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ACER'S RECENT "AQUIND DECISION":

HOW IT MAY JEOPARDIZE THE REALIZATION OF THE INTERNAL ENERGY MARKET

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ABSTRACT

Ever since the adoption in 1996 of the first Directive relating to the Internal Energy Market, increasing available power transmission capacity among Member States has been a priority for the European Union (EU).

Since then, the European energy market has gone, and is still going, through fundamental transformations and priorities have shifted. Nonetheless, ensuring adequate transmission capacity remains high on the EU's agenda.

Renewable energy, which is set to take center stage in the EU's energy mix, comes with inherent issues that need to be addressed. For one, many renewable energy sources (RES) are typically located where there is space, thus far from demand centers. The distance needs to be overcome through transmission lines. Similarly, increasing the share of RES also means a system that is subject to more generation output fluctuation, which also requires interconnections.

Historically, reliance was placed on transmission system operators (TSO) to build the required infrastructure. For various reasons, however, the burden of building the grid can no longer fall on TSOs alone. In 2003, the first steps were taken to open up the market: The era of exempted links saw the day thanks to the introduction of the possibility of obtaining an exemption from certain obligations inherent to the regulatory regime. The exemption possibility was carried over when legislation was amended in 2009. In 2013, a new Regulation finished opening up the market by creating the concept of projects of common interest (PCI) and explicitly authorizing third party promoters to develop such projects.

The importance of exempted links is undeniable. They allow critical projects to be realized that would otherwise likely not be taken on by TSOs for various reasons. They also allow catering to the market with products that are in demand but not necessarily offered by TSOs, etc.

To ensure the realization of important infrastructure, EU law provides various financing options. Third party promoters (TPP) can apply for an exemption form certain provisions of EU law so as to be authorized to operate their transmission asset as an exempted one. TPPs who choose to forgo such exemption or who do not obtain it and whose project becomes a PCI have another chance at financing: They can become regulated through a cross-border cost allocation (CBCA) decision and recover the costs of their project through a tariff regime. This second layer of possible financing serves as a sort of "safety net" to ensure that projects that become PCIs obtain financing and are effectively implemented. Actually, if a project is a PCI, it seems that it in principle must ask for a CBCA decision and the exemption route is, in principle, no longer available, although there may/should be exceptions.

Despite the widespread acknowledgment of the importance of adequate transmission and the efforts made to foster its implementation, project promoters still face important hurdles when developing their projects.

Some issues can be blamed on certain Member States that have fallen behind in meeting their responsibilities under EU law, others may be inherent to the procedure through which promoters go to have their projects included in network development plans and/or to become a PCI. Some

of these issues are common to TSOs and TPPs, while others are more specific to TPPs, adding an additional obstacle to the construction of these projects.

The recent "Aquind case" sheds light on yet another possible hurdle to TPP projects' coming to fruition and it is all the more concerning that it pertains to TPP PCI projects, the importance of which has already been recognized by their obtaining PCI status.

Aquind is a TPP promoting an interconnector between France and the United Kingdom (UK). It submitted a request to the relevant national regulatory authorities (NRA) for an exemption that would allow it to operate its project as an exempted line. The NRAs were unable to come to a decision within the prescribed period and the case was thus referred to the Agency for the Cooperation of Energy Regulators (ACER). In June 2018, ACER handed down its decision, rejecting Aquind's exemption request. Among other things, ACER asserted that Aquind's claim that no financial underpinning is available to it in France was invalid since, as a PCI project, Aquind could prevail itself of the TEN-E Regulation to request a CBCA decision that would allow Aquind to recover the project's costs through tariffs under the regulated regime. Aquind is currently in the process of appealing the decision.

ACER may be correct (although this is subject to discussion) in asserting that where a CBCA decision becomes available, a TPP of a PCI may no longer seek an exemption and must go the CBCA route, however, we believe there should be room for exceptions in certain cases. Indeed, ACER's reasoning presupposes, and ACER seems to assume, that national law complies with EU law. As practice has shown, however, this is not always the case.

When national law restricts the ownership and operation of the transmission grid, including interconnectors, to the TSO, it becomes very cumbersome for a TPP to effectively implement a potential CBCA decision in that country. In this respect, national law presents a significant risk for promoters.

Although it is not ACER's prerogative to decide upon the compliance of national law with EU law, ACER can also not ignore the fact that in practice, there are unfortunately oftentimes examples where national law contradicts EU law. Without having to take a decision on compliance, if there is a reasonable doubt regarding the ability for a promoter to effectively implement a potential CBCA decision in a specific country, ACER should take this doubt into account and consider it a risk factor that may prevent the realization of the project. Such a risk would justify granting an exemption, even, and especially, if the project is already a PCI.

Failing to allow for an exemption when there is a question as to the compatibility of national law with EU law would equate to failing to acknowledge a significant risk for promoters. In such cases, a little flexibility is required and an exemption should be granted so as to ensure that a project that is already a PCI, and thus the importance of which has been recognized, can effectively be built. The exemption could be conditional upon the absence of any finding confirming that national law is in line with, and does not prevent the application of, EU law.

In addition, ACER's reasoning results in restricting the contractual freedom of investors, since it has the effect of imposing a certain type of investor to TPP PCIs if they were not previously granted an exemption. We believe this goes beyond ACER's powers.

The industry should thus be hanging onto the edge of its seat for the Appeal decision. If ACER's decision is upheld, this could mean the end of the road for many critical projects, both now and in the future and it would put a serious dent in the realization of the EU's energy policy objectives.

I. CONTEXT

1. Infrastructure and the Internal Energy Market

A. Historical Context and Evolution

Ever since 1996 with the first Directive relating to the Internal Energy Market, increasing available power transmission capacity among Member States has been a priority for the EU.

Over the years, focus has been placed on various elements (from enabling producer competition, to sharing reserve capacity for balancing, from creating a wholesale market to realizing a wide-spread integration of RES, etc.), yet the need to increase transmission capacity throughout the EU remains.

The addition of interconnection capacity was initially a way of enabling competition in monopolistic markets. It now represents the most efficient and sustainable way to ensure security of supply and the integration of RES across Europe, in addition to promoting the liberalization of the energy market.

Today, despite more than two decades of political and regulatory focus on transmission capacity, some of Europe's main energy assets remain largely untapped, namely the important diversity in generation technologies and the abundant and diversified locations of these resources, industries and storage facilities.

Day-ahead and intraday energy markets are now well established, albeit with a fairly low volume of exchanges in many countries compared to over the counter (OTC, cleared and non-cleared) transactions. Price transparency helps market participants identify commercial opportunities for consumers, aggregators and producers alike.

Although the "energy only market" is still the main focus, we are witnessing an increasing differentiation amongst products based on time (e.g., long-term contracts, futures, day-ahead, intraday, reserve markets, capacity markets, etc.). Concomitantly, new products (such as EU-wide reserve of balancing, or black start and reactive power) are emerging in the context of the contemplated "Clean Energy for all Europeans" package.

The "final energy service consumer" is being put at the center of the energy system, with distributed local generation, storage facilities and demand control. Energy as a service is emerging quickly. Large on- and offshore wind parks and (rooftop and large) solar PV parks are being developed. Gas-fired power plants are being used to fill the gaps where there is insufficient renewable generation. The entire market structure is going through a revolution.

B. The Critical Role of Transmission

With all the forthcoming changes to the sector, the sight is set on a flexible power system for the future, where interconnectors will be able to transport zero marginal cost wind, solar or ocean wave energy. But for this vision to materialize, adequate transmission capacity is necessary.

Indeed, most renewable energy is typically harvested and stored where there is a lot of space and population is scarce, thus far away from demand centers. Transmission is therefore required to efficiently and effectively dispatch renewable energy from where it is produced to where it is needed.

What constitutes "adequate" transmission capacity, however, varies according to location and how that location experiences congestion. The results of having such transmission capacity will also vary largely. For example, within Continental Europe, decreasing congestion through interconnections reduces price differentials between bidding zones[1], increases liquidity on the power exchanges, helps share resources for balancing and security of supply and facilitates the day-to-day operation of the entire system while also facilitating market coupling and eliminating infrastructure bottlenecks. The impact of added transmission capacity will be even more significant when considering exchanges between Continental Europe and the UK, Ireland or Scandinavia. Interconnectors may also contribute to the consolidation of security of supply by offering ancillary services such as frequency response and black start.

The ten percent (10%) of peak demand minimum transmission capacity between Member States mentioned at times by the European Commission loses its relevance in cases where power flows driven by natural resources will be much more important than the ones resulting from the further coupling of the European power markets. In this context, both TSOs and private investors are necessary to build the indispensable grid infrastructure.

C. The UK and Ireland Examples

With their massive offshore wind and ocean wave potential, the UK and Ireland are ideally poised to be a primary source of cost efficient RES. These resources will generate much more power than the demand on both islands at any time.

It is expected that by 2020, 15 GW of onshore wind will be installed in the UK[2] and by 2030, the UK should have 30 GW of offshore wind power[3]. Considering that the UK's absolute peak demand is 60 GW, the increasingly important share of RES in the mix will entail more exposure to fluctuations in generation. There will therefore be a strong need for interconnections to cope with these fluctuations.

[1] Despite the introduction of the Third Energy Package, which greatly contributed to a reduction in the wholesale price of energy across the EU, as well as to an increase in liquidity in electricity markets over the last decade, considerable price differences between bidding zones still prevail.
[2] See: https://www.statista.com/statistics/240178/uk-onshore-wind-power-capacity/
[3] https://www.renewableuk.com/news/410144/UK-Offshore-wind-capacity-set-to-double-following-Government-announcement-.htm

As to Ireland, it is expected that 4 GW of offshore wind will be developed in the near future,[4] while wave and ocean power is estimated will be around 1.5 GW. Such figures are rather substantial compared to the island's total 6 GW peak demand. This means that, here as well, a lot of interconnections will be necessary to cope with the inevitable fluctuations in generation output.[5]

In terms of reliability, the geographical location of the UK allows it to support the power system in Continental Europe in the event of a severe cold spell as was experienced a few years ago. The inverse holds true in case of a severe incident on the UK grid: Continental Europe should be able to step in. In other words, the UK has an important part to play in the implementation of the regional energy policies, regardless of the pending Brexit issue.

D. The Traditional Role of TSOs

Transmission systems are considered natural monopolies and are therefore subject to economic regulation. The operator of the system (i.e., the TSO) is not only tasked with operating and managing the existing network but also with making new investments, including in interconnections. The national regulator assesses the pertinence of new investments so that the TSO may carry out its investment plan. Once approved, investment costs are included into the TSO's regulatory asset base (RAB) to be recovered through the regulated network tariff.

Historically, the functions now performed by TSOs were carried out by the vertically integrated utilities. The EU's Third Energy Package and the liberalization of the energy market changed this by requiring the separation of transmission activities from distribution, generation and supply activities to prevent anticompetitive behavior. The unbundling requirement resulted in independent TSOs, responsible for the management and development of the national high-voltage network and related investments.[6] The Third Energy Package also tasked TSOs with the development of interconnections so as to ensure a.o. the long-term reliability of the power system.

2. A New Approach: Opening the Market to Third Party Promoters

The adoption of Regulation 1228/2003[7], which has since been replaced by Regulation 714/2009[8], while not yet effecting fundamental changes, did lay the premises for what would later become a major shift in the market. Although the rule remained that TSOs were to build, own and operate the infrastructure, an exception found its way in Article 7 (corresponding to the current Article 17 in Regulation 714/2009). This provision allowed, and its replacement still allows, for limited exemptions from some of the otherwise applicable rules for certain projects that present greater

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[4] See in this sense: https://www.owjonline.com/news/view,4-gw-of-irish-offshore-wind-queuing-for-connection_51708.htm

[5] See: http://www.eirgridgroup.com/site-files/library/EirGrid/Generation_Capacity_Statement_20162025_FINAL.pdf

[6] Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC, *OJEU*, August 14, 2009, L 211/55 states in its Article 1(4) that TSOs are responsible for the development of the transmission infrastructure in a given area and, where applicable, its interconnections with other systems.

[7] Regulation (EC) No 1228/2003 of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity; *OJEU*, July 15, 2003, L 176/1.

[8] Regulation (EC) No 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003; *OJEU*, August 14, 2009, L 211/15.

risks. With these exemptions, the door opened a crack for TPPs and put a dent in the, until then, incumbent TSOs' unchallenged monopoly.

The TEN-E Regulation[9], which followed later, created the concept of projects of common interest (PCI) and with the explicit reference to TPPs, finished to dissipate any doubts as to the possibility for TPPs to challenge the TSO-monopoly.

A. Regulation714/2009 (previously Regulation 1228/2003)

Although EU Regulation 714/2009 (and its predecessor, Regulation 1228/2003) does not purport to drastically affect the historic TSO monopoly, it does open the door to some flexibility via exemptions, thereby recognizing that some projects may not fall neatly under the, then current, regulatory regime.

Indeed, Regulation 714/2009, in its Article 17 (former Article 7 under Regulation 1228/2003), allows for certain exemptions to be granted for a limited period of time to new direct current interconnectors.

Among these, are the exemption from Article 16(6) of Regulation 714/2009 (which determines the way revenues resulting from the allocation of interconnections should be used) and Articles 9 (unbundling), 32 (third party access) and 37(6) and (10) of Directive 2009/72/EC (pertaining respectively to the NRAs' role in determining tariffs, network access conditions, balancing services and access to cross-border infrastructures; as well as to the right for NRAs to request the modification of the system operator's terms and conditions).

When conditions are met and the exemption is granted, it allows a TPP (or even a TSO) to operate its transmission line as an exempted one and to better ensure it can obtain appropriate levels of returns on investment, thereby reassuring existing and/or potential investors.

Conditions that apply to the granting of an exemption under Article 17 are that:

- "The investment must enhance competition in electricity supply;
- The level of risk attached to the investment is such that the investment would not take place unless an exemption is granted;
- The interconnector must be owned by a natural or legal person which is separate at least in terms of its legal form from the system operators in whose systems that interconnector will be built;
- Charges are levied on users of that interconnector;
- Since the partial market opening referred to in Article 19 of Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity[10] no part of the capital or operating costs of the interconnector has been recovered from any component of charges made for the use of transmission or distribution systems linked by the interconnector; and

[9] Regulation (EU) No 347/2013 of the European Parliament and of the Council of 17 April 2013 on guidelines for trans-European energy infrastructure and repealing Decision No 1364/2006/EC and amending Regulations (EC) No 713/2009, (EC) No 714/2009 and (EC) No 715/2009; *OJEU*, April 25, 2013, L 115/39.
[10] *OJEU*, January 30,1997, L 27/20.

- The exemption must not be to the detriment of competition or the effective functioning of the internal market in electricity, or the efficient functioning of the regulated system to which the interconnector is linked".

B. The TEN-E Regulation

The TEN-E Regulation, adopted in April 2013, goes further in opening the market than did Regulation 714/2009 (and the earlier Regulation 1228/2003). Because the task of building the infrastructure that the EU requires to achieve its goals and continue to meet demand has become too substantial for TSOs alone, the latter's work will have to be supplemented by TPP projects which are now, at least in theory, on an equal footing with TSOs. The TEN-E Regulation facilitates this by explicitly allowing TPPs to develop infrastructure, including interconnections.

The TEN-E Regulation establishes priority corridors and thematic areas and, for projects that serve those priorities and are thus essential to completing the Internal Energy Market, it creates the concept of PCI.

The introduction of the concept of PCI was designed to streamline regulatory approval procedures and accelerate the construction of critical infrastructure, such as transmission capacity, reflecting the widespread acknowledgment of the need to ensure adequate investment therein.

As of now, the TEN-E Regulation remains the cornerstone of the current EU energy infrastructure policy.

As mentioned, the TEN-E Regulation had the ambitious goal of opening the infrastructure market to new entrants, including in particular TPPs. It applies to electricity, gas, oil, smart grids, electricity highways and carbon dioxide transport.

PCIs are carefully selected every two years on the basis of the ENTSOs' respective preceding TYNDP – so the TYNDP 2018 will serve as the basis for the PCI list 2019 and so on. Becoming a PCI brings with it numerous advantages, at least in theory, including becoming eligible for funding under the Connecting Europe Facility (CEF).

Other advantages of becoming a PCI include for instance a three and a half year time limit on permitting (that may be extended by nine months) and access to a one-stop-shop permitting authority in the relevant Member States; the granting by Member States' NRAs of "appropriate incentives" for "high risk" PCIs or the fact that Member States must treat PCIs with the highest national significance so they receive the fastest treatment legally possible.

While the intention is certainly there, unfortunately in practice, PCIs do not always benefit from the promised advantages. Nonetheless, the status remains a highly coveted one that is not easy to obtain. Indeed, approximately half of the projects that begin the process (i.e., that apply for inclusion in the TYNDP) get cut before the final PCI selection. TPPs typically represent a mere 10-20% of all PCI projects (electricity and gas combined).

II. THE NEED FOR EXEMPTED LINES

1. The Need for Adequate Transmission Capacity

The European Commission, in its Expert Group on Electricity Interconnection Targets Report, estimates that necessary investments in European electricity interconnection infrastructure by 2030 will range between 125 and 148 billion Euros, and between 300 and 420 billion Euros by 2050 and adds that these numbers are in line with ENTSO-E's appraisal in the 2016 Ten Year Network Development Plan (TYNDP).[11]

The size of congestion rents across the EU further highlights that there are considerable economic benefits to be reaped from expansions to interconnection capacity. A significant increase in investments from TSOs will thus be required to achieve these commitments, raising the question of whether all or even a majority of the TSOs are adequately equipped to handle such a feat, even with EU funding.

As mentioned above, cost effective large renewable power plants usually require a lot of space. Accordingly, they are typically located either offshore or inland in locations with a low to very low population density and where industry is scarce.

To dispatch the energy produced from these sources to demand centers typically located far away, transmission assets remain essential. This holds true even though more and more demand can be met through decentralized solutions (e.g., home batteries, batteries at the street or village level for PV or in medium voltage switching stations for onshore wind). Indeed, although decentralized storage will help reduce the impact of massive distributed PV installations and onshore wind farms connected to distribution grids, these sources remain volatile and need to be backed up by transmission.

Developing the grid sufficiently to accommodate increasing RES integration and an increasing demand for electric energy will require major investments. Such investment needs become even larger when dealing with large power capacities, such as underground or undersea direct current (DC) cables.

In addition, changes to carbon prices will likely increase the economic viability of interconnection projects between areas characterized by high levels or RES, and those which rely on conventional generation, respectively. As the electricity price differential between regions grows, so will the opportunity for price arbitrage and the return on investment. However, when the distribution of costs and benefits associated with the construction of interconnection are not symmetrical, that is to say that, they appear to benefit one Member State more than the other, national interests may act as a barrier to investment.

[11] These estimates are based on the EC's PRIMES modeling system, which simulates energy consumption and the energy supply system across the EU according to consistent carbon price trajectories. A copy of the Expert Group Report can be accessed at the following link: https://ec.europa.eu/energy/sites/ener/files/documents/report_of_the_commission_expert_group_on_electricity_interconnection_targets.pdf

2. Limitations to TSO Investments

As explained above, traditionally TSOs were tasked with developing the grid infrastructure. Nonetheless, European energy literature indicates that most EU TSO's often lack sufficient incentives to invest in cross-border interconnections or sometimes lack the capital or the shareholder structure that would allow for such significant investments. This is particularly important considering that many TSOs are not able to finance the required level of infrastructure investment by raising debt. Indeed, increasing debt beyond certain limits downgrades the credit rating of the concerned TSOs, which in turn increases the cost of capital for them.

In addition, given the difficulty of building a nearly risk-free business case for long-life assets in the current evolving context, TSOs may be tempted to invest exclusively, and NRAs to approve such investments, in the regulated tariff environment.

Similarly, direct regulation under which TSOs must invest in interconnectors provides insufficient incentives, especially where unbundling is not as strong. In such cases, TSOs may be reluctant to invest in projects that could jeopardize the profitability of existing assets under their control (e.g., in a cable competing with an existing interconnection) and have little, if any, incentive to invest in new interconnections, which lead to increased competitive pressure on the TSOs' existing assets.

Another potential hurdle lies in the difficulty of accurately assessing the impact of interactions between different interconnectors and bidding zones, especially when dealing with different generation portfolios or industry bases.

For example, a given NRA in Scandinavia may have trouble correctly evaluating the merit of various projects purporting to connect that NRA's country with different countries in Continental Europe or with the UK. Each project may jeopardize the financial value of other existing connections.

Accordingly, while the role they have to play in building tomorrow's grid remains undisputed, TSO investments alone may not be enough to fulfill the EU's infrastructure requirements. Indeed, the EU's regulated investment model has been unable to unlock all of the necessary investment in cross-border interconnection. Given this situation, it has become important to attract TPPs and their specific investors.

Private investors thus often enter the market based on the assumption that they will be exempted (in whole or in part) from the regulatory restrictions that prevail under the regulated model, it being understood that this "exemption model" should remain the exception.

3. The Need for Exempted Lines

Exempted links are set to play a key role in the realization of the EU Internal Energy Market. Indeed, considering the aforementioned limitations on TSO regulated investment, the market may no longer turn exclusively to them to build the necessary infrastructure. To this end, EU legislation allows a.o. for exemptions from the traditional regulated regime when a project's risk level is considered prohibitive of investment.

Third party (i.e., non-TSO) developers backed by private investors can bring in a breath of fresh air with a perspective that is largely economically driven (i.e., based on the prospective profit of an investment in infrastructure that is exempted from regulation) and less likely to be subject to bias based on local interests.

Indeed, private investors and TPPs are not influenced in their evaluation of the merits of a project by that project's possible impact on existing potentially competing interconnectors.

Furthermore, TPPs are more likely to integrate into their business case the added value from various generation sources, or will integrate into it storage facilities or procure storage capacity. Such business case may also include new markets, like black start or reactive power, for which TSOs are the main consumers albeit not necessarily owning the assets.

Accordingly, TPP exempted lines may allow for products to be offered in the market that may otherwise not be available despite existing demand for such products. For regulated interconnections, the investors' revenue depends mainly on the flow of power, not on the amount of congestion. Where an interconnection is congested, an efficient and non-discriminatory congestion management method (e.g., an auction) must be designed to allocate the interconnection capacity. Under EU legislation, the congestion rent paid to the regulated transmission investor does not constitute an additional source of revenue but rather must be reinvested to ensure the availability of allocated capacity, to maintain the existing network or to carry out new investment in interconnection capacity and be distributed among network users through the tariffs.

In exempted transmission projects, on the other hand, investment costs can be recovered either through congestion rents or through the sale of financial (or physical) transmission rights (TR). The TRs, the allocation of which is usually market-based (e.g., auction like Open Season), entitle their holder to the price difference of the transmission line's point-to-point. In other words, rather than collecting the price differential at both ends of the interconnection, the exempted investor sells the TRs, allowing the purchaser to hedge against locational price differences.

In a similar manner, physical TRs provide their holder with access to the physical interconnection capacity. This would, for instance, typically be the case for RES-related long-term power purchase agreements (PPA) by which the RES-power purchaser must also ensure long-term capacity. Requests for such long-term contracts will increase at the same time as demand from corporations for RES-power increases. Under the currently applicable market rules, owners of regulated transmission interconnections may not provide these long-term capacity contracts. Owners of exempted assets, however, may provide them and thus offer to the market a product that it is requesting and that would otherwise not be available.

Moreover, transnational infrastructure projects incur large sunk costs, which may sometimes exceed purely economic benefits, and act as a disincentive to investment for TSOs and TPPs alike. The servicing of the debt accrued by exempted projects usually involves a long payback period. Project promoters are then faced with the challenge of finding innovative solutions to hedge the risk (such solutions may include e.g. the aforementioned products).

Investors in interconnectors are thus exposed to various risks, which exposure affects the cost recovery, credit rating, cost of capital and profitability. Such risks (especially for large capacity DC links) may go beyond the mere technical risk and may be project specific (such as those related to

construction, operation, or dilution of demand for capacity) or result from commercial or market uncertainties (e.g. convergence of prices and erosion of congestion rents), technological progress and changes in the legal and regulatory environment (e.g., changes in congestion management guidance, introduction of new products, or revision of tariffs) or to the political context (such as Brexit). They may pertain to promoters' initial investment, the financial uncertainty associated with an extended timeline for cost recovery, potential changes to the price of energy (potentially significantly reducing possible revenues across the assets' lifetime) or the prospect of competition from new interconnectors or a drop in consumer demand, leading to the under-use of capacity or asset stranding.

Rating agencies often assess interconnectors' risk against a set of factors such as stability of the business model and regulatory uncertainty. Investors face a trade-off between the lower risk and lower return regulated model, or the higher risk and potentially higher return exempted model.

Instead of socializing the cost and the foregoing risks of the project and burdening more people, an exempted line is paid for by the users of the available transmission capacity and the risk is shared by the investors and specific users.

In light of the foregoing, it becomes evident that both TSOs and TPPs are indispensible pivots in building the EU's required grid infrastructure to ensure adequate transmission capacity for the realization of the energy goals for the future.

III. Hurdles to Developing the Appropriate Infrastructure

1. Procedural Hurdles Inherent to the TYNDP/PCI Process

The complexity of the regulatory regime that project promoters must negotiate to ensure the viability of their investment magnifies existing economic disincentives, making the cost of regulatory compliance a significant investment risk. The inconsistency between the regulatory frameworks and permitting procedures, incentives, etc. for infrastructure projects across EU Member States further compounds the issue.

This comes despite the acknowledgment that interconnection projects yield transnational social welfare benefits, which represent an important step in the liberalization of the Internal Energy Market and the achievement of a more secure, affordable and sustainable Energy Union.

Despite the EU's efforts, and the adoption of the TEN-E Regulation, TPPs not only run into issues they share with TSOs, they also still run into issues specific to TPPs.

A. Common Issues

Both TSOs and TPPs face a number of common issues that are inherent to the TYNDP/PCI application procedure. Without going into full details or purporting to be exhaustive, the following identifies and summarizes some of the main common issues:

- ***Morphing and Increasingly Complex and Time-Consuming Procedure***: So far, the application process has been different each time, making it just about impossible to know in advance what the process will entail, the level of engagement that will be required or the

resources (in terms of time, money and staff) that will need to be mobilized. Rather than being simplified, the process has become increasingly complex with every round, including for repeat applicants.

- ***Uncertainty of Status (and Related Funding):*** As currently worded, in addition to the PCI progress monitoring, the TEN-E Regulation requires that promoters re-apply every two years for inclusion in the TYNDP and to maintain PCI status. This implies that once a promoter enters into the process, he will likely constantly have a pending application (since the TYNDP application for the subsequent round already begins while the EU PCI list is pending approval). The main issue, however, is that the outcome of the process is uncertain, even for existing PCIs. This raises a concern as to certainty of funding: If a PCI project that has obtained funding, including under the CEF were unable to maintain its PCI status, would it have to reimburse the received funding? If so, would the funding have to be reimbursed in its entirety or only to the extent it has not yet been used? These questions, which remain unanswered to date, certainly leave room for investors to be worried.
- ***Difficulty Implementing Advantages***: Although in theory, the TEN-E Regulation grants numerous advantages to promoters of PCI projects, in practice, these benefits are not always possible to implement. Indeed, the one-stop permitting within three and a half years is rarely respected, PCIs are not always given the highest level of priority by the relevant Member States, etc. Since the TEN-E Regulation does not provide for any sanctions if the advantages are not granted, most advantages, unfortunately, remain theoretical.

B. TPP Specific Issues

In addition to the issues that are common to TSOs and TPPs, TPPs face an additional layer of issues that are specific to them:

- ***Criteria Compliance***: Many of the criteria that must be fulfilled for a project to be included in the TYNDP (which extends to becoming a PCI since the latter is not possible without the former) require cooperation from the TSO(s) whose territory is affected. This puts TPPs at a disadvantage because TSO cooperation is not something they can control or force and TSOs, especially with competing projects, may be less than eager to cooperate.
- ***CBA Indicators***: TPPs typically do not have access to the algorithm used by ENTSO-E in determining the value of the CBA indicators. While all promoters are given the opportunity to comment on the values of the indicators, the exercise becomes moot for TPPs since without knowing the algorithm, they cannot confirm or infirm the figures.
- ***Reporting of Additional Benefits***: TPPs lack access to (confidential) information required to demonstrate the existence of additional benefits for their project. Indeed, the criteria that must be met/information that must be provided to claim additional benefits of a project are often elements to which TPPs do not have and will not be granted access since such information is often confidential. This results in TPPs being prevented from claiming certain benefits, putting them at a disadvantage when their project's value (including non-monetary) is being assessed.
- ***Procedure Objectivity***: The way that ENTSO-E is structured means that TSOs may weigh in and be involved in decisions that will affect TPP projects on their territory. This raises the question of impartiality, particularly when TPP and TSO projects might compete with one another.

2. Additional Hurdles Potentially Deriving from National Law

In addition to the issues inherent to the TYNDP/PCI process, TPPs may face further hurdles deriving from national law when such law is restrictive towards anyone other than the incumbent TSO, thereby preventing the full application of prerogatives granted by EU legislation.

A. Regulation 714/2009 and TEN-E Regulation Article 12

Article 12 of the TEN-E Regulation, which Regulation was mentioned above, pertains to "enabling investments with cross-border impacts". Under this provision, the "effectively incurred costs, which excludes maintenance costs, related to a project of common interest (…) shall be borne by the relevant TSO or the project promoters of the transmission infrastructure of the Member State to which the project provides a net positive impact, and, to the extent not covered by congestion rents or other charges, be paid for by the network users through tariffs for network access in that or those Member States".

Paragraph 3 of the same provision prescribes that "[a]s soon as such project has reached sufficient maturity, the project promoters, after having consulted the TSOs from the Member States to which the project provides a significant net positive impact, shall submit an investment request. That investment request shall include a request for a cross-border cost allocation and shall be submitted to all the national regulatory authorities concerned (…)".

If NRAs are unable to reach a decision within six months of the request for a CBCA decision, the case is brought before ACER who has three months from the referral to take a decision.

This provision, at least in theory, allows TPPs of PCIs who may otherwise not qualify for a regulated regime to become regulated and for their respective project to be paid for by network users via tariffs. This, in principle, should comfort investors by alleviating some of the uncertainty regarding the financial aspects of a TPP project, which typically is more volatile in terms of long-term returns, and thus normally requires a higher rate of return than a regulated project. However, becoming regulated thus also implies likely lower rates of return, which not all types of investors will accept.

B. When National Law Allows the Continuance of Monopolies

Despite the TEN-E Regulation's provisions, certain national laws (including, but not limited to, France) have not yet been adjusted to reflect the European intention of opening the market to new players to ensure the realization of the EU Internal Energy Market.

In some cases, national laws still foresee an ownership and/or operational monopoly of the transmission grid in favor of the national TSO. This effectively prevents the application in practice of Article 12 of the TEN-E Regulation by TPPs (see above).

Indeed, if national law restricts the right to operate the grid, the TPP will not be able to implement a CBCA decision it may have obtained under Article 12 of the TEN-E Regulation, since it may not operate the asset under the national law in question. If the TPP may not operate its asset, it will not receive any revenues despite the CBCA decision.

If a TPP knows in advance that it may not be able in practice to recover the costs of its project due to constraints created by national law, the likelihood of the asset being built plummets. As a consequence, TPPs are more likely to abandon their project (sometimes after significant investments have already been made), which in turn implies less competition in the market and jeopardizes the achievement of the EU objectives. The issue is even more significant since the projects concerned are PCIs, which, by definition, have been recognized as highly important. In other words, competition is stifled and critical projects are not built.

IV. THE AQUIND CASE

1. Overview

The entire industry is (or should be) paying close attention to the Aquind case. How this case will be decided has far reaching consequences that may impact the ability of the EU to reach its energy targets.

Aquind, as TPP developer of an interconnection project between France and the UK, submitted an exemption request under Article 17 of Regulation 714/2009 to the relevant NRAs. Aquind claimed, among others and not exclusively, that the exemption was necessary because it was not possible to obtain financial underpinning in France.

The NRAs were unable to reach a decision within the prescribed deadline, partially due to considerations regarding the impact of the "Brexit" scenario, which they considered themselves unable to assess. The case was thus referred to ACER.

After several exchanges between Aquind and ACER, ACER handed down its decision in June 2018, rejecting the exemption request. ACER inter alia referred to the fact that Aquind, as a PCI, should request a CBCA decision under Article 12 of the TEN-E Regulation and hence concluded that Aquind could benefit from financial underpinning in France, despite Aquind's claim to the contrary.

Aquind is now in the process of challenging the decision by appealing ACER's Board of Regulators' decision.

How the case is decided will have critical implications for the energy market, and TPPs in particular.

2. Consequences

If ACER's decision is upheld, it will create a precedent that raises even larger hurdles for TPPs than those thus far encountered. These hurdles may be so overwhelming that it could jeopardize the realization of the EU Internal Energy Market by deterring TPPs from participating in the development of critical infrastructure.

Regardless of the merit of ACER's reasoning (there has been some debate as to ACER's authority to impose a recourse to Article 12 of the TEN-E Regulation over Article 17 of Regulation 714/2009), ACER fails to consider the practical implications of its decision and incorrectly dismisses the risks posed by French law.

As currently worded, French law restricts the right to develop, operate, etc. the grid in France (including interconnectors). As a result, even if ACER's reasoning were applied and even if Aquind were to obtain a CBCA decision under Article 12 of the TEN-E Regulation, the decision could not be implemented in practice and would result in the restriction by ACER of a TPPs private right to contract with the investor(s) of its choosing.

A. Practical Impossibility to Recover Costs

French law currently prevents Aquind from operating its asset, which would in turn make it impossible to derive revenues unless Aquind benefited from an exemption under Article 17 of Regulation 714/2009. In other words, French law currently prevents any TPP (including Aquind) from effectively putting into practice a potential CBCA decision obtained under Article 12 of the TEN-E Regulation. Under such circumstances, no TPP in their right mind would want to develop a project, knowing that they would later not be able to operate it (unless an exemption is granted).

Consequently, if ACER's decision were to be upheld, it would result in deterring TPPs whose project has become a PCI (the importance of which has thus been recognized) from developing the much needed infrastructure. This defeats the purpose of the TEN-E Regulation, which aims a.o. to open up the market, not restrict it even further.

One of the most concerning aspects, is that Article 12 of the TEN-E Regulation applies only to promoters (TSO and TPP) of PCIs. Non-PCI project promoters would not have to apply Article 12 and would thus remain eligible for a possible exemption under Article 17 of Regulation 714/2009. It follows that ACER's decision, in effect, would result in PCIs being worse off than non-PCI TPP projects where the PCI is being built in one or more Member State(s) that maintains the incumbent TSO's monopoly absent an exemption.

B. Impeding the Promoter's Contractual Freedom to Choose a Type of Investor

ACER's decision also has the effect of limiting a TPP's freedom of choice of investor. Indeed, exempted infrastructure projects typically attract private investors seeking a higher return than for regulated projects, in part due to their assumption of higher risks.

Imposing the recourse to a regulated regime (i.e., a CBCA decision under Article 12 of the TEN-E Regulation), amounts to restricting the type of investors that may be interested in the project since, even if returns may be negotiated, they will likely not reach the level of returns that exempted projects might reach.

While the choice of an investor should not dictate whether or not an exemption is granted, ACER should also not go beyond its reach by limiting the contractual freedom of project promoters and forcing upon them certain types of investors.

C. Intermediate Conclusion

Allowing ACER's decision to stand unchanged would yield results that are contrary to the spirit and intention of the TEN-E Regulation and may jeopardize the much needed development of PCIs developed by TPPs. This in turn would impact the achievement of the EU objectives (especially in terms of interconnection targets).

While overturning ACER's decision entirely may not be warranted (as mentioned, there is an ongoing debate regarding the merits of the decision), it would also be unwise to uphold it in its entirety.

ACER seems to assume that national law, by definition, complies with EU law and, relying on these premises, concludes that it is not competent or even required to examine French law. ACER indeed lacks the authority to make a determination regarding the compliance of French law (or any national law for that matter) with EU law – that prerogative is reserved to the EU courts.

However, ACER should not, under that pretext, avoid and dismiss the discussion altogether, especially when it is based on the erroneous assumption that national law always complies with EU law. Instead, ACER should consider the possibility that French law may not be in line with EU law and take this possibility into account in its decision as a potential risk factor for Aquind's project.

Ideally, ACER's Board of Appeals will recognize the detrimental effects of the decision as it stands. Regardless of whether or not the reasoning is upheld, it is important to take into account the impossibility of implementing it in practice. This will hopefully in turn lead to an exemption being granted, at least until the issue brought about by (French) national law has been appropriately addressed.

V. CONCLUSION

The further development of additional infrastructure, especially electricity interconnectors, is critical to enable the smooth implementation of Europe's so-called "energy transition" and realization of the Internal Energy Market without endangering the EU's security of supply.

The level of investment required to build the infrastructure necessary to this end is significant. It must therefore remain one of Europe's priorities to ensure that such investments are consistently attractive and available to the widest possible spectrum of investors.

For these infrastructure needs to be met, the focus on investments cannot be limited exclusively to regulated assets, even if such assets appeal strongly to certain investor profiles (e.g., pension funds, some infrastructure funds, etc.).

Europe needs both regulated and exempted assets. Otherwise, Europe will most likely lose its attractiveness towards other classes of investors (including without limitation private equity, the majority of infrastructure funds, or pure entrepreneurs), which are indispensable to meeting the EU's infrastructure needs, particularly with the increase in long-term corporate RES PPAs and related infrastructure capacity as well as the increasing demand for other market products, which cannot be provided in the traditional regulated environment under today's legal framework.

As it currently stands, ACER's decision in the Aquind case provides a loud and unfortunate signal to a significant number of project developers (especially TPPs under the TEN-E Regulation) and their investors that, going forward, Europe will increase even further already daunting hurdles for developers who venture into developing exempted infrastructure projects.

It is critical to the future of the EU's energy policy and for a smooth energy transition that ACER's decision is overturned.

FRIENDS OF THE SUPERGRID

Friends of the Supergrid (Supergrid) is an international Brussels-based non-profit association that represents the key players in the electric grid industry. Its aim is to actively support the development of Supergrids, which consists in the interconnection of the various grids (i.e., HVDC, transmission and distribution, storage and smart grids), all of which are essential components to the realization of a smooth energy transition, mainly in Europe but also beyond.

Supergrid actively participates in efforts to improve the European energy policy framework, including in particular the TEN-E Regulation. In this context, it frequently assists its members in dealing with the various stakeholders involved in the tenuous process for a project to become a PCI.

Supergrid believes that the change we want to see tomorrow begins today and that educating consumers at an early age about the behind-the-scenes of our increasingly electrified world is crucial to continued progress and thus engages in various energy education initiatives.

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