

EuroPEX Response to ERGEG's ERI Convergence and Coherence Report

12th of September 2007

On 18th of July 2007, the European Regulators Group for Electricity and Gas (ERGEG) published *ERI Convergence and Coherence Report* (hereinafter referred to as "Report") and launched a public consultation on the issue. The Report seeks views on the issues with the intention to follow up issues and views in the second half of 2007 and during 2008.

EuroPEX response is structured in three distinct sections. In the first section the general comments on the ERI process and its outcomes are presented, the second provides answers to the specific questions asked in paragraph point 131. of the Report and the third comments on the body of the Report in the form of proposed changes to the text.

We would be more than happy to continue a structured dialogue and consultation with ERGEG and other parties on the various topics within the report, and more specifically to elaborate further on some of the areas we at this point have chosen to provide input on.

Furthermore we – as EuroPEX and as individual members – are active within the various ERI regions, expect to contribute considerably in the continued process and hope that ERGEG will ensure full recognition of the need and purpose of power exchange inputs and involvement in implementation of market based solutions in all of the ERI regions and IEM as a whole.

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About this document

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General comments on the ERI process and its outcomes

EuroPEX appreciates the opportunity to comment the Report and overall ERI achievements and hopes that its response will help both to refine and change the Report to make it even better reflect the current status and stress essential practical, policy and regulatory developments towards gradual markets evolution in a truly integrated IEM and to evolve the ERI framework to its next level.

ERI process has been continually evolving for almost three years now, the period through which it facilitated valuable discussions between the parties and provided for significant progress in certain fields of market development. Nevertheless, EuroPEX would like to point out some of the issues that have emerged in relation to the ERI process.

Firstly, there seems to be too little effort put by the regulators to enforce the powers given them by the task of ensuring TPA to the infrastructure in terms of market transactions. Security of supply is by all means prerequisite for market functioning, but with the energy market liberalisation the regulators should adopt a significantly more market-oriented attitude, primarily by building their own internal competences in order not to depend too much on the infrastructure operators of, for example, physical grids or market services.

Secondly, there have been numerous evidence of its limitations by confinement to the (energy) sectoral framework, while a blind eye has been turned to apparent substantial overlapping with others like, for example, financial sector. ERI process should consider the overlapping regulatory issues properly, not least by recognising the fact that many of the parties and/or their activities are in fact regulated and deserve to be treated as such, regardless who actually regulates them. In order to effectuate the real powers of regulation, which appears to be of paramount importance for further development of the IEM, the (energy) regulators should actively engage in cross-sectoral co-ordination.

Thirdly, overwhelming reliance to the *acquis communautaire* to lead to automatic convergence towards IEM of the regional markets that individually comply with it has proved to present great challenges to future integration. An elaborate common vision of the IEM should be presented by all the regulators of the impacted sectors in order to allow the energy market to fully develop all across the EU and truly deliver benefits of liberalisation.

In terms of the forward process, EuroPEX particularly wishes to point out the need for greater clarity and enforcement of co-ordinated policies leading towards implementation

of the models and practises which have been recognised, also by this Report, for their superiority.

Taking the overall achievements into account, we call for a greater attention to be paid to bringing the markets forward from recognised “second best practises” to “best practices” in order to effectively promote opportunities for a competitive and efficient IEM to develop. In that respect ERGEG has, together with the EU Commission, a key role in facilitating visions and methods to enforce gradual convergence of policies and regulations to achieve this objective. One such example is the development of implicit capacity allocation. On that issue EuroPEX is, as expressed in the comments to paragraph points 21. and 22., concerned about the lack of guidance on how implicit allocation methods in the short-term timeframe should gradually replace others all across the IEM.

Answers to specific questions asked in the paragraph point 131. of the Report

Answers in this section are following the individual questions replicated below.

I. Capacity calculation

1. The level of transparency of the current and future capacity calculation methods applied by the different TSOs

In principle, the capacity calculation methods to in order to provide for a reasonable level of transparency have to:

1. clearly state all the parameters of the physical reality and of the assumptions used in the calculation process;
2. be made in strict compliance with the (pan-European) harmonised definition of firmness;
3. undergo strict and (pan-European) harmonised regulatory scrutiny;
4. be made publicly available in a market participant friendly format and thoroughly commented/explained;
5. be implemented to the last detail stated;
6. enable calculation results to be auditable (by the regulators).

2. The need and the importance of long term (year, month) capacity rights (physical or financial) and the associated need for long term capacity calculation

Long term capacity rights are essential for market players to hedge price difference risk and precise long term capacity calculation method is needed to ensure that auctioned capacity is consistent with the best expectations of real time transfer capacity. The merely financial role of long term contracts suggests that the most flexible and efficient cross border congestion management scheme should be based on day ahead implicit auctions to allocate physically available capacity and long term (year ahead, month ahead) FTRs and/or CfDs to hedge price differentials volatility. Intraday markets could be used to manage efficiently the forecast errors made in the day ahead and to manage any contingencies reducing the scope of intervention of the balancing market. Nevertheless, it has to be noted that TSOs and interconnector operators are the only market actors “long” on cross-border capacity; therefore their

(regulated) participation in the long term capacity market, where operated, is very much needed.

3. *Which information should be published in the case of a flow (PTDF) based capacity allocation? Indeed, some implementation scheme may imply that ex-ante cross border day ahead capacity estimation should not be available anymore.*

It is very important that there is full transparency in any flow based solution, otherwise the entire arrangement will be a black box that no-one other than the TSOs will understand. This would rapidly erode confidence in the capacity calculation and associated allocation.

It would be necessary to provide full information on the PTDF model design, the parameters used (both static and daily dynamic data) and the results. It might be efficient for the TSOs to make available a computer model that parties could use to analyse the network.

The statement in the second part of the question is not true as coherence between PTDF&BC matrices for allocation on different timeframes (stating the values as if no trade/allocation has occurred before) has to be possible. The only difference lies in the non-existence of the available capacity between the individual two markets as all the available BC is shared between all of them.

4. *Is there any added-value of implementing PTDF-based allocation method without an implicit allocation method or an explicit auction of obligations to nominate?*

The added value of PTDF-based allocation method as such comes from:

1. the greatly improved responsiveness of the capacity allocation to the individual borders with shared constraints, what lessens the importance of the TSOs' predictions of the market outcomes,
2. the probable lowered needs for reliability margins reserved for dealing with parallel and loop flows from within the region covered (the so-called unwanted outside flows in the NTC/ATC calculation that become internal within PTDF calculation) as PTDF matrix accounts for them,
3. the greatly improved cooperation between the TSOs in the region covered in capacity calculation process.

There may be value in the TSOs jointly operating a day ahead PTDF-based capacity model even if the output is translated into NTC capacities for use in the present

capacity allocation methods. Such an approach would involve much better co-ordination between the TSOs than at present, in particular in the use of the most recent locational load/generation forecasts in the PTDF model, resulting in more optimal and fair set of NTC values across the region. So it would be valuable in its own right as well as being a key step in the implementation of a flow-based implicit auction.

II. Long and medium term capacity allocation

1. Current auction procedures as well as the products auctioned are different in some aspects:

- i. Can different auction procedures (where to go to acquire capacity, nominations, functioning of secondary markets, time frame....etc) on different interconnections hamper cross border trade where a market player wishes to or must trade over more than one interconnection?***

Any further harmonization between different countries improves cross border trade. Anyway, considering that a full harmonization can be difficult to reach and could require time and efforts, reasonable differences can be accepted in a start up phase as an improvement on the status quo. A step by step and case by case approach should be considered.

- ii. Can different auction products (product profile, duration, degree of firmness etc) on different interconnections hamper cross border trade where a market player wishes to or must trade over more than one interconnection?***

Differences in auction products could hamper cross border trade. In particular the case of different degrees of firmness would expose to risk those traders who arrange a delivery through several interconnections of which some auctioning firm capacity and others non firm capacity; while the case of different product profile/duration would increase for the trader the risk of a mismatch between the capacity profile/duration bought on the different borders. A step by step and case by case approach should be considered.

- 2. *Can the coexistence of PTRs and FTRs on different borders reduce the degree of hedging for a market player who wishes to or must trade over more than one interconnection? Can such coexistence on different borders cause any other obstacle to cross border trade where a market player wishes to or must trade over more than one interconnection?***

The coexistence of PTRs and FTRs is possible, but FTRs are preferred as they naturally combine with implicit auctions which guarantee consistency between power flows and price differentials and the maximization of capacity through the netting of flows in opposite directions. Assuming relevant and reliable price indices underlying the FTRs and harmonised firmness of both PTRs and FTRs, no reduced degree of hedging is implied, while FTRs can be used to hedge the physical capacity reserved for the day ahead implicit auction, whereas PTRs cannot.

III. Day ahead capacity allocation

- 1. *Can day-ahead NTC based allocations and flow (PTDFs) based allocations coexist as such?***

Yes.

- 2. *Can day-ahead market coupling and market splitting coexist as such? Would you consider market splitting (a single power exchange) more efficient, in the longer run?***

Market coupling and market splitting can coexist as there is no difference in principle between the capacity allocations deriving from either of them: the results should be the same. The differences in market design arrangements in the different countries often address country specific issues that might be difficult to harmonize, hence the question of market splitting or market coupling is an issue of individual country's market rules and the organisation and structure of the exchanges, and is not itself an issue to do with capacity allocation. In theory, the only potential difference in efficiency could appear in results derived from a more flexible (or "loose") volume-based variety of market coupling, while market coupling and market splitting in their pure form deliver equal results.

3. *Does the linking or merging regions using implicit auctions require a high degree of harmonization of “algorithms” and to some extent products and legal framework?*

Linking regions using implicit auctions implies a high degree of compatibility (at a minimum) and possibly full harmonisation. Implicit auctions can coexist in adjacent regions, but if the capacity between the regions is also to be implicitly auctioned this requires compatibility of design. This includes operational procedures (including gate closure times), fallback arrangements, products specifications, change management and governance/decision making. The degree of harmonisation can potentially be reduced through the use of more flexible (or “loose”) volume-based market coupling.

4. *Do you regard “volume coupling” (each PX participating in a joint auction office still calculating own prices, but based on auction office calculated volumes on interconnectors) as a flexible option in a transitional period towards a price coupling?*

Depending on the cross-border congestion situation, volume coupling can be an acceptable solution, but leaving the final price setting to the local PX may be required due to other regulatory requirements. In this case, it is no easier or harder to implement from a technical or governance perspective, and the arrangement may be needed for the long term.

Nevertheless, it has to be noted that market coupling, either volume- or price-based, delivers its results on actual price differences, effectively allowing only for economically justified cross-border transactions. The difference lies only in the final price setting method used at individual participating exchanges, i.e. whether they individually implement their own price setting method respecting only bids and offers they individually received (with cross-border volumes priced at marginal clearing price) or they accept the imposed price by the central mechanism as the final clearing price in their market. In either case, each individual cross-border transaction remains economically justified.

A different consideration is the use of more flexible (or “loose”) volume-based market coupling – an option which is likely to be easier to implement and maintain than price coupling (from both a technical and governance perspective). This does make it attractive as a possible way to make faster progress. It is still to be evaluated whether flexible coupling is materially sub optimal – it may be that the difference from full

price coupling is minimal, which if the case might make this a very acceptable long term solution.

IV. Intra day

REMARK: The possibility of implementing market splitting/coupling sessions in intra-day time frame is not a question asked, and it is a viable market based congestion management solution already implemented and has been successfully operated for 9 years in the Spanish market, allocating capacity with France, Portugal, Morocco and Andorra.

1. Should regions pursue the implementation of continuous trading platforms?

Yes, but it may also be valuable to explore other options such as a combination of a series of implicit auctions each followed by continuous trading implicit allocation session.

2. What could or should be the geographical scope of such continuous trading platforms?

The minimum geographical scope should be a single control area, to catch all the benefits of liquidity and market efficiency. The arrangements should be flexible to enable step-wise geographic extension.

3. Will the development of several competing intraday platforms in the same geographical area not be detrimental to the development of liquidity in intraday?

It might, and therefore introduction of a series of market coupling auctions could prove to be the right solution for the relatively illiquid intraday markets.

4. If, for liquidity reasons, one single intraday platform appears to be relevant, who should offer this service? TSOs? PXs? Other? Should it be regulated, and how?

Any single market platform should be provided by PXs, once guaranteed the coordination with the TSOs, because they have the relevant expertise can make access available on an open and transparent basis to all and can utilise their existing ICT (information and communication technology), contractual, operational and clearing/settlement infrastructure. As far as regulation is concerned, see answers below under title *VI. Governance and regulation*.

V. Balancing

1. Is the harmonization of the remuneration schemes for balancing bids/ offers (pay-as-bid versus pay-as-cleared) a pre-requisite to the integration of balancing markets?

As balancing markets have to be continuously traded, the question of pay-as-bid probably refers to whether the platform owner/operator is allowed to collect the possible spread between the bid and offer prices. In principle, the spread should be allocated to the parties concluding the deal according to the market rules and the platform owner/operator should be entitled only to the fees as contracted. Otherwise the platform owner/operator would be sharing the interest in the actual prices in the market it operates and such schemes do not work well.

2. Is the harmonization of the methods which determine the share of automatically activated reserves and manually activated reserves in the balancing reserves procurement a pre-requisite to the integration of balancing markets?

Harmonisation is probably not needed as the TSOs shall in any case ensure adequate production/load capacity reserves for both active and reactive power throughout their respective control zones to enable secure operation in compliance with operation of the wider network their grid forms a part of. As the balancing market does not necessarily rely only on the bids and offers relating to such reserves (cross-border reserves sharing), but (primarily, in fact) allows for other participants entering their bids and offers as well, harmonisation of the reserve share definition methods would provide for a very limited value added. Nevertheless, harmonisation might be needed if serious risk of inadequate reserve procurement would emerge as a threat to the market functioning.

3. To what extent a common intraday trading platform could be used for or interact with balancing trades?

Apart from the cross-border capacity sharing between the two markets during the time both markets overlap, the interaction is possible to a very limited extent. Intraday and balancing markets differ significantly and both markets should be operated in parallel, if their trading times overlap. Interaction would most probably be limited to sharing the bids and offers in the intraday market (for active power) that TSOs use to balance their control zone in relation to the wider network, while all the other aspects of

balancing market (intra-zonal redispatch, reactive power balancing, etc.) would have to be operated separately.

4. ***Could “TSO to TSO” balancing trades co-exist with “Actor to TSO” balancing trades? Could both processes co-exist and interact using a common balancing trade platform?***

Yes.

VI. Governance and regulation

1. ***Who should preferably be the owners of joint auction offices? How should “shares” (ownership and voting rights) be determined?***

It is by no means clear that a central entity is required. The TLC region, for example, does not have a central entity; the market coupling activities are provided under service agreements by PXs and the overall scheme is governed through multiparty agreements. In any case, even if an entity is established, the key issues of decision making and funding will probably need to be determined through multiparty agreements, not simply via ownership shares. The governance arrangements will need to ensure that the respective interests of the parties are met: typically TSOs with respect to the capacity allocation and PXs with respect to the matching/price formation and the exchange services/products supported. This is not a simple issue, and the level of understanding and refinement will develop through experience.

2. ***Should auction offices, interconnectors operators and PXs disposing of all or part of interconnection capacity (disposing of an “essential facility”) be regulated?***

The regulation of the monopolistic management of an essential facility must be regulated. However in the case of previously non regulated subject like PXs a distinction must be kept between regulated activities and regulated entities, avoiding an extension of regulation of congestion management activities to include all other PX activities. Furthermore, normally capacity allocation is already a regulated activity. Through this means it can continue to be regulated. The regulated entity (such as the TSO or the PX) would need to put in contracts or other arrangements to satisfy itself and its regulator that it was able to comply with its regulatory responsibilities.

Ultimately, where the PX is not regulated by the energy regulator, the TSO has the ultimate option of appointing or creating an alternative exchange. This, together with the natural incentive on PXs to be involved in any market coupling, has meant that

market coupling initiatives have progressed very successfully having the necessary regulatory involvement.

3. *Which governance elements could ensure non discriminatory access of additional owners to a joint auction office?*

Again, it is not clear that a central entity is required. However, the issue is valid even where there is no entity – here the issue is how a new party would be admitted to the existing scheme on a fair basis. Unfortunately, there is no easy way to define “non-discriminatory”. While there may be an obligation on the existing parties in the governance arrangements to facilitate new parties joining, key issues will arise such as the treatment of costs associated with adapting the coupling arrangements to support the new party. To what extent should this be borne by the new party or all the parties? Ultimately these issues may require a consensus to be reached between the impacted regulators.

4. *Could you mention other important governance requirements for PXs and auction offices*

- i. providing “essential facilities”?*
- ii. undertaking purely competitive business?*

Where PXs provide essential services to the implicit auction these should be undertaken through clear contracts or direct regulation, depending on the regulation status of each exchange. In cases where the service is to a TSO for the purposes of market coupling, presumably these would be open to regulatory approval where this is needed. Contracts between unregulated entities would not, however, be subject to regulation.

Comments on the ERI Convergence and Coherence Report

Comments in this section are presented in the form of text change proposals with respective justifications.

Executive Summary

1. Reference: Page 3, Paragraph 3, 2nd bullet, 2nd sub-bullet

Day ahead - most regions are developing implicit day ahead auctions. ~~In principle these are compatible but~~ **Issues here arise around ways of jointly determining flows (in particular between regions and where regions do not correspond to meshed transmission regions), plus** care is needed in terms of the detailed design and implementation (e.g. gate closure times, role of power exchanges) in order that regions are compatible.

Justification: Linking implicit auction arrangements in different regions is not simply an issue of compatibility: they need to be very closely integrated and possibly merged.

Section 1.2 - Regions interact

2. Reference: Page 7, New paragraph point before paragraph point 10.

While the REMs set out in Table 1 have proved valuable in taking forward many initiatives, it is clear that the geographic impact of some issues does not correspond to the REM definitions (they may involve more than region or a subset of a region). There needs to be flexibility by the REMs to establish fora that bring together the right parties where this is the case.

Justification: Reliance on the parties that are members of several regions to provide the linkage on common issues is likely to be extremely ineffective. If the REMs do not create appropriate structures for these cross regional issues they will not be able to play a constructive role: the issues will be addressed by the relevant parties in other ways.

Section 1.3 – Congestion Management Guidelines

3. Reference: Page 9, Paragraph point 15.

Currently, regulators work on the consensus principle. There is nevertheless little direct provision in the Guidelines for an overarching regional regulatory oversight. To this extent then the Guidelines provide only a partial legal framework for the ERI. All those questions are solved as soon as the powers of national regulators are fully harmonised on cross border issues and compliant with the guidelines, in particular article 1.10. **In this process close attention has to be paid to presently existing efficient market based regimes and products in some regions, the ability to implement such regimes elsewhere and also to their further development in line with the evolving market needs.**

Justification: It is naturally important that the regulatory powers among national regulators are further harmonized. However, it is also important that any development of cross-national, or even at the IEM level, harmonization of regulatory regimes ensures that requirements placed on market parties and market facilitators are justifiable, based on efficiency and competition parameters and that they do not limit the ability of market-based developments following the basic principles that should be adhered to within a free and competitive market environment.

Section 1.3 - Balancing integration

4. Reference: Page 9, Paragraph point 17.

ERGEG intends to provide final advice to the European Commission on this topic after ~~consideration of interrelationship between intra-day markets, automatically activated reserves and balancing~~ **public consultation on the second version of the GGP EBMI - which will soon be published – is concluded and results evaluated.** This work is foreseen in the ERGEG Work Programme for 2007/2008.

Justification: The public consultation on the issue was based on an ERGEG paper of a more conceptual nature, resulting in fairly diverse comments and proposals. ERGEG should aim for drafting a second version of the GGP EBMI and a new public consultation procedure before finalisation of the advice to the EC.

Section 1.3 – Transparency

5. Reference: Page 10, Paragraph point 19.

The incorporation of these guidelines into a legally binding framework is presently being discussed with and by the European Commission. **Input provided by, for example, the TWG ad-hoc work led by the Commission, regarding changes of some specific requirements of the 2 August 2006 ERGEG GGP IMT proposal will be accounted for in that process.**

Justification: Although many parameters within the ERGEG GGP IMT are supported by many stakeholders, as reflected in, for example, the TWG ad-hoc process, a number of specific requirements have been found to need changes. Among others:

- the 10 MW limit (table 3) for reporting of generation data, which is very questionable from cost of delivery and monitoring and thus efficiency perspective, i.e. the 100 MW limit in Annex to EC/1228/2003 should apply.
- the P-1 for P (point 5.1) disclosure of supply/demand curves on PX markets, which is not warranted since it among others increases the risk for market power, and unduly discriminates PX based markets, thus a P+1 for P minimal requirement is a more justifiable and acceptable market practise. Further, such curves only exist in auction based markets, thus such a requirement is not applicable on continuously traded markets, which should also be accounted for.

Section 1.3 - Harmonisation and efficiency

6. Reference: Page 10, Paragraph point 21.

The ERGEG Regional Initiative is based on these conditions. The Regional Initiative endeavours to speed up the integration on a voluntary basis, ERGEG and its members acting as catalysts of the process. **The membership of Regional Implementation Groups is particularly important, as it has to comprise all the parties needed in the process of regional market integration, especially Regulators, TSOs, Market Operators and Power Exchanges.** This process is especially important in the transitional period between the second liberalisation package, now to be finally implemented nationally, and the much higher level of pan-European harmonisation expected in the 3rd package. The drafting, agreement and implementation of this package necessarily will take some years.

Justification: In order for the Regional Implementation Groups to deliver relevant results based on the actual implementation ability of the participating parties, RIG has to comprise all the parties needed to do so. In the CEE IG, for example, Power Exchanges have not been introduced in the work of it regardless of them being recognised by the Operational framework of the ERI as the guardians of relevant market rules. The same applies to involvement of Market Operators that some even adopt relevant national secondary legislation (e.g. in Slovenia).

7. Reference: Page 10, Paragraph point 22.

The monitoring of the development must ensure that regional solutions chosen must not diverge and preferably converge. However, the basic nature of such a regional approach means that solutions might not be totally compatible. Therefore at this stage we might be content with “second best solutions” regarding compatibility between regions **as a transitory measure, while it has to be ensured that it does not present itself as an obstacle to the development of the “best feasible solution” which has to be actively pursued and implemented as soon as possible.**

Justification: Being content with a “second best solution” should not be confused with lack of vision. Opting for a “second best solution” shall never be seen as an obstacle to development of the “best feasible solution” and it should only be allowed if it does not condition postponing the implementation of the latter. In any case development and implementation of a “second best solution” should only be allowed if the “best feasible solution” is already being actively developed.

8. Reference: Page 11, Paragraph point 24.

Concerning compatibility of solutions chosen in various countries and regions it generally should be borne in mind that market integration might not require 100% harmonization of rules and other framework conditions. It is – and will increasingly become – an important task to distinguish legal and organizational differences that constitute barriers to cross border trade and those which do not. ~~In this respect a clear distinction should be drawn between the wholesale market and the retail market.~~

Justification: The way it is written, it might be interpreted in the sense that substantial separation between the wholesale and retail markets is promoted, while we believe that both form a single market within the scope of Internal Electricity Market and that such approach is not beneficial for the price significance of the wholesale market.

Section 1.4 - Process for ensuring coherence

9. Reference: Page 11, Paragraph point 29.

The EU legal framework provides that for some topics adopted solutions meet common requirements. As described above, the principal legislative instrument here is the Congestion Management Guidelines. It is therefore a requirement in law that the Guidelines are adhered to in each Member State and hence in each electricity REM. In doing so, an important degree of common approach will be maintained, **while it has to be noted that the Guidelines provide for a variety of different options and hence the potential for a substantial incompatibility of the final regional designs.** This should be ~~facilitated~~ **addressed** by the regular review realized by the Regulatory Authorities of the compliance with the principles and rules established in the Regulation and Guidelines, and, in particular, ~~the efficiency of applied congestion management methods~~ **the broader goal of establishing an efficient and competitive IEM.**

Justification: Any given combination of the different options allowed by the Guidelines does not guarantee compatibility of the individual regional implementations at all. Also, efficiency of congestion management methods is too narrow a measure. The intent of the Regulation is to encourage a competitive, efficient electricity market and we should keep this is the broader goal. Efficient congestion management is one contributory element to this.

10. Reference: Page 12, Paragraph point 31.

The creation of an **efficient and competitive** single European Electricity Market is the over-all target for any development and improvement of conditions of cross-border electricity trade.

Justification: The intent of the Regulation is to encourage a competitive, efficient electricity market and we should keep this is the broader goal. Efficient congestion management is one contributory element to this.

Section 2.1 - Introduction

11. Reference: Page 13, Paragraph point 36.

Convergence and coherence should finally result in market outcomes which reflect the existence of a regional or even single market, such as ~~price convergence~~ **efficient capacity utilisation and price formation.**

Justification: Price convergence is not the objective of regional or single markets: there should be efficient capacity utilisation and efficient price signals. But prices may vary due to real network constraints, significant differences in production mix and consumption patterns between countries/regions, for example. Price convergence will tend to occur if capacity is better used, but this is a corollary effect.

Section 2.2.1.1 - Definition of concepts and practices

12. Reference: Page 15, Paragraph point 41.

It should be noted that these calculation methods, whether NTC-based or PTDF-based, are somehow imperfect to the extent where they all face the fact that TSOs have to calculate NTC or PTDFs without precisely knowing what will be the physical flows in the network. In principle the PTDF approach goes further to solve this problem than NTC since optimization across multiple lines creates greater degrees of freedom **and allows TSOs to make security reservations (reliability margins) smaller due to lesser risk of unwanted outside flows as all the flows within PTDFs are taken into account automatically.** In addition, the problem may also be addressed through the simultaneous calculation and allocation of obligations to nominate on transmission line users.

Justification: The fact that PTDF-based calculation and consequential allocation enable reliability margins (FRM) to be lower than by bilateral NTC-based (TRM) calculation/allocation should be stressed. By introduction of PTDFs the outside flows taken into account are lowered for all the flows following the exchanges between the markets within the PTDF area.

Section 2.2.1.2 – Relevant developments

13. Reference: Page 16, Paragraph point 46.

Both internally within the Nordic countries and between the Nordic countries and the Continent transfer capacity definitions in line with definitions used in ETSO are applied. On interconnections where only implicit auctions are applied (internal Nordic and KONTEK) total NTC is at the disposal for these implicit auctions. The issue of determining NTC is relatively straightforward on all of these interconnectors some of which are DC lines and all are outside the meshed continental system. Loop flows, therefore, is a relatively limited problem. The specific rules on determining hourly NTC is laid down in the joint Nordic System Operation Agreement and in bilateral

agreements with non Nordic TSOs. In addition to fixed transmission reliability margins NTC is depending on certain capacity constraints and operational conditions within each TSO area. TSOs on both side of an interconnector calculate hourly NTC and the lowest capacity-figure apply as trading capacity. These are published on Nord Pool Spot website **as well as the actual capacities, which on a fully firm basis are utilized in the co-ordinated day-ahead market splitting operated by Nord Pool Spot**. In order to increase transparency for market players recently codes indicating types of capacity reductions are applied.

Justification: It is of vital importance to recognise that the announced capacities between the Nordic price zones (bidding areas) plus the link between East Denmark and KONTEK (VE-T Control Area) are physically firm and used to facilitate non-discriminatory access to capacity via the Elspot market operated by Nord Pool Spot, the Nordic PX.

Section 2.2.1.3 – Assessment

14. Reference: Page 16, Paragraph point 49.

~~Border and inter regional issues at first sight include:~~

- ~~— What is the relevant level of details for the calculation of PTDFs? One node/zone or several nodes/zones per country?~~
- ~~— What would be the best sharing rule of auction revenues within a PTDF framework approach? How can transparency within the calculation process of PTDF based calculation be achieved properly?~~
- ~~— Interaction of Central West, Central East and Central South. All the regions are developing a common grid model and examine the implementation of flow (PTDF) based allocation, mainly for the day ahead timeframe. Even if there is coherence in objective, overall coherence needs to be ensured in practical implementation.~~
- ~~— Evaluation of the proposed methods by relevant regulatory authorities.~~
- ~~— Treatment of firmness — e.g. will a market player receive different firmness if he trades in different regions?~~
- ~~— Timing issues. In other words, how capacity should be shared between the different timeframes?~~

Justification: As it is written, this paragraph does not deserve inclusion in the body of the Report, while developed by further clarifications could find its place within, for example, paragraph point 131. The questions and statements are way too ambiguous as they simply leave too many doors for interpretation open in order to be properly analysed as there is no substantial clarification provided elsewhere in the Report. Therefore EuroPEX asks ERGEG to clarify how the various parts fit together and within which context; for example, should the expected answer to the question regarding nodes and zones relate to geographical definition of market price zones, are the statements related either to the capacity calculation process or to actual operations of physical congestion management or to the cross-border trading regimes, etc. EuroPEX is more than willing to provide its input and develop elaborate proposals on various aspects of these issues, which are all indeed important for development of IEM, and calls for further clarifications in order to enable us to do so.

Section 2.2.2.2 - Assessment

15. Reference: Page 18, Paragraph point 54.

At present, except in the Northern Region, at most borders annual and monthly explicit auctions for physical capacity rights take place. Auction Rules are different in some aspects, for example, where to go to acquire capacity, functioning of secondary markets, definitions, nature of allocated products, processes for nominations and so on. Developments in several regions indicate that for long and medium term capacity allocation explicit auctions will be the congestion management solution for the next few years. **As it is clearly a pan regional matter,** it is ~~therefore~~ necessary to ensure that improvement and developments in the design of explicit auctions should occur in a compatible way. One necessary improvement will be the harmonisation of the auction rules **both** within a region **and** interregionally in order to set up identical conditions for taking part in the auctions. ~~Then, at a later stage, interregional harmonisation might be envisaged.~~

Justification: The pan regional nature of the cross-border capacity allocation has to be reiterated and related processes should reflect it.

Section 2.2.2.2 - Coexistence of different explicit auctions

16. Reference: Page 18, Paragraph point 56.

~~Since the processes of capacity allocation by explicit auctions are not directly linked to wholesale price differences between countries,~~ Different kinds of explicit auctions can technically coexist on different borders of one country. There are many examples of this at present in the EU.

Justification: Reading the sentence, it could be interpreted in the sense that capacity prices and wholesale market prices are not directly related, while they are clearly related. With explicit auctions, the issue is just that every bidder uses own forecasts of the future wholesale price differences between the markets and respective bids eventually form the capacity price, while in the implicit allocation the actual wholesale prices are formed and the capacity price is a direct result of the price differences established in the process.

17. Reference: Page 18, Paragraph point 58., introductory paragraph

~ In practice, differences might imply overall welfare losses compared to for example more harmonised auction models (auctions rules, processes and IT platform). When market actors experience different auction products and different timing from one border to another, it indeed increases their transaction costs and **decreases** their interest in trading cross-border. As described above several harmonisation and improvements will be elaborated in the Central-West, Central-South, and Central-East Regions.

Justification: Correction of an obvious error.

18. Reference: Page 19, Paragraph point 58., 1st bullet

~ One example of an incoherent development might be the acceptance of incompatible congestion management mechanism at borders within one region or between countries that are linked to several other regions, such as France and Germany. It has to be considered that developments within one region need to be evaluated concerning their effects on the development in other regions, ~~by those countries that are part of more than one region in order~~ to assure a coherent and compatible development.

Justification: While it is important to consider the effects on other regions that a certain mechanism in a given region can have, it must be ensured that it is not a matter for only the countries that happen to be part of several regions to influence and

conclude upon. In other words, equal reciprocity between countries, regardless of how many regions they are part of, should apply on this matter. A more top-down and/or cross-regional process may be needed if problems occur due to non-compatible market regimes being implemented in different regions.

19. Reference: Page 19, Paragraph point 58., 2nd bullet

~ Harmonisation of auction rules is one of the possible ways to contribute to a convergent development. The discussion on several issues such as the status of transmission rights once awarded – are they Physical Transmission Rights (PTRs) financially firm (e.g. is there Force Majeure definition and compensation and curtailment rules?) - are led in many regions. The assessment of any differences between the rules in one region is a first step. The later step might be an extension of the discussion with other regions. **The physical firmness of the nominated long term capacity rights, and the capacity allocated in the day-ahead and/or intraday implicit auctions, is an important characteristic that should be respected in all regions.**

Justification: Add to the considerations that complete physical firmness of the capacity rights, either long term rights nominated prior to day-ahead implicit auctions, or allocated during the day-ahead and/or intraday implicit auctions, is a very important characteristic that should be respected in all regions for the correct formation of the wholesale market prices.

20. Reference: Page 19, Paragraph point 58., 3rd bullet

~ One potential problem for long and medium term capacity allocation is the set of differences in wholesale market designs – e.g. the ~~quarterly~~ **thirty-minute** products in Great Britain versus not having them in continental markets. Also this specific issue requires a strong coordination between the actions taken on the regional level, in order to achieve improvements based on harmonisation but not to distort the functioning of markets.

Justification: Correction of a factual error.

Section 2.2.3.1 - Relevant development

21. Reference: Page 20, Paragraph point 62.

~ In the Nordic area, all the available day-ahead capacity is allocated via implicit auctions. Day-ahead implicit auctions are also applied between France, Belgium and

the Netherlands, and at the Kontek Cable which connects the Danish and the German market **and between Spain and Portugal in the Iberian Market.**

Justification: In the Iberian markets day-ahead and intraday market splitting are in operation since 1st of July 2007 and should be mentioned in the point.

Section 2.2.3.2 - Assessment

22. Reference: Page 21, Paragraph point 67.

~~There is no indication from practical experience and analysis that different types of day-ahead explicit auctions as well as different types of day-ahead implicit auctions together with day-ahead explicit auctions cannot coexist. However, “the devil is in the detail”, and it is therefore important to identify which differences in design of day-ahead capacity allocation systems might potentially constitute barriers to the wholesale market trading~~ **It appears that implicit day ahead auctions can coexist with different types of explicit auction. However, there are fundamental design and integration issues where an area needs to be part of more than one implicit auction.** Having identified such potential obstacles, a clear distinction must be drawn between situations, where the obstacle will be transitional due to different timing of introduction of new allocation methods and situations where potential obstacles are built into “final” solutions. **For example, where a PTDF approach is taken to calculate capacities in a meshed network, the capacity allocation may need to be for the corresponding geographic area.**

Justification: Unfortunately, implicit auctions do not easily “coexist” – if an individual price area is involved in more than one implicit auction then the arrangements need to be very closely aligned or even integrated. This is much more than “devil in the detail”, and will necessitate cross-regional co-ordination and leadership.

2.2.3.2 - Coexistence of different implicit auctions

23. Reference: Page 22, Paragraph point 73.

Issues arising to bear in mind as each region considers the detailed solution to the question of day ahead capacity allocation therefore include:

- Harmonization of market design (in particular the implementation of a day-ahead fixing with a common gate closure time) will highly facilitate the development of implicit auction methods all over Europe.
- **The harmonization of Gate Closure time is desirable in the prospect of coupling the markets.**
- **Precise definition of the method for calculation of the day-ahead capacity that is firm enough for the implicit allocation.**
- **Fallback arrangements for the cases of unavailability of results in due time.**

Justification: The harmonisation of gate closure times will have to take into account the time by which the day-ahead market schedules of every market participant have to be fixed, as referred to in the first bullet point as facilitation of development of implicit auctions, while for the Gate Closure times of the individual PXs' auctions desirability is established only in the actual prospects of coupling the markets. In relation to implicit day-ahead capacity allocation at least two sets of issues have to be added to the list, i.e. physically firm capacity calculation and fallback arrangements.

24. Reference: Page 22, Paragraph point 74.

There seems to be a consensus among regions on the willingness to implement implicit auctions. ~~For the moment, different implicit mechanisms have been implemented (market splitting, market coupling). No problems are identified concerning coexistence of market splitting, market coupling and flow (PTDF) based market coupling as such. However,~~ As a general rule, in order to have implicit auctions between two regions each with implicit auctions (or merging two such areas), gate closure times, "algorithms" and to some extent products and certain legal framework must be harmonized. ~~Looking forward such harmonization,~~ Day ahead explicit auctions could remain an acceptable interim second best solution, **while the focus of the regional implementation groups should nevertheless remain on coordinated developments of solutions that introduce implicit auctions as a more**

efficient method of capacity allocation between the regions, replacing the transitory explicit auctions.

Justification: To say no problems are identified is to gloss over the fact that significant issues have emerged regarding the coexistence of implicit auctions, and these require careful, co-ordinated resolution. Coexistence implies a high degree of compatibility. However, having recognised in the paper the clear superiority of implicit auctions encouraging their further development seems the only reasonable option.

2.2.3.2 - Governance

25. Reference: Page 23, Paragraph point 79.

For example, the governance of Power Exchanges (PXs) strongly differs from one country to another. In general, PXs are ~~non-regulated~~ entities, **regulated in different ways and** separated from the TSOs. **The two most common situations, as far as cross-border implicit capacity allocation responsibilities, are:**

- **They are assigned directly by the regulation to the PX, in case the PX is under the supervision of the Energy regulator.**
- **They are assigned to the TSO, that is always a regulated entity, and then the TSO contracts the function with a non-energy regulated PX.**

In both of the above cases, the regulator has always control over the implicit auction mechanism performance, but the contractual relations, in the case both kinds of situations are mixed in a region, or between regions, need to be considered properly. ~~This status could lead to difficult situations in the context of the development of implicit auctions, which is, as already seen, the allocation mechanism to be generalised.~~

- ~~— First, regulators have no way to stimulate PXs to participate to implicit auctions projects;~~
- ~~— Second, PXs have no guarantee that the project costs they support for developing market coupling (or merging into market splitting) would be covered, in particular if the project is abandoned; this may curb PXs' willingness to develop such projects;~~
- ~~Third, implicit auctions give to PXs a monopoly for the day-ahead capacities, but their services and fees are not regulated.~~

Justification: In this point it is wrongly stated that PX are non-regulated entities, while in reality they are; they are regulated by either the energy regulator or the financial regulator or even both. It also points out a series of potential problems, derived from the non-regulated status assumption of the PXs that are not real. Moreover, regulation applies to either the entity as a whole or to the individual functions the entity performs, thus clear distinction has to be made in this respect.

The energy regulators, either directly, in case the PX or its individual functions are regulated by the energy regulator, or through the TSO, in case they have no direct powers over a PX, always have the same control over capacity allocation functions as required by the legislation for the control that the regulator has over any other energy regulated activity.

26. Reference: Page 23, Paragraph point 80.

~~For these reasons, the harmonisation of PXs' status and the possibility to regulate their cross border day-ahead activity should be addressed~~ **Due to the above considerations, the regulation, or the contractual relations between PXs' and TSOs', need always to be examined by the regulator, to make sure that a correct regulatory control is maintained over the day-ahead and intraday cross border capacity allocation and other regulated activities.**

Justification: Based on the explanation given in the previous point, the harmonization of the PXs' status should not be an issue.

2.2.4.1 – Relevant development

27. Reference: Page 24, Paragraph point 81.

Only **the Iberian interconnections (including those with Andorra and Morocco)**, the Nordic part of the Northern region (except Norway's borders), the French interconnections (except IFA and the French-Italian border), and the German – Swiss interconnections **and the Czech – Slovak interconnection** have already implemented cross-border intraday allocation mechanisms. **Spain and Portugal have implemented series of market splitting auctions in the intraday, while all the other Spanish interconnections feature series of unilateral market splitting auctions synchronised with the one with Portugal (note the coexistence with the French solution on the French border).** The **Iberian and** Nordic countries have implemented a performing **either auction-based** or continuous intraday trade platforms whose main characteristic is the simultaneous (implicit) management of

capacity and energy, which considerably facilitates efficient cross-border trade. The intraday allocation mechanisms applied on the French interconnections are less sophisticated: they allocate capacity only and they offer only a limited number of intraday gates (between 2 and 12 depending on the interconnection). In addition to this previous allocation mechanism, at the German-French interconnection, a pilot project has been set up in May 2007 that allows a web-based allocation of intra-day capacities, with possibilities for acquiring intra-day capacity for the direction Germany to France for 60 minutes ahead of every hour. **The Czech – Slovak capacity allocation is based on a first-come, first-served principle of allocation of cross-border transfer obligations.**

Justification: Two omissions have occurred in this overview: the Iberian and the Czech-Slovak markets that all feature intraday capacity allocation mechanisms. The Iberian is implicit method based on multiple market splitting auctions, while the other is a FCFS method with a series of gate closures (presently it allocates only the capacity in the 12:00 – 24:00 timeframe).

28. Reference: Page 24, Paragraph point 82.

The Central-West is planning to revise intraday allocation mechanisms towards a system of continuous intraday ~~platform similar to the one implemented in the Northern region~~ **trading**. As specified in the topic three of the action plan, TSOs are to submit an implementation study in July 2007 with implementation scheduled for 2008.

Justification: The model proposed by the TSOs is indeed a continuous trading system but not similar to the one implemented in the Northern region. Unlike the latter, the presented model is a “multi-platform” model, i.e. several trading platforms (exchanges, brokers, OTC, etc.) connected to a capacity platform/matrix.

29. Reference: Page 24, Paragraph point 83.

Other regions, e.g. South West REM, have also announced plans to consider and introduce region wide intra-day cross-border trading mechanisms in order to facilitate cross-border trade and to be compliant with article 1.9 of the CM Guidelines **that demands intraday capacity allocation mechanisms to be set-up by 1st of January 2008.**

Justification: The deadline set by Congestion Management Guidelines is missing, while it should be stated in order to put the developments into the right perspective.

2.2.4.2 - Assessment

30. Reference: Page 24, Paragraph point 87.

The treatment of intra-day trade within regions remains on the work programmes for a number of regions. Different options are still on the table, **like continuous trading or a series of intraday market splitting/coupling auctions** but most of stakeholders support continuous trading (as already developed in Nordic countries). ~~In the longer term the form of such continuous trading could be elaborated further.~~ **The potential combination of both kinds of trading/allocation methods should be explored further.**

Justification: Implementations of continuous trading and a series of intraday market splitting auctions have been in operation in various markets for many years, and the stakeholders of such markets support each of them. Also, other considerations should be made prior to recommending a form of intraday cross-border trading/allocation method to be implemented.

2.3.2 - Assessment

31. Reference: Page 27, Paragraph point 100.

Moreover, as the developments for cross-border balancing trade, **although they** are ~~closely linked~~ **substantially** different to the developments ~~for~~ **of** cross-border intraday trade, **need to be coherent** ~~the issues of coherence and convergence are similar in both areas. Target common platform for balancing markets should be compatible with the common intraday capacity platform that would be developed in Central West region. A common target for all regions could be the model developed in Nordic countries.~~

Justification: Balancing mechanisms and intraday markets are two different things, although they need to be coherent.

The main differences between intraday markets and balancing mechanisms are:

- Intraday market is a participant to participant market. The purpose is to balance their energy positions and to allow participants to benefit from trading

opportunities. Participation is voluntary and similar to the day-ahead market. Third party access is guaranteed.

- Balancing mechanism is a TSO-centric one (deals are subject to TSO's operational needs) that enables TSOs to assure internal balance and system integrity.

A recommendation of the most adequate solution for intra-day trading seems to be premature at this stage.

Section 2.4.2 – Transparency

32. Reference: Page 28, Paragraph point 108.

As the guarantee of transparency is one of the most important features for the liberalisation process and needs to be accompanied, monitored and enforced by the regulatory authorities a common approach is of high importance. The purpose of a transparent market is to provide all market participants with necessary data equally, **in order to ensure fair and efficient price discovery and to enable different market parties to engage in competitive trading based on applicable regulations imposed on them, i.e. primarily energy regulations and, when applicable, financial regulations in the field of transparency.** The feasibility of implementation of better transparency in national markets and across regions will also be heavily influenced by the legal framework applying in each country, including obligations or liabilities on ~~TSOs and other~~ relevant parties to release and publish data. **Proper attention shall also be paid to existing practises that have proved their efficiency in terms of providing equal and simultaneous access to data on fundamentals influencing prices and volumes in the market, such as, for example, established PX regimes of publishing data received from various market parties, either on voluntary or mandatory basis.**

Justification: It is important to note the fact that not only energy regulations on transparency are applicable on the parties engaged in short and long-term trading in national and cross-border energy markets, but also financial regulations such as for example MAD and MiFID (with respective national implementations), not least due to the fact that in some regions a significant part of the medium- to long-term hedging and trading products are based on derivatives contracts. Without proper consideration of financial regulations some parties may not be able to engage in the markets, what could lead to limited competition in markets.

Furthermore, it is of paramount importance to recognise existing efficient arrangements and properly consider their further development like, for example, those provided by PXs, which have already been proved in practice and that guarantee equal and simultaneous access to the relevant data in the field of market transparency.

33. Reference: Page 28, Paragraph point 111.

Three of the regions – Central-West, Northern, and Central-East - are striving for adoption of the same approach and broadly speaking the same Transparency Report including data definition, **while it has to be noted that the processes with stakeholders within each region have been carried out independently from each other. A report on implementation has been created in the Northern region and it is currently under review. Significant portions of it may also serve as a model for the other referred to regions.** ~~This report was agreed and developed in the Northern Region.~~ The France-UK-Ireland region is also adopting a coherent approach with the GGP. In principle this provides for a consistent approach.

Justification: Involved stakeholders, such as PXs in the various regions, have neither been involved in nor been explicitly informed of the referred to cross-regional process on this matter. Furthermore, although the direction is generally similar, it is essential to recognise that already applied transparency practises and methods differ substantially between countries and regions for a variety of reasons, such as the degree of maturity and the type of traded markets. That fact is accounted for in the report, i.e. in some cases differences are accepted and supported due to the benefits and efficiency they provide for.