# E.ON proposals to

# ERGEG's Call for Evidence on Incentive Schemes to Promote Cross-Border Trade in Electricity (E08-ENM-07-04)

The E.ON Group welcomes and appreciates ERGEG's Call for Evidence as it allows a discussion of how to set appropriate incentives for electricity TSOs to offer as much as possible cross-border capacities and, hence, to contribute as much as possible to European market integration.

Our amendments reflect the wish to promote an efficient internal market for electricity and to contribute to a sensible solution for overdue issues such as

- maximization of cross-border capacities across all time frames as required by Article 6 (3) of Regulation 1228/2003, respectively Article 16 (3) of Regulation 714/2009 and
- financial firmness of those capacities once allocated long-term.

**1. In the current regulatory and institutional framework could incentive schemes be a useful tool for promoting cross-border trade? If so, why?**

We observe on many European borders that interconnection capacities available for trading have decreased over the recent years. This particularly applies to annual capacity products. Taking this shortcoming into account, we find any incentive to promote cross-border trade very reasonable.

The same applies to ongoing projects such as a common set of auction rules, market coupling or intra-day which could be incentivised for their timely implementation.

However, this does not mean that a single indicator should cover all aspects. Although we acknowledge that this consultation has a specific focus, we even think that a comprehensive incentive scheme should comprise of several pillars:

- **Short-term**: maximisation of cross-border capacities, optimal distribution of capacities across the different timeframes
- **Mid-term**: project related incentives for timely implementation
- **Long-term**: appropriate and sufficient remuneration of new investments

Any financial incentive to be financed from congestion revenues will face the problem that the use of congestion revenues is fully conditional to either Article 6 (6) of Regulation 1228/2003 respectively Article 16 (6) of Regulation 714/2009. That means an incentive in terms of an extra income for TSOs for taking over a higher risk position is difficult to implement. As long as Regulation 714/2009 will not be changed in this provision, any incentive needs to be paid by national grid users. However, in terms of a symmetric system with penalties national grid users might benefit from it.

**2. If not, which regulatory or other framework would be more suited to promoting cross-border trade?**

**Long-term incentive**s need to be financed through appropriate return on equity rates and, thus, grid charges. It might be particularly reasonable to define a higher return on investment for projects with cross-border relevance which lead to a higher interconnection capacities.

This applies particularly for borders where there is no interconnection yet. In all other cases the amount of congestion revenues is in principle such that additional investments could be financed from them without putting a strain on grid customers' bill. Furthermore regulators should monitor that transmission investments are made that are positive from a European socio-economic perspective.

**Mid-term incentives** would allow to focus on the implementation of specific projects which facilitate cross-border trade and thus market integration. This could apply to market coupling projects where market participants face frequent delays. It would be even more important for intra-day projects which are overdue for two years with regard to the still applicable Congestion Management Guideline under Regulation 1228/2003. Even if not all reasons will lay in the sphere of TSOs, financial incentives will help to make the reasons for delays more transparent towards the regulators and this kind of transparency usually motivate the entities involved to find acceptable solutions in a more timely manner.

We furthermore see opportunities to promote cross-border trade by refraining from **trading licensing practices** across Europe. In extreme cases trading companies are required to establish separate country offices, to employ people just to comply with national bureaucracy etc. If those obstacles to trade would be removed many new market participants could be attracted. This could be easily implemented as a low cost measure.

It is also fair to say that the **Inter-TSO mechanism** must provide an adequate recovery of costs for TSOs which host transits. These costs as well as congestion revenues need to be treated in a reasonable and fair manner when setting revenue caps etc. in the national environment. Otherwise it may create a disincentive to restrict transits or to lower available cross-border capacities.

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

In principle we agree with the features proposed but can not really follow the evaluation.

However, we do not think that an "ideal" incentive scheme, as described in your consultation document, can be achieved for cross-border trade. There are too many external factors that TSOs cannot influence and situations are different around Europe. We would rather like to see incentives targeted to the most important issues or even to the single most important issue only.

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?**

We think that an incentive scheme should primarily focused on actions which are the daily business of TSOs. Any other measures such as projects relevant for market integration or investment should be incentivised in a different way as described in question 1 and 2. To state it clearly, short-term and any longer-term incentives should not be combined to avoid a very complex incentive regime.

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?**

We prefer a slightly adjusted approach in the light of chapter 3 as described in the question 7.

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?**

As described above there are too many external factors that TSOs cannot influence and situations are different around Europe, which makes the sole application of indicators presented in Chapter 2 difficult.

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?**

We believe that incentives schemes could be a useful tool as TSOs take daily decisions related to cross-border capacities where trade offs have to be considered. Appropriate incentives would ensure that TSOs adequately prioritise cross-border trade. We favour the following two incentive parameters to be combined to an index:

- **Optimisation of the distribution of transmission capacities among the different timeframes is very important for cross-border trade and can to a large extent be influenced by TSOs. Maximising long-term capacity that is auctioned as physical or financial transmission rights should be encouraged.**
  Justification: This incentive parameter would motivate TSOs to allocate as much capacity as technically possible to long-term timeframes such as year- and month-ahead. It would contribute to a higher liquidity in forward markets and help to make price expectations converging.

- **Maximisation of cross-border capacities has a clear value to cross-border trade and can to a large extent be influenced by TSOs. The number of congested hours should be used as a very sensible proxy which an individual target value for each border.**
  Justification: As natural complement to the first parameter TSOs would be incentivised to improve their day-ahead capacity calculation, find economic solutions for cross-border redispatch etc. This could increase available day-ahead capacities (even for a small number of hours per day). It also set an indirect incentive to contribute to an acceleration of market coupling projects even if it should be inventivised separately.

These indicators could be combined into one index for cross-border trade.

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?**

We agree that publication of all indicators for an incentive scheme before any incentive scheme is set could help promote the development of cross-border trade and represent a step towards increased transparency and trust. It will also increase the understanding of specific TSO action in the market.

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

We recommend that each TSO should have its own annual target within the same incentive scheme for at least neighbouring TSOs. As soon as highly independent instruments such as flow-based market coupling are applied the targets should be agreed in a cooperative manner among regional regulators avoiding reverse impacts on other TSOs by individual efforts to outperform its own incentive scheme.

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

As described in question 2, we see opportunities to promote cross-border trade by refraining from trading licensing practices across Europe. This could be easily implemented as a low cost measure.

A stronger focus and more project management style could also help to accelerate market coupling and intra-day implementation projects.

**ERGEG welcomes any additional contributions that could help regulators to define an incentive scheme aimed at promoting cross-border trade.**

- Congestion cost is a good measure from a society perspective, but not a fair measure of TSO short term performance as merit orders on both sides of the border is a major driver for congestion costs.
- Social welfare generated by cross-border flows is a very good measure from a society perspective, but in the same way as for congestion costs there are important factors that cannot be controlled by the TSOs short term.
- Implementation of market coupling and cross-border balancing are important measures to improve cross-border trade. However, these measures are not related to the daily operations of TSOs. We therefore think that incentives in terms of a single indicator are not the best way for regulators to make sure that these measures are implemented.
- Details on price areas, including the existence or duration of price areas, percentage of time per year for every price area (e.g. existing in Nordic market). This is a very specific indicator for the Norwegian TSO and precipitation is more important than short term TSO actions for existence or duration of price areas
- Annual congestion income for every TSO. Price levels are very important and in the Nordic case precipitation is more important than short term TSO actions for the annual congestion income.
- Annual countertrade costs for every TSO. Price levels and availability of power plants are very important and more important than short term TSO actions for the annual countertrade costs.
- Annual duration of normal transmission capacity per interconnection, percentage of time. This would be an appropriate option for an incentive scheme as TSO can influence this to a large extent.
- Annual price difference between bidding areas. TSOs can only influence this to a limited extent short term.
- Price differences across the interconnections compared to transmission capacity. TSOs can only influence this to a limited extent short term.
- Reasons for capacity reductions per interconnection. It is interesting for regulators and market participants to understand the reasons, but it would be difficult to base an incentive scheme on this.