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Foreign Trade License - Section 4-2 of the Energy Act

Reference is made to the letter from the EFTA Surveillance Authority (ESA) dated 5 November 2010, in which the Norwegian Government is invited to submit its observations concerning section 4-2 of the Energy Act. Reference is also made to discussions at the package meeting in Oslo 12 November 2011.

In this letter the Ministry will provide its comments relating to the question whether Section 4-2 of the Energy Act can be considered as a restriction under the rules on free movement of goods within the scope of Articles 11 and 12 in the EEA agreement. Furthermore, the key objectives in the general public interest that are pursued under the foreign trade concession system will be explained in further detail. The Ministry will also explain how the assessment of applications in accordance with section 4-2 is conducted in accordance with socio-economic criteria and how this assessment relates to other concessions under the Energy Act.

The assessment of the foreign trade concession as a restriction

As a starting point, the Ministry would like to comment upon the assessment of Section 4-2 of the Energy Act as a restriction under the rules on free movement under the EEA Agreement. If the assessment is limited to the wording of section 4-2 of the Energy Act without taking into consideration how this provision is applied, section 4-2 might appear as a restriction directly linked to imports and exports of electricity. However, a key function of the trade concession in section 4-2 is to provide a legal basis for approving, prioritising, organising and facilitating an efficient and secure system for power exchange between Norway and other countries. Thus, the provision enables the development and enforcement of a policy regarding cross-border infrastructure, in

accordance with the general public interest, including security of supply, environmental and resource management considerations, as explained in the Ministry's letter of 3 February 2010.

As stated in Ot.prp. nr. 56 (2000-01) on page 47-58, the amounts of physical exports or imports are limited by the capacity and physical limitations in the overall infrastructure for electricity. In this respect, the Ministry would like to draw attention to the fact that the two concessionaires with regard to the transmission system are Statnett SF (Statnett) and Nord Pool Spot AS (Nord Pool Spot). These entities do not perform any functions relating to production and/or sale of electricity. The activities of these entities are confined to tasks related to electricity transmission infrastructure and organising the Nordic Power Exchange for trade in electricity. Statnett's trade licences according to section 4-2 provide a legal basis for requiring the undertaking as a TSO to secure, among other issues, third party access and implicit auctions. In a similar manner, the Nordic Power Exchange, Nord Pool Spot, has concessions linked to the ones of Statnett SF, safeguarding that the power exchange is open to all market players.

The trade concession in section 4-2 makes it possible for Norwegian authorities to secure, inter alia, that capacity is made available to the market and that the market design is in line with national and European objectives. As a result, physical power contracts can be traded in all Nordic countries through Nord Pool Spot. Electricity is also traded between Nord Pool Spot and power exchanges in other countries, as through the NorNed cable from Norway to the Netherlands.

With regard to long-term contracts, it should further be emphasised that grid capacity cannot be traded separately in the Nordic System, due to the requirement of implicit auctions.¹ As a consequence, long-term bilateral contracts are by their nature financial contracts and not physical commitments. Long term contracts therefore fall outside the scope of section 4-2 and no concession is required, as explained in Ot.prp. 56 (2000-2001), page 31 and 48. When assessing the effects of section 4-2 in the Energy Act, those basic features of the organisation of the Nordic wholesale market should be kept in mind. The provisions in section 4-2 ensure that the trade on the cross-border capacity is organised in the same way as the trade between bidding-areas within Norway, through implicit auctions. Hence, cross-border capacity is not treated differently than internal capacity. Further, it should be emphasised that this way of organising trade through implicit auctions is fully in line with EU/EEA legislation and objectives on this field.

To the extent that the trade concession in section 4-2 can be considered as a limitation of the commercial freedom of individual market players, this effect is in the Ministry's view in practice bound to the construction and operation of new cross-border

¹ Except the trade on the NorNed cable which for the moment is organised by explicit auctions. According to the plan, implicit auctions will be implemented also on this trade capacity within the first half of 2011.

infrastructure. If considered a restriction, the Ministry does not agree that the provision necessarily has an equivalent effect to a quantitative restriction on imports or exports of goods. On the contrary, the main impact of section 4-2 of the energy act would rather seem to affect the provision or establishment of infrastructure services related to transport of electricity. In this regard, it should also be taken into account that a main principle according to the third energy market package is to separate control over infrastructure and activities involving production and supply.

Key objectives under Section 4-2

As for all concessions under the Energy Act, a fundamental objective of Section 4-2 is to achieve the best possible socio-economic organisation of the electricity sector in line with section 1-2 of the Energy Act. The sector has undergone substantial developments while section 4-2 has been in force. In recent years it has been one of the key objectives for Norwegian authorities to ensure an efficient flow of power in the system.

Key policy objectives relate, among other issues, to securing non-discriminatory market access, efficient capacity allocation and market based exchange of power through implicit auctions. The Norwegian regulator (NVE) can enforce these rules as they are legally binding in accordance with the terms of the concession. The main principles upon which the foreign trade concessions of Statnett and Nord Pool Spot are based are explained in parliamentary documents. Reference is made to St.meld. nr. 11 (1995-1996) and Innst. S. nr. 97 (1995-96) on the power exchange with Sweden and St.meld. nr. 9 (2000-2001) and Innst. S. nr. 93 (2000-2001) on the power exchange with Denmark.

The concession of Statnett requires the Norwegian TSO to facilitate physical electricity exchange in accordance with objectives set out in these Parliamentary documents. The concession is also linked to the agreement between Nordic transmission system operators (systemdriftsavtale) requiring, inter alia, amendments to this agreement to be notified to NVE.²

Other key objectives relate to security of supply, environmental concerns and resource management, with particular regard to the Norwegian electricity sector as an almost exclusively hydropower based system. Such considerations have been expressed in parliamentary documents pre-dating the total deregulation of the electricity market in Norway. Reference is made to St. prp. nr. 81. (1991-92), c.f. Innst. S. nr. 178 (1991-92) and St. meld nr. 46 (1992-93), c.f. Innst S. nr. 229 (1992-93).

Among other issues, in St.prp. nr. 81 (1991-92) it is particularly referred to the possibility of the Norwegian hydropower based system to provide services in terms of balancing capacity, in interaction with thermal power systems in other countries. In light of the strong commitments by the EU in the field of renewable energy, the need

² This agreement can be found on Entso-E's web pages:

https://www.entsoe.eu/fileadmin/user_upload/library/publications/nordic/operations/060613_entsoe_nordic_SystemOperationAgreement_SCAN.pdf

for a legal basis for developing the system's ability to meet the demands of this policy appear even more evident. In this regard, the general wording of section 4-2 provides a possibility for control and surveillance by the authorities as regards approving, prioritising, organising and facilitating an efficient and secure system for power exchange on new and existing interconnectors between Norway and other EEA countries.

The above considerations are not static, as the electricity system is constantly evolving. In general terms those considerations encompass the need for a controlled overall system development, including the need for grid re-enforcements, assessments of the socio-economic costs and benefits of different projects. Such assessments are also necessary to clarify costs and benefits of different, often mutually exclusive projects and thereby making them comparable.

Criteria for the assessment in accordance with section 4-2

As mentioned above, in accordance with section 1-2 of the Energy Act the main criteria for assessing an application for a trade license according to section 4-2 are the socio-economic considerations relating to the project in question and (if relevant) in comparison to other projects. For each new project it needs to be assessed whether the socio-economic benefits exceed the costs. Such an assessment will constitute the basis for the decision as to whether to accept or deny the application for that specific project. This is the same approach as for any other assessment of projects under the Energy Act (section 1-2). In cases where the benefit is unevenly distributed between two countries, the parties can in principle negotiate in order to agree on a share of the costs and income that reflects the unevenly distributed interest in the project.

This analysis encompasses a broad range of considerations. In addition to the direct economic consequences of the project in question (included for example the effects on trade with other countries), other elements relate to security of supply, effects on the grid and environmental concerns. A particular feature of the Norwegian electricity system is the dependency of water reservoirs for security of supply. It is vital to assess the impact of a new interconnector on the security of supply for the system as a whole. In most cases, new interconnectors also necessitate further commissioning of grid or grid reinforcements in the Norwegian system, for which all relevant costs and benefits need to be assessed. Environmental costs and benefits of the project are an integrated part of this analysis.

Due to the system's evolution over time and differences between projects, it is difficult to provide an exhaustive list of criteria that are included in this assessment at a certain fixed point in time. Each application concerning cross-border interconnectors requires a thorough investigation of that particular project.

In some cases the Ministry has to prioritise between projects. Infrastructure projects may be mutually exclusive due to capacity restrictions in the electricity system. One interconnector may also influence the profitability of another interconnector. The

assessment according to section 4-2 aims at identifying the projects with the highest socio-economic gain. Only projects of a certain maturity level will be considered, in order to secure that favourable projects are not blocked by concessions given to projects never materialized.

The Norwegian policy that TSO cables are preferred to merchant lines should also be mentioned. This is partly due to the principle of unbundling of transmission and production/sales activities, and partly to the view that the income from the interconnector should be used either for new grid investments or for reducing grid tariffs.

In accordance with Regulation 1228/2003 the Norwegian policy has been to prefer open access and implicit auctions for allocating capacity on the interconnectors, as for the Norwegian grid. Statnett, the Norwegian TSO, is unbundled from production and/or sales activities and is responsible for investments in the transmission grid. To have a TSO that acts in a non-discriminatory way is perceived as a precondition for efficient competition in the power market. This has been, and still is, an important principle in the organisation of the Norwegian power market. Reference is made to Ot.prp. nr. 61 (2005-2006).

In light of the issues discussed above, the Ministry is of the opinion that a prior authorisation procedure is necessary to ensure regulatory oversight of interconnectors and ensure that only interconnectors which present a socio-economic benefit are built.

The relationship between section 4-2 and other concessions etc.

In the letter of 5 November, ESA points at, inter alia, the risk of duplicating the control over investments in cross-border infrastructure. It is among other referred to section 3-1 of the Energy Act. According to the wording of the provisions, it is not evident which considerations fall under section 3-1 (anleggskonsesjon) and which fall under section 4-2. Both provisions have in common that the assessment shall be based on socio-economic considerations in accordance with article 1-2 of the Energy Act. In cases where a concession is required under both provisions, the task of assessing issues of a more technical nature and obtaining information on the effects of the measure, including public consultations etc., is conducted by NVE in accordance with section 3-1, cf. section 3-4. The Ministry will carry out the overall socio-economic analysis of the measure based on the criteria mentioned above, in accordance with section 4-2. In the Ministry's experience, there have been no difficulties in the practicing of these provisions. The application of section 4-2 is reserved for the cross-border infrastructure, and applications have been assessed on an individual basis. However, and also in light of the recent correspondence with ESA, it might be feasible to discuss possibilities for increased procedural transparency.

The purpose of the provision contained in section 4-1 of the Energy Act is to provide for necessary control with trade in electricity, in particular as regards the market conduct

of natural monopolists. In the Ministry's view those considerations are of a different nature than what is being assessed under Section 4-2.

In the letter of 5 November, in section 4.2.4 the question is also raised as to whether there are differences between cross-border electricity and domestic electricity as to justify a different administrative regime. In addition to the objectives mentioned above, it is the Ministry's impression that Regulation 1228/2003 does not resolve all aspects needed in order to secure an efficient trade on interconnectors. For example, there are no requirements in the regulation about implicit auctions, which the Ministry perceives as the most efficient way to organise cross-border trade in electricity. As pointed out on page 2 in St. meld nr. 11 (1995-96), even after the deregulation of the electricity markets in Norway and Sweden, further contact between the participating countries would be needed, as the electricity markets would develop on each side of the border. The need for a separate approach to cross-border infrastructure when assessing the coupling of two systems through new infrastructure also seems recognised in the agreements entered into between the collaborating TSOs and the approach taken by the EU when adopting regulation 1228/2003 as a separate regulation dealing exclusively with issues relating to cross-border infrastructure.

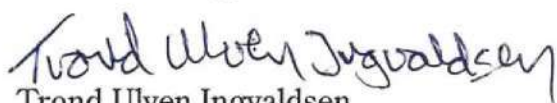
In section 4.2.3 of the letter from ESA it is referred to the provisions on system responsibility in accordance with regulation 448 of 7 may 2002. The Ministry fails to see that this regulation solves all issues related to the topics explained above.

Concluding remarks

In light of the questions put forward by ESA, and the present legal position of section 4-2 of the Energy Act related to cross-border exchange in electricity, the Ministry will consider updating this specific section of the Energy Act. In this regard, the concerns raised by ESA, in particular related to the need for increased legal transparency and avoiding administrative duplication in the concession system will be assessed.

The need for an effective legal instrument in order to ensure a controlled development of new interconnectors between different jurisdictions must also be taken duly into account. The Ministry therefore invites the Authority to a continued discussion with the aim of finding an amicable solution and achieving a fair balance between the interests described herein and in ESAs letter, to resolve the matter within the scope of the EEA Agreement.

Yours sincerely,



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