

REGULATORY INVESTMENT INCENTIVES FOR PROMOTION OF NEW GAS AND ELECTRICITY INFRASTRUCTURE IN THE ENERGY COMMUNITY AND, IN PARTICULAR, PROJECTS OF ENERGY COMMUNITY INTEREST

- ECRB RECOMMENDATION TO THE PHLG -

1. Introduction

The Energy Community Ministerial Council in October 2012 approved the Energy Strategy of the Energy Community¹. As a follow up, a process of identifying Projects of Energy Community Interest (PECI)² was initiated mirroring the European discussions on Projects of Common Interest (PCI). A final list of PECI is expected to be adopted by the Energy Community Ministerial Council in its 2013 meeting. This approach is in line with the recently adopted European Regulation on guidelines for trans-European energy infrastructure³, defining the priority corridors of trans-European energy infrastructure, establishing the label PCI and identifying possible measures to support them, related to permit granting, regulatory treatment and financial assistance as key pillars for promoting new infrastructure investments.

2. The role of regulators in promoting investments

The crucial role of regulators in facilitating infrastructure investments has been strongly emphasized during the PECI process. The Energy Community regulators underlined their support for assisting the PECI process by letter of the President of the Energy Community Regulatory Board (ECRB) October 2012.

The ECRB already in 2010 discussed possible regulatory instruments for promoting new investments⁴. In its 2010 report the ECRB underlined that *facilitating and stimulating new investments is a core responsibility of both national legislation and regulatory praxis* and recommended a number of instruments to be implemented (ref. Annex 1). In addition, the Energy Community Secretariat (ECS) in 2011 commissioned a study on regulatory investment incentives that also recommended a number of possible regulatory investment incentives practiced in the European Union and further⁵.

For regulatory promotion of the PECI, the ECRB in its December 2012 meeting recommended making use of the ECRB 2010 report and the 2011 E-Bridge study. The ECS therefore addressed the Energy Community and neighboring EU regulators with a questionnaire compiling the key recommendations of said documents, asking for the regulators' support on individual investment incentives (ref Annex 2). Feedback on the questionnaire has been received by the regulators Austria, Croatia, FYR of Macedonia, Kosovo⁶, Moldova, Romania, Serbia and Ukraine.

¹ <http://www.energy-community.org/pls/portal/docs/1810178.PDF>. For details on the Regional Energy Strategy's background and process, please consult: http://www.energy-community.org/portal/page/portal/ENC_HOME/AREAS_OF_WORK/Regional_Energy_Strategy.

² For details on the PECI process, please consult: http://www.energy-community.org/portal/page/portal/ENC_HOME/AREAS_OF_WORK/Regional_Energy_Strategy/PECIs.

³ OJ L 115 p 39 et seq of 25.4.2013.

⁴ ECRB, Cooperation of Regulators with Regard to Cross Border Investment Projects - Regulatory Instruments for Promoting New Investments, Assessment of Existing Mechanisms, Recommendations (March 2010).

⁵ E-Bridge, Best Practice Recommendations on Regulatory Incentives Promoting Infrastructure Investments (November 2011), <http://www.energy-community.org/pls/portal/docs/1288179.PDF>.

⁶ Throughout the whole text (*) refers to * *This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo declaration of independence.*

3. Analysis

The role of regulators in promoting new investments, such as the PEI, is an essential pillar next to financial project support. The Secretariat therefore carefully analyzed the **European Regulation on guidelines for trans-European energy infrastructure and, in particular, the regulatory investment incentives** provided in there, which are:

- a. The requirement for regulators to coordinate with neighboring regulators on the allocation of costs and their inclusion in the regulated network tariffs for cross-border projects (Article 12 paragraphs (4), (5)).
- b. The requirement for regulators to ensure appropriate investment incentives for projects incurring a comparably higher risk for development, construction, operation or maintenance (Article 13 paragraph 1)⁷, inter alia
 - Providing additional return on capital invested for the project (Article 13 paragraph 3(c))
 - Recognition of efficiently incurred costs already before commissioning of the project (Article 13 paragraph 3(b))
 - Development of best practice and a common methodology for identifying an incurred higher project risk by the Agency for the Cooperation of Energy Regulators (Article 13 paragraph 4(b))
- c. The requirement for regulators (and other competent authorities) to ensure accelerated permit granting via efficient administrative processing of the files and establishment of one single national coordinating authority (Articles 7 – 10)
- d. The requirement for regulators to, together with other regulators, establish and make publicly available values for the comparison of unit investment costs for comparable projects

It shows that the regulatory investment incentives provided by the European Regulation on guidelines for trans-European energy infrastructure to a large extent conform to the recommendations of the 2010 ECRB report (ref. Annex 1). Also, feedback from regulators on the ECS' questionnaire (ref. Annex 2) was positive prevalently related to these regulatory incentives.

4. Policy Recommendations

The ECRB expresses the commitment of its member regulators, including Participants, to coordinate with each other, and implement incentives that foster the realization of PEIs in line with the elements of the toolbox in the Regulation on guidelines for trans-European energy infrastructure, which can already be implemented within the existing legal framework

The ECRB is of the opinion that the European Regulation on guidelines for trans-European energy infrastructure can provide a good basis for the necessary regulatory investment incentives to the PEI and therefore proposes to the Energy Community Ministerial Council in October 2013 to:

⁷ This is not applicable to projects that have been granted (I) an exemption from Articles 32, 33, 34 and Article 41(6), (8) and (10) of Directive 2009/73/EC pursuant to Article 36 of Directive 2009/73/EC; (II) an exemption from Article 16(6) of Regulation (EC) No 714/2009 or an exemption from Article 32 and Article 37(6) and (10) of Directive 2009/72/EC pursuant to Article 17 of Regulation (EC) No 714/2009; (III) an exemption under Article 22 of Directive 2003/55/EC; or (IV) an exemption under Article 7 of Regulation (EC) No 1228/2003.

- (1) **Issue a recommendation addressed to Contracting Parties to empower national regulators (if applicable)**
 - a) To issue decisions on the allocation of costs and their inclusion in the regulated network tariffs for cross-border projects.
 - b) To grant incentives to eligible projects characterized by high risks, which may cover:
 - Rules of anticipatory investment
 - Rules for recognition of certain costs before commissioning of the project
 - The introduction of longer regulatory periods⁸ with a view to facilitate investments by increasing the stability and predictability of the regulatory system.
 - Additional return on capital invested for the project
 - Stimulative depreciation⁹
 - “Negative” incentive for promotion of investments in infrastructure¹⁰
 - Other measures deemed necessary
- (2) **Consider adopting the provisions of the Regulation on guidelines for trans-European energy infrastructure, which are instrumental in facilitating investments in the Energy Community** in its meeting of 2014.

5. Additional Measures

In addition to this, the ECRB shall include in its Work Program issuing recommendations / guidelines concerning¹¹:

- A toolbox on regulatory incentives that can be used depending on national specificities
- A common methodology for project risk evaluation

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⁸ I.e. timeframes within which regulated tariffs are not changed or reviewed by the national regulator but only adjust according to the parameters of the tariff methodology set by the regulator.

⁹ This concept allows regulators to apply project targeted depreciation for new investments, deviating from the general tariffication methodology. This can be either a longer depreciation (e.g. to facilitate greenfield projects with high start up costs) or a shorter depreciation period.

¹⁰ This concept builds on the principle that network operators have to use revenues they gain from auctioning grid capacities (congestion revenues) for investments in the network. If the investment is *not* made, the congestion revenues lead to reduction of the regulated network charge (cf. Article 6 (6) Regulation (EC) 1228/2003.)

¹¹ The guidelines should be shifted 3-6 months in comparison with ACER recommendations (31 December 2013) in order to be able to take them on board.

Annex 1

ECRB Report on "Cooperation of Regulators with Regard to Cross Border Investment Projects - Regulatory Instruments for Promoting New Investments, Assessment of Existing Mechanisms, Recommendations" (March 2010)

- Summary of ECRB Recommendations -

1. Without additional legislative adjustments needed the **first recommendation** calls for:
 - Full implementation of the *acquis* as minimum set of a harmonized regulatory framework.
 - Harmonization of regulatory market rules across borders.
 - Introduction of regulatory investment incentives promoting investment on national basis. The ECRB specified that this may include incentive tariff models supporting the promotion of new investments, capacity agreements (deposits)¹², a higher rate of return for new investments, a "negative incentive" using congestion revenues which are not re-invested for system expansion for tariff reduction or others.
2. A **second recommendation** addressed the "regulated gap" related to non-domestic investments and requires legal adjustments: National regulators should be empowered to recognize extra-territorial costs in their regulated asset base (RAB) as far as beneficial for the national customers¹³.
3. A **third recommendation** addressed the requirement of regional investment planning, also requiring legal adjustments:
 - Where not so far, the ECRB recommended national TSOs to be made responsible for developing investment plans having in mind that TSOs are responsible for sorting out congestion related to reasonable demand increase¹⁴.
 - In a second step the ECRB recommended national regulators to be empowered to approve the reasonability of these investment plans. The ECRB underlined that a related approval of the national regulator has to link to a guarantee of recognition of related investment costs in the RAB and stressed that such approach would thereby minimize the TSOs' investment risk.
 - The ECRB further underlined that appropriate cost allocation across border requires coordination of investment planning – first to ensure appropriate dimension of interconnection and national capacity taking into account the requirements of neighboring and further linked markets and second to allow national regulators to properly assess the cost of foreign investments realized for the benefit of their national consumers. Consequently this led the ECRB to the proposal of introducing a system regional investment planning. As an example the ECRB suggested using the mechanisms of the Third Energy

¹² Meaning a financial guarantee provided by a network user requiring additional network capacity that cannot be covered by existing capacities and would require capacity expansion. This is of special relevance in the case of huge investment need involved, e.g. by a big industrial user planning an expansion of production leading to significantly higher demand. The risk of such capacity expansion lies in the fact that at the time of realization of the investment the party originally requesting the additional capacity might have changed its capacity need - for the case mentioned above, the industrial user e.g. might have decided not to expand production. In this case the investment realized would represent sunk cost that have to be borne by all network users. For meeting this risk the tool of deposits or ex ante capacity agreements can be used: the party requesting additional network would either pay a deposit or sign an ex ante capacity commitment that would cover the costs of investments irrespectively of the capacity then used after realization or not. In case of the capacity being used by the relevant party, network tariff payments would be deducted from the deposit given.

¹³ In this context the ECRB noted that "*Having in mind Article 3 para 6 (EC) Regulation 1228/2003 (Article 13 para 6 (EC) Regulation 714/2009 – 3rd package) regarding non-domestic investments in the future lines, the Inter TSO Compensation Mechanism (ITC) helps up to the certain extent*" [to address non-domestic investments in electricity]. However, the ECRB stressed that "*it is not 100% clear whether the ITC mechanism is 100% able to allocate non-domestic investment costs to the beneficiary, especially when the ITC fund is capped.*"

¹⁴ Article 2 lit 4 Directive 2003/55/EC (OJ L 176 of 15.7.2003, p 57 et seq) as well as Directive 2009/73/EC (OJ L 211 of 14.8.2009, p 94 et seq) and Article 2 lit 4 Directive 2005/54/EC (OJ L 176 of 15.7.2003, p 37 et seq) as well as Directive 2009/72/EC (OJ L 211 of 14.8.2009, p 55 et seq).

Package¹⁵, requiring TSOs to develop a 10 year EU wide investment plan for review by the newly introduced Energy Regulatory Agency (ACER). Following this example and upon implementation of the first and second recommendation, the ECRB might be empowered to approve an Energy Community investment plan, developed by the national TSOs and approved by the national regulators of the Region.

Annex 2

Secretariat's questionnaire sent to regulators

National regulators have been addressed with the list of regulatory investment incentives below and have been asked whether these instruments already exist in their regulatory systems and, if not, whether the regulator would be interested to introduce it.

1. INFRASTRUCTURE	
1.1 FINANCIAL INCENTIVES	
Higher rate of return for new investments ¹	
Higher rate of return for new investments ¹	
"Negative incentive" ²	
Stimulative recognition of depreciation costs for new investments (accelerated, functional, other) ³	
Infrastructure investments made outside the country	
<ul style="list-style-type: none"> - can be covered in the RAB if beneficial for national customers - allocation of investment costs across the borders and tariff setting is coordinated with all concerned Regulatory Authorities within a pre-agreed time limit 	
1.2 INCENTIVES INCREASING FINANCIAL PREDICATBILITY	
Longer regulatory period for new investments ^{1, 4}	
Capacity expansion agreement ⁵	
For a project included in the national investment plan approved by the NRA, investment costs are covered in the RAB	
Recognition of stranded costs for certain infrastructure investment ⁶	
1.3.OTHER SUPPORT	
Accelerated permit granting	
Coordinated licensing decision with other concerned Regulatory Authorities	
Providing cross-border streamlined regulatory rules for a cross-border project	
In cooperation with other NRAs develop and publish a set of indicators and corresponding reference values for the comparison of unit investment costs for comparable projects of the infrastructure categories is established	
Other proposals	
2. GENERATION	
Accelerated permit granting	
Other proposals	

¹ without granting an exemption from the regulated tariff model

¹⁵ By Decision 2011/02/MC-EnC of the Energy Community Ministerial Council of 6 October 2011, the Third Package, was incorporated in the Energy Community. In Article 3 of the Decision, the Contracting Parties were given a deadline by 1 January 2015 to transpose and apply the provisions of that Directive. None of the Contracting Parties has implemented the Third Energy Package into national legislation so far. However, Decision 2011/02/MC-EnC also amended Article 11 of and Annex I to the Treaty with immediate effect. Annex I (as amended) lists Directive 2009/73/EC, as adopted by the Ministerial Council, as part of the Energy Community's "acquis communautaire on energy".

² the network tariff methodology approved by the regulator foresees that congestion revenues not used for capacity expansion investments lead to tariff reduction

³In case of accelerated depreciation, the annual charge for depreciation is higher in the beginning of the useful life and gradually diminishing, so that incurred annual costs are higher in the first years of assets use. In case of functional depreciation, annual charge is calculated on the basis of the actual usage of asset during its life under the assumption that total outputs of the assets during its useful life can be reasonably estimated.

⁴"Regulatory period" meaning the time span (years) within which network tariffs are calculated based on the methodology approved by the regulator but are *not* subject to regulatory review / change or only updated automatically to reflect the variable parameters in the tariff formula

⁵in case a network investments is required only for the benefit of one new (big) consumer (e.g. new power plant), the investment is only realized if this consumer *before* realization of the investment confirms in a specific agreement ("capacity expansion agreement") to cover the investment costs irrespectively if the capacity would be used by the specific customer *after* realization (e.g. in case the new power plant was planned to be fired by gas but, finally, switches to oil)

⁶Ex-post recognition of costs of an infrastructure constructed in accordance with approved investment plans that cannot be recovered from its operation, under predefined conditions.



Annex 3

Feedback of National Regulators to ECS Questionnaire

[insert]