

# LEGAL GUIDANCE ON PERMITTED CHARGES UNDER THE THIRD ENERGY PACKAGE

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This advice was prepared for the P361 Workgroup by ELEXON's internal legal team.

## Summary advice

1. There is a significant risk that BSC Charges on Lead Parties of Interconnector BM Units (to the extent derived from Funding Shares) ("**Relevant BSC Charges**") are contrary to EU law. The extent of the risk is subject to the P361 workgroup's discussion on the extent to which the current charging methodology risks distorting cross border trade.
2. It may be possible to re-structure the Relevant BSC Charges so that they are not based on volumes of energy. This would make the charges less obviously a charge on the importing and exporting of energy over interconnectors. However, if the Workgroup concludes that a fixed charge regime was still likely to distort cross border trade the consequent conclusion is that any BSC Charges on Lead Parties of Interconnector BM Units is likely to be contrary to EU law.

## Background

BSC Parties are required to pay charges to BSCCo in respect of their participation under the Code. The methodology for determining these charges are set out in Section D of the BSC. This methodology allows ELEXON to recover all of the costs it incurs in administering the BSC arrangements.

The BSC is a document established pursuant to an obligation on National Grid in its Transmission Licence in order to set out the terms of the balancing and settlement arrangements (Condition C3). The BSC charging methodology is wholly contained in the BSC and is not addressed under the Transmission Licence.

The Transmission Licence separately sets out the arrangements by which National Grid must establish a methodology for use of system charges and charge participants in accordance with that methodology (Conditions C4, C5 and C5A). This document includes the methodology for (i) TNUoS charges which are use of system charges to recover National Grid's costs of the installing and maintaining the transmission system and (ii) BSUoS charges which are use of system charges to recover National Grid's costs for keeping the transmission system in balance and maintaining security of supply.

Both the BSC and the Transmission Licence are subject to EU legislation. In the context of this advice, the key elements of the European regulatory framework are as follows:

- 1.1 Regulation EC No 714/2009 on conditions for access to the network for cross-border exchanges in electricity (referred to in the BSC as the Electricity Regulation)
  - Article 13 provides for transmission system operators to receive compensation for costs as a result of hosting cross border flows of electricity on their networks through the Inter-transmission system operator compensation mechanism
  - Article 14(1) allows network operators to apply charges for access to networks (subject to certain criteria)
  - Article 14(3) requires charges for network access to take account of payments and receipts resulting from the ITC mechanism
- 1.2 Regulation 838/2010 relating to the inter-transmission system operator compensation mechanism and a common regulatory approach to transmission charging
  - Article 1 - Transmission system operators shall receive compensation for costs incurred as a result of hosting cross-border flows of electricity on their networks on the basis of the guidelines set out in Part A of the Annex (see below for relevant extract).

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- Article 1.2 – ENTSO-E must establish an ITC fund for the purpose of compensating transmission system operators for the costs of hosting cross-border flows of electricity. The ITC fund shall provide compensation for:
    - the costs of losses incurred national transmission systems as a result of hosting cross-border flows of electricity; and
    - the costs of making infrastructure available to host cross-border flows of electricity.
  - Part A of the Annex (paragraph 2.1) - transmission system operators must participate in the ITC mechanism and no additional charges for hosting cross-border flows of electricity may be included in charges applied by transmission system operators for access to networks.
- 1.3 Regulation 2017/2195 establishing a guideline on electricity balancing. Though not directly relevant to this question, that part of ELEXON's costs which are incurred in relation to obligations set out in this Guideline are recoverable in accordance with that guideline as follows:
- Article 8(1) - Costs related to the obligations imposed on system operators or assigned third entities in accordance with this Regulation shall be assessed by the relevant regulatory authorities in accordance with Article 37 of Directive 2009/72/EC.
  - Article 8(2) - Costs considered as reasonable, efficient, and proportionate by the relevant regulatory authority shall be recovered through network tariffs or other appropriate mechanisms as determined by the relevant regulatory authorities.
- 1.4 We don't consider that there is anything relevant in Regulation 2015/1222 establishing a guideline on capacity allocation and congestion management. Although this refers, at Article 77, to the costs of clearing and settlement, this Article refers to the costs of central counter parties and shipping agents, neither of which is a role that ELEXON performs under CACM.

## Ofgem's previous decisions

There are a number of relevant previous Ofgem decisions which are set out here by way of context:

- 2.1 Use of System Charging Methodology Modification Proposal GB ECM-26: "Review of interconnector charging arrangements". The Authority's decision not to veto this change to the Transmission Company's Use of System methodology to, amongst other things, remove TNUoS charges from Interconnector Operators, was based on the following considerations:
- The mandatory ITC mechanism is the sole method for compensating TSOs for cross border flows. Continuing to levy TNUoS charges on the IOs would give rise to the IOs being exposed to overlapping charges for the same costs.
  - The proposals could impact on competition by providing consistent charging arrangements to parties that import and export electricity across Europe, impacting the basis upon which all parties compete with each other in terms of cross-border trade
  - At the time of ECM-26, the Transmission Company distinguished between TNUoS and BSUoS charges on the basis that only former related to network access whereas the latter was an operational charge
- 2.2 P278: Treatment of Transmission Losses for Interconnector Users. The Authority's decision to approve this BSC Modification which removed charges for transmission losses from Interconnector Users (and IEAs) was based on the following consideration:
- that the proposed modification would remove the irregularity of charging interconnector users in GB for transmission losses, as this should be dealt with through NGET's participation in the ITC Mechanism

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- that the modification proposal would remove a barrier to cross-border trade and provide a consistent basis upon which all parties compete in the wider European market. Furthermore, it would reduce the risk of cross-border flows being inefficiently impeded at times when price difference is not sufficient to cover the cost of losses. Ofgem's view was that reducing this risk would facilitate price convergence and market integration.
- 2.3 CMP202 – Revised treatment of BSUoS charges for lead parties of Interconnector BM Units. The Authority's decision on this CUSC Modification which removed BSUoS charges from Interconnector BM Units was based on the following considerations:
- charging BSUoS to interconnector users constitutes an additional charge for importers and exporters of electricity
  - removing BSUoS charges for interconnector users would reduce the cost faced by market parties to trade across borders and therefore it removes a potential obstacle to cross-border trade
  - the mandatory ITC mechanism is intended to remunerate TSOs for accommodating cross border flows and the ITC mechanism overlapped with the BSUoS charging on interconnector users. Removing overlapping charges (BSUoS and ITC payments to/from NGET) for the same costs improved cost reflectivity consistent with European legislation
- 2.4 P285: 'Revised treatment of RCRC for Interconnector BM units'. The Authority's decision on this BSC Modification which removed Interconnector BM Units from RCRC charges/payments was based on the following consideration:
- P285 would prevent a distortion to cross-border trades, and allow trades across Interconnectors to be based on market price differentials. Although RCRC is related to the imbalance arrangements, and imbalance charges are permissible under the Third Package, this Modification was argued to be consistent with the wider European objective of enabling the development of a single internal electricity market
  - P285 would remove the potential for RCRC to be perceived as a charge on Interconnector flows when negative and an improper incentive to flow when positive should therefore ensure that trades across Interconnectors are based on price differentials, thereby improving competition within the single EU internal electricity market.

## Are Relevant BSC Charges levied on Lead Parties of Interconnector BM Units contrary to EU law?

There are two limbs to this question:

- Are Relevant BSC Charges a charge for access to networks?
  - Are Relevant BSC Charges a charge for hosting cross border flows of electricity?
- 3.1 Are Relevant BSC Charges 'charges for access to the network'?
- Whilst Relevant BSC Charges do not explicitly form part of the use of system charging framework under the Transmission Licence, our view is that Relevant BSC Charges would be likely to be considered to be a charge for access to the network by the EU institutions.
- I've formed this view because participation in the BSC, and therefore BSC charges, only arise because parties are involved in the BSC arrangements. The BSC arrangements are specified in the Transmission Licence, at a high level, to cover the following:

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- parties may make, and the licensee may accept, offers or bids to increase or decrease the quantities of electricity to be delivered to or taken off the total system
- assist the licensee in co-ordinating and directing the flow of electricity onto and over the national electricity transmission system and balancing the national electricity transmission system
- determination and allocation to BSC parties of the quantities of electricity delivered to and taken off the total system
- determination and financial settlement of, obligations between BSC parties arising by reference to the quantities of electricity delivered to and taken off the total system
- determination and financial settlement of, obligations between BSC parties and the transmission company in relation to the system operator's role in co-ordinating and directing the flow of electricity onto and over the national electricity transmission system

Based on this specification, our conclusion is that the BSC arrangements, and therefore BSC charges, relate to the quantity of electricity delivered to and taken off the network and are therefore network access charges.

Furthermore, ELEXON's functions are, to an extent at least, explicitly envisaged in the guideline on electricity balancing (2017/2195). This guideline was made pursuant to the terms of the Electricity Regulation (on conditions for access to the network for cross-border exchanges in electricity). From the perspective of Europe's legislative framework, therefore, ELEXON's functions appear to be an integral element of accessing networks, with the inevitable conclusion that Relevant BSC Charges are network access charges.

## 3.2 Are Relevant BSC Charges an additional charge for hosting cross border flows?

This is the crucial question but is less clear than was the case in previous Ofgem decisions. Based on the EU legislative framework and Ofgem's subsequent decisions, this can be broken down into further questions:

- What is the scope of Relevant BSC Charges and are they intended to recover the costs of hosting cross border flows of electricity?

BSC Charges cover the costs of ELEXON in administering the BSC arrangements. ELEXON's costs are not intended to cover any of the infrastructure costs associated with hosting cross border flows of energy.

It is notable, however, that Ofgem concluded, in CMP202, that BSUoS charges were an 'additional charge'<sup>1</sup> despite these being an 'operational' charge. To the extent that Ofgem articulated its rationale in CMP202, they appear to have concluded that the inevitable consequence of levying a charge on interconnector users is an additional charge on cross border flows within the meaning of the ITC Regulation:

"We are of the view that charging BSUoS to interconnector users constitutes an additional charge for importers and exporters of electricity and thus does not complement the intent of the applicable European legislation. Therefore we consider that removing BSUoS from interconnector users would facilitate compliance with European legislation"

EU institutions are likely to take a wide view of what constitutes a cost on hosting cross border flows of electricity. They would not simply look at how BSC Charges are comprised. Rather they would look at the impact of BSC Charges because their aim is to remove barriers to cross border trade.

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<sup>1</sup> It should be noted that CMP202, which related to BSUoS charges was raised by National Grid and recommended by an industry working group and the CUSC Panel.

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Lead Parties of Interconnector BM Units participate in the BSC arrangements and the cross border flows of energy for which such Parties are responsible create imbalances that require settlement. There is consequently a significant risk that Relevant BSC Charges, which are calculated based on the extent of these flows, would be deemed to be a charge on cross border flows of electricity. The impact, if not the intent, of this is to create a charge on flows of electricity across borders. This charge is additional to the ITC compensation.

- Is there an overlap with the ITC Regulation?

There does not appear to be an overlap between BSC Charges and the ITC mechanism. The existence of this overlap was a key element for Ofgem because it indicated an additional charge in that the same costs were being recovered twice by the Transmission Company.

However, whilst the existence of an overlap in GB charges and the ITC mechanism would be a clear indication that the GB charges were an 'additional charge', the absence of an overlap just indicates that there is no double charging taking place, and is therefore not key to determining whether the GB charge is an 'additional charge'.

In the case of Relevant BSC Charges, therefore, the lack of an overlap with the ITC mechanism is inconclusive.

- Do Relevant BSC Charges on Lead Parties of Interconnector BM Units have the potential to distort cross border trade?

This is really a question for the WG to consider. This is, however, likely to be a crucial issue because the EU adopts a purposive approach to interpreting EU laws. Given that the purpose of the Electricity Regulation and the ITC Mechanism are to remove barriers to cross border trade, if the WG considers that the current BSC charging arrangement distorts cross border trade then there is a significant risk that the BSC arrangements would be contrary to EU law.

Taking these three questions as a whole, our view is that, whilst clear differences exist between Relevant BSC Charges and the previous Ofgem decisions, there is a significant risk that the BSC Charges on Lead Parties of Interconnector BM Units do not comply with EU law. The extent of the risk will be impacted by the Workgroup's assessment of the impact of the current charging methodology on cross border trade.

## Would a different charging methodology be more likely to comply with EU law?

A charging methodology that was based on a fixed charge rather than being based on volumes of energy flowing to or from the interconnector would constitute a lower risk. However, noting that Ofgem concluded in CMP202 that any charge on interconnector users would be an 'additional charge on hosting cross border flows of electricity' there is still some risk with this approach.

Ultimately, this point would need to be resolved by reference to the wider objectives of the EU law, specifically whether a fixed charge on Lead Parties of Interconnector BM Units would lead to distortions in cross border trade. If the answer to this is no then the charging methodology will be lawful, but if the answer is yes then there is still a significant risk with a revised methodology.