

# **CEER's Response to a Regional Independent Operator (RIO) proposal by EURELECTRIC**

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## 1. Introduction

Eurelectric has proposed an approach where Transmission System Operators (TSOs) in a given regional market gradually bring together network related activities, in particular those affecting cross-border issues, into a Regional Independent Operator (RIO). Eurelectric sees that the RIO model can provide a number of advantages to consumers, for example:

- limiting the role of vertically integrated companies to pure asset owners guarantees non-discriminatory and fair access to the network, as the operation of the grid will be handled by an independent regional entity;
- providing for fair and non-discriminatory access, as the day to day operation of the grid is no longer handled by TSOs, but by an independent regional entity;
- driving market integration on a regional level without waiting for ownership unbundling, which may be a lengthy process; and
- assessing capacity adequacy from a regional grid perspective.

This CEER position paper addresses these issues, gives first views and indicates challenges in implementation. The paper introduces views on a general level due to the fact that the RIO model is not yet defined sufficiently in detail. This has also been recognised by Eurelectric who has stated that the aim has not been to deliver a self-contained proposal which answers all possible questions, but to provide a basis for discussions.

## 2. Regional co-operation among TSOs

Alternative approaches exist to enhance regional co-operation among TSOs:

- improved co-operation through more formalised co-operation agreements; and
- company-based integration of TSOs with alternative models

In the first approach, the increased co-operation is based on co-operation agreements that can cover, for example, system responsibility, balancing and congestion management. Company-based integration includes several models, such as joint Independent System Operator (ISO), joint TSO, market operator or an interconnector company.

A joint regional ISO has no direct or indirect ownership of any grid assets. Its task is to ensure the secure operation of the interconnected regional power system. A joint regional TSO is created by merging together the national TSOs. As a grid owner, the joint regional TSO will have to ensure adequate expansion and maintenance of the transmission grid across the region. As a system operator, the joint regional TSO will also be charged regionally with system responsibility.

An alternative model is an interconnector company, which can be established to speed up the interconnector projects in the region. This requires that TSOs delegate this activity to a single entity with the mandate to plan, finance and ensure the completion of interconnector projects.

The market operator model can be seen as the extension of the joint ISO, as in this case the ISO is also responsible for market operations including, for example, operation and ownership of the regional power exchange as well as responsibility for the market rule setting and development.

**Regional co-operation among TSOs is practised in various forms already today.** The main emphasis within the regional co-operation has been on the operational co-ordination, where the operation of the interconnected power systems has been secured regionally.

For practical reasons, the development of large synchronous areas like the Union for the Co-ordination of Transmission of Electricity (UCTE) or Nordel has been based around the regional approach and gradual expansion of new control areas and members. It has enabled development and validation of the technical and organisational standards and rules in the practice – this has been the key condition which has allowed for the further evolution and integration of the European power system and market.

However, a single company being in charge of regional system operation and co-ordination has not been established previously.

### **3. Regional co-operation of TSOs in the 3<sup>rd</sup> package**

The European Commission adopted on 19 September 2007 a third package of legislative proposals. The documents contain provisions about the eligibility of undertakings to be part of a joint transmission system operator (proposal to amend the Directive) and the regional co-operation of TSOs (proposals to amend the Directive and the Regulation (EC) 1228/2003 and a new proposal to set up an EU Agency). The eligibility provisions have direct relevance to the concept of a joint regional independent system operator. The provisions on regional cooperation are more general and apply to all forms of arranging the system operation activities. The focus on cooperation by grid operators, combined with the new obligations on the national regulatory authorities who now have an obligation and a duty to create a single energy market, and the role of the EU Agency in monitoring the regional co-operation of TSOs, should foster greater regional co-operation.

The proposal to amend the Directive 2003/54/EC concerning common rules for the internal market in electricity contains new provisions that are relevant here. The proposed new Article 8 on the unbundling of transmission systems and transmission system operators in paragraph 5 allows for several undertakings which own transmission systems to create a joint venture, which acts as a transmission system operator in several Member States for the transmission systems concerned. However, it stipulates that no other undertaking may be part of the joint venture unless it has been approved under Article 10 because an ISO. Article 10 contains *inter alia* detailed provisions on the issues that relate to approving and designating an ISO.

Accordingly, the proposal makes it a precondition that the participating undertakings in a joint TSO are efficiently unbundled by either applying ownership unbundling or by an ISO approach at national level.

Furthermore, in the proposal for amending the Directive the new Article 5a on “Promotion of Regional Cooperation” states that in relation to regional cooperation, Member States shall promote the cooperation of network operators at a regional level and foster the consistency of their legal and regulatory framework. The article also touches upon the specification of relevant cooperation regions by saying that the geographical area covered by regional cooperation shall be in line with the definition of geographical areas by the Commission in accordance with Article 2f(3) of Regulation (EC) No 1228/2003.

In the proposal for a Regulation for amending the Regulation (EC) No 1228/2003 on Conditions for Access to the Network for Cross-border Exchanges in Electricity in Recital (7) on page 22 it

has been stated that “Given that more effective progress may be achieved through an approach at regional level, transmission operators should set up regional structures within the overall cooperation structure, whilst ensuring that results at regional level are compatible with codes and investment plans at Community level. Cooperation within such regional structures presupposes effective unbundling of network activities from production and supply activities in the absence of which regional cooperation between transmission system operators gives rise to a risk of anti-competitive conduct.”

Article 2(h) of the proposal for amending the Regulation also contains a requirement on TSOs to cooperate regionally. According to it, TSOs shall establish regional cooperation within the European Network for Transmission System Operators (ENTSOs) for Electricity to contribute to the tasks dedicated to them in the Regulation. Furthermore, the geographical area covered by each regional cooperation structure may be defined by the Commission. For this measure, the comitology process is to be used and the Commission may consult the ENTSOs for Electricity and the Agency.

The proposal for a Regulation establishing an Agency for the Cooperation of Energy Regulators contains the responsibilities of the Agency as regards the cooperation of TSOs. In Article 6 it states that the Agency shall monitor the execution of the tasks of the European Network of Transmission System Operators for Electricity. Article 6.6 explicitly states that the Agency shall monitor the regional cooperation of TSOs.

To sum up, in order to be able to establish a joint ISO, the participating undertakings are required to be effectively unbundled (either ownership or ISO) according to the rules specified in the proposal to amend the Directive. Thus the undertakings participating in a joint (regional) ISO would not be treated more leniently than those who choose to operate separately as an ISO or to choose to run the activities by following the rules on ownership unbundling.

The proposals support and foster regional co-operation of TSOs but quite correctly do not presuppose any joint venture like joint independent system operation. The objective is to ensure that TSOs cooperate in relevant issues in appropriate combinations – certain issues require a European approach whereas other issues can, at least in the near future, be best tackled on a regional scale while also ensuring coherent outcome at the European level. The monitoring task of the regional cooperation activities foreseen in the proposals is planned to be given to the Agency for the Cooperation of Energy Regulators.

## **4. Assessment of the Eurelectric RIO proposal**

### **4.1. Main features of the RIO model<sup>1</sup>**

In the RIO model, the model of joint regional ISOs, TSOs work together and integrate their tasks into a regional institution. The RIOs members could be either ownership unbundled TSOs or vertically integrated TSOs.

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<sup>1</sup> This description is based on Eurelectric discussion paper “*Towards Regional Independent Operators: a main driver for successful market integration*”, May 2007 Ref: 2007-384-0011.

The key issue would be that the RIO would have the responsibility for granting access to the whole transmission grid within its region. The RIO would be responsible for day-ahead and intra-day issues, real-time operation, system adequacy analysis and grid planning and have an important role in taking investment decisions.

The integration of activities into a RIO should start with the common calculation of grid capacities followed by other day-ahead activities, subsequently adding intra-day issues before finally including real-time system operations. In parallel, functions for grid planning and investments should be built up within the RIO so that it will be fully enabled to perform these functions when it becomes responsible for system operations.

The RIO also has to ensure sufficient inter-regional coordination with other RIOs taking into account the capacity situation in neighbouring RIO areas. This touches upon areas like investment planning, calculation of capacities and capacity allocation.

It is envisaged that the RIO is will be set up by legislation, which would preferably be at European level so as to avoid influence by any national interests. Additionally, an efficient and consistent regulatory process must be established to match the regional scope of a RIO. It would therefore be necessary to confer responsibilities on the national regulators for cross-border and regional transmission issues and oblige them to take further market integration into consideration when making regulatory decisions. In addition, the sharing of the responsibilities between national regulators and the regional/European regulatory function will have to be clearly defined.

A proposal is made to create regional sub-committees within an "EREGG-plus". The European Commission wish to have an active role in the establishment and development of the RIO. The regulatory framework should be clearly defined by the legislation setting up the RIO.

#### 4.2. Merits of RIO approach

CEER considers the RIO proposal as an alternative to promote and deepen TSO cooperation. It should be studied along with other alternatives (improved co-operation through more formalised co-operation agreements and company-based integration of TSOs with alternative models) to find out the most efficient models that foster the market integration to the regional market and further to the Internal Electricity Markets (IEM).

**The main merit of the RIO model is that it gives rise to increased regional integration, which is seen to foster competition in the electricity market.** Up until now, most Member States have not been able to guarantee a workable competition, partly because of their country size and the inherent size of the national market but also partly because of the lack of commitment. Especially for small countries but also for countries with high market concentration (i.e. almost all Member States) integration of the market is seen to promote competition through the larger geographical size of the market and the usually following decrease in market concentration.

The RIO model is more favourable to regional integration than any national model of ISO because it establishes a multinational entity which is responsible for system operation. **Under the RIO approach it should be more difficult to protect national interests by Member States in the region (provided that appropriate governance rules are in place). Thus the potential advantages of the RIO model are related more to market integration and prevention of national discrimination.**

### 4.3. Operational weaknesses of the RIO approach

The proposal leaves open the solution to the main weak points of all ISO models, i.e. how to define and arrange the relationship between the ISO (RIO) and the asset owner (national TSOs), how to make sure that decisions taken by the RIO are really implemented by the national TSO (such as new investment) and how to construct an ISO which has the financial capacity to support all its liabilities. Thus **the main challenge of the RIO model to be solved is the legal, regulatory and operational interface between the RIO and the national TSOs**. This interface should be carefully designed and defined.

Eurelectric proposes a supportive role of the RIO in relation to new investments, where the RIO itself must have the possibility to invest it if the national TSO blocks important projects, which immediately raises the question that in this respect the RIO finally becomes a regional TSO. This would also gradually facilitate taking over liability for the whole regional power system. A pure ISO (as well as the pure RIO) may not be able to take over responsibility and liability for the functioning of the system. The Eurelectric paper does not provide any solution to this problem.

An important challenge to be solved is **how to guarantee the full independence of the RIO from the national asset owners (national TSOs) and other market participants**.

One major weakness of the RIO concept as proposed by Eurelectric is that **it may not be efficient in preventing potential discrimination by the vertically integrated companies in guaranteeing fair and non-discriminatory access to the network**. Therefore any concept of RIO and/or regional approach cannot compensate for the necessary and sufficient independence and neutrality of the involved entities (TSOs) – in other words, the concept of the RIO is not a substitute for proper unbundling as long as the members of the RIO are not efficiently unbundled.

Furthermore, compared with ownership unbundling, the RIO model:

- **Requires more detailed legislative and regulatory framework** in order to define the relationship between the RIO and the asset owners, the TSOs (e.g. where responsibilities and regulatory obligations fall, how they are fulfilled and how parties are remunerated); and
- **It is less effective in addressing discriminatory issues in relation to both access and investments**. Vertically integrated network owners (TSOs) may find a way to bias investment decisions by the RIO or to delay investment implementation if they are responsible for applying for site-licensing and for carrying out the investment plans (e.g. they may have an incentive to delay network expansions because of their potential impact on integrated generation and/or retail market business).

### 4.4. Issues of coverage, jurisdiction and regulation to be solved

**The RIO proposal is not fully elaborated with regard to the issues of the division of the EU into RIOs** (how many RIOs, which Member States and their TSOs would be belonging in which RIOs), where the RIOs would be established (which are the jurisdictions where they would operate) and who would have the regulatory powers and mandate to oversee them and ensure compliance with the legislation governing their operation.

According to Eurelectric the starting point for the definition or the discussion concerning the regions) should be the DG TREN Strategy Paper “Medium term vision for the internal electricity market”, which provides for clearly defined regions. Additionally, this definition can be further

refined by taking other criteria into account, e.g. compatibility of systems, no additional division of existing national markets or price areas.

The definition of regions should be carefully designed to avoid inefficient structures, especially in the UCTE region. The CEER sees that when the regional concept for Europe is discussed, the synchronous systems of Nordic and Baltic countries are natural regions for regional co-operation entity and thus for the RIO. Also UK and Ireland form one region. The UCTE synchronous system on continental Europe may have different groupings for regions. Thus the UCTE area and criteria for forming regions within this area should be further studied.

The regional approach within the RIO itself raises the potential divergence of the regions and therefore an even more manifested separation of markets in Europe. Any structural implementation of the regional concept will have to cope successfully with this issue. Eurelectric's proposal does not contain a plan for co-ordination between neighbouring RIOs, which is necessary in order to achieve integrated European market.

As the RIO would consist of system operation activities of TSOs based in many countries, an issue to be solved is the jurisdiction of the RIO. This includes sub-issues like where the headquarters of the RIO is located and which country's legislation is it subject to. These are delicate issues as the RIO would be in charge of controlling a critical infrastructure covering many countries.

**The establishment of RIOs requires that the regulatory framework is clear and the responsibilities, obligations and rights of the regulatory organ are properly specified and anchored in legislation.** Eurelectric has envisaged that the RIO would be set up by legislation, which would preferably be at European level. Additionally, the sharing of the responsibilities between national regulators and the regional/European regulatory function will have to be clearly defined. To this end Eurelectric has made a proposal to create regional sub-committees within an "ERGEG-plus".

According to Eurelectric, if it should not be possible to mandate a model like the RIO through EU legislation, it should be for the Member States to define the regions based on guidance by the European Commission and/or EU legislation. Such a combination of EU legislation, providing for incentives, the definition of criteria for the decision on the RIO regions, etc., and treaties between the involved Member States could prove to be the fastest and most efficient way forward.

Even if a RIO is set up and the regulatory problems are solved there will still be different market rules in most Member States. It might be the case that the RIO would be trying to manage the networks where, for example, there is a bilateral market in one area of the region and a pool in another. The RIO proposal does not indicate how these market rules would be harmonised.

If the RIO model is the chosen approach, network rules will require harmonisation. They include rules on security, access rights, balancing and congestion management. Currently these rules are grounded in national regulation and harmonisation of them would require a lot of work and time. Of course, a harmonisation development will inevitably take place on the European and regional level but it will require time.

#### **4.5. Is RIO a precondition for market integration?**

Most of the benefits related to the efficient use of the cross-border interconnection capacity can be obtained at the ex-ante or at the operational planning stage (day ahead or intraday) within the

European legal framework. **The co-ordination among System Operators (SOs) that is needed to achieve ex-ante market integration is unlikely to require such a high degree of centralisation as implied by the RIO proposal.** To clarify this it should be studied further if regional market integration necessarily requires so centralised functions as within RIO.

There may be a trade-off between benefits stemming from centralisation of activities and responsibilities and also drawbacks in terms of reduced control over the power system at the national level. **It is true that full integration among SOs – in line with the RIO proposal – would bring efficiency gains in cross-border capacity utilisation, but those gains may be relatively small, if the advances being made within the ERGEG Regional Initiatives (ERI) are taken into account.**

CEER considers that there may be fewer functions that should have regional or pan-European relevance compared to the activities proposed for RIO. These functions, such as security of supply and investment planning and financing, should be precisely defined and addressed at a regional and European level. This could be achieved by co-operation agreements, binding guidelines and codes for TSOs, which should be carefully designed to take into account both the national and regional aspects.

**The regional concept and the regional market integration have been enhanced through ERGEG Regional Initiatives (ERI).** Eurelectric's proposal can be seen based on the idea that the ERI is not adequate enough to ensure a suitable degree of co-ordination among the system operators in a reasonable time. As a consequence, unifying in one (or fewer) entity(s) the responsibilities and powers currently assigned to various SOs within a region would be the only viable and fast way to enhance co-ordination.

**ERI is already showing progress, both in terms of integrating regional markets and increasing coherence among regions.** The results recently achieved in some regions (e.g. France-Belgium-The Netherlands, Mibel), as well as experiences of pre-existing cross-border regional market organisations (e.g. Nordpool), suggest that co-ordination among separate SOs is also a feasible and effective way to integrate national markets into regional ones.

Furthermore the European Commission's proposals of 19 September **set up a framework that should allow for further regional co-operation by first obliging national regulators to have an objective and duty to create a single energy market and secondly through the EU Agency which shall monitor the regional co-operation of TSOs.**

## 5. Conclusions

The details of the RIO model are not currently defined and available which prevents a thorough evaluation of the model and its effects on integrated market against other modes of regional co-operation and organisational structures.

**The CEER recognises the potential merits inherent in the RIO model to enhance market integration.** The RIO model is more favourable to regional integration than any national model of ISO because it establishes a multinational entity which is responsible for system operation. In principle, the RIO model (or any regional entity model) may have advantages in relation to more informal and looser regional co-operation. It also lends itself to contributing to first coherent and subsequently harmonised technical and market rules in system operation.

**However, improving market integration does not remove the need to resolve the EU's deep seated problem of undue discrimination on the part of vertically-integrated companies. A strong precondition for RIO's acceptability is effective unbundling.** The members of RIO must be effectively unbundled. Application of the RIO model cannot compensate for the necessary and sufficient independence and neutrality of the involved entities (TSOs) – in other words, the concept of the RIO is no substitute for proper unbundling. Therefore we strongly endorse the European Commission's position that effective unbundling is a critical precondition that needs to be fulfilled in case a joint TSO is established.

**Compared with ownership unbundling, the RIO model requires a more detailed legislative and regulatory framework in order to define the relationship between the RIO and the asset owners. It would also be less effective in addressing discriminatory issues in relation to both access and investments if members are not effectively unbundled.**

Among the issues that need to be considered in further detail include

- an elaborated plan of the division of EU into RIOs (how many RIOs, which Member States and their TSOs would be belonging in which RIOs) and the jurisdiction of the RIOs?;
- how a RIO would work in a region with different market design and rules? Or is a certain degree of harmonisation with regard to these issues required before the establishment of a RIO?; and
- who would have the regulatory powers and mandate to oversee them and ensure compliance with the legislation governing their operation (the division of powers between national regulators, national regulators cooperating and acting regionally and the agency for cooperation of energy regulators)?