

Second Compliance monitoring report on Regulation 1228/2003

SSE Response to ERGEG consultation

This paper sets out SSE's key concerns regarding compliance with the provisions of Electricity Regulation 1228/2003. The consultation asks for opinions on

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

We welcome the continuing efforts to facilitate and improve cross border trade through the regional initiatives and recognise that some of the provisions in place are at present guidelines rather than firm obligations. However we do have a particular concern regarding non-compliance in the United Kingdom with the Regulation itself particularly regarding tariffication and the application of the inter TSO compensation (ITC) mechanism. Our concerns are further explained in Annex 1. One of the main conclusions of the ERGEG report is that the Commission should adopt and implement the ITC and the Transmission Tariffication Guidelines as soon as possible. Given our concerns about the application of this as explained in the Annex, we would support this and urge in particular for

- clarification on the "maximum average G charge" since at present this does not give any protection from distortionary pricing in MS where there is an extreme locational tilt to prices. In particular, a prescriptive limit on the permitted variation from the average would provide greater certainty for new generators;
- a clear prohibition of "pancaking" of charges at National or TSO boundaries such as currently practised by National Grid in the UK. This is a barrier to trading across the Anglo-French interconnector and also the Moyle interconnector, which is the only route for Irish generators to access the rest of the FUI market.

Regarding the other main conclusions of ERGEG, we agree that should be a mechanism for TPA for the old merchant interconnections and that there should greater harmonisation of the regulatory issues in terms of governance.

Annex 1 – Issues with Tarification and Cross-Border Charging in UK

Key Requirements of Regulation 1228/2003

Article 4 of Regulation 1228/2003 sets out obligations regarding charges for access to networks. Article 4.1 requires that charges applied by network-operators for access to networks shall be applied in a non discriminatory manner and shall not be distance-related. Article 4.4 states that “charges for access to networks applied to producers and consumers shall be applied regardless of the countries of destination and, origin, respectively, of the electricity, as specified in the underlying commercial arrangement.”

Application of Article 4.1

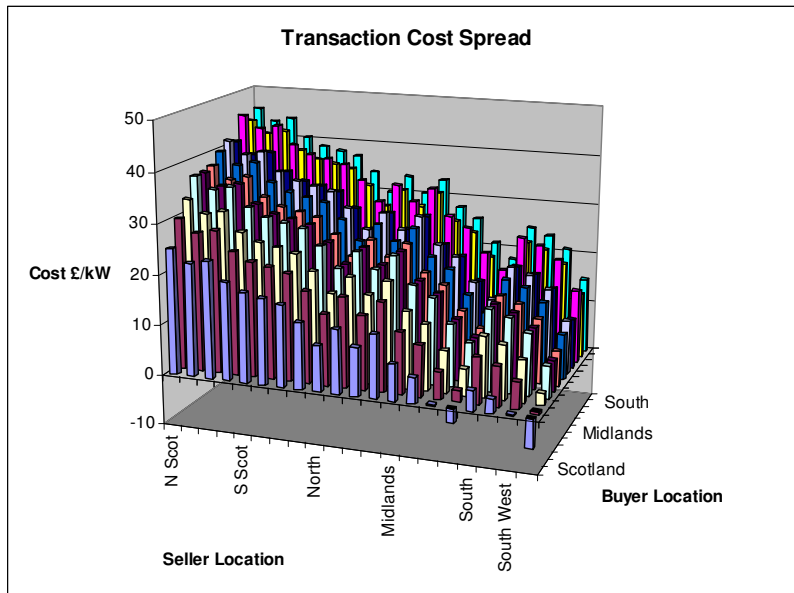
Our key issue with the tarification methodology in GB is its discriminatory nature because generators in the North of Scotland face excessive and discriminatory charges compared to generators in the rest of Great Britain. This arises primarily because of the distance related nature of the tariff methodology and the large variation from the maximum average generation charge specified in the transmission tarification (TT) guidelines. ERGEG states that the charge paid by generators for access to networks is more important than the charge for load and we strongly agree with this. This is why the TT guidelines set a maximum average generator charge – zero in most MS but up to €0.5 per MWh in some MS including the UK. However, we believe that setting a maximum average charge without specifying how the average is calculated or the maximum permitted variation from the average is meaningless.

As an example, the access tariffs in GB for a renewable generator with a 30% load factor vary from over €10/MWh to -€4/MWh (i.e. a payment of €4 per MWh). The average is €3.5/MWh, more than the €2.5 maximum average allowed for GB in the guidelines (itself a factor of 5 higher than the rest of the EU) and the highest rate is over four times the maximum average. However the overall compliance with the guideline is no doubt justified by the amount paid by the GB generation community as a whole, and the volume transmitted. This, we believe, is a good example of how strict legal compliance with a guideline can be achieved while ignoring the underlying principles of the guideline.

The guideline recognises that competition between generators can be distorted not by the absolute level of access charges paid by generator, but by the differentials in tariffs for the same service. The range of tariffs in the UK can only be described as extreme and we believe serves to distort competition within Great Britain as well as causing large tariff discontinuities at the national borders which distort competition in Europe.

Also, the Article 4.1 of the Regulation requires that tariffs should not be distance related, and in section 5.6.1 of the consultation ERGEG states that “all charges are independent of distance” and that “NRAs have ensured that charges comply with Article 4.1 of the Regulation”. We are somewhat confused by this conclusion because the GB charging methodology is based on the distance from a reference node, and result in charges that increase the further a generator is from the load centres of Southern England.

The Result of this is shown in the chart below which shows, broadly that for a given seller location, the further south the buyer, the higher the charge and similarly for any given buyer location, the charge increases the further north the supplier. These are clearly not independent of distance.



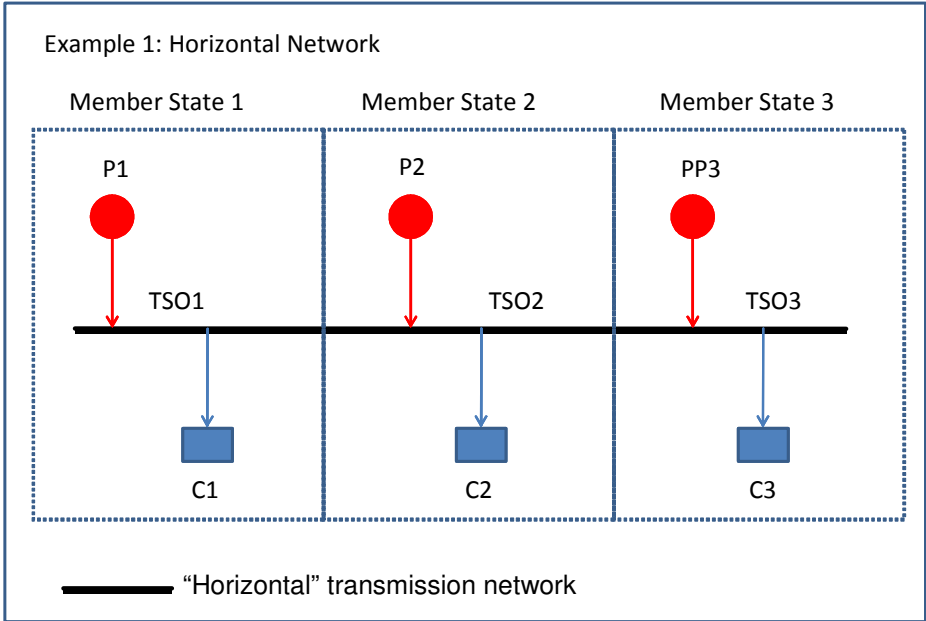
Conclusions on Tarification

The application of National Grid’s current methodology means that a new entrant generator can have no confidence that the access charge will be anywhere near the maximum average permitted in the guidelines. We therefore believe that a more prescriptive definition of “maximum average” should be specified in the guidelines, perhaps specifying a plus or minus range from the average to give generators more certainty over their access charges.

Application of Article 4.4

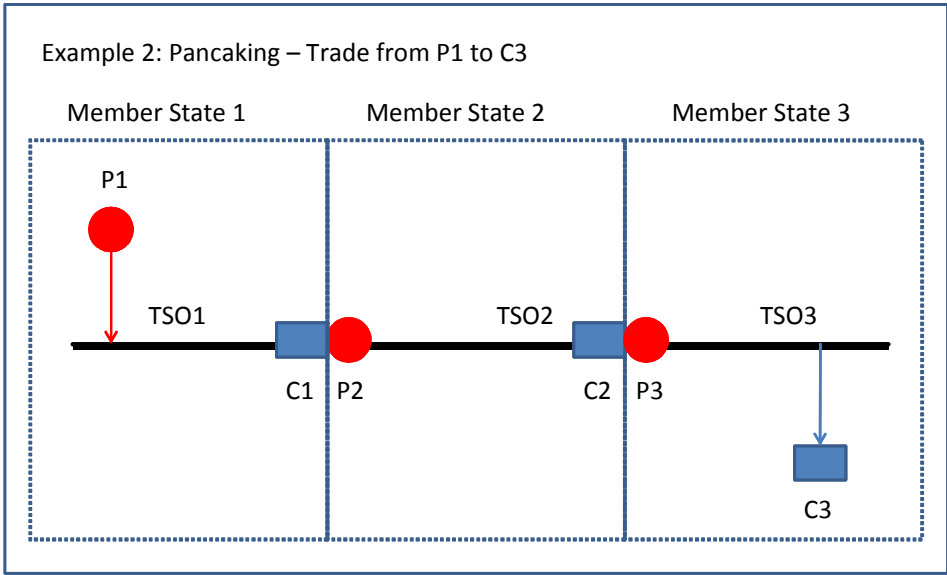
Our understanding of Article 4.4 is that for any particular transfer of energy between producer and consumer, the only access charges payable are the production related access charge in the member state where the transfer initiates, and the demand related charge in the member state where the transfer terminates. With limited exceptions (as discussed below) there should be no further network access charges for the transfer. The ITC mechanism is designed to ensure that intermediate TSOs are compensated for any transits across their systems. This mechanism was designed to avoid “pancaking” of charges at national borders. The principle is that there is a “horizontal” transmission network across Europe and once national access charges are paid, traders can in principle at least, access the whole network. The main exceptions are where congestion occurs and for which additional measure and charges may be applicable to ensure the transfer takes place, and merchant interconnectors where the remuneration for those assets falls outside both the national tarification systems and the ITC mechanism and so additional access charges are levied.

This key underlying principle of tarification and the ITC mechanism is illustrated in example 1 below.



Once a producer in Member State 1 has paid the access charge P1 in that Member State, he is free to trade with consumer C1 in the same Member State or with C2 or C3 in other Member States (subject to any charges for congestion and/or merchant interconnectors). Similarly for producers P2 and P3. Any payments to TSO2 in the event of transfers across his network are dealt with through the ITC. The total of the access charges will be either $P1+C1$ for a trade within the same MS, $P1+C2$ for a trade in MS2, and $P1+C3$ for a trade in MS3.

Pancaking occurs where a transfer entering a member state's horizontal network is treated like a generator, and a transfer leaving a member state is treated like a demand. This is illustrated below.



Instead of each transmission system being treated as an interconnected part of the European transmission system, each Member State operates like an island, with access charges at the borders. For the example trade between P1 and C3, the actual access charges would total $P1+C1+P2+C2+P3+C3$, instead of $P1+C3$ as required by Regulation 2003/1228.

Within the UK, National Grid applies pancaking of charges at the boundaries of its networks in England, Scotland and Wales. This creates a problem in distorting trade across the Interconnector with France. It also severely hampers companies in the Republic of Ireland (who are now able to trade freely with Northern Ireland since the establishment of the single electricity market in Ireland) from trading with the rest of Europe.

Prior to 2008, the UK did not participate in the ITC mechanism and therefore was not strictly bound by this “pancaking” constraint. Trading with mainland Europe was subject to these border charges, but once onto the main interconnected European system, no further border charges applied. However, now that the UK has joined the mechanism we believe there can be no justification for continuing with this border charge.

Conclusions on ITC and pancaking

Pancaking as described above is clearly in contravention of the Regulations and is restrictive of trade. Since it appears very similar to a border tax, it could also contravene the Treaty of Rome regarding the free movement of goods and services. Despite this, National Grid not only applies such a methodology at its boundaries with France, it applies it within UK at the boundary with Northern Ireland, limiting trade from the Republic of Ireland.

We fail to understand why the UK regulatory authorities have been able to approve such a methodology. It is therefore clear that more precise prohibitions are required either in mandatory guidelines or in the Regulation itself that make it clear that such border charges contravene the Regulation.