

## **CONCLUSIONS**

### **Eleventh Meeting of the European Electricity Regulatory Forum Rome, 16-17 September 2004**

The eleventh meeting of the European Electricity Regulatory Forum took place in Rome on 16-17 September 2004.

Representatives of the regulatory authorities and responsible ministries of candidate countries participated in the meeting of the Forum with a view to assist these countries in preparing for full participation in the internal electricity market.

#### **1. A competitive and sustainable electricity market**

Director-General Lamoureux, whilst underlining the progress that proper implementation of the new package could potentially bring, pointed out the currently persisting limitations of the electricity market: transposition of the new directives in Member States is insufficient; market opening in Member States remain at the moment still rather asymmetrical; since the market opening process started the degree of concentration in the industry has consistently increased and there is a clear risk that the public will assimilate recent price increases in electricity with this ongoing concentration process; infrastructure development is still not satisfactory, despite the political objective of the European Council, agreed in Barcelona in 2002, to have in each Member State an interconnection capacity of at least 10 % of the generation capacity. In this context, the Commission envisages to make the integration of an electricity cable in railway or road tunnels a condition for cofinancing of projects comprising such tunnels under the transeuropean networks programme for transport.

Mr. Lamoureux underlined that the new Commission, pending the outcome of the report to be submitted by the Commission in 2005, will have to consider further measures if these drawbacks, notably the maintenance of dominant positions and non-competitive market structures, are not removed.

Mr. Turmes, MEP, noted that the key problems in the electricity market were not be resolved by additional huge investment in new power lines. To tackle the underlying real causes both of congestion and recent raises in electricity prices market concentration and bad functioning of different national and regional markets has to be addressed. Not new "hardware" but new "software" measures, such as divestment, ownership unbundling as well as the congestion management improvements being discussed at the Forum, are necessary. Appropriate economic signals, particularly to encourage decentralised generation, would be necessary in this context.

Regarding the issues relating to climate change, Mr. Turmes looked forward to the adoption of a clear long-term target which would provide the regulatory certainty which the industry was looking for. On renewables and energy efficiency, the need to develop of offshore electricity networks, e.g. in the North Sea, was underlined. Finally, the importance of the proposed energy services Directive to deliver improvement in energy efficiency was stressed by Mr. Turmes.

The representative of Spain stressed that new interconnectors are essential with respect to Spain in order to ensure the development of effective competition.

IFIEC, the association of industrial energy consumers, explained their perception of the current situation of the market. Wholesale prices are high, uniform and controlled by few dominant players who do not compete between themselves. Therefore the current market design endangers the EU industry. Reinforced unbundling and increased competences of regulators is necessary. IFIEC argued that at present the sole item on which price negotiations are possible is the trading margin. In addition, suppliers are not offering sufficient flexibility relating to contract structure and there appears to be reluctance on the part of suppliers to make realistic offers outside their traditional regions.

The Alliance of Power Intensive Industries argued that potential windfall profit could result from emission trading and underlined the impact of high electricity prices on power intensive industries. They called for transparency of the cost of environmental policies and highlighted the announced monitoring of electricity prices by the Commission and regulators and further measures by the Commission in the context of emission trading.

Eurelectric argued that the accumulation of a number of legislative measures, notably in the field of the promotion of sustainable development, has significantly impacted on actual and future prices and has outweighed the high productivity gains in the electricity sector. They proposed a road map for a review of the existing legislation with respect to its consistency, cost effectiveness and compatibility with market integration.

The CEER underlined the need to improve the current status of the internal electricity market through appropriate regulatory and anti-trust remedies. The definition of a comprehensive regulatory framework in line with Directive 2003/54/EC and Regulation 1228/2003/EC and the adoption of measures aimed at facilitating the construction of cross-border lines are urgent. The CEER welcomes the recent Commission's initiative of bringing together national competition authorities and national energy regulatory authorities aiming at improving consistency of application of competition law in the energy sector.

## **2. Neighbouring countries**

### **2.1. Switzerland**

The Swiss representative declared that the Swiss government and electricity industry will further pursue the objective of a regulatory reform that aims at an EU-compatible solution. The representative informed the forum about the ongoing process in Switzerland and the private initiative taken by the industry to establish an independent TSO. He thanked the participants of the Forum, notably ETSO and the Commission, for the good co-operation in past and expressed the desire for continued and increased co-operation and involvement under the new EU legislative framework, notably the Regulation on cross-border exchanges and the comitology procedure foreseen in it.

The Forum underlined that effective and pragmatic solutions would have to continue to be based on bilateral arrangements between the TSOs in the EC and Switzerland

at least as long as a respective legislation provides for a comparable legal framework ensuring fair conditions for all market players. The Forum underlined the need for the rapid development of parallel rules in Switzerland, particularly with respect to those rules contained in the electricity Regulation. Such solutions are necessary to allow an efficient functioning of the cross-border trade regime and ensure the effective participation of Switzerland in the EC mechanisms.

The Forum stressed the importance that Switzerland considers carefully the need to make rapid progress in this respect, particularly in the light of the application of the reciprocity principle and the need to ensure the continued excellent co-operation between the EU and Switzerland with respect to electricity trade.

## **2.2. The South-East European energy market**

The Commission informed on latest developments with respect to the creation of the South-East European energy market. Following the grant of the negotiating directive (mandate) by the Council, the Commission is in the process of negotiating a legally binding agreement on energy with South-East European countries. The ultimate objective is to create an Energy Community in the region based on the *acquis communautaire*. With respect to technical issues, a CBT mechanism is already in place and discussions on a standard electricity market design across the region are well advanced.

The representative of Algeria expressed its appreciation for the opportunity to participate in the Forum and referred to the Commission initiative to promote the development of a Maghreb electricity market based on the same principles as the EU electricity market.

## **3. Implementation of the new cross-border Regulation - draft guidelines**

### **3.1. Introduction**

Taking into account the outcome of the discussions on the issues concerned at last Florence Forum of July 2003, the Commission had distributed in March 2004 a first draft of three guidelines, intended to be adopted under the Cross-border Regulation, for consultation to stakeholders. On the basis of the comments received and the opinion of the European Regulators Group for Electricity and Gas (EREG), adopted on 10 August 2004, the Commission had circulated prior to the meeting a revised version of the draft guidelines.

The Commission explained that, in terms of timing, two approaches appear conceivable. Either the guidelines, which reflect the current state of the art but do not provide for final solutions, are adopted rather quickly to provide for first progress. Or more work is done first on developing final solutions with respect to the issues concerned, before adopting improved guidelines at a later stage.

### 3.2. Congestion management

The Commission recalled in its introduction that since 1<sup>st</sup> July 2004 the Regulation on access to the network for cross-border exchanges in electricity is applicable. As a consequence, all network congestion problems shall be addressed with “non-discriminatory market based solutions”. This is, however, currently not the case on many congested borders in the internal market. Since the Regulation is directly applicable European legislation, it will be applied as such by national Courts and, as opposed to directives, does not require further implementing measures by Member States.

The Commission presented its draft guidelines on congestion management intended to complement and update the rules contained in existing guidelines, which already form an integral part of the Regulation. The rules concern in particular more detail regarding the general provisions of the Regulation on the methods used for congestion management, co-ordination between TSOs, maximising of available capacity and transparency, by publication of relevant information on transmission and generation, provisions for merchant interconnectors as well as the treatment of congestion rents.

Europex and ETSO presented a joint proposal for congestion management based on flow-based market coupling. This model, which concerns only day-ahead trading, is based on regional price areas, with inter-regional trading facilitated by market coupling. It strives to improve congestion management, through the use of a flow-based approach and market efficiency. The Forum called for a continuation of the ongoing work of ETSO and Europex. To further develop this concept, on the basis on further investigations of technical, contractual and regulatory matters.

ERGEG presented its comments on the draft initial guidelines, which the Commission has submitted in March for consultation, pointing out that nearly all comments have now been taken into account by the Commission in the second draft submitted prior to this meeting.

EFET underlined the importance of increased transparency with respect to the physical electricity infrastructure (capacity of network and generation plants, demand forecast) for the wholesale market in a give region.

GEODE expressed its preference for re-dispatching as the preferred congestion management methods and the cost introduced to transmission tariffs.

Eurelectric underlined that market splitting, implicit and explicit auctions are the only true market-based methods and called for their recognition in the guidelines.

The Commission proposed that in order to further pursue the work in this area, and in particular to permit a rapid movement to flow based implicit auctions, a two-pronged approach be taken in this area:

- a number of horizontal questions/issues have been identified common to all parts of the EU; for example how to deal with issues of market power. These should be further addressed by the CEER/ERGEG, in close co-operation with the Commission, ETSO, Europex and other relevant market actors, reporting back to the next forum scheduled for spring/summer 2005.

- in order to make progress in the different regions where such congestion management mechanisms need to be introduced, in particular regarding the concrete manner how to implement the principles contained in the draft guidelines in the different regions of the Community, a series of "mini-fora" will be set up, jointly convened by the Commission and CEER/ERGEG and including representatives of the TSOs concerned, ETSO/Europex and where appropriate all other relevant market actors and in particular Member States. These fora are requested by the Forum, based on the papers presented at the Forum by the Commission and ETSO/Europex, to provide a plan and detailed timetable for the introduction of at least day-ahead co-ordinated market based mechanisms, such as auctions. This should be completed in good time for presentation at the next Florence Forum. The regions in question are as follows:
  - Iberian peninsula (PT-ES-FR)
  - UK and Ireland (IE-UK-FR)
  - Benelux (FR-BE-NL-LU-DE)
  - Italy (FR-IT-CH-DE-AT-SI)
  - Nordic countries (NO-DK-SE-FI-DE-PL)
  - Central Eastern Europe (DE-PL-CZ-SK-AT-HU-SI)
  - Baltic states (EE-LV-LT)

It was agreed that the identification of these regions should not be considered as a definitive determination of which countries should participate in which regional co-ordinated mechanism. This will be determined by the work of the mini-fora.

The Forum agreed to this approach but stressed that the mini-fora need to consider for each relevant area the best congestion management mechanism, in line with the Regulation, that is appropriate given the particular circumstances that exist in the region in question.

The Forum expressed the view that market based allocation mechanisms were expected to be only implicit auctions and explicit auctions.

The European Associations present in the Forum expressed their wish to have the possibility to further comment on any revised version of the guidelines in order to contribute to the quality and the flexibility of solutions.

### **3.3. Harmonisation of tariffs**

The Commission presented its draft guidelines on tariff harmonisation. The objective of these guidelines is to be the first step in a progressive harmonisation of the level of transmission charges paid directly by generation in order to reduce unnecessary distortions of the internal market. The draft fixes the current position as a starting point to ensure that there are no further increases in divergence between different Member States.

ERGEG expressed its general agreement with the draft guidelines and underlined the need for further work on this issue, notably with respect to the improvement of the concept of the average national G and the development of long-term locational signals.

ETSO supported the guidelines but stressed that they must provide for the possibility for exporting TSOs to reflect its contributions to the inter-TSO compensation fund in G

charges. Furthermore, the definition of G should be further developed, to include for instance losses and ancillary services.

Eurelectric stressed the importance of the issue from the generating industries' point of view. G charges should be harmonized at a level of "0". Unfortunately the guidelines do not provide much progress in this respect, the need for further harmonisation in the near future should be made clearer.

EFET explained that from a wholesale traders' point of view, congestion management issues should be addressed by regulators and TSOs as first priority, tariff harmonisation and inter-TSOs compensations being of less importance for the market in the short term.

### **3.4. Inter-TSO compensation mechanism**

The Commission presented its draft guidelines on the inter-TSO-compensation mechanism. These, in particular, have been drafted in order to reflect the Requirement in the Regulation for costs to be based on long run average incremental cost. The Commission proposes that this figure is submitted by national regulators.

The CEER noted that the draft guidelines did not in their opinion adequately reflect the intention of the regulation. They called for further examination of different network models before adopting guidelines. The CEER expressed its opposition to further significant increases in the value of the compensation fund. CEER suggested that the definition of LRAIC needed to be clarified and in any case, should not refer simply to the replacement costs of the assets.

ETSO stated a series of technical improvements that needed to be made. It concurred with the views of the CEER concerning the definition of LRAIC and suggested the current approach would need to be maintained.

It was agreed by the Forum that further modeling work would be needed between ERGEG, ETSO and the European Commission before a definitive methodology could be agreed on a long-term basis.

The Forum agreed that the results obtained with the 2003 and 2004 inter-TSO mechanisms should be analysed in a quantitative way by the European Commission and ERGEG in close co-operation with ETSO. The outcome of this analysis should be presented at the next Florence Forum meeting.

The Forum invited ETSO, as a temporary measure, to continue the current inter-TSO compensation mechanism for one more year without, however, increasing the present level of the inter-TSO compensation fund.

The concepts of long-run-average-incremental-cost (LRAIC) and cross-border flows need clarification. The impact of different definitions upon inter-TSO compensations should be quantified by ETSO during the first quarter of 2005 and assessed by the European Commission and ERGEG.

An overall impact assessment of the revised draft guidelines should be provided as soon as possible by the European Commission in close co-operation with ERGEG and ETSO.

#### **4. Security of Supply and Infrastructure Directive**

The Commission provided an update of progress concerning the above proposal that is currently passing through Council and Parliament. It underlined its view of the need for greater co-ordination of interconnection investments and the involvement of Regulators. The Dutch presidency explained the progress made to date and stated its intention to seek political agreement before the end of the year. It noted its commitment to ensuring a market framework supportive of investment.

Mr. Turmes noted that the European Parliament was in the process of examining the proposals and that a number of questions had been raised by the rapporteurs.

The CEER stressed the need for a positive investment climate and that this should be the focus of the discussions being undertaken to draft the Directive. It's agreed the need for the role of the regulator to be clarified concerning investment decisions although it noted the key role of transmission system operators in the planning and implementation of investment projects.

ETSO also strongly stressed the primary responsibility of TSOs regarding investments. It explained some of the key concepts relating to security of supply and the roles of the different stakeholders. It set out some of the important issues that in its opinion should be dealt with in the Directive. UCTE generally concurred with the analysis put forward by ETSO underlining the necessity of specific approaches to quality and security of supply in the five synchronous systems in Europe out of which some common layers could be identified..

EURELECTRIC very much supported the idea of clarifying roles and responsibilities of the different actors. Establishing a functioning market is a key prerequisite in ensuring security of supply. However, it suggested that the current drafting of the proposals may in fact lead to further uncertainty and it called for a period of regulatory stability, noting that the key aspects of security of supply have already been covered, adequately in its opinion, in the Directive 2003/54.

CEDEC underlined the need for regulatory decisions to support an adequate level of investment in the network. This should include sufficient revenues for both transmission and distribution system operators to maintain and develop the networks. In particular, an economically and technically realistic view of depreciation should be taken by regulators in setting access tariffs. When benchmarking, not only costs should be taken into account, but equally quality standards.

Europex supported the Commission's call for standards on authorisation for investments in interconnectors, and in general a stable investment climate stressing the importance of forward and futures markets as a clear investment indicator.

#### **5. European Reliability standards**

The Forum stressed that a comprehensive set of binding common security and reliability standards, to be observed by TSOs and network users, is necessary in order to ensure the efficient and secure functioning of the interconnected system and appropriate quality of electricity supply. UCTE presented the work on the operational handbook. The first three

policies have been adopted, the next stage, a multilateral agreement (MLA) referring to the Operational Handbook, and aiming to make the OH standards binding first between TSOs are under preparation and expected to be signed by the end of 2004. The MLA contains details of enforcement procedures and sanctions in the event of infringements.

Both Mr. Turmes and the CEER stressed the need for independent oversight of the contents of the operational handbook and its implementation. It was also noted that damages from non-compliance could go much wider than simply the signatories to the agreement and that there was a need to protect grid users. EFET recalled the interaction between network operation and the question of congestion management, particularly relating to intraday allocation of capacity, and recommended a balance between the requirements of security and reliability standards (which might lead to a reduction of the offered cross border capacity) and market needs.

The Commission informed the Forum about a study to be launched in the near future to analyse the present national and multilateral security and reliability rules. The study will look at the interaction of these rules and will assess the need and scope for binding security and reliability rules for the European Union as a whole.

The Forum welcomes the important progress of UCTE in developing the new handbook and its support on the overall approach. It invited the Commission and the ERGEG, in close co-operation with UCTE, to reflect on the issue of a complementary and preventative compliance, monitoring and enforcement process, and stressed the importance of ensuring that the new handbook is ready for entry into force by 1<sup>st</sup> January 2005. CEER also expressed the need to discuss at a technical and operational level specific questions related to policies, multilateral agreement and other issues of importance for grid users.