

ERGEG
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Nordenergi response to ERGEG call for evidence on “Incentive Schemes to Promote Cross-Border Trade in Electricity”

Nordenergi welcomes the initiative taken by ERGEG to analyse and to discuss ways of improving the utilization of interconnectors. Nordenergi fully endorses the importance of this subject for improving competition, market integration, integration of RES and for security of supply. TSO's are the main drivers – and thereby also the most important potential source for creating barriers to efficient utilization. Consequently appropriate and consistent regulatory treatment of TSO's is crucial.

Nordenergi would like to point out that the wording “Cross-Border Trade” is misleading in this paper, and the incentive schemes and transparency requirements must cover also the handling of price areas in national grids. This is crucial in order to avoid giving TSO's an incentive to move congestion inside the national grid and limit transmission there. Having focus only on cross-border trade may eventually lead to new congestion in national grids and fragmentation of the market.

Nordenergi agrees that “direct” regulation of the TSO operation of interconnectors is difficult for the regulatory authorities. The report, thus, rightly points to the numerous practical problems to be overcome in order to create a reasonably fair system, which promotes a sound development of interconnector capacity usage::

- Fair indicators will be extremely complicated to establish.
- It could become a hard task to establish the national legal basis for rewards/penalties, as the economic regulation in many countries is not based on such elements.
- The focus in some TSO's probably will be on formally obtaining the best results in the performance indicators – disregarding “perverse” spin offs on best utilization of interconnectors seen from a European perspective.

- The legal basis of TSO's is so different, that the incentive structures are not comparable at all. Some TSO's are to offer return on capital to their owners while other TSO's are "non profit" companies.

Nordenergi, therefore, regards it as more realistic and beneficial in practice to focus on **transparency of TSO decisions on operational elements**. The ERGEG proposal to continuously publish a number of indicators as elements of kind of "yard stick competition" is a good start. However, this must be supplemented with legally based requirements on TSO's to continuously publish the reasons for their operational actions, especially those which restrict the capacity available for commercial transactions. In the longer run the legally based conditions for TSO's should include a **specific requirement to act according to socioeconomic (preferably European socioeconomic) considerations**. The balance between this and company-economic considerations due to shareholder value, return on capital for investors etc. should be outlined in legislation and regulation. Such transparency might also provide the information necessary to facilitate eventual establishment of incentives.

Below please find a number of comments to the specific questions posed in the report:

1 – 2. In the current regulatory and institutional framework could incentive schemes be a useful tool for promoting cross-border trade? If so, why? If not, which regulatory or other framework would be more suited to promoting cross-border trade?

As explained above Nordenergi does regard incentive schemes for promoting cross-border trade including economic rewards/penalties as difficult to establish in practice. Transparency requirements on TSO operation including explanations is however an absolute must.

3. Do you agree with the features of an "ideal" incentive scheme? If not, why not? What features should an "ideal" scheme have?

Nordenergi agrees in most elements. However, it might be difficult to apply all these features in reality. As mentioned above for example due to different national legislation/regulation TSO's in different countries have different "incentive structures".

4. This paper presents "short-term" incentive schemes for improving capacity calculation and allocation methods. Should an incentive scheme address these short-term incentives together with longer-term incentives, e.g. for infrastructure investments? If so, how?

It is the view of Nordenergi that short term incentive schemes focussing on operation of transmission interconnectors must be planned together with incentives of midterm projects such as price coupling and longer-term incentives to investments. Short-term incentive schemes must respect mid and long term goals and not have a negative impact on them. However, it would be useful to measure short-term operations with specific measures, such as congestion income. Otherwise incentive schemes could get very non-transparent.

However, the limits of short term incentives have to be recognised, e.g. the share of hours with congestions might cover a situation where 100% of TTC is made available to the market, but if considerable price differences between the markets persist, TTC is short of the capacity required by the market. In that case additional investments - eventually promoted by long term incentives - will be required.

5. Which approach presented in this paper do you favour: an incentive scheme based on a single indicator of performance reflecting the efficiency of congestion management as a whole (Chapter 2), or one or several incentive schemes aiming at fostering one or several specific projects or topics related to congestion management (Chapter 3)? Why?

As mentioned above Nordenergi favours a comprehensive transparency scheme to the incentive schemes based on performance indicators and rewards/penalties. If, however, the two sets of incentive schemes options are to be compared “specific incentive schemes” are to be preferred to “single indicator of performance”. The first mentioned specifically addresses the elements of congestion management to be incentivised and allows the medium and long term addressed through additional incentive schemes.

6. Which, if any, of the indicators presented in Chapter 2 do you favour? Why? Do you have any alternative proposals for a single indicator of performance?

If the three sets of incentive “single indicator” schemes options are to be compared, Nordenergi would prefer the “congestion cost approach”. It is a more comprehensive indicator than “number of congested hours”, which does only address one limited aspect of congestion management. In addition social welfare would also be a valuable measure. Though, referring to example 3 in chapter 2, it can be improved by increasing auction revenue without actually increasing available cross border capacity which illustrates the challenges of indicators.

7. Which, if any, of the incentive schemes presented in Chapter 3 do you favour? Why? Do you have any alternative proposals for a specific project or combination of projects which could usefully be incentivised?

Concerning the short term project of “maximisation of cross border capacities” a set of indicators like:

- number of congested hours
- number of hours where total (more than 80%, 50% etc) transmission capacity (TTC) is made available to the market

and a combination of the two could illustrate the operational situation quite well. Fixing any sort of “target value” will always be slightly arbitrary. However, increased transparency will make it easier to fix appropriate short term targets.

Medium time targets, linked to the implementation of PCG target models for day-ahead, intraday and balancing markets, could be also used to formulate incentive schemes for TSOs, as described in Chapter 3.2.

Still, in order to analyze the impact on social welfare, it is necessary to associate the number of congested hours to volumes and price differences.

8. Despite the potential limitations of all indicators for implementing an incentive scheme, do you share the view that their publication before any incentive scheme is set could help promote the development of cross-border trade and represent a step towards increased transparency?

As mentioned above Nordenergi welcomes publication of indicators to develop increased transparency of operation of interconnectors and thinks that this is absolutely essential. In addition, quantitative indicators must be supplemented with qualitative explanations by the TSO’s. The TSO’s could also be encouraged to make good use of the indicators when they design incentive bonuses for their staff.

9. If so, at which frequency and on which geographical scope (bilateral/regional/European) should these indicators be designed and published?

In principle indicators to increase transparency should be published continuously, but monthly publication might be adequate. Indicators should be published for each interconnector – or each “bundle” of parallel interconnectors. Aggregation on country-level or even regional level tends to blur the information to be communicated.

10. What would be alternative options for promoting cross-border trade?

As mentioned above Nordenergi favours a comprehensive transparency scheme as a low cost, first step scheme. With the information gathered incentive schemes based on performance indicators and rewards/penalties would be easier to implement.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Lars Aagaard'.

Lars Aagaard, chairman of Nordenergi
Danish Energy Association

On behalf of
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