



## **ETSO Answer to ERGEG Public Consultation on “The Creation of Regional Electricity Markets”**

25 August 2005

### 1. Introduction

ETSO welcomes the opportunity to comment on this consultation paper “The creation of regional electricity markets - An ERGEG discussion paper”.

TSOs are market facilitators and have as a mission to develop together with the authorities a well functioning market. TSOs are not market players but neutral bodies, whose independence is established by the previous Internal Electricity Market Directives. Should a TSO not behave as a neutral body following the national legislation, ETSO expects the concerned Regulatory Authority to take the required action. TSOs make trade feasible, especially in wholesale markets, by transforming complex physics into a set of ‘virtual’ tools and products that market participants can understand and manage. TSOs ensure that the regulatory framework can be effectively implemented on a day-to-day practical basis, without jeopardizing the secure operation of the interconnected power system and contributing to the establishment of the necessary confidence in the market.

Since its formation in 1999 ETSO has supported, and continues to support the development of the Internal Electricity Market (IEM) whilst maintaining security of supply. In view of the fact that the proposals put forward in the paper are also designed to take steps toward reaching this objective we are supportive of the proposals to the extent that they meet this objective. Our comments below address issues relating to whether the proposed steps in the paper are the best way to achieve the goal and the practical issues and implications associated with the proposals.

Sections 2-5 of this response to the discussion paper set out our comments on each of the issues on which comments have been requested in the discussion paper. Sections 6-10 provide more general comments on other issues covered in, or relevant to, the discussion paper.

### 2. Key Market Design Features

Views are provided below, as requested in the discussion document, on:

**The key market design features that may need to be addressed in creating a regional market (including any additional features not discussed within this paper).**

In order to determine the key market features a clear understanding of the objective of the IEM is required. If the objective is free trade but not necessarily equal and non-discriminatory competition between market participants then less “key features” are required. It is only necessary to provide sufficient transmission capacity, and a means of accounts for any flows between the different settlement areas. However if the objective is to create a single market where all participants can compete on an equal and non-discriminatory basis then a much wider range of issues must be addressed including:

- a. A single regulatory framework (or at least a very high level of harmonisation) for the market model and for cross-border issues
- b. Common transmission charging principles
- c. Stable investment environment for TSOs in order to promote new infrastructure between TSOs and within TSO areas and to speed up licensing procedures
- d. An acceptance of taking the rough with the smooth, that is a realisation that costs (particularly investment costs) may fall on some countries while the benefits of such investment may fall on other countries, while aiming at a fair balance of benefits and costs
- e. Common technical criteria such as Grid Codes and connection conditions.

The ERGEG paper seems to accept that moving to such a single market in the short to medium term is not practicable, as most of the issues above are currently governed at a national level across Europe. ETSO agrees with this view and hence believes the correct area for focus in a regional market approach is how to ensure that there is open and non-discriminatory trade between whatever regional blocks develop. We give some views on the priority issues to enable a regional market to develop in the following sections of our response.

A key issue impacting on any regional market design will be the ability to reinforce or develop interconnections between countries and between regions. Unfortunately, nothing is said in the paper about the lengthy procedures required to obtain the necessary permissions to construct such interconnection assets, or indeed transmission assets in general. In all known cases today, the lack of interconnector (or transmission) capacity is just due to the strong opposition from local communities, and the impossibility for TSOs to get rights of way, and the construction authorisations. It can not be ignored that many projects are blocked after more than 10 years of procedures. Regulators should actively address this crucial issue in consultation with Member States and other relevant bodies who generally have the responsibility to issue construction permits.

Furthermore governments and Regulators will need to jointly consider how investment in interconnectors and transmission lines inside a country essential for a region is to be financed and

included in tariffs in such cases where the benefits of such investment may not necessarily fall in the countries or regions bearing all or part of the investment cost.

### 3. Overarching Regional Framework

Views are provided below, as requested in the discussion document, on:

**The possible need for an overarching regional framework through which interaction across a regional market would be organised and regulated.**

The paper identifies a large number of issues starting with TSO issues, moving onto wholesale market arrangements issues, then regulation issues, finally identifying the role of governments and Regulators as one of the priority areas for further action. As TSOs in an association that supports the creation of the Internal Electricity Market we are in agreement that TSOs have an important role to play. However we believe that the ordering of these sections in the discussion paper should not be seen as the sequence in which issues should be addressed. Every TSO operates under national legislation and national regulation, the same is true for wholesale market arrangements in each Member State. Legislation and regulation determine the extent to which TSOs are able to participate in the activities identified in the paper to support the development of the Internal Electricity Market.

The case studies in the paper are a good example of this. In the Nordic region progress by TSOs has been supported and overseen by the governments and Regulators of each country who have provided the necessary support for the TSO co-operation, even years before the European Directives on the IEM. The BETTA system has been implemented with a single Regulator and legislative area. Whilst the Australian case study involves a number of states, these are all part of a single country. The discussion paper notes that in the Iberian market formal treaties have been established to provide the legal basis for the regional market. The All Island market case study recognises the role of the “Multi-Party Agreement” between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Ireland as a key factor in the developments.

The clear message from all the case studies is that explicit agreements between governments are required such that the TSOs and regulatory bodies involved will be supported and financed in undertaking their roles in regional markets.

### 4. The Role of Regulators and Governments

Views are provided below, as requested in the discussion document, on:

**The role of Regulators and governments in delivering regional electricity markets.**

As set out above both Regulators and governments have a key role in delivering the Internal Electricity Market, and any regional markets that are being developed.

The lack of a European consistent framework is today by far the biggest obstacle to trade. Up to now, the IEM has been built with a heavy reliance on subsidiarity left to Member States. In many countries, due to history, to a local wish to protect what was perceived as a valuable national interest, or to support other objectives potentially in conflict with IEM objectives, even basic market arrangements were decided without consultation of neighbouring areas, with incompatible market models as a consequence. The resulting overall legal and regulatory framework embeds inconsistencies that do may hinder the usual cooperation between TSOs to take place. A number of examples do exist, such as the common proposal of a market-based congestion management scheme between France and Spain by the two TSOs at the 2000 Florence Forum still waiting for the necessary legal modifications, or the example of the wind power priority infeed which restricts trading capacities within Germany and at borders to neighbouring countries.. In some cases, this legal and regulatory framework has been established as a rigid set of rules, disabling any possibility of improvement or adaptation to match new needs of market participants, or to prevent gaming by some parties. Also, Energy Regulators have different responsibilities and powers in the different Member States, which also makes coordination and cooperation between these bodies more difficult.

Legislation is likely to be needed in each country that is involved in a regional market, especially to provide flexibility in establishing and continuously improving common frameworks. This will then need to be supported by enhancing the role of national Regulators to enable them to provide the correct funding and support to TSO organisations that are involved in undertaking activities and investments that are needed to implement the regional market in an effective manner.

## 5. Process for Taking Forward Regional Markets

Views are provided below, as requested in the discussion document, on:

**The proposed process for taking forward work on the creation of regional markets, in particular:**

- **the use of practical case studies through which the detailed issues for delivery of particular regional markets can be assessed, noting that the issues faced may vary depending on the national markets included within a region**

In the discussion document for consultation, the use of case studies is helpful. However these should only be seen as useful in identifying the type of issues that need to be addressed when considering regional markets, in relation to their own relevant conditions. The inclusion or exclusion of a case study should not be seen as approval or otherwise for the case studies involved.

- **The use of existing mini-fora regions as the basis for these case studies (with other ‘regional groupings’ being taken forward where countries agree) and the proposed involvement of Member State governments, the Commission, Regulators, TSOs, market operators and market participants in taking this forward.**

One of the main issues with regional markets is their exact definition. Several countries were involved in more than one mini-fora grouping, this creates uncertainty as to the boundaries of geographically distinct regional markets (e.g. France and Germany each participate to 4 mini-fora). In the ERGEG case studies not a single country was involved in more than one region. The issues to be addressed with countries that could be involved in several regional markets need to be considered along with the implications that would have for each of the regional markets.

Hence we agree that it is essential that Member State governments, the Commission, and Regulators are involved in the first stages of the creation of these “regional groupings”. TSOs should be involved in all stages of developing and implementing regional market grouping given their central role. However the TSOs will not be able to undertake the role envisaged for them without the support of governments, Regulators and the Commission, and especially without a clear and stable political vision and commitment by Member States, including energy and market policy.

## 6. Collecting and Assessing Grid Users’ Needs

When implementing the ‘virtual’ tools that set the framework for the wholesale market, or in choosing the detailed arrangements for access to international interconnections, there are often conflicting opinions from the different kinds of grid users: big industrial customers, traders, retailers, generators, power exchanges... Such discrepancies have always been obvious in the different sessions of the Florence Forum. On several occasions, these opinions also diverged between similar grid users established in different Member States.

These users are consulted on a regular basis by most European TSOs. Their different opinions often correspond to different risk profiles and uneven possibilities to hedge them.

Reaching an agreement on a key market feature (e.g. balancing mechanism or explicit auction timing) is in most cases impossible when the solution has to satisfy the interests of *all* market actors. As done by ERGEG for congestion management and tariffs guidelines, Regulators should, together with TSOs and on a regional basis, organise public and transparent collection and assessment of the different viewpoints before taking a coordinated decision. For ETSO, for the sake of efficiency, this

consultation process, to be developed on a regional basis, should be kept separate from meetings between Member States, Regulators and TSOs, while of course being strongly in interaction.

### 7. The Question of Risk Sharing Between TSOs and Market Participants

As mentioned above, such an assessment is likely to raise the question of the optimal economic sharing of risk between market participants.

This issue is also relevant for risk sharing between TSOs on one-hand and market participants on the other. When converting the 'physical' world into the 'virtual' tools appropriate for trading, new risks appear that must be assigned. The firm access to capacity requested by some market parties like traders and larger industries for cross-border long-term (yearly...) auctions is an example of such risk. Their objective is to avoid risk management costs. The counterpart is a heavy financial risk for the TSOs that is linked to the price difference between areas, a type of risk that TSOs cannot (and are not allowed to...) hedge properly. This risk, providing Regulator approval, can be transferred to the transmission tariffs. In such case, the financial risk of some market parties is transferred to all consumers, which may appear as discriminatory.

On the overall, such a long-term firmness obligation to TSOs is likely to be widely sub-optimal from an overall public welfare viewpoint.

More emphasis should be put on the global economic effect of different types of solutions. ETSO has carried out such a study<sup>1</sup> on the effect of extensive preventive counter-trade, showing its disoptimisation and redistributive effects (some market participants cross-finance others, and the overall social benefit is reduced). This can also happen with intensive use of other non-economical approaches.

### 8. Information Provision in an Imperfect Market

In its Discussion Paper, ERGEG addresses several times the question of information provision to market participants. ETSO is clearly on the same line and has recently published a position paper on market monitoring where ETSO promotes adequate transparency as a key issue for market sustainability through confidence. In this respect, today most European TSOs are forbidden by law to publish data about generation (real-time outputs, maintenance schedules...). Even in the current state of the IEM where important dissymmetries on information do exist, information on generation is often considered to be commercially confidential by national laws.

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<sup>1</sup> [http://www.etso-net.org/upload/documents/2-ETSO-An\\_evaluation\\_of\\_preventive\\_countertrade\\_final.pdf](http://www.etso-net.org/upload/documents/2-ETSO-An_evaluation_of_preventive_countertrade_final.pdf)

## 9. Power System Security

European TSOs are experienced in the technically critical questions relating to large disturbances (black start, emergency planning...). Regional associations dealing with Power System security issues (UCTE, NORDEL, UKTSOA,...) have developed methods and rules to face such situations. Recently, for example, UCTE has carried out an outstanding work in editing an Operation Handbook and making it binding for all its members. If TSOs are the ones bearing the responsibility for operation during large disturbances, ETSO then considers that TSOs, through their associations, should still be responsible in the future for establishing such technical rules.

TSOs also remind that the physical process they control to keep the lights on differs according to the nature of the generation mix in the concerned geographical area (e.g. the balancing mechanism arrangements differ between a mostly hydro and a mostly nuclear area, or in presence of a high level of wind power), or peculiar geography of the grid (peninsulas...).

ERGEG's help is much welcome in giving to TSOs, when and where necessary, the possibility to enforce rules and performance requirements to other parties who manage physical assets connected to the grid. TSOs are not responsible only for grid operation, but for Power System operation, the performance of which is highly influenced by the one of generation plants, distribution grids (e.g. ability to carry out efficient load shedding) as well as energy intensive industries, etc.

ERGEG's support will also be very useful in the field of monitoring security of supply. TSOs are ready to implement Europe wide security of supply assessment in order to provide appropriate signals for market parties and investors.

## 10. Conclusion

In order to give a new momentum to the development of an efficient Internal Electricity Market, ETSO, as an Association, its TSO members and the other TSO associations are ready to develop coordinated regional approaches together with Member States, Regulatory Authorities and ERGEG, in the presence of the EC. A separate transparent consultation process with market participants and other parties like power exchanges and distributors should also be organised to collect all opinions and proposals.

Precise and pragmatic targets should be assigned to these regional market platforms, the success of which will rely on the long-term commitment of high-level representatives from Member States, Regulators and TSOs.