

To: Antitrust Registry
(Energy Sector Inquiry)
DG Competition
European Commission
B-1049 Brussels

From: Regional Centre for Energy Policy Research
Corvinus University of Budapest
1093 Budapest
Fővám Tér 8
Tel: +36 1 482 89 71
rekk@uni-corvinus.hu

April 27, 2006

Dear DG Commission Staff:

We would like to take this opportunity to present to the EU Commission our research findings and possible solutions to reducing market constraints in Central and Eastern Europe. In March 2006 we completed a study that looked into the barriers preventing greater market cooperation and coordination in the region. Our efforts were guided by the various EU directives that strive for open and efficient markets. We believe our findings can offer a unique perspective while suggesting some possible solutions to the issues raised in the *Sector Inquiry under Article 17 Regulation 1/2003 on the gas and electricity markets*.

Described below is a brief outline of our recent findings for increasing market and regulatory efficiencies presented in our report, *Finding the Barriers Preventing Regional Cooperation and Coordination in the Electricity Sector in Central and Eastern Europe*.

Over the past 14 months we have been carrying out a project titled, 'the Central and Eastern European Energy Market (C3EM) Project'. The main objective of the project is to promote the harmonisation of energy market regulation, under the framework of EU legislation and directives. We have been actively engaging with a range of experts in the region to define the barriers to greater cross-border trading and how best to create a liquid and transparent regional market. This study was funded by a large cross-section of companies in Hungary who were interested in a regional perspective in the electricity and gas sector. Our enquiry has focused on establishing if there is legal, market and infrastructure compatibility between seven Central and Eastern European countries. We are also creating a partial equilibrium economic model under the premise that the C3EM region is a common market.

We are proud to say that some of the answers that have emerged do correspond with the findings of the Commission's *Sector Inquiry*. Other findings give a more detailed answer to what needs to be done in Central and Eastern Europe in order to create an open and

competitive marketplace. We conducted 32 interviews with key government and private industry personal along with receiving back 22 questionnaires from participants in the seven countries studied. The findings briefly presented below (the fully study is attached), recommend how to overcome national obstacles to foster a more coordinated regional electricity market.

The *C3EM First Stage Report* published in March 2006 underscores the gaps in national transmission networks and regulatory authorities. The interview and questionnaire stage of the C3EM study started in June 2005 and finished at the start of November 2005. This was a comprehensive survey that involved six countries in East Central Europe: Austria, Croatia, Czech Republic, Hungary, Romania, Slovakia and Slovenia. The goal of the study was to develop a list of critical issues to allow the unencumbered flow of electricity throughout the region's transmission network. There are three identified barriers where action needs to be taken; within these areas there are six issues that if acted upon, can create a more dynamic, efficient and nationally supported regional electricity network.

The three identified barriers preventing greater regional coordination and cooperation are:

1. Restrictions on cross-border capacity.
2. The need for regional common rules and regulations.
3. The need for political support to allow greater regional coordination and cooperation.

Common problems range from the dominance of a single (formerly) state owned generation company to the need to build more transmission capacity both inside and between each country. Participants felt their countries' were beginning to meet EU expectations for market reforms and were now better off in a liberalised market. The push for greater market opening and regional cooperation in electricity issues has emerged as the most prominent theme from the interview phase of the C3EM project. The results of the interviews and the identified barriers for greater cooperation can be reduced to six key points which need to be addressed in the future. These are:

1. Inform and get the cooperation of policy makers to move forward in regional coordination issues.
2. There needs to be greater transparency of cross-border capacity, and all capacity not needed for security of supply, should be placed on the regional auction block.
3. Create a regional electricity exchange.
4. Develop a regional set of good practice guidelines for information collection, institutional authority, and establish a determined amount needed for reinvestment in transmission and interconnection.
5. Define the unique role of energy traders regionally and find solution to third-party trading disputes.
6. Understand the future affects of a unified South East European market on the East Central European market.

The DG Commission is taking a pan-European approach to liberalising the electricity and gas markets. This is understandable; however many participants expressed their desire to develop a regional solution. This was viewed as offering all actors greater input in how an open market could develop. Of course, this also offers the ability for actors to prevent change. This is where the authority and directives of the EU Commission can be used to prod these actors to move forward in a regional manner in order to develop a market with greater transmission capacity, transparency and reduce market power.

Currently we are developing a research project starting in September 2006 that focuses on implementing the findings from the C3EM study. The preliminary outline corresponds with some of the Commissions findings in the *Sector Inquiry*. Three stages have initially been proposed:

1. Regional Standards Working Group
 - a. Develop a consensus on regional common interests
 - b. Develop a regional set of good practice guidelines, which address issues like transmission building, energy trading and institutional authority
2. Energy Exchange: improving the security of supply and market liquidity through an open trading platform
 - a. What are the benefits/drawbacks of a regional energy exchange
 - b. Determine if regional actors are willing to support a regional gas and electricity exchange
3. Increase the cooperation with South East European market participants
 - a. Would SEE countries be interested in adopting the 'common regional good practice guidelines' or a derivative of it?
 - b. Would SEE countries be interested in participating in a CEE energy exchange?

The interests of the DG Commission and REKK demonstrates our common interests in reducing the barriers to cross-border trade in energy and reducing the market power of incumbents through greater transparency. We applaud your efforts in effectively engaging the energy industry through your Sector Inquiry. We look forward to the proposed solutions. If there is anything that we at REKK can do to help move forward the prospects of competition in Central and Eastern Europe then please do not hesitate to contact us.

Sincerely,

Michael LaBelle
 Research Associate
 Region Centre for Energy Policy Research
 Corvinus University of Budapest