



Council of European Energy Regulators Principles on Regulatory Control and Financial Reward for Infrastructure

Comments by ETSO – 30 June 2003

1. Set out below are comments on each of the eight principles identified in the document. As indicated in the text of the CEER document, these represent a preliminary stage of establishing principles prior to the CEER developing guidelines, as required by the European Commission's invitation. It is particularly important therefore that these principles are sound and consistent, otherwise the subsequent guidelines will be ill founded.
2. At an overall level, many of the principles set out are in line with the Directive and the Regulation aiming at facilitating the development of a competitive market in electricity supply and generation. However, it is important to recognise that ongoing regulation of TSOs should not degenerate into micro management of the TSO's activities by the Regulatory Authorities. Conditions need to be established, where they do not exist already, for the appropriate degree of independence of the TSO from all, other market participants and, of course, an obligation should be placed on TSOs not to discriminate between market participants.
3. Given such pre-conditions, the regulatory framework needs to be established in such a way as to encourage TSOs (acting independently of all other interests) to act in the interests of developing and supporting a competitive market in generation and supply and safeguarding security of supply. Not only ownership unbundling but also legal and management unbundling can fulfil these objectives.
4. Before turning to the principles themselves, it is necessary to consider a definitional point. The term transmission system operator (or TSO) is used throughout the CEER document and throughout these comments. It is important to establish at the outset explicitly what is meant by this, as indeed appears to be implicit in the CEER document. It is taken here to mean the organisation or company that is responsible for minute to minute operation of the system including system balancing, and is also responsible for directing the availability of and investment in the physical transmission system.
5. Against this background, set out below, are comments on each of the eight principles in the CEER document.

Principle 1– the Importance of New Infrastructure for Competition and Security of Supply

6. It is clearly important that regulatory authorities should incentivise TSOs to provide sufficient infrastructure to facilitate competition in generation and supply and to ensure sufficient transmission capacity is provided by the TSO in order for the lack of such capacity not to inhibit the ability of generation to meet demand.
7. The CEER paper indicates that “CEER with the co-operation of ETSO (and UCTE) could develop the methodology and criteria for the development of interconnections that would lead to the above mentioned threshold”. If the “above mentioned threshold” refers to the minimum 10% target, this is clearly inappropriate. What is needed instead is the development of criteria for investment that meets the facilitation of competition and security of supply criteria and not one that meets the 10% target. The 10% target may be too little in some circumstances and too much in others. It is highly doubtful that the application of this target will correspond to an appropriate and, in particular, an efficient reinforcement of the transmission system.
8. In short, the criteria for investment in infrastructure should facilitate efficient competition and safeguard security of supply. By doing so infrastructure investment will implement an efficient internal energy market. CEER in conjunction with ETSO should attempt to develop guidelines for assessing the appropriate level of investment in infrastructure to meet these joint criteria.

Principle 2 – Efficient Use of Infrastructure

9. The discussion of this principle in the guidelines refers, amongst other things, to the development of principles and approaches, which are of considerable theoretical or practical complexity and which will take some time to develop. These include:
 - (1) Potential developments of secondary markets in transmission capacity
 - (2) Methods for dealing with congestion
10. On the specific issue of the ETSO approach to cross border trade and its possible development into a harmonised pan European structure of transmission tariffs, it is important that CEER are aware that:
 - (1) Progress towards a harmonised European tariff methodology will need the support of individual country regulators, who are in many countries required to approve charging principles and structure.
 - (2) There will need to be agreement amongst individual regulators and the Commission as to both principles and practice, if any progress is to be made

- (3) Harmonisation will result in major changes to the status quo in some countries, if not all, and will affect the commercial position of generators and suppliers in those countries

As such, it is clear that progress towards harmonisation requires the involvement and agreement of the regulators across Europe as to the principles to be put in place.

Principle 3 – Role and Responsibilities of Public Authorities

11. It is clearly appropriate that the role of regulatory authorities in any member state could include the establishment of investment principles to be applied in respect of infrastructure developments and for the remuneration of such investment.

Principle 4 – Transparency of Investment Plans

12. It is entirely appropriate that TSOs should make public their committed system reinforcements. However, as much transmission investment will depend on the proposals of generators for the construction of new plant and on demand developments, the concept of firm “transmission plans” for more than a few years in the future is not appropriate in a liberalised market. TSOs are primarily investing in this context in response to market developments. It is therefore more appropriate to consider the publication of information on transmission developments to provide information to potential developers as to the most favourable location on the transmission system to locate their developments, rather than to require plans to be published that may then be challenged by disaffected users. The approach to this principle outlined by CEER implies a TSO investing in its system on some other basis than users’ requirements. Regulatory principles supporting investment need to be developed to preclude this as a possibility.

Principle 5 – Independence in Network Management

13. While the principle of independence in Network Management is strongly supported, the principles set out in this section of the text, supporting this principle, give rise to a number of issues. In particular Approach One:
 - (1) Implies a very high degree of micro management by the regulator, where in effect the Regulator is deciding the TSOs individual investment projects. In our view the regulator should set principles, which the TSO is required to meet and leave the decision making on specific projects to the TSO
 - (2) The above criticism of regulatory micro management of within country investment equally applies to the issue of investment between countries and, specifically, to the concept of European Commission determination of investment in interconnections
 - (3) Similar comments apply to the issues related to the remuneration of investment.

14. The issues arising in Approach Two relate to the need for market signals to emerge to determine the level of investment required in transmission capacity. It is in our view essential that investment is undertaken to meet the needs of users of the system. There are many ways in which market players can signal to the TSO the need for investment in the transmission system. Some are well proven, while others depend on developments of some complexity and give rise to issues of market liquidity. Auctions and resale of rights in secondary markets is one way forward but far from the only way forward in this context. As yet no country has successfully applied such an approach to the development of its internal infrastructure. In certain parts of the US, which come closest to this with SRMC pricing and financial transmission rights, investment in transmission has not been forthcoming at appropriate levels.
15. As far as Approach Three is concerned this requires the ability to identify specific users and while such an approach is appropriate for DC interconnectors, where it is possible to do so, it is not practical for the general development of a meshed AC system.

Principle 6 – Applicability of Regulatory Regime

16. As has been indicated above, the concept of “merchant infrastructure” can in our view only be applied in the case of DC interconnectors, where it is possible to identify the users and charge them accordingly for that part of the overall infrastructure. It is clearly the case that TSOs should be aware, before the event, of the basis on which they will be remunerated for capital investment undertaken. In the case of independent TSOs, the concept of “third party access “ does not apply, as all usage is by “third parties” that are users who are separate and independent from the TSO. The concept of third party access is only relevant in the case of a vertically integrated company where a “third party” is allowed access to the transmission system. This will not be the case so long as appropriate level of separation of TSOs from generators and suppliers is achieved.
17. Where merchant infrastructure is to be provided it is necessary for access to the infrastructure to be provided on non-discriminatory terms and it is reasonable for the principles for such access to be subject to regulatory scrutiny. However, as the provider of the infrastructure has no monopoly power and is carrying the full financial risk of such developments, it is not appropriate that charges should be regulated.

Principle 7 – Procedure for Licensing New Infrastructure

18. It is clearly the case that such procedures should be non-discriminatory and efficient.

Principle 8 – Principle on the Applicable Regulatory Regime

19. Again, it is clearly the case that the authorisation terms for the provision of infrastructure should be expeditious, taking into account proper consideration of all issues including environment and security.