

The electricity regional initiative – a practical tool to integrate markets in the way to IEM

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1. The emerging need for regional approach

The first Electricity Directive^[1] adopted in December 1996 was followed by the launch of the Florence Electricity Regulation Forum in 1998. The growth of the Forum to encompass the Commission, the energy regulators, the Member States and the major stakeholders showed the importance of collective discussing and voluntary agreeing on the measures to develop the Internal Electricity Market. However, the common treatment of the whole EU and its relatively separated electricity markets being then at very different stages of development, market opening and integration with neighbouring markets revealed the need for complementary regional approach.

The second Electricity Directive^[2] together with Electricity Cross-Border Regulation^[3] was adopted in 2003 with implementation deadline in July 2004. One of the main objectives of the second legislative package was to move from national markets to more integrated European markets.

In March 2004, a strategy paper^[4] prepared by the European Commission was published in which a proposal for a regional approach as an interim step to establish the integrated single market was made. The paper recognized that the Member States were not particularly well interconnected but at the same time some countries had already adopted harmonized rules which went beyond the second package. The paper envisaged a more developed harmonization of the regulatory approach taken to issues like degree of market opening, transmission tariffication, rules for trading and congestion management.

Concrete measures to promote regional integration were proposed at the 11th Florence Electricity Regulation Forum^[5] in September 2004 when the Forum requested the setup of a series of mini-fora to be jointly convened by the Commission and CEER/ERGEG and to include the TSOs concerned, ETSO/EuroPEX and where appropriate all relevant market actors and in particular Member States. The fora were requested to provide a plan and detailed timetable for the introduction of at least day-ahead coordinated market-based mechanisms such as auctions. The Conclusions also contained a grouping of the countries into seven regions.

In June 2005 European Regulators Group for Electricity and Gas – ERGEG – published its consultation document “The Creation of Regional Electricity Markets”^[6], which proposed establishing regional electricity markets and invited comments on it. ERGEG noted that a pragmatic way of reaching single, efficient and effectively competitive electricity market would be via the interim step of the establishment and further development of a number of regional markets.

On the basis of the results of the mini-fora, which were organized during the winter 2004/2005 ERGEG prepared its proposition to amend the annexed Congestion Management Guidelines of the Electricity Regulation. Based on ERGEG advice the European Commission launched the reform of the said Guidelines convening the Electricity Cross-Border Committee in January 2006. The amended Guidelines^[7] were adopted in November 2006 with entry into force in December 2006. The new Guidelines established the grouping of EU Member States within which a common coordinated congestion management method and procedure for the allocation of capacity to the market at least yearly, monthly and day-ahead were to be applied not later than 1 January 2007.

2. ERGEG takes action

On 27 February 2006 ERGEG launched its Electricity Regional Initiative followed a couple of months later with a similar initiative for gas. The objective was to identify and remove barriers to competition in seven EU regions defined in the Congestion Management Guidelines and to speed up progress in regional level. The Initiative was designed on the basis of ERGEG Conclusions Paper “The Creation of Regional Electricity Markets”^[8].

The first steps to be taken during the spring 2006 were the finalization of the memberships, establishing ways of working and governance and identifying priorities. Quite recently the number of regions increased to eight with the establishment of the new South-East European electricity REM. The Ministerial Council of the Energy Community made a decision in June 2008 to implement the amended CM GL in the Energy Community context and with that specified the group of countries – the so-called 8th region – where the coordinated congestion management methods are to be applied by the end of 2009 at the latest. The present eight regions cover the

following countries:

Region	Abbr.	Countries (Lead regulator in bold)
Baltic	Baltic	Estonia, Latvia , Lithuania
Central-East	CEE	Austria , Czech Republic, Germany, Hungary, Poland, Slovakia, Slovenia
Central-South	CSE	Austria, France, Germany, Greece, Italy , Slovenia
Central-West	CWE	Belgium , France, Germany, Luxembourg, The Netherlands
Northern	Northern	Denmark , Finland, Germany, Norway, Poland, Sweden
South-West	SWE	France, Portugal, Spain
France-UK-Ireland	FUI	France, Ireland, UK
South-East	SEE	Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR of Macedonia, Greece ¹ , Hungary, Italy ² , Montenegro, Romania, Serbia ³ , Slovenia, UNMIK ⁴

Notes:

¹ Greece is the Chair of the Common Auction Office Implementation Group.

² The Decision of the Energy Community Ministerial Council of the 27th of June, 2008.

³ Serbia is the Chair of the ECRB Electricity Working Group.

⁴ Territories within the United Nations Interim Administration Mission in Kosovo.

An integral part of the Electricity Regional Initiative was the design of the institutional setting for the Electricity Regional Initiative and its electricity Regional Energy Markets (REM). The Regional Coordination Committee (RCC) was founded for each REM, led by the lead regulator and attended by all the regulators in the region including the European Commission. The RCCs have set up their decision-making processes and they drive forward the work.

A practical doer for the tasks within the region is the Implementation Group (IG), which is comprised of the representatives of regulators, transmission system operators (TSOs) and eventual other market operators and stakeholders depending on the issue worked upon.

A regional replica of the Florence Forum is the Stakeholder Group meeting, which brings together the region's regulators, Member States, the European Commission, TSOs and representatives of other market operators and stakeholders.

In case of electricity, the Florence Electricity Regulation Forum is the place for discussing and reporting progress and also overseeing pan-European consistency.

ERGEG established a dedicated task force – Electricity Regional Initiative Task Force – to bring together the lead regulators and other regulators playing an active role in the ERI. Furthermore, the foremost task of the ERI Task Force has been the preparation of the coherence and convergence report of the ERI. Additionally, regular reporting on the progress within the various REMs has kept the regulators updated on the issues discussed and agreed in the regions. This has helped to disseminate promising practices and to follow the development.

The General Assembly of the Council of European Energy Regulators has regularly reviewed the regions in its meetings through presentations of the regions and the regular updates. The wider audience has got the opportunity to follow the process via the European energy regulators website and the monthly newsletter. In addition to that, the Regional Initiative Annual Conference has so far twice brought together all the relevant parties to the Initiative.

3. Setting priorities

The first year of the ERI was occupied with the choosing and setting priorities. Among the priorities selected, congestion management, transparency and balancing have been selected the three top priorities. Congestion management is on the agenda of all but one REM – namely the Baltic region – as congestion has not traditionally been a major issue in the region. Transparency has been the second most common topic being tackled so far by all other regions except the Baltic and the FUI. However, an Implementation Group dedicated for transparency has recently been established for the Baltic region with the objective of delivering results by summer 2009.

The third priority, which has been balancing market integration, has been chosen by a group of regions and this group is now growing in number. Additionally, there have been region-specific topics like interconnections in those regions where the development of new interconnection capacity is a key to market integration (South-West, Central-East, Central-South), regulation with a focus on regulatory gaps and differences in the powers of regulators (Central-East, South-West, FUI) and market barriers (Central-East).

The priorities have been set independently by each region although there is a great degree of consistency in the themes selected. The urgent needs for region-wide coordination of congestion management methods have naturally placed that topic on top of the agenda in nearly all the regions. At the same time the fact that for example transparency has not been tackled simultaneously by all regions to ensure a timely, efficient and uniform improvement of transparency across the EU has been an issue to consider. The second ERI Coherence and Convergence Report^[9] has raised this issue and flagged in favour of more simultaneous implementation of transparency rules.

4. Concrete achievements in the regions

The second ERI Coherence and Convergence report provides a good overview of the recent progress of the regions and the issues across the regions. Furthermore, it follows closely whether the progress is converging or disjointed.

A lot of effort in the regions has rightly been placed on the development of congestion management methods. The work has covered the development of the allocation procedures for long and medium term physical capacity rights, day-ahead cross-border capacity allocation and intra-day allocation.

A number of regions (CSE, SWE, CEE, CWE, FUI) have worked on improving the allocation rules of explicit auctions and three of the regions (CEE, CSE, CWE) are in the different stages of the process of establishing a single auction office or platform to manage the allocation of capacity on the interconnectors in a coordinated way. The ERI Coherence and Convergence Report has highlighted the importance of cross-regional coherence of regional platforms and proposed that long-term improvements in the auction mechanisms be studied in coordination with

other regions.

When looking at day-ahead allocation of cross-border capacity, currently on about two thirds of the EU interconnectors explicit auctions are applied and instead of region-wide coordination the coordination of capacity allocation is undertaken bilaterally, which though is an improvement compared with the earlier status.

On one third of the interconnections implicit auctions are applied to manage congestion. So far none of the ERI regions applies in full implicit auctions whereas it is sub-regions where implicit method is being used (the Nordic countries, France-Belgium-Netherlands and Spain-Portugal).

Since the launch of the ERI a project to couple Denmark and Germany through implicit auctions has been underway. The day-ahead market coupling was launched at the end of September 2008 but was suspended due unexpected deviations in flow and price calculations between the European Market Coupling Company (EMCC) – a joint company of the TSOs and power exchanges involved – and Nord Pool Spot system. The market coupling is expected to be relaunched during the first quarter of 2009.

Also other regions are heading for implicit auctions. The Central-South European REM's regulators have agreed that the region should be heading for day-ahead implicit auctions through a stepwise project. The South-West European REM has scheduled an implicit mechanism to couple MIBEL (the Spanish-Portuguese market) with the trilateral market coupling (France-Belgium-Netherlands) and the future Central-West market coupling. However, it has been difficult to reach an agreement between the TSOs and power exchanges on this.

The ERI regions are dealing with the projects of coordinated explicit auctions and implicit auctions. However, there are currently about a dozen projects targeted on implicit auction schemes which are not enough coordinated considering the fact that there are interregional implications. The XVth Florence Forum in November 2008 paid attention to this and established an expert group to steer the work on interregional coordination of congestion management methods.

Transparency is the area where the Electricity Regional Initiative has produced its most visible results. Based on the Congestion Management Guidelines (CM GL) with their rules on information to be published by the TSOs, the European energy regulators in 2006 adopted Guidelines of Good Practice for Information Management and Transparency (GGP IMT). Though detailed in nature, the practical application of the CM GL and the GGP IMT showed that much more detailed rules for which information and in which timeframe should be made available. The Northern region was the first to prepare a Transparency Report with detailed specifications on the data requirements and a stepwise timetable for its publication. The Northern region Transparency Report was taken as a basis for the work subsequently in the Central-East, Central-West, Central-South and South-West regions of which the first two have already approved their corresponding Transparency Reports and started their implementation.

Balancing has been the priority area with the least progress. The FUI region has been the only region to efficiently tackle balancing in order to create cross-border balancing market. The solution is based on TSO-to-TSO model without any need to harmonize national arrangements. An advantage from the viewpoint of convergence is that the solution has been designed to ensure compatibility with the future harmonization of the continental balancing markets.

5. How does the third package promote development at the regional level?

In September 2007 the European Commission published its propositions to amend the current Electricity and Gas Directives and Regulations setting rules for cross-border exchanges of gas and electricity. Furthermore, the so-called third package included a proposal for Regulation establishing an agency for cooperation of energy regulators. At the beginning of 2009, the third package has received a status where the Council has reached a political agreement on it and the European Parliament has initiated the Second Reading. To be adopted, the Council and Parliament need to find an agreement on the third package by mid-April at the latest.

The third package takes into account the importance of regional cooperation. It contains obligations for Member States, regulators and TSOs to cooperate also at the regional level in addition to the European level. The Member States shall cooperate among themselves for the purpose

of integrating their national markets, and in particular, they shall promote the cooperation of network operators at the regional level and foster the consistency of their legal and regulatory framework as stated in the proposals to amend the Electricity and Gas Directives. Similarly, the national regulatory authorities are given the objective to work towards the development of regional markets with a final target of achieving the internal energy market. With regard to the regulatory regime for cross-border issues the regulators have the obligation to cooperate at least at the regional level to foster the arrangements to ensure optimal management of the networks including allocation of transmission capacity and to develop joint power exchanges.

The proposed Agency for the cooperation of energy regulators is also intended to promote regional cooperation among regulators. However, the third package does not contain specific provisions for regional bodies with formal decision-making powers. This means that the actual decision-making powers rest with the national regulatory authorities, the Agency and the Commission. An exception to this is the proposition to give the Agency decision-making powers with regard to interconnectors linking two or more Member States. This proposal is a disputed one and the final outcome of it will be decided during the Second Reading of the Parliament and the concurrent trilogy process.

The coordination of regional and European work on energy market integration in the aftermath of the adoption of the 3rd package has been touched upon by the European energy regulators in their autumn 2008 consultation paper.^[10] The paper has concluded that formalised governance structures will be needed to co-ordinate decisions within a region and to ensure that regional developments converge towards single European market there must be strong links between regional governance structures and those of the Agency. The European energy regulators have considered that rather than create new regional governance structures it would be better to build on the existing Regional Initiative arrangements. In practice this means that before the Agency is up and running, ERGEG will continue to coordinate the work within the RIs. After the interim period when the Agency is established, the Agency would be in charge of coordinating and monitoring the regional development.

6. Conclusions

The Electricity Regional Initiative has proven its usefulness through delivering concrete results especially in the areas of transparency and congestion management. The initiative has drawn attention and resources in the regions towards working on practical solutions to issues important to enhancing market integration and market functioning. The regulators, TSOs and power exchanges have actively participated in the regions whereas the low level of participation of the Member States has been an issue that needs to be remedied.

The expectations towards the outcomes of the regions have been high. Accordingly, delays and postponements met in some deliverables have caused a need for evaluation of their reasons and assessment of what could be done to ensure the path of progress. In that respect, the two ERI Coherence and Convergence reports allowed to identify the main obstacles met in the different regions. In some cases the delays have been due to overly optimistic time schedules which have been impossible to follow because of the complex nature of the issues or the parallel projects of the neighbouring regions have led to insufficient resources of various parties to cover all the needed work streams. In other cases, the differences of market designs and regulatory gap were the main causes put forward to explain delays and postponements. Finally, the high number of parties involved in the process, each potentially following their own private agenda, is a common feature shared by all the regional initiatives, which can also explain a large part of delays.

An important issue for the Regional Initiatives is their anchoring to the wider context of European market development. Presently the tasks to be carried out in the regions are agreed within the regions and are not agreed or included explicitly as part of the regulators' European work programme. It is also of utmost importance that the regulators' European work programme addresses the obstacles identified by the ERI Coherence and Convergence reports and proposes solutions to tackle them. The role of the Regional Initiatives should be more visibly shown and understood as an integral part of the implementation process. The Initiative is a vehicle to implement the European level binding (EU legislation) or non-binding (ERGEG Guidelines of Good Practice) rules. The monitoring undertaken by ERGEG is able to provide valuable feedback to the further development

of the original rules. Finally, the initiative is an important means to achieve concrete progress towards the final goal, which is the creation of an integrated European electricity market.

An important aspect of the Electricity Regional Initiative lately has been a shift in its focus; the work in the regions was at the beginning concentrated on the region-specific issues relying on the information and effects within the region. The most recent evidence from the ERI Coherence and Convergence Report suggests that the focus now has started to shift to cover more inter-regional aspects – a feature that is vital for the future development of the single market.

7. References

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