

RELEVANT ISSUES FOR A PROPOSAL ON THE IMPROVEMENT OF THE REGULATORY CLIMATE FOR INFRASTRUCTURE INVESTMENTS

A) INTRODUCTION:

The aim of this paper is to elaborate a preliminary identification of some key issues to be taken into account to improve the regulatory climate for investment in infrastructure that could serve as a basis for a possible request of the EC to regulators in the framework of the Commission proposal for the “Energy Infrastructure Initiative”.

B) SUGGESTIONS TO DEVELOP INFRASTRUCTURE INVESTMENTS:

In this proposal issues to incentive infrastructure have not been clearly separated between gas and electricity issues, as most of them are common for both sectors.

1- The development model of the infrastructure system:

Two extreme different system models could be distinguished:

- a) An infrastructure planning system for the network
- b) A complete free infrastructure development system

In the first case, the planning of the network infrastructure is a compulsory task, where lines construction contracts could be assigned by public tenders. One of the main ways to encourage investments is to guarantee an attractive rate of return of installations during their working life, which allows to recover the investment and get a reasonable profitability from the financial resources

invested. The infrastructure planning system could include a settlement mechanism, which should assure the investment recovery and the benefits from all the installations built by the transmission companies under the mandatory planning. Another way is to pre-finance the future investments. These objectives should be obtained by the design of an appropriate fare system.

In the second case, the planning is not a compulsory task and the development of the transmission system is made by each company.

In a complete free infrastructure development system, a long term capacity booking would be the main strategy to assure the future use of installations as well as the costs recovery and to obtain profits.

These two are just the extreme system models. In between, many different systems can be considered, according to national circumstances, etc.

It is also possible to distinguish between two types of infrastructure: domestic or transit network infrastructure.

i. Domestic network infrastructure. This is a natural monopoly activity that should be subject to regulatory arrangements that control the inherent monopoly power. In general, the monopoly model means an compulsory investment plan, a guaranteed remuneration, with a cap, for the transmission operator and a minimum unbundling, taking into account a cost-reflective tariff structure. Network owners must, of course, be able to finance their activities including network development. There will be, under any regulatory arrangement, an interaction between the regulatory framework and the incentives to invest faced by a network monopolist. It is important that regulatory arrangements do not incentive network operator to under (over) invest but to respond dynamically and efficiently to market signals.

In the field of gas transmission, domestic network infrastructure is not an automatic preserve of incumbents TSOs : the directive 98/30/CE permits the competition between gas network operators for the construction and

operation of transmission pipelines. The transit should be considered at the light of the new directive proposal.

ii. Transit network infrastructure. This is not necessarily a monopoly activity. There is, therefore, no reason why this activity should be an automatic preserve of incumbent TSOs. Terms of access and use of interconnectors are, however, crucial for a well functioning internal market. A sound and transparent regulatory framework is therefore necessary also when interconnections are financed and constructed on an entrepreneurial basis.

The model of competition can work with an indicative plan, with a no-guaranteed remuneration and no caps, but requires a more advanced ownership-unbundling between the transport and supply departments and at least a level playing field.

In any of the above mentioned models, issues to be considered in the development of infrastructure are the following:

a) Importance of the tariffs :

A major element concerns the domestic transport and transit tariffs : they must include an equitable profit margin, evaluated by the public authorities (the regulator when it exist) for the return on the capitals invested in the grid system to ensure the optimal development of this one in the long run.

The tariffs must as far as possible optimize the use of the grid system capacity. The real costs must be approved to be taken into account in the tariffs, so it strongly discourages the setting of useless and non-profitable investments. The transport operator will have to ensure that the cost of a given investment could be taken into account in its tariffs.

As far as possible and when that is reasonable, the tariffs will have to aim to reach the best possible use of the already existing investments (for example via advantageous tariffs adjusted seasonally in period of weak use of investment) The tariffs should give incentives which will encourage new "good " investments and will discourage from new "bad " investments.

There are two main ways to get infrastructure investments back : tariffs based on capacity (system usually proposed by transmission operators in order to try to guarantee a reasonable return on investments – but generating over-return and constraints risks) and tariffs based on commodity (interesting for customer, which pays what he has consumed – but generating a commodity risk for the operator). The tariff system must combine the two principles in order to minimize the different kinds of risks, to be effective on the short and long term and to send the right signals to the market.

b) The possibility to define long term contracts and the provision of a use-it –or lose-it principle:

A part of infrastructure capacity could be booked for long term contracts in order to increase the security of investment return and guarantee the benefits for promoters - if a part of infrastructure capacity could be booked for long term contracts, it must be as transparent as possible and there must be no discrimination - The mode of financing new lines and priority rights should be analyzed in detail.

Irrespective of the term of the capacity holding, use-it-or-lose-it provisions should apply, in order to make available the unused capacity to other participants.

c) Secondary capacity markets:

The establishment of secondary capacity markets would increase market flexibility as well as additional capacity in gas and electricity infrastructure. This measure coupled with use-it-or-lose-it arrangements provide a financial incentive to release capacity for sale that would be otherwise unused.

d) Financial incentives:

The fact of promoting activities with financial incentives could be justified when there is an urgent necessity of gas and electricity infrastructure development. Nevertheless, this measure can result in an over investment.

e) Administrative proceedings speeding-up:

A shorter period of time in administrative procedures for the approval of projects would allow to reduce the necessary time to build new infrastructures.

f) Avoiding pancaking (accumulation of tariffs)in borders:

The design of an appropriate cross border tariffication system is essential for the promotion of future infrastructure investment. In this sense, the pancaking effect (the accumulation in tariffs) should be avoided. A cost reflective system should be developed.

Where interconnections are constructed entrepreneurally the ability to recover the full cost of the investment cannot be guaranteed.

g) Definition of a methodology allowing an efficient allocation of the costs of new infrastructures:

An objective, transparent and non-discriminatory methodology should be developed in order to determine how to allocate the costs from international interconnections infrastructures development between all countries that will benefit from these new interconnections. In the electricity case, this methodology should be in tune with the permanent methodology proposal defined for cross border transactions tariffication (CBT).

h) Available capacity transparency:

The knowledge of the available capacity provides with a more precise information on congestions as well as on infrastructure needs.

Furthermore, the TSO would need to be encouraged to make the maximum physical capacity available to market participants and to invest to an efficient level in the right locations. In addition, the relation between interconnections and security of supply issues should be studied.

i) Regulatory stability:

A stable regulatory context, provided with the measures considered above on incentives for efficient investment, would improve the investment climate.

j) Benchmarking of the international interconnection level between countries:

Together with the fact of constructing new interconnections wherever there is a need, assuming market transparency, setting benchmarks could also be used as a tool to enhance the internal market. It could be useful to know, for instance, each country commercial capacity level regarding the international interconnection as well as to value the mentioned capacity in relation to the internal demand.

In this sense, in the electricity case, it could be interesting to define an indicator that measures the internal demand percentage that can be supplied by other countries. For instance, a ratio that represents the maximum commercial capacity available for one year in relation with the maximum demand per hour of that same year could be a good indicator for that kind of measure.

A regulatory framework to encourage investments in infrastructure could have as a reference a minimum indicative value of this ratio in order to achieve a true internal electricity market, encouraging infrastructure investments when needed.

This does not presuppose that each Member State needs an equivalent level of interconnection, as it also depends on their specific circumstances. Nevertheless having this indicator adapted to those circumstances, it could serve as a good reference of the internal market integration.

k) Effective use of the interconnection capacity:

The available interconnection capacity's estimate should be completed with an analysis of the effective use of the mentioned capacity. It would be convenient to ask Member States to provide with transparent information on the available commercial capacity use regarding interconnections, on the congestions produced in borderlines, and on the real limitations to transits for cross border trade.

This analysis would be used to value the international interconnections that are not yet fully developed but are important for the different agents' needs.

l) European institutions that value the necessity to increase interconnections' support:

The design of interconnections should not only be the unilateral decision of any Member State (we have to consider the subsidiarity principle). A European Union mechanism should be put in place to assess the new interconnections needed. Experience to date has shown that some projects on interconnection enlargement have been obstructed by political decisions.

m) Efficient development of infrastructure:

In parallel to interconnections' development, an efficient development of infrastructure is needed.

n) Development planning:

Indicative plans for the development of the network should be elaborated periodically and published, identifying bottle-necks, connections needed, interconnections to be build, ... and make a year-by-year follow-up of this planning.

This task is essential for the security of supply (especially in the gas sector). When transmission is not operated by a monopolist, no individual TSO can be made responsible for the security of supply of the country. Planning is then a responsibility of the public authority.