All TSOs’ proposal for Use of Congestion Income methodology in accordance with Article 19(4) of the Regulation (EU) 2019/943 of the European Parliament and of the Council of 5 June 2019 on the internal market for electricity

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Webinar for stakeholders
15 April 2020
10:00 – 13:00

Agenda

Part 1 (45 min)

- ❑ Foreword
- ❑ Scope
- ❑ Cost categories contributing to priority objectives for Use of Congestion income (chapter 3 of the methodology)

Q/A session on part 1 (30 min)

Part 2 (45 min)

- ❑ Congestion income allocation (chapter 4 of the methodology)
- ❑ Summary

Q/A session on part 2 (30 min)

Wrap-up, next steps and conclution (15 min)

Foreword

The new Regulation 2019/943 of 5 June 2019 on the internal market for electricity

This Electricity Regulation is part of the **Clean energy for all Europeans package.**

It has been subject to extensive negotiations from November 2016 to February 2019.

Those negotiations have involved a wide range of stakeholders.

Negotiations in Trilogues (European Commission, Council of the European Union and European Parliament) were successfully concluded and have lead to the final text.

Negotiations for the new regulation have lead to a balanced text which now needs to be efficiently implemented

The previous Regulation 714/2009 of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity

Regulation 714/2009 included following provisions:

- Article 16(6):
    - Priority uses of CI:
      (a) guaranteeing the actual availability of the allocated capacity; and/or
      (b) maintaining or increasing interconnection capacities through network investments, in particular in new interconnectors.
    - If CI cannot be efficiently used for (a) and/or (b): used for tariff calculation
    - Rest of revenue: separate account line for future use
- Annex 1:
    - 6(4): TSOs shall establish beforehand the use of CI and report on the actual use. NRAs shall verify compliance with Art 16(6)
    - 6(5): by 31 July each year NRAs shall publish a report and verify the use of CI

Use of Congestion Income is already focused on purposes regarding interconnector capacities, according to TSO's common practice

Article 19 of the Regulation (EU) 2019/943

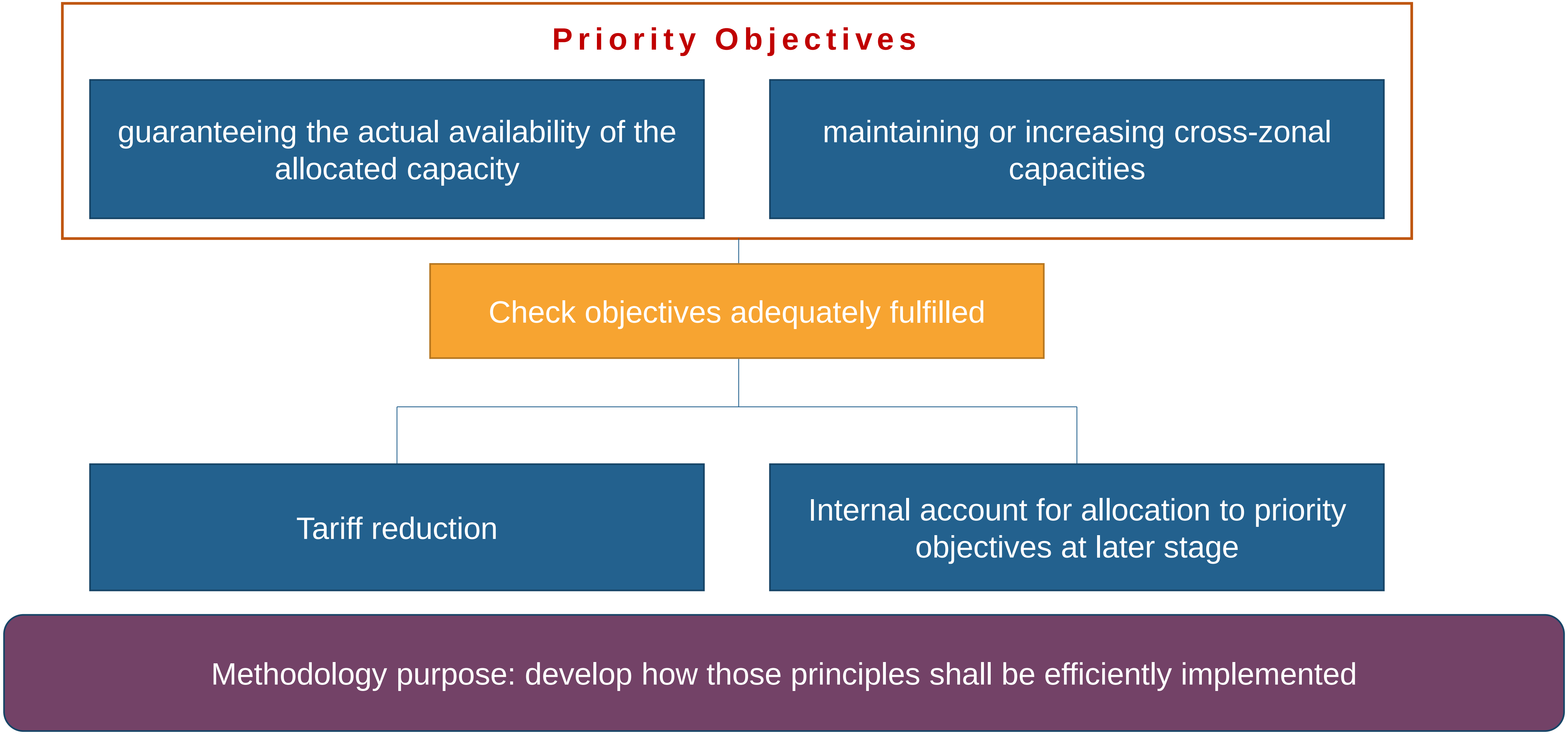
- 19(2): **Revenues resulting from the allocation of cross-zonal capacity** shall be used **in priority** for
  - **(a)** **guaranteeing the actual availability of the allocated capacity** including firmness compensation; or
  - **(b)** **maintaining or increasing cross-zonal capacities** through optimisation of the usage of existing interconnectors by means of coordinated remedial actions, where applicable, or covering costs resulting from network investments that are relevant to reduce interconnector congestion.

- 19(3): Congestion revenues may be **used for tariff calculation** where **priority objectives according to Article 19(2) have been adequately fulfilled**. The **residual revenues** shall be placed on **a separate internal account for future use** for the above purposes

- 19(4): By 5 July 2020, a **methodology** on the use of revenues for the purposes referred to in Article 19(2), the conditions under which those revenues may be placed on a separate internal account line for future use for those purposes, and for how long those revenues may be placed on such an account line shall be **proposed by the TSOs** after **consulting NRAs and relevant stakeholders.**

- 19(5): **TSOs shall report to their NRA on the actual use of that income**. Each year by 1st March, **NRAs shall inform ACER and shall publish a report setting out how the CI of the previous year was used**, including, inter alia, verification that the amount used for calculating tariffs complies with the methodology developed pursuant to Article 19(4).

Logic of Article 19



Scope

Balance: respecting the objectives of Article 19 while allowing sufficient level of flexibility

General principle: the methodology must be implemented by every TSO in such a way:

- it ensures implementation of efficient measures compliant with national and European regulation
- it does not provide any disincentive to reduce congestion (Article 19(1))
- it does not provide any economic disadvantage for the tariff payers and the TSOs.

National heterogeneity exists with respect to:

- **Regulatory frameworks:** European law does not impose a single regulatory framework for all TSOs.
- **Tax regimes:** the way various income sources of a TSO may be considered by tax administration can be different across Member States.
- **Accounting regimes:** depending on national accounting standards, some cost items might be considered differently.

The proposed methodology intends to comply with Article 19 while taking into account various national situations

Cost categories contributing to priority objectives

Article 3 of the UCI Methodology

Detailed list of possible costs

- **Two categories** (see next slides)**:**
  - **System operation costs**
  - **Costs resulting from network investments**

- Depending on **national regulatory framework**, TSOs shall allocate CI to **one or some** of the following cost categories.

- It is not obligatory for every TSO to allocate CI to all of these cost categories
- The exact list and the detailed definition of such costs categories depend on national regulatory framework

System operation costs

i. **Firmness costs** meant as costs related to measures activated by TSO(s) that guarantee cross-zonal schedules resulting from firm allocated capacity, in accordance with CACM and FCA Regulations, while complying with the safety standards of secure network operation.
ii. **Firmness compensation costs**: TSOs' costs related to compensation of the owners of curtailed transmission rights which cannot be used in order to ensure system security, in accordance with FCA and CACM Regulations.
iii. **Costly Remedial actions** activated to maintain or increase capacities with the objective of maximising available capacity in accordance with **Article 16 of Regulation (EU) 2019/943**.
iv. **Financial net costs associated to hedging options**: costs related to hedging products against volatile market spreads, different from long-term transmission rights, offered by TSOs to market operators in accordance with FCA regulation.
v. **Remuneration of non-nominated Long-Term Physical Transmission Rights and Financial Transmission Rights** as provided by the FCA Regulation.
vi. **Costs of regional security coordinators (RSCs) and regional coordination centres (RCCs)** which perform tasks related to TSO regional coordination in one or more capacity calculation regions.

Costs resulting from network investments

- **Investments contributing to maintaining or increasing cross-zonal capacity:**
  - **Interconnectors** which crosses or spans a border between Member States
  - **Cross zonal assets** liking bidding zones
  - **Internal assets that contribute to additional cross-zonal capacity**

vii. **Investments costs:**
- **Investment expenditures** for reinforcement of existing assets or new assets.
- **Costs included in the TSO's Allowed revenue**, usually made of:
  i. Capital expenditure costs during the depreciation period of the asset: **depreciation and capital remuneration** (equity and/or debt).
  ii. **Remuneration of assets under construction**.
  iii. Where appropriate, **cost of long-term leasing of network elements**.

viii. **Other costs resulting from network investments** included in the TSO's Allowed revenue:
- **Maintenance OPEX**
- **Taxes directly linked to assets** which are thus considered as OPEX.
- **Electrical losses** (excluding those losses covered by the Inter-TSO Compensation mechanism).
- **Other costs** related to the optimisation of usage of new and existing interconnectors, where it is duly justified by the TSO and NRA how such costs are of cross-zonal relevance.

Efficiency on incurred costs

Such costs categories shall be incurred **only if they are considered efficient by the relevant NRA at national level.**

System operation costs:

- ❑ TSOs coordinate the use of costly resources (such as countertrading and redispatching) taking into account their **economic efficiency.**
- ❑ Costs relating to firmness shall be assessed by the competent NRAs. Costs assessed as **reasonable, efficient and proportionate** shall be recovered in a timely manner through network tariffs or other appropriate mechanisms as determined by the competent regulatory authorities.

Investment costs:

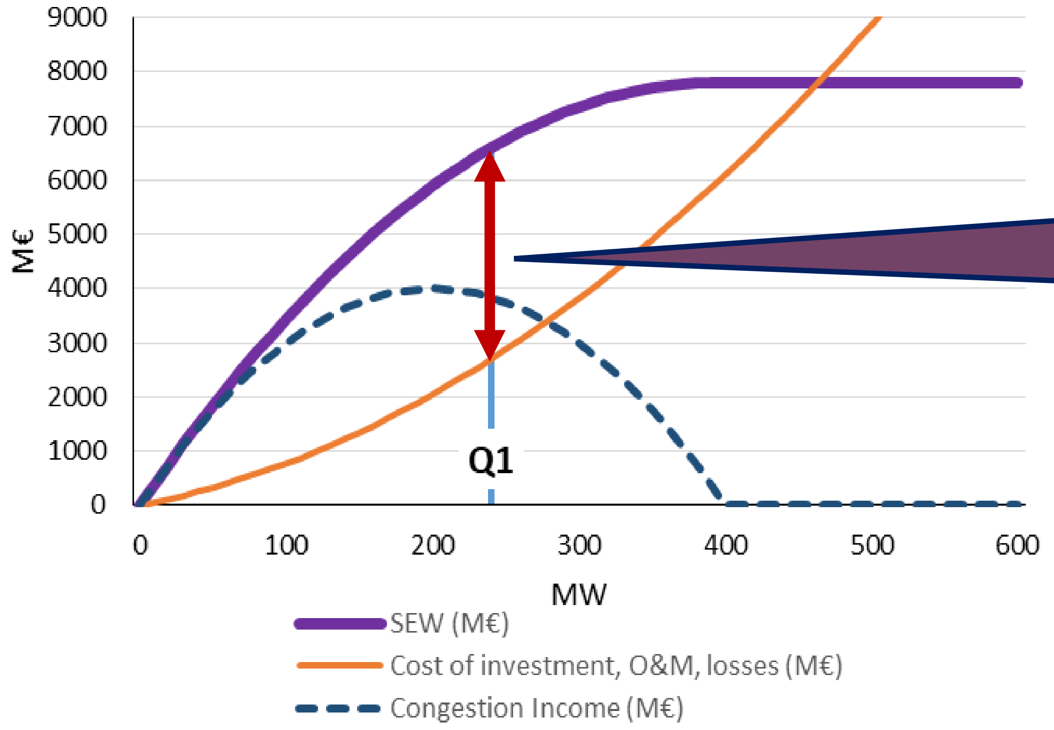
- ❑ **Optimum investment level:** considering that in any case all CI should mandatorily be spent sooner or later may result in costs that are **economically unjustifiable for the community** *(see next slide)*
- ❑ **Suitable investment projects and related costs:** once such investments are approved by the NRA, CI shall be allocated to the **full cost associated to these investments** *(see slide after next slide)*

Optimum investment level

$$Net\ benefit = SEW - investment\ cost - operation\ \&\ maintenance\ costs - losses\ cost$$

TSO should invest as long as the **marginal increase of SEW is higher than the marginal capital, operation & maintenance and losses cost** – i.e. as long as:

$$\frac{\Delta\ SEW}{\Delta\ [investment\ cost + operation\ \&\ maintenance\ costs + losses\ cost]} > 1$$



Below Q1, net benefit increases
Beyond Q1, net benefit decreases
No investment should be undertaken beyond Q1

Suitable investments and related costs

Some investments on **national network** contribute to cross-zonal capacity.

→ But is it possible to quantify in an indisputable way the contribution of such investment to cross-zonal capacity?

→ How CI shall be allocated to such investments?

- **Drivers and the expected benefits related to internal investment projects are many:**
  - Security of supply
  - new consumption and / or new generation,
  - Increased exports and imports through new interconnectors…
- **Impact of an internal project on the capacity of each zone border in MW depends on many parameters** such as the time horizon considered, the selected European demand / offer scenario, if the investment comes first or later…
  - Compute all possible scenarios? → impossible.
  - Considering a limited number of scenarios? → does not provide an indisputable single number precisely quantifying the investment's contribution (in MW) to cross-zonal capacity in all future scenarios.
- **Splitting costs components of the internal project by drivers** such as security of supply, new capacity requirements, maintaining or improving cross-zonal capacity → impossible

TSOs and their respective NRA shall jointly decide to which investments CI will be allocated.
Once such investments are approved by the NRA, CI shall be allocated to the full cost associated to these investments

Justification and approval of cost categories

- **Cost categories justification by the TSO** can be based inter alia on:
  - The TYNDP
  - the Union list of PCIs (Regulation 347/2013),
  - National Development Plans,
  - Action plans in accordance with Article 15 of the Regulation (EU) 2019/943,
  - Solutions to the issues that the derogation in accordance with Article 16(9) of the Regulation (EU) 2019/943 seeks to address; and,
  - Any applicable provision from the national regulation in force.

- TSOs shall clearly establish, in advance, for which of the cost categories CI will be used (Art 19(5)).

- The requested information shall be provided by the TSO to the NRA **in accordance with the national regulatory practices or any other method decided by the NRA**, and according to **a frequency decided by the NRA**.

The NRA shall assess and approve the cost categories identified by the TSO in terms of their relevance in contributing to the priority objectives set out in Article 19(2) of Regulation 2019/943.

Q&A on foreword, scope and cost categories

- ❑ **Foreword: the new regulation**
- ❑ **Methodology scope: balance Art 19(2) priority objectives / national situation**
- ❑ **Cost categories contributing to Art 19(2) priority objectives:**
  - **System operation costs**
  - **Cost resulting from investments**
- ❑ **Cost efficiency**
  - **System operation costs**
  - **Optimum investment level**
  - **Suitable investments**
- ❑ **Justification and approval of costs to which CI is allocated**

Ask your question when you are unmuted

If time remains after all questions are answered: please raise your hand

Congestion income allocation

Article 4 of the UCI Methodology

Possible features of cost categories

- In most national applicable regulations, above cost categories are part of TSO's allowed revenue or investment expenditures.

- In some national regulatory frameworks, CI and some of above cost categories, in particular system operation costs, are not TSO revenue and cost, they are pass-through items in the TSO's financial statement

Assessment of adequate fulfilment of priority objectives

- Where some of the CI is used when calculating network tariffs, **the NRA is competent to assess if the TSO under its regulatory oversight has undertaken adequate efforts with respect to the priority objectives set out in paragraph 2 of Article 19 of the Electricity Regulation.**

- This assessment shall concern the **12-month period ending on 31 December of the previous year**

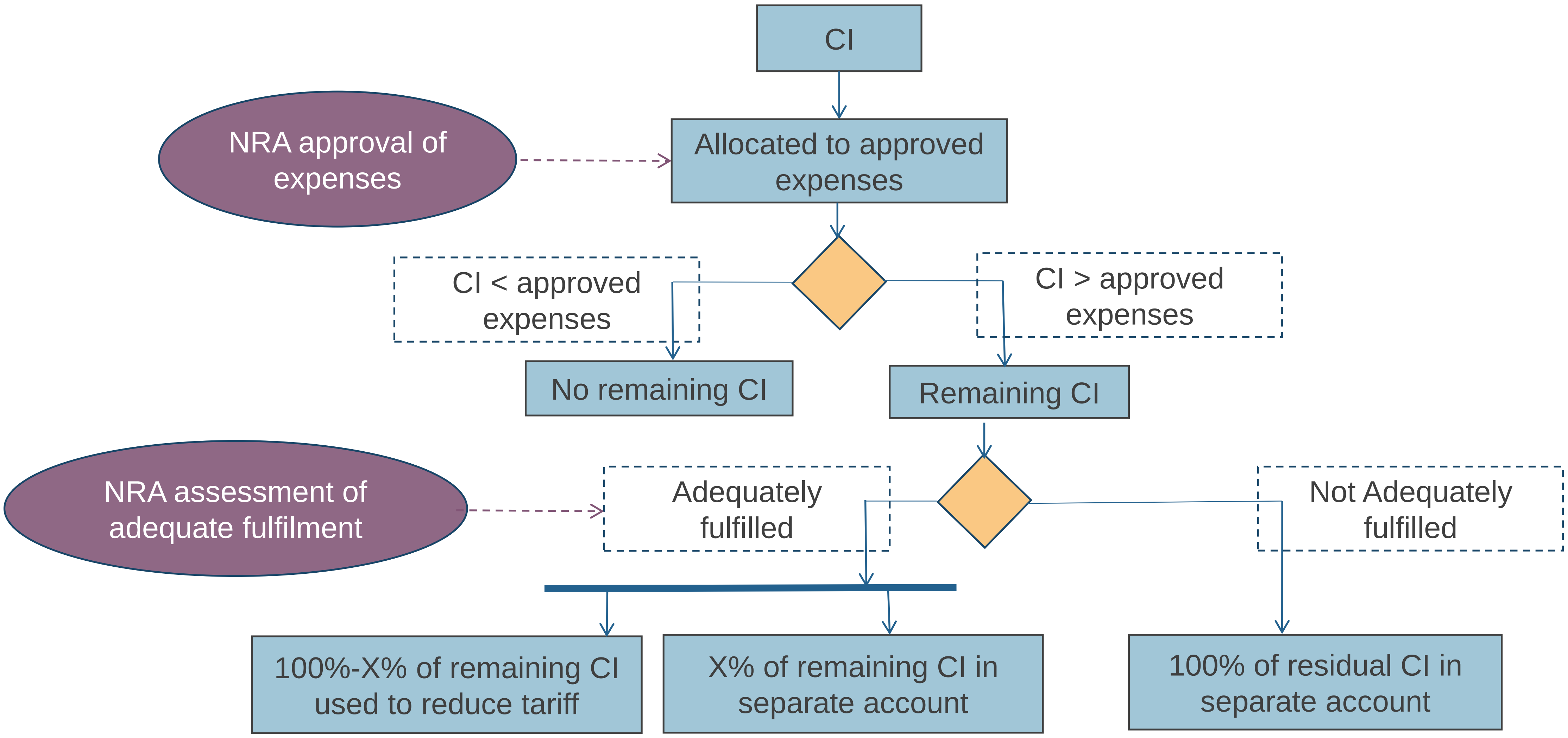
- It shall be **based on the cost categories approved by the NRA beforehand**.

- **Adequately fulfilling** = spending money for the measures established in advance and agreed with the NRA, including investing and surveying future investments.
  - **Even if such investments are currently stalled due to various reasons such as technical problems, lack of resources from cable manufacturers, local opposition etc.,** planning adequate investments for the future means priority objective (b) is fulfilled.

The adequate fulfilment for a given year can be **granted by the NRA**:

- **even if in this given year the expenditures corresponding to the approved cost categories are lower than CI**
- **even if all agreed infrastructure projects have not been commissioned yet**
- **even if availability of the minimum binding level of capacity available for cross-zonal trade (70%) has not been achieved yet and a derogation or an action plan has been approved for that year**

Congestion income allocation



Considerations regarding the separate account

For setting the feature of the internal separate account line, following aspects must be surveyed on a national basis:

- ❑ **Usefulness?**
- ❑ **Efficiency?**
- ❑ **Consequence on the tariff level?**
- ❑ **Possible advantages of the internal separate account?**

Those four aspects are addressed in next slides

❑ Usefulness of a separate account in TSO's account book

❑ Network investments: basically two ways to fund a network investment:

- Using capital (debt and / or equity),
- Using contribution from third parties (such as EU grants from the CEF).

❑ OPEX costs are recovered by tariff.

→ Adequate investments and operational expenditures can in most cases be undertaken **without storing money in a separate internal account line**.

→ There should be **no obligation** to establish a direct **financial** relation between congestion income and interconnection investments and OPEX.

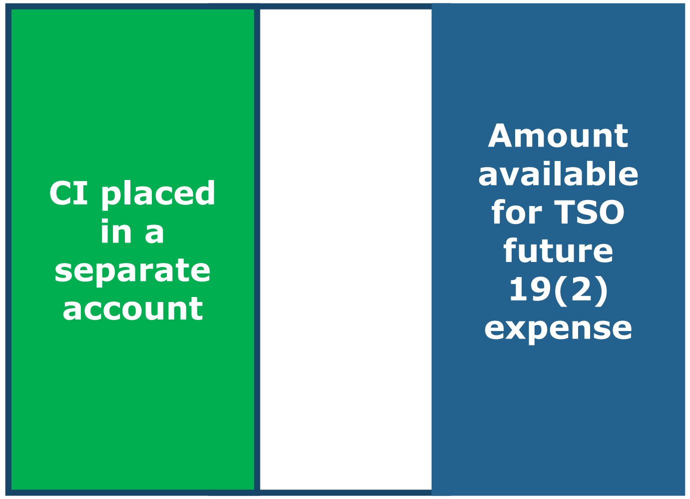
❑ There should be **no obligation to "store" CI in a separate internal account** line during preceding years to fund adequate future cross-zonal related expenses.

❑ **Allocating CI to tariff calculation is another possibility:** if in the future it becomes adequate to spend additional money for meeting article 19(2) objectives, then:

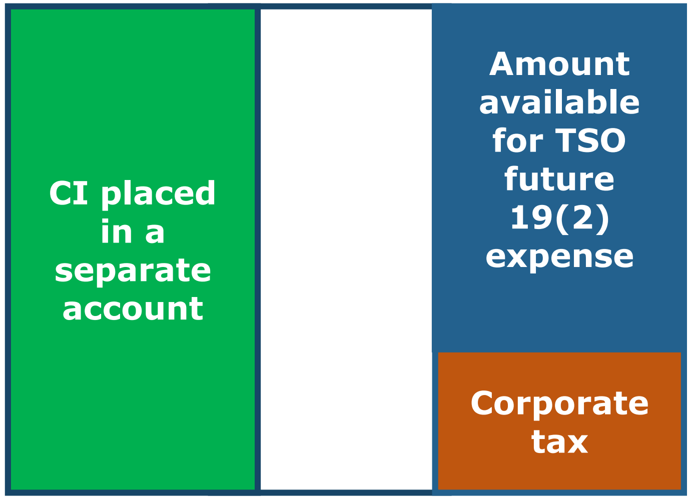
- increase of tariff or of other transmission-related charges can cover the cost of remedial actions, firmness costs or OPEX,
- whereas most TSOs can resort to additional debt or equity for investments. Depreciation and return of such investments are then covered by future tariffs.

❑ Efficiency of a separate account in TSO's account book

❑ Certain national accounting principles:
CI can be treated as deferred income.
→ **no corporate taxes** or other levies have to be paid.



❑ In other countries:
constituting tax-free provisions for future investments not allowed.
→ **corporate tax is due.**



- ❑ **In several countries, the amount available for TSO's future 19(2) expenses is reduced by corporate tax, thus reducing the efficiency of the separate account line.**
- ❑ **Corporate tax level depend on Member States**
- ❑ Avoiding this loss would necessitate a disproportionate change in Member States tax policies that would not be in line with the practice of other economy sectors.

❑ Consequence on tariff level due to implementation of a separate account in TSO's account book

- ❑ **Placing CI on a separate internal account line in TSO's account book means that for the years CI is initially stored on the account:**
  → network users can not benefit from CI
  → **tariff level is higher.**
  Example if CI is placed on a separate internal account line for an investment scheduled X years later:
  → Network users are required to **pay the full cost of an investment <u>in advance, i.e. before they benefit from the associated welfare</u>**.
  → Current grid users are not always the same as future grid users.

- ❑ **Using CI for calculating tariff (i.e. reducing tariffs at the time CI is collected), then using debt or equity when the investment is done** and then put the asset in the RAB:
  → Before commissioning date, reduction in tariff level
  → After commissioning date, network users **pay total asset cost progressively every year thus <u>at the same time they benefit from the associated welfare</u>**.

- ❑ **Implementing a separate account in TSO's book leads to:**
  - ❑ Initial tariff increase since network users don't benefit from CI
  - ❑ Requests users to pay investments in advance
- ❑ **Using CI for reducing tariff and using debt and equity to fund assets means:**
  - ❑ Network users perceive benefit from CI at the same time CI is collected
  - ❑ Network users pay a share of the asset every year, after the commissioning date, at the same time they benefit from the associated SEW

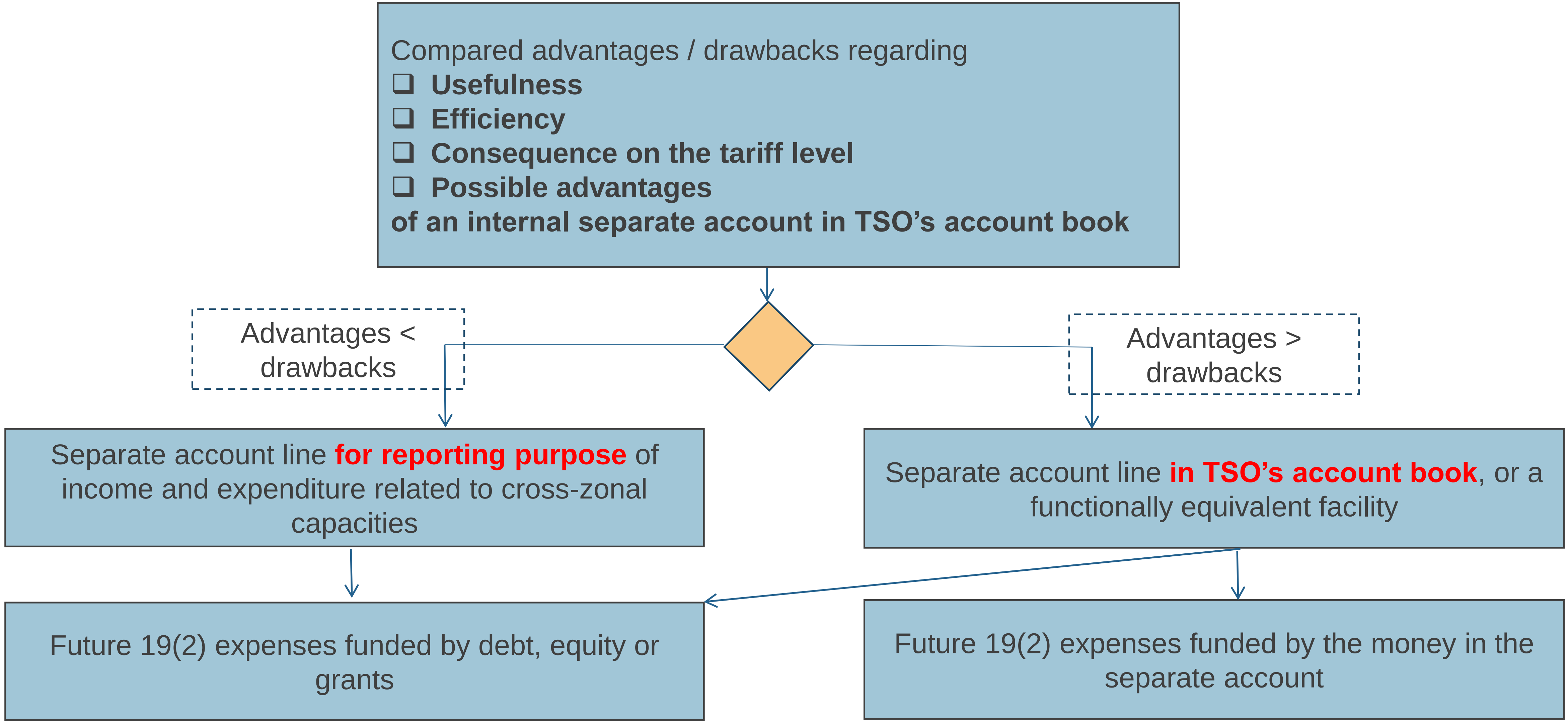
❑ Possible advantages of a separate account in TSO’s account book

- ❑ Some countries use a separate account to **compensate difficulties to forecast** exact values of OPEX, investment expenditures and congestion revenues in a given period

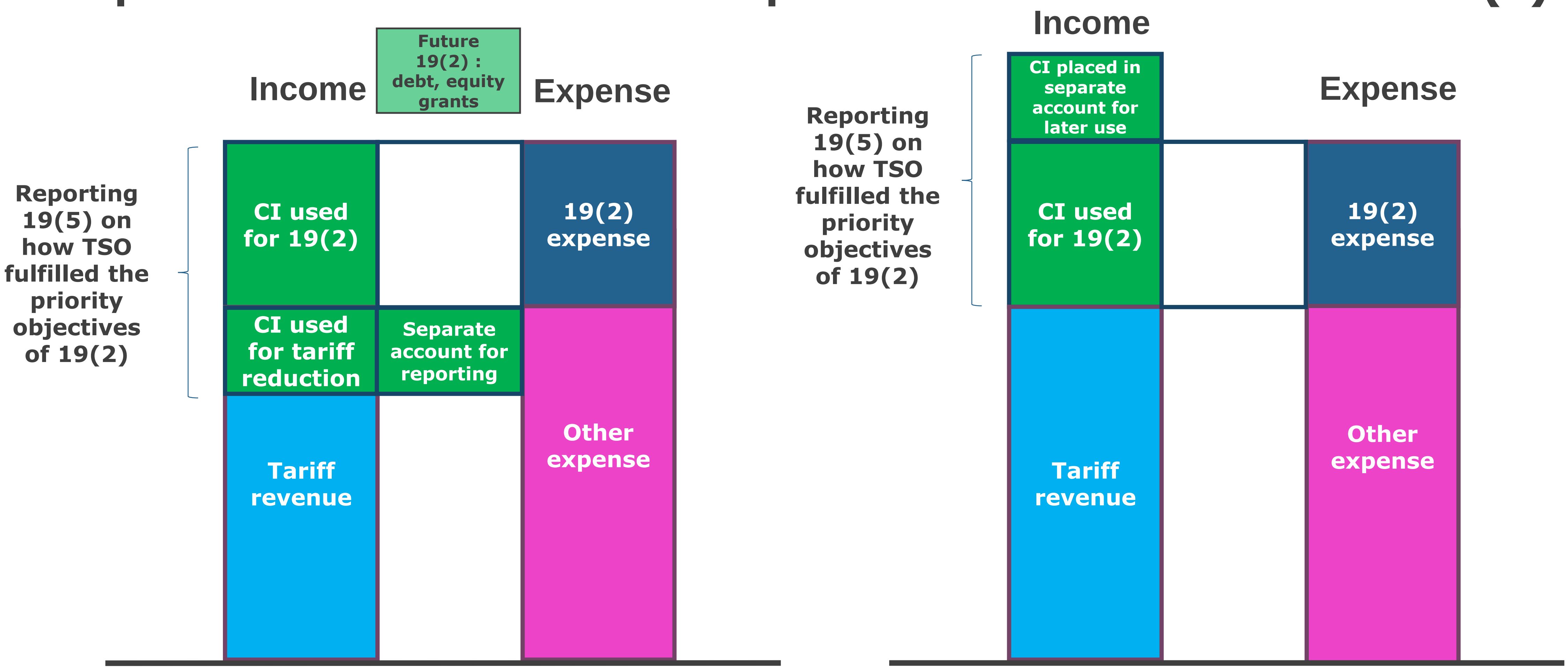
- ❑ Separate internal account line in TSO’s account book would be useful, *for instance*:
  - where it is considered the **TSO might have difficulties in the future to find new sources of money such as debt or equity,**
  - or when it is considered necessary to **smooth out anticipated large tariff increase** due to expected high counter trading and redispatching costs or investments.

A separate account line in TSO’s account book can be useful in specific and limited circumstances

Two possible features of the separate internal account line (1)



Two possible features of the separate internal account line (2)



Separate account for reporting purpose

Separate account in TSO's account book

In both options same clarity and transparency is provided on CI use for cross-zonal expenditures.

Multiyear approach of the separate account for reporting purpose

The compliance with Article 19(2) objectives should be considered from a **multi-year approach**, since CI and expenditures are volatile. Therefore, where the separate account is for reporting purpose, it must be ensured the amount of the separate account is independent from CI and expenditure paths:

Expenditures path 1

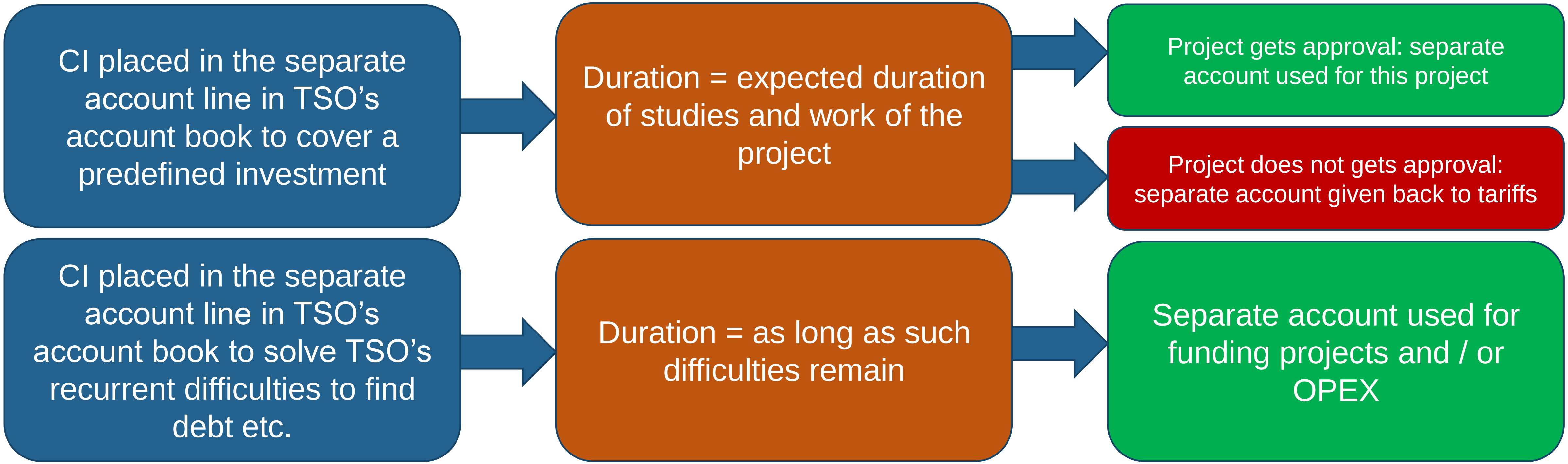
Year	CI	Expenditure	Placed in separate account	Carried forward to next year	**Separate account end of Y**
1	100	70	30	0	**30**
2	100	100	0	0	**30**
3	100	100	0	0	**30**

Expenditures path 2

Year	CI	Expenditure	Placed in separate account	Carried forward to next year	**Separate account end of Y**
1	100	70	30	0	**30**
2	100	**150**	-30	-20	**0**
3	100	**50**	50	0	**30**

Duration of the separate account line

Examples

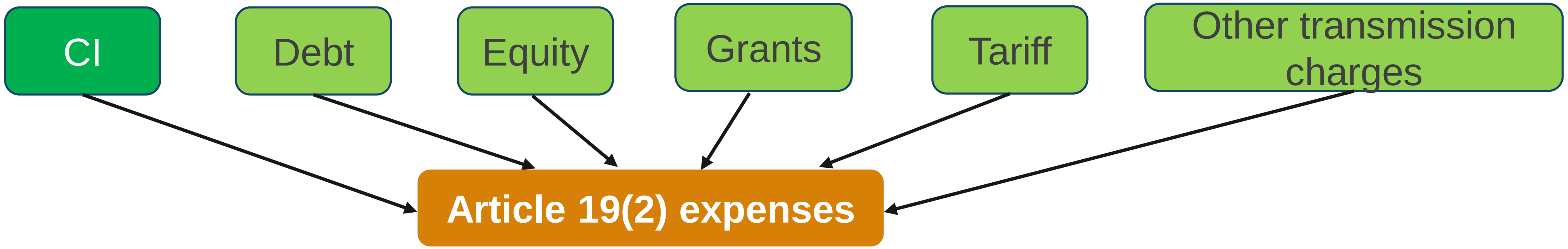


- The CI may remain placed in the separate account line for a **period defined by the NRA depending on TSO's situation**. If after this period no present or future effective use within the constraints of the priority objectives is possible, **CI from the internal account line may be used to calculate and/or fix network tariffs.**
- The resulting tariff reductions may be distributed over a period clearly defined beforehand at the proposal of the TSO

Summary

Conclusion of CI allocation

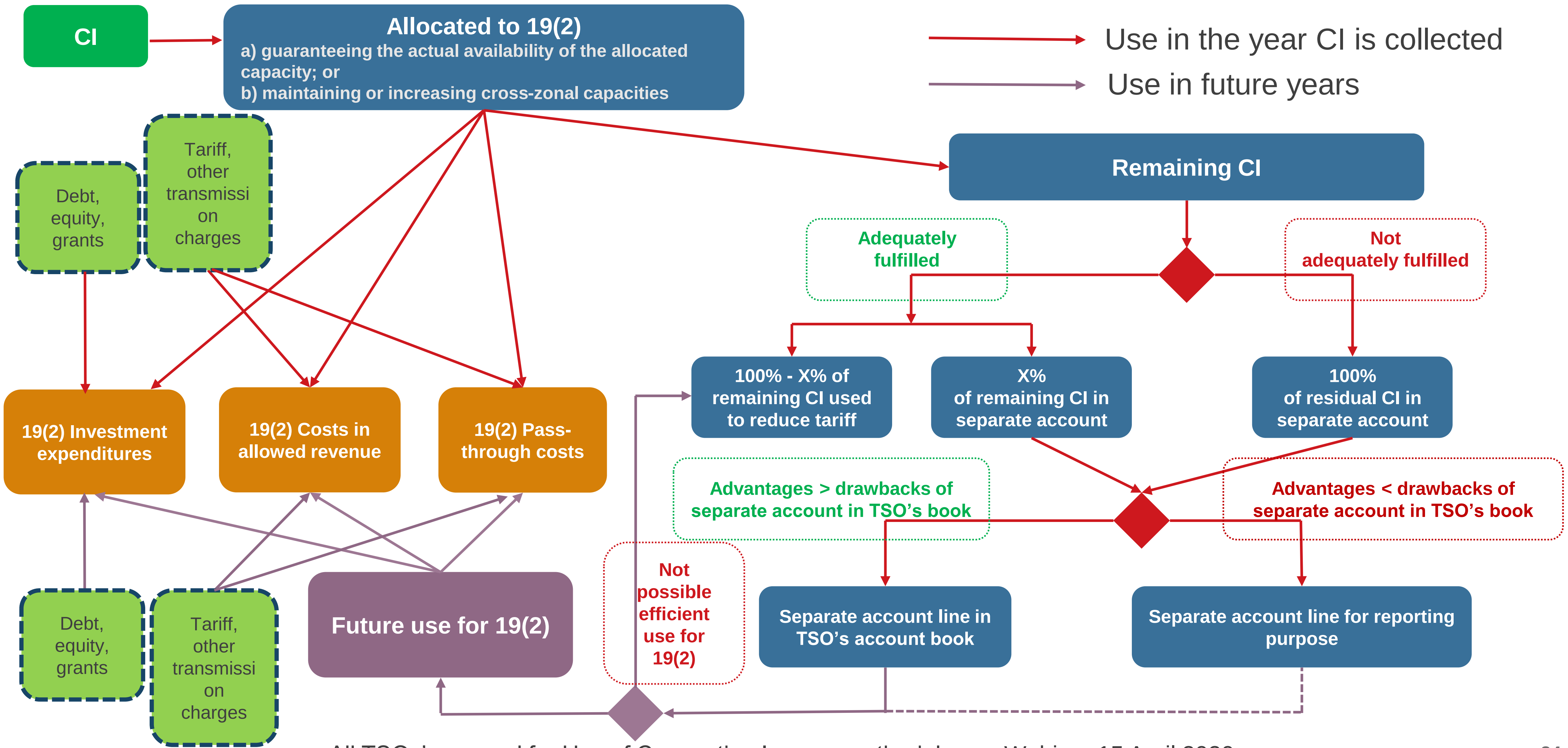
Sources for covering costs varies across the jurisdictions:



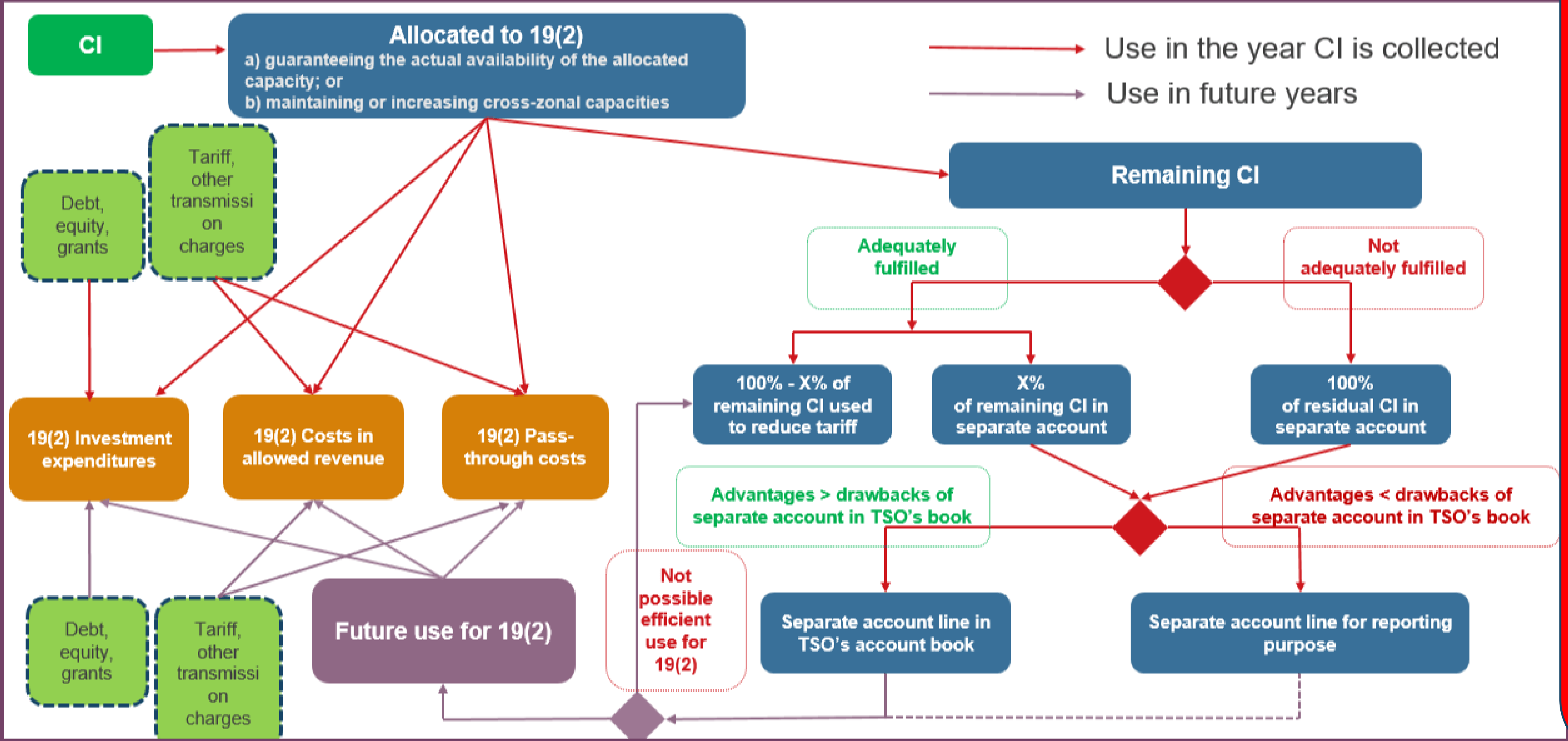
- ❑ **The adequate fulfilment of priority objectives is not linked to the source of the money used to this purpose.**
- ❑ **The separate account** might constitute an appropriate incentive to fulfil Article 19(2) objectives in the future **for some TSOs but not for all of them**.
- ❑ **The option of using CI to set tariffs also fully allows to comply with Article 19(2) objectives.**

- ❑ **EU regulation does not impose a one-fits-all regulatory framework**
- ❑ **Before implementing a separate account line in jurisdictions where it is currently not implemented, efficiency in terms of usefulness, corporate tax effect, and consequences on tariff level must carefully be considered.**
- ❑ **Where appropriate, then the separate account should be for reporting purposes, of income and expenditure related to cross-zonal capacities.**

Diagram of the methodology



Q&A on Congestion income allocation and conclusion



Ask your question when you are unmuted

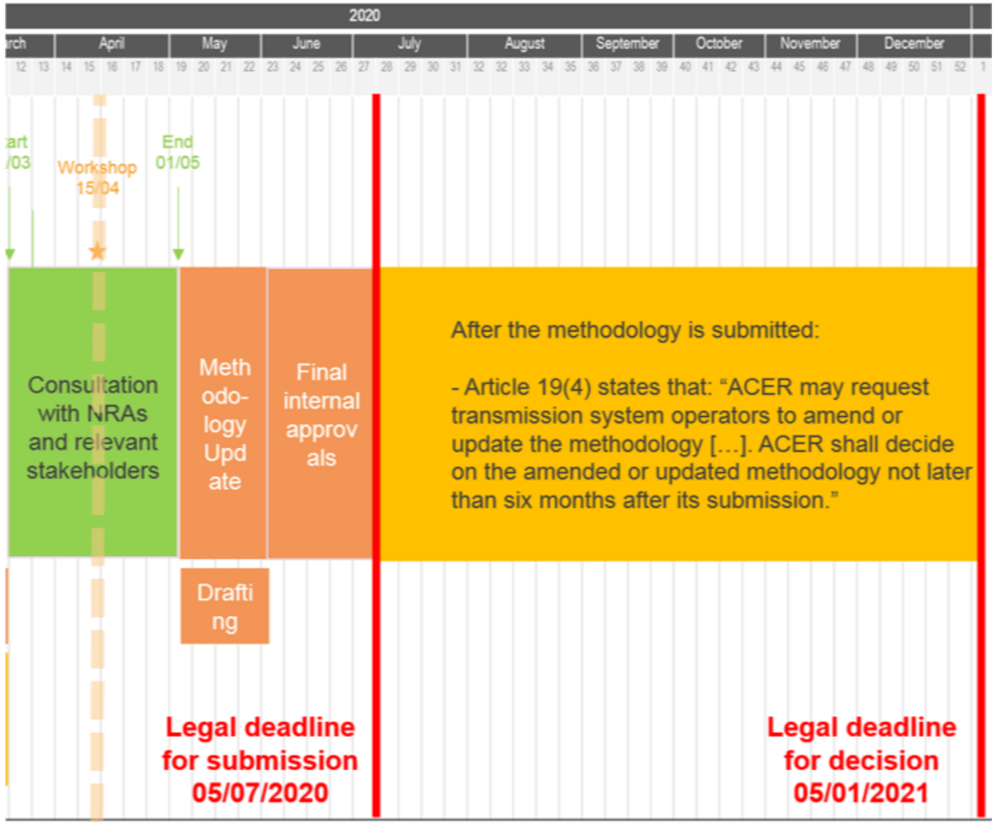
If time remains after all questions are answered: please raise your hand

Wrap-up, next steps and conclusion

Wrap-up, next steps and conclusion

- ❑ **Summary of main topics raised by stakeholders during the Q&A sessions**

- ❑ **Reminder about the planning**



Please send your contribution by 1 May
Thank you for your participation

Backup

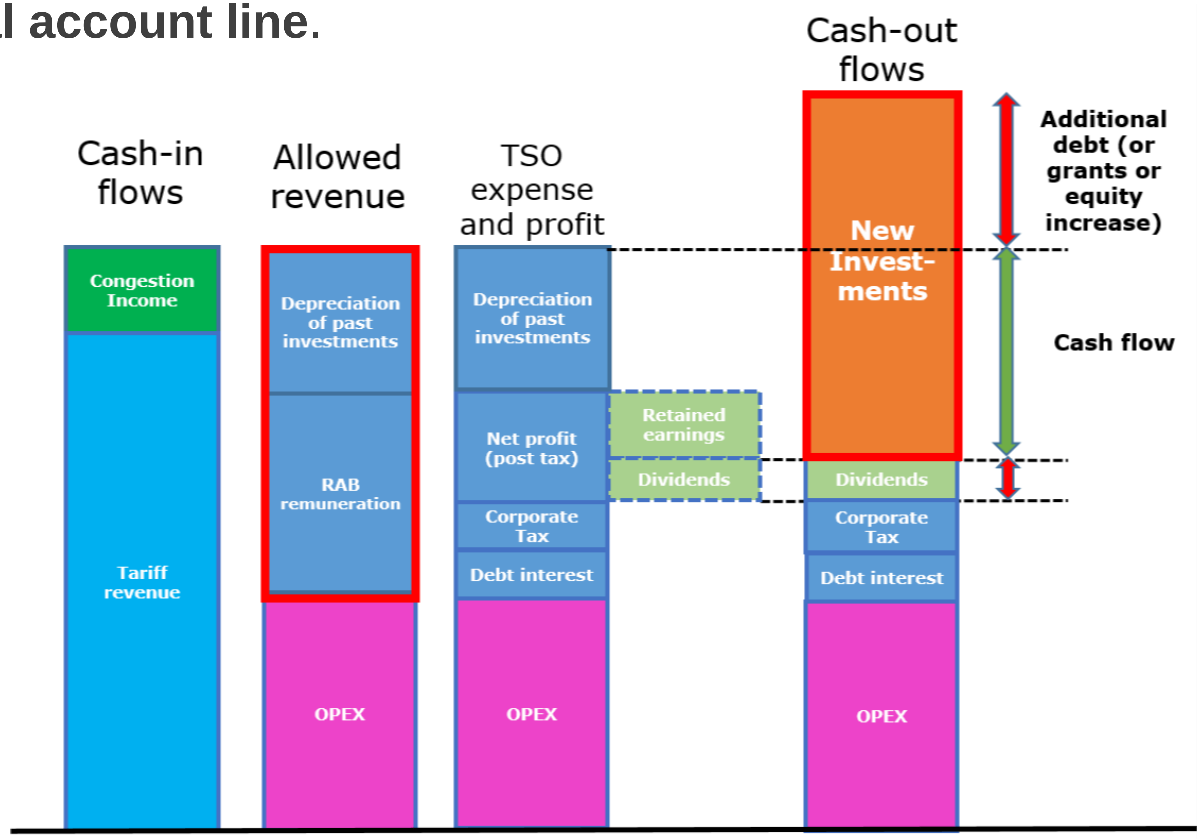
❑ Usefulness of a separate account in TSO's account book

In general for TSOs (as for any other companies in other industry sectors), there are basically two ways to fund a network investment:

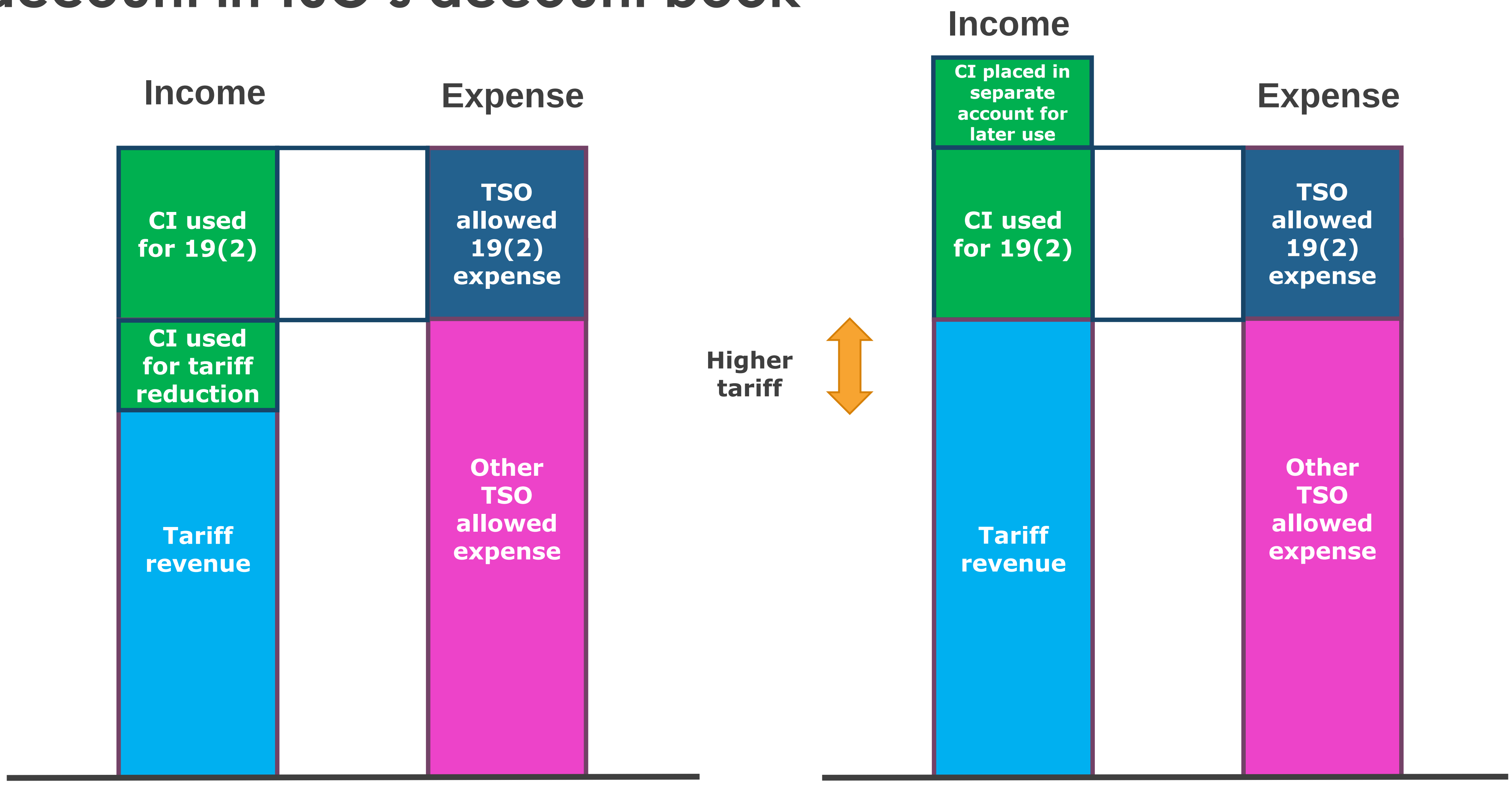
- Using capital (debt and / or equity),
- Using contribution from third parties (such as EU grants from the CEF).

OPEX costs are recovered by tariff.

→ Adequate investments and operational expenditures can in most cases be undertaken **without storing money in a separate internal account line**.



❑ Possible tariff increase due to implementation of a separate account in TSO's account book



Part of CI used for tariff calculation

Part of CI used placed in a separate account