

ERI convergence and Coherence Report – ERGEG consultation

SSE welcomes the progress made in the Electricity Regional Initiative (ERI) in facilitating cross-border trade. Looking specifically at the France-UK-Ireland (FUI) region, the initiatives across the Interconnector France Angleterre (IFA) are welcome, particularly the development of a new auction platform that will be consistent with arrangements at other French borders. In this respect, we believe it is important that Member States participating in several regions ensure that developments such as this are consistent and travelling in the same direction so that markets really do converge.

However, we do have two concerns in the FUI, which do not appear to be receiving sufficient attention. These are National Grid's transmission tariffication and the arrangement on the Moyle interconnector in the UK.

The key issues with transmission tariffication are the "pancaking" of charges at the boundaries of National Grid's tariff zone, and the extreme locational signals in the methodology which result in sharp discontinuities at the boundaries giving perverse trading signals. These issues are dealt with in more detail in the annex to our response to the consultation on the Regulation 1228/2003 compliance report, which is attached for reference.

The Moyle interconnector is the DC interconnector between Ireland and Scotland and although it is within the UK, it is the only link between the Republic of Ireland and the rest of the European electricity market. It is therefore essential that it is given the same attention as given to the IFA for the reasons detailed below.

Since the establishment of the single electricity market (SEM) in Ireland, the interconnectors between the Republic of Ireland and Northern Ireland are treated as part of the main transmission system. Generators in the whole of Ireland can therefore access the Moyle interconnector and, in principle, the rest of the European electricity market. However, generators who have paid for access to the transmission system in Ireland face an entry charge into National Grid's system in contravention, we believe, of the Inter-TSO compensation scheme. Also, the SEM day-ahead, single gate closure market structure places a restriction on market participants accessing cross-Border balancing services. This is particularly important in the context of suppliers buying energy from renewable generation facilities. We therefore believe that a roadmap should be developed to converge aspects of National Grid's GB market and the SEM market in a manner that permits improved frequency of SEM gate closure, increases inter-operability of market processes and removes the entry charge at the system boundary.

Annex 1 – Issues with Tarification and Cross-Border Charging in UK

Key Requirements of Regulation 1228/2003

Article 4 of Regulation 1228/2003 sets out obligations regarding charges for access to networks. Article 4.1 requires that charges applied by network-operators for access to networks shall be applied in a non discriminatory manner and shall not be distance-related. Article 4.4 states that “charges for access to networks applied to producers and consumers shall be applied regardless of the countries of destination and, origin, respectively, of the electricity, as specified in the underlying commercial arrangement.”

Application of Article 4.1

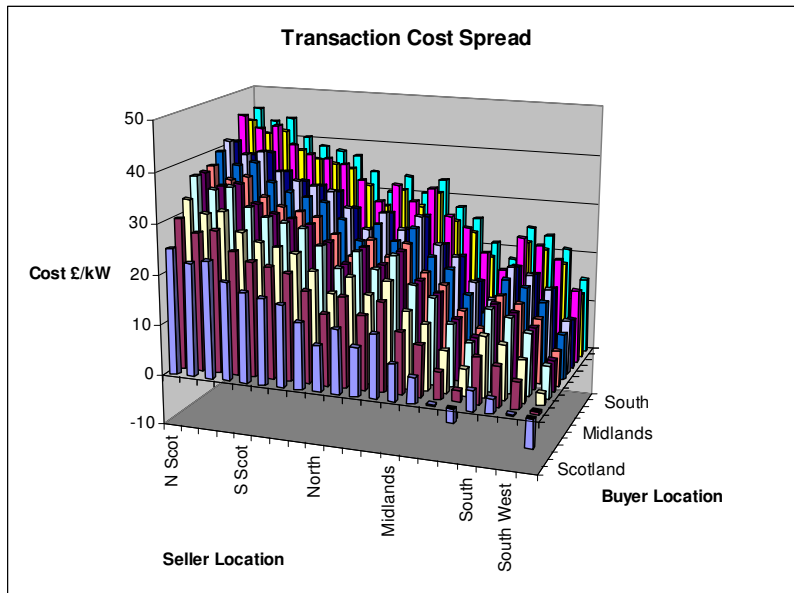
Our key issue with the tarification methodology in GB is its discriminatory nature because generators in the North of Scotland face excessive and discriminatory charges compared to generators in the rest of Great Britain. This arises primarily because of the distance related nature of the tariff methodology and the large variation from the maximum average generation charge specified in the transmission tarification (TT) guidelines. ERGEG states that the charge paid by generators for access to networks is more important than the charge for load and we strongly agree with this. This is why the TT guidelines set a maximum average generator charge – zero in most MS but up to €0.5 per MWh in some MS including the UK. However, we believe that setting a maximum average charge without specifying how the average is calculated or the maximum permitted variation from the average is meaningless.

As an example, the access tariffs in GB for a renewable generator with a 30% load factor vary from over €10/MWh to -€4/MWh (i.e. a payment of €4 per MWh). The average is €3.5/MWh, more than the €2.5 maximum average allowed for GB in the guidelines (itself a factor of 5 higher than the rest of the EU) and the highest rate is over four times the maximum average. However the overall compliance with the guideline is no doubt justified by the amount paid by the GB generation community as a whole, and the volume transmitted. This, we believe, is a good example of how strict legal compliance with a guideline can be achieved while ignoring the underlying principles of the guideline.

The guideline recognises that competition between generators can be distorted not by the absolute level of access charges paid by generator, but by the differentials in tariffs for the same service. The range of tariffs in the UK can only be described as extreme and we believe serves to distort competition within Great Britain as well as causing large tariff discontinuities at the national borders which distort competition in Europe.

Also, the Article 4.1 of the Regulation requires that tariffs should not be distance related, and in section 5.6.1 of the consultation ERGEG states that “all charges are independent of distance” and that “NRAs have ensured that charges comply with Article 4.1 of the Regulation”. We are somewhat confused by this conclusion because the GB charging methodology is based on the distance from a reference node, and result in charges that increase the further a generator is from the load centres of Southern England.

The Result of this is shown in the chart below which shows, broadly that for a given seller location, the further south the buyer, the higher the charge and similarly for any given buyer location, the charge increases the further north the supplier. These are clearly not independent of distance.



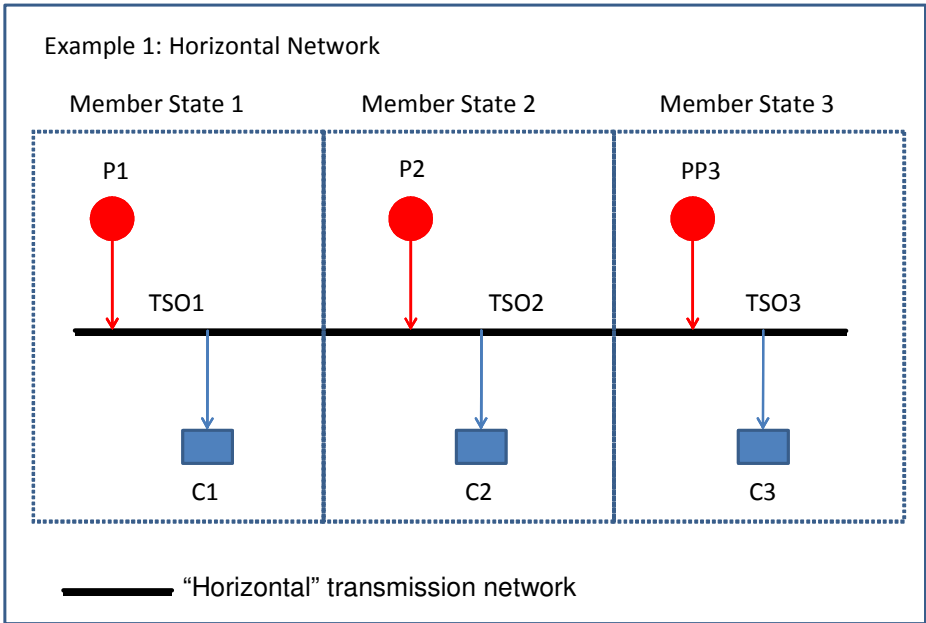
Conclusions on Tarification

The application of National Grid’s current methodology means that a new entrant generator can have no confidence that the access charge will be anywhere near the maximum average permitted in the guidelines. We therefore believe that a more prescriptive definition of “maximum average” should be specified in the guidelines, perhaps specifying a plus or minus range from the average to give generators more certainty over their access charges.

Application of Article 4.4

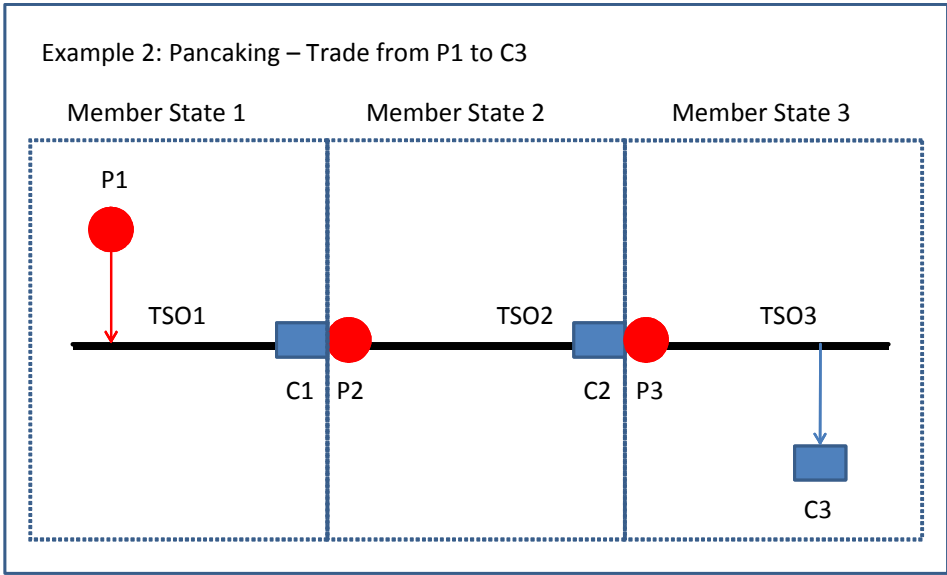
Our understanding of Article 4.4 is that for any particular transfer of energy between producer and consumer, the only access charges payable are the production related access charge in the member state where the transfer initiates, and the demand related charge in the member state where the transfer terminates. With limited exceptions (as discussed below) there should be no further network access charges for the transfer. The ITC mechanism is designed to ensure that intermediate TSOs are compensated for any transits across their systems. This mechanism was designed to avoid “pancaking” of charges at national borders. The principle is that there is a “horizontal” transmission network across Europe and once national access charges are paid, traders can in principle at least, access the whole network. The main exceptions are where congestion occurs and for which additional measure and charges may be applicable to ensure the transfer takes place, and merchant interconnectors where the remuneration for those assets falls outside both the national tarification systems and the ITC mechanism and so additional access charges are levied.

This key underlying principle of tarification and the ITC mechanism is illustrated in example 1 below.



Once a producer in Member State 1 has paid the access charge $P1$ in that Member State, he is free to trade with consumer $C1$ in the same Member State or with $C2$ or $C3$ in other Member States (subject to any charges for congestion and/or merchant interconnectors). Similarly for producers $P2$ and $P3$. Any payments to $TSO2$ in the event of transfers across his network are dealt with through the ITC. The total of the access charges will be either $P1+C1$ for a trade within the same MS, $P1+C2$ for a trade in MS2, and $P1+C3$ for a trade in MS3.

Pancaking occurs where a transfer entering a member state's horizontal network is treated like a generator, and a transfer leaving a member state is treated like a demand. This is illustrated below.



Instead of each transmission system being treated as an interconnected part of the European transmission system, each Member State operates like an island, with access charges at the borders. For the example trade between P1 and C3, the actual access charges would total $P1+C1+P2+C2+P3+C3$, instead of $P1+C3$ as required by Regulation 2003/1228.

Within the UK, National Grid applies pancaking of charges at the boundaries of its networks in England, Scotland and Wales. This creates a problem in distorting trade across the Interconnector with France. It also severely hampers companies in the Republic of Ireland (who are now able to trade freely with Northern Ireland since the establishment of the single electricity market in Ireland) from trading with the rest of Europe.

Prior to 2008, the UK did not participate in the ITC mechanism and therefore was not strictly bound by this "pancaking" constraint. Trading with mainland Europe was subject to these border charges, but once onto the main interconnected European system, no further border charges applied. However, now that the UK has joined the mechanism we believe there can be no justification for continuing with this border charge.

Conclusions on ITC and pancaking

Pancaking as described above is clearly in contravention of the Regulations and is restrictive of trade. Since it appears very similar to a border tax, it could also contravene the Treaty of Rome regarding the free movement of goods and services. Despite this, National Grid not only applies such a methodology at its boundaries with France, it applies it within UK at the boundary with Northern Ireland, limiting trade from the Republic of Ireland.

We fail to understand why the UK regulatory authorities have been able to approve such a methodology. It is therefore clear that more precise prohibitions are required either in mandatory guidelines or in the Regulation itself that make it clear that such border charges contravene the Regulation.