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European Internal Energy Market:
'World most beautiful' or 'Could get better'?

European Internal Energy Market: Five critical areas

EU single energy market most ambitious project in the world BUT not yet achieved. At least 10 to 15 years long journey from 1999. In UK electricity system changed again a decade after the start.

EU market achievement and performances (notably efficiency & reliability) do not depend on only one critical factor but the interplay of 5 critical areas:

- ***MARKET RULES***
  - *Area 1 Member States' Market Design*
  - *Area 2 EU Internal Market Design*

- ***MARKET PLAYERS***
  - *Area 3 Industry Structures*

- ***AUTHORITIES DEFINING or IMPLEMENTING the RULES***
  - *Area 4 Transmission-and-System Operators*
  - *Area 5 Regulatory Governance*

Area 1- Member States' Market Design

➢ ***Overall***

** Market design = set of several mechanisms >> Modularity of each Design*

** No consensus on a single "perfect" market design >> Diversity of Designs*

→ A market design recognized as "workable" could be insufficiently efficient, insufficiently "open to entry" or insufficiently reliable

- ➢ ***Issue 1 Bilateral & OTC markets (the bulk of energy transactions)***
- ➢ ***Issue 2 PXs (Day Ahead & Forward) (from "pure PX" to "light Pool")***
- ➢ ***Issue 3 Congestion management (from "Redispatching" to "Implicit Auctioning")***
- ➢ ***Issue 4 Balancing arrangements ("Bal. Mechanism" vs "Bal. Market")***
- ➢ ***Issue 5 Fuel Market (Gas & Elec. convergence) & Capacity Adequacy (Generation Investment Cycle)***

STILL UNSATISFACTORY

(to be adressed for Efficiency or Entry or Reliability)

CORE issues ***SECONDARY issues***

Member States' Market Design: ***STILL UNSATISFACTORY***

<u>CORE issues</u> = Entry

(easier entry →/ better security of supply)

ISSUE N°4

<u>Balancing Arrangements</u> being Transparent & Robust in Gas & in Elec (& not hostile to entry or to non integrated firms) >> by ex. End the 4 German zones

ISSUE N°5

In Gas Markets: <u>Offer of Long Term Contracts</u> to Buyers (permitting Generator entry)

<u>Secondary issues</u>

N°1 To end old "non competitive" <u>bilateral agreements</u> & old "<u>regulated tariffs</u>" for eligible customers

N°2 To link <u>PXs' Rules</u> with System Operation (congestion & balancing)

N°3 To promote <u>Congestion signals</u> giving incentives to Grid users to behave efficiently

N°4 To promote <u>Balancing Markets</u> favouring efficient behaviour of generators

N°5 To promote <u>Capacity Mechanisms</u> as remedy to Generation Investment Cycle

Area 2 EU Internal Market Design

- ***Overall***

**EU a set of National or Regional Markets? *With a few gates between?*
**Will EU future be locked in with incompatible local Designs?*
**Will it affect efficiency, openness or reliability of EU electricity system?*

- *Is a common EU “Standard Market Design” needed?*
- *Could some harmonization suppress much of the “seams’ effect”?*
- *How much to harmonize National Designs or Regional Designs?*

- ***Issue 1 Bilateral & OTC market***
- ***Issue 2 PX Day Ahead & Forward***
- ***Issue 3 Congestion management***
- ***Issue 4 Balancing arrangements***
- ***Issue 5 Fuel Market + Capacity Adequacy***

STILL UNSATISFACTORY
(to be adressed for Efficiency or Entry or Reliability)

CORE issues ***SECONDARY issues***

EU Internal Market Design :
STILL UNSATISFACTORY

CORE issues (effi.+ relia.+ entry)

***N°3 Transparent & Robust Congestion management** *definition & allocation of TRSM capacity at the borders; *exchange of information (TSOs & users); *coordination of TSOs emergency procedures*

***N°3bis Congestion management** *favouring competitive methods *linking Elec. energy trade and transmission access (implicit auctioning) *linking congestion rent and interco. investment*

N°4 Transparent & Robust Balancing Arrangements in Gas & Elec. (+ open to foreign oversight & participation)

Secondary issues

N°1 To build open EU bilateral market with minimal harmonized rules. To end non competitive bilateral agreements & regulated tariffs for eligible customers.

N°2 To harmonize national PXs' Rules (linking with System Operation: balancing & congestion)

N°3 To harmonize national internal Congestion managements

N°4 To harmonize nat. Balancing arrangements (toward international Balancing Market)

N°5 To harmonize national support mechanisms for energy sources

Area 3 Industry Structures

➢ ***Overall***

***Disintegrated model (merchant plants + wholesale traders + independent suppliers) is over**

Plenty of M&As are for vertical reintegration + horizontal concentration + Gas & Electricity integration

****An EU electricity oligopoly of "seven brothers" is foreseen***

Many markets deal with an incumbent monopoly or duopoly + 1 or 2 new entrants.

→ ***Will EU market building go faster than industry consolidation? Is that oligopoly yet coherent or still feeble (gas poor vs gas rich)? Will oligopoly of vertical firms invest more (less?) better (worse?) than a fragmented industry?***

→ ***Will Member States' governments play more "national championship" than pushing towards larger & deeper EU competitive market?***

→ ***Will Competition Authorities and Energy Regulators succeed in ex ante preventing or ex post contesting the establishing of dominant positions?***

Area 3 Industry Structures

- ***Issue 1 Mergers and Acquisitions*** *(M&As as competitive entry mean; national champions becoming cross-borders players; single fuel & dual fuel)*

- ***Issue 2 A EU bilateral market made of vertically integrated firms*** *(Day Ahead & "Forward" liquidity; balancing mechanism vs balancing market)*

- ***Issue 3 Market Power*** *(Use, Abuse, Surveillance & Remedies)*

- ***Issue 4 Coordinating investment in Generation & Transmission***

- ***Issue 5 Preparing EU wide Market Retail Opening for 2007***

Industry Structures:

STILL UNSATISFACTORY

CORE issues

N°1 Prevent increase market power *in gas-elec M&A (access to fuel's closure) * in cross-border M&A (adjacent competition's closure)

N°3 Use M&As *to force divestiture (from network assets) *to have swaps (small new entry "paid" by smaller incumbent position)

N°5 Prepare an EU common regulatory and information technology basis to 2007 Retail Competition (= a "GSM like" EU standard for retailing)

Secondary issues

N°2 Vertical Integration dries Day Ahead & Forward markets' liquidity >To push to Regional PXs & To promote real Balancing Markets

N°3 To create a EU Task Force Investing in Market Surveillance tools & techniques – To cooperate in data collection & screening with independent TSOs (1st: Balancing)

N°4 Push towards an EU "Seven Years Statement" of Gen & TRSM invest.

N°5 To push towards an EU project of "cheap smart meter" for *choice & competition infrastructure*security of supply by demand response *energy efficiency with demand management

Area 4- Transmission and TSOs

- ***Overall***

TSOs are critical to EU success or failure: They *manage the national gates to EU internal market ; **implement the flows corresponding to wholesale & retail transactions

→/ TSOs were born national but have to be conducted to behave as EU internal market's agents > Many Organization, Coordination & Incentives PBs.

- ***Issue 1 ORGANIZATION (Independence as Structural Safeguard in their 2 basic functions: Access to TRSM facilities + Operation of the System)***
- ***Issue 2 System Operation Coordination (from "Independent control areas" to "Coordinated control areas") and System Operation Incentives (from "Costs Past Through" to "Costs Sharing")***
- ***Issue 3 Interconnection Capacity Expansion (from "National Veto" to "International Codecision")***
- ***Issue 4 TRSM Access tariff (from one "Single Postal Stamp" to several differentiated tariffs)***
- ***Issue 5 Connection Costs Allocation (from Shallow to Deeper Costs)***

Transmission and TSOs :

STILL UNSATISFACTORY

***CORE issues** (effi. + relia. + entry)*

N°1 Independence of TSOs – Should be expended to property

N°2 Coordination of TSOs' System Operation between their control areas ("seamless operation") +TSOs' Incentives to actual costs & benefits of "Cross Border" Operations (some sharing rules)

N°3 EU & CEER assessment on interconnection expansion process and financing

Secondary issues

N°1 Will "I-SOs" not owning any TRSM assets ensure better independence and management?

N°2 Will R-TSOs or R-ISOs coordinate & manage better?

N°4 To harmonize Postal Stamps' Scope, Structure and Allocation (G / L) towards Generators' Incentives to System Operation Costs

N°5 To harmonize Connection Charges towards Generators' Incentives to Grid Expansion Costs

Area 5 Regulatory Governance

- ***Overall***

National Energy Regulators as critical as TSOs to EU success or failure.

At least three functions: *defining regulatory rules with enough operational details to make it work on the battle field; *monitoring the observance of rules by other players; *settling conflicts between these players

- ***(Like TSOs) Regulators were born national but have to behave as EU internal market's agents > Organization, Cooperation & Incentives PBs.***
- ***Nat. Regulators have regulatory powers DG Energy doesn't have and vice versa.***
- ***DG & Nat. Regulators' Cooperation core tool if no new Directive in sight***
- ***Both have to share the regulatory governance with DG Comp, National Competition Authorities or Nat. Financial Authorities (PXs).***

- ***Issue 1 Independence Safeguard and Accountability at national level***
- ***Issue 2 Scope of Powers and Operation Resources***
- ***Issue 3 Think and Behave as EU agents***
- ***Issue 4 Division of Labour and Cooperation with DG Energy***
- ***Issue 5 Inter Institutional Cooperation in the Competition and Market Monitoring areas***

Regulatory Governance :

STILL UNSATISFACTORY

CORE issues

1° Independence of regulators from nat. government veto or appeal and for their budget funding

2° Their powers' scope [for tariffs *network *reg. energy; public service charges ; congestion & balancing rules, interco. access] + Sufficient staff & budget

3° Organization of regulators' cooperation by regional Forums & Reg.'collective decisions

4° DG Energy to lead a 'Market Monitoring Task Force' & 'Retail Competition Task Force'

5° Organization of EU cooperation between energy regulation and Competition Authorities

Secondary issues

1° Accountability of national regulation at EU level (through participation to benchmarking process?)

2° Could energy regulation benefits from operation with non energy regulation (Germany)?

3° How to combine national welfare & EU welfare in regulators' decision criteria (ex. Interco.)

4° What Issues DG Energy will leave to nat. regulators agreements?

5° To Offer to Competition Authorities a co-training in "Energy Market Monitoring" techniques & tools?

Five areas: real scope for improvements

+*…. Things I forgot?*

Like: ‘New Member States’ Transitory Regime

Better to be heard from a Latvian Commissioner?