Comments of Elia System Operator SA/NV on the Preliminary Report of the European Commission on the Sector Inquiry under Article 17 Regulation 1/2003 on the Gas and Electricity Markets – 16 February 2006 – Part C – Electricity

Elia System Operator SA/NV (Elia) welcomes the opportunity to comment on the Preliminary Report of the European Commission on the Sector Inquiry (The Report).

Comments concerning the issue of "unbundling" (p. 100)

On page 100, § 311 of its Report, the Commission states that:

> "*The Directive requires legal unbundling – in addition to accounting and management unbundling – between network activities and all other activities. In practice this means that transmission and distribution system operators must be independent in their legal form, organisation and decision-making (separate headquarters and separate board of directors).*"

Elia considers that the use in the Report of the concept of "board of directors" leads to confusion and is liable to misinterpretation. Elia understands that in some countries the term "board of directors" means the management board, whereas in others, it refers to the supervisory board. In this context, Elia considers that a strict and coherent approach as between DG COMP and DG TREN is necessary. Therefore, Elia would like to see consistency as between the Report and the guidelines of DG TREN concerning Unbundling[1]. According to these guidelines, management unbundling refers to the independence of the management team (in French "le comité de la direction"). The guidelines state that:

> "*The provisions of the directive on management separation require firstly that the management staff of the network business do not work at the same time for the supply/production company of the vertically integrated company. This applies to both the top executive management and the operational (middle) management. Thus, for instance, an executive director of the network company may not at the same time be an executive director of the related supply/production company, and vice-versa*." (p 8 of the guidelines).

It is therefore incorrect to state that management unbundling means a separate board of directors as such a statement goes further than the requirements of Directive 2003/54/EC.

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[1] Note of DG TREN on directives 2003/54/EC and 2003/55/EC on the internal market in electricity and natural gas – The Unbundling Regime – 16 January 2004.

Elia has noticed this type of error or lack of precision in the terminology used in other official Commission documents or in studies the Commission has commissioned. In particular, Elia has noticed the inconsistent or incorrect use of some key concepts, such as "ownership unbundling" or "vertically integrated undertaking" [2]. Generally speaking, Elia considers that this situation does not lead to the requisite amount of legal certainty and clarity.

Lastly, Elia fully agrees with the Commission's statement that "*(the provisions of the second electricity and gas Directives on unbundling need to be fully implemented, not just in their letter but also in their spirit*"[3]. Elia considers that the Belgian electricity Act implements fully the unbundling regime "in its letter and spirit". Under Belgian law, in addition to legal unbundling, corporate governance provisions which are specific to the electricity sector and which apply in addition to general company law governance requirements govern the independence of Elia and ensure very strict management unbundling.

[CONFIDENTIAL]

Comments concerning the issue of "level of interconnector capacity" (p. 153 - 156)

On page 155, §489 of its Report, the Commission states that:

> " *It is unclear at this stage if TSO's relieve congestion on their internal lines at the expense of lower cross border capacity, and if so if it is done for sound cost efficient reasons*."

Elia would like to mention that there are two separate issues in this context. First, Elia does not consider the closing/reduction of capacity at a border as a means of increasing the capacity of its internal grid. Secondly, it is possible that if occasional congestion occurs on the internal grid[4], some effect will be felt at one or both borders, but this is merely a consequential effect and not the intention of the TSO.

Elia would like to take this opportunity to provide the Commission with an update on the progress of three major investments which have been undertaken by Elia to further open the Belgian market and which were mentioned in its response to the Commission's information request.[5] These are the following:

[2] For example, these concepts have also been incorrectly applied in the Communication of the European Commission on progress in creating the internal gas and electricity market 2005 (COM (2005) 568 final) and in the recent report on unbundling of electricity and gas transmission and distribution system operators "Unbundling of electricity and gas transmission and distribution system operators – Final report", 1 December 2005, prepared for the Commission by Gomez-Acebo & Pombo Abogados and Charles Russell LLP.

[3] Report, page 191.
[4] Not in the sense of the questionnaire sent by the Commission.
[5] Question n° 46.

- the commissioning of the second circuit on the 400 kV line Avelgem-Avelin was made on 26 November 2005 (The maximum increase in capacity as a result of this additional circuit is approximately + 700 MW);
- the commissioning of the reinforcement of the Jamiolle-Monceau line is anticipated [CONFIDENTIAL] (The maximum increase in capacity as a result of this work is approximately + 800 MW); and
- the commissioning of the phase shifters of Zandvliet and Van Eyck is anticipated [CONFIDENTIAL] (The maximum increase in capacity as a result of this work is approximately + 300 MW).

Comments concerning the issue of "non market based mechanisms" (p. 161)

On page 161, § 502 of its Report, the Commission states:

> *"Long term contracts should with certain exceptions be disqualified as a method for allocating scarce interconnector capacity. Recent reports indicate that efforts to dismantle these contracts are in progress. For example, the Netherlands have directly reacted to the ECJ decision and the French Regulatory Authority decided not to grant priority rights any more for long term contracts on the interconnection with other EU Member States."*

In its decisions of 1 and 22 December 2005 the CREG, the Belgian regulator, decided that, from the start of the new auctioning mechanism for the allocation of transport capacity on the interconnections between Belgium and France and the Netherlands respectively, no more capacity shall be allocated with priority to parties to long term contracts entered into before the entry into force of Directive 96/92/CE. As a consequence, all the capacity available at the interconnectors has been awarded to the market since 1 January 2006.

Comments concerning the issue of "market based methods" (p. 163 - 175)

On page 165, §510 of its Report, the Commission states that:

> "*Further there remain a few borders where the allocation of interconnector capacity is not carried out according to a harmonized and economic-based mechanism*."

So that the Commission is fully informed, Elia would like to mention in that respect that since 1 January 2006, auctions are organized at the border between France and Belgium.

On page 164, § 511 of its Report, the Commission states that:

> *"The result of the above analyses illustrates that, although explicit auctioning is theoretically with perfect foresight an efficient mechanism and it is in practice compatible with Regulation 1228/2003, it has efficiency deficits compared to implicit auctioning."*

[CONFIDENTIAL]. Indeed, the Belgian, Dutch and French national power exchanges will couple their respective markets (trilateral market coupling). Therefore, implicit auction mechanisms will be implemented between France, Belgium and the Netherlands and the Belpex will not face the above criticism related to the inefficient allocation decision implied by explicit auction mechanisms.

Comments concerning the issue of "level of transparency" (p. 169 - 170)

Concerning the transparency of the allocation mechanism on the interconnectors, Elia has adopted, since the beginning of 2006, a policy aimed at increasing the amount of information made available to market parties. Among other things, the following items are currently, or will soon be, published on the website of Elia:

- the flows which are nominated in the context of the yearly, monthly and daily auctions (since March 2006);
- the capacities which are released by application of the use-it-or-lose-it principle (from April 2006);
- the physical flows on the interconnectors (since March 2006); and
- the disconnections of network elements which have an influence on interconnector capacitys (since March 2006).

From 1 January 2006, Elia is publishing more information concerning the balancing mechanism (see "comments from Elia concerning the balancing market").

From the end of 2006, Elia also expects to publish information concerning load forecast and generation availability.

Comments concerning the balancing market (p. 97)

The Commission mentions on page 97, §300 of its Report that « *the balancing markets will be analysed in more detail in the final report.* ». So that the Commission is completely informed, Elia would like to mention that since 1 January 2006, a new Balancing Mechanism is used on the Belgian market.

Elia is also publishing the following operational information on its website (usually every quarter of an hour):

- net regulation volume
- sourcing:
    - average price for upward regulation;
    - marginal price for upward regulation;
    - average price for downward regulation;
    - marginal price for downward regulation;
- imbalance price
    - price positive imbalance;
    - price negative imbalance;
- present imbalance control area.