The Right to Regulate
Best practices in regulatory reforms to attract investment

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The **Right** to Regulate 
or 
the **Need** to Regulate?
Introduction: the obvious!

- **Competition** should be the general rule in a modern economy, as it:
  - promotes **efficiency** and the cost-reflectiveness of prices
  - Stimulates **innovation** (new products/processes) thus resulting in better prices and greater choice for consumers

- Therefore, **promoting competition**, wherever possible, shall generally be the **priority**, including in the energy sector

- However, as we know, it may be difficult or impossible to develop competition for some activities in the energy sector
Energy Networks

- (Energy) Networks are:
  - essential facilities, as they are necessary for delivering energy and for competition in other parts of the (energy) sector to develop
  - often Natural Monopolies (at least with the current technology), as they cannot be (economically) replicated

Therefore, Network activities needs to be:
- Unbundled
- Regulated

The boundary between those activities which need to be regulated and those where competition can develop changes over time (e.g. distribution/supply)
Unbundling

- Unbundling of monopoly (network) activities from other activities where competition can develop is essential ...

... to avoid:

- possible **cross-subsidisation** in tariff setting
- possible **discrimination** in access
- possible **distortions** in network development

- Which type of unbundling?

  - Accounting
  - Managerial
  - Legal
  - Ownership

**Inadequate unbundling might deter new entry and investment in competitive activities!**
Regulation (1)

- Different dimensions of Regulation
  - Price/revenue regulation, to ensure
    - fair and just revenues/return to monopoly activities
    - that prices charged for monopoly activities are as cost-reflective as possible
  - Access regulation, to ensure:
    - non-discriminatory access to essential facilities
  - Quality-of-service regulation, to ensure
    - adequate quality of the monopoly activity services
    - consumer protection (commercial quality)

Regulation is not a goal in itself or an ideology! ... and it is always a second-best wrt competition!
Energy Sector Regulation

- The long-term nature of energy sector investments requires stable and time-consistent regulation
- Regulation can be significantly helped by an appropriate sector structure and market design
- Policy and regulation are separate dimensions ... and should be kept separate. Politics should stay out of the way!
- The independence of the Regulators is key!
  - from industry and other commercial interests
  - from Government and other political interests

Proportionate and well-designed regulation promotes economic freedom and competition
## Index of Economic Freedom (1)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>2016 Score</th>
<th>Δ 2016/5</th>
<th>Δ 2015/4</th>
<th>Δ 2014/3</th>
<th>Δ 2013/2</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Hong Kong</td>
<td>88.6</td>
<td>-1.0</td>
<td>-0.5</td>
<td>+0.8</td>
<td>-0.6</td>
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<tr>
<td>2</td>
<td>Singapore</td>
<td>87.8</td>
<td>-1.6</td>
<td>0.0</td>
<td>+1.4</td>
<td>+0.5</td>
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<tr>
<td>3</td>
<td>New Zealand</td>
<td>81.6</td>
<td>-0.5</td>
<td>+0.9</td>
<td>-0.2</td>
<td>-0.7</td>
</tr>
<tr>
<td>4</td>
<td>Switzerland</td>
<td>81.0</td>
<td>+0.5</td>
<td>-0.6</td>
<td>-0.6</td>
<td>-0.5</td>
</tr>
<tr>
<td>5</td>
<td>Australia</td>
<td>80.3</td>
<td>-1.1</td>
<td>-1.1</td>
<td>+0.6</td>
<td>-0.1</td>
</tr>
<tr>
<td>174</td>
<td>Turkmenistan</td>
<td>41.9</td>
<td>+0.5</td>
<td>+0.4</td>
<td>+2.2</td>
<td>+0.1</td>
</tr>
<tr>
<td>175</td>
<td>Zimbabwe</td>
<td>38.2</td>
<td>+0.6</td>
<td>+2.1</td>
<td>+6.9</td>
<td>+2.3</td>
</tr>
<tr>
<td>176</td>
<td>Venezuela</td>
<td>33.7</td>
<td>-0.6</td>
<td>-2.0</td>
<td>+0.2</td>
<td>-2.0</td>
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<tr>
<td>177</td>
<td>Cuba</td>
<td>29.8</td>
<td>+0.2</td>
<td>+0.9</td>
<td>+0.2</td>
<td>+0.2</td>
</tr>
<tr>
<td>178</td>
<td>North Korea</td>
<td>2.3</td>
<td>+1.0</td>
<td>+0.3</td>
<td>-0.5</td>
<td>+0.5</td>
</tr>
</tbody>
</table>

Source: The Heritage Foundation, 2015
Index of Economic Freedom (2)

Free:
+80.0
Mostly Free:
76.7-79.9
73.3-76.6
70.0-73.2
Moderately Free:
66.7-69.9
63.3-66.6
60.0-63.2
Mostly Unfree:
56.7-59.9
53.3-56.6
50.0-53.2
Repressed:
45.0-49.9
40.0-45.0
-39.9

Source: The Heritage Foundation, 2017
Completing the Internal Energy Market

- **Market Integration** (by 2014)
  - More Efficient Use of Existing Infrastructure
  - Market Design Improvements

- **Removal of Energy Islands** (by 2015)
  - Infrastructure Expansion
  - Efficient Infrastructure Planning and Development
Infrastructure Planning and Development

- Projects of Common/European Interest
  - Long list of approx. 550 projects
  - Selection based on political agreement
  - No revision of the list envisaged in 7 yrs

Third Energy Package (2009)
- TYNDPs
  - Non-binding, ... but reference for national NDPs
  - EU dimension in Network Planning
  - TYNDPs updated every two years

TEN-E Regulation (2013)
- Projects of Common Interest (PCI)
A new framework for the development of infrastructure with cross-border relevance

The “traditional” framework
(for cross-border infrastructure)

- TSOs' planning mainly on a bilateral basis
- Cost sharing based on ownership / national territory
- Cost recovery through network tariffs (NRAs)
  - usually RoR for TSOs - with some incentive elements; except for exempted infrastructure
- Permitting typically a long process, involving several authorities

Current EU framework
(for infrastructure development)

- Pan-EU planning, identification of priority projects
  - Cost-Benefit Analysis (CBA)
  - ENTSO Ten-Year Network Development Plans (TYNDP)
  - Projects of Common Interest (PCI)
- Facilitating project implementation
  - Cross-border Cost Allocation (CBCA)
  - Risk-related incentives
  - Use of congestion revenues
- Facilitating third party projects
  - Exemptions from TPA requirements
- Fast-tracked permit granting
Cross-border cost allocation (CBCA)

Main features of the Agency’s approach
(Recommendation No 05/2015 of 18 December 2015)

- Economic, social and environmental costs and benefits of the projects to be taken into account
- Compensation provided only if at least one hosting country bears negative net impact
- Compensation should mainly aim at the “elimination of the negative net impact”
- Compensation should be provided by countries to which the project provides a “significant” positive net impact
  - “significance threshold” equal to 10% of the sum of positive net impacts of all net benefiting countries
**CBCA Decision: an Example - GIPL**

- Gas Interconnection Poland Lithuania
- 530 km pipeline with initial capacity 2.4 bcm/y
- Cost: €558m, Net Benefits €830m
- Aimed at ending isolation of Baltic Member States from EU gas market and at diversifying gas supply

**GIPL Costs and Benefits (€m)**

![Graph showing costs and benefits for TSOs](image)

**Cross-Border Cost Allocation**

<table>
<thead>
<tr>
<th>Payer TSO</th>
<th>Recipient TSO</th>
<th>Compensation Payment (€m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>LT</td>
<td>PL</td>
<td>54.9 (64.0%)</td>
</tr>
<tr>
<td>LV</td>
<td>PL</td>
<td>29.4 (34.3%)</td>
</tr>
<tr>
<td>EE</td>
<td>PL</td>
<td>1.5 (1.7%)</td>
</tr>
<tr>
<td><strong>Total Compensation</strong></td>
<td><strong>85.8 (100%)</strong></td>
<td></td>
</tr>
</tbody>
</table>

ACER Recommendation No 07/2013 of 25.10.2013
Project implementation
(PCI implementation monitoring 2016)

- 111 electricity PCIs on the 2015 Union list:
  - 100 transmission
  - 2 smart grids
  - 9 storage
- Fewer than in the 2013 Union list which included 134 PCIs
- 40% of the PCIs in the 2015 Union list are in an early stage of advancement:
  - “under consideration”
  - “planned, but not yet in permitting”
Expected Investment Costs
(PCI implementation monitoring 2016)

- Total expected investment costs of all electricity PCIs over the next decade: €52.5 bn
- 2015 level of actual CAPEX: €1.2 bn

- No strong interest visible from promoters to use financial and regulatory support tools
  - 7 CBCA decisions, 3 specific incentives, 7 exemptions*
  - CEF support: approx. €303m for 28 studies and 4 works
    (source: INEA, May 2016)

*Not only PCIs. Granting exemptions already started with the 2nd Energy Package.
Approximately 60% of the PCIs are on time, while approximately 40% are delayed or rescheduled.

Over longer time-horizon an accumulation of delays and further rescheduling is noticed.
The most frequently mentioned reason for delays is linked to permitting and licensing.
Reasons for Rescheduling of PCI Development (PCI implementation monitoring 2016)

- Reasons for rescheduling and delays are diverse
- The most common reason for rescheduling is that priority is given to other investments / may be dependent on other network developments
Thank you for your attention