

Conclusions
Sixth meeting of the European Electricity Regulatory Forum,
Florence, 9./10. November 2000

Introductory remarks

1. The objective of the Florence process is to contribute to the creation of a true internal European electricity market without obstacles to cross-border trade. All participants of the Forum, i.e. the European Commission, the representative of the French Presidency, a representative of the European Parliament, Member States, national regulatory authorities, transmission system operators as well as producers, consumers, traders, power exchanges and other market actors, shared this goal. The need to make progress in this respect was accentuated by the European Council in March 2000 which requested to accelerate the process of opening of the internal energy market.
2. With reference to the call of the European Council, the Director General for Energy and Transport of the European Commission gave an overview of the considerations that will lead the Commission when making concrete proposals aimed at the completion of the internal energy market:
 - It must be ensured that efficient cross-border trade in electricity, currently still underdeveloped compared to other sectors of the economy, increases. The aim of the Commission is not a juxtaposition of 15 liberalised market but the creation of a real internal European electricity market.
 - In terms of level of market opening, the Commission considers that completion of the internal market means that within an appropriate period all consumers in all Member States must be free to choose their supplier.
 - In order to ensure that market opening provided for in legislation develops into real and effective competition in practice, it is necessary to ensure fair and non-discriminatory access to the network. This is largely facilitated if the commercial interests of grid-operators on the one hand and producers on the other hand are separated in a truly effective way. In addition, effective regulation by competent and independent regulatory authorities must be ensured in all Member States.
 - High standards of public service, notably universal service, must be maintained and improved.
 - In order to promote the development of cross-border trade, appropriate mechanisms for cross-border tariffication and congestion management have to be in place. In this respect the Florence Forum has produced significant results so far. In the context of an acceleration of the completion of the internal market, it seems appropriate to incorporate and, where necessary, complete the results obtained so far in Community legislation. It is considered necessary to develop a regulatory instrument which will allow formal decisions to be adopted on issues such as cross-border tariffication. Any such mechanism must ensure the permanent involvement of national regulators/Member States.

3. The representative of the European Parliament declared that any new proposal from the European Commission on further liberalisation should be guided by the objective to maximise consumer benefits. Though the creation of the right conditions to ensure fair competition are important, fundamental issues such as the environment, renewables, co-generation, energy efficiency and energy saving must be taken into account, issues which are of particular importance in the light of the Kyoto commitments and which should be part of the next session of Florence.

I Cross border tarification mechanism

1. At the fifth meeting of the Florence Forum in March 2000 it was agreed to introduce a tariff system for cross-border trade in electricity, in a first step on a provisional basis and - after refinement - on a definitive basis one year later. The Forum referred to the conclusions of the Forum of March 2000; the representatives of the German government and the Belgian regulator stressed in particular paragraph 5 of these conclusions.

With regard to the provisional mechanism it was agreed at the Forum in March, and respectively at subsequent working group meetings, that:

- Operators of the national transmission systems (TSOs) would compensate each other for the costs incurred due to the hosting of transit flows of electricity on their network.
- The dimension of the compensation fund would be – for the provisional one-year period - € 200 million, proposed by ETSO, on the basis of the available information provided by national TSOs.
- The methodology developed and proposed by ETSO to measure exports and transits would be used, in order to define the amount of compensations and contributions to be made by TSOs under the provisional system.

As regards the way in which national TSOs reflect the compensations and contributions in their national tariff system, it was agreed to leave this issue during the provisional one-year period to the discretion of the Member States (subsidiarity). However, the conclusions of the last Forum stipulated in this respect that Member States would forward the intended national mechanisms to the Commission, as they "*remain subject to overall co-ordination and control by the European Commission to ensure that the potentially different approaches at Member State level do not result in distortion of the IEM.*"

The necessity to avoid distortions of the market under the provisional system was stressed by the Energy Council in May 2000.

2. The Commission explained its conclusion that, on the basis of the information received from all national regulators/competent authorities concerned on their

intended approach, it is not possible to accept “*that the potentially different approaches at Member State level do not result in distortion of the IEM*”. In fact, different groups of Member States exist, falling into two broad categories: one group intends to charge exporters with the costs whereas the second intends to opt for a system of repartition of costs and revenues over all users of the network. The Commission has concluded that under such circumstances it an introduction of the provisional system would be likely to lead to an unacceptable degree of discrimination between operators and distortions of trade:

- Certain neighbouring countries would apply different systems. For example, for a delivery of electricity to a customer by a generator in country A, which applies an export charge, a potential supplier from country B would be handicapped compared to a supplier in country C if - contrary to the latter - he or she would have to pay an « *export charge* ». The supplier in country C for its part would benefit from the socialisation of costs and revenues among all operators using the network.
- The level of the export charges envisaged – around € 2 per MWh – is considered by the Commission to be too high, which accentuates potential trade distortions. First, it would lead in many cases to considerably higher transaction costs than under current national tariff systems.

The representatives of large industrial consumers, traders, local distributors, a number of Member States, a number of national regulators and the representative of the European Parliament have re-emphasised at the meeting their serious concerns with respect to the concept and the level of the intended export charge. The representative of the European Parliament asked why transmission costs are so high in several Member States and asked for benchmarking in order to make costs and prices more transparent for the broader public.

The Commission stressed the need to ensure that already the provisional mechanism, though being temporary, needs to be based on principles that ensure a proper functioning of the internal market and does not contain elements which constitute a barrier to trade.

3. On the other hand, all participants of the meeting stressed the importance to put the provisional system in place as soon as possible, in order to gain experience and to achieve an abolition of existing tariffs, also leading to as a simplification of the tariff structures. In order to make rapid progress on the interim mechanism, the Commission invited those Member States envisaging the introduction of an export charge to examine whether the proposed level of the charge could be eliminated or significantly reduced, in order to limit possible distortions of trade and competition.

With regard to the concerns expressed by the Commission the German government suggested a balanced split between exporting generators and consumers in order to facilitate the speedy implementation of the interim system based on a harmonised approach.

4. The Commission will undertake further discussions with individual regulators/national authorities in order to resolve this issue expeditiously with the objective of allowing the introduction of the provisional system at the latest in the

first quarter of 2001. It will on a regular basis inform Member States and regulators on the results and, where appropriate, convene a meeting of the Florence working group “tarification”.

5. The participants welcomed the work undertaken by ETSO during the previous months in preparing the implementation of the temporary system, which would enable the system to enter into force rapidly once these final issues are resolved. It requests ETSO to provide the outstanding information with respect to the conclusions of the previous meeting of March 2000 by 15 December 2000.
6. The Forum stressed the need to make rapid progress in developing a definitive tariffication system. It welcomed the intention of the CEER to present a proposal at the beginning of next year. It was agreed that this definitive system (which may include the valuation and methodology of inter-TSO payments and methods implemented to finance/dispose of such sums) must be non-transaction-based and rely on the principles of cost-reflectiveness, non-discrimination, transparency and simplicity. It will therefore need to ensure that TSOs are properly compensated for the additional costs they incur as a result of hosting transits and will need to provide appropriate locational signals. Furthermore, under the definitive system significant progress will need to be made on harmonising the national charges on generation (“G”) and consumption (“L”). The work undertaken by the CEER and the Commission was welcomed in this respect.

II Infrastructure development

1. The availability of sufficient infrastructure was noted as an important element in the creation of a truly internal electricity market on which all Member States are given equal opportunities to profit from the benefits of an integrated European electricity market. The Forum participants agreed that interconnection capacity, if allocated in a fair and transparent way, can play an important role in avoiding undue problems of abuse of market power on the internal market.
2. The absence of sufficient interconnection capacity in some constrained areas in the European Union was noted as potentially problematic for the development of fair competition.
3. The Forum participants welcomed the intention of the European Commission to present an infrastructure plan to highlight the improvements to be made in the current network and to determine which interconnections of European interest are required in the long term. Existing EU funds should be used to help implement the infrastructure plan, which should be linked to national priorities. Special consideration shall be given in this context to the integration of peripheral countries into the single European electricity market.

III Guidelines on congestion management

General rules for congestion management

1. With regard to confidentiality and non-discrimination issues, it was reiterated that the TSO of a vertically integrated electricity company must protect its managerial

independence and the confidentiality of sensitive business information in accordance with the unbundling provisions contained in Directive 96/92/EC. This is an absolute minimum requirement to be guaranteed by Member States, under control of the national regulatory authority

2. The congestion management method(s) implemented should deal with short-run congestion in an economically efficient manner whilst simultaneously providing signals or incentives for efficient network and generation investment in the right locations.
3. In order to minimise the negative impact of congestion on trade, the current network should be used at the maximum capacity that complies with the safety standards of secure network operation.
4. The TSOs should provide non-discriminatory and transparent standards, which describe which congestion management methods they will apply under which circumstances. These standards, together with the security standards, should be described in open and publicly available documents.
5. Discrimination between the different types of cross-border transactions, whether they are physical bilateral contracts or bids into foreign organised markets, should be kept to a minimum when designing the rules of specific methods for congestion management. The method for allocating scarce transmission capacity must be transparent. Any differences in how transactions are treated must be shown not to distort or hinder the development of competition.
6. Price signals that result from congestion management systems should be directional.
7. Every effort should be made to net the capacity requirements of any power flows in opposite direction over the congested tie line in order to use the congested tie line to its maximum capacity. In any adopted congestion management scheme, transactions that relieve the congestion should never be denied.
8. Any unused capacity must become available to other agents (the *use-it-or-lose-it* principle). This may be implemented by devising notification procedures.
9. Congestion rents may be used for redispatching or counter trading in order to comply with the firmness of the capacity that was allocated to market parties. In principle, any remaining rents should be spent on network investments for relieving the congestion or on reducing the total network tariff. TSOs may manage these funds, but should not represent extra income to the TSOs, as this would give them a perverse incentive by rewarding them for congestion.
10. TSOs should offer transmission capacity to the market as 'firm' as possible. A reasonable fraction of the capacity may be offered to the market under condition of decreased firmness, but at all times the exact conditions for transport over cross-border lines should be made known to any market party that applies for the capacity.
11. Considering the fact that the European continental network is a highly meshed network and that the use of interconnection lines has an effect on the power flows on at least two sides of a political border, it should be ensured that no congestion management procedure with significant effects on power flows in other networks,

be devised unilaterally. At least, co-ordination of congestion management procedures on both sides of an interconnection line should be ensured.

Position of long term contracts

12. A way should be found to deal with existing transport commitments. Priority access rights to an interconnection capacity can not be assigned to those contracts for which violate Articles 81 and 82 of the EC Treaty.
13. Existing long-term contracts shall have no pre-emption rights when they come up for renewal.
14. Solutions for long-term contracts in which the transmission capacity taken can be freed up and made available to the market are preferable (e.g. by transforming the physical transmission right into a financial transmission right).
15. If this is not possible, long-term transmission commitments should be treated in the same way as other contracts. It should be avoided that stranded costs and long term contracts hamper the development of the internal electricity market.

Provision of information

16. The TSOs should implement appropriate co-ordination and information exchange mechanisms. These are essential for providing fair and secure access to the networks within the EU internal electricity market. The progress realised by ETSO in this respect was welcomed by all the participants of the Forum
17. The TSOs should publish all relevant data concerning the cross-border total transfer capacities. In addition to the winter and summer ATC values, which ETSO currently publishes, estimates of transfer capacity for each day should be published by the TSOs at several time intervals before the day of transport. At least accurate week-ahead estimates should be made available to the market and the TSOs should also endeavour to provide month-ahead information. A description of the firmness of the data should be included.
18. The TSOs should publish a general scheme for calculation of the total transfer capacity and the transmission reliability margin based upon the electrical and physical realities of the network (total transfer capacities should not be net of contracted flows). Such a scheme should be subject to approval by the regulators of the involved member states. The safety standards, the operational and planning standards should form an integral part of the information TSOs should publish in open and public documents. ETSO was asked to ensure that these data would be published by TSOs no later than by March 2001.

Preferred methods for congestion management

19. Network congestion problems should be addressed with market based solutions. More specifically, congestion management solutions are preferred which give appropriate price signals to the market parties and the TSOs involved.
20. Network congestion problems should preferentially be solved with non-transaction based methods, i.e. methods that do not involve a selection between the contracts of individual market parties. Market splitting meets this requirement. However it is considered a method too difficult to implement in the short-term, since it requires

the existence of exchanges or power pool based arrangements on both sides of the interconnection.

21. Examination of the current state of development of the EU internal energy market indicates that, in the short term, the most feasible methods for congestion management seem to be implicit and explicit auctions and cross-border co-ordinated redispatching.
22. Cross-border co-ordinated redispatching or counter trading should be used jointly by the concerned TSOs in those cases where the lack of a systematic congestion pattern and the network topology make it difficult to use auctions. The costs that TSOs incur in counter-trading and redispatching must, however, be at an efficient level.
23. Transaction curtailment, following pre-established priority rules, should be left only for emergency situations where the TSOs must act in an expeditious manner and redispatching is not possible.
24. Whereas it is generally acknowledged that there are imperfections attached to the system of explicit auctioning, imperfections that are difficult to fully counter, and which the method of market splitting might resolve, there is a strong preference among the Forum participants for the immediate exploration of the possible merits of a combination of market splitting for solving 'permanent' congestion and counter trading for solving temporary congestion as a more permanent approach to congestion management.
- 25. Guidelines for explicit auctions**
26. The auction system must be designed in such a way that all available capacity is being offered to the market. This might be done by organising a composite auction in which capacities are auctioned for differing duration and with different characteristics (e.g. with respect to firmness).
27. Total interconnection capacity should be offered in a series of auctions, which, for instance, might be held on a yearly, monthly, weekly, daily and intra-daily basis, according to the needs of the markets involved. Each of these auctions should allocate a prescribed fraction of the net transfer capacity plus any remaining capacity that was not allocated in previous auctions.
28. The explicit auction procedures should be prepared in close collaboration between the national regulatory authority and the TSO concerned and designed in such a way as to allow bidders to participate also in the daily sessions of any organised market (i.e. power exchange) in the countries involved.
29. The power flows in both directions over congested tie lines should in principle be netted in order to maximise the transport capacity in the direction of the congestion. However, the procedure for netting of flows should comply with safe operation of the power system. The TSOs are invited to propose a workable scheme for offering as much capacity to the market as possible.
30. In order to offer as much capacity to the market as possible, the financial risks related to the netting of flows, should be attributed to those parties causing those risks to materialise. This might take the shape of a penalty system for parties that deviate from their notified transports, in order to provide the TSO with the financial

means to guarantee the firmness of auctioned capacity by taking operational measures (e.g. counter trading, redispatching). This does presuppose, however, the publication of fully accurate ATC data by the TSO.

31. Any auction procedure adopted should be capable of sending directional price signals to market participants. Transports in a direction opposite the dominant power flow relieve the congestion and should therefore result in additional transport capacity over the congested tie line.
32. In order not to risk creating or aggravating problems related to any dominant position of market player(s), capping of the amount of capacity that can be bought/possessed/used by any single market player in an auction should be seriously considered by the competent regulatory authorities in the design of an auction mechanisms.
33. To promote the creation of liquid electricity markets, capacity bought at an auction should be freely tradeable before the moment of notification.

Process for implementing congestion management systems

34. Specific arrangements should be decided bilaterally or multilaterally regarding the concrete implementation of the rules that will be developed within the framework of these guidelines.
35. A Working Group on congestion management will be set up shortly, consisting of the Regulators, the European Commission, ETSO, Member States and any other interested market party represented at the Forum. An important task of this Working Group is the examination of the market splitting method, as referred to in paragraphs 20 and 24.
36. The design of specific methods for congestion management for each of the systematic bottlenecks should be reported to this Working Group.

The agenda for 2001

37. The three actions mentioned above – i.e. a permanent system for cross-border trade, harmonisation of G/L and long-term solutions for congestion management – have a strong interrelationship. Sufficient progress on one issue facilitates progress in other actions. Forum participants are aware of this interrelationship and will take this in account in their next session.