

Mr. Alejo Vidal-Quadras
European Parliament
Rapporteur draft Electricity Regulation

(Copies to government officials involved in the Council Energy Working Group)

October 2008

EFET proposals for the draft Electricity Regulation

Dear Sir,

The European Federation of Energy Traders - EFET welcomed the 3rd Energy Package but expressed some serious reservations. Now that we have studied the European Parliament amendments to the proposed Electricity Directive and Regulation, and had a series of discussions with the respective Rapporteurs, we consider that a series of improvements are still possible.

EFET, representing a large majority of those companies active in trading energy instruments in Europe, are interested in helping to achieve the reform, so that the European Parliament and Council can ensure that the new EU internal energy market (IEM) legislation is relevant and effective.

In our positions expressed at an earlier stage, EFET listed several priorities:

- Proper definition of firm transmission rights;
- Wider information exchange between TSOs, so as to improve their calculation and allocation of cross border transmission rights;
- Facilitating secondary markets in transmission rights;
- Eliminating national TSO and regulatory discrimination in favour of internal transmission access;
- Setting a hierarchy of purposes for efficient spending of cross border auction revenues, which recognises the role of operational measures to maximise allocation of cross border transmission rights and guarantee their firmness once granted;
- Mandating regulatory incentives to maximise availability of cross border capacity and improve its firmness.

We would like to bring to your attention two specific issues, when which we are currently working on for the Florence Forum and had highlighted in our conversations: the use of revenues resulting from the allocation of interconnection capacity, and TSO incentives to maximise the cross border capacity they allocate to the market.

In our opinion, the existing language of the main part of the Regulation and of the Congestion Management Guidelines should be made clearer, if we all want to move TSOs and Regulators faster towards an electricity wholesale market in Europe without national barriers.

1. Use of revenues resulting from the allocation of interconnection capacity

All additional costs of measures to increase cross-border capacity availability, which lead to lower congestion costs, should be considered by TSOs. Those measures could include redispatch, changes in planned maintenance and counter-trading.

Inefficiencies arising from a failure to implement such measures ultimately lead to higher price differences between the markets and thus to a lower market integration level and lower socio economic benefits. Congestion management income of TSOs from capacity auctions ought to not primarily be used for reducing grid charges to national consumers, but rather for the following purposes in strict priority order:

1. Guaranteeing the firmness and/or availability of the capacity (including compensation at market prices for any buy-back or curtailment);
2. Maximising the capacity given to the market, through innovative ways of managing the system, through other operational measures mentioned above (and over longer maturities i.e. transmission rights sold one year or more in advance, TSOs could offer more contractual capacity to the market than the occasional minimum forecast to be physically available);
3. Increasing the availability of cross border capacity by means of physical network investments; and
4. Reimburse national grid users part of their point of load fees (but only when all other options have been exhausted).

The Commission proposal covers availability, or firmness of capacity and investment needs, but omits expenditure to maximise allocations.

For these reasons, we insist on the necessity to amend the **Article 2h “Regional cooperation of transmission system operators”** as follows:

“(5) In Article 6, paragraph 6 is replaced by the following:

“6. Any revenues resulting from the allocation of interconnection capacity shall be used for the following purposes in the order of priority:

- a) Guaranteeing the actual availability of the allocated capacity (i.e. via redispatch);
- b) Financial compensation of transmission capacity holders at market spreads if curtailment of physical delivery was necessary;
- c) Allowing TSOs to keep a part of the long term capacity payment as an appropriate incentive to secure that TSO auction the maximum expected transmission capacity already in the longer term and facilitate a secondary market;
- d) Operational, dispatch related or counter-trading measures utilised by TSOs, after obtaining any necessary regulatory approval, therefore, to facilitate the fulfillment of the duty under Article...to maximize allocations to market participants considered on a regional scale, over varying maturities and at day ahead, of cross border capacity;
- e) Network investments maintaining or increasing interconnection capacities;

If the revenue cannot be used for the purposes set out in points (a), (b) or (c) of the first subparagraph, the revenue shall be placed on a separate account until such time as it can be spent on those purposes.”

2. TSOs incentives to maximise the cross border capacity they allocate to the market

EFET believes that TSOs should be offering to market participants the maximum practicably attainable amount of cross border capacity, separately estimated for each trading day and hour of the year on a fully financially firm basis. TSO should make sure that the allocated cross border capacity is then tradable in secondary markets, in the form of transmission capacity rights. These duties are already quite clearly set out in the EU Regulation 1228/2003, but they are not being honoured by most TSOs nor enforced by most energy regulators.

Therefore TSOs must be given incentives to maximise the cross border capacity they allocate to the market. This means rewarding TSOs if they manage to maximise capacity provision and potentially penalising them if they do not¹. Otherwise the congestion management income from auctions will not be used as efficiently as it could be, ultimately leading to less capacity being made available to the market and less competition². Robust incentives based regulation becomes vital for achieving capacity maximisation and firmness.

We suggest the following wording to be inserted in the **Article 9 “Guidelines”**:

At Article 9, the following paragraphs 2 and 3 are added:

(2) In pursuit of their duty to enforce the provisions of this Regulation, the regulatory authorities shall determine and implement appropriate financial incentives on a regional basis for TSOs to optimise the management of the interconnected European high voltage grid, in keeping with their various duties described in this Regulation. In particular, the regulatory authorities shall provide on a regional basis to TSOs monetary incentives, determined on a sliding scale according to fulfilment, which may include the following:

- Success in agreeing a common transmission product across Europe which is an effective hedge for the difference between to regional markets;
- Success in maximising the allocation of transmission capacity at borders between Member States on a regional basis in pursuit of paragraph (3) of Article 6;
- Success in improving the firmness allocated capacity in both contractual and physical

¹ **Ensuring that TSOs face appropriate regulatory incentives:** When choosing between curtailing cross border capacity or managing congestion by other means, TSOs should not enjoy a free option to curtail cross border capacity at the potential expense of foreign market entrants, only so that domestic generators can run their plant. The management of overall continental European constraints in such a manner comes at a significant cost to wholesale market participants trying to compete across national boundaries. According to DG Competition figures, congestion management income was more than €1 billion from 2001-2005 alone. These revenues are furthermore likely to escalate significantly from 2006 onwards, given the new or expanded capacity auctions being introduced on many borders

² **Ensuring that effective incentives based regulation of TSO services and charges can be developed for the entire internal power market,** not just within national boundaries. When price signals are available to TSOs, the TSOs will be aided in their judgments as to where congestions should be declared, whether or not to build new transmission lines and when and how to re-dispatch generating plant or counter-trade to reduce congestion. *It is indeed hard to see how EU national regulators collectively could discharge their obligation under Regulation 2003/1228 to enforce maximized availability of cross border capacity and firmness of allocation, if they do not formulate related incentives for TSOs to improve their performance in these respects.*

- terms, in pursuit of paragraph (2) of Article 2h (?);
- Success in eliminating discrepancies between the calculations and methodologies used to determine which transactions within a national transmission system, and which transactions spanning two or more national transmission systems, may be scheduled, in the event of a bottleneck occurring at any given point on the interconnected high voltage grid, in pursuit of ...the Annex (?);
 - Facilitation of trading in secondary markets of previously allocated transmission rights, for example by creating an efficient electronic registry and minimising any administrative obstacles;
 - The optimisation of methods to calculate available transmission capacity, harmonisation of auction rules and auction design, and transmission right transfer processes, which, when taken together, demonstrably promote competition across borders in the internal electricity market and facilitate access by suppliers based in one country to customers in another;
 - Investments in transmission infrastructure with the purpose to increase cross-border capacity.

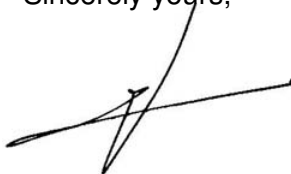
(3) Notwithstanding the specific uses of revenues resulting from the allocation of interconnection capacity permitted by, and set out in, paragraph 6 of Article 6, the regulatory authorities shall have the power to set aside a portion of the revenue earned by any particular TSO in any auction sanctioned by the regulatory authorities, for the purpose of rewarding behaviour and accomplishments fulfilling the incentive criteria mentioned in paragraph [(x)] “.

EFET is **still advocating transparency improvements** too, but following the CESR-EREGG Consultation, on the CESR and ERGEG advice to the European Commission in the context of the Third Energy Package (Draft Response to Question F.20, Market Abuse) it is crucial that new transparency improvements are considered in the context of any new arrangements for market abuse.

We realise the complexity of the legislative process and the political priorities in ensuring the passage of the 3rd Energy Package as a whole. We believe the rather basic amendments to the text of the Regulation we suggest are necessary, however, in order for the amended Regulation to achieve a tangible and fast improvement in the functioning of the internal electricity market.

In order better to explain our concerns and our suggestions for amendments, we would welcome a further meeting with you. We shall also be approaching key officials in Member State governments to discuss the need for the amendments.

Sincerely yours,



J.N.H. van Aken
Secretary General
EFET

cc [MS officials]