

Vattenfall's submission to the 2005 IEM progress report

In its work preparing the 2005 Progress Report the Commission has invited market participants to submit their observations on the functioning of the electricity and gas markets to the Commission

Vattenfall wants to take this opportunity to develop our views on what is most important in order to further develop the Internal Energy Market.

Wholesale Markets

The wholesale electricity market is not just one sector of the market, but the prerequisite for the functioning of all market sectors. Therefore it is very important that the wholesale market is well functioning, otherwise the end user markets will not become as competitive as they need to be in order to deliver the potential welfare to society and customers.

One of the most important issues is credibility, which is a condition for other actors than the most advanced to be able to participate on the wholesale market, making it more liquid. Vattenfall thinks that the following three measures are central in order to enhance the credibility and liquidity of the wholesale markets in EU:

1. Access to transparent and free information. On stock exchanges and financial markets there are very strict demands on the market actors to immediately reveal all relevant information that could influence the price. It should not be possible for an insider to act before the information is known to the market. All members of the market should have free access to the information. Otherwise other actors cannot have confidence that trade is fair.

It is our general position that rules regarding access to information must be developed by markets, electricity exchanges, legislators and regulators that balance the legitimate but different interests of traders, generators, sales units and network operators.

For example, in the Nordic market NordPool has set up clear rules for market information, which include rules that handles reporting, information disclosure and prohibition of insider trade and market manipulation as well as Ethical Guidelines. Breaking the rules means that Nord Pool may decide on sanctions of up to NOK 1 000 000 (approx. €125 000).

However, Vattenfall is open to every further development and harmonization, since it is of high importance for all market participants doing business in the internal European electricity market to have access to sufficient market information.

One effort to achieve this is the proposed Congestion Management Guidelines from ERGEG connected to the Regulation of Cross Border Trade, Chapter 5 deals with the information issue, and in § 5.8 it states that “The TSO shall publish also the relevant information on generation...”, which we interpret as a basis for demanding improved information access for all actors in the common European Electricity Market. In that way the continuation of the Florence Process including this issue would be very helpful, since all stakeholders could be invited in the discussions.

2. Develop the TSO role. The TSOs have a key role in facilitating the market functions:
 - They should have a set of sufficiently harmonised TSO rules to allow cross border trading on all markets, e.g. gate closures, nomination procedures, balancing rules, and
 - They should have co-ordinated and market-based congestion management mechanisms for bottlenecks.

The two activities above would reduce the uncertainties and demand for specific country wise knowledge for actors being active in several countries. Specifically, it is very important that the harmonisation and co-ordination is executed within the Regional Markets that are now identified and being under development.

The TSOs should be encouraged to speed up this process, and a new round of Mini-fora would be of much help in this. This doesn't mean that the Mini-fora have to be institutionalized, instead the agenda should be ad-hoc. Other stakeholders than in the last round should be added in this new round, as generators/suppliers and customers. This would of course make the process more complicated, but the concrete knowledge on the current practices and difficulties would be positive, we think. The suppliers and big customers have, from a business perspective, a big interest in making the regional markets work.

3. Further development of Regional Markets. Development of Regional Markets may be a way forward, that in the short and medium term could be useful for increasing the geographical scope and reducing market power. In order to develop the Regional Market, TSOs should develop common planning and operating guidelines with the aim to offer the customers a harmonised transmission system in the Regional Market where the same rules for network usage apply in each grid. This could be made by strongly increasing the cooperation between the TSOs and would make the transmission systems look as if there was only one TSO.

The TSOs should in a co-ordinated way develop interconnection capacity to reduce structural bottlenecks when economically reasonable. In this case economically means from a societal point of view rather from a company point of view. The regulator, who would approve of including a new or reinforced interconnection in the rate base of the TSO, will make his decision from the society's view of economic efficiency, and hence from the view of market development.

The need for a common transmission planning process was acknowledged by the Nordic Council of Ministers in their meeting in Akureyri, Iceland 2004, where they assigned the Nordic TSOs to develop a common planning practice in the Nordic transmission system. This has since resulted in a common package of five concrete projects to reduce bottlenecks in the Nordic transmission system.

In the operation of the transmission system, the TSOs on both sides of a congested interconnection should cooperate to make the trade as easy and as little risky as possible for the market participants. That means for example that traded capacity should be firm from the system user's point of view until the hour of operation. The TSOs should hence practice counter-trade to balance the physical flow in case of changes in the operating conditions.

The cooperation between TSOs is currently under strong development, but could be enhanced further in the above proposed new round of Mini-fora.

Develop Retail Competition

The IEM Directive stipulates that there should be full retail competition in all Member States before 1 July 2007. This is important, because the market is not open until all customers are free to choose their supplier. It is however not enough to have formal market opening, in order to have real market opening there has to be some development. Below are two examples of changes that are needed:

1. No price regulation. All price regulation and price caps on the electricity supply should be ceased. The retail price should be allowed to converge with the wholesale price in order to make it possible for new and independent actors to enter the supply business. Otherwise only generators can be suppliers and the market development will be slower. The new actors will also reinforce the functioning of the wholesale market, since they will be active as buyers on that market.

In a functioning market there is no need for regulating the consumer prices, as prices are the result of competition and free choice of supplier. The Commission should in its future Progress Reports also measure this issue and report on how price caps distort the market.

2. Well functioning supplier switching processes. The process of changing supplier can sometimes be very time consuming and cumbersome. This should not be the case, on the contrary, from the customer's perspective it should be fast, reliable and with minimal effort for himself.

It is in most countries (UK and Ireland are exceptions) the responsibility of the DSOs to develop the processes needed for supplier switching, and it is not an easy task. E.g. in the Swedish retail market it has taken almost ten years before it is now

working properly. The DSOs really have to be aware of and be committed to this new task.

In order not to have to repeat all the mistakes that other DSOs have made, there should be a cooperation in the industry on the development and standardisation of the processes. This has to be done in strong cooperation with the regulators, and in order to enhance the standardisation between the different Member States, CEER should support the development.

The regulators should also take initiative on how to improve price information to potential customers, so they can make well informed decisions on their choice of supplier. CEER should support also this development.

The Commission should in future Progress Reports measure the reliability and time for supplier switching and also the availability and quality of price information.

Subsidies and Taxes

There are in principle three main parts of the cost of electricity for a customer, namely electricity supply, network tariffs as well as taxes and charges. Only the first part is subject to negotiation for customers. Due to different systems for taxes or charges comparison of prices for the customers may be quite problematic.

The way that renewables or CHP is supported may affect the functioning of the market, if the support schemes are not market-based. Feed-in tariffs separates the generation of the supported electricity from the rest of the market, making it more fragmented. This does not have to be the case – it is possible to both support renewables and keep the market working, e.g. via a quota based support scheme with green certificates. See further discussion below.

Disclosure

According to article 3.6, in the IEM directive each member state must implement a system for electricity disclosure. The purpose of the disclosure is to request the suppliers to provide the customers with information about the origin of the electricity supply, enabling them to choose supplier not only based on the price but also based on the origin of the supply. For making this option possible the disclosure information must be reliable, meaning that the information is unique, that the origin of the electricity has only been used once, guaranteeing non-double selling and non-double counting. The idea with electricity disclosure is understandable and acceptable, but the big question is how to track the origin of the electricity from the production to the supplier and customer.

It is very important that the disclosure systems do not interfere with the electricity market in a negative way. A tracking system based on physical electricity contracts will have a negative impact on the electricity market. The reason is that a diversification of the trade of electricity into different products due to the origin of the electricity will lead to an

increased share of bilateral contracts and an unwanted reduced liquidity for the power exchanges in the wholesale market.

To avoid this, a tracking of the origin of electricity based on certificates is the most reliable and accurate way. According to the directive 2001/77/EC the so called guarantee of origin (GoO) for electricity from renewable energy sources (RES-E) has to be implemented by each member state. The purpose of the guarantee of origin is to facilitate the transfer of the RES-E value, also for import and export. The GoO is the “exclusive proof” of the RES-E value. A consistent implementation of the guarantee of origin, standardised across Europe, will be an important contribution to a reliable system for electricity disclosure. Hereby the conflict with the development of a liquid wholesale market for electricity will be avoided and at the same time guaranteeing reliability avoiding double selling and double counting. The use of GoO for disclosure must also be linked to the discussion of using GoO for support schemes and the fulfilment of the national indicative targets.

Support schemes for Renewables (RES-E)

We agree with the policymakers of the EU that one of the means to help ensuring a secure supply of energy as well as to reduce emissions of CO₂ is to further develop electricity generation from renewable energy sources. Introducing renewable energy sources does, with today’s costs and prices, require some form of support. We are concerned that this should be made in a way that least distorts the European electricity market and at least cost to society.

Having 25 different national systems will distort the market, regardless of their type, and, thus, Vattenfall is in favour of harmonisation across Europe. The support schemes must be able to operate for a considerable time without creating excessive cost burdens. The schemes must be in line with the principles of the internal electricity market, and possible to harmonise with all countries in Europe, as well as supportive of cost efficiency.

Market based systems like green certificate schemes with a quota obligation, harmonised across the EU-countries will be the most cost efficient solution over time. The instrument used for the cross border trade must be a standardised certificate, guarantee of origin (GoO) within EU. The trade should be separated from the trade of physical electricity contracts. The standardised GoO can be used for both the quota obligation and disclosure purposes, thus avoiding double counting and double selling of the RES-E value.

A first step in the direction towards a harmonisation of the support schemes within Europe is to the remove the import and export barriers on national level. The RES-E directive supports cross border trade but the national legislators have in most cases introduced cross border trade barriers.