



Energy Community Regulatory Board

## **Cooperation of Regulators with Regard to Cross Border Investment Projects**

- Regulatory Instruments for Promoting New Investments –
  - Assessment of Existing Mechanisms –
  - Recommendations –

10 March 2010



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## 1. INTRODUCTION

### 1.1 Background

The Energy Community extends the EU internal energy market to South East Europe (SEE). By signing the Treaty<sup>1</sup> the signatory parties<sup>2</sup> agreed to implement the *acquis communautaire* on electricity, gas, environment, competition and renewables<sup>3</sup> with a view to realize the objectives of the Treaty and to create a regional gas and electricity market within South East Europe (SEE<sup>4</sup>) capable of attracting investment. Given the small size of the national markets it is commonly understood that following a **harmonised regional approach** for the energy market of the Energy Community remains the key requirement for the promotion of investments in the Region.

The Energy Community Regulatory Board (ECRB)<sup>5</sup> operates based on Article 58 of the Energy Community Treaty. As an institution of the Energy Community the ECRB advises the Energy Community Ministerial Council (MC) and Permanent High Level Group (PHLG) on details of statutory, technical and regulatory rules and should make recommendations in the case of cross-border disputes between regulators.

**Attracting investments is of core relevance** for market development in SEE. Realization of the necessary infrastructure calls for a stable regulatory and market framework, a common regulatory approach on regional level, the creation of a single energy market<sup>6</sup> without internal frontiers, developing competition on a broader geographic scale and exploring economics of scale. Investments in new transmission line projects remain a key requirement for the developing of a liquid and competitive electricity market in SEE. Where bottlenecks exist, market integration and cross border trade can not develop appropriately. Facilitating and stimulating new investments is therefore a core responsibility of both national legislation and regulatory praxis.

The need for coordinated project planning has also been recognized by the proposal for new legislative measures for the EU gas and electricity internal market ("3rd package")<sup>7</sup>.

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<sup>1</sup> The Energy Community has been established by the Treaty establishing Energy Community, signed in October 2005 in Athens and entering into force on 1 July 2006. Treaty establishing the Energy Community (hereinafter "The Treaty"). The Treaty was signed in October 2005 in Athens, Greece and entered into force on 1 July 2006. Details on the Energy Community and ECRB see [www.energy-community.org](http://www.energy-community.org);

<sup>2</sup> The **Parties** to the Treaty are the European Community, on the one hand, and seven **Contracting Parties**, namely, Albania, Bosnia & Herzegovina, Croatia, former Yugoslav Republic of Macedonia, Montenegro, Serbia and UNMIK. As of March 2009, 14 European Union Member States have the status of **Participants**. Georgia, Moldova, Norway, Turkey and Ukraine take part as **Observers**.

<sup>3</sup> For details of the relevant *acquis* see: [http://www.energy-community.org/portal/page/portal/ENC\\_HOME/ENERGY\\_COMMUNITY/Legal/Treaty](http://www.energy-community.org/portal/page/portal/ENC_HOME/ENERGY_COMMUNITY/Legal/Treaty)

<sup>4</sup> Title III of the Treaty. Covering territories of Contracting Parties and neighboring EU countries.

<sup>4</sup> Title III of the Treaty.

<sup>4</sup> Title IV of the Treaty.

<sup>5</sup> For ECRB details see [www.enc-ecrb.org](http://www.enc-ecrb.org).

<sup>6</sup> Title IV of the Treaty.

<sup>7</sup> OJ L 211, 14 August 2009 [http://ec.europa.eu/energy/gas\\_electricity/third\\_legislative\\_package\\_en.htm](http://ec.europa.eu/energy/gas_electricity/third_legislative_package_en.htm).



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Cross border cooperation of regulators with regard to investment projects of regional dimension has therefore been included in the ECRB Electricity Working Group (EWG) Work Program 2009<sup>8</sup>.

## 1.2 Scope of work

This report analyses the **regulatory instruments** for stimulating investments in new infrastructure projects and the powers of regulators as regards cooperation and harmonisation of regulatory rules related to projects crossing more than one border of Contracting Parties (“cross border investments”).

Based on this the **report concludes on necessary improvements** of related regulatory and legislative provisions and suggests possible regulatory options for promoting investments.

The report purely focuses its considerations on the instruments **regulatory mechanisms** can provide for facilitation of investments and recommends on related best practice solutions. The suggestions aim at providing a common regulatory framework that best supports and attracts investments.

The present discussion document also draws a link to existing **European experience**. By signing the Energy Community Treaty the Contracting Parties committed to implement parts of the European Union’s *acquis communautaire*. When implementing the *acquis* streamlining with best practice experience gained on European level is not only recommended from an efficiency point of view but also when keeping in mind the goal of integrating regional markets. Alignment with European experience of course needs to take into account national and regional specificities of the Energy Community.

The discussions of the present paper focus on the electricity market. It has to be underlined, however, that the general assessments are to a similar extent applicable to the gas market<sup>9</sup>. For outlining this, the report also refers to relevant gas market legislation. Comparisons with experience on EU level also involve both electricity and gas practice.

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<sup>8</sup> [http://www.ecrb.eu/portal/page/portal/ECRB\\_HOME/ECRB\\_DOCUMENTS/WORK\\_PROGRAMME](http://www.ecrb.eu/portal/page/portal/ECRB_HOME/ECRB_DOCUMENTS/WORK_PROGRAMME).

<sup>9</sup> See similar discussions of the ECRB Gas Working Group 2009 ([http://www.ecrb.eu/portal/page/portal/ECRB\\_HOME/ECRB\\_DOCUMENTS/WORK\\_PROGRAMME](http://www.ecrb.eu/portal/page/portal/ECRB_HOME/ECRB_DOCUMENTS/WORK_PROGRAMME)).

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## 2. INVESTMENTS IN INFRASTRUCTURE – THE ROLE OF REGULATORS

### 2.1 Legal background – possible regulatory instruments

National regulators have a number of possible instruments allowing them to address this responsibility, including tariff incentives without<sup>10</sup> or within Article 7 Regulation (EC) 1228/2003<sup>11</sup> (Article 17 Regulation (EC) 714/2009 – 3<sup>rd</sup> package) exemptions. For projects crossing national borders coordination of regulatory activities is a key requirement for facilitation of these investments. This first involves the provision of regulatory rules harmonized across borders but second also the question of coordinated project planning across borders.

For regulatory tariff setting Article 4 para 1 (EC) Regulation 1228/2003 (Article 14 (EC) Regulation 714/2009 – 3<sup>rd</sup> package) requires that “*The costs incurred as a result of hosting cross-border flows shall be [...] taking into account investment in new infrastructure*”.<sup>12</sup>

In addition to this general principles of tariff calculation regulators can provide a number of other: **regulatory instruments facilitating investments.**

- For the case of an investment not realized otherwise, Article 7 Regulation (EC) 1228/2003 (Article 17 Regulation (EC) 714/2009 – 3<sup>rd</sup> package) provides a mechanism to exempt projects from the regulated scheme. It has to be noted, however, that such exemptions need to remain the *ultima ratio* and take into account the necessity to balance between the disadvantages of the infrastructure in question not being built at all and the disadvantages for competition and market development that result from exempting pieces of infrastructure from third party access<sup>13</sup>.
- Before considering an exemption, it is the responsibility of national regulators to assess other options of facilitating investments, namely to develop regulatory investment incentives<sup>14</sup>.
- This might for example include a higher rate of return for a specified period of time or a shorter depreciation schedule for new investments to mitigate the volume and the revenue risk. For the purpose of incentivizing investment, national regulators should commit themselves to a certain tariff methodology for a long-term.

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<sup>10</sup> E.g. a higher rate of return for new investments. See later discussions.

<sup>11</sup> Regulation (EC) 1228/2003 of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity, OJ L 176 of 15.7.2003, p 1 et seqq. The same provision is stipulated for the gas market by Article 22 Directive 2003/55/EC (Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC; OJ L 176 of 15.7.2003, p 57 et seqq).

<sup>12</sup> For the gas market Article 3 Regulation (EC) 1775/2003 similarly calls national regulators to reflect in the national network tariffs “*actual costs incurred, insofar as such costs correspond to those of an efficient and structurally comparable network operator [...] whilst including appropriate return on investments. [...] Tariffs, or the methodologies used to calculate them, shall [...] providing incentives for investment [...]*” (Regulation (EC) No 1775/2005 of the European Parliament and of the Council of 28 September 2005 on conditions for access to the natural gas transmission networks; OJ L 289 of 3.11.2005, p 1 et seqq).

<sup>13</sup> See as well: Commission staff working document on Article 22 of Directive 2003/55/EC concerning common rules for the internal market in natural gas and Article 7 of Regulation (EC) No 1228/2003 on conditions for access to the network for cross-border exchanges in Electricity, para 11 and 12, SEC(2009)642 final (6.5.2009), [http://ec.europa.eu/energy/gas\\_electricity/interpretative\\_notes/doc/sec\\_2009-642.pdf](http://ec.europa.eu/energy/gas_electricity/interpretative_notes/doc/sec_2009-642.pdf).

<sup>14</sup> See fn 13, para 15.

- Starting from the responsibility of TSOs to meet reasonable demands and sort out capacity congestions by adding new investments as stipulated in Article 2 lit 4 Directive 2005/54/EC<sup>15</sup> “negative” investment incentives are a possible regulatory tool. Where Article 6 para 6 lit c Regulation (EC) 1228/2003 (Article 16 para 6 Regulation (EC) 714/2009 – 3rd package) provides national regulators the possibility to decide on the use of congestion revenues, this allows national regulators to introduce a negative incentive of tariff reduction through congestion (e.g. auction) costs not used for sorting out long term congestion. Related to this Article 6 para 6 lit b Regulation (EC) 1228/2003 (Article 16 para 6 lit b Regulation (EC) 714/2009 – 3rd package) requires congestion revenues to be used for “network investments maintaining or increasing interconnection capacities”. Article 6 para 6 lit c Regulation (EC) 1228/2003 further specifies that “Revenues [...] shall be used [...] as an income to be taken into account by regulatory authorities when approving the methodology for calculating network tariffs, and/or in assessing whether tariffs should be modified.”<sup>16</sup> In addition, Article 16 para 6 Regulation (EC) 714/2009 of the EU 3rd energy package requests “If the revenues cannot be efficiently used for the purposes set out in points (a) and/or (b) of the first subparagraph<sup>17</sup>, they may be used, [...] as income to be taken into account by the regulatory authorities when approving the methodology for calculating network tariffs and/or fixing network tariffs.”

## 2.2 Cross border investments

Realization of cross border projects basically involves two key challenges for regulatory systems:

1. **Harmonisation of regulators rules**, especially if a single market models is to be applied to the whole infrastructure (this might involve a “one stop shop” for capacity bookings).
2. **Non-domestic investments**: cross border projects typically to a certain extent exceed the infrastructure necessary for covering national demand. Reasonable and economically efficient transmission line planning, taking into account economies of scale, requires considering the capacity need necessary for transports trough a Contracting Party for covering demands of neighboring and further linked markets. National investments plans do not necessarily include interconnections to other markets from/to which they do not expect imports/exports.

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<sup>15</sup> Directive 2003/54/EC of the European Parliament and the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC, OJ L 176 of 15.7.2003, p 37 et seqq.

<sup>16</sup> For the gas market similar: Article 3 para 1 Regulation (EC) 1775/2003.

<sup>17</sup> Lit (a) and (b) requiring that [Any revenues resulting from the allocation of interconnection shall be used for the following purposes; Art 6 para 6] (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.

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From the investors' point of view there are basically two approaches to grid investments – the 'fully regulated' approach and the 'contract' approach<sup>18</sup>. The **fully regulated approach** addresses a core principle of market liberalization, namely that it is the responsibility of transmission system operators (TSOs) to meet reasonable market demand and sort out congestion by adding new capacities<sup>19</sup>. Regulation (EC) 1228/2003 requires national regulators to include efficiently incurred investment costs in their regulated asset base (RAB). This approach understands that the investment risk is not covered by the market benefitting from the investment. The direct risk of the TSO remains marginal.

The **contract' approach** on the other hand recognizes the fact that in some cases investment is required which is of benefit for the network users and consumers outside the network where the investment is made. This question is widely known as discussion of "non-domestic investments"<sup>20</sup> and links to the so-called "regulatory gap".

- The issue of "**non-domestic investments**" addresses the problem that national regulators will typically not accept to including (interconnection) costs which are of benefit only for customers of neighboring markets only in the national RAB. Reasons for that are first consumer protection responsibilities of national regulators but second also difficulties to justify tariff increases for the benefit of neighboring markets. 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, Inter TSO Compensation Mechanism (ITC) helps up to the certain extent. Contrary to gas, non-domestic investments are not covered ex ante<sup>21</sup> but ex post via ITC compensation. However, 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.
- The so-called "**regulatory gap**"<sup>22</sup> in a next step addresses the fact that powers of national regulatory are typically limited to the national boundaries of their market. Consequently, costs created outside this territory can not be included in the national RAB. This "regulatory gap" has similarly already identified for the EU Member States<sup>23</sup>.

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<sup>18</sup> See as well CEER, Response to the Energy Green Paper (Ref: C06-SEM-18-03, 11 July 2006), chapter 2.1.1, [http://www.energy-regulators.eu/portal/page/portal/EER\\_HOME/EER\\_PUBLICATIONS/CEER\\_ERGEG\\_PAPERS/Cross-Sectoral/2006/CEER-ResponseToGP\\_2006-07-11.pdf](http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_ERGEG_PAPERS/Cross-Sectoral/2006/CEER-ResponseToGP_2006-07-11.pdf).

<sup>19</sup> Article 2 lit 4 Directive 2003/55/EC and Article 2 lit 4 Directive 2005/54/EC. Commission staff working document on capacity allocation and congestion management for access to the natural gas transmission networks regulated under Article 5 of Regulation (EC) No 1775/2005 on conditions for access to the natural gas transmission networks, chapter 2.2 item 4, SEC(2007) 822 (12.06.2007); [http://ec.europa.eu/energy/gas\\_electricity/interpretative\\_notes/doc/sec\\_2007\\_822.pdf](http://ec.europa.eu/energy/gas_electricity/interpretative_notes/doc/sec_2007_822.pdf).

<sup>20</sup> See fn 17.

<sup>21</sup> E.g. recognition via RAB/tariffs/guarantee by NRAs to cover investment costs via long term planning.

<sup>22</sup> CEER, Response to the Preliminary Report of the Gas and Electricity Sector Inquiry (Ref. C06-GA-21-06; 20 April 2006), page 2 (lack of market integration) and 14; et al.

<sup>23</sup> See fn 20.

### 3. EUROPEAN EXPERIENCE

Having in mind the common legal basis (*acquis communautaire*) for the electricity market(s) of the European Union and the Energy Community, European regulatory experience can provide useful input to the regulatory discussions in the Energy Community. Streamlining of approaches of neighbouring regions should also be considered against the background of the larger scope of the Energy Community envisaging integration with the market(s) of the European Union. Alignment with European experience of course needs to take into account national and regional specificities of the Energy Community.

A practical assessment of the legal framework – discussed in chapter 2 – gives examples of European experience<sup>24</sup>:

Table 1: Regulatory investment incentives - European experience

Regulatory Instruments		Applied by <sup>25</sup>
<b>Regulatory investment incentives without exemption</b>	Higher rate of return for new investments	France
	Deposit for capacity expansion/capacity agreement <sup>26</sup>	Austria, Spain, UK
	“Negative incentive” – revenues used for tariff reduction if not re-invested	Austria
<b>Regulator has the power to recognize non-domestic investments in RAB</b>		Greece <sup>27</sup>

Source: Survey Energy Community Secretariat

<sup>24</sup> Table 1 providing examples for existing models - enumeration not exhaustive.

<sup>25</sup> The enumeration in this table aims at providing a picture of possible measures but does not make a claim to be complete.

<sup>26</sup> Meaning a financial guarantee provided by a network user requiring additional network capacity that can not 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 realisation 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 born 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.

<sup>27</sup> More in detail DESFA has to buy capacity in upstream networks if requested by the national regulators. The related costs have to be recognized by RAE in the RAB.

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It can be summarized for the European Union Member States that:

- As regards regulatory investment incentives used for promotion of investments *without* Article 7 Regulation (EC) 1228/2003 (Article 17 Regulation (EC) 714/2009 – 3<sup>rd</sup> package) respectively Article 22 Directive 2003/55/EC exemptions – although neither harmonised nor applied area-wide – a number of incentive models are applied.
- Incentive tariff regulation can serve as tool for promoting investments, e.g. when taking into account the number of congestion hours.
- The challenges linked to the “regulatory gap” and addressing non-domestic investments has been identified for the EU Member States and has been recognized by the third legislative package for the internal gas and electricity market (“third package”)<sup>28</sup>.
- Not all regulators have competences as regards investment planning<sup>29</sup>. Where empowered, the approval/review competences of national regulators are limited to national investment plans. Regional planning coordination is not stipulated legally. Identifying the need and relevance for such coordination, European regulators however started to discuss regional investment planning on a voluntary basis within the framework of the Regional Initiatives<sup>30</sup>. Practical implementation and enforcement of these projects was limited by their voluntary character. The necessity of first regulatory involvement in investment planning and second regional coordination of such planning is also recognised by the 3<sup>rd</sup> package. More in detail, the 3<sup>rd</sup> package requires TSOs to develop a 10 year EU wide investment plan for review by the newly introduced Energy Regulatory Agency<sup>31</sup>.

#### 4. EXISTING MODELS IN CONTRACTING PARTIES

For assessing the possible future measures for improving regulatory promotion of new infrastructure projects, the currently existing instruments have to be analysed. This in particular relates to:

- Regulatory investment incentives used for promotion of investments *without* Article 7 Regulation (EC) 1228/2003 (Article 17 Regulation (EC) 714/2009 – 3<sup>rd</sup> package) respectively Article 22 Directive 2003/55/EC.
- Competences as regards non-domestic investments.
- Competences as regards investment planning – both on national and regional level.

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<sup>28</sup> OJ L 211, 14 August 2009.

<sup>29</sup> Add reference to ERGEG report.

<sup>30</sup> For details see [www.energy-regulators.eu](http://www.energy-regulators.eu).

<sup>31</sup> Regulation of the European Parliament and of the Council amending Regulation (EC) No 1775/2005 on conditions for access to the natural gas transmission networks, Articles 2c and 2d, [http://ec.europa.eu/energy/gas\\_electricity/third\\_legislative\\_package\\_en.htm](http://ec.europa.eu/energy/gas_electricity/third_legislative_package_en.htm).

#### 4.1 Regulatory investment incentives – regulatory competences as regards non-domestic investments

Based on the results summarized in Table 2 it concludes that for the Energy Community jurisdictions:

- Regulatory investment incentives for promotion of investments *without* Article 7 Regulation (EC) 1228/2003 (Article 17 Regulation (EC) 714/2009 – 3<sup>rd</sup> package) are only applied in FYR of Macedonia.
- Regulators do not have the power to recognize non-domestic investments in RAB.
- The tariff regime does not provide any specific tools for promoting investments.

Table 2: Regulatory investment incentives - Contracting Parties to be added by CP

Regulatory Instruments		Applied by CPs
<b>Regulatory investment incentives without exemption</b>	Higher rate of return for new investments	FYR of Macedonia
	Deposit for capacity expansion/capacity agreement <sup>32</sup>	No
	“Negative incentive” – revenues used for tariff reduction if not re-invested	FYR of Macedonia
	Others	No
<b>Regulator has the power to recognize non-domestic investments in RAB</b>		No
<b>Tariff investment scheme</b>		No
<b>Others</b>		No

Source: Regulators Contracting Parties

#### 4.2 National and regional competences regarding investment planning

In order to evaluate the present role of SEE regions’ regulators in relation to investment projects, a short questionnaire has been prepared and circulated by the ECRB EWG. The outcome of the survey in

<sup>32</sup> Meaning a financial guarantee provided by a network user requiring additional network capacity that can not 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 realisation 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 born 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.

Table 3 shows that:

- regulators of the SEE region do not have harmonized responsibilities in relation to investment projects;
- some regulators do not have power with regard to cross border transmission line investment plans at all;
- Cooperation of regulators regarding cross border transmission investments in SEE region so far is insignificant.

Table 3: Overview of competences

	Is the regulator legally obliged to approve the transmission network investment plans?	Are cross border transmission line investments approved within the transmission network investment plans?	Did the regulator have bilateral cooperation with neighbouring markets regarding cross border investments?	Did the regulator participate in multilateral regional activities regarding cross border transmission line investments?	Are there any finalized cross border transmission investment projects that the regulator participated in?
<b>Albania</b>	Yes	Yes	No	No	No
<b>Austria</b>					
<b>Bosnia and Herzegovina</b>	Yes	Yes	No	No	No
<b>Bulgaria</b>					
<b>Croatia</b>	Yes	Yes	No	No	No
<b>Greece</b>	No <sup>33</sup>	Yes	Yes	No	Yes
<b>FYR of Macedonia</b>	Yes, indirectly <sup>34</sup>	Yes	No	No	Yes, indirectly <sup>35</sup>
<b>Hungary</b>					
<b>Italy</b>	No <sup>36</sup>	Yes	Yes	No	Yes
<b>Montenegro</b>	Yes	Yes	No	No	No
<b>Romania</b>	Yes	Yes	Yes	Yes	Yes
<b>Serbia</b>	No	Yes	No	No	No
<b>Slovenia</b>	No	Yes	No	No	No
<b>Turkey</b>	Yes	Yes	No	No	No
<b>UNMIK</b>	Yes	Yes	No	No	No

Source: Regulators Contracting Parties

<sup>33</sup> RAE provides an opinion to the Minister, you has the competence to approve a 5 year development plan.

<sup>34</sup> In accordance with the Rulebook on regulating electricity prices, Energy Regulatory Commission approves the investments in the transmission network. Also there are obligations in the license to submit the Plan for development of the transmission network for 5 years and the yearly program for realization of the Plan to the ERC every year by the 10th of March.

<sup>35</sup> In accordance with the Rulebook on regulating electricity prices, Energy Regulatory Commission approves the investments in the transmission network and also for cross border investments. Costs for interconnection with Greece have been approved in regulated revenue of the TSO.

<sup>36</sup> In Italy the Ministry for Economic development approves the development plan, the Regulatory Authority issues an informal opinion to the Ministry.

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## 5. CONCLUSIONS

Making use of best practise experience on European level, the analysis of this report on existing approaches in the Contracting Parties concludes as follows:

1. Without additional legislative adjustments needed the **first recommendation** calls for:
  - Full implementation of the *acquis* as minimum set of a harmonised regulatory framework.
  - Harmonisation of regulatory market rules.
  - Introduction of regulatory investment incentives promoting investment on national basis. This may include incentive tariff models supporting the promotion of new investments, capacity agreements (deposits)<sup>37</sup>, 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.

The ECRB should develop best practice recommendations on regulatory incentives for promoting investment.

2. A **second recommendation** addresses the “**regulated gap**” related to **non-domestic investments** and requires legal adjustments: National regulators should be empowered to recognize extra-territorial costs in their RAB as far as beneficial for the national customers. 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, Inter TSO Compensation Mechanism (ITC) helps up to the certain extent. Contrary to gas, non-domestic investments are not covered ex ante<sup>38</sup> but ex post via ITC compensation. However, 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.
3. A **third recommendation** addresses the requirement of **regional investment planning**. It also requires legal adjustments:
  - Where not so far, national TSOs need at first to be made responsible for developing investment plans. TSOs are responsible for sorting out congestion related to reasonable demand increase (Article 2 lit 4 Directive 2003/55/EC and Article 2 lit 4 Directive 2005/54/EC).

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<sup>37</sup> Meaning a financial guarantee provided by a network user requiring additional network capacity that can not 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 realisation 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 born 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.

<sup>38</sup> E.g. recognition via RAB/tariffs/guarantee by NRAs to cover investment costs via long term planning.

- In a second step national regulators need to be empowered to approve the reasonability of these investment plans. This approval of the national regulator has to link to a guarantee of recognition of related investment costs in the RAB. Such approach minimizes the TSOs’ investment risk down to zero and ensures that reasonable capacity demand is met on national level.
  - 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 leads to the proposal of introducing a system regional investment planning. As an example the mechanisms of the 3rd EU energy package can be used, requiring TSOs to develop a 10 year EU wide investment plan for review by the newly introduced Energy Regulatory Agency (ACER)<sup>39</sup>. 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.
4. **Cooperation of TSOs** regarding their coordination of regional investment planning has to be discussed in parallel. While, certainly, this does not fall into the decision making competences of regulators, the question of related TSO coordination is of key relevance for the development of regional investment planning.

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<sup>39</sup> Regulation of the European Parliament and of the Council amending Regulation (EC) No 1775/2005 on conditions for access to the natural gas transmission networks, Articles 2c and 2d, [http://ec.europa.eu/energy/gas\\_electricity/third\\_legislative\\_package\\_en.htm](http://ec.europa.eu/energy/gas_electricity/third_legislative_package_en.htm).

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- One of the key conclusions of the Study on transmission network investment criteria (2007<sup>40</sup>) was the suggestion to establish an official SEE regional transmission planning group which should be supported by the Energy Community, SEE TSOs, SEE regulatory authorities and the European Commission. This was reasoned by a relatively high number of TSOs in the SEE region making coordination more complex. The group should direct TSOs' attention to a more SEE regional project planning perspective, while currently TSOs focus on national territories. The planning group should deal with SEE transmission system planning including collection of planning data, establishment of planning scenarios, preparation of common network models for necessary analyses (load flow, dynamic, short-circuit, probabilistic models), performance of analyses, comparison of candidate projects according to pre-defined criteria, prioritization of investments and publication of reports concerning the SEE transmission system's future bottlenecks, prediction of congestions from a planning perspective and suggestions for further development. The planning group responsibilities are similar to the 3<sup>rd</sup> package's role of the European Networks of Transmission System Operators (ENTSO-E) that *"shall adopt and publish a Community-wide network development plan every two years. The Community-wide network development plan shall include the modelling of the integrated network, scenario development, a European generation adequacy outlook and an assessment of the resilience of the system."*<sup>41</sup>.
  - Against the background of the newly established European Networks of Transmission System Operators for Electricity and Gas (ENTSO-E and ENTSO-G) coordination with their 10 year investment planning is highly supported.

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<sup>40</sup> Transmission Network Investment Criteria , Energy Institute Hrvoje Pozar, 2007 .

<sup>41</sup> Article 8 para 10 of Regulation (EC) No 714/2009