industry to develop common approaches and implement the quick wins. The current discussions on market integration and in particular in relation to ownership unbundling are becoming more and more ideological in stead of finding solutions. As discussed above, it is in the end not a matter of either ownership unbundling or transparency or harmonisation of TSO's and regulators measures they are all parallel processes.

³ As proposed in the EURELECTRIC report "Integrating Electricity Markets through Wholesale Markets: EURELECTRIC Road Map to a Pan-European Market" (June 2005)