

Key Regulatory Messages to Foster Investments

2nd Roundtable of ECRB and MEDREG Regulators – 29 September 2015, Athens

A ECRB-MEDREG roundtable on the role of regulators in promoting investments in the electricity and gas sectors produced several technical and policy messages that help framing the main challenges that current energy regulatory frameworks have in accommodating sufficient and cost-reflective infrastructure investments in Eastern Europe and the Mediterranean. In particular, these underlined the relevance of having a predictable regulatory framework and the need to fully understand the costs and benefits of the regionalization of energy investments.

The second edition of the joint roundtable between the Energy Community Regulatory Board (ECRB) and the Association of Mediterranean Energy Regulators (MEDREG) took place in Athens on 29 September 2015. It was chaired by ECRB President and Chairman of the Montenegrin Regulatory Authority, Mr. Branislav Prelević. The 18 participants to the roundtable were officers from the member regulators of ECRB and MEDREG, covering 10 different countries member of the two organizations.

President Prelevic stressed the value of the information exchange between ECRB and MEDREG to mutually increase the understanding of the Euro-Mediterranean energy sector and learn from best practices and errors taking place in other environments. He underlined that the topic of investments remain at the forefront of the regulatory debate in most countries, as it calls for the 'perfect combination' of political will, technical sustainability and clear regulatory provisions.

The key messages that emerged from the roundtable indeed revolve around the regulatory tools that can move network development forward from the planning to the realization phase:

- Establish effective and accountable regulators

The presence of an independent and pro-active regulatory authority for electricity and gas is pivotal to reinforce the opening of energy markets. Public policy decisions should aim at fostering and securing investments, notably through the establishment of a stable regulatory framework. The creation of a regulator is not sufficient in itself to send a positive signal to international financiers. The regulator should be endowed with clear and comprehensive powers, which make it a neutral and accountable arbiter of the energy market. In particular, it was noted that the European electricity industry considers unstable and unpredictable regulation as the single most important risk for investments.

- Ensure risk management

The Ten Year Network Development Plan (TYNDP) is insufficient to determine the efficiency of investments. This risks making TYNDP a list of wishes with no real economic feasibility. National Regulatory Agencies (NRAs) should require Transmission System Operators (TSOs) to couple investment plans with proper risk management mechanisms to increase diversification and reduce unsystematic risk.

- Establish a proper measure for the Weighted Average Cost of Capital (WACC)

Because the WACC model is based on the calculation of appropriate debts and equity returns, the limited development of capital markets in transition economies may make it difficult to use market data in order to statistically calculate risk premiums. In this case, the regulator should be able to use international data to estimate the return and derive them from

similar regulatory regimes that have a proven track of regulatory success. The regulators should also work to harmonize WACC correction mechanisms. In particular, the costs of not interconnecting specific zones (such as islands) should be evaluated.

- Establish clear and context-related rules to evaluate and remunerate investments

Investment initiatives should be evaluated in the context of the regional and national needs. Regulators should commensurate incentives to risks through a pre-defined methodology and project promoters should know the methodology to evaluate investments remuneration in advance. The right level of remuneration stimulates the introduction of the correct amount of investments in the network.

- Recognize the economic value of regional investments

The simplification and integration of procedures to deploy cross-border investments can have a huge impact on the results that investments have at the local level. An example is the construction of the undersea transmission cable between Montenegro and Italy that brings benefits both to Italy, Montenegro and the Western Balkans. Only the regional Western Balkan market makes the project economically viable. Regional investments in power network should however be strongly linked with national needs, as they may entail local disinvestments.

- Ensure adequate capacity-building to regulators

The staff of national regulators should be exposed to international experiences and be trained on the latest development in terms of technology transfer, networks and markets and deployment of transparent administrative procedures. MEDREG and ECRB have a pivotal role to ensure this result.

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