Are the regional market initiatives working and would a "top down" EU approach deliver better results?

Walter Boltz – Managing Director, E-Control and Vice President, CEER

Regional initiatives are slowly but steadily delivering improvements to European energy markets, even though many impediments to an integrated market remain, and these will have to be overcome by a "top down" enforceable approach, based on EU-wide legally binding rules.

SETTING THE SCENE

Regional energy market (REM) initiatives, established by ERGEG in 2006, were at the time the only answer to the lack of progress in achieving market integration in gas and electricity markets in the EU.

The main reasons for the lack of progress on a European scale were the huge diversity of energy markets in the Member States, the conflicts of interest in vertically integrated energy companies (who feared they would lose out through integration) and the absence of enforceable rules.

Some markets already had a long track record of competition, whereas others were only at the very beginning of liberalisation and where competitive markets and regulated or monopolistic markets co-existed. Lack of physical and commercial interconnection capacity was only the consequence and not the main cause of these uncompetitive market conditions.

"The result was stalemate."

Therefore, no one-fits-all solution could be devised and development was blocked by different priorities in respective regions. In the end, the traditional "top down" EU approach did not succeed in demonstrating a strong commercial case to force organisations to support the liberalisation process. The result was stalemate.

The main objective of the regional initiative was to enable market participants to develop profitable business cases, to put concrete pressure on individual companies blocking progress and thereby to get sufficient support for liberalisation on a regional basis.

It was clear from the beginning that there would be limits to this voluntary approach, but nonetheless regulators decided it was worth trying, especially as there was no alternative available at that time.

SOME POSITIVE RESULTS OF REGIONAL INITIATIVES

Regional initiatives have delivered positive results. Co-operation between TSOs has seen major improvements in many regions due to regular and focused contacts. This is also true for national regulatory authorities which (being set up primarily to regulate their respective national markets) traditionally have no specific mandate to look across borders in a co-ordinated way.

This semi-formal mode of co-operation has resulted in several tangible and noticeable modifications of market rules in the regions. In particular, in the field of transparency, TSOs in gas and electricity in several regions are complying more diligently with the rules set out by regulations or guidelines.

In addition, regional initiatives have resulted in a much better understanding of the issues hampering market integration, and, therefore, the process has made it easier to devise specific, focused and practical rules for the Third Package.

Another area where improvements are noticeable is in electricity, where all the regional projects to maximise commercial interconnection capacity (by calculating capacity on a regional basis) and to optimise usage (e.g. the trilateral market coupling, the All-Island project of Ireland and Northern Ireland, the Iberian market etc.) have made progress, even though the lack of enforceability has resulted in significant delays in many cases.

In addition, the integration of balancing markets which is important to encourage competition in national markets and as a pre-requisite for further integration of retail markets, has made progress in some regions.

Gas interoperability between TSOs has been improved and just recently new IPA (interconnection point agreements) have been concluded. Also, the harmonisation of Article 22 exemptions for gas infrastructure has been co-ordinated within some regional initiatives.

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Still the question arises as to whether we can be satisfied with progress so far. This is clearly not the case. There are many weaknesses in the regional approach, which only new legislation can fix.

WEAKNESSES OF THE REGIONAL APPROACH

Although there have been improvements in transparency, we have to recognise that transparency is only a prerequisite for market players to make informed decisions and for regulators to identify weaknesses in the system. So transparency is only the first, albeit the easiest step on the road to a better market model for integrated energy markets. Why is progress elsewhere lagging behind?

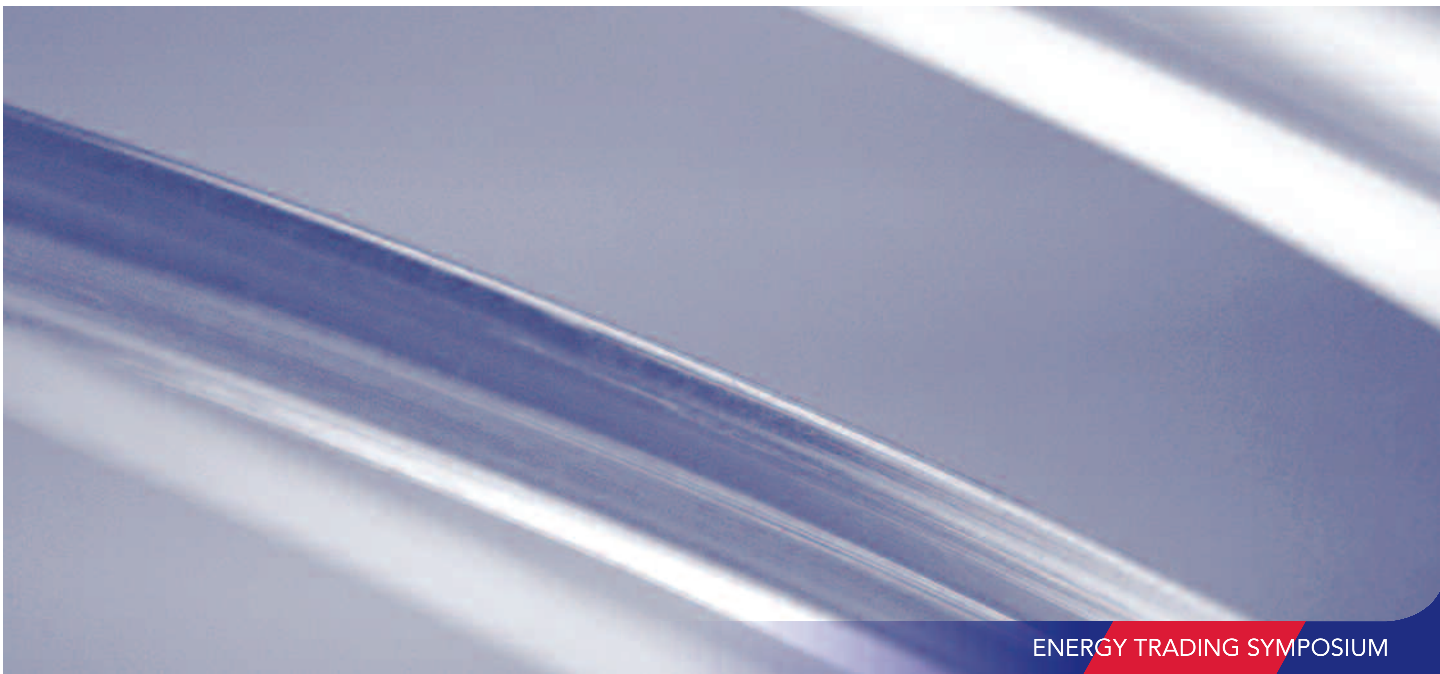
First the REM process hinges upon voluntary co-operation. Progress is only possible because participants decide to forego profitable business. Because many technical problems have to be solved, it is very often difficult to point to the party responsible for delays and in many cases those causing delays change over time.

In the end, it is clear to all those involved that, under the REM framework, there is no way to guarantee consistency between regional solutions. This does not undermine the regional approach per se, but regional solutions rarely take account of the broader picture (e.g. the case of EASEE gas standards which are currently not taken up in parts of Central and Eastern Europe as they are allegedly biased towards standards operating in the North West).

Nevertheless, some consistency has still been achieved because of the involvement of some countries in several regions, which leads to a natural check for consistency. However, there are no defined criteria for assessing success. And, as progress is naturally slow, some stakeholders, including EU institutions feel – rightly or wrongly – that progress is unsatisfactory, although they themselves have no practical alternative to offer.

There is currently no external assessment of progress and of the solutions agreed upon. The pace of market integration is dependent on those market participants most unwilling to integrate – a situation which is very likely to produce undesirable results.

A second driver, in those cases where clear progress can be seen, is the legal requirement to change existing rules. For example, the establishment of regional auction offices



for co-ordinated allocation of interconnection capacity was supported by binding congestion management guidelines without which an even slower pace of change would have resulted.

A further consequence of the voluntary approach is the high degree of diversity of regional solutions. In electricity, there are, for example, some 16 different sets of auction rules for cross-border capacity across Europe.

WHAT DO WE MEAN BY "TOP DOWN" EU APPROACH AND WILL IT SOLVE THE PROBLEM?

The obvious conclusion to the aforementioned problems is to strengthen unifying elements. These could be the 11 areas where, under the Third Package, rules have to be elaborated by TSOs, based on Framework Guidelines developed by ACER and finally "approved" (the details remain to be finally agreed by legislators) by ACER/EC.

Consequently, there is a strong likelihood that there will be more consistency between regional developments. Still, even the Third Package foresees and allows for regional diversity. And, we still are not sure if the process of achieving binding, harmonised rules will be efficient and effective or if we will see a slow, bureaucratic process with many delays and infighting between the parties involved. Also, a clear distinction has to be made between areas where regional differences are necessary and others where diversity will pose major barriers to market integration.

"Therefore, a clear mandate to promote the European market is necessary."

Market rules in most areas must not allow regional differences, if we really want to realise an integrated European market. In this respect, the draft rules by the ENTSOs will have to take into account the final goal of a European market. But will ACER or the EC be able to withstand political pressure to sustain regional differences? Pressure from within the regions to keep traditional regional freedoms will be significant. Therefore, a clear mandate to promote the European market is necessary.

This mandate has to take the form of European legislation. "Top down" in this sense depends on a firm legal basis on which the whole process can be based. The process conceived in the Third Package where European institutions more or less have to show that specific market-wide proposals impede market integration could hold up the whole liberalisation process.

To sum up, even the Third Package might be too "co-operative" and not enough "top down" as the whole idea of the package is still based on quite a high degree of self-regulation, which has proved to be insufficient to really bring market integration to fruition.

Regulators, market participants and the EC, together with the Member States in the Council will have to focus all their attention and efforts on the creation of a truly integrated EU energy market and put less priority on individual, national issues to make the new approach work successfully, in the interest of EU energy consumers.