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Union of the Electricity Industry - EURELECTRIC Position Paper
Contribution to the 10th Electricity Regulatory Forum

June 2003

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These comments have been drafted by the EURELECTRIC Sub-Group "Cross-Border Transactions" on May 2003:

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The **Union of the Electricity Industry - EURELECTRIC**, formed as a result of a merger in December 1999 of the twin Electricity Industry Associations, UNIPEDE and EURELECTRIC, is the sector association representing the common interests of the European Electricity Industry and its worldwide affiliates and associates. Its mission is to contribute to the development and competitiveness of the Electricity Industry and to promote the role of electricity in the advancement of society.

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INTRODUCTION

At the 9th European Electricity Regulatory Forum, Union of the Electricity Industry – EURELECTRIC had submitted to the discussion its Position Paper on the more permanent mechanism[1].

New developments are taking place since this last Forum, notably in relation to the forthcoming entry into force of the draft Regulation on cross-border electricity exchanges and the elaboration of related proposals by the European Commission regarding tariff harmonisation and locational signals. It is at present the intention of EURELECTRIC to actively contribute to the 10th Forum with the present Position Paper.

This paper builds notably on the following existing EURELECTRIC position papers, which remain valid: "Position Paper on Congestion Management" of November 2000, "Position Paper on the Harmonisation of the G and L Charges at EU level" of June 2001 and "Position paper on the more Permanent Mechanism" of September 2002.

SECTION I – REQUIREMENTS FOR A WELL-FUNCTIONING INTEGRATED ELECTRICITY MARKET

There are three basic pillars that sustain well-functioning markets in general:

- Efficiency, whereby markets must contribute to the provision of goods, trying to reduce as far as possible the cost of supply, and accordingly promoting all trade that can contribute to this objective, as well as eliminating all artificial trade obstacles.
- Non-discrimination, which means creating a level playing field, so that market players can compete on equal conditions.
- Stability, so that decisions taken by market players in either trade or investment keep their economic justification and contribute to the rational design and structure of the market.

[1] EURELECTRIC Position Paper on the more permanent mechanism – September 2002

In the particular case of integrated electricity markets, i.e. a multi-area market where agents can be involved in either internal or cross-border trade, these basic pillars are transformed into the following concrete requirements:

- **National transmission charges for generators must be harmonised so that a level playing field can be created in the Internal Electricity Market (IEM). In practice, the best approach for creating this level playing field is to make charges to generators equal to zero (G=0).**

- Available capacity in interconnections must be homogeneously calculated in a transparent way to the upper limit compatible with system security limits. The allocation of this capacity shall be made on a transparent and non-discriminatory basis, using harmonised market-based mechanisms.

- **Locational signals can contribute to the efficient operation and development of the IEM at both national and regional levels. Appropriate congestion management mechanisms will allow a true identification of price differences in connected markets. Harmonisation in generation charges is required first, before more sophisticated mechanisms for locational signals (losses or transmission charges) could be applied at a regional level.**

- Compensation for Transit (or Cross Border Trade) must be transparent, cost-reflective and be performed among TSOs, eliminating any explicit export or import fees.

- Market participants need to know with some certainty, what is the regulatory framework in which they are involved and it is therefore essential that a certain degree of regulatory stability be ensured.

SECTION II – CURRENT SITUATION

The various electricity markets in the European Union are at different stages in the liberalisation process, and a variety of solutions to the question of transmission charging have developed.

It is to be expected that the overall level of transmission charges should vary between Transmission System Operator (TSO) areas, as this should reflect the variable cost of providing and operating transmission systems in different regions of the EU. However, there are also marked differences in the proportion of charges levied on generators and loads, and also in the basis for charging (e.g. the split of charges between capacity and utilisation).

It is worth noting that in all cases loads bear over 50% of transmission charges, and in a number of European countries (Belgium, France, Germany, Luxembourg, East Denmark, Spain and Portugal), loads pay 100% of transmission charges (G=0). Within individual TSO areas, there is no regional differentiation of transmission tariffs in the majority of cases. Exceptions to this rule are England & Wales, Ireland, Norway and Sweden.

Charges for losses are generally included in the transmission tariff for loads. These charges are not uniform in Ireland, Norway and Sweden. A controversial decision has been made to introduce a locationally varying charge for losses in England and Wales from 2004.

Mechanisms for resolving congestion within TSO areas are also diverse. Some countries include congestion costs in the transmission tariff (e.g. France, Sweden, and Netherlands). In England & Wales, congestion costs are recovered through a separate charge on all market participants.

In the Nordpool area, a market splitting mechanism is used to handle long-term bottlenecks, with counter trading to resolve them at short-term.
In parallel with the development of transmission charging arrangements in individual TSO areas, a diverse set of arrangements have evolved to deal with cross-border trades at different borders. The tendency has been to introduce auctions at borders where capacity is congested and pre-existing contractual rights to the capacity are absent or expired. However, there is no standard approach to such auctions and limited co-ordination between auctions at different borders. Secondary markets in capacity have been slow to emerge.

SECTION III – WAY FORWARD

Harmonisation of tariffs

While all stakeholders agree that harmonisation of transmission charges is needed to avoid distortions among generators located in different transmission areas, EURELECTRIC has demonstrated that G=0 is the option that best leads to a level playing field for generators and, as a consequence, to a more efficient operation of the IEM. One of the arguments used for applying a G charge superior to zero is that this would reduce the income of those producers that have market power. This argument is however not robust: if this were the case, most of the income would disappear after the entrance into the market of new agents ready to take up this margin. Moreover, in the absence of any market power, the cost would be transferred immediately to consumers.

The G=0 solution could be considered as a starting reference situation that can be later modified to correct individual charging of generators as a result of the application of long-term locational signals.

Congestion management

EURELECTRIC supports the general principles of the draft Regulation with regard to congestion management. In this position paper, EURELECTRIC would like to stress some of those principles with the aim of strengthening its implementation:

- **The problems of network congestion should be tackled in a non-discriminatory manner and with market-based mechanisms.** This will give more even opportunities to all agents and will contribute to creating effective economic indicators for both agents and TSOs. The use of market-based mechanisms would also need to be generalised.

- Except in cases of "force majeure", market operators to whom capacity has been allocated will have to be compensated for any restriction. In this way, TSOs are obliged to perform a better forecast of the net transport capacity (NTC) in the networks and the available transport capacity (ATC) once the commitments included in the current contracts have been taken into account. Better co-ordination between all TSOs is required in order to obtain better information for the elaboration of forecasts.

- Market agents should be offered the maximum capacity of the interconnections compatible with security standards. This would require TSOs of neighbouring countries to jointly evaluate the available capacity and implies more requirements in the delivery of information, especially as regards the capacities that are available and the commitments previously acquired, which at the same time implies a certain level of "capacity reserve".

- Any capacity which has been allocated and not used will have to be reallocated to the market, according to an open, transparent and non-discriminatory procedure. This would avoid the situation that some agents - with "transport capacities reserved" acquired from current contracts - exercise power in the market. The authorities in each Member State need to implement mechanisms in order to avoid situations where part of the capacity is lost due to a lack of reallocation.

Locational signals

In a liberalised market, some form of locational signals are necessary to:

- achieve efficient short-term operation of the existing system, taking account of the geographical distribution of generation and load.
- guide long-term decisions for the siting of new generation and loads, and for investment in the network to relieve bottlenecks or reduce losses.

Locational signals in the short-term are related to congestion (except where this is a chronic bottleneck) and to losses. Adjustments to the energy-related charges for loads and/or generators can be made to reflect their location in the network and their impact on transmission losses.

Long-term locational signals can be obtained by applying non-uniform charges on load and/or generation for connection to and use of the transmission system.

However, these signals will only lead to overall efficient operation and development of the electricity system if certain other conditions are fulfilled. In the first place, it is essential that there be adequate harmonisation of transmission charging arrangements. Secondly, any locational signals must be applied uniformly to all generators and loads and should not be in conflict with other policy measures.

Other factors which affect decisions on the siting of generation and load include fuel transport costs, availability of cooling water for thermal power plants, tax incentives, environmental regulations and planning restrictions. At the national level, these factors will often be decisive, rather than any locational factors arising from measures related to efficient operation of the system.

EURELECTRIC is in favour of applying locational signals at multi-regional level (i.e. affecting multiple TSO areas). However, the application at national level is not always essential, and depends on the extent to which there is a non-uniform distribution of generation and load and whether or not there are public service obligations on the uniformity of prices.

EURELECTRIC supports the development of market-based mechanisms for congestion management, as these give some form of locational signals at specific cross-border links, both short-term and long-term (if the congestion persists). In addition to these particular locational signals, more sophisticated locational signals schemes should be discussed provided that progress on the harmonisation of tariff structures is achieved. Indeed, EURELECTRIC believes that harmonisation of transmission tariffs represents the key priority.

2004 inter-TSO compensation mechanism

The last European Electricity Regulatory Forum (9th meeting, October 2002) constituted a step forward in relation to the mechanism of inter-TSO payments. The current 2003 temporary mechanism, put in place by the TSOs, represents an improvement in terms of simplification for access to networks. Nevertheless, EURELECTRIC would like to underline that the discussions in the Regulatory Forum should no longer put the sole focus on the inter-TSO compensation mechanism.

Once the draft Regulation on conditions for access to the network for cross-border exchanges in electricity enters into force, the next inter-TSO compensation mechanism will be based on the principles of that Regulation and adopted by "comitology procedure". **The European Commission made clear at the last Regulatory Forum that the adoption of the draft Regulation on cross-border exchanges "must include full involvement of all stakeholders" and therefore continuous consultation with all industry stakeholders must be ensured.**

In that context, EURELECTRIC would like to insist on the following principles, which should be taken into account during discussions on the 2004 compensation mechanism:

- ***Export fee*: complete and unconditional abolition of the export fee must be ensured for participating countries**

- *Transparency and exchanges of information*: the experience gained from the last two years shows that there has been insufficient information on both the operation and economic effect of the compensation mechanism 2002 and on the current 2003 mechanism.

  Providing this information along with the definition of the shared network used as a basis for compensation would allow EURELECTRIC to understand about the real cost of cross-border trading and could only improve market efficiency and the network utilisation.

4. CONCLUSIONS

In order to facilitate the development of cross-border trade across the European Union, EURELECTRIC takes the view that priority should be given to the question of harmonisation of tariff structures, leaving to a later stage the development of a co-ordinated approach to congestion management and the decision as to whether additional locational signals are necessary for the IEM.

In EURELECTRIC's view, the proposals currently under elaboration by the Commission should be based on the principles developed throughout this paper, which are as follows:

- transmission charges for generators: G charges need to be harmonised and, in order to ensure the existence of a real level playing field in the IEM, the best option is G=0. This harmonisation is also an absolute pre-requisite for an efficient application of any locational signals.
- congestion management: there should be systematic use of market-based mechanisms on all EU interconnectors. Market operators must also be compensated for any curtailment of allocated capacity and TSOs must ensure that the maximum capacity of interconnections, compatible with security standards and according to the "use it or lose it principle", is made available.
- locational signals: there are a number of factors which influence the siting of plants. Among them, signals deriving from congestion management provide at present some form of locational signals. However, more sophisticated locational signals at multi-regional level could be envisaged, once harmonisation of tariffs is achieved.
- 2004 inter-TSO compensation mechanism: this mechanism must unconditionally be exempt from any export fee, and transparency of information on the functioning of the mechanism should be further developed.

EURELECTRIC also wishes to underline the importance, once the Regulation is in place, of maintaining and developing a continuous consultation between the European Commission and the industry stakeholders on all cross-border issues. In this respect, EURELECTRIC wishes to reiterate its intention to remain an active contributor in all related discussions.