Nordenergi's* comments on the Sector Inquiry on the gas and electricity markets

Introduction

In the Nordic electricity market electricity generation has been traditionally subject to competition resulting in a diversified structure of power production companies and other market actors. The trade of electricity was opened for competition in the Nordic countries well in advance to the stipulations of the concerned EU-directive. As part of the market opening, also completely free access to the networks was introduced. Cross-border trade has been exercised practically without limitations and the Nordic exchange Nordpool has been in operation in the whole sale market since the mid 1990´s.

Electricity market legislation in the Nordic countries – Denmark, Finland, Norway, and Sweden – gives a good basic prospect for the further development of the Nordic market in a European perspective. The so called 2nd IEM package has been implemented in the legislation of the Nordic countries.

However further development is still needed. A comprehensive work in cooperation between the concerned authorities and industries is going on. The main issues are the following: cross-border transmission investment planning and financing, congestion management, the core activities of the transmission system operators, maintaining the security of supply and balancing questions.

In the following Nordenergi is giving its remarks to the sector inquiry of the DG Competition.

Cross-border transmission capacity and transmission congestion management

We underline the importance of adequate cross-border transmission capacity for a competitive market. This task should be clearly assigned to the TSOs. The transmission capacity should be dimensioned economically in view of the total regional market in order to avoid competition distortions caused by transmission bottlenecks.

In this respect the neutral role of TSOs is extremely important.

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* Nordenergi – the Nordic co-operation organisation - joins the industry organisations for electricity producers, suppliers and distributors (Association of Danish Energy Companies, Finnish Energy Industries, Icelandic federation of district heating, electric utilities, and waterworks – Samorka, Norwegian Electricity Industry Association – EBL and Swedenenergy). Our main task is to promote the development of the Nordic electricity market in a European perspective.

On the basis of the Nordic experience good results have so far been achieved in a voluntary cooperation. An investment plan for the cross-border transmission investments has been agreed upon between the respective TSOs. Transmission investment planning, however, should be a continuous process with a regular reporting on the progress.

As to the congestion management, the role of the TSOs is essential. Therefore transparent information of the available transmission capacity and a guarantee from the TSO side on the available transmission capacity is needed for an efficient functioning of the market.

The Member States should facilitate construction of new transmission lines. Efficient licensing procedures are called for. In addition, cooperation between the concerned authorities is required. As to legislation, some harmonisation is necessary.

EU-initiatives influencing electricity market

Nordenergi is also referring to the EU-legislation, which is influencing the competition conditions in the electricity generation branch.

The Member States are currently implementing the requirements of the climate change in their industrial sectors. Due to the burden sharing of the reduction requirements of the green house gases between the Member States the various industrial sectors – energy and other industries – are meeting different requirements also in the competition point of view. The situation also concerns competitiveness of the European industries internationally.

The influence of the European emissions trading system can be clearly seen on the basis of the first year of the operation of this system.

A neutral system for managing climate change requirements should be developed in order to maintain a level playing field for the European industries in Europe and worldwide.

EU electricity market legislation

The basic EU-legislation concerning gas and electricity market, the first IEM-package, became effective in the late 1990´s. In the course of the implementation of 2nd IEM-package, the market will be formally opened by the mid 2007. Nordenergi supports the full implementation of the IEM-legislation in all Member States, but is, however, concerned for the long transition times allowed by the directive. This has already had an impact on the market: companies having a protected base market in their home country, have a competitive advantage compared to their competitors in the totally opened market environment.

Power generation investments

Nordenergi also calls for open investment possibilities in power generation. Some national energy policies are creating conditions which tend to limit open competition and efficient functioning of the electricity market.

Investments in power generation are essential both for the well functioning of the market and for the security of supply. All energy options should be available to allow efficient competitive conditions.

Market concentration

Excessive market concentration can be avoided by opening investment possibilities in generation and transmission as described above. Creating fully functional regional markets can be another tool in this work.

Dealing with market concentration regionally can increase a risk of a scale distortion on the company level. Companies operating in different regions would be in a different position in a mutual European wide or international company-based comparison.

Demand-side participation

Market mechanisms should be developed so that load management can efficiently respond to the changes of electricity market prices. Customers' active participation and demand response will reduce opportunities to use market power. Thus schemes that promote demand response are not beneficial only for energy policy or security of supply, but also important from a competition perspective.

One part of active demand-side participation is that big end-users, or user coalitions, have access to electricity and gas exchanges and this access is used. This will help them both in hedging their price risks and enabling them to bid their load in peak load situations.

Market transparency

Nordenergi agrees with the preliminary report that transparency is of crucial importance. In this context we are happy to refer to the Eurelectric fresh position paper on market transparency that was published February 16. Nordenergi supports the measures suggested in the Eurelectric paper and its annex.

The Nordic electricity market is considered to be quite transparent. Information concerning both generation and load is available, but real-time aggregated information on generation and especially information concerning transmission bottlenecks, should be improved. This is the responsibility of the TSOs.

Rules regarding interconnectors and bottlenecks

Probably the best strategy to reduce market concentration, especially in generation, is to create larger markets. We support a regional approach as an intermediary step towards a united European electricity market. This approach has been described in several documents, especially in the Eurelectric road map ("Integrating Electricity Markets through Wholesale Markets: EURELECTRIC Road Map to a Pan-European Market", 2005).

Nordenergi supports the use of market-based measures in allocation of limited transmission capacity. Explicit auctions should only be seen as a temporary tool and shift to implicit auctions should be promoted. Implicit auctions and price areas are used to handle congestions in the Nordic grid today. As mentioned in our general remarks, TSOs should also guarantee the capacity available over an interconnector. Only through larger price areas the desired dilution of market power will take place.

Guidelines for congestion management are drafted in a Commission committee. These guidelines should set clear requirements to the TSOs in favour of market development.

Price setting practices

Price setting is mentioned in the preliminary report as an issue under review. Nordic power market actors are fairly satisfied with the price setting mechanism in Nord Pool. When market place reforms are discussed by participants, market transparency, congestion management, or product variation may be considered, but not the price mechanism in itself.

Among others, a report requested by the Swedish government (Prisbildning och konkurrens på elmarknaden , published March 6, 2006; Statens energimyndighet ER 2006:13) observed that the market is in general functioning quite well. It was also stated in a report to the Finnish government in December 2005 (Kara, Mikko: Sähkö- ja päästöoikeusmarkkinat Suomen näkökulmasta), that the present price mechanism efficiently drives the existing power resources.

Effect of emission trading

As to the effect of the emission trading on the electricity market the biggest problem is the character of the emission trading itself. Market fundamentals are missing. The content of the emission trading scheme is decided in very short terms. Member states have not implemented their allocations and registries timely. Trust in the future of the scheme is low, which prevents needed investment in generation.

The theory-based mechanism between the emission allowance price and the electricity price is clear in itself. When a form of generation causing emissions is in the margin, opportunity cost is one of the price fundaments.

Fine-tuning or even fundamental changes of the electricity market and its mechanisms will not eliminate the price effect of emission trading. Possible remedies must be aimed where the problem is: emission trading system itself. If the allowances were not so scarce and thus allowance price not so high, the price effect would not be significant.

Powers of regulators

Regulators have an important role in a deregulated market. At the same time it has to be remembered, that the market itself has to be the primary driver and regulating bodies can at their best only facilitate the market. Strict or detailed regulatory powers and a good market functioning do not necessarily correlate.

If increased powers of regulators are to be considered, also a review of unnecessary - or from a market perspective even harmful - regulatory activity must be screened and powers adjusted to findings.

“Full structural unbundling”

In some countries so called ownership unbundling or full structural unbundling has been discussed. Based upon experience we would like to draw your attention to the following views.

(1) Neutrality of the TSO is fundamental for market functioning, due to its central role, as described in our general remarks. In the Nordic market area TSOs are not a part of any market participant’s organisation.

(2) A high level of market opening and customer choice has been reached in the Nordic countries without structural unbundling of the DSOs, in several cases even without legal unbundling. It is most important to implement neutral practices for DSOs in reporting, supplier switching etc, including confidentiality rules. If this kind of an approach does not give the needed benefits, further measures could be considered case-by-case.

(3) Many energy companies create corporate and social synergies in combined heat and power generation (CHP). CHP has helped to supply affordable heat for homes and industry. A CHP plant needs a district heating network which has synergies with the electricity network. Breaking down this kind of a unit would not be beneficial for energy efficient CHP development.

(4) A full structural unbundling would conflict ownership rights and the principle of subsidiarity. In many cases this would also conflict municipal autonomy enshrined in member state constitutions.

(5) Implementation of a full structural unbundling would cause a huge restructuring of assets, which would be extremely costly. It is very questionable if the benefits of such a move would be bigger than the costs.

Joint-ownership in generation is needed

Major investments in power generation will be needed in near future. Big end-users want to hedge their energy price risk. To achieve these goals, it is very important that the competition policy and law do not prevent joint ownership of power plants in the future.

Main characteristics of a good joint ownership organisation are the following: The shareholders receive the electricity at production cost. Shareholders are market participants in electricity themselves, not the generation company. Corporate governance restricts the shareholders' cooperation to running the plant as efficiently as possible, in front of market price.

Such an arrangement will help both big end-users and all kind of suppliers to access generation.

Retail price regulation must be terminated

In a number of member states electricity and gas supply (energy) prices for customers, that have not switched supplier or renegotiated their contracts, are subject to regulation. Especially if the regulated price level in such a case is relatively low, this will effectively prevent competitive choice by consumers and thus market development. Termination of supply price regulation is a precondition for market functioning.

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On behalf of Nordenergi;

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