



# **Strategic Guidelines and Codes: Rationale and Scope**

## **Example related to Congestion Management in Electricity**

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## 1 Rationale

The purpose of this paper is to explain how the Regulators' approach to the development of codes and rules will work in practice and, most importantly, how the Strategic Guidelines envisaged being agreed at an early stage in the process will be developed. The paper illustrates the difference between areas involving substantive discretion (and therefore must be dealt with through a comitology process) and those issues which include technical details and therefore could be dealt with in technical codes to be prepared by the ENTSOs and approved by the Agency.

The 3<sup>rd</sup> package should provide the opportunity to give the Agency (acting in the EU consumer's interest) the power to take binding technical decisions on defined cross-border issues within regulatory framework agreed by the Institutions. The regulators have proposed an alternative approach which the regulators believe to be consistent with Meroni, which would enable the Agency to take decisions on cross-border issues within a flexible framework set through comitology process, and at the same time ensure appropriate stakeholder/consumer involvement. In essence, regulatory policy objectives would be agreed through comitology, early on in the process, which would establish clearly the technical decisions that the Agency should make, and mandatory codes would result at the end of the process.

At the beginning of the process Strategic Guidelines (that would guide ENTSOs in their subsequent drafting) would set out the general objective, level of priority, roles and responsibilities for each code or rule and should therefore be agreed at a political level. ENTSOs would then draft the technical codes to meet the "strategic guidelines". Following the approval by the Agency, the codes and rules become binding. In the view of Regulators many of these codes must be legally binding in order to provide the degree of regulatory certainty needed to create a sound investment climate and for competition to develop. This approach would eliminate the uncertainty inherent in the Commission's proposal.

Figure 1 shows the difference between the Commission's proposal and the approach proposed by European Regulators.

It is worth reinforcing some points in our proposal:

- The Strategic Guidelines will be established through the comitology procedure so that Member States and the European Parliament will have a full and proper opportunity to determine the pace and scope of the transition to a competitive single European energy market early on and avoid detailed comitology scrutiny of highly complex, technical codes. The Agency will be able to have direct decision making powers over the detailed codes and rules given that the strategic guidelines would be established under comitology and thus the Agency is not entrusted with any discretionary powers. The role of the Agency will therefore closely parallel that proposed for national regulatory authorities. This will reinforce close collaboration at EU and national levels.
- Binding codes, which form the basis of the single European energy market, will provide regulatory certainty for investors and for competition to develop. Binding codes are needed at European level in many cases, which include those where third parties must also be bound; where national legal codes and binding rules must be made to conform with European codes and rules; where certainty is needed about the

regulatory framework so that long term investments can be made; and where standards of behaviour of market parties must be set and capable of enforcement in order for the market to operate effectively and to ensure effective competition.

- Modifications to codes – inevitable and frequent as markets develop and integration of markets deepens – will not need regular detailed comitology scrutiny. Only changes to the “strategic guidelines” would require this. There will be many codes (possibly different ones to account for regional differences) which could easily swamp the normal comitology processes. The principle of independent regulation which is essential for a sound investment climate would be compromised. There is also the question of responsibilities – changes to critical codes made in comitology may reduce the direct accountability of TSOs for the secure and efficient operation of their networks. The Regulators’ proposal will overcome those problems.

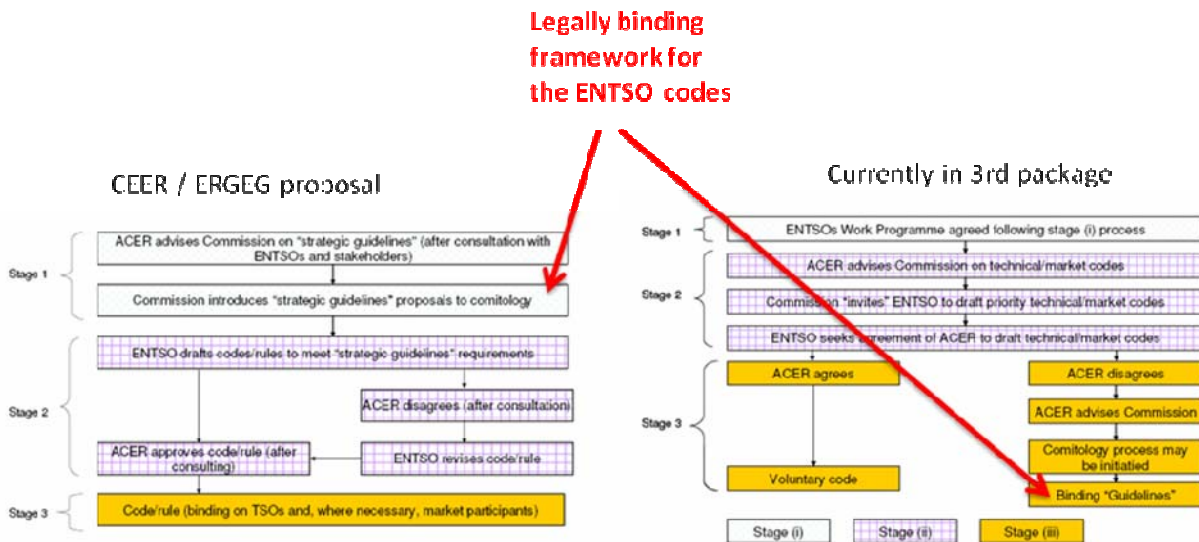


Figure 1: Existing EC proposal and novel CEER approach to Strategic Guidelines and related codes & rules.

## 2 Way forward to Strategic Guidelines and Codes / Rules

This paper illustrates how this alternative approach would work in practice with regard to the process for the adoption of the codes and rules and the issues that need to be addressed under the Strategic Guidelines. Furthermore, an example related to congestion management (CM) for electricity is provided to illustrate how this approach would work in practice. Existing CM Guidelines are already in place (2006/770/EC) and include elements which are relevant to the issues to be addressed under the Strategic Guideline as well as some elements which relate to the detailed technical codes (e.g. procedures, and methods). However, the example illustrates the issues and areas to be treated under the Strategic Guidelines under the CEER approach, and those to be incorporated in the technical codes in the Regulators’ approach.

What follows are our views on: (a) the criteria which can be used to determine which issues should be addressed in Strategic Guidelines, and which in codes (par.2.1); (b) the scope and structure of the strategic Guidelines (par. 2.2); (c) the application of these in the area of the

congestion management Guidelines (par. 2.2). Furthermore, there are related tasks which we should recognise, but which are not part of this paper.

## 2.1 Criteria for Strategic Guidelines and Codes / Rules

The criteria for distinguishing between issues under the Strategic Guidelines and the codes are relevant to the ambit of responsibilities and roles between of TSOs and regulators and those of the Commission and Member States. TSOs and regulators, after all, manage and regulate networks in this context and don't have the mandate to determine the shape of the European market. That mandate needs to be given in the Strategic Guidelines. The following criteria may be applied when the Strategic Guidelines and the codes / the rules are prepared:

**“Classification criteria”** → for determining which issues should be addressed in Strategic Guidelines, and which in codes

- (i) An issue that meets one or more of the following criteria shall be a subject of the relevant Strategic Guideline:
  - a. Identified and clear need for a **legally binding code** (as a distinct from a contractually binding (non legislated) code)
  - b. Describing the **outcome of the code** or providing a **mandate** to develop a code (i.e. what needs to be achieved, but not how)
  - c. **No subject to subsidiarity** (e.g. non-discrimination, level playing field between MS, general functioning within and between the synchronous area, transparency, etc.)
  - d. Specifying **roles and responsibilities** of different stakeholders globally (what shall be done by whom at a pan-EU level)
  - e. Energy **regulation policy** related issues (e.g. an administrative definition of regions)
- (ii) An issue that meets one or more of the following criteria shall be a subject of the relevant code:
  - a. **Technical details** (irrespective of the pan European, regional or national scope)
  - b. **Operational details** (irrespective of the pan European, regional or national scope)
  - c. **Organisational or procedural details** (provided no criteria from (i) applies)
  - d. **Subject to subsidiarity** (i.e. possibly different regional or national solutions)
  - e. Subject to **frequent amendments** (either due to the nature of the issues themselves or due to the changing environment around them) provided no criteria from (i) applies

**“Completeness criteria”** → for checking that all the necessary aspects of a given issue are covered appropriately by the Strategic Guideline or by the code

- (iii) All **implications of a given code** are anticipated in the related SG?
- (iv) Is adequate **mandate for a given code** ensured in the related SG? (e.g. the code might relate only to one region of Europe)
- (v) Is the **underlying model** against which the code / rule is being developed clearly anticipated in the SG – what should the SG contain to provide adequate legitimacy of the model? (e.g. the model might relate to the architecture of the codes – laying above national codes, or to the principles and objectives adopted – e.g. market based etc).
- (vi) Are the **actors to be given responsibilities and obligations** adequately identified in the SG?
- (vii) Is the **level of collaboration, coordination and communication** between those given responsibilities in the code, including the proposed data exchanges adequately foreseen in the SG?
- (viii) Is the level of **monitoring and oversight** proposed adequately foreseen in the SG?
- (ix) Are the **enforcement procedures** foreseen in the SG and implemented in the code?
- (x) Is the allocation of **liabilities** proposed adequately foreseen in the SG?
- (xi) Is any **reallocation of rights or costs** adequately foreseen in the SG?
- (xii) Are all relevant **cross-issues** (e.g. between different SGs and/or codes) considered accordingly?
- (xiii) Are all the **specific technical/market details** contained in that single code, or does it make reference/use of other codes?

**“Application criteria”** → for general application framework of a SG or code

- (xiv) If and when is that code / that SG really **needed**? (e.g. for an ex-post check after completing a new subject)
- (xv) What are **overlaps**, with what else and how to resolve them?
- (xvi) When an **issue meets at least one selection criteria for SG and one for code**, a detailed resolution and split of the definitions between the related SG and code is necessary

## 2.2 Generic Structure of Strategic Guidelines

To achieve this, the Strategic Guidelines will address questions such as the extent and pace of harmonisation and/or compatible alternatives; the degree of subsidiarity or harmonisation inherent in the codes and rules; the degree of resilience (or reliability) expected in the EU's networks with the resulting costs; and the prioritisation of the different codes and rules for the ENTSO's work. Although the underlying policy objective may be (for example) to integrate

markets over a period in an evolutionary way, in practice the scope and depth of Strategic Guidelines and the codes will differ.

The generic structure of Strategic Guidelines might be as follows:

### **1. General provisions, objectives**

Besides setting the scope for the codes, the Strategic Guidelines must also refer to any cross-issues with the other Guidelines and areas of the EU electricity market framework.

Example in the CM Guidelines: Section “1. General Provisions”

### **2. Roles and responsibilities**

Besides the general definition of the roles and responsibilities of different stakeholders affected by the specific issues in the guidelines, this part of the guidelines must also contain any references to the legal responsibility and liability of involved parties in relation to the definition, development and implementation of the guidelines in the dedicated codes and rules under these codes.

Example in the CM Guidelines: Throughout the CM Guidelines as a whole, e.g. Articles 1.1 (TSOs), 1.10 (regulators), 2.6, 2.11 (market participants’ rights and obligations), 3.6, 4.4, the whole section 5 (Transparency), etc.

### **3. Specific technical/market issues covering the contents of relevant topic**

Example in the CM Guidelines: Section “2. Congestion Management Methods” – including both objectives and more detailed rules to be defined by TSOs

### **4. Co-operation, Coordination and Communication, including regional aspects**

Example in the CM Guidelines: Section “3. Coordination”, Article 3.2 (regions)

### **5. Monitoring**

Example in the CM Guidelines: Article 6.5 (Regulators’ monitoring of the congestion income)

## **2.3 Example of Congestion Management Guidelines**

Table 1 shows chapter 2 “Congestion Management Methods” of Congestion Management Guidelines which has been used as an example to illustrate the topics to be included in Strategic Guidelines and codes/rules.

Table 1. Chapter 2 “Congestion Management Methods” of present Congestion Management Guidelines (Commission Decision 2006/770/EC of 9 November 2006 amending the Annex to Regulation (EC) No 1228/2003 on conditions for access to the network for cross-border exchanges in electricity) and its division to Strategic Guidelines and Codes/Rules according to CEER proposal.

<b>Congestion Management Guidelines under Regulation (EC)1228/2003 – Chapter 2 “Congestion Management Methods”</b>	<b>→ applied selection criteria Strategic Guidelines</b>	<b>→ applied selection criteria Codes / rules</b>
<p><b>Paragraph 2.1</b></p> <p>Congestion management methods shall be market-based in order to facilitate efficient cross-border trade. For this purpose, capacity shall be allocated only by means of explicit (capacity) or implicit (capacity and energy) auctions. Both methods may coexist on the same interconnection. For intra-day trade continuous trading may be used.</p>	<p><b>→ (i)a, (i)b, (i)c,</b></p> <p>Objectives for CM methods</p> <ul style="list-style-type: none"> <li>- market-based</li> <li>- allocation only explicit or implicit</li> <li>- co-existence</li> </ul> <p>Furthermore, intra-day trade may be based on continuous trading</p>	<p><b>→ (ii)a, (ii)b, (ii)e</b></p> <p>Codes / rules</p> <ul style="list-style-type: none"> <li>- giving clear indications for explicit and implicit allocation</li> <li>- principles and opportunities for coexistence of these methods</li> <li>- principles and conditions for intra-day trading</li> </ul>
<p><b>Paragraph 2.2</b></p> <p>Depending on competition conditions, the congestion management mechanisms may need to allow for both long and short-term transmission capacity allocation.</p>	<p><b>→ (i)b</b></p> <p>Objective:</p> <ul style="list-style-type: none"> <li>- both long and short-term transmission capacity allocation may be needed</li> <li>- specify competition conditions when to use long/short term only or combined transmission capacity allocation</li> </ul>	<p><b>→ (ii)a, (ii)b, (ii)d, (ii)e</b></p> <p>Codes / rules</p> <ul style="list-style-type: none"> <li>- details for long and short-term transmission capacity allocation, if both applied on interconnectors (e.g. as seen in the auction rules)</li> </ul>



<b>Congestion Management Guidelines under Regulation (EC)1228/2003 – Chapter 2 “Congestion Management Methods”</b>	<b>→ applied selection criteria Strategic Guidelines</b>	<b>→ applied selection criteria Codes / rules</b>
<p><b>Paragraph 2.3</b></p> <p>Each capacity allocation procedure shall allocate a prescribed fraction of the available interconnection capacity plus any remaining capacity not previously allocated and any capacity released by capacity holders from previous allocations.</p>	<p><b>→ (i)b</b></p> <p>Objective:</p> <ul style="list-style-type: none"> <li>- allocate a prescribed fraction of available interconnection capacity and what remains from previous allocations</li> </ul>	<p><b>→ (ii)a, (ii)b</b></p> <p>Codes / rules</p> <ul style="list-style-type: none"> <li>- for each allocation procedure</li> <li>- definition of fractions to each allocation procedure</li> </ul>
<p><b>Paragraph 2.4</b></p> <p>TSOs shall optimise the degree to which capacity is firm, taking into account the obligations and rights of the TSOs involved and the obligations and rights of market participants, in order to facilitate effective and efficient competition. A reasonable fraction of capacity may be offered to the market at a reduced degree of firmness, but the exact conditions for transport over cross-border lines shall at all times be made known to market participants.</p>	<p><b>→ (i)a, (i)c</b></p> <p>Objectives</p> <ul style="list-style-type: none"> <li>- optimise the degree of firmness to facilitate effective and efficient competition</li> <li>- transparency on conditions</li> <li>- mandate for TSOs to optimise</li> </ul>	<p><b>→ (ii)a, (ii)b, (ii)d</b></p> <p>Codes / rules</p> <ul style="list-style-type: none"> <li>- for firmness of long term and short term capacity</li> <li>- for products characterised by different degrees of firmness</li> </ul>
<p><b>Paragraph 2.5</b></p> <p>The access rights for long- and medium-term allocations shall be firm transmission capacity rights. They shall be subject to the use-it-or-lose-it or use-it-or-sell-it principles at the time of nomination.</p>	<p><b>→ (i)a, (i)c</b></p> <p>Objectives:</p> <ul style="list-style-type: none"> <li>- long- and medium-term allocations shall be firm transmission capacity rights</li> <li>- UIOLI/UIOSI principles at the time of nomination</li> </ul>	<p><b>→ (ii)a, (ii)b</b></p> <p>Codes / rules</p> <ul style="list-style-type: none"> <li>- for access rights for long- and medium-term allocations</li> <li>- principles and specific examples for UIOLI/UOSI</li> </ul>



<b>Congestion Management Guidelines under Regulation (EC)1228/2003 – Chapter 2 “Congestion Management Methods”</b>	<b>→ applied selection criteria Strategic Guidelines</b>	<b>→ applied selection criteria Codes / rules</b>
<p><b>Paragraph 2.6</b></p> <p>TSOs shall define an appropriate structure for the allocation of capacity between different timeframes. This may include an option for reserving a minimum percentage of interconnection capacity for daily or intra-daily allocation. This allocation structure shall be subject to review by the respective Regulatory Authorities. In drawing up their proposals, the TSOs shall take into account:</p> <p>(a) the characteristics of the markets,</p> <p>(b) the operational conditions, such as the implications of netting firmly declared schedules,</p> <p>(c) the level of harmonisation of the percentages and timeframes adopted for the different capacity allocation mechanisms in place.</p>	<p><b>→ (i)a</b></p> <p>Objectives</p> <ul style="list-style-type: none"> <li>- Mandate to TSOs to define structure for allocation of capacity between different timeframes</li> <li>- Allocation structure is subject to review by NRAs</li> <li>- for allocation structure</li> </ul> <p>Furthermore, option for reserving a minimum percentage of capacity for daily and intra-daily allocation.</p>	<p><b>→ (ii)a, (ii)b</b></p> <p>Codes / rules</p> <ul style="list-style-type: none"> <li>- on how to structure the allocation of capacity between different timeframes and what should be taken into account</li> <li>- on cases where reservation of a minimum percentage for daily and intra-daily allocation could be appropriate</li> </ul>
<p><b>Paragraph 2.7</b></p> <p>Capacity allocation may not discriminate between market participants that wish to use their rights to make use of bilateral supply contracts or to bid into power exchanges. The highest value bids, whether implicit or explicit in a given timeframe, shall be successful.</p>	<p><b>→ (i)a, (i)c</b></p> <p>Objectives</p> <ul style="list-style-type: none"> <li>- non-discrimination between bilateral or power exchange trading</li> <li>- highest value bid successful</li> </ul>	<p><b>→ (ii)a, (ii)b</b></p> <p>Codes / rules</p> <ul style="list-style-type: none"> <li>- for capacity allocation taking into account bilateral and power exchange trading</li> <li>- for explicit/implicit auctions in all timeframes</li> </ul>

<b>Congestion Management Guidelines under Regulation (EC)1228/2003 – Chapter 2 “Congestion Management Methods”</b>	<b>→ applied selection criteria Strategic Guidelines</b>	<b>→ applied selection criteria Codes / rules</b>
<p><b>Paragraph 2.8</b></p> <p>In regions where forward financial electricity markets are well developed and have shown their efficiency, all interconnection capacity may be allocated through implicit auctioning.</p>	<p><b>→ (i)b, (i)f</b></p> <p>Objectives</p> <ul style="list-style-type: none"> <li>- implicit auctions for all interconnection capacity in regions where forward financial electricity markets are well developed</li> </ul>	<p><b>→ (ii)a, (ii)b, (ii)d</b></p> <p>Codes / rules</p> <ul style="list-style-type: none"> <li>- for implicit auctioning for allocation of interconnection capacity where financial markets have developed and shown their efficiency</li> </ul>
<p><b>Paragraph 2.9</b></p> <p>Other than in the case of new interconnectors which benefit from an exemption under Article 7 of the Regulation, establishing reserve prices in capacity allocation methods shall not be allowed.</p>	<p><b>→ (i)a</b></p> <p>Objectives</p> <ul style="list-style-type: none"> <li>- no reserve prices in capacity allocation for regulated interconnectors</li> </ul>	<p><b>→ -</b></p> <p>Codes / rules</p>
<p><b>Paragraph 2.10</b></p> <p>In principle, all potential market participants shall be permitted to participate in the allocation process without restriction. To avoid creating or aggravating problems related to the potential use of dominant position of any market player, the relevant Regulatory and/or Competition Authorities, where appropriate, may impose restrictions in general or on an individual company on account of market dominance.</p>	<p><b>→ (i)a, (i)c</b></p> <p>Objectives</p> <ul style="list-style-type: none"> <li>- participation in allocation process for all potential market participants</li> <li>- restrictions may be imposed on market dominance</li> <li>- mandate for Regulatory and/or Competition Authorities to impose restrictions</li> </ul>	<p><b>→ (ii)a, (ii)b</b></p> <p>Codes / rules</p> <ul style="list-style-type: none"> <li>- for allocation process to ensure participation</li> </ul>

<b>Congestion Management Guidelines under Regulation (EC)1228/2003 – Chapter 2 “Congestion Management Methods”</b>	<b>→ applied selection criteria Strategic Guidelines</b>	<b>→ applied selection criteria Codes / rules</b>
<p><b>Paragraph 2.11</b></p> <p>Market participants shall firmly nominate their use of the capacity to the TSOs by a defined deadline for each timeframe. The deadline shall be set such that TSOs are able to reassign unused capacity for reallocation in the next relevant timeframe — including intra-day sessions.</p>	<p><b>→ (i)a, (i)c</b></p> <p>Objectives</p> <ul style="list-style-type: none"> <li>- firmly nomination by a defined deadline for each timeframe</li> <li>- reallocation for unused capacity in the next relevant timeframe including intra-day sessions</li> </ul>	<p><b>→ (ii)a, (ii)b</b></p> <p>Codes / rules</p> <ul style="list-style-type: none"> <li>- for process of nominations for market participants including a defined deadline for each timeframe</li> <li>- for reassigning unused capacity including intra-day sessions</li> </ul>
<p><b>Paragraph 2.12</b></p> <p>Capacity shall be freely tradable on a secondary basis, provided that the TSO is informed sufficiently in advance. Where a TSO refuses any secondary trade (transaction), this must be clearly and transparently communicated and explained to all the market participants by that TSO and notified to the Regulatory Authority.</p>	<p><b>→ (i)a, (i)c</b></p> <p>Objectives</p> <ul style="list-style-type: none"> <li>- capacity freely tradable on a secondary basis</li> <li>- transparently communicated to market and RA if TSO refuses</li> </ul>	<p><b>→ (ii)a, (ii)b</b></p> <p>Codes / rules</p> <ul style="list-style-type: none"> <li>- for the different options on trading on a secondary basis</li> <li>- for communicating transparently to market participants and RA if TSO refuses any secondary trade</li> </ul>

<b>Congestion Management Guidelines under Regulation (EC)1228/2003 – Chapter 2 “Congestion Management Methods”</b>	<b>→ applied selection criteria Strategic Guidelines</b>	<b>→ applied selection criteria Codes / rules</b>
<p><b>Paragraph 2.13</b></p> <p>The financial consequences of failure to honour obligations associated with the allocation of capacity shall be attributed to those who are responsible for such a failure. Where market participants fail to use the capacity that they have committed to use, or, in the case of explicitly auctioned capacity, fail to trade on a secondary basis or give the capacity back in due time, they shall lose the rights to such capacity and pay a cost-reflective charge. Any cost-reflective charges for the non-use of capacity shall be justified and proportionate. Likewise, if a TSO does not fulfil its obligation, it shall be liable to compensate the market participant for the loss of capacity rights. No consequential losses shall be taken into account for this purpose. The key concepts and methods for the determination of liabilities that accrue upon failure to honour obligations shall be set out in advance in respect of the financial consequences, and shall be subject to review by the relevant national Regulatory Authority or Authorities.</p>	<p><b>→ (i)a, (i)c</b></p> <p>Objectives:</p> <ul style="list-style-type: none"> <li>- financial consequences attributed to those who are responsible</li> <li>- if market participants fail to use/trade/give back the capacity they shall lose the rights to such capacity and pay a cost-reflective charge, which shall be justified and proportionate.</li> <li>- if a TSO does not fulfil its obligation, it shall be liable to compensate the market participant and here no consequential losses shall be taken into account.</li> <li>- mandate to NRA(s) subject to review</li> </ul>	<p><b>→ (ii)a, (ii)b</b></p> <p>Codes / rules</p> <ul style="list-style-type: none"> <li>- for the determination of liabilities that accrue upon failure to honour obligations (both for market participants and for a TSO)</li> </ul>