

# ENTSOG: Consultation Workshop on the initial Draft Incremental Proposal

24 June 2014



43 Members and 3 Associated Partners  
in 26 EU countries

4 Observers from EU affiliate countries

- Gassco AS (Norway)
- Swissgas AS (Switzerland)
- GA-MA AD (FYROM)
- Ukrtransgaz (Ukraine)

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- gaslink
- nationalgrid
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- gasum
- GASSCO
- swede gas
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- LATVIAS GAZE
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- jordgas transport
- ontras
- gasunie
- GRTgaz
- gasunie
- GAZ system
- GTG NORD
- Open Grid Europe
- The Gas Wheel
- nowega
- Thyssengas
- CASCADE
- NERGAS
- creos
- FLUXYS
- bayern
- ERDGASLOGISTIK
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- SLOVAK GAS TSO
- FLUXYS
- terraneis bw
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- Pligovodi
- Infrastrutture Trasporto Gas
- punacro
- SNAM RETE GAS
- enagas
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- BULGARTRANS-GAZ
- FAMA
- DESFA
- UKRAINE GAS



european network  
of transmission system operators  
for gas

# Draft Incremental Proposal

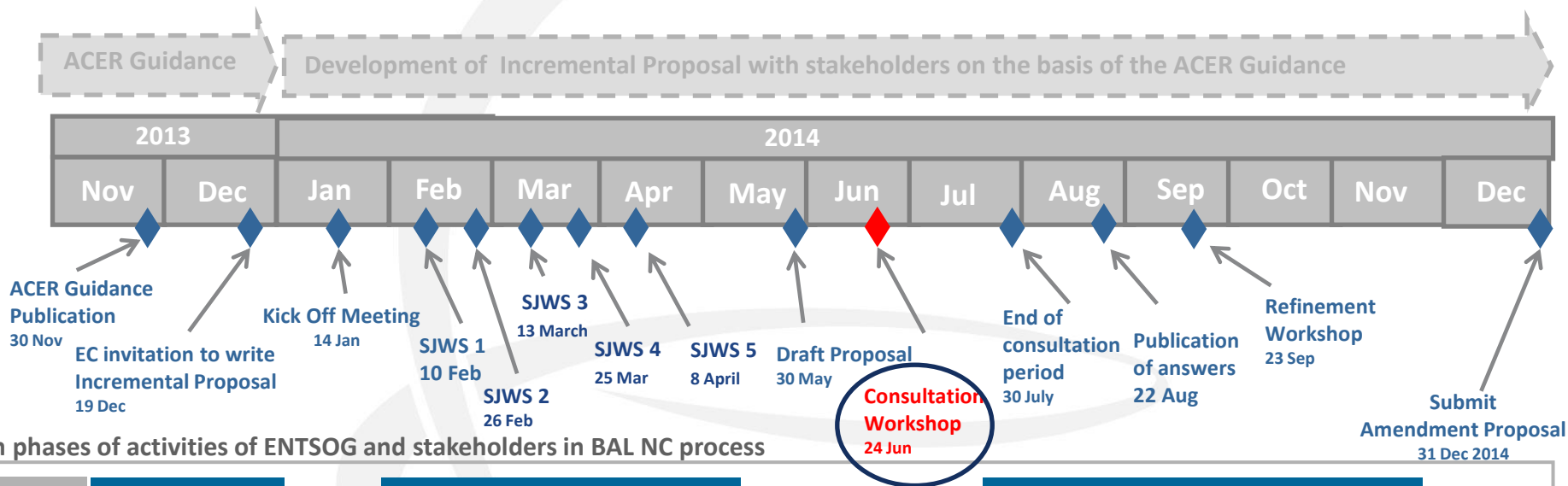
## Consultation Workshop

Brussels – 24 June 2014

# Agenda for today

No.	Description	Time
	<b>Welcome coffee</b>	<b>10:00-10:30</b>
1.	ENTSOG welcome and opening	10:30-10:35
2.	Update on project status ➤ How to respond to the Public Consultation	10:35-11:00
3.	Amendment of CAM NC ➤ Co-ordination and information provision requirements ➤ When to offer incremental and new capacity ➤ Open season procedures ➤ Auctions	11:00-12:00
	<b>Lunch Break</b>	<b>12:00-13:00</b>
4.	Incremental/new capacity chapter in Tariff NC ➤ Economic Test principles ➤ Tariff-issues	13:00-14:15
5.	ACER preliminary response	14:15-14:30
	<b>Coffee Break</b>	<b>14:30-14:45</b>
6.	Prime Mover presentations	14:45-15:45
7.	Conclusions and next steps	15:45-16:00
Next event: 23 <sup>rd</sup> September 2014 → Refinement Workshop INC proposal		

# Timeline for incremental proposal Development and consultation overview



Main phases of activities of ENTSOG and stakeholders in BAL NC process

ENTSOG	Development of launch documentation and Project Plan	Development of draft Incremental Proposal in cooperation with stakeholders					Refinement of Incremental Proposal based on the feedback by stakeholders				
		Kick-off Meeting	SJWS 1	SJWS 2	SJWS 3	SJWS 4	SJWS 5	Consultation period 30 May – 30 July		Refinement Workshop	SSP

# ENTSOG Workshops on Incremental Proposal

Meeting	Kick-Off Workshop
Issues covered	<ul style="list-style-type: none"> <li>➤ Presentation of Draft Project Plan</li> <li>➤ Summary of initial ENTSOG positions</li> <li>➤ ACER presentation of Guidance</li> <li>➤ Initial Stakeholder positions</li> </ul>

Meeting	SJWS 1
Issues covered	<ul style="list-style-type: none"> <li>➤ Presentation of Project Plan</li> <li>Initial ENTSOG ideas on:                             <ul style="list-style-type: none"> <li>➤ Cross-border co-ordination and Information Provision</li> <li>➤ Economic Test and Tariff Issues</li> </ul> </li> </ul>

Meeting	SJWS 2
Issues covered	Initial ENTSOG ideas on: <ul style="list-style-type: none"> <li>➤ When to offer incremental and new capacity</li> <li>➤ Auction procedures</li> <li>➤ Open Season Procedures</li> </ul>



**Collected into Business Rules**

Meeting	SJWS 3
Issues covered	Draft Business Rules on: <ul style="list-style-type: none"> <li>➤ Cross-border co-ordination and Information Provision</li> <li>➤ Economic Test and Tariff Issues</li> </ul>

Meeting	SJWS 4
Issues covered	<ul style="list-style-type: none"> <li>➤ Auction simulation</li> <li>Draft Business Rules on:                             <ul style="list-style-type: none"> <li>➤ When to offer incremental and new capacity</li> <li>➤ Auction procedures</li> <li>➤ Open Season Procedures</li> </ul> </li> </ul>

Meeting	SJWS 5
Issues covered	<ul style="list-style-type: none"> <li>➤ Business Rules on outstanding issues and refinements</li> <li>➤ Presentations on stakeholder views of Business Rules</li> </ul>



**Resulting in initial Draft Incremental Proposal**

# What we consult on?



## Amendment of CAM NC

- Extending the scope of the CAM NC
- Amending the auctioning principles where necessary
- Addition of co-ordination and transparency requirements
- Addition of Open Season procedures as allocation mechanism



## Chapter VIII of Draft Tariff NC

- Covering principles of the Economic Test
- Covering principles of tariff setting for incremental and new capacity

# Documents constituting the Incremental Proposal:

## Draft Incremental Proposal

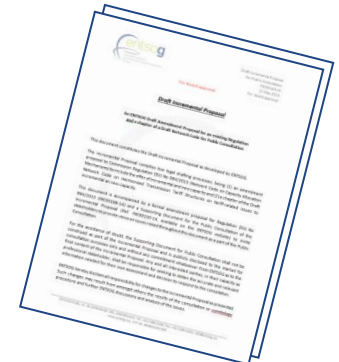
- User friendly and easy-to-read document compiling the relevant parts of both NCs
- Table contrasting the original CAM NC text to the proposed amended text
- Relevant chapter and definitions of Tariff NC

## Draft amendment Proposal

- Formal amendment proposal to Regulation (EU) 984/2013 (CAM NC)
- Only covering those articles of CAM NC, for which an amendment or addition is proposed
- Providing proposal for entry into force and applicability date

## Supporting Document

- Serves as a basis for the Public Consultation (including consultation questions)
- Explains policy decisions and argumentation for ENTSOG proposal



# How to respond to the public consultation?

Follow [Link on ENTSOG website](#) to get to the Consultation

The screenshot shows the 'Introduction' page of the 'Initial Draft Incremental Proposal Consultation Questionnaire'. It features the ENTSOG logo and title. The text explains that ENTSOG was invited by the European Commission in 2013 to draft an amendment to Commission Regulation (EU) No 984/2013. It also states that ENTSOG invites stakeholders to express their opinion on the initial draft proposal. A deadline is set for 17:00 UTC on Wednesday, 30 July 2014. Contact information for Mark Wiensens is provided, along with a 'Next' button and a 'Powered by SurveyMonkey' notice.

Provide contact details at the end of the consultation questionnaire

The screenshot shows the 'Contact Details' section of the questionnaire. It includes a dropdown menu for selection and a form with the following fields: First and Last name, Company Name, Job Title, Do you represent an association (please specify), Email, Tel, Mobile, Street, Postal Code, City, and Country. A 'Next' button is visible at the bottom of the form. Below the form, there is a 'Thank you for your participation' message and a 'Notice' instructing users to print out their completed questionnaire before pressing the 'Done' button. A 'Prev' button is also present. The 'Powered by SurveyMonkey' logo and notice are at the bottom.





# How to respond to the public consultation?

## Instructions:

- To assess the overall response we need at least the name of responding organisation, therefore anonymous responses cannot be taken into account (does not preclude anonymous publication)
- Contact details necessary in case clarification are needed
- No saving of preliminary responses possible. We therefore advise to finalise all text answers in a word document and to copy the final text into the respective fields of the questionnaire when submitting
- In case of accidental or incomplete send of response, clear cookies in the browser and access questionnaire again (a notification to disregard previous response is appreciated)

# Housekeeping – recall general information

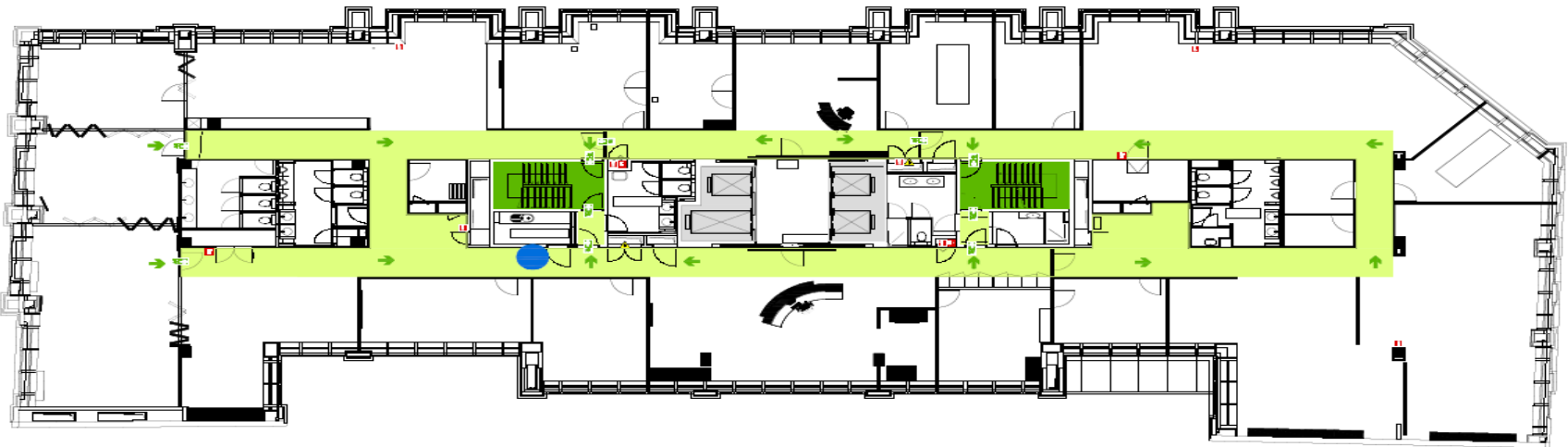
- Attention to the wires from webcast people
- Webcast – questions via mail possible before and during the webcast
- This Consultation WS (including webcast) is intended for the stakeholders, but notes and presentations will be available for the press and the public shortly after the meeting

# Emergency Evacuation

- Emergency Evacuation Plans - Plans located on two main corridors of ENTSOEG office indicating the way of evacuation from offices located on the Second Floor of Cortenbergh 100 Building.
- The meeting point is in front of the Mosque –Parc du Cinquantaenaire,

## Plan d'évacuation | Evacuatie plan | Evacuation map

ENTSOEG aisbl - GIE aisbl



### CONSIGNES EN CAS D'INCENDIE

Ne paniquez pas  
N'emportez rien  
Ne revenez pas sur vos pas  
Dirigez-vous vers une issue de secours  
N'utilisez pas les ascenseurs  
Rendez-vous au lieu de rassemblement

### VEILIGHEIDSRICHTLIJNEN IN GEVAL VAN BRAND

Blijf kalm  
Neem niets mee  
Keer niet terug  
Begeef u naar een nooduitgang  
Gebruik geen liften  
Afspraak op verzamelpunt

### WHAT TO DO IN CASE OF FIRE

Keep calm  
Don't take anything  
Don't come back in your room  
Leave building via emergency exit  
Do not use the elevator  
Go to the meeting point



VOUS ETES ICI  
U BENT HIER  
YOU ARE HERE



CHEMIN D'EVACUATION  
VLUCHTWEG  
EVACUATION WAY



POINT DE RASSEMBLEMENT  
VERZAMEL PUNT  
MEETING POINT



EXTINCTEUR  
BRANDBLUSAPPARAAT  
FIRE EXTINGUISHER



DEVIDOIR  
HASPEL  
FIRE HOSE REEL



BOUTON D'ALARME  
ALARM DRUKKNOP  
ALARM BUTTON



LOCAL ELECTRICITE  
ELEKTRICITEITSLOKAAL  
ELECTRICAL ROOM



SORTIE DE SECOURS  
NOODUITGANG  
EMERGENCY EXIT



SORTIE NORMALE ET DE SECOURS  
UITGANG EN NOODUITGANG  
USUAL AND EMERGENCY EXIT

+2

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punaero  
DESFA

UKRAINE  
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BULGARTRANSOAZ  
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Other logos visible on the map include: BGE (UK) Ltd., ontras, goa, GTG NORD, Open Grid Europe The Gas Wheel, nowega, Thyssengas, CASCADE, NERGAS, eustream, SLOVAK GAS TSO, TERRANETS BW, GAS CONNECT AUSTRIA, MAGISTRALA ENERGIIE, and FAMA.

# Agenda

- **Cross Border Co-Ordination and Information Provision**
- When to Offer Incremental/New Capacity
- Open Season Procedures
- Auction Procedures

## Lunch

- Economic Test
- Tariff Issues

# Identified topics: Cross Border Co-Ordination and Information Provision

## 1. Role of the NRA in the processes

- Role of NRA more emphasised in the text

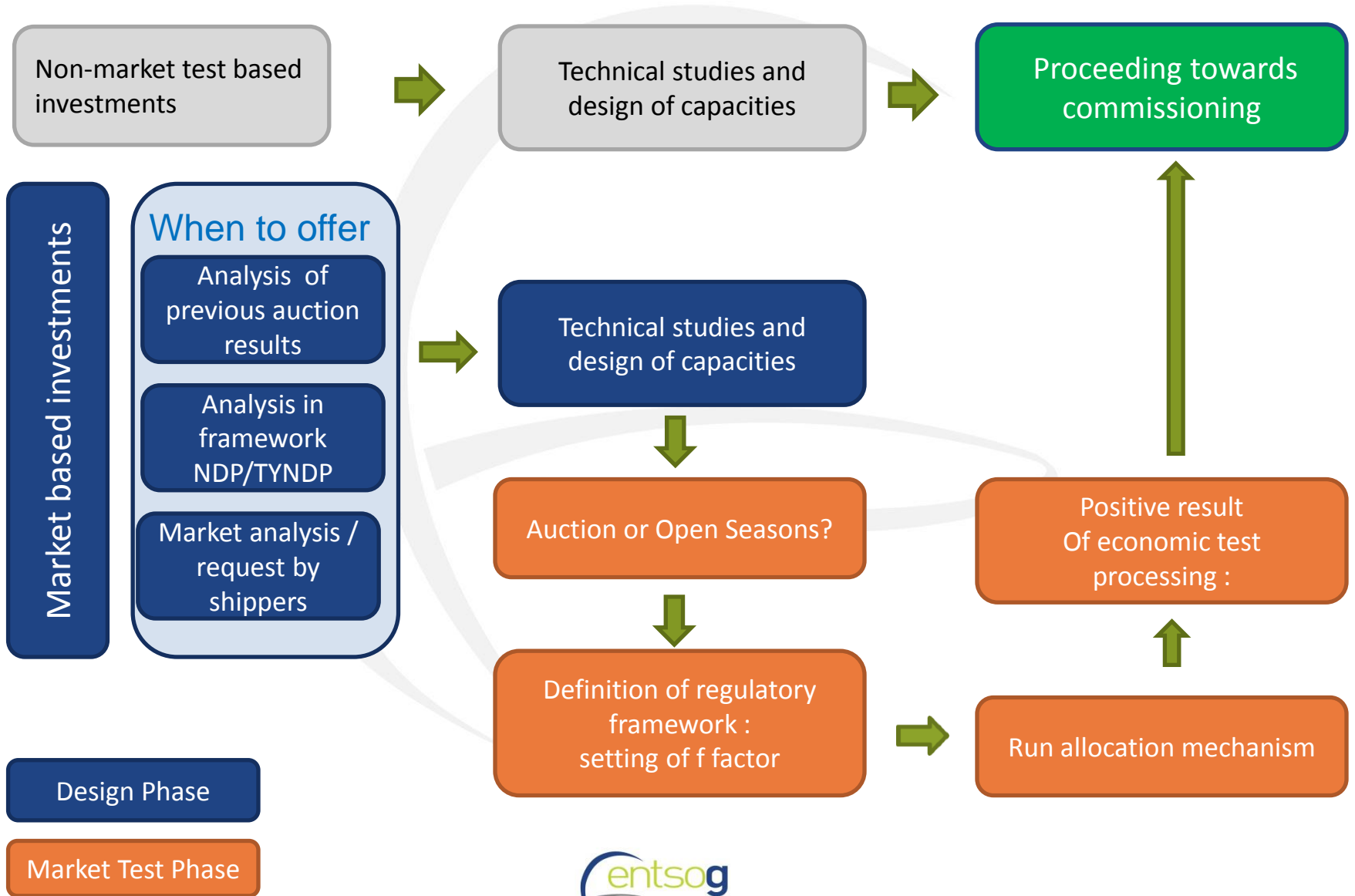
## 2. Distinction between Auctions and OSP

- Graphic examples outlining the differences

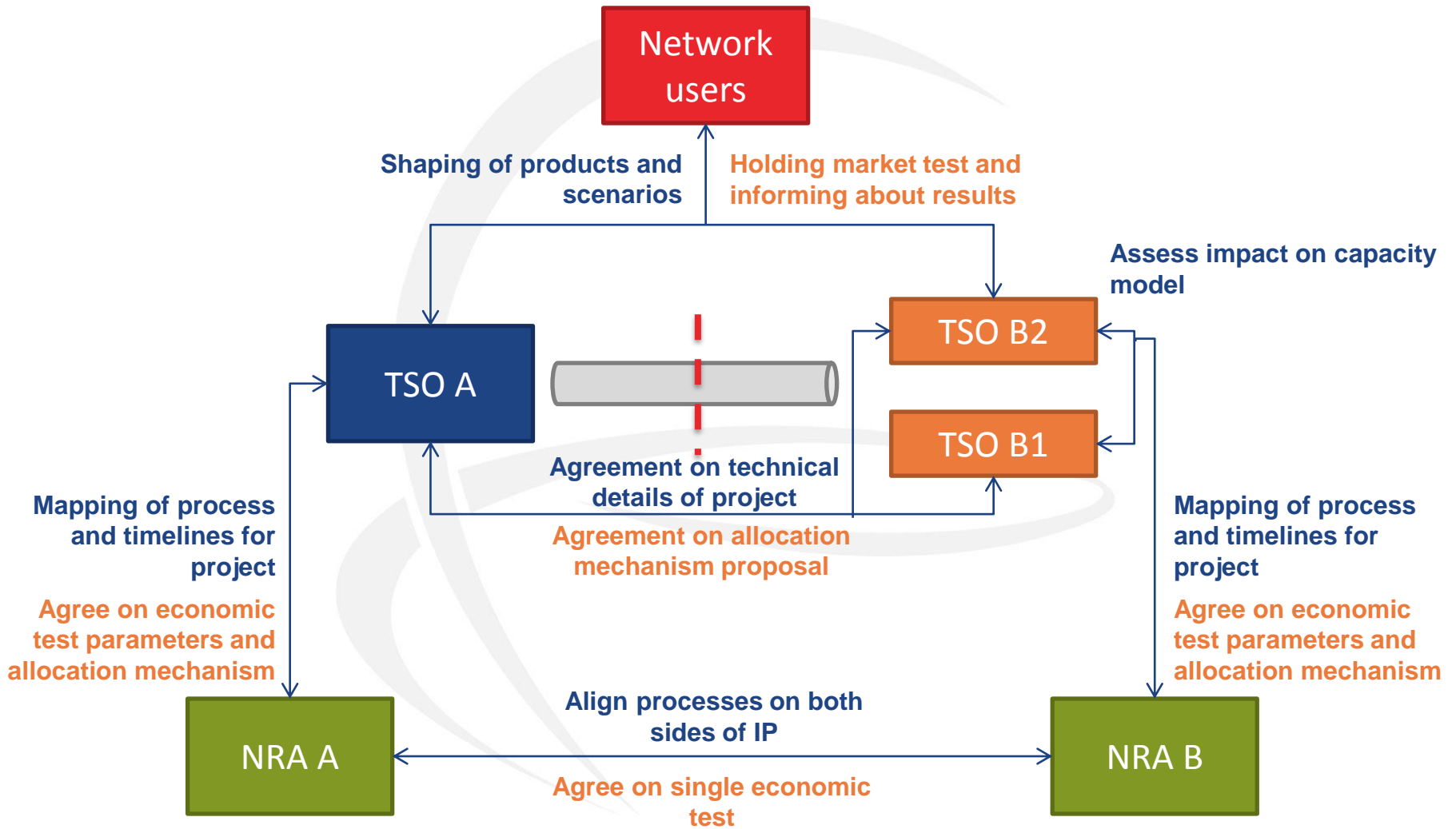
## 3. Level of detail in the proposal

- Clarity on process, flexibility on specifics

# High level process diagram



# Interaction between stakeholders



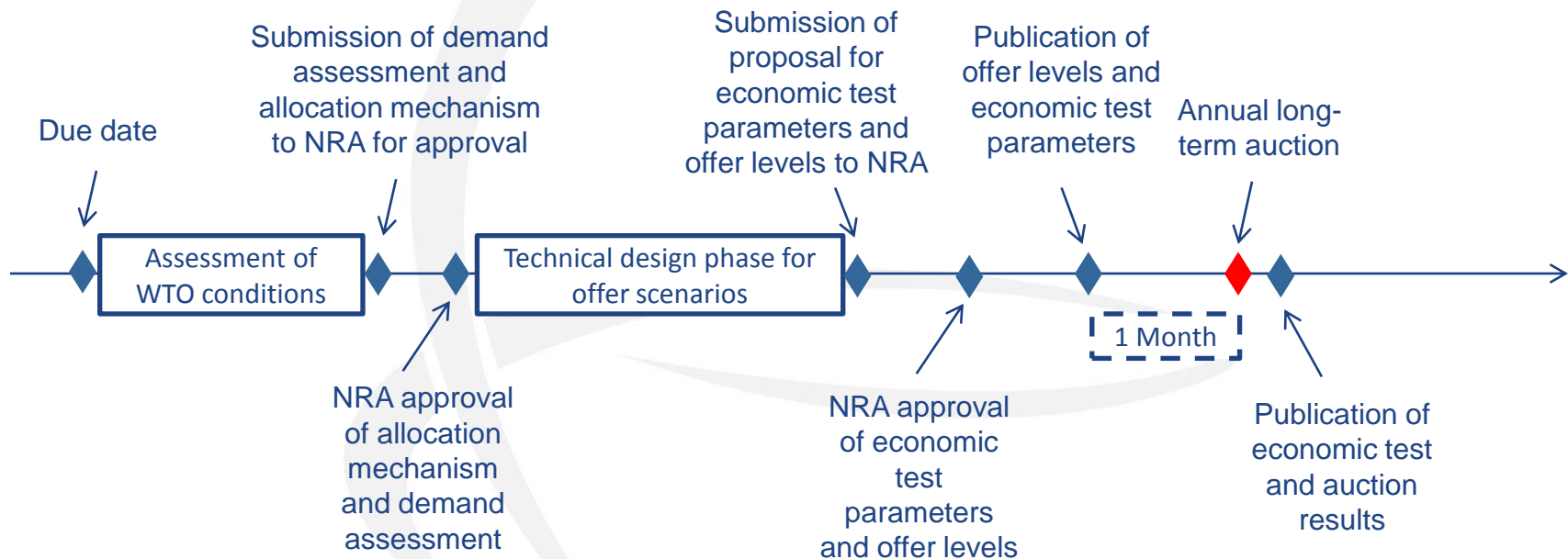
Design Phase  
Market Test Phase





# Process steps: auctions

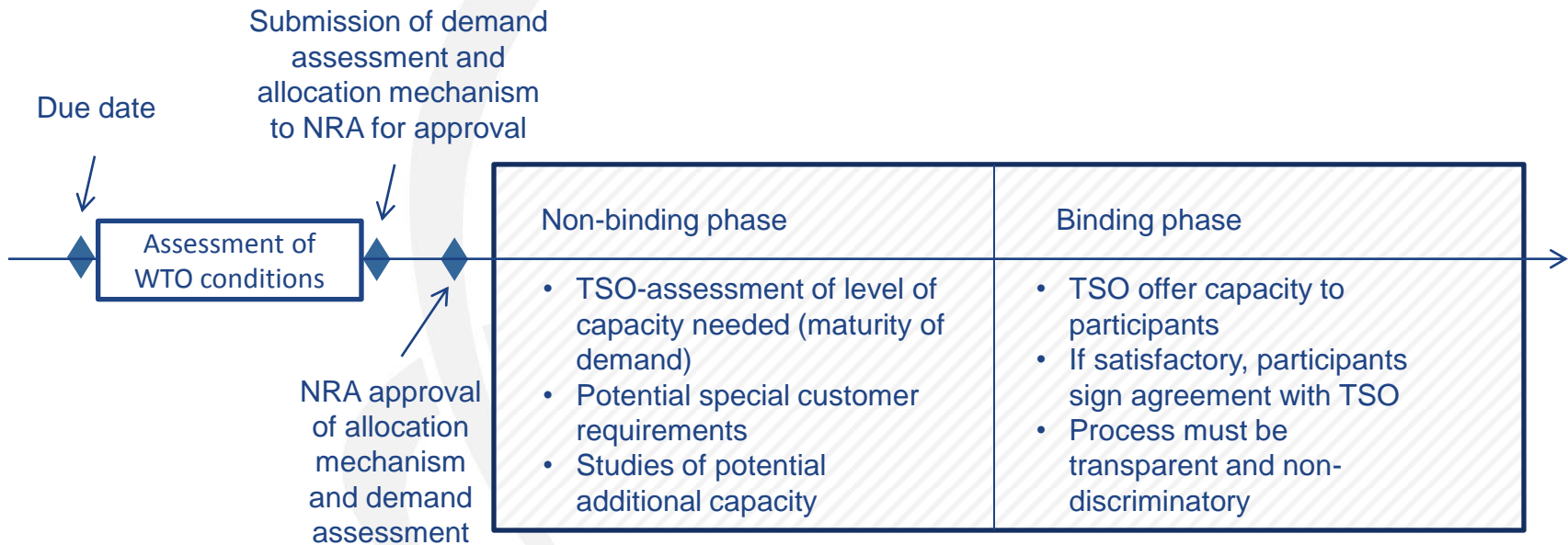
The following timeline shows the main process steps in case an auction is chosen as allocation mechanism:



Please note: The timeframes in this diagram are only indicative and are not necessarily in the correct ratio to each other

# Process steps: Open Season

The following timeline shows the main process steps in case an open season procedure is chosen as allocation mechanism:



Please note: The timeframes in this diagram are only indicative and are not necessarily in the correct ratio to each other

# How to address multi-IP projects

Either there is explicitly no rationale for linking the two (or more) IPs

- Bundled capacity is sold at IPs linking Entry-Exit zones; this is equivalent to two incremental/new capacity projects

Or the whole project has a single rationale, and is offered that way to the market

- Conditionnalities are handling the consistency of commercial offer
- Multi IPs coordination necessary in FIDs : the Memorandum of understanding signed by TSOs must compel combined FID process
- Delay mechanism for the availability of incremental/new capacity at each IP must ensure minimum period of non availability the allocated incremental/new capacity at all points

# Consultation Questions on CBC & IP

**Question 3:** Do you agree with the level of co-ordination between TSOs and NRAs involved in an incremental or new capacity project as foreseen in Article 20a (CAM NC)? If not, please elaborate.

**Question 4:** Do you agree with the auction default and the alternative open season procedure as defined in Article 20a (5) (CAM NC)? If not, please elaborate.

**Question 5:** Do you have any additional remarks to the provisions in Article 20a (CAM NC)?

**Question 6:** Do you agree with ENTSOG's proposal of a demand assessment to be the basis for conducting technical studies and subsequently designing offer levels? If no, please elaborate.

**Question 7:** Do you agree with the scope of information to be provided to the NRA and to be published by TSOs involved in an incremental or new capacity process as foreseen in article 20b(2) (CAM NC)? If not, please elaborate.

**Question 8:** Do you agree with the lead-time foreseen for the publication of information relevant to an incremental or new capacity project and especially the economic test as described in article 20b (3) (CAM NC)? If not, please elaborate.

**Question 9:** Are there any other issues that you wish to address regarding information provision as foreseen in article 20b? If yes, please elaborate.

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BULGARTRANSOAZ

# Agenda

1. Cross Border Co-Ordination and Information Provision
- 2. When to Offer Incremental/New Capacity**
3. Open Season Procedures
4. Auction Procedures
5. Economic Test
6. Tariff Issues

# Identified topics: When to Offer

## 1. Criteria for When to Offer

- Criteria individually trigger the aggregated assessment of offer levels

## 2. Time flexibility for submitting non-binding indications

- More time flexibility needed
- Allow for submission throughout the year

# When to launch the offer process?

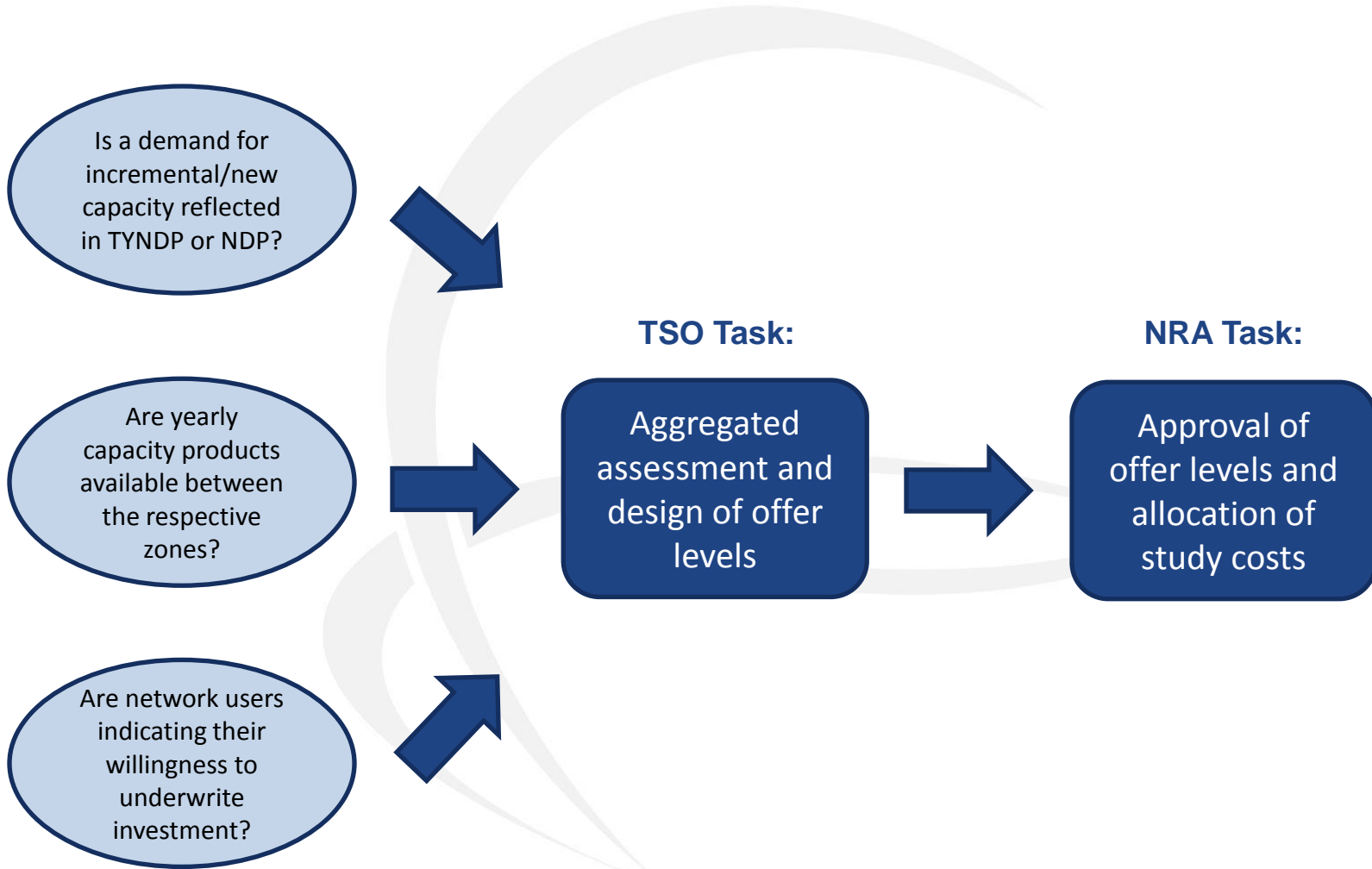
The process for offering incremental or new capacity shall be launched if at least one of the following conditions is met:

- In case the ENTSOG Ten Year Network Development Plan or a Network Development Plan of the respective Member State identifies in a reasonable peak scenario that a specific region is undersupplied and offering incremental or new capacity could close the supply gaps
- In case no yearly capacity product linking two adjacent entry-exit-zones is available in the long-term annual capacity auctions for the year in which incremental/new capacity could be offered first and in the three subsequent years, because all the capacity has been contracted
- In case network users submit a non-binding demand indication requesting incremental or new capacity for a sustained number of years

What follows if conditions are met...?



# Designing offer levels



# Submitting non-binding indications

- Incremental and new capacity should be offered as quickly as possible if it is required
- Network users should have the possibility to express their demand for incremental/new capacity on a regular basis
- Especially in meshed networks, TSOs need to have a full picture of demand for incremental/new capacity in order to allow a meaningful design of offer levels
- Likelihood of reaching a sufficient level of demand to invest is much higher, if all indications of network users are aggregated

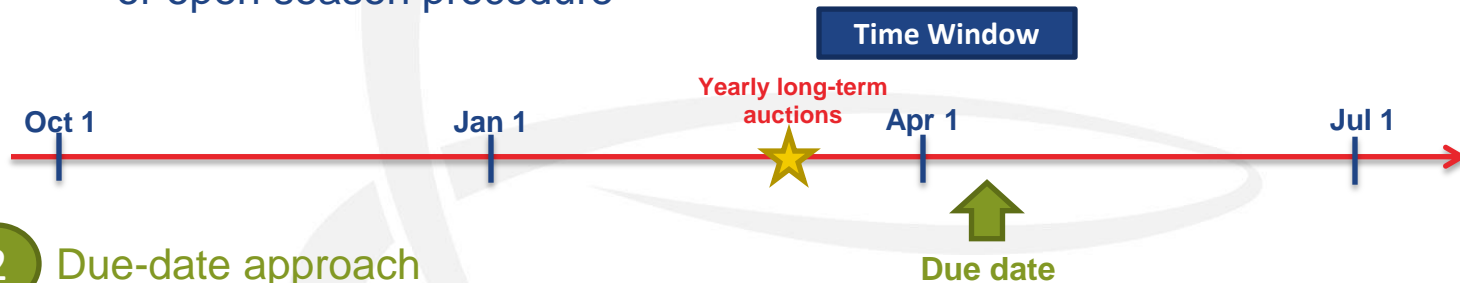
**How to strike a balance...?**

# Period for submitting non-binding indications

Two approaches were discussed in the Draft Proposal development phase:

## 1 Time window approach

- Specified time window after the annual long-term auctions
- Indications received in time window will be considered for next possible auction or open season procedure



## 2 Due-date approach

- Specified - at least - bi-annual due date (potentially after long-term auctions)
- TSOs will fully assess and report based on indications received
- If indications are sufficient, TSOs have the possibility to shorten the process and to offer launch the offer process before the due date

# Consultation Questions on When to Offer

**Question 10:** Do you agree with the conditions that shall lead to the offer of incremental and new capacity as defined in Article 20c (1), (6), and (7) (CAM NC)? If not, please elaborate.

**Question 11:** Do you agree that the due date approach is preferable to the time window approach as foreseen in article 20c (3) (CAM NC)? If not, please elaborate.

**Question 12:** Are there any other issues that you wish to address regarding conditions of when to offer incremental and new capacity as foreseen in article 20c (CAM NC)? If so, please elaborate.

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# Agenda

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# Identified topics: Open Seasons

## 1. When to use OSP instead of Auctions

- Enumeration of the examples

## 2. Principles

- Focus on non-discrimination and transparency

## 3. Allocation rule

- CAM NC auction as default with an alternative mechanism as back-up

# When to use OSP instead of auctions

- Where a project stretches across more than two entry exit zones or involves more than one interconnection point
- Where a project is so complex, that standardised auctions are not a robust approach to the realisation of incremental and new capacity

#	Examples of when Open Season Procedures > auctions
1.	<i>Involves more than one interconnection point or more than two entry exit zones or is linked to or impacted by the realisation of an exempted infrastructure according to Article 36 of Directive 2009/73/EC</i>
2.	<i>When conditional commitments according to Article 20f(3) are envisaged</i>
3.	<i>When the required offer level or offer levels cannot be efficiently derived from the demand assessment according to Article 20c(6)</i>
4.	<i>When the horizon of 15 years for network user commitments provided in the auction procedures as set out in Article 11 would not be sufficient for a positive economic test at the reserve price</i>
5.	<i>When transmission system operators and national regulatory authorities might select the iterative approach as described in Article 44(4) lit. c of Regulation (EU) No XXX/201X (TAR NC) as a mechanism for possible redistribution of revenues.</i>



# Principles of OSP

- Principles of OSP in Incremental Proposal are inspired by ERGEG Guidelines on Good Practice in Open Seasons (GGPOS)
- High focus on transparency and non-discrimination
- High involvements of the relevant national regulatory authorities throughout the process of the open season
- Clear definition of process steps and milestones within the open season

# Refined proposal for the allocation mechanism

- Default rule is willingness-to-pay per year
- Alternative allocation rule applied only if willingness-to-pay per year leads to a failed economic test
  - The rule shall consider the added-value of longer duration bids in contributing to passing the market test
  - Alternative rule is described in the Open Season notice (Information Memorandum)
  - For all Open Season Procedures it is a fall-back solution
  - The design of an alternative business rule is optional and does not presuppose that it will be applied

# Consultation Questions on Open Seasons

**Question 17:** Do you agree with the provisions that shall lead to conducting an Open Season Procedure instead of auctions for incremental and new capacity as foreseen in article 20e (2) (CAM NC)? If not, please elaborate.

**Question 18:** Do you see any other conditional capacity commitments in Open Season Procedures than the issues raised in the Draft Incremental Proposal article 20f (3) (CAM NC)? If yes, please elaborate.

**Question 19:** Do you agree that the proposed Open Season Procedures notice contains sufficient information as foreseen in 20f (8) (CAM NC)? If not, please elaborate.

**Question 20:** Do you agree with the default allocation rule foreseen for Open Season Procedures, being willingness to pay per unit and year as foreseen in article 20g (3) and the alternative allocation rule subject to NRA approval as foreseen in article 20g (4) (CAM NC)? If not, please elaborate.

**Question 21:** Are there any other issues that you wish to address regarding Open Season Procedures as foreseen in article 20e, article 20f and article 20g (CAM NC)? If yes, please elaborate.

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# Agenda

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4. **Auction Procedures**
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# Identified topics: Auctions

- 1. Parallel bidding ladders**
- 2. Possibility for bid revision**

General aim: To keep the integrity of the CAM NC auction process

# Parallel bidding ladders approach

Parallel bidding ladders for incremental/new capacity auctions at an IP:

- One bidding ladder for the offer of existing capacity, without any incremental capacity
- One bidding ladder for each incremental/new capacity (offer) level, offering existing capacity plus the respective amount of incremental/new capacity

**Shipper bidding for bundled capacity at one IP with incremental capacity on offer**



Bidding Ladder Base Case (only existing):

Price	Cap on offer	Year 1	Year 2	...
X	100	100	100	...

Bidding Ladder Level 1 (Existing plus 25 INC):

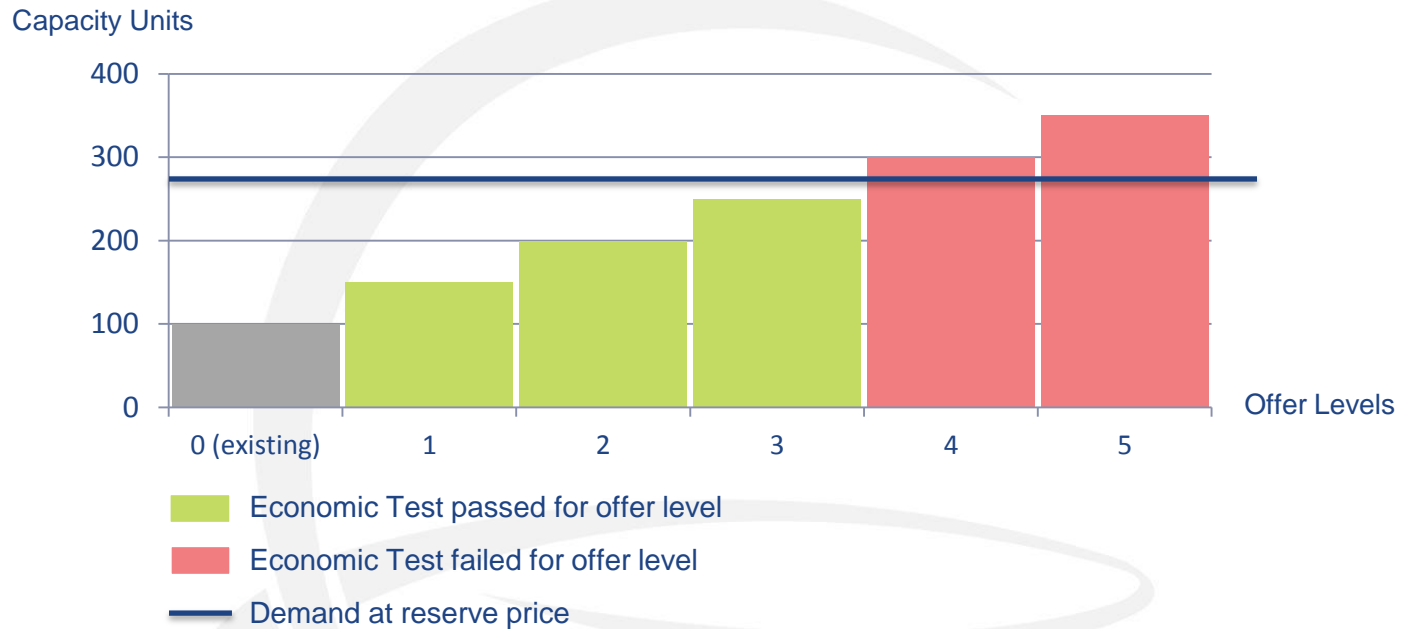
Price	Cap on offer	Year 1	Year 2	...
Y	125	125	125	...

Bidding Ladder Level 2 (Existing plus 50 INC):

Price	Cap on offer	Year 1	Year 2	...
Z	150	150	150	...

After all bidding ladders close, the economic test is applied and the bidding ladder which results in the highest level of incremental capacity and a positive economic test is passed into the next phase

# Possible principle for bid revision

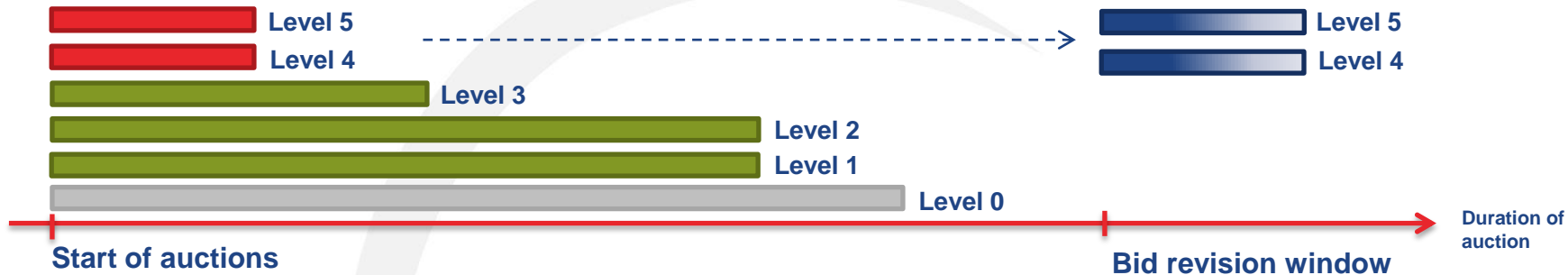


## In such a case:

- Actual demand at reserve price is higher than the level of capacity offered in the highest offer level that is resulting in a positive economic test outcome
- For network users, a higher offer level at the reserve price might be preferable to the successful lower offer level at a premium



# How to conduct bid revision



- **Once the auctions for all offer levels have cleared**, the TSOs will assess whether the conditions for bid revision are met (highest positive offer level cleared at a premium)
- If this is the case, the TSOs will repeat the auction for the higher offer levels
- Repeated auctions will also run according to the principles of parallel bidding ladders (if there is more than one higher offer level)
- In case the repeated auction leads to the circumstances allowing for bid revision again, another repeated auction could be conducted

# Further principles of bid revision

## ➤ Bids stay binding!

In case of bid revision (as the highest offer level with a positive economic test cleared with a premium), the bids for the successful bidding ladder in the initial auction stay binding until and unless another higher bidding ladder is successful in the repeated auction

## ➤ No limitations to bid revision!

In order to increase the chance of passing the economic test in the repeated auction, no limitations with regards to participants and volume bids should apply in this auction

## ➤ Bid revision should bring maximum benefit!

In case a repeated auction again leads to circumstances calling for bid revision, another repeated auction should be conducted

# Consultation Questions on Auctions

**Question 13:** Do you agree with the concept of parallel bidding ladders to auction incremental and new capacity as foreseen in article 20d (CAM NC)? If not, please elaborate.

**Question 14:** Do you agree with ENTSOG's opinion that repeating the identified bidding ladder(s) represents the clearest way to allow for bid revision as foreseen in article 20d (3) (CAM NC)? If not, please elaborate.

**Question 15:** Do you prefer: 1) a continuous approach for bid revision as proposed by ENTSOG in article 20d (3) (4); or 2) an approach according to which bid revision is only applied once? Please elaborate.

**Question 16:** Are there any other issues that you wish to address regarding auction mechanisms as foreseen in article 20d? (CAM NC) If yes, please elaborate.

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- Amber Grid
- jordgas transport
- ontras
- gasunie
- GRTgaz
- gasunie
- GOA
- GAZ system
- GTG NORD
- Open Grid Europe
- The Gas Wheel
- nowega
- Thyssengas
- CASCADE
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- BULGARTRANSOAZ
- FAMA
- DESFA
- UKRAINE
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# Agenda

1. Cross Border Co-Ordination and Information Provision
2. When to Offer Incremental/New Capacity
3. Open Season Procedures
4. Auction Procedures
- 5. Economic Test**
6. Tariff Issues

# Identified topics: Economic test

## 1. Change of PVAR to PVRR

- To accommodate both price-cap and revenue-cap regimes

## 2. The f-factor

- 1-f part shall be recovered by future bookings or other means

## 3. Combination into single economic test

- Means to calculate parameters for a single economic test

# PVAR to PVRR

Economic test formula used in TAR FG:

$$PVUC \geq f * PVAR$$

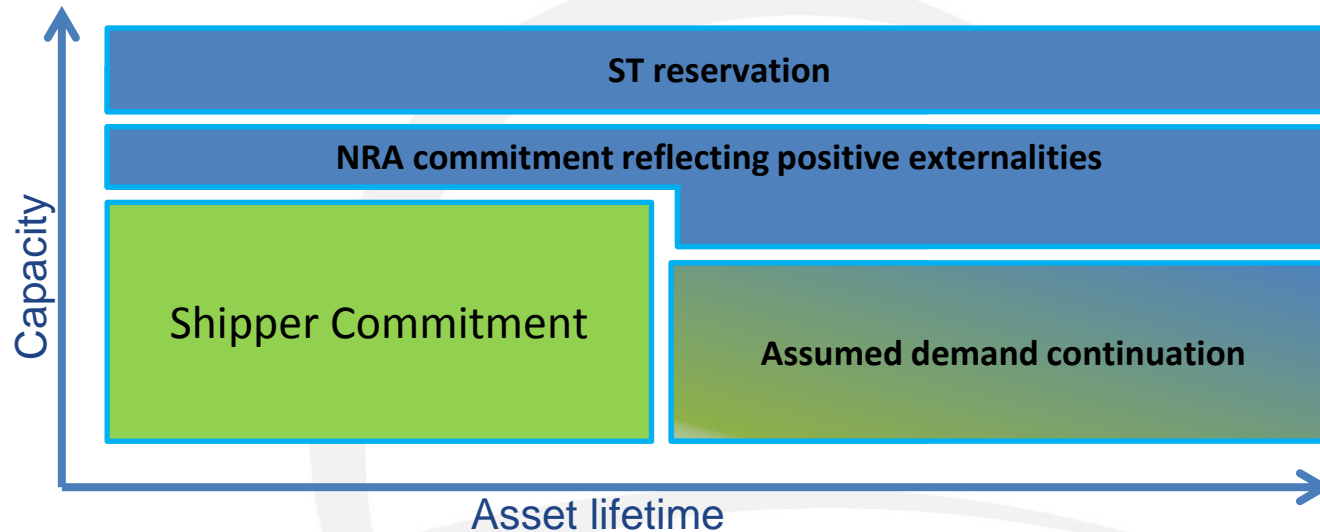
- “PVAR” = Present Value of increase in Allowed Revenues related to the respective capacity expansion
- The term ‘Allowed Revenues’ is defined in the TAR FG as *“The maximum level of revenues set or approved by the NRA that a TSO is allowed to obtain within a defined period of time for undertaking its regulated activities.”*
- In price cap regulatory regimes, no maximum level of revenues is set or approved by the NRA, therefore ‘Allowed Revenues’ do not exist

Formula used for draft NC proposal:

$$PVUC \geq f * PVRR$$

- ‘Regulated Revenues’ are either the Allowed Revenues in Revenue Cap Regimes or the expected revenues in Price Cap Regimes
- General principle of formula is unchanged!

# Split of PVRR into f and 1-f



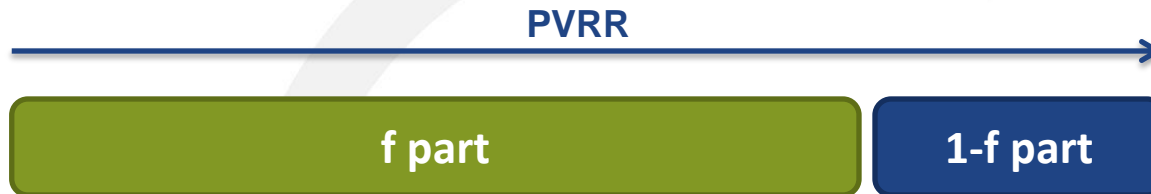
Market underwritten part of investment for which investment recovery is guaranteed by market

Regulatory underwritten part of investment for which investment recovery is guaranteed by NRA



# Recovery of PVRR

How to recover PVRR for an investment?



**f part**

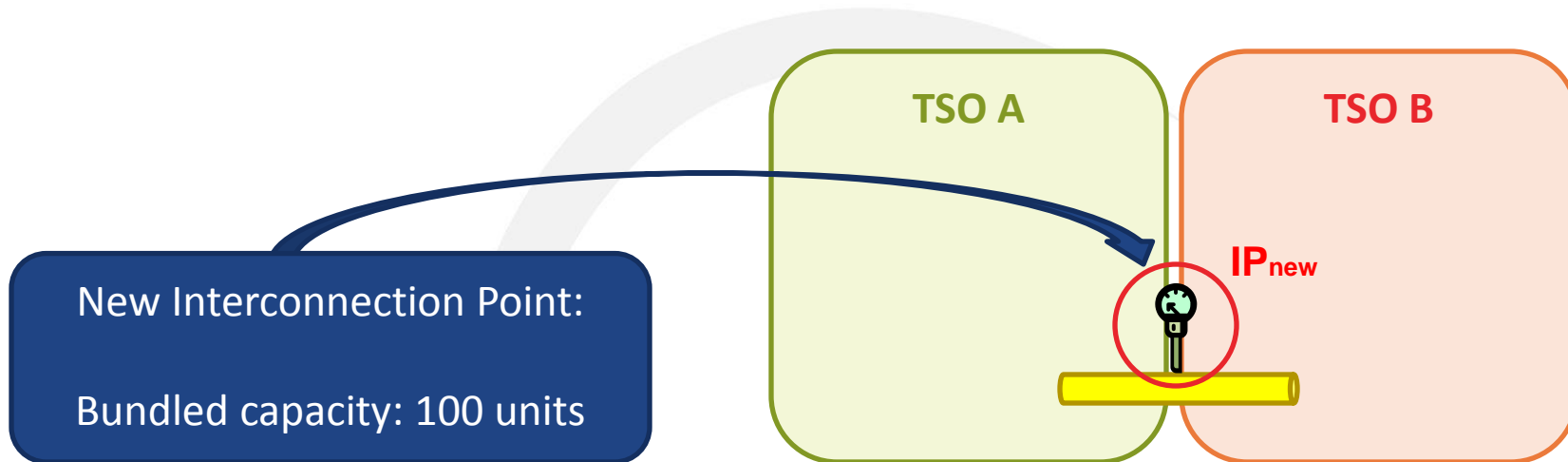
= Will be recovered by upfront commitments from network users

**1-f part**

= Will be recovered by either:

- Other bookings of the incremental/new capacity (being demand continuation or capacity reserved for short term)
- Other bookings at any other point(s) via socialisation
- Any other financing through e.g. EC subsidies
- If none of the above can be ensured, the share of 1-f needs to be decreased, i.e. the f-factor needs to be increased

# Single Economic Test principles



Investment at TSO A	
Level of Increment	100 capacity units
PVRR	300 EUR
f Factor	0.5
Tariff	2.50 EUR
Required level of UC	60 capacity units/year

Investment at TSO B	
Level of Increment	100 capacity units
PVRR	375 EUR
f Factor	0.75
Tariff	4 EUR
Required level of UC	70 capacity units/year



To be combined into a single economic test...

# Calculation of Single Economic Test

Single Economic Test needs to reflect a **minimum level of user commitment** that allows all involved TSOs to cover the share of their PVRR associated with their investment.

Investment at TSO A	
Level of Increment	100 capacity units
PVRR	300 EUR
f Factor	0.5
Tariff	2.50 EUR
Required level of UC	60 capacity units/y

Investment at TSO B	
Level of Increment	100 capacity units
PVRR	375 EUR
f Factor	0.75
Tariff	4 EUR
Required level of UC	70 capacity units/y

**Minimum level of UC to pass Single Economic Test is therefore 70 capacity units**

Aggregated f-factor as a mathematical calculation based on combined PVRR, Tariffs and minimum level of UC

Single Economic Test for A and B	
Required level of UC	70 capacity units/y
Tariff	6.50 EUR
f Factor	<b>0.677</b>

f-Factor is only a mathematical calculation and can theoretically be higher than the two individual f-factors



# Minimum level of User Commitment

The Single Economic Test identifies three different sections of user commitment levels:

Economic Test Result	10	20	30	40	50	60	70	80	90	100
TSO A	Red	Red	Red	Red	Red	Light Green	Green	Green	Green	Green
TSO B	Red	Red	Red	Red	Red	Light Red	Green	Green	Green	Green
Single Economic Test	Red	Red	Red	Red	Red	Light Red	Green	Green	Green	Green

1. A section where the individual Economic Tests at both sides of the IP are not passed (level <60 in the example);
2. A section where the individual Economic Test is passed at one side of the IP but not on the other side of the IP (level 60-70 in the example);
3. A section where the individual Economic Tests are passed on both sides of the IP, and therefore also the Single Economic Test is passed (level >70).



Section 3 – the only section where the Single Economic Test is passed – can potentially be increased by a redistribution of revenues for the investment...

# Three possible ways to structure the process of a potential redistribution of revenues

Approach	Description	Advantage	Disadvantage
<b>Ex-ante approach</b>	Assessment of potential redistribution of revenues once the individual economic tests are defined but before parameters of single economic test are published	➤ More certainty for network users on parameters of the economic test	➤ Potentially unnecessary delays due to long-lasting revenue discussions
<b>Ex-post approach</b>	Assessment of potential redistribution of revenues only once a single economic test based on the highest minimum level of user commitment is negative	➤ Resources and time for assessment only used if really necessary	➤ Final outcome of economic test could be delayed due to assessment
<b>Integrated and iterative approach</b>	Assessment of potential redistribution of revenues integrated into the design and the binding phase of an open season, thus open season could be chosen in case redistribution of revenues is expected to be necessary	➤ Efficient combination in which recourses and time are used rationally	➤ Requires full immersion of network users throughout the whole process

# Consultation Questions on Economic Test

**Question 22:** Do you agree with the structure of the economic test in the Incremental Proposal as foreseen in article 42 (TAR NC)? If not, please elaborate.

**Question 23:** Do you agree with the factors that shall be taken into account when defining the f-factor as foreseen in article 43 (TAR NC)? If not, please elaborate.

**Question 24:** Do you agree with the structure of the recovery mechanisms for the share of 1-f as foreseen in article 43 (2) (TAR NC)? If not, please elaborate.

**Question 25:** Do you agree with the way the single economic test is aggregated as foreseen in article 44 (TAR NC)? If not please elaborate.

**Question 26:** Do you agree with the three approaches for a potential redistribution of revenues as described in article 44 (4) (TAR NC)? If not, please elaborate.

**Question 27:** Are there any other issues that you wish to address regarding economic test as foreseen in articles 42-45 (TAR NC)? If yes, please elaborate.

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- gasum
- Open Grid Europe
- The Gas Wheel
- nowega
- Thyssengas
- creos
- FLUXYS
- ERDGASLOGISTIK
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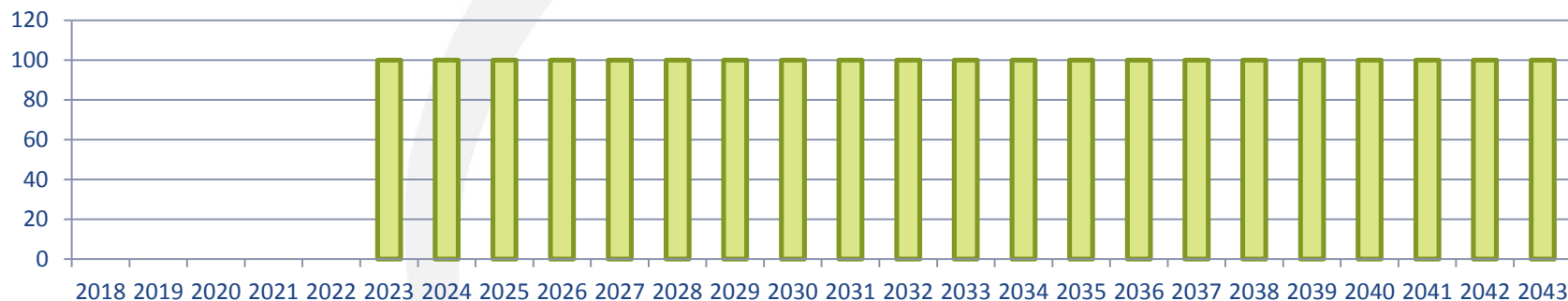


# Identified topics: Tariff issues

- 1. Fixed vs. Floating tariffs**
- 2. Tariffs and methodology to calculate PVUC**
- 3. Mechanisms for tariff adjustment**

# Long-term bookings required

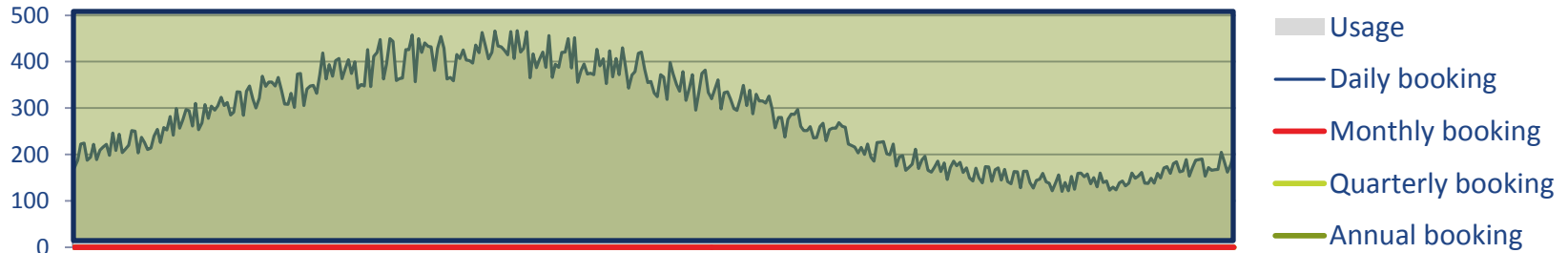
- Long-term capacity bookings required to pass the economic test and to ensure economic viability of a project



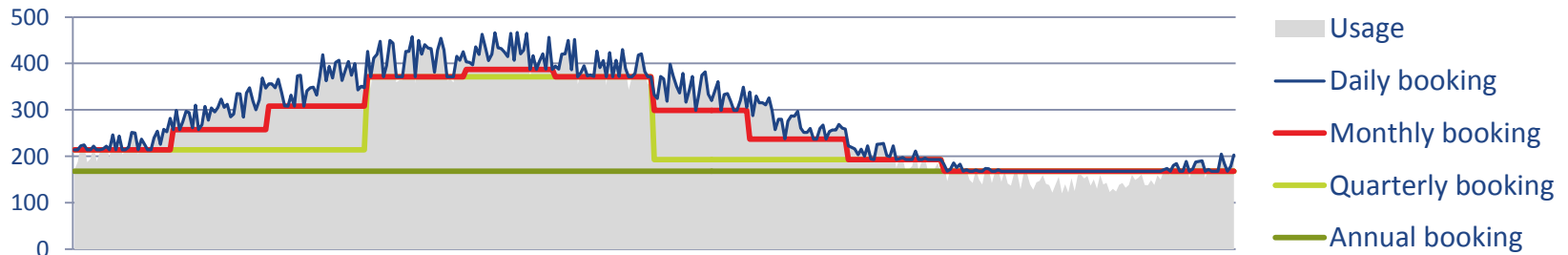
- With extended booking horizon in OSP, a booking horizon of up to 25 years from the initial auction could be required
- In order to work, the Incremental Proposal must provide sufficient incentives for network users to commit for such a future period!

# Optimisation of bookings

(1) No multipliers and sufficient availability of capacity on short-term basis



(2) Multipliers and sufficient availability of capacity on short-term basis



Different booking behaviour does not influence system costs.



Lower average bookings lead to higher tariffs.

# Long-term bookers vs. short-term bookers

Profit of Shipper A \ Shipper B		Alternatives of Shipper B	
		Book long-term	Book short-term
Alternatives of Shipper A	Book long-term	2 \ 2	-1 \ 4
	Book short-term	4 \ -1	0 \ 0



Both shippers have rationales to book short-term irrespective of competitors decision, if capacity is available and multipliers are not set appropriately.



Long-term bookers have a disadvantage due to generally lower capacity bookings and thus higher tariffs.



Absence of long-term bookings lead to failed economic test and no incremental capacity will be provided.

# (Dis)-Incentives for long-term bookings

Incentives for long-term capacity bookings	Disincentives for long-term capacity bookings
<ul style="list-style-type: none"><li>➤ Possible <b>congestion at IP</b> could make long-term booking preferable in order to ensure the usability of capacity</li></ul>	<ul style="list-style-type: none"><li>➤ <b>Uncertainty of the future</b> in terms of costs and risks</li><li>➤ <b>Short-term reservation quota</b> ensures availability of capacity on short-term basis</li></ul>



No sufficient incentives for network users to make long-term bookings, as capacity is most certainly available on short-term basis at much lower cost risks!



Multipliers and risk perception of shippers are key for long-term bookings

# Floating vs. fixed tariffs

- Floating tariffs result in a high uncertainty for network users on the evolution of tariffs in the future
- Fixed tariffs for incremental and new capacity allow a more certain calculation of costs associated with a long-term capacity commitment

## Article 41(2) of Draft Tariff NC

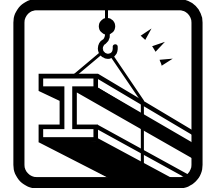
2. The reserve price (referred to in paragraph 1) shall be either of the following:
    - (a) **floating price**, where such price is the one that is applicable at the time when the concerned standard capacity product may be used;
    - (b) **fixed price**, where such price is the one that is applicable at the time when the concerned standard capacity product is auctioned;
    - (c) the combination of approaches referred to in points (a) and (b);
    - (d) fixed price referred to in point (b) with an additional variable charge.
- Both completely fixed or completely floating tariffs might not be optimal for incremental and new capacity. A combination might be preferable

# Which tariff to be applied?

Tariff to be used in the Economic Test to calculate PVUC:

➤ Fixed tariff elements:

**Payable Price at usage = Reference Price at initial offer**



➤ Floating tariff elements:

**Payable Price at usage differs from Reference Price at initial offer**



- In order to calculate an Economic Test, necessary assumptions on the evolution of the reference price have to be made
- Tariff used for the calculation of PVUC in the Economic Test is an estimated projection of indicative reference prices



**Fixed tariff elements can reduce the risk at time of offer**

# Tariff adjustments

- Reference price calculated following the cost allocation methodology could be inappropriate for the incremental capacity and the economic test
- Adjustments are already foreseen in the FG
- ENTSOG analysed further the conditions for and mechanisms of tariff adjustments

## Article 46 of Draft Tariff NC

3. National regulatory authorities may decide to apply the mechanisms defined in paragraphs 4 and or 5 if at least one of the following conditions is met:

(a) in case the allocation of all incremental or new capacity offered at the reference price [...] would not generate sufficient revenues for a positive economic test;

(b) in case the reference price is set to a level not attracting sufficient capacity bookings for a positive economic test;

(c) in case the relevant national regulatory authorities have reasonable doubts whether future capacity bookings will generate sufficient revenues [...]



# Positive tariff adjustment

- Some cost allocation methodologies allow not to allocate costs in that way, that all costs of incremental capacity are allocated to incremental capacity
- Setting of higher f-factor assures cost-reflective economic test, but may lead to pre-defined negative economic test (even if all offered capacity is sold)
- Higher tariffs for incremental capacity **avoid subsidisation**
- Default tariff adjustment is the **application of a positive minimum premium** for the incremental and new capacity in the initial auction or in the open season procedure



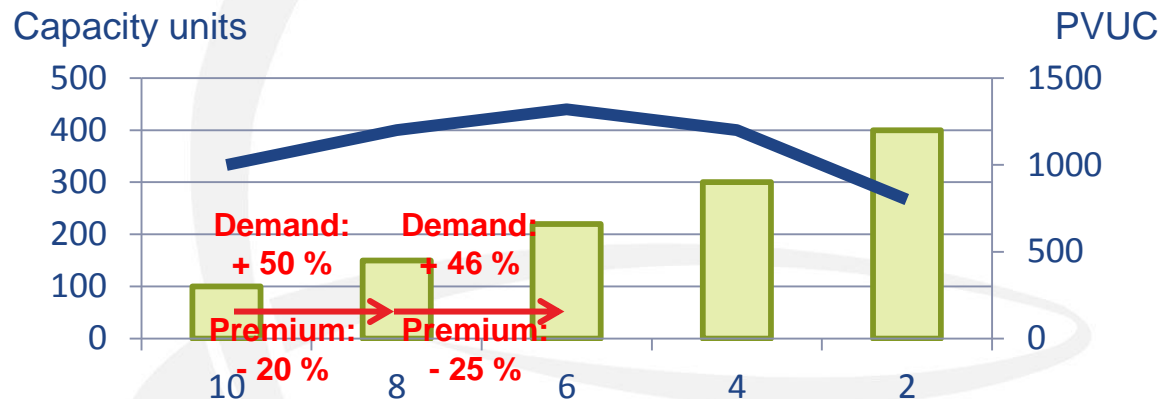
Floating elements are not appropriate for adjustments as they may change afterwards.



Higher tariffs may disincentivise shippers to book long-term. Other incentives may be necessary to equal the risk-chance balance.

# Negative tariff adjustment

- Reference price has to be calculated by applying the cost allocation methodology, but
  - There could be a price elasticity which leads to higher PVUC when decreasing the tariff

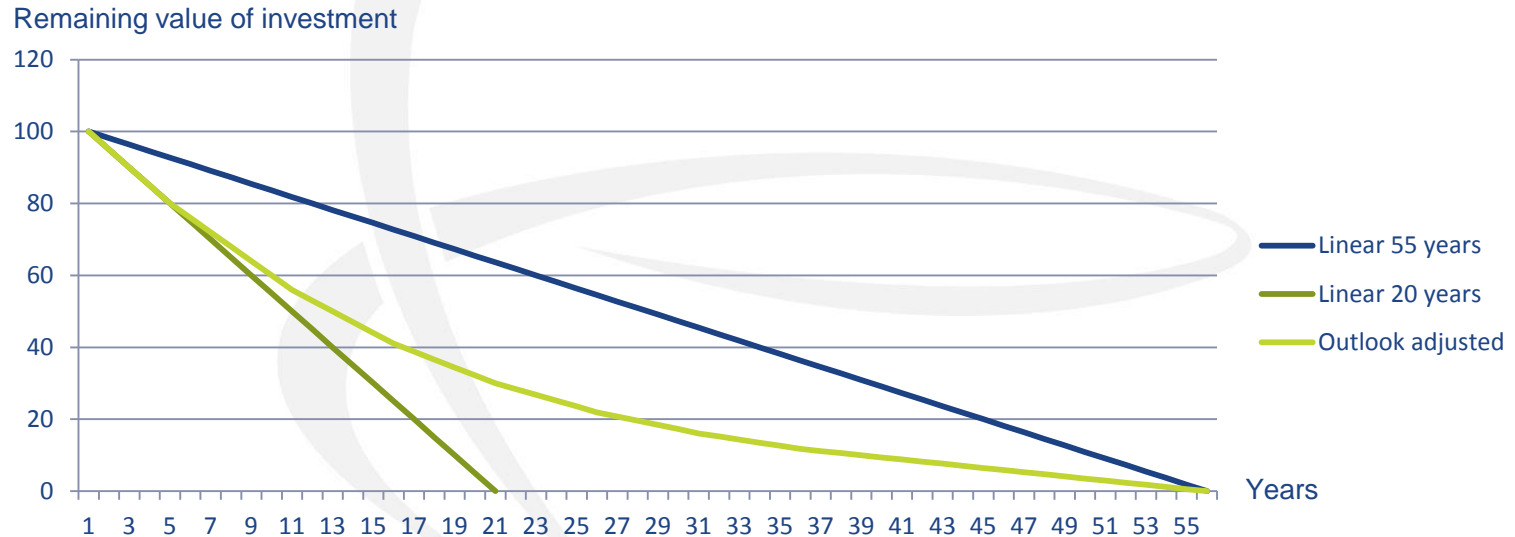


➤ Negative premium allows network users to acquire incremental and new capacity at a discount thus incentivising **long-term bookings**.

➤ Negative premium can potentially help passing the economic test by increasing the possible PVUC!

# Adjusting depreciation rates

- An adjustment of the depreciation rate of an investment can decrease the share of 1-f for the economic test
- Increased depreciation rate allows for a larger share of the PVRR to be covered by capacity commitments in the initial auction or OSP



# Effects of shorter depreciation outlook

## Assumptions

Inflation rate	1,5%
Social discount rate	4%
WACC	6,5%
Investment	100 €, linear depreciated according to outlook
OPEX	0,8 € in first year, indexed by inflation rate
Capacity allocation	90% due to short-term reservation

## Scenarios

Scenario 1 (depreciation outlook 55 y)		Scenario 2 (depreciation outlook 20 y)	
PVRR	160,98 €	PVRR	138,03 €
Costs allocated in first year	8,21 €	Costs allocated in first year	10,17 €
Maximum f-Factor	63%	Maximum f-Factor	82%



Shorter depreciation outlook allows for higher f-factor, if costs are allocated to the incremental capacity only.

# Dependencies

## Floating tariff regime


**Tariff adjustments** are only possible with fixed auction premia

**Tariff estimation** is only important to calculate PVUC, because actual Reference prices may change every tariff period


## Fixed tariff regime

**Tariff adjustments** can be made to the Reference prices as well as the auction premia

**Tariff estimation** is important to calculate PVUC and for selling the capacity



It has to be decided which regime and adjustments assure the balance between cost-reflective pricing and long-term incentives.



Dependencies of tariff estimation, adjustments and chosen regime have to be respected.

# Consultation Questions on Tariff issues

**Question 28:** Do you agree with the default mechanism foreseen to adjust tariffs if required as covered in article 46 (TAR NC)? If not, please elaborate.

**Question 29:** Do you agree that in order to raise the level of commitment a downward tariff adjustment rewarding long-term booking can be included as foreseen in article 46 (TAR NC)? If not, please elaborate.

**Question 30:** Do you agree with including a possibility to adjust depreciation rates as a mechanism to avoid socialisation of costs as foreseen in article 46 (TAR NC)? If not, please elaborate.

**Question 31:** How do different tariff options impact on the markets' willingness to commit long term in order to pass the economic test? Please elaborate.

**Question 32:** Are there any other issues that you wish to address regarding tariff related issues as foreseen in article 46 (TAR NC)? If yes, please elaborate.

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SWISSGAS  
TAG  
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SNAM RETE GAS

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punaero  
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BULGARTRANSOAZ  
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Other logos visible on the map include: BGE (UK) Ltd., ontras, goa, GTG NORD, Open Grid Europe The Gas Wheel, nowega, Thyssengas, CASCADE, NERGAS, eustream, SLOVAK GAS TSO, TERRANETS BW, FLUXYS, GAS CONNECT AUSTRIA, MAGISTRALA ENERGIIE, and FAMA.

**ACER**

 Agency for the Cooperation  
of Energy Regulators

# **Incremental Proposal for NC CAM amendment – ACER's preliminary comments**

**Johannes Heidelberger, ACER Task Force Chair**

ENTSOG Incremental Proposal Workshop  
Brussels, 24 June 2014



## Process of the Agency

After 31 December 2014, ACER must provide:

On the NC CAM amendment:

- Consultation and reasoned proposal to the Commission (Art 7(2) of Gas Regulation)

On the NC Tariffs:

- A reasoned opinion to ENTSOG, within 3 months (Art 6(7) of the Gas Regulation); A recommendation for adoption to EC, once the Agency is satisfied that the network code is in line with the Framework Guideline (Art 6(9) of the Gas Regulation).

At this early stage, ACER provides preliminary views to facilitate the process.

## **Preliminary views on the draft CAM amendment and TAR NC**

- ENTSOG has run inclusive & transparent process, but not always well balanced;
- ENTSOG drafted a detailed text within time constraints;
- Constructive dialog with ACER;
- CAM amendment covers all topics identified;
- Scope for improving the draft;
- Regarding draft NC TAR some objections regarding:
  - The current level of compliance between FG and NC;
  - FG requests for ENTSOG to provide additional expertise;
  - Overall reach of Regulation objectives.

## **Draft NC CAM amendment proposal**

- Consensus on fundamental principles – aligned with ACER guidance;
- Legal text overly complex and unclear in some areas (e.g. §20d (3));
- Sequence of co-ordination requirements and process steps, including approvals by NRA(s) do not form a coherent picture yet;
- Some implied milestones to be made explicit: most notably that a positive single economic test means that a project can proceed towards commissioning;
- Conditions for alternative allocation method in OS to be revisited

Draft CAM NC amendment proposal is a good basis for further refinement of drafting. Network users are requested to provide input where such refinement is required.

## **Draft NC CAM amendment proposal – Open Seasons**

- Commitments can be obtained for 15 + 5 additional years with NRAs' assessment of the effect on competition
- In specific cases, where WTP (auction) is demonstrated not to work:
  - > Cases shall be identified to the extent possible
  - > Non discriminatory allocation rules designed by NRAs/ Agency (independent of bid sizes)
    - > Options: priority granted to the commitments with the higher unit present value/booking duration (currently under development), intelligent pro-rating or other
    - > if duration is prioritised, NRAs may consider higher quotas

## **Draft TAR NC - Incremental capacity (1/2)**

***Please also refer to ACER feedback @ tariff workshop***

**Overall, the consistency of this section, both internal and with other sections of the NC, is hard to assess and would need further streamlining.**

**In general, the text, and in particular Article 46, goes beyond the scope established in the FG.**

- **Fixed payable price** – general issue to be raised at Tariff Workshop; no ring-fencing of incremental/new cap
- **Depreciation period** – the current proposal opens a debate that was kept at national level in the Framework Guidelines. The SD does not provide a clear rationale for the necessity of the debate, nor the chosen solution;

## **Draft TAR NC - Incremental capacity (2/2)**

- **Adjustment of the reference price:**
  - The NC is now more open than the FG on the factors which could lead to tariff adjustments. The ET is not intended to stimulate demand, therefore we are opposed to downward adjustments.
  - The default rule for tariff adjustment is in line with the FG but Article 46 seems to allow NRA discretion to deviate without any further analysis of criteria – this is inconsistent with the FG.
- **The SD does not provide any comparative analysis of the various possible adjustments, although this was a FG request.**

The NC proposal is not in line with the FG. ACER invites stakeholders to provide views and facts in the consultation.

## **Preliminary conclusions:**

- CAM amendment covers all topics identified; drafting under time constraint is appreciated;
- Scope for improving the draft;
- Improved alignment: draft NC TAR some principled objections (feedback at tariff workshop); OS, Sequence of co-ordination requirements and process steps, Role of NRA approvals,

**Beyond these preliminary views, the Agency will continue the scrutiny of the NC in the light of stakeholders comments in the public consultation.**

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- BULGARTRANS-GAZ
- FAMA
- DESFA



# Consultation Workshop for the Incremental Proposal

CEFIC-IFIEC preliminary position

**Dirk Jan Meuzelaar**  
chair of the CEFIC IT Market Liberalisation  
member IFIEC Working Party Gas

**Brussels, 24 June 2014**

Ample transport capacity is a prerequisite for an efficient IEM, leading to more security of supply and increasing competition

IFIEC/CEFIC welcomes any IC/NC-investment on the following conditions:

- **Stimulation New entrance players;** decrease long term dependence by more short term capacity
- **Regulation:** any IC/NC within EU under regulated regime (TPA and strict unbundling)
- **Obligation:** TSOs are responsible for sufficient capacity. TSOs should invest in case of shortage or congestion

Economic test is too much focused on long term User Commitments leading to more dependence on incumbents

$$PVUC \geq f * PVRR$$

This test should be used as an indicator instead of a threshold

- We agree 1-f part shall be recovered by future bookings or other means
  - Including positive externalities e.g. security of supply should be main drivers of the economic test;
  - Future bookings (short term bookings do not affect total demands, leading to limited volume risks).

# 100% appliance with European legislation (3<sup>rd</sup> package) should be a prerequisite for Open Season Procedures (OSP)

CEFIC & IFIEC are reluctant to support OSP

- **Transparency:** current OSPs are flexible but not transparent;
- **Level Playing Field:**
  - OSP conditions easily set by current dominant market parties;
  - OSP + long term economic tests are detrimental for new entrants: capacity is allocated to shippers with highest PV and deepest pockets
- **Third Party Access:** new OSP-capacity will easily lead to request for exemptions as many examples have shown;
- **New TSO:** erecting a separate 'Multi Member States' TSO for realizing a dedicated large cross border project to make the project financeable will lead to higher dependence, lower security of supply and lower competition

## Shorter depreciation periods could trigger new investments and stimulate new domestic supply like shale gas

- Shorter depreciation periods could be an incentive for new investments and decreasing risks,
- We are willing to accept shorter depreciation periods on the condition that strong legal safeguards are provided:
  - Shorter depreciation periods only applies for new or incremental capacity;
  - New and incremental capacity are part of regulated asset of the TSO of a European Member State;
  - After depreciation the assets may not be revaluated;
  - Profit due to increase of the net book value of all assets should be reimbursed to end-users.

The Incremental Proposal supports this position, however more guarantees in the NC are necessary to safeguard our future rights

# ENTSOG: Consultation Workshop on the initial Draft Incremental Proposal

24 June 2014



43 Members and 3 Associated Partners  
in 26 EU countries

4 Observers from EU affiliate countries

- Gassco AS (Norway)
- Swissgas AS (Switzerland)
- GA-MA AD (FYROM)
- Ukrtransgaz (Ukraine)

A light blue abstract graphic on the left side of the slide, composed of several overlapping, curved lines that resemble a stylized globe or a network of connections.

# **Views on ENTSOG Incremental Proposal**

**Presentation by OGP  
Davide Rubini  
Consultation Workshop  
Brussels, 24 June 2014**

- All in all the incremental proposal represents a good framework to cater for the development of new and incremental capacity
- However, there is potential for improvement in particular wrt:
  - The acknowledgement of the contribution of long-term booking for the realisation of incremental and new capacity
  - The degree of involvement of network users in the definition of the parameters underlying a capacity proposal
  - The streamlining of the process leading to a capacity offer
  - The alignment with the discussions on the tariff network code
- In addition, some further clarity may come from improving a number of definitions used in the proposal



- Any credible cost estimate entails a contingency element that cannot be ignored. When complex projects are realized normally part of this contingency turns into actual costs and more rarely in actual saving:
  - The ceiling to be passed during an economic test is based on estimates and a too strict observation of such ceiling would be blind to the inherent contingency that such estimates may hide
  - Bid revision in case of suboptimal outcomes as defined in the proposal could be acceptable provided that the matching of the  $f$  factor in the economic test is managed with sufficient flexibility
- The implications of setting the  $f$  factor are such that all the network users of an entry/exit system are affected by it. Therefore any decision in this regard should be subject to public consultation

- Articles on coordination between TSOs and NRAs should be improved as to identify:
  - A clear list of mandatory deliverables
  - The process leading to those deliverables
  - The consequences of not delivering
- Capacity needs assessment should occur at least once a year
- With respect to the selection of open seasons versus auctions:
  - It is unclear when and how the choice is performed
  - It is of concern that it is not automatic when the relevant criteria are met, in particular as the choice is made without the involvement of network users
- Timing for the publication of final tariff offers should be aligned with the Tariff network code

- We understand the bidding ladder as the sequence of price steps relevant for each offer level against which bids for capacity quantity are submitted by network users
- The definition of economic test could be improved by simply saying that it is the assessment of the economic viability of incremental and new capacity projects
- The definition of open season is probably unnecessary as it is a way to market capacity that works as described in the text of the code. Hence, it could be defined with reference to the relevant article

- Infrastructure development is underpinned long-term bookings and a few aspects contribute to their subscription more than others:
  - The visibility over the tariff evolution
  - The stability of the tariff level
  - The economic equivalence, if not the convenience, of long-term booking versus short term bookings
- The incremental proposal does little to address these aspects and while it is understood that these aspects are mainly in the scope of the tariff code the proposal could have at least established that
  - Any congestion management mechanism in case of excess of demand in an auction or an open season is resolved by giving priority to booking delivering a higher NPV
  - Fixed tariff or partially fixed are the sole option at least for capacity marketed via open season

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- premier TRANSMISSION
- gaslink
- nationalgrid
- Interconnector
- BGE (UK) Ltd.
- energine
- gasum
- swede gas
- GASSCO
- EG
- Võrguteenus
- maagaas
- LATVIAS GAZE
- Amber Grid
- jordgas transport
- ontras
- gasum
- gasum
- Open Grid Europe The Gas Wheel
- GAZ system
- Ukrtransgaz
- FLUXYS
- nowega
- Thyssengas
- creos
- ERDGASLOGISTIK
- bayern
- NERGAS
- eustream
- FLUXYS
- FLUXYS
- 3·G
- eustream
- GAS CONNECT AUSTRIA
- SWISSGAS
- Pligovodi
- Infrastrutture Trasporto Gas
- punacro
- SNAM RETE GAS
- enagas
- REN Gasodutos
- BULGARTRANSOAZ
- DESFA



Gas Infrastructure Europe

## **Incremental Proposal**

*Philipp Palada, GIE, 24 June 2014*

### **Subject to intensive discussions among stakeholders**

- Floating tariffs might decrease Network User's willingness to book long term capacity, resulting in problems for TSO to recover costs and lead to increases in following regulatory period
- Fixed tariffs might disadvantage some network users
- There are merits of fixed tariffs when it comes to new/incremental capacity

**Fixed tariffs might be needed at least for  
incremental/new capacity**

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premier TRANSMISSION  
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enagas  
REN Gasodutos

GASSCO  
swede gas  
ENERGINET DK  
jordgas transport  
gasunie  
GRTgaz  
FLUXYS  
creos  
bayern  
GASCONNECT AUSTRIA  
TIGF  
Infrastrutture Trasporto Gas  
SNAM RETE GAS

EG  
Vörguteenus maagaas  
LATVIJAS GAZE  
Amber Grid  
GAE system  
GAS-ITHE  
Open Grid Europe The Gas Wheel  
nowega  
Thyssengas  
CASCADE  
NERGAS  
eustream  
3·G  
GAS CONNECT AUSTRIA  
Pligovodi  
punaero  
FAMA  
DESFA

Gasum  
UKRTRANGAZ  
BULGARTRANGAZ





# **Prime Movers' comments on draft CAM amendment for Incremental Capacity**

**Andrey A.Konoplyanik, Alex Barnes  
Gazprom export LLC/Gazprom Marketing & Trading/WS2 GAC,  
Prime Movers, ENTSOG Incremental Proposal**

**6th JSWS on ENTSOG “Incremental Proposal” (CAM NC amendment),  
Brussels, ENTSOG, 24<sup>th</sup> June 2014**



## Objectives of the CAM Amendment

- To create a market based mechanism for the release of incremental and new capacity that is subject to regulated Third Party Access (i.e. Not exempt under Art. 36 of Gas Directive)
- CAM Amendment needs to enable different potential projects for incremental / new capacity, e.g.:
  - “Simple” reinforcements of cross border capacity
  - “Large, complex” additions of new capacity across several market zones
  - . . . And all variations in between
- ENTSOG, ACER, NRAs and EUC need to create framework that enables different projects



## Key issues: Enabling the Economic Test to work

- The Test is the lynch pin of the mechanism as it enables investment to go ahead if it is economic and efficient
  - Assurance to NRAs / TSOs that project will not lead to undue risk of stranded assets
  - Assurance to shippers that project will go ahead if test is met
- Therefore Economic Test must “mimic” commercial reality as if in a competitive market because shippers act in a commercial way
- Two key elements that impact this:
  - Tariffs – predictability to enable shippers to commit
  - Capacity Allocation – knowing what shippers will get if they do commit



## Tariff issues

- Economic Test requires shippers to book for several years to pass test . . .
- . . . But floating tariffs / system wide recovery of allowed revenues mean low predictability of tariffs over booking period . . .
- So shippers will not know the scale of their financial commitment
- Two potential solutions:
  - Separate regulatory account for new projects (could be linked to size of investment relative to existing capacity)
  - More predictable tariffs (transparency, fixed, fixed plus indexation etc.)



## Allocation issues

- Link between shippers' decisions to book capacity and need for sufficient bookings to meet Economic Test
- Shippers' decisions based on need for capacity – risk in open season that if not all capacity allocated, shipper will book none
- Allocation procedure should reflect contribution that shippers make to meeting economic test
- Capacity should be provided at regulated cost – auction premium approach creates cross subsidy risk as TSO only able to recover Allowed Revenue



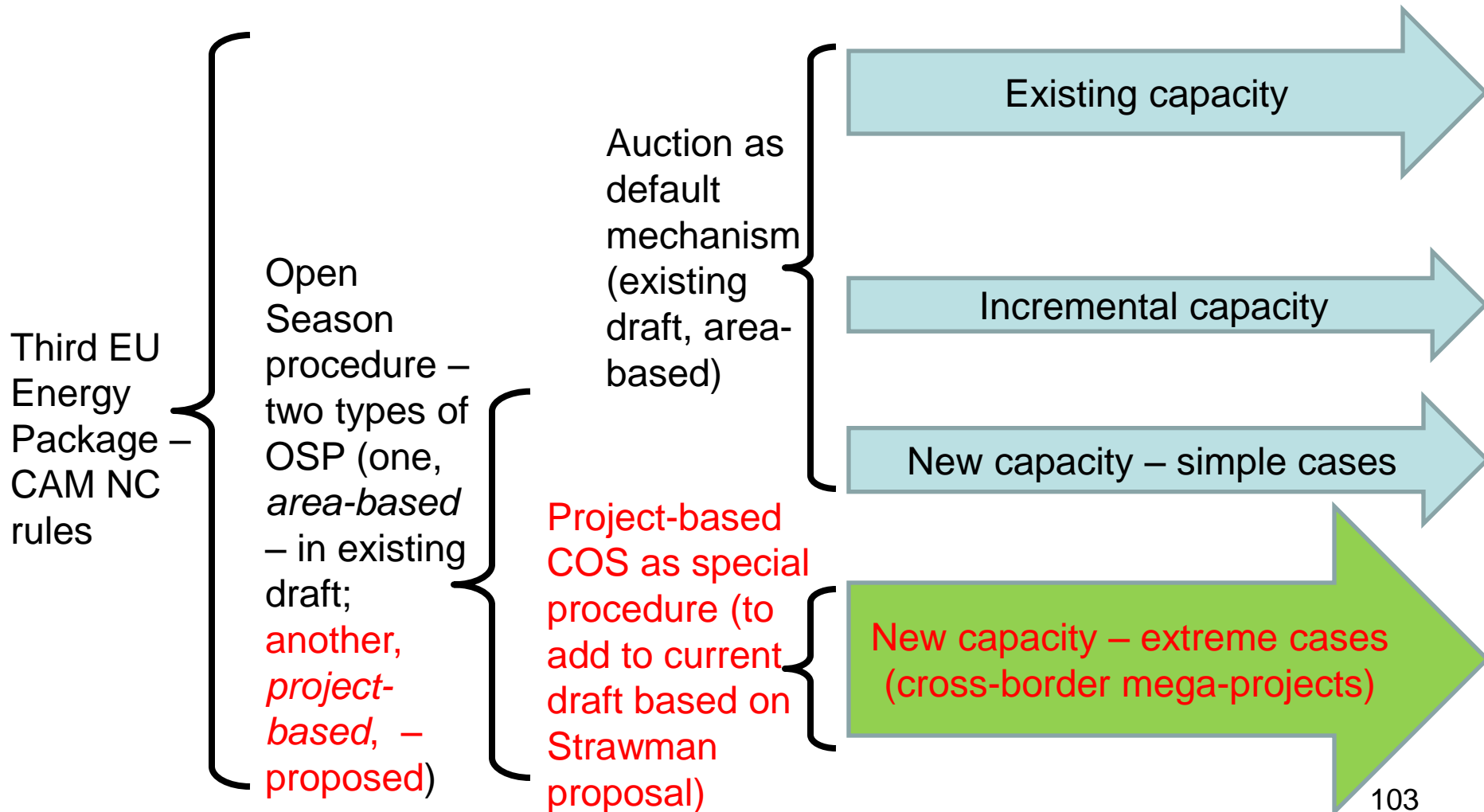
## Conclusions (1)

- Welcome possibility of fixed / indexed tariffs in ENTSOG draft Tariff NC . . .
- . . . But more transparency and clarity of how TSOs calculate tariffs is essential
- Welcome recognition that default auction allocation mechanism may lead to unnecessary negative Economic Test result and consideration of alternative . . .
- . . . ACER and NRAs need to be open to use of such an alternative if they want market based mechanisms to work.

For detailed explanations see slides from 5<sup>th</sup> SJWS  
(Reserve slides).



# Conclusions (2): Coordinated Open Season (COS) & its place in CAM NC





# Slides from 5<sup>th</sup> SJWS 8<sup>th</sup> April 2014 (Reserve slides)





# What is fundamental fault of current “default mechanism” in draft Busn. Rules for creation of new capacity

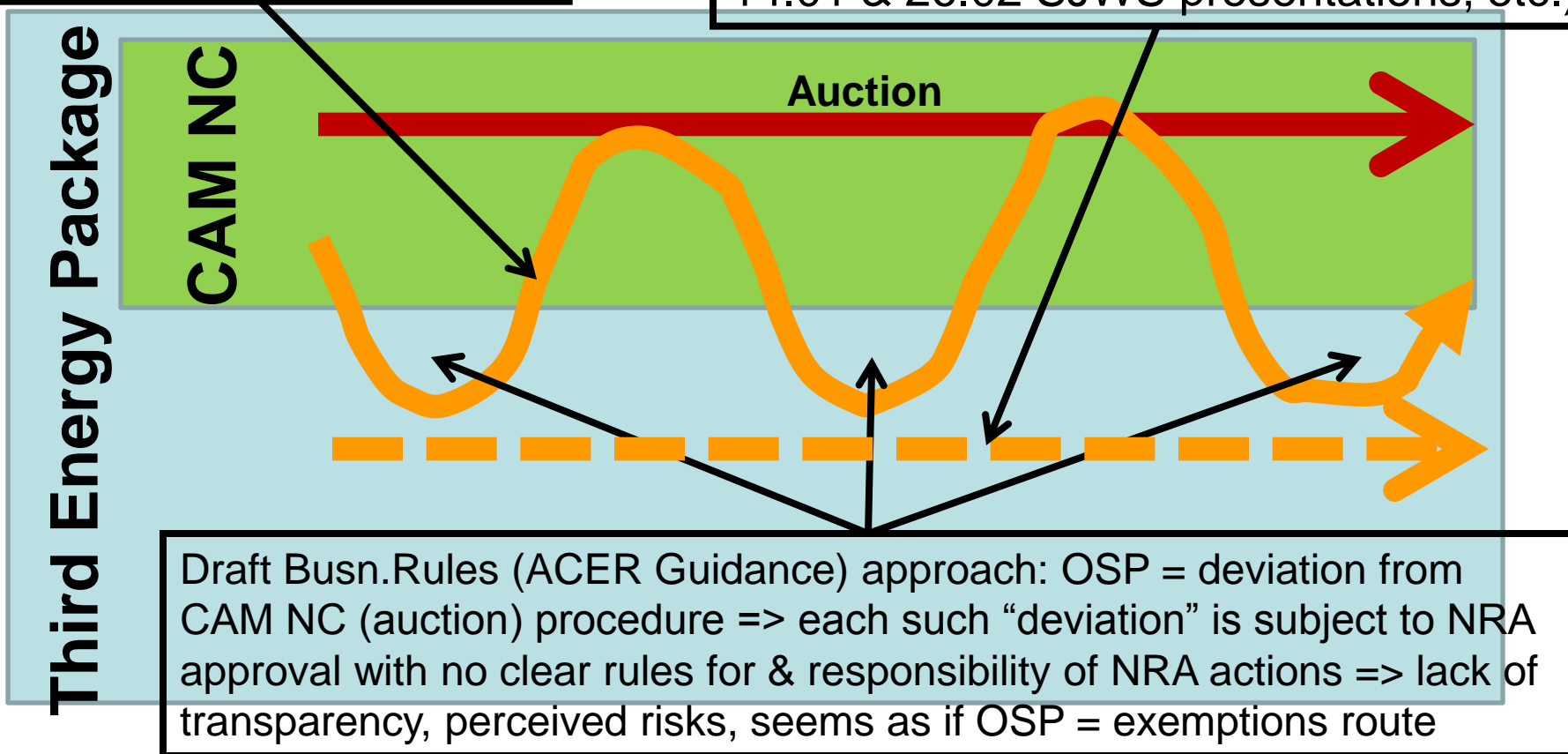
- “Auctions are the default mechanism for the allocation of incremental/new capacity” (Business Rules, art.III.1.5), but:
  - Incremental/new capacity = yet non-existing capacity,
  - To allocate non-existing capacity you should first create it, but CAM NC deals with existing capacity only => implementation of CAM NC rules to new capacity is economically incorrect in principle
  - To allocate (**trade**) existing capacity and to create (**invest** in development of) not yet existing capacity is not the same => **trade & investment** are NOT synonyms, but different types of economic activity => their mixture seems to be a systemic long-term default in EU (energy) legislation (the reason for Art.21/36 in 2<sup>nd</sup>/3<sup>rd</sup> Directives)
  - ACER intention to put “investment” into Procrustean bed of “trade” is counterproductive since considers the first just as occasional (from time to time) deviation from the latter => procedural faults in ACER Guidance reproduced in ENTSOG Busn.Rules, at least for new cap.



# Procedural risks & uncertainties of OSP in current draft Busn.Rules – results of wrong ACER concept

OSP (in its current vision by ACER => ENTSOG)

OSP (in Strawman proposal/17.09.2013; 14.01 & 26.02 SJWS presentations, etc.)





# Strawman “project-based” proposal for OSP – yet not considered

**New cross-border capacity project life-cycle**

**Invest.+pay-back period**

**Post-pay-back**

## OSP (Strawman-based proposal)

- Project-based approach through pay-back
- Tariff as swing parameter in economic test
- NPV as criteria for economic test
- Fixed tariff through pay-back period
- F-factor =100% (90% - shippers demand, 10% NRA guarantees, securitized by EU fin. Inst.)
- No cost socialization
- Cross-border unitization, ITSO for unitized project, coordination within single project
- Costs/revenues reallocation within project
- No contractual mismatch...

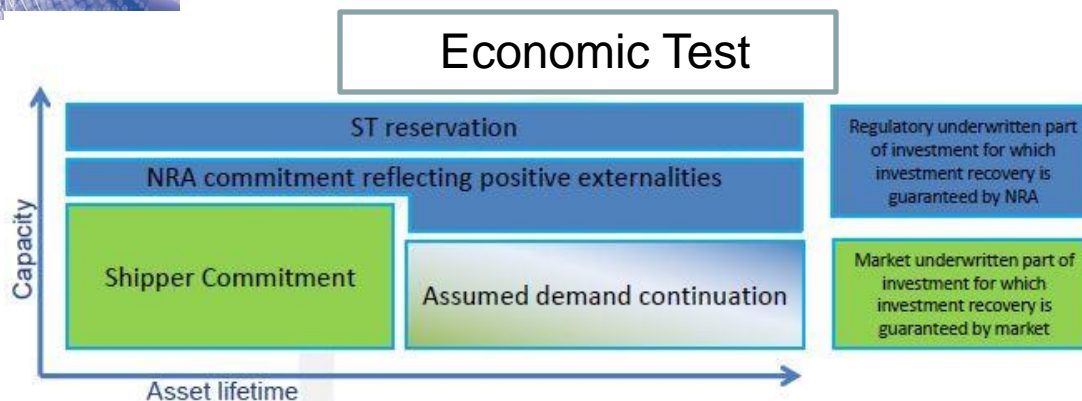
## CAM NC + draft NC HTTS

- System-based approach
- Volume as swing parameter
- WTP as criteria
- Floating tariff
- F-factor established by NRA, flexible, less 100%
- Huge cost socialization (1-F)
- Cross-border coordination for existing & not yet existing cap.
  - ...between diff. market areas
- Risk contractual mismatch...

Cross-border (“transportation route”) new capacity principle: until capacity is built & paid-back – OSP procedure based on project-based (not system-based) approach



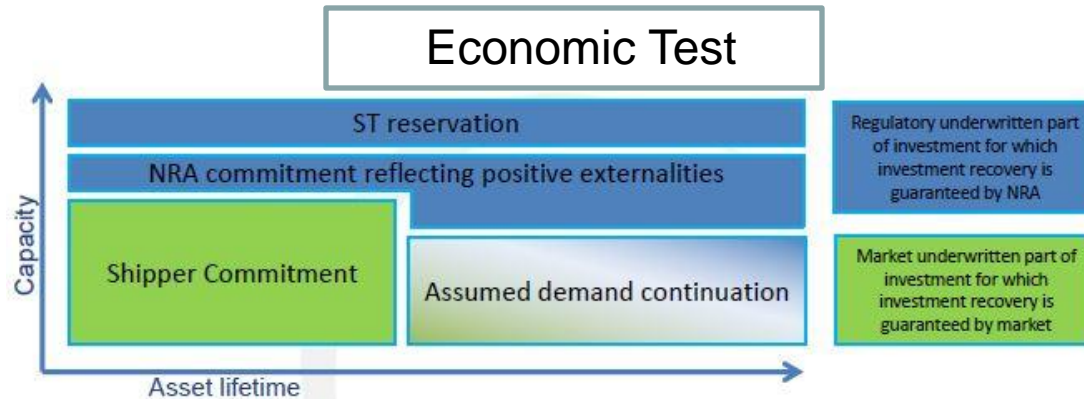
# Floating Tariff Problems for Incremental / New capacity



- Economic Test depends on shipper commitment which is function of years of capacity booked and commitment to pay reference price prevailing at time of economic test
- But price paid at time of use will be different to reference price at time of economic test because of the floating tariff
- This means the Economic Test is no longer directly linked to the financeability of the incremental/new capacity nor a true test of shippers' willingness to pay/market requirement for incremental/new capacity
- It makes it unlikely that shippers will be prepared to book sufficient years of capacity to meet the Economic Test as they will be required to sign an open ended financial commitment for a fixed quantity of capacity
- Result will be incremental/new capacity will either not occur due to failure of economic test OR will go ahead as part of central planning type process (10YNDP) which raises risk of stranded assets



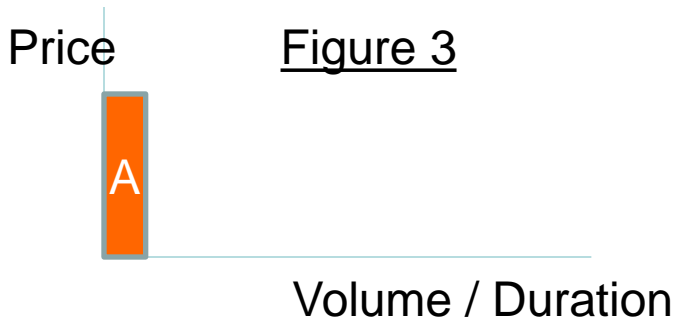
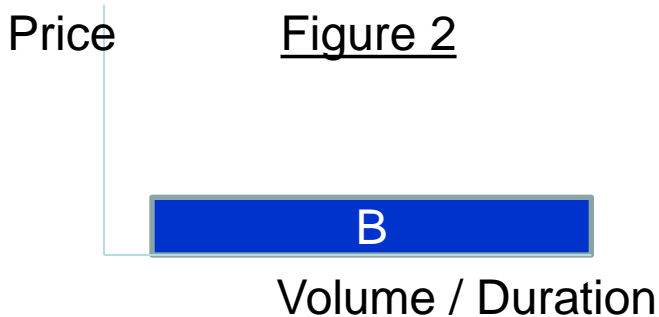
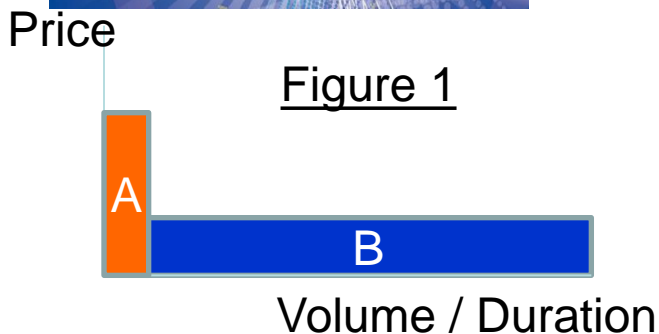
# Potential Solutions to Floating Tariff Problems



- Shippers need a degree of certainty or predictability to commit to several years of capacity required to pass economic test
- The following approaches, or a combination of them could be used to provide this certainty:
  - Fixed tariffs – the tariff used at time of economic test is the payable tariff at time of use
  - Fixed tariffs with indexation - tariffs indexed to inflation (Retail Price Index, Producer Price Index etc. depending on structure of TSO Price Control)
  - Fixed tariffs with agreed level of variation – e.g. Increases allowed up to a certain level to allow for increase in construction costs. This will need to be linked to level of risk undertaken by TSO as part of its Price Control e.g. Allowed rate of return for new investments
  - Separating tariffs associated with new investment from tariffs for the rest of the TSO network so that users of new investment pay only for under-recovery associated with that project.



# Why willingness to pay (NPV) does NOT equal pay as bid (CAM NC)



Figures represent the economic test  
Figure 1 shows the result if allocation is based on highest bid for an annual strip of capacity  
A is allocated Year 1, B is allocated the remaining years

Economic Test is met overall

BUT

B contributes more to passing the economic test but will not want to accept capacity as he receives no capacity in Year 1

AND

Although A has paid more for capacity than B, A's bid is not sufficient on its own to meet the economic test

**Use of CAM algorithm does NOT take account of need for shippers to book contiguous strips of capacity => NPV-based approach suits best for this**





# Willingness to pay measured by NPV is consistent with Third Package Principles

- “Each TSO **(1) shall** build sufficient **(2) cross border capacity** to integrate European transmission infrastructure accommodating **(3) all (4) economically reasonable and (5) technical feasible (6) demands for capacity**” (Directive 2009/73/EC, Art.13.2) by matching supply of new capacity to demand for it in (the only possible economic) way that maximises financeable (paid-back) investment to the level fully covering demand for capacity (*mark-up & numbers by AB/AK*):
  - Use of simple pay as bid approach would therefore **NOT** be compatible with Directive as it would **NOT** accommodate economically reasonable demand (see previous slide)
  - Directive takes precedence over ACER Guidance since the latter is **NOT** legally binding as guidance is **NOT** a legal term in either Gas Directive or Gas Regulation or the ACER Regulation and Framework Guidelines are “**NON** binding” (Regulation EC/715/2009, Article 6 (2))
- This is why NPV approach being fully compatible with Directive is compatible also with ACER Guidance:
  - NPV approach is market based and is consistent with standard ways of determining viability of investments (NPV / discounted cash flows). “Capacity demand . . . can be satisfied in a **market based manner**, if the necessary investments are **efficient** and **financially viable**”. (Para 1(a)).
  - NPV gives more weight to bookings in the near future compared to those farther out; this favours those preferring to book more in the short term compared to the long term.
  - NPV measures willingness to pay as it is a function of capacity booked and price. This is consistent with ACER Guidance which requires “an allocation rule based on willingness-to-pay should be used as priority.”



## Way forward

- To take a cross-border new capacity project structure from AK/AB presentation at 2<sup>nd</sup> SJWS and to test step-by-step applicability of both OSP procedures (business game/case study):
  - From current draft Business rules
  - From Strawman proposal (17.09.2013, 14.01 & 26.02.2014)
- ENTSOG team with Prime Movers to organize such case study/business game for next (?) Incremental proposal meeting
- To develop draft Business Rules for OSP for cross-border new capacity based on project-based approach



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# Thank you for your attention

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## **Concluding remarks**

### **Next steps:**

- > Publication of AoD report 22 August**
- > Refinement workshop in Brussels on Tuesday  
23 Sep 2014**

**Mark Wiekens  
Advisor, Market Area**