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## **ETSO comments on Draft Guidelines on Inter TSO Compensation (1 September 2004)**

ETSO considers that the latest (1 September 2004) draft of the Guidelines is an improvement on the previous draft. As stated before we welcome the proposal to define a global framework for the inter-TSO compensation mechanism. We are also very much in favour to largely keeping the basic principles of 2004 for 2005, to allow time to study further development, after the improvements already made.

### LRAIC

ETSO favours the idea of a more standardised way of costing the horizontal network providing cost-reflectivity is not fully jeopardised. However our main concern is that the use of LRAIC based on replacement values available at this stage, calculated in the absence of a clear and unambiguous definition, will lead to a greatly increased fund with additional burdens placed on the main contributors, without any change to the service provided by the European horizontal network.

Many TSOs consider that the general principles (annuity computation, with 6% nominal interest pre tax, 40 year depreciation period, and operating costs of max 2% of asset replacement value) are unrealistic. There is a concern that regulators would be tempted to apply the same principles to national tariffs, even though there is now a statement to the contrary in the Guidelines. There was also a concern that use of these principles would result in the LRAIC computation underestimating the costs in several cases. The specified ranges of LRAIC values in the previous Guidelines, which have now been removed, reinforced this fear.

Contrary to the perception that LRAIC values would be lower than the presently-used regulated asset values, collection of data from our members shows that the cost of the horizontal network using LRAIC is significantly higher! A partial explanation is that all assets are costed at replacement value, even those which are already partially or entirely written off. Also, unlike the telecommunications sector, which also applies LRAIC, the power sector has not undergone revolutionary technical developments, which simultaneously reduce costs and increase capacity. Stricter environmental considerations have even significantly increased our costs.

The collected replacement costs also differ widely from TSO to TSO. The differences are even greater than those between the regulated costs. Further analysis is needed to explain why the ranges differ so much and to find, together with DG TREN and CEER, a more stringent definition for LRAIC leading to more cost-reflective costs.

#### Transit factor

We note that the transit factor has been modified to be  $\text{Transit} / (\text{Transit} + \text{maximum of national generation or load})$ . As defined this cannot be applied, as measurements of national generation, or load, are not readily available on an hourly basis. The modification introduces a new complication, which could significantly change, but not necessarily improve, the resulting inter-TSO compensation. ETSO is opposed to introducing such a change without further analysis of the consequences.

#### Cross-border flows

In Annex A (2 b and c) it is proposed to use forecasts for cross-border flows for the following year in the calculation. Such forecasts are not possible to compile in a liberalised market environment as flows vary greatly depending on market conditions. Consequently ETSO has used measured values for the preceding 12 months as a "standardized forecast". We trust that this method can continue to be used. For 2005 the period 1 July 2003 – 30 June 2004 is proposed.

#### Loss compensation

The proposed method for loss compensation (total annual losses on the horizontal network multiplied by the market-based average yearly price for energy) is in line with that being discussed in ETSO.

However it is not altogether clear how the market-based price should be defined. It may be difficult to define a single European market price and ETSO has therefore considered the use of regional market prices based on power-exchange prices for futures. However, it may be necessary to have an alternative method for some countries (e.g. Italy, Greece, Hungary, Slovakia) that neither belong to a regional market, nor have a well-established liquid power exchange.

For loss compensation the Guidelines specify also that the transit factor should be maximized to 15%. ETSO does not understand the reason for this and would appreciate to know the basis for such a value. (In the present ETSO mechanism for 2004 the total cost for losses is capped at 15 % of the total cost of the horizontal network assets. This was introduced solely to limit the total size of the fund, and is nothing ETSO recommends for future use.)

#### Procedure

ETSO finds the procedure and timetable defined in the Guidelines a little unclear. It is proposed that the LRAIC values should be submitted by Regulators, but Annex A specifies (point 2a) that ETSO shall submit this data to the Commission in November on a MS per MS basis. Clarification is required before the process can be started.

### Perimeter countries

As regards perimeter countries two possible alternative treatments are described:

- an injection fee of 1 €/MWh on declared imports, with a new exception, apparently to solve the problem of the Russian complaints (no injection fee for months where an edge country imports both from a perimeter country and from the ETSO area for more than 90% of the hours).
- participation in the mechanism for countries (e.g. Switzerland or the SEE countries), where TPA is effectively implemented, subject to a bilateral agreement with ETSO.

As regards the proposed exception for the injection fee from perimeter countries, it is important to note that perimeter flows are already treated more favourably than internal cross-border flows in the ETSO system. This can be motivated by the fact that perimeter countries do not receive compensation for transit. However the proposed treatment would further emphasise this preferential treatment.

ETSO would also prefer there to be a possibility for a third treatment for the SEE countries. Since July 2004 most of these countries (Romania, Bulgaria, Albania, Serbia, Bosnia-Herzegovina, and FYROM) operate a parallel transit compensation scheme based on ETSO's model. Croatia and Montenegro are expected to join in October, when the reconnection of the two parts of the European network is planned. ETSO and the SEE countries have been considering the introduction of a special interface solution between the two mechanisms. Such a solution would be a compromise between the two treatments defined in the Guidelines. However, as it is difficult to estimate the flow situation after reconnection, it may not be possible to define and gain acceptance for a solution, which can be operable from 1 January 2005.

### Confidentiality of information

The Guidelines call for the provision of confidential data to the Commission (e.g. information on horizontal network assets). In this context it is important that such information be treated as confidential and therefore ETSO would appreciate the addition of a confidentiality statement in the Guidelines.

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### **Summary**

The latest (1 September 2004) draft of the Guidelines is an improvement on the previous draft but clarification is needed on several basic definitions, principles and formulae before the system can be practically implemented so as to avoid misunderstanding by the concerned parties (regulators, market parties and TSOs). ETSO is more than willing to continue working with the Commission on these elements given the short time remaining before 1<sup>st</sup> January 2005.