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Public Consultation on the Results and Findings of the Regulation (EC) 1228/2003 Compliance Monitoring Second Report - 2008

The development of common European rules and regulations to secure a common platform for trade and competition in the electricity sector is of imperative importance. Monitoring the compliance with EU Regulations and binding Guidelines is important to support the process and foster rapid implementation of the changes which are needed. Hence, The Norwegian electricity industry association - EBL supports ERGEGs work on these issues and welcomes the opportunity to comment on the Compliance Monitoring Second Report 2008 concerning the (EC) 1228/2003 (Regulation) and the amended Congestion Management Guidelines 2006/770/EC (CM Guidelines).

The key findings of the Second Compliance Report show that the Regulation and the CM Guidelines have not yet been fully implemented. ERGEG has in the Second Compliance Report identified a number of critical instances of non-compliance and suggests a number of recommendations. Changes and improvements required are of a complex nature and will depend on participation and full commitment of European stakeholders. We therefore support ERGEGs goal of achieving a wide understanding along the common lines of what needs to be done, when and by whom to improve the situation.

ERGEG invites proposals from all stakeholders on the following issues:

1. Most **effective and rapid actions achieving compliance** where non-compliance and deviations from the legal provisions in the Regulation and the CM Guidelines have been identified.
2. Suggestions on **any further needs for more precise and detailed provisions in the Regulation and the CM Guidelines**, possibly also beyond the findings in the Second Compliance Report.

ERGEG recommendations – comments and proposals from EBL

In the following ERGEGs recommendations, in italic, are commented on and recommendations for further needs and amendments are given.

- *Open the “old merchant interconnections” without exemption from TPA according to Article 7 of the Regulation to the market with a TPA regime;*

From a socioeconomic point of view, the most important issue regarding “old merchant interconnections” is whether the utilisation is efficient or not, and not who is receiving the congestion rent (in terms of transported volume times the price difference). The latter regards distribution of income, whereas the former regards both economic efficiency (in terms of efficient utilisation of resources) and competitive pressure. Any interconnection, new or old, without proper mechanisms to ensure that the flow of power is always from the cheapest to the most expensive market, represents a potential for improvement. To the extent there are evident efficiency problems on certain interconnections TPA should certainly be considered. However, introducing TPA unnecessary or without proper and sufficient compensation to owners raises the risk of introducing an even more serious efficiency problem. If TPA is considered necessary to ensure efficient utilisation, one option could then be to demand that current owners arrange for implicit or explicit auctions. This can be done without significant losses for the capacity owner.

- *Complement the existing general provisions in Section 5 (Transparency) of the CM Guidelines, with legally binding and detailed provisions on information management and transparency;*

All though the transparency requirements throughout the European power markets shall be coordinated between the regulators involved, we still see differences in interpretation and in implementation of the Guidelines and a lack of transparency on important issues in the system. Transparency is an important prerequisite in securing a trustworthy market, and particularly important when markets are integrated and where there is direct competition between individual bids, as there will be in e.g. new intra-day markets.

We therefore support ERGEGs proposal to complement the Guidelines with legally binding and detailed provisions on information management and transparency. In this respect it is important that the binding rules do not reduce the information and transparency requirements necessary for a well functioning integrated market and that the level of detail is set at providing a further boost for market integration. Some basic requirements regarding the transparency and information disclosure in the different regions is therefore necessary:

- Development of transparency should be in line with the integration and maturity of the market, focusing on timely publication of essential price drivers.
- When two markets are coupled, equal transparency and information disclosure requirements must be applied for both markets.
- Implementation of transparency needs strong coordination and enforcement from the involved regulators.

Further more we would like to underline that transparency concerning the fundamentals in the evaluation of future grid investments is important in order to secure a proper development of the system and should be improved.

- *Harmonise the key regulatory issues in terms of governance;*

We support the need to harmonise key regulatory issues of governance. In particular we would like to point out that appropriate legislation at EU level should be developed to allow investments from a regional perspective. Member States should harmonise their regulatory framework to enhance market integration by:

- Implementing regional committees that decide on cross-border related issues.
- Oblige TSOs to plan cross-border related investments from a regional perspective.

- Develop a common model for evaluating regional socio economic benefits.
 - Assess and prioritise investment plans according to the result of a regional model and positive socio economic welfare.
 - Ensuring transparency and appropriate involvement of market stakeholders through early and extensive consultations.
 - Implementing legal and regulatory instruments that can ensure that transmission investments with socio economic welfare gain are made and a appropriate cost allocation between TSOs. This distribution should be based on the expected benefits from a regional perspective in a way that makes it attractive to invest. In practice, it could mean that a third country TSO, not involved in the construction of the transmission line, but benefiting of increased socio economic welfare due to increased cross-border capacities, could take part in financing the investment.
- *Explicitly assign the responsibility to impose restrictions on market participants to participate in the allocation process (e.g. anti-hoarding measures according to Point 2.10 of the CM Guidelines) to the energy regulators, who in turn may implement this provision in cooperation with the responsible competition authorities;*

With in the Nordic market, where capacity allocation is done by implicit auctioning, this issue does not represent a problem. On interconnections between the Nordic market and adjacent markets (e.g. Norway – Holland, Sweden-Poland etc.) where explicit auctioning at the moment is being used it is important to secure that the capacity allocation and most of all the use of capacity is done efficient. We therefore support the proposal of explicitly assigning the responsibility of imposing restrictions to the energy regulators.

- *Anchor reporting by the TSOs on all relevant descriptions, documents, etc. in the amended CM Guidelines, so that it becomes an “inherent” and “self-explanatory” duty of the TSOs; and*
- *Adopt and implement the ITC and Transmission Tariffication Guidelines as soon as possible.*

Independent studies show that the Inter TSO Compensation mechanism (ITC) distorts the creation of a real internal electricity market in Europe. ITC distorts operational efficiency and gives clear disincentives for several TSOs in developing new cross-border capacity. ITC will thus decrease international trade and the economic benefits from such trade.

ETSO (European Transmission System Operators) has for a long time struggled to find a well defined analytical basis for the compensation scheme that complies with the regulation 1228/03 art 3. So far no attempts have succeeded, firstly because there is no unique optimal solution and secondly because the resulting payment flows vary wildly between different calculation models. In a meshed system, the path of flow is impossible to define in a unique and logical way.

Following the main rule in paragraphs 2 and 5 /1228/03 art.3) has proved impossible, and further attempts to do so should be avoided.

Flow based compensation was initially intended to replace cross-border tariffs, but makes little sense in an open market. Congestion revenues and trading incomes now logically replace such tariffs many times over. Past capital expense should therefore not be compensated continuously.

The principles behind the existing paragraph 6 are in conflict with the principles applied by most national regulators regarding capital compensation for grid assets. The last sentence, concerning benefits, has up to now been completely disregarded by ETSO, and has resulted in a very one-sided proposals. Major benefits of hosting cross border flows are related to congestion

rent and reduced costs for maintaining security of supply. Involved parties will have reciprocal benefits from trade across borders with a better utilisation of the generation resources. Trade will result in increased operational reliability, also because the power reserve capacity can be divided between countries. Additionally exchange of power can result in reduced losses. Cross-border exchange will also make the market larger, which will contribute to more efficient competition, increased liquidity in the market and price stability. The price will be more correct, market oriented and determined by the participants. According to conservative income calculations made on actual hourly cross-border flows and actual hourly prices, it is apparent that network benefits from cross-border flows exceed the calculated ITC by 5-10 times for many “transit” nations. Hence, benefits according to EU-regulation 1228/2003 are not accounted for in the ITC calculations.

In our view, amendments to the existing regulation are necessary to ensure future development of an integrated and efficient European electricity market, and in particular the integration of renewable energy sources. There is a need to incentivise the TSOs to undertake correct investments in transmission infrastructure and facilitate cross border trade in order to guarantee the delivery of renewably sourced electricity to consumers.

As of today the finalising of Guidelines for tariffication is dependent on the finalising of guidelines on ITC. As far as we know there is a broad consensus concerning the Guidelines on tariffication and we strongly support the need to harmonise tariffication principals in Europe. However the Guidelines have not been taken into committology and not implemented due to the excessive difficulties in implementing Guidelines for Inter TSO compensation.

The tariffication Guidelines are important in order to level the playing field for the market players. The lack of finalising these Guidelines has lead to a disturbing development in e.g. Norway as the Norwegian TSO seeks to diverge from an earlier harmonisation processes and alter national tariffs in a way that will violate the proposed Guidelines and reduce the degree of harmonisation between Norway and adjacent countries operating in the same synchronous common market.

In order to secure a future level playing field for all market participants the implementation of Guidelines for tariffication should be disconnected from the implementation of Guidelines for ITC and the implementation process of the Guidelines speeded up.

Member States should:

- *Put in place the legal framework that is necessary to create an efficient cross-border trade with electricity and to support the implementation the rules in CM Guidelines. This concerns both the powers of the NRAs and the requirements put on the TSOs.*

There is an obvious need to elaborate the legal framework to secure efficient cross border trade and the implementation of the rules in the CM Guidelines. However, such a legal framework must be carefully scrutinized before implementation so that rules and regulations that are not possible to fulfil e.g the existing regulation on ITC, are not introduced.

TSOs should:

- *Truly commit to and implement the agreed projects, because the TSOs are the key players and market facilitators, bearing thus the highest responsibility for implementation of the Regulation and the CM Guidelines. This is important not only for the sake of TSOs themselves, but also as otherwise efforts made by other stakeholders would be in vain;*

An important prerequisite for implementing agreed projects is that these are the best projects

from a socio economic welfare point of view. This may not always be the case and will be highly dependent on the actual planning and investment criteria used for the different projects, differences in regulatory framework in different countries and the incentives given by EU regulation. In the Nordic region the planned cable between Norway and Denmark, SK4, is a good example. This interconnector is one of the five agreed Nordel projects. However the socio economic welfare gain of this project compared with other interconnection projects can be questioned, and is highly dependent on the future ITC mechanism. A given ITC solution can increase the costs for this interconnector in such a way that it undermines the socio-economic welfare benefits of the project. This is one of the reasons for why this project has been delayed. We assume that this might be the fact for several potential projects throughout Europe.

All though the TSOs are key players and market facilitators the costs of investments will be socialised and allocated to the grid users. It is therefore important to secure transparency in the investment decision criteria and documentation for all stakeholders. Experience so far indicates that this is not the fact to day.

Further more it is important to develop common planning and investment decision rules for such projects.

- *Define and agree on a common approach and detailed rules for solving internal and cross-border congestion throughout Europe and in line with the general provision in the Regulation and the CM Guidelines.*

The up-coming ENTSO-E and the TSOs in charge should take an active part in resolving these issues. However, this will also be an important task for the new regulatory agency ACER and the NRAs.

The Congestion Management Guidelines are in our opinion too vague and result in different interpretations between different countries. In certain cases, on the same border, the TSO have different views on implementation of the guidelines and the competent regulatory authorities have different views on the degree of compliance with the regulation and the guidelines. One example of this is the practice in Sweden of moving internal bottle-necks to the surrounding borders. Hence, the CM guidelines need to become more precise on these issues in order to omit inefficient national practices.

In a longer term perspective, considering the prospects for substantial increase in the share of intermittent and low-carbon generation, one can easily argue that the current European mixture of methods and principles to calculate transmission capacity and solve various kinds of congestions, both cross border and those within each price zone, will lead to increased challenges with respect to balancing and utilisation of transmission capacity. As both items are associated with very high capital intensity and significant environmental concerns, efficiency becomes a key aspect in these matters. This calls for a thorough review of “European” market design at large. A comparison with the “US” market design could be a starting point for such a review¹. Characteristic of the former is zonal prices and sequential clearing of submarkets (transmission market, day-ahead market and market for ancillary services), whereas the latter is characterised with nodal pricing and simultaneous clearing of several such submarkets. The choice of sequential before simultaneous clearing leads to a less complex market design, but more complex coordination measures and (presumably) less efficient market outcomes.

¹ Special issue of *The Energy Journal*, titled *The Future of Electricity: Paper in Honor of David Newber*.

Regulators/ERGEG should:

- *Define and put in place concrete measures to speed-up the implementation process of CM Guidelines;*

We fully agree on this issue. In order to do so regional cooperation and harmonisation of legislation and regulation between NRAs should be increased. In these processes it is important to establish good information processes and dialog with TSOs and Stakeholders within the region.

- *Assess economic efficiency of congestion management methods;*


We agree that there is a need to assess the economic efficiency of the existing congestion management methods, in particular those cases where explicit auctions are in use. In the Nordic system implicit auctioning has been used for over a decade and the experience so far has been very good except for those cases where internal congestions have been moved to the national borders. Such practice is in violation with the Guidelines and should promptly be resolved by the regulator in charge.

- *Advise the Commission on amendments to the Regulation and CM Guidelines:*
 - treatment of curtailment and firmness of the transmission capacity, which require more detailed and exact provisions,*
 - detailed and precise provisions on how the TSOs shall maximise the capacity,*
 - provisions on when and how to use countertrading and redispatching,*
 - effects to the market of the use of congestion income by one TSO e.g. for redispatching and by the other TSOs for building new lines.*

We support these actions.

This concludes our remarks to the Compliance Monitoring Second Report 2008 concerning the (EC) 1228/2003 (Regulation) and the amended Congestion Management Guidelines 2006/770/EC (CM Guidelines). If there are any needs for further clarification regarding our comments and proposals do not hesitate to contact us.

Best regards,
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