

## **EFET Position on Inter TSO Compensation – ERGEG Draft Guidelines**

**May 2006**

### **1. Reminder of why an ITC mechanism may be justified**

The discussion on cross-border transmission tariffs has been high on the agenda of the Florence Forum since its creation, in 1998. Existing cross-border or transit charges, levied on wholesale sellers and buyers in some EU countries till as late as 2002, were seen as a major impediment to the development of cross-border trade. They tended to discriminate between different users of the high voltage transmission system and led to complex transaction tracking and payment mechanisms, which tended in themselves to act as a barrier to trade between countries. TSOs used to justify levying a charge on transits or exports or imports to help meet their own system costs. EFET argued consistently and vehemently from the start that cross-border nominated transactions should be free of any such levy.

All participants in the Florence process have since agreed upon the principle of a completely non-transaction-based transmission tariff scheme across continental Europe. Pending EU-wide harmonisation of the G (generation) and L (load) components of national tariffs, and in the absence of locational signals within the differentiated attribution of such tariffs by zones, according to where generating capacity was deficient or load excessive, TSOs requested permission to organise a mutual compensation (ITC) mechanism.

The ITC mechanism has thus been developed as a supposed solution to TSOs losing import, export and transit fees. Although these fees were shown to be illegitimate according to the basic rules of the EU internal market, nonetheless, TSOs argue that they must be compensated for the costs of those specific assets, which permit cross-border flows to take place. They have so far concluded, in consultation with Regulators, that concentrating on the costs of infrastructure, installed in anticipation of true transit, would be the most equitable basis for establishing mutual compensatory arrangements.

The claimed legitimacy of the ITC mechanism thus consists only in the compensation of “loss” on the part of the TSOs, who bear such costs and have not had them reimbursed by national system users. Certainly the amount of the compensation fund should be kept at the minimum necessary, with the aim to avoid distortions in national G and L based charging regimes.

From a technical and regulatory perspective, determining a fair and sound system for cost re-allocation between the TSOs, in such a way as to avoid hampering cross-border trade, and yet not discriminating against some national system users, has proved in fact a difficult task.

### **2. A risk that an ITC mechanism distorts the electricity market**

EFET welcomes the opportunity to comment on the ERGEG Guidelines on an Inter TSO compensation mechanism. We express our continuing concerns that the ITC mechanism may have a negative impact on the creation of a pan-European electricity

market. The issues we present below are oriented to the goal that fully traded wholesale power markets should be established throughout Europe.

An ITC solution is not only a problem for TSOs to agree on, but for traders as well. Many traders are also producers or large industrial consumers – as such they are not prepared to accept increased transport costs (by way of G or L charges respectively) if the solution is not accepted as fair or reasonable.

Behind the ITC mechanism there is the assumption that physical cross border flows arise, because a producer in one country has agreed to deliver electricity to a customer in a distant country, and therefore will cross a country in between. This assumption is a gross simplification of sales patterns, and should prove incorrect in a functional internal market in electricity. In a truly open and efficient pan-European market, inter-regional physical flows with the limited exception of some loop flows) would arise through inter-regional arbitrage of price differences. Any profit arising from such arbitrage will be shared between wholesale traders active in the different countries/ markets and TSOs making money from selling congested transmission capacity linking those countries/ markets. In these circumstances individual TSOs will have no need to claim also compensation from each other, except in isolated cases of exceptional loop flow volumes.

The all-encompassing ITC mechanism may in the meantime work against the objective of creating an efficient pan-European power market, by distorting both operational and investment incentives for TSOs. As long as payments between TSOs depend directly on flows, some TSOs that are net contributors to the ITC will face incentives to set available transfer capacity (ATC) artificially low to reduce their payments. One possible example is the Czech TSO - CEPS - which, according to one ITC calculation variant proposal (IMICA) would face a heavy contributory burden. Meanwhile some other TSOs may be falsely incentivised to reconsider developing new physical cross-border capacities, which would result in increases to their net ITC contribution. One victim of this effect could be a fourth cable between Norway and Denmark/Jutland. Furthermore, there is the general risk of distorting the incentives for companies to locate generation and for large consumers to locate load, as long as significant ITC payment receipts dissuade beneficiary TSOs from pursuing the harmonisation of G and L tariffs and of related locational signals across Europe.

The antagonistic process of fixing the ITC mechanism can also be expected to prolong a national win-lose focus on the part of TSOs and Regulators, to the detriment of a more desirable focus on the win-win objective of developing a pan-European electricity market.

### **3. Net proceeds from an ITC mechanism**

We believe, in view of our analysis under section 2 above, that any individual TSO receiving net income from the ITC should use it for similar purposes to those designated in the Congestion Management Guidelines under the Regulation. In addition they should apply funds in strict order against the three permitted uses:

1. Guaranteeing the firmness of cross border transmission capacity actually allocated (where firmness is understood to entail promising compensation for any curtailment at prevailing wholesale power market price differentials across the relevant border) e.g. by plant re-despatch or counter-trading;
2. Maximising the cross border transmission capacity given to the market, through innovative ways of managing the system internally, through other operational measures co-ordinated across borders, or through network investments, in each case with regulatory approval.; and
3. Reimbursement to national grid users (i.e. only when expenditure options under 1. and 2. have been exhausted).

#### **4. The worrying example of the SETSO scheme**

Finally we would like to refer here to a salutary reminder of how patchwork, non-harmonised European solutions to transmission charging could regress to open strife between national operators.

We have seen in the last 18 months the near total failure of the previously much vaunted SETSO ITC scheme. Some key countries in south-east Europe, though nominally declaring adherence to the principles of a single European electricity market, continue effectively to permit the levying of export, import or transit fees. EFET particularly objects, in the EU context, to the continuing existence of so-called injection fees between the ETSO and SETSO areas, though both are now within a single synchronous UCTE zone.

EFET has argued in the Athens Forum that the injection fees constitute a barrier to the cross border trade. Moreover, the injection fee for import to the Balkan “perimeter” countries, which used to be 1 €/MWh, has been raised to 1.99 €/MWh (and named “average Ex-Ante Net Flow fee” as though to add legitimacy to it). The existence in parallel of ETSO and SETSO ought not to preclude efforts towards an ITC organisational interface, which removes injection fees for entry to, or exit from, the SETSO area. The subsistence of such a monetary and bureaucratic barrier to trade at system frontiers, unhindered by any physical barriers, is simply unnecessary. EFET will continue to remind south-east European TSOs and Regulators that the fundamental purpose, behind commencement of the ITC mechanism, is to achieve abolition of not just transit fees, but also of any export and import related grid charges (whether names as such or not).

We would be pleased to further participate to the consultation process and the continuing elaboration of the Guidelines.