EuroPEX
Association of European Power Exchanges

EuroPEX Response to the "*European Commission Everis/Mercados Final Report on Regional Markets*"

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Methodology

EuroPEX response to the European Commission (EC) consultation on the Draft Final Report of Everis/Mercados Study on Regional Initiaves is divided in four parts including the introduction, general comments, analysis of the Report regarding "Reference Models" and annex on different models of market coupling mechanism. This document does cover only the points of the Report which are more relevant to EuroPEX and the response to the consultation aims to contribute clarifying some misconception of particular topics.

I. Introduction

1. In the 17th Florence Forum of 10-11 December 2009, the EC launched a public consultation on the Report produced by Everis/Mercados on Regional Initiatives. The consultation aims to collect the views of interested parties on the proposed approaches.

2. EuroPEX welcomes the opportunity offered by the EC to comment on and provide input to the "*Draft Final Report – From Regional Market to a Single European Market*". Power exchanges are major actors and are the vital vehicle toward the development of the integrated energy market. EuroPEX members are committed to the objective of creating a more transparent, efficient and integrated energy market.

3. EuroPEX notes that the Mercados' Report has been drafted without consultation of all relevant stakeholders, in particular Power Exchanges (PXs). This lack of consultation is surprising, since PXs are officially involved in two out of the three main bodies of decision and discussion of the Regional Initiatives (Implementation Groups and Stakeholder Groups), and European consultation forum (Project Coordination Group - PCG- and now the Ad-Hoc Advisory Group on Market Integration - AHAG).

4. As experienced stakeholders in the Regional Initiatives, and all market integration projects in general, PXs would surely have contributed positively to the conclusions of the Report, and may have helped avoiding some inaccuracies of the Report, in particular in respect to the description of the Market Coupling "reference model". Some other propositions of the Report are quite radical and far-reaching, in particular in terms of institutional analysis, and are not fully reflective of the PCG conclusions presented in the last Florence Forum of December 2009 – our present response will go deeper on that matter. On all these subjects,EurEPEX has always been active in contributing to the discussions related to the Regional Initiatives (examples include the *EuroPEX Response to ERGEG's ERI Convergence and Coherence Report*, Sept. 2007).

II. General comments on the analysis of the Regional Initiatives by the Report

5. The Report can in general be credited for being well documented, and for including in general updated status of the local initiatives and market structures in place. However, it contains some conceptual inaccuracies[1].

6. As regards to the "diagnoses" of the Report concerning the limited progress of the Electricity Regional Initiatives (ERIs), **Europex shares the critics related to the geographic definition of these ERIs:** on most issues of congestion management, having overlapping ERIs is a hindrance to projects coordination, which is a point that have been raised several times by EuroPEX[2].

7. In that respect, different PXs-led day-ahead market coupling cooperation have proven that this problem of ERIs geographical overlapping can be overcome by "bottom-up" type of project, as these projects can easily be initiated across ERIs (see for example the recent **Price Coupling of Regions initiative** involving today three PXs (EPEX Spot, OMEL and NordPool Spot) which are involved in six different ERIs – South-West, Central-West, South-East, Central-East, Nordic, Baltic.

8. EuroPEX also agrees with the Report when it stated that the need for more active involvement of the national government in the work of the ERIs would be needed, but more specifically where local Regulator may lack decision-making power on the topics dealt by the Regional Initiatives; otherwise, high-level support from the government to the Regional Initiatives should be sufficient to help stakeholders reaching good results.

[1] See for example the classification of the different « implicit auctions » variants made in the Report p.120, which mixes-up organisational and technical aspects of implicit auctions mechanisms. Implicit auctions can be organised in two ways, "Market Splitting", where one PX operates the market for different market areas, and "Market Coupling", which result from a cooperation of different PXs. In the second case, price and volume computations can be done either in a non-sequential way ("price-coupling"), or in a less efficient, sequential way ("volume coupling").

[2] See in particular the conclusions of the ENTSO-EuroPEX common Report on Development and Implementation of a Coordinated Model for Regional and Inter-Regional Congestion Management (Feb. 2009): " The ERIs have contributed a significant impetus to this, but the overlapping regional approach is becoming a barrier to implicit day-ahead coupling solutions (a particular bidding area can only be involved in one price coupling mechanism (p.39)."

III. Focus on the "Reference models" analysis of the Report

9. We notice that the Report systematically links lack of progress of the ERIs with a lack of "Top-down guidance" backed by "Roadmaps" and "Reference Models".

10. This analysis might be correct when ERIs come to deal with trans-regional issue such as Transparency: in this specific topic, EuroPEX has stated that more legally binding rules, enforced at the European level, and accompanied by close monitoring from the relevant Regulators for compliance purpose, would probably be needed.

11. The same diagnose is true only to a limited extend on congestion management issues. Important initiatives on congestion management have delivered and keep delivering successfully, based mostly on voluntary, bottom-up initiatives. The **Trilateral market Coupling (TLC) project**, mainly driven by PXs together with the TSOs, is a good example in that matter. Successful models of top-down involvement are mainly provided by high-level fora for support and guidance (see Pentalateral Forum - PLEF - model in the **CWE Market Coupling project**).

12. Some high-level reference-models may still be needed, to allow regional initiatives to converge into interregional projects in a coordinated way (its worth noting that those projects do not necessarily follow the geography of ERIs geography, but develop rather where markets are mature enough, in terms of market liquidity and/or institutional readiness). However, these reference models cannot afford to be too specific (in terms of definition of products, detailed governance arrangements…) otherwise the risk would be high to hinder market integration where some differences exists between the local markets due to unnecessary requirements of harmonisation: **a "proportionality principle" in terms of market harmonisation is therefore an important condition to ensure an even tighter and wider market integration**.

13. In the typical case of Day Ahead market coupling, the Project Coordination Group has already delivered a "Pan-European Price-Coupling" reference model which should provide sufficient guidance for bottom-up initiatives to convergence towards this model[3]: required harmonisation of local market features will occur as the projects of market coupling between the regions will face these issues on a case-by-case basis, allowing flexible market design to be maintained only to the extend it is possible and beneficial for the market. In the last Florence Forum of December 2009, EuroPEX has presented an ambitious bottom-up "**Multiregional Price-Coupling Initiative**",

[3] See related presentation of the PCG in the 2009 Florence Forum: *Project Co-ordination Group target model* (Dec.2009).

stemming from the local PXs initiative (*EuroPEX presentation on the Project Co-ordination Group*, Dec.2009): in this case, it is an initiative of the local stakeholders rather than a specific Roadmap which has shaped the scope of this truly interregional initiative. In that respect, we can only quote and agree with the Report when it states that "**the search of a reference model for the Internal Electricity Market would be superseded by events"** (p.126 of the Mercados' Report).

14. In general, "top-down" directions should thus aim at providing long-term targets to bottom-up projects, and its related forum of discussions or institutions could be contemplated to provide means of conflicts resolution that may occur at the bottom-up level.

15. Probably due to much focus on the requirements related to detailed "Reference models", or any other biased input information, the Report reaches very contestable conclusions regarding the governance and institutional implications of market integration in terms of congestion management (market coupling).

16. Contrary to what is assumed in the Report, **the various regulatory statuses of PXs neither affects cooperation, nor governance of the congestion management activities**. Market coupling services offered by the PXs do not affect the way the monopoly activity of capacity allocation is regulated: when the entities in charge of this task (often TSOs) cooperate with PXs to implement implicit auctions, they remain fully accountable and in control of the regulated task of capacity allocation, as they are the main recipients of the PXs for the set-up of Market coupling and can gain full assurance for this service - while energy Regulators keep reviewing and approving the Cross-Border capacity allocation rules. Therefore, the "monopoly activity" of capacity allocation is preserved (and optimized), without the need to modify its applicable "monopoly regulation", nor to extend it to the activities of order matching and price setting, which have always been successfully ensured by the PXs (such a success being is notably linked to the flexibility of the regulation framework of PXs activities, allowing them to adapt market organization to local needs).

17. **Price coupling only requires the implementation of a single algorithmic solution but not centralisation of operation. A decentralized operation of the single price-coupling algorithm can be a more robust technical solution, as it offers more secure partial decoupling possibilities**, which become increasingly important elements as the price-coupling mechanism extends and impacts more market areas: for example, decoupling procedures can be more robust in a decentralised mechanism. **At the same time, a decentralized mechanism would still ensure a fully-optimised solution of**

price formation and Cross-Border capacity allocation, with one algorithm determining all prices and volumes for all the areas coupled.

18. **Such a decentralised approach facilitates also the cooperation of different PXs**: it accelerates the process of market integration by providing a more flexible governance framework for all the parties involved.

19. **The centralised approach of Market Coupling as suggested by the Report would be in our view quite unstable, both on operational and governance point of view.** The Report suggests that the operation of the common European price-coupling algorithm should be undertaken by a central entity, distinct from the market operators (PXs), and owned instead by ISOs/TSOs mainly, while its operational rules would be defined by the Network Codes drafted by the ENTSO-E. **Such a scheme would dangerously reshuffle the respective roles of the entities involved in the price setting within the Integrated European Market (IEM) at a time when this sensitive function is critical to building the IEM**.

20. Rules for sharing responsibility between the coupling and the matching are today clear in all current market coupling mechanisms (TLC, MIBEL…), because the functions allocated to each party are clear and distinct. In particular, in all these models, there is a clear distinction between the functions and interests of the grid operators and the ones linked to price-setting, generation and supply: **this crucial point is in line with the unbundling requirements as set-out in the 3rd Energy Package.**

21. **On the contrary, the centralized approach proposed in the Report and described in §18 above does not ensure this unbundling requirement**. It is indeed worth noting that TSOs and ISOs usually resort to the market either via bilateral exchange or organized markets to source their losses or to sell/purchase power for other purposes[4]. Given their positions of "users of the market", the legitimacy of grid operators to manage the price-setting mechanism of the IEM (controlling the operational rules and the management of the price-coupling algorithm) is thus highly questionable.

22. Today, PXs have clear responsibilities to run orderly and fair markets (in contract and/or regulation). This involves responsibility for the full process of: Order receipt / Matching and price formation / Settlement and notification. Unless PXs retain responsibility for the matching/price formation process there will be no clear responsibility for the operation of markets. Indeed, in the centralized approach proposed

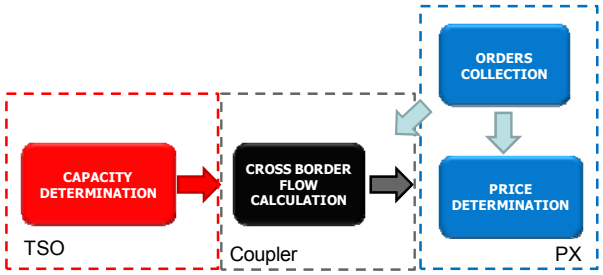
[4] To fulfil for instance their obligations in terms of renewable energy management and integration in the public network, as it is the case in Germany with the so-called EEG law.

in the Report, either the participants will have a direct contract with the "Central Auction Office" (CAO) to guarantee orderly execution of their orders, or the CAO will have to back this responsibility to the PXs vis-à-vis their participants. **The distribution of the functions implied by this model renders the sharing of the responsibility quite challenging, and in case of problem, tracing the error back might be impossible: the end-users will turn dissatisfied and will lose confidence in the price setting mechanism.**

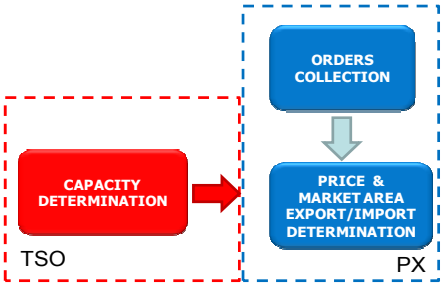
23. **The institutional proposals of the Report brings a major change at the heart of price-setting functions; benefits of these proposals are thus far from being obvious, as they may run the risk of instability in the price setting and good-functioning of the IEM. PXs have constantly improved their organization, systems, rules, etc., to fulfil the demanding needs concerning price setting.** Their current structure, flexible in terms of operation, dynamic in terms of project management, and clearly distinct from the tasks of network system operations, works well and keep delivering sound market integration solutions, securing both the interest of efficient capacity allocation and efficient price-setting.

IV. Annex: Different models of market coupling mechanism

Volume Coupling: Clear allocation of roles ensuring unbundling, but imperfect technical solution



Decentralised price-coupling Coupling: Clear and efficient allocation of roles ensuring unbundling, optimum and robust technical solution



Centralised price-coupling Coupling, as suggested in the Everis/Mercados Report: Unstable governance without insurance of unbundling, possibly more risky technical solution as market coupling expends