

## POLICY ASPECTS of WHOLESALE MARKET OPENING IN THE ENERGY COMMUNITY

Discussion Paper, prepared by the Secretariat

### 1. RATIONALE AND SCOPE

Recent discussions related to electricity trading in the Energy Community Region - such as the World Bank financed study on Wholesale Market Opening Study (“WMO Study”)<sup>1</sup> and follow-up Action Plans for its implementation, corresponding ECRB activities, the establishment of ENTSO-e<sup>2</sup> and ACER<sup>3</sup> and prospects for participation and close cooperation with these institutions, progress in the establishment of a Project Company responsible for setting up a Coordinated Action Office in South East Europe (“SEE CAO”), potentials for implementation of the 3rd Legislative Package<sup>4</sup> and the new Directive on the promotion of the use of energy from renewable sources<sup>5</sup> - proof the stakeholders’ interest for rapid development of an effective framework for competitive electricity trading in the Region in line with the EU internal market principles.

Within the *existing* market frameworks the promotion of workable trading solutions benefits from practical experience and engagement of trading companies active in the Region, EFET<sup>6</sup>, individual investors, investment banks and the Donors’ community.

Opening of the electricity market has become a true benchmark for the overall reforms in the Energy Community Contracting Parties. Irrespective of any particular interest and specific solutions, each of the above processes and individual stakeholders has indicated the need for effective **practical implementation of the TREATY** as the common denominator for regional compatibility and compliance with the corresponding EU processes.

Transposition of the *acquis* provisions in the legal framework of a Contracting Party requires corresponding **measures for enforcement** – this, among others, includes the completion of regulatory rules and their harmonization across borders; the introduction of efficient monitoring instruments, transparency, investment incentivizing tariff systems and, transparent and non-discriminatory authorization procedures; phasing out of regulated energy prices at non-market based level; as well as the abolishment of barriers to trade in legislation and practical application.. Further to that, effective functioning of an energy market requires a set of **support measures** for protection of vulnerable customers and fostering liquidity of the market. Such policies may encompass public service, protection of socially vulnerable customers, energy efficiency, security of energy supply, infrastructure contingencies, sustainability, environmental impact, etc.

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<sup>1</sup> <http://www.energy-community.org/pls/portal/docs/594181.PDF>.

<sup>2</sup> European Network of Transmission System Operators for Electricity; see [www.entsoe.eu](http://www.entsoe.eu).

<sup>3</sup> Agency for the Cooperation of Energy Regulators; [www.acer.europa.eu](http://www.acer.europa.eu).

<sup>4</sup> [http://ec.europa.eu/energy/gas\\_electricity/legislation/third\\_legislative\\_package\\_en.htm](http://ec.europa.eu/energy/gas_electricity/legislation/third_legislative_package_en.htm).

<sup>5</sup> OJ L 140 p 16 et seq. of 5.6.2009.

<sup>6</sup> European Federation of Energy Traders; [www.efet.org](http://www.efet.org).

Related **policies** often encounter the need for tradeoffs or compromises between conflicting priorities and phased implementation subject to the investment absorption capacity and the socio-economic environment of individual markets. In the majority of responsibility for taking measures is with the policy authorities – Ministries and Governments.

**On this ground, with the current draft Paper the Secretariat proposes for initial discussion the structure and the contents of a Policy Paper to be developed by the Energy Community aiming to address the relevance and the applicability of national and regional policies for faster and effective liberalization of the Energy Community electricity market.**

The draft proposal follows the basic structure of the Treaty. The scope and criteria for practical implementation shall reflect the assessment of the Secretariat and the ECRB as well as the findings in the WMO Study and corresponding comments from relevant EU energy associations, the Donors' Community, investors and traders.

At this stage the draft Paper refers to the *acquis* contained in the “2<sup>nd</sup> Package”<sup>7</sup>. Any corresponding aspects specific for the “3<sup>rd</sup> Package” shall be considered and introduced on a later stage.

## **2. BACKGROUND**

Establishment of an integrated market in natural gas and electricity in the Energy Community, based on common interest and solidarity is one of the core targets of the Energy Community Treaty (“Treaty”)<sup>8</sup>. This determination is present even in earlier statements and declarations of the Contracting Parties, most notably in the Athens Memoranda of 2002 and 2003.

The process of development of a competitive electricity market is continuously supported. A number of policies in support of its practical implementation are embedded in the Treaty, in the relevant *acquis* and in several subsequent decisions of the Energy Community Ministerial Council. Each Party has benefitted from bilateral technical support for studies, custom gap analysis and legislation drafting assistance. A number of regional projects and studies have been developed by the Energy Community and the Donors' Community targeting this matter. Important studies and measures have been developed by the ECRB as well.

Substantial advancement is registered in the legal framework of most Contracting Parties compared to the conditions for electricity supply five years ago. The structure of the electricity sectors has been modified. All Parties established authorities for regulating of the electricity market and progressed in development of corresponding enforcement tools. Various policies have also been implemented for supporting this process in all Contracting Parties.

Despite of this, the targeted date for full opening of the electricity market for all non-household customers has passed without effective and successful realization in the Contracting Parties. Even minimum trading patterns are yet to be developed in most of the local markets. Acknowledging the efforts made on establishing a common platform for long term cross border capacity allocations by setting up a Project Company responsible for preparing the operation of a SEE CAO, at the given moment there is no commercially available power exchange or other kind of organized platform for liquid electricity trading across the Region. Large industry, typically be the first customer sector eligible for free purchase of energy, is in most cases still balanced and backed up by the incumbent supplier or regulated generator. Full and continuous electricity supply at regulated prices is available to commercial customers to a prevailing extend. Regulated cost of electricity supplied to the end-customers under the umbrella of public service is often below the average wholesale market price. Access of a new supplier to the market and access for eligible customers to new

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<sup>7</sup> I.e. the Energy Community *acquis*.

<sup>8</sup> [http://www.energy-community.org/portal/page/portal/ENC\\_HOME/ENERGY\\_COMMUNITY/Legal/Treaty](http://www.energy-community.org/portal/page/portal/ENC_HOME/ENERGY_COMMUNITY/Legal/Treaty).

suppliers is hardly supported. Incumbent, state-owned generation is typically regulated, concentrated and dedicated to “public supply” thus imposing market dominance, averting competition, distorting cost-reflectivity of tariffs and stability of market prices, freezing the supply within the national or system borders, de-incentivizing investment opportunities, often involving state aid, and fostering policies which indicate a nationally protective approach to the “national” market and a “national” approach to the regional market. There is no average surplus of capacity and the Region as a whole is net importer of electricity. Cross-border exchanges are not always sufficient and load shedding schemes are still relevant. Indigenous generation capacities are progressively insufficient, outdated and incompatible with current environmental needs. Transmission is facing increasing challenges to comply with the EU infrastructure development plans and market requirements.

These and other diversions from a liquid competitive market require serious consideration, comprehensive treatment and carefully balanced policies.

### 3. LOCAL POLICIES on Contracting Party level

General pre-conditions for effective development and implementation of policies on local level are:

- (i) broad public awareness of the targets and required measures,
- (ii) internal political consensus and focus on the policy priorities,
- (iii) adequate administrative capacity for implementation

#### 3.1. TITLE II

- a. Full legal compliance with the relevant acquis on **electricity** and **competition** including immediate eligibility status of all non-household customers (Chapters II and IV);
- b. Development of coherent **regulatory framework** and secondary legislation for enforcement and monitoring of the transposed legal provisions as applicable, including calendar for implementation (Chapters II and IV);
- c. Due legal compliance with the acquis on **environment** and **renewables** including action plans for further phased transposition (Chapters III and V).

#### 3.2. TITLE III

- d. Transmission grid codes in compliance with the acquis – including sustainable and cost-reflective **third party access** rules, grid operation rules, adequate treatment of losses and ancillary services, effective use of transmission capacity, long-term investment planning in transmission, balancing rules, transparency and availability of operational and commercial information, etc. (Article 28);
- e. Mechanisms for enhancement of **security of supply** – long-term demand forecast and generation adequacy including strategy for investment in new generation capacity covering diversity of primary sources and transport routes, plans for refurbishment and decommissioning of old capacities, options for renewable energy penetration and use of CHP generation, prospects for reduction of energy intensity (Articles 29 and 35);
- f. Measures related to **electricity supply to end-customers** – specific obligations for public service, quality of service, supply contingencies, protection of customers including socially vulnerable customers and evasion of energy poverty, energy efficiency and demand management, collection rate, treatment of losses, tariff methodologies, transparency, treatment of cross subsidies and state aid (Chapter IV).

### 3.3. TITLE IV

- g. Measures for removal of all non-compliant **administrative levies and quantitative restrictions** on exports and imports of electricity (Article 41), reduction of all unnecessary administrative procedures or corporate preconditions for cross-border trade of electricity;
- h. Measures required for the **establishment of local electricity markets** consisting of platforms for all commercially viable forms of trading, including day-ahead trading and adequate balancing responsibility, development of corresponding market rules, establishment of market operator and settlement agent as applicable (Article 42);
- i. Measures required for **supporting the local electricity market operation** consisting of gradual unbundling of domestic generation (enabling cost-reflectivity and transparency of prices and effective control of subsidies and state aid as well as providing capacity available to market participants), measures for purchasing energy for losses, balancing and ancillary services through market instruments and measures in support of access to market for new suppliers and their withdrawal (Article 42).

## **4. REGIONAL POLICIES** on Energy Community level

General pre-conditions for effective development and implementation of policies on Energy Community level are:

- (i) broad public awareness of the regional processes and required local measures,
- (ii) common political consensus and support for regional priorities,
- (iii) adequate individual engagement in implementation by each Contracting Party
- (iv) overcoming differences in local economic development and conflicting interests of different stakeholders participating in the process

### 4.1 TITLE II

- a. Measures for **adaptation of the acquis** to the non-EU institutional framework (Article 24);
- b. Measures for adoption of **new acquis** – III Legislative Package, New RES Directive (Article 25);
- c. Measures on cooperation, coordination and participation in ENTSO-e and ACER activities – including on cooperation in implementation of corresponding rules and criteria for **security of network operation** (Article 23).

### 4.2 TITLE III

- d. Development of a regionally coordinated market-based allocation of **cross-border transmission capacity** and congestion management (Article 28);
- e. Measures related to **compatibility** of electricity market designs, reciprocity and mutual support of trading licenses and free establishment of companies (Article 34);
- f. Common policy for coordination and support for **investments** in new electricity generation – penetration of new renewable energy sources, environmental

incentives, certificates of origin, renewable energy targets and investment support schemes, etc;

- g. Measures related to coordinated treatment of **safeguard measures** in case of sudden crisis and protection of market conditions in such cases (Chapter VII).

#### 4.3 TITLE IV

- h. Measures required for **establishment of a regional wholesale electricity market** consisting of commercially viable forms of trading based on rules and principles compliant with the targeted EU internal electricity market (Article 42) including market model and rules, market operator;
- i. Measures for **operational support to regional electricity trading** (Article 42) including operational platform for regionally coordinated NTC calculation and cross-border capacity allocation, platform for coordinated operation of power exchanges in the region, commercial settlement agent (clearing house), regional dispute settlement authority, etc.;
- j. Common policy for treatment of exports and imports of electricity to / from third countries in compliance with EU principles (Article 43);
- k. Workable measures for mutual assistance in the event of disruption of electricity supply (Chapter IV).

### **5. PROPOSAL FOR NEXT STEPS**

Based on the abovementioned considerations, the Secretariat hereby proposes the following steps (to be considered in 2011) for approval by PHLG:

- Development of a draft Policy Paper of the Energy Community for effective liberalization of the wholesale electricity market in line with EU policy priorities, the EU market development strategy<sup>9</sup> and considerations of Donors, investors, traders and their associations active in the Energy Community Region;
- Decision on commitment for implementation with applicable timing and monitoring.

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<sup>9</sup> EU electricity target model and its coordinated implementation process across the 8<sup>th</sup> Regions as streamlined by ACER.