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## **Review of the ITC annual cross-border infrastructure compensation sum**

Please find enclosed Statnett`s reply to ACER`s consultation regarding " Review of the ITC annual cross-border infrastructure compensation sum.

Best Regards  
Statnett SF

Bente Hagem  
Excecutive Vice President

## Statnett's answer to the public consultation launched by ACER regarding Consentec's report on the "Review of the ITC annual cross-border infrastructure compensation sum"

Statnett welcomes the opportunity to respond to ACER's consultation on the ITC mechanism.

Statnett recognizes the work from Consentec as an analysis of the scope for ACER's opinion on the ITC fund to be delivered to the European Commission.

It is Statnett's view that ITC will significantly reduce incentives to facilitate trade, as ITC parties who are net contributors to the ITC fund will have an additional cost associated with trade. The ITC-cost reduce the welfare economic value of trade in general, and interconnector investments in particular.

Presently there are approximately 5000 MW interconnector capacity between Norway and other countries. Furthermore, in 2020, there will be an additional 4000 MW to Denmark, UK and Germany. An important motivation behind interconnector investments is to exploit the flexibility in the hydropower system which can facilitate integration of more renewable power production. With the proposed increase in ITC fund, an extra unit cost for exchange over these interconnectors can however be between 1,5 €/MWh and 5 €/MWh. The proposed raise in the ITC fund hence threatens the business case for interconnectors between Norway and surrounding countries.

More generally, we can see that ITC reduces incentives to facilitate trade and has corresponding detrimental consequences for the IEM and the possibility to reach EUs 20/20/20-targets, and subsequent climate ambitions.

Another weakness with the report is that different benefits of trade for transiting countries are not taken into consideration.

It is hence our view that the size of the fund should in principal be set to zero, and that local solutions should be found to finance investments where there are undue distributions of costs and benefits from trade.

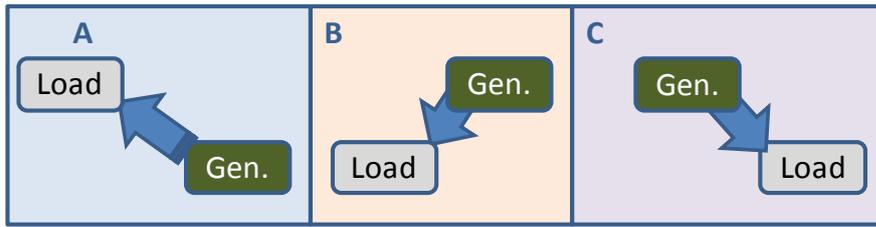
### 1) Has Consentec's study considered a sufficient range of potentially suitable options for assessing the ITC infrastructure fund? What other options do you believe should be included in the assessment?

It is Statnett's view that Consentec should also have considered status quo or even reductions in the fund. The reason is that a country can significantly benefit from transiting power. Firstly, a country will have significant benefits from transit in the form of congestion rent on at least two borders, and secondly country can get reduced internal flows in their grid due to transit flows.

The importance of the first point, that transiting countries receive double compensation, can be illustrated by the fact that the total congestion rent received by ITC parties have in average been 1.500 M€ yearly since 2007.

Figure 1 below shows illustrates the second point. In this example, country B will have reduced flow in its internal grid due to transit (whereas the exporting and importing countries A and C see increased flows).

Flows without XB exchanges :



Flows with XB exchanges :

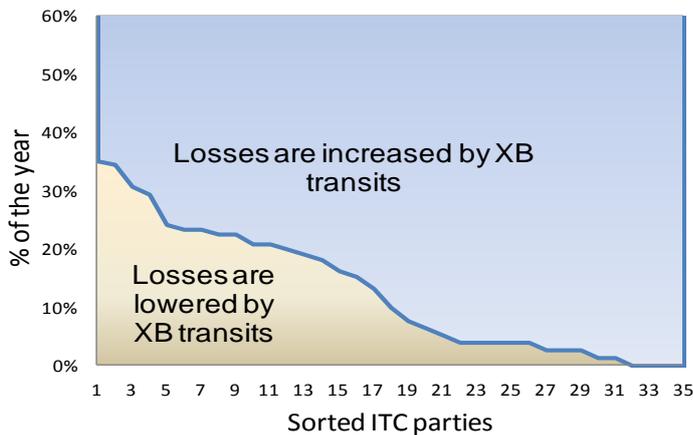


**Figure 1: Example where international exchanges generate more needs for assets in exporting and importing countries, but diminish the need for assets in country B.**

Figure 2 shows the share of time in 2010 in which losses were decreased due to transit for the various ITC countries. We can see that 4 out of 10 ITC parties experienced reduced losses due to transit more than 20% of the time. This means that the transit actually reduced the internal flows in more than 20% of the time for these ITC parties.

These aspects are not taken into account and the result becomes therefore more arbitrary.

Statnett's view is that local solutions should be found to finance investments where there are undue distributions of costs and benefits from trade, rather than a European wide mechanism.



**Figure 2: percentage of the time, for 2010 ITC parties, where cross-border (XB) transits were lowering or increasing losses**

2) Are the criteria adopted to assess these options and their application to the identified options appropriate? What additional or alternative criteria do you think should be applied?

When assessing the size of the fund, Consentec should also have taken the following criteria into account:

- **The potential consequences of ITC on the goal of reaching a seamless internal market.** New investments in cross border capacity is crucial for further integration of the internal energy market and as already stated, the ITC fund reduces incentives for some ITC parties to invest in cross border transmission capacity.
- **The possibility of developing a solution to local challenges with undue distribution of costs and benefits of trade.** This could be an agreement to share costs before an investment is made based on the expected benefit in adjacent countries. This will make the sharing of costs more of a local / regional issue. We have experienced a sharing of costs diverging from 50/50 on increased cross border capacity between Norway and Sweden.
- **Some of the transit compensation allocated is due to loop flows.** Loop flows are a local /regional "problem" and costs caused by loop flows should accordingly be solved locally/regionally. As an example, loop flows in Northern Europe should not be compensated by grid users on the Iberian Peninsula. To tackle loop flows, the market design should be changed to increased transparency, smaller bidding zones and flow based market coupling.

3) Of the options identified by Consentec, do you have any preferences? If so, please provide reasons for your preferences.

ITC gives an arbitrary distributional effect between countries. Furthermore the ITC has serious side effects by reducing the incentives for net paying countries to facilitate trade. This is unfortunate as the consequence will be less competition, higher production costs and significantly higher cost to reach the 20/20/20 goals. We hence think the ITC fund in principal should be set to zero. It follows from this that Statnett's resistance to ITC increase with the size of the fund.

- The absolute approaches will be worse since they propose much higher increases in ITC fund size compared to the incremental approach.
- The way the incremental model is described, it does not seem that the assets become fully depreciated. We believe that this is a mistake.

4) Are the assumptions adopted for the illustrative numerical analysis appropriate? Considering the practical limitations of availability, what other data or assumption do you believe should be used in such analysis?

The Consentec report is based on a wide range of assumptions and interpretations, for instance how to interpret the concept of LRAIC in the electricity sector, how to interpret the specific elements in the current legal framework and assumptions on which infrastructure elements are used for cross-border purposes.

The wide range of legal, economical and technical assumptions and highly uncertain interpretations and their impact on the final results in the report should be explained and examined in a better way when the final report is being made. This is valid for instance for the following two statements in the report:

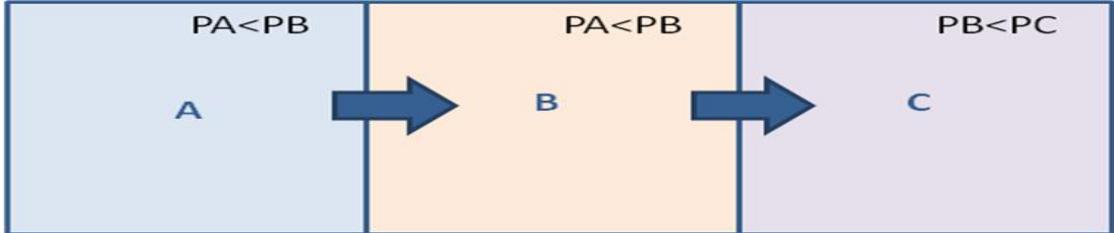
*“In practice, it would be difficult and onerous to try and properly decide for each investment project whether it constitutes an extension of the grid or a replacement of existing infrastructure. Therefore, we propose a simpler process to implement the above ideas: Every investment leads to “new” infrastructure ...” (p20)*

*“It is important to note that the GTS contributes to the ITC mechanism fulfilling the prerequisite of Regulation 714/2009 demanding that “benefits that a network incurs as a result of hosting cross-border flows shall be taken into account to reduce the compensation received” (p21)*

5) How do you believe the different parts of the congestion revenues should be treated in calculating the ITC infrastructure fund and why?

Congestion rent is a benefit of trade which transit countries will receive from at least two borders. This is illustrated in figure 3. Here country B will receive congestion rent both on the border to country A and the border to country C. Country A and Country C will only receive congestion rent on one border. Additionally getting congestion rent on two borders, country B will also get compensation for ITC.

Similarly, the sum of trading activities for the two neighboring countries equals the trading activity of country B, and the cost of ITC equals the benefits of ITC for country B. A transited country retains naturally most benefits of commercial exchanges, and this difference increases with an increase of the ITC infrastructure fund.



	Country A	Country B	Country C
Congestion Revenues collected	+	++	+
ITC receiver	-	+	-

**Figure 3: Distribution of congestion revenues for a transit T in a 3-countries system**

The example illustrates how the transiting country receives congestion rent on two borders as well as ITC compensation. This is double compensation. Statnett's position is therefore that the ITC fund should be set to zero, alternatively kept as today. If the ITC fund is kept, it is our view that 100 % of the congestion rent is deducted from the calculated compensation for each country. In other words if a country receives 5 M€ in congestion rent this will reduce his transit compensation by the same amount.

By reducing the compensation by the congestion rent received, unduly double compensation will be avoided.

6) Do you agree with Consentec's assessment and the preliminary conclusions on the options for determining the ITC infrastructure fund?

No, we do not agree. The conclusions are made based on a partial analysis of implementing a mechanism which will have a distortive effect on developing the IEM.

As explained above the calculations are also based on a lot of assumptions which have no explanations of why they have been chosen. These include:

- the lack of depreciation in the incremental approach;
- that all investments replacing existing infrastructure are considered as new investments and fully remunerated; and
- the way that congestion rents are handled leads to a double compensation.

7) What are your views regarding the suitability of using LRAIC to determine the ITC infrastructure fund? Do you consider the LRAIC proposed by Consentec appropriate?

As explained above we believe that the fund in principle should be zero. In this regard it will not be suitable to use LRAIC as principle to calculate the fund.

8) Are there any other issues that you believe should be taken into account in this review? In particular, how do you believe the on-going wider developments in the European energy market and regulatory arrangements should impact the Agency's proposal on the infrastructure fund

We believe that the analysis should also cover unintentional effects of the ITC mechanism, including the consequences on the development of the IEM. As explained above it will have significant effects on cross border investments.

The proposed ITC models will by 2022 give an annual cost to Norway between 25 M€ and 90 M€ for the framework fund with the exchange in 2011. The extra unit cost will be between 1,4 €/MWh and 5 €/MWh exchanged on the interconnectors.

The result is that ITC will have major negative consequences for investments that are needed to facilitate both more intermittent generation and integration of markets.

A likely outcome of a large increase in the ITC fund is that we must reduce trade on existing interconnectors significantly, by adjusting the market algorithm to take the ITC costs into account.