Energy Infrastructure Development - Regulators' views on Cost Allocation and Financing Mechanisms

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Cost Allocation overview

- Traditional **cost allocation** methods (user pays, beneficiary pays, taxpayer pays) continue to be **appropriate** for much of the **new infrastructure** investment envisaged, including **cross-border** (where inter-MS, inter-TSO and inter-NRA cooperation has been frequent and usually effective).
- BUT, completing IEM implies **more RES**, more **storage**; their efficient location usually does not coincide with load, so more **energy transits** needed, over several MS. Also, to contain prices by **competitive threat** could justify investing in infrastructure that may be used only occasionally but benefit a whole region.
- General principles **apply equally** to electricity and natural gas, despite technical differences in their practical application.

New challenges, new solutions

- In cases where ex-ante cost allocation agreements (with governments, TSOs, NRAs) are not possible, on projects of European interest (PEI) where beneficiaries cannot be identified, a **commonly agreed EU cost allocation procedure** could ensure that IEM completion is not jeopardised.

- Need to ensure each project is **essential** and the most **cost-effective** solution – such projects should be:
  - In TYNDP;
  - Part of a “priority corridor” (EIP, p.8);
  - Confirmed by RI(s);
  - Impossible to realise otherwise;
  - Highly ranked in the list of PEI;
  - Confirmed by a specific EU act as eligible (with financing rules).

Conclusions (1/2)

- CEER work has identified **3 specific issues** that could benefit from a **new legislative initiative**:
  - Unanimity about **urgent need to streamline licensing and permitting;**
  - 3rd Package foresees **NRA oversight** of TSO investment programs only in case of ITO – **should cover all TSOs;**
  - **Fast-track procedures** needed for priority projects – current ACER powers for **cross-border conflict-resolution** between TSOs and/or NRAs could prove very time-consuming, delaying priority projects.

Conclusions (2/2)

- Any new legislative or other initiative should respect following **principles**:
  - **Benefits must exceed costs,** both comprehensively measured in full **social cost-benefit analysis** (incl. externalities);
  - **Market-based** cost allocation options should apply whenever possible, rather than subsidies or public funds;
  - **NRA estimates** of **tariff impacts** should be required in inter-government ageements on cost allocation and in the **inter-temporal smoothing** of lumpy up-front costs;
  - Any EU funding mechanism requires **project selection criteria** that are **clear**, **well-defined, transparent, non-discriminatory** and **commonly agreed.**

CEER work on financing mechanisms

Following internal discussions within CEER, **4 NRAs*** indicate “projects at risk” due to financing difficulties and small domestic markets in electricity.

- Financing is a problem of **marginal** importance in electricity and of **moderate** importance in gas;
- Main reason cited for lack of investment are **overly complex and lengthy** permitting and licensing procedures.

*** Czech Republic, Cyprus, Poland and Lithuania**

CEER results on innovative financing mechanisms (1)

- **Sufficient debt and equity capital** is available on the market;
- Investment projects **can be financed by TSOs;**
- **Existing financial institutions and mechanisms** should be used to finance infrastructure in a speedy way;
- Mechanisms can be gradually **adapted towards current market needs** and be creatively developed further on, where required
  - The use of **existing financing instruments** via EIB or KfW must however **not** lead to crowding out of private capital;
  - Make sure limited **EU funding is focused** on Projects of European Interest with duly justified financing need.
- **Main issues** for **investors**:
  - **stable returns; and**
  - **a stable transparent regulatory regime.**

CEER results on innovative financing mechanisms (2)

- CEER suggestions (1)
  - **Cooperation among TSOs** could improve their financial capability and rating;
  - Offer shares and bonds from network companies to the **retail investor market**
    - Low risk investments can be offered to households and citizens as **“people’s shares”** in order to not only raise capital but also to improve public acceptance.
  - Invite **manufacturers** from cable and pipeline industries to participate in funding infrastructure projects.

CEER results on innovative financing mechanisms (3)

- CEER suggestions (2)
  - Inflow of additional equity will have impact on **ownership structure** – **operational management** should remain with the **TSO**, secured by shareholder agreements (as is international best practice);
  - 3rd Package **unbundling provisions must <u>not</u> be interpreted** in a way that would **introduce new obstacles for equity investment.** Ongoing discussion with Commission to avoid erecting any such barriers to investment.
- Financial investors interviewed share CEER analysis.

Thank you for your attention

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