CEE electricity markets

What are the barriers to the harmonisation of market rules and who should ensure compliance?

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Setting the scene

Since the beginning of the market liberalisation in Europe, more than ten years ago, the business-models of energy companies have changed considerably. New market rules, which unfortunately have not yet been fully harmonised between all countries, and new market players and trading platforms determine today's electricity trading.

In Eastern Europe, these developments started with EU enlargement in 2002, a few years later than in Western Europe. Many obstacles still remain, with a single European energy market far from reality. Despite numerous initiatives to reduce barriers to trade, the integration of national markets into one Pan-European market might still not be achieved. This paper describes the general framework under which power trading currently takes place and the resulting challenges for the future, focusing on Central-East-Europe (CEE).

Legislative and regulative framework

In Spring 2009, the EU adopted it's "Third Energy Package". At the heart of it the concept of "unbundling" is defined – the objective to separate supply and production activities from the operation of transmission networks.

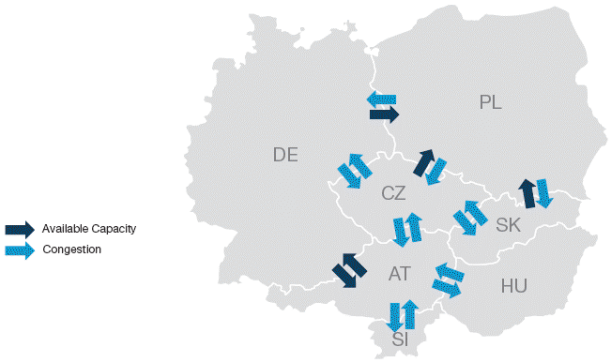
In addition, the package envisages the foundation of an *"Agency for the Co-operation of Energy Regulators" (ACER),* which will have a key role in setting framework guidelines for the energy market. And, in its regulation on cross-border exchanges of electricity, it also establishes a European Network of Transmission System Operators for Electricity (ENTSO-E) *"in order to promote the completion and functioning of the internal market in electricity and cross-border trade and to ensure the optimal management, coordinated operation and sound technical evolution of the European electricity transmission network.*[1]*"*

Generally, measures to improve market transparency regarding network operation and supply should ensure equal access to information and transparent pricing, in order to strengthen confidence in the market and prevent market manipulation.

Furthermore, the electricity market is influenced by the EU Energy and Climate Package, with its three directives on emissions trading, renewable energy sources and carbon capture and storage[2].

The current picture

Currently the European electricity market consists essentially of national markets representing their own price zones. In general, there is congestion at all borders, except between Austria and Germany. (see chart below)



(Source: PricewaterhouseCoopers, Electricity Traders Survey 2008)

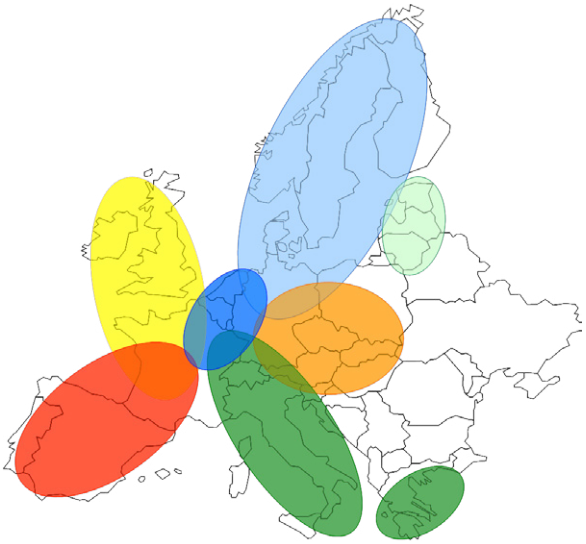
With their "Electricity Regional Initiative" the European energy regulators (ERGEG and CEER[3]) created seven "regional markets" as an interim step on the way to one Pan-European market. (see chart below) In accordance with EU-regulation, the aim of this initiative is to tackle barriers to trade and competition and to encourage market integration

[1] Regulation (EC) no 714/2009 on conditions for access to the network for cross-border exchanges in electricity, Article 4

[2] Directive 2009/29/EC to improve and extend the greenhouse gas emission allowance trading scheme of the Community; Directive 2009/28/EC on the promotion of the use of energy from renewable sources; Directive 2009/31/EC on the geological storage of carbon dioxide

[3] Committee of European Securities Regulators (CESR) and European Regulators' Group for Electricity and Gas (ERGEG) advice to the European Commission in the context of the Third Energy Package"

Region	Countries	Lead-Regulator
Baltic	EE, LV, LT	PUC (LT)
Central-Eastt (CEE)	AT, CZ, DE, HU, PL, SK, SI	E-Control (AT)
Central-South (SEE)	AT, FR, DE, GR, IT, SI	AEEG (IT)
Central-West (CEW)	BE, FR, DE, LU, NL	CREG (BE)
Northern	DK, FI, DE, NO, PL, SE	DERA (DK)
South-West	FR, PT, ES	CNE (ES)
France-UK-Ireland	FR, IE, UK	Ofgem (UK)



through the co-operation of regulators, companies, Member States, the European Commission and other interested parties. In line with this overall objective, the development and implementation of respective solutions in the seven regions concentrates on their different regional concerns.

Since the launch of this initiative in 2006, especially in the CWE and the Northern region, numerous projects have been initiated and implemented (TMC, CASC CWE, EMCC). Some of them have failed, are delayed or have been relaunched because of complexity (counter flows).

In the CEE region, the Central Allocation Office (CAO) was established in 2008 as a co-operation between eight Transmission System Operators (TSOs) [4] to centrally co-ordinate and operate the congestion management within the control areas. Currently, the CAO is preparing the implementation of the load-flow based explicit auctioning process to allocate physical transmission rights for cross-border capacity. After completion, which is planned for January 2010, CAO will take over the daily operation of the allocation process.

On 1 September 2009, the market coupling of the short-term electricity markets of Czech Republic and Slovak Republic was launched, bringing to an end the use of explicit auctions on the countries' border. On the second day of operation traders noted that, since coupling started, the prices in all hours were exactly the same in both markets – an indication that cross-border capacity is equally available in both directions. Before market coupling, Slovak prices were generally at premium to Czech levels.

Generally most trading activity in the CEE region takes place on an OTC-basis. At present, five power exchanges are operating in the region, with very different levels of liquidity: EEX (Germany; more than 100 participants), EXAA (Austria; approx. 50 participants), PXE (Czech Republic, Slovak Republic, Hungary; approx. 30 participants), POLPX (Poland; approx. 30 participants) and BSP SouthPool (Slovenia, Serbia; approx. 15 participants). Additionally OTE (Czech Republic) and ISOT (Slovak Republic) organise the spot balancing market as market operators/ organisers. In Hungary, no exchange or market operator has yet been established. OTC-trading via broker-platforms and bilateral contracts are currently the only possibilities to trade electricity in Hungary. The foundation of an Hungarian power exchange (HUPX) for day-ahead products is planned by MAVIR in co-operation with OPCOM, but the launch has been postponed several times.

[4] Shareholders of the CAO Central Allocation Office GmbH are eight transmission system operators from Central-Eastern Europe : ČEPS a.s., ELES Electro-Slovenija d.o.o. MAVIR Hungarian TSO Company Ltd., PSE-Operator S.A., SEPS a.s., transpower stromübertragungs gmbh, Vattenfall Europe Transmission GmbH, Verbund - Austrian Power Grid AG

It is clear that the pace of market integration is very different throughout Europe and especially within the CEE region. On the one hand in Germany and Austria, power trading has been quite effectively liberalised and unbundled from TSOs over the last ten years. National regulators have been installed to watch over the functioning of the market. The power exchanges EEX and EXAA have been established successfully with increasing numbers of participants and volumes traded. On the other hand, in eastern countries the establishment of liquid and freely accessible power markets is still far from reality.

Success factors for energy exchanges

The successful establishment of energy exchanges in Western Europe has shown the importance of these trading platforms for the functioning of the market. In addition to OTC-trading, liquid exchanges like EEX or Nord Pool nowadays serve as an essential supplement to the electricity market and operate as independent and transparent price barometers.

But not all exchanges, especially in Eastern Europe, have been developed to this degree and still do not offer a real alternative to other trading options. To be successful and attract enough participants a power exchange needs to offer a physical, financial and environmental product portfolio ensuring transparent and standardised pricing methods and a cost-effective fee structure.

A further requirement is evidence of corporate governance with the guarantee of transaction security and a trustworthy central counterpart and clearing company. International co-operation and/or mergers like in Western Europe (e.g. EEX and Powernext, APX and Endex) could facilitate economies of scale.

Impediments to electricity trading in CEE

In 2008, a market survey on impediments for electricity traders in the CEE-region was updated, analysing regulatory, administrative and information-related inconveniences for traders in the region. According to this report [5] the main conclusion was that electricity traders are still facing significant impediments in their daily work, which could be quite easily reduced by national legislation. The survey identified four typical barriers to market entry that prevail especially in Poland, Hungary, Slovakia and Slovenia:

- bureaucratic and administrative obstacles to market and network access
- complicated market structures and timetables
- complex and non-standardised IT platforms and late data delivery
- market fragmentation and poor international co-operation

To increase the attractiveness of the market for traders, administrative and bureaucratic requirements should be reduced to the necessary minimum. But in most countries in the CEE-region, market participants have to fulfil many additional rules beside national laws to gain access to the network.

According to traders, unusual bureaucratic procedures, export fees, language barriers and overwhelming amounts of paperwork cause significant troubles. Important obstacles can also be seen in the requirement to establish a subsidiary or a licensed company in the country to be traded in or the setting up of balancing groups. The time to obtain a trading licence varies considerably between single countries, from less than one month to up to and sometimes even more than six months. In some countries, problems in obtaining relevant market documents and trader information (e.g. forms, rules, contracts, market data) in English remain a major issue.

Serious problems in obtaining relevant information on cross-border capacity and power generation still appear in most of the countries. In this context, traders complain about the non-transparent calculation of net transfer capacity values, different, unsynchronised auctioning systems and the unpredictable available transfer capacity. With regard to power generation traders experience difficulties in obtaining information about planned outages, forecasts and specific plant data. Traders also claim that there is a lack of regular data updating and data transparency in these countries. In addition different IT platforms are generally used for cross-border, balancing energy, power exchange and OTC nominations, a fact that hinders the effective operation of a regional electricity market.

[5] „Impediments to Electricity Trading in CEE“, Electricity Trader Survey 2008, PricewaterhouseCoupers 2008

For the regional electricity market it is necessary to improve the level of international co-operation between regulation authorities, ministries, TSOs and exchanges. TSOs are especially required to handle congestion. Most traders are in favour of a regional independent co-ordination office which should organise regional auctions for cross-border capacities and would welcome a secondary market for cross-border transmission capacities and a "use-it-or-get-paid for it" option for holders of transmission rights.

The ten measures traders identified to be the most urgent are:

- elimination of congestion at cross-border lines:
- increase the size of the physical market
- more information on power plant production
- implementation of market coupling
- transparent balancing energy market
- reduction of transaction costs
- reduction of software implementation costs
- increase of software compatibility and usability
- reductions in licence and trading fees
- transparency in prices published

Next steps

Essential for the elimination of the existing impediments is the establishment of harmonised market rules. The 3rd EU Energy Package with its institutions ACER and ENTSO-E sets out the respective EU-wide framework, where the responsibility for the implementation into national law lies with national governments. At a national level the responsibility of regulators and TSOs should not be neglected. And, from the market side, energy exchanges could also "voluntarily" harmonise their conditions for access and trading.