



Communications from the Commission to the European Council and the European Parliament on the EC Strategic Energy Review

ETSO Response

16 March 2007

1. Introduction

1.1 ETSO welcomes the opportunity to give its view on the European Commission's strategic energy review (SER) announced on 10 January 2007 and its focus on sustainability, security of supply and competitiveness. At a time when some €73 billion¹ of energy infrastructure investment is required in the EU by 2013, creating a positive investment climate for this infrastructure (much of which will be regulated) is vital. Electricity TSOs will have a central role in this investment, either by reinforcing and developing their networks to meet reliability and market needs for a reliable and secure competitive market, or by facilitating new generation investment to connect to their networks. ETSO's initial response to the SER is made against the backdrop of this investment requirement. Given the raft of documents underlying the SER, ETSO has focussed its comments on those documents of most direct interest to TSOs, namely 'An Energy Policy for Europe', 'Prospects for the internal gas and electricity markets' and the 'Priority Interconnection Plan'.

1.2 ETSO's comments are grouped under the following headings:

- A Single European Grid
- Investment
- Unbundling
- The Governance Framework for ETSO+ and ERGEG+
- Transparency

2. A Single European Grid

2.1 There are many examples of good TSO co-operation, be these through the development of interconnectors and the joining together of market areas (the Trilateral Coupling of the French, Belgium and Dutch markets, the establishment of Nordel priority interconnection projects, the development of new interconnectors such as several 400 kV lines, and DC cables such as Norned, Britned and Germany/Netherlands, and congestion management initiatives such as the Central European Auction Office) or through the creation of the Operational Handbook in the UCTE area. But ETSO would agree that there is a need for ongoing improvement of cooperation between TSOs on European level issues. However, this needs to be matched in parallel by better cooperation between national regulators.

¹ As identified in the Priority Interconnection Plan COM(2006)846 page 5, consisting of €49bn for electricity transmission (including €6bn outlined in the TEN-E Guidelines), €19bn for gas pipelines and €5bn for LNG terminals.

- 2.2 The UCTE report on the 4th November 2006 system disturbance sets out a number of improvement areas in the UCTE control bloc, but ETSO would agree with the EC that we should now focus on developing an EU level 'Grid Code' which clarifies what rules need to exist where systems or control areas interconnect (for more detail see section 5 below). ETSO had been discussing the development of such a code with the EC toward the end of 2006 and would welcome the opportunity to re-open these debates under the auspices of the SER. Clearly this work could also be seen as a key future responsibility of ETSO+, an organisation which we address later in this response.
- 2.3 An important aspect of a European Grid Code will be to focus this code at the right level. The focus should be functional reliability at the cross control bloc level and how these EU level rules interact with the regional 'codes' already in place (e.g. in the British Isles, UCTE, Nordel, Baltic States). The detail of what happens within control blocs should remain at the regional level but there will be a need to review these regional rules for compatibility with the EU level rules. Another important aspect will be for the EU level rules (and regional rules) to apply to all network users (i.e. generators and distribution networks as well as TSOs) and for the EU level technical rules to align with EU level access rules.
- 2.4 ETSO intends to set up a small team from across its regional sister organisations to take this work forward and will engage with the EC at an early stage to share its thinking on developing an EU level Grid Code.

3. Investment

- 3.1 As mentioned above the need for increased investment in electricity infrastructure across the EU is a central theme of the SER. A prerequisite is a positive and stable climate for investments set by the regulators. The Priority Interconnection Plan (PIP) is perhaps the main document dealing with investment. As ETSO has made clear before in its papers on Cross Border Network investment², two main issues frustrate increased interconnectivity across the EU.
- 3.2 The first is the ever increasing difficulty to obtain planning permits for both cross border and within member state infrastructure. The second is the so called 'regulatory gap' where there is currently no requirement for member state regulators to consider issues outside their member state border. The result is the absence of a favourable cross border legal and regulatory framework to encourage cross border investment and to ensure its financing. ETSO welcomes the fact that both these points are recognised in the PIP paper and elsewhere in the SER documents. We comment further later in this response, on the need for regulators' duties to be changed to include an obligation to promote the development of the EU market, but we cannot stress enough the urgent need to adopt across the EU, the acceleration proposals for permitting.

² Cross-border Network Investment Paper

<http://www.etso-net.org/upload/documents/cross-border%20network%20investment%20paper.pdf>

Procedures for building 110kV to 400kV lines

<http://www.etso-net.org/upload/documents/procedures%20400%20kv%20lines.pdf>

- 3.3 Despite the problems with permitting, significant investment has been planned by TSOs. The problem is not one of a lack of willingness to invest rather the problem is one of gaining siting permits for investments. The Regional Initiatives may offer potential to bring some of this investment forward and to progress greater TSO co-operation beyond that which exists today.

4. Unbundling

- 4.1 The SER puts forward two options for further unbundling of networks:
- full TSO ownership unbundling (which already exists in around half the countries in the EU and EEA);
 - an Independent System Operator (ISO) where ownership can remain with another party but some other aspects of the network function sit with the ISO.
- 4.2 In looking at these options ETSO believes it is important to differentiate between electricity and gas transmission and between transmission and distribution in dealing with this question. Therefore ETSO's views relate entirely to electricity transmission.
- 4.3 Clearly there will be a need for subsidiarity on this issue as whilst half the EU and EEA countries have ownership unbundling, the other half have different methods of transmission separation in line with the IEM Directives. ETSO believes that the perception of TSO independence is one key issue to address. Ownership unbundling is one successful possibility to address this issue and many ETSO members are ownership unbundled. However, ETSO believes other options are available to address the perception of independence issue, other than just the specific ISO model proposed by the EC

This ISO model has many drawbacks as can be seen from experience in the USA, where in respect of transmission networks, it has not fostered innovation, nor investment, nor enhanced efficiency. It also requires quite intrusive regulatory oversight for both system operator and asset owner. We would also point out that Italy and Hungary have recently moved away from the ISO model and adopted a TSO model.

As an appropriate alternative to the ownership unbundling to address the perception issue with regard to independence, a strengthened regulation or control of conduct (e.g. with clear rules to ensure full independence of the TSOs top management) to ensure demonstrable separation of generation and supply from transmission even beyond that which exists today will bring comparable successful results.

- 4.4 Whatever the outcome in this area, the EC should ensure that those countries in which the perception of independence is no controversial issue (by whatever means this has been achieved) should not have to take a backward step. It is also important to note that unbundling of itself will not solve many of the issues identified in the SER (e.g. greater cross border investment and greater cross border co-operation). The resolution of these issues also lies in the development of binding regional co-operation among TSOs and other entities, such as power exchanges. These binding regional co-operation, implemented for example through regional services (auction offices, market

coupling...)should be backed by regulatory regimes to address the 'regulatory gap' (see section 3 above) and in the development of the regulatory governance framework (see section 5 below).

- 4.5 Perception of market dysfunction may also derive from other design imperfections, and, while the trust in TSO independence is clearly an issue, other aspects should not be underestimated. One might be the regional market power of some big incumbents. Another one is the defence of supposed 'national interests' by a combined action of national regulatory authorities, state agencies and state owned companies, that may result in market distortion, whatever the means of unbundling the TSO..

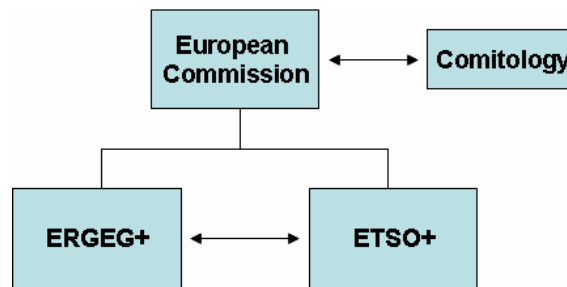
5. The Regulatory Governance Framework

- 5.1 In this section we consider the proposals for developing the roles and responsibilities of European regulators and European TSOs which are set out in the SER documents.
- 5.2 Starting with the Regulators, ETSO agrees with the EC that there is a need for greater consistency across the EU regulators in terms of their responsibilities. The most important of these at an EU level is the regulatory gap issue mentioned above. It is vital that any issues determined at EU level link straight through to the national level such that, among other things, the financial impact on TSOs is recognised in national transmission revenues. A good example here is the cooperation concerning the ITC mechanism which is currently based on a broad consensus between European TSOs and implemented in the form of a voluntary agreement. Once an overall legally binding scheme is adopted via Comitology or whatever other legislative measure may arise from the SER, national regulators are obliged to allow the financial consequences of this scheme (be they positive or negative) to flow into national transmission revenues.
- 5.3 Turning to the concepts in the SER documents, ETSO's view is that the developments of both regulatory and TSO organisations need to be examined in parallel. Of the three options considered for Regulators, we would favour the ERGEG+ option but would like to understand better how ERGEG+ decisions would develop into mandatory requirements which must be funded at member state level (e.g. is this via Comitology or new legislation).
- 5.4 In terms of TSO governance, ETSO has long argued for ETSO to be given a formal, institutional role and as such we welcome the SER thinking in this area. We would favour developing the ETSO+ option alongside ERGEG+. We would see ETSO+ focussing on the following areas:
- developing, monitoring and recommending the means to enforce the European 'Grid Code'
 - regular reporting on generation and transmission adequacy (for example via the reports on a short and long term basis already produced by ETSO)³
 - coordinated planning of the pan-European 'horizontal' network, as an input to the Priority Interconnection Plan

³ Generation Adequacy Report 2006
<http://www.etso-net.org/upload/documents/adequacy%20report%202006.pdf>
2006-2007 Winter Outlook Report
http://www.etso-net.org/upload/documents/WOR_2006-07_v2.pdf

- improving real-time system monitoring and TSO operation coordination
- reviewing and developing existing network access conditions
- facilitating the market in developing consistent/harmonised mechanisms
- developing a transparency platform for market data via the evolution of ETSOVista⁴ (see below)
- reporting on cross border investments

5.5 A key issue will be to determine the relationship between ETSO+, ERGEG+ and the EC and we look forward to debating this with the other bodies. The governance formulation we envisage at present is one where ETSO+ would develop proposals (taking into account market actors' views via consultation) and make recommendations to the EC and ERGEG+ such that were these recommendations adopted, it is the responsibility of ERGEG+ to ensure these recommendations make their way into national arrangements where the financial consequences of such decisions can be recovered via national transmission tariffs. This process may or may not involve Comitology depending upon the nature of the issue and/or whatever legislation emerges from the SER. Pictorially this could look as follows.



6. Transparency

6.1 ETSO welcomes the support for greater transparency in the SER. ETSO has already taken a leading role in the transparency debate with the launch in November 2006 of ETSOVista, our public transparency platform available via the ETSO website. Today ETSOVista contains data on operation and capacity allocation on interconnector infrastructure and we intend to develop this further in 2007 to enhance the quality and value of the data close to real time.

6.2 We have offered ETSOVista as a platform on which generators could site their data to provide a complete picture for market players in one place. The challenge is now with the generators to agree what data they are prepared to place in the public domain.

7. Summary

7.1 ETSO welcomes the opportunity to engage with the EC and ERGEG on the future development of the ideas set out in the SER. This paper should be seen as our initial reaction only based on what limited discussion has been possible to date but we hope the EC will incorporate our thoughts into the further analysis which is being undertaken in line with the conclusions of the February 2007 Energy Council.

⁴ www.etsovista.org