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Issue Papers Licensing/Competition Committee

- **Regulation of the Import and Export of Energy**

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Regulation of the Import and Export of Energy

1. INTRODUCTION

- 1.1. For many countries there are significant flows of energy in either import, export or transit trade which the Energy Regulator must analyze carefully to protect the interests of local consumers.
- 1.2. It is important in these matters, as in others, to clarify the general State interest in controlling foreign trade relations and that of the Energy Regulator that has been given a more narrow mandate.
- 1.3. Concerns about adequate domestic supplies may arise in cases where facilities are used both to import/export energy and to carry energy in transit through the country. Questions concerned with allocation of available capacity and priority of use need to be analyzed with respect to existing or prospective contracts and the relationship between costs borne by domestic consumers and use-of-network fees earned by the transportation licensee.
- 1.4. Within the restructured energy sector framework being implemented within each country, the regulation of import/export needs to be coordinated carefully in relation to transactions within the country's borders. Regulators need to identify the special characteristics of cross-border trade that make such transactions different and what, if any, special license conditions or pricing methodologies should be imposed to protect domestic consumers.
- 1.5. Cross-border trade may also have important impacts, good or bad, on opportunities to create competitive energy markets within a particular country.

2. ISSUES CONCERNING THE IMPORT AND EXPORT OF ENERGY

- 2.1. Energy flows between countries is a subject addressed within the EU Energy Charter. Those countries that aspire to EU membership should review these provisions and adopt regulatory policies (and perhaps other policies not within the regulator's authority) which will comply with these mandates.
- 2.2. The transportation facilities used for import, export and transit of energy are the same networks, generally, that are licensed by the Regulator to provide domestic transport services. License conditions usually would require such licensees to provide and maintain adequate capacity on their systems to insure reliable service to energy suppliers (retailers)

who use these network facilities to supply domestic consumers¹. Any contracts that have the affect of diminishing network capacity available to serve domestic consumers should be subject to review and approval of the Regulator before becoming effective.

- 2.3. The import, export or transit of energy utilizing the transport networks (which should only be possible when the regulator agrees that assigning network capacity to this purpose will not injure domestic users) poses both State policy issues and energy regulation issues.
- 2.4. State policy is principally concerned with strategic energy issues and the relationships between sovereign countries. One way for the State to exercise its interests is to require separate approval of cross-border energy trade at the Ministerial level (or perhaps delegated to the Department of Energy) in addition to (but not substituting for) the normal regulatory authorities of the Energy Regulator. Alternatively, the State could provide formal guidance or direction to the Regulator concerning threshold criteria that the Regulator would be required to apply before authorizing the issuance of a license.
- 2.5. Assuming that the State's policy concerns are satisfied, then from the Regulator's perspective, the opportunity to import energy is either a matter of necessity (if insufficient domestic resources are available) or represents an alternative supply which can only benefit consumers since it must compete on price with other potential suppliers.
- 2.6. Retail franchise or default suppliers (the existing supply function of the Disco) should be required by license condition to seek the least cost supplies available. Imported energy offers the potential to reduce average supply costs either directly by becoming part of the suppliers resource portfolio or indirectly by forcing other suppliers to lower their prices in order to remain competitive and retain the business.
- 2.7. To the extent that independent suppliers participate in retail markets, the source of their energy (assuming State policy issues are satisfied) and its price is of no consequence to the Regulator. Such suppliers always pay the costs of using network facilities and market administration costs (dispatch and settlement) in accordance with Market Rules.
- 2.8. The export of energy may be subject to restrictions to insure that all domestic needs, present and future, are given priority of use (a condition which would be imposed by law or the State authorities, not the Energy Regulator) or other criteria.
- 2.9. Generally the Regulator is indifferent to such sales unless a franchise supplier incurs increased supply costs as a result of an export sale (in this case the recovery of such higher costs in tariffs should not be permitted). Costs related to the use of the transport network for export (or transit) purposes should be excluded from domestic network tariffs.

¹ Such licensees should be required to prepare forecasts of demand on their systems and plans to relieve any future constraints on the ability to serve projected loads. For example, this might take the form of a ten year forecast prepared annually.

- 2.10. In some countries the State may want to impose, as a policy matter, separate taxes or fees which would apply only to the import, export or transit of energy. In the case of transit, for example, the State may take the view that payments by the transit supplier for use of the system that only cover direct costs related to the facilities used (as determined by the Regulator) should be supplemented by payments to the State which provide compensation for the value (unrelated to costs) of transiting the country in order to make the sale.
- 2.11. Monitoring of import/export activities would normally be performed by the Regulator based on data provided by licensees pursuant to their license conditions. Copies of these reports should be sufficient for the policy levels of the State.
- 2.12. All entities that use network transportation facilities to move energy from the resource provider to the end user (or border) should be required to obtain an energy supply license issued by the Regulator and pay established license fees². This includes import, export and transit businesses. In the electric sector this means that such licensees must comply with Market Rules³ and may be required to become market members.
- 2.13. The cross-border connection point for imports and exports should be limited normally to transactions at the bulk supply level, not conducted using the distribution network, except in the case of “convenience” or incidental sales to accommodate local conditions.

3. KEY ISSUES

- 3.1. Because the import or export of energy across national borders affects each country’s international relationships and, at least for some countries, imports or exports are of vital importance to the national economy and quality of life, such transactions require policy decisions and guidance from the State as well as normal regulatory oversight.
- 3.2. The State may want to impose its own requirements on cross-border trade in order to monitor its trading relationship with another country or to extract taxes or fees for this activity.
- 3.3. For the Energy Regulator, the supplier (either the regulated or independent supplier) who holds a license for the purchase and sale of energy may obtain its resources either from within the country itself or by importing energy.
- 3.4. The license conditions of import/export energy licenses, if separate licenses are issued, should be essentially the same as for independent suppliers.
- 3.5. Suppliers are obligated to pay for the use of transmission and distribution networks (“open access facilities”) to move energy from its source to consumers without regard to the whether the energy is produced internally or imported.

² In cases where the independent supply license is identical for domestic activity and import/export, these fees should be the same for all such supply licensees.

³ Market Rules would normally require that all participants provide adequate proof of financial capability and perhaps guarantees or cash deposits to cover any potential default.

- 3.6. The use of facilities for transit through the country requires an analysis of the nature of the transaction, energy volumes and technical characteristics of all transactions using the same assets and the development of appropriate cost allocations and pricing methodologies.

4. ACTION STEPS

- 4.1. The Energy Regulator should not attempt to represent the State in matters of international relations by its issuance of import or export licenses for energy.
- 4.2. Import/export transactions can be licensed by the issuance of supplier licenses which do not restrict the source of supplies purchased to serve retail consumers or, alternatively, by the issuance of separate import and/or export licenses, which should contain nearly identical license conditions.
- 4.3. Where energy is in transit through the country, the costs associated with facilities and operations devoted to the transit service should be excluded from costs reflected in network tariff pricing for domestic transportation in order to prevent cross-subsidies paid by local consumers.