

Power Exchanges: A key contributor to European market integration

According to Jean-Francois Conil-Lacoste, CEO of Powernext, new regulations will encourage both more consolidation and competition amongst EU power exchanges.

Rush towards consolidation

Following the sudden rush of international mergers and acquisitions which has thrown traditionally low profile "bourses" into the spotlight, we should ask ourselves what is the trigger behind this development?

In many respects, it looks like a frantic reaction to a changing regulatory and competitive landscape from the global players looking to diversify. It falls short in most cases of recognising the constraints of physical power markets as well as what is required for achieving an integrated EU energy market.

Regulation encouraging competition and consolidation.

Because of MIFID, competition in the traditional securities and financial futures exchanges is increasing. For example, the big liquidity providers (the US and European majors) have launched their own colourful platform in equities ("Turquoise") and derivatives ("Rainbow") in direct competition with the exchanges. This is also true in the US with the "Four Seasons" project. They are also threatening the broker business in interest rates with the V10 project.

As a result, and in light of sky-rocketing energy prices, many of these cash-rich "financial" exchanges have gone shopping in the energy market.

A few examples:

- OMX takeover of the international activities of NordPool ASA while in turn being acquired by the US electronic cash equity market, NASDAQ

- CME Group purchasing NYMEX, which has bought a 15% stake in Imarex which in has turn acquired the energy broker Spectron

- Eurex launching the South Pool alliance with the Slovenian Borzen, while reinforcing its presence in EEX and bidding on its own for the UK power exchange tender in spite of a lack of track record in physical power markets

NYSE/Euronext preferred to follow another track and acquire the carbon trading activity of Powernext, which has worldwide potential better fitting its ambition and size than the increasingly regulated European power sector.

Expanding choice of settlement

Furthermore, the McCreevy's Code of Conduct for Clearing and Settlement will reshuffle the cards as customers will be free to choose their agencies for settlement/delivery and clearing. But in practice, there is no exchange or clearing house that can offer a full range of options for reasons of cost and complexity.

As a result, many exchanges, all served by LCH.Clearnet, have reacted by integrating their clearing. For example, ICE Futures Europe will open ICE Clear Europe in July and Euronext/LIFFE will segregate its own clearing within LCH.Clearnet, which has reacted to both these moves by linking with NYMEX.

Powernext has chosen to ally itself with a dedicated energy clearing house, ECC, owned by EEX but open to other shareholders. This compromise between horizontal and ►

vertical integration seems to be the proper response to the needs of the market place and should facilitate the market integration process. It has also been chosen by Endex, the Dutch energy derivatives exchange.

On the broker side, it is worthwhile mentioning, (besides the purchase of Spectron by Imarex), the call by ICAP for a regulated exchange status in the fields of CO₂, power and freight, and the takeover of the benchmark system provider Trayport by GFI.

Regulatory support for exchanges

The frontiers between exchanges and brokers are blurring and competition is intensifying, especially on the power derivatives side. We estimate the potential of European power derivatives to exceed 10000 TWh/year, i.e. some 80 to 100 million euros, a significant package to compete for.

But exchange knowledge and competencies on the physical side of the business should not be ignored or underestimated.

The EU Commission's Third Energy Package has for the first time mentioned and supported the role of the power exchanges in its proposal:

"Regulatory authorities shall co-operate at least on a regional level to foster the creation of operational arrangements in order to ensure an optimal management of the network, develop joint electricity exchanges and the allocation of cross-border capacity, and to ensure a minimum level of interconnection capacity within the region to allow for effective competition to develop."

Furthermore, "Transmission system operators shall promote operational arrangements in order to ensure optimum management of the network, and promote the development of energy exchanges, the allocation of cross-border capacity through implicit auctions and the integration of balancing and reserve power mechanisms."

Regional "hubs" and integration

In this context, the spot power exchanges are the front runners. Thanks to their pools of liquidity and centralised order books, they are instrumental in the deployment of market coupling. Regional hubs will be the necessary first step for market integration.

The potential for listed derivatives will not emerge if this physical integration fails.

So far 80% of power transactions on the continent are OTC and non-cleared unlike the Scandinavian market where the establishment of NordPool has allowed 100% clearing of a solid wholesale market, representing six times the national consumption of which half of the flows are matched through the organised futures market.

It is interesting to note that the Scandinavian TSOs are the owners of NordPool Spot, while the clearing and the non-Scandinavian power activities of NordPool ASA have been sold to OMX/Nasdaq.

The integration process is at cross roads and so are power exchanges. The Central West Europe(CWE) power market coupling/splitting project will be key to success.

In order to pave the way for market splitting in the CWE region and beyond, EEX and Powernext realised there was a unique opportunity to merge their spot and futures power activities into dedicated exchanges. TSOs will be involved in the governance of the new spot company, which is open to other partners (Belpex has already signed a letter of intent and APX spot is welcome).

This is a timely and logical move, to create an exchange platform covering one third of all European electricity consumption as well as a decisive step towards broader market integration. ■