Draft Business Rules

Economic Test and Tariff Issues KG

I. Tariff Framework Guidelines

2.4.1. Incremental and new capacity (Publication requirements)

After NRA approval, TSOs shall publicly provide at least the following information with a sufficient lead time, before an offer of incremental or new capacity is made for binding commitments:

- PVAR ,the present value of the estimated potential increase of the TSOs' allowed revenue in each year during the economic life of the new asset, which is attributable to the investment (outgoing cash flows);

- The fraction ("f") of the PVAR, which refers to the estimated increase in allowed revenues attributable to the investment that needs to be underwritten by user commitments to pass the economic test (incoming cash flows), including the factors that have influenced the determination of f, which should be quantified, where possible and relevant;

- An estimated projection of tariffs for the bundled yearly capacity products of the capacity expansion(s) considered and an explanation of how it is calculated.

3.5. Incremental and new capacity (Cost allocation and determination of reference price)

Section 3.5 applies to all incremental and new capacity at entry and exit points under the scope of the Network Code on CAM, where the decision to invest is market-based, i.e. based on binding user commitments made during a CAM auction or open season.

In such situations the decision to invest will be conditional on the validation of an economic test showing that the project is financially viable considering network users' binding commitments to purchase the incremental or new capacity.

3.5.1.1. Economic test formula

The Network Code on Tariffs shall specify that network users' binding commitments in respect of an incremental or new capacity project shall be deemed sufficient to justify the investment, when a financial test is passed: the value of expected future payments from network users' commitments shall be equal to or exceed an appropriate proportion of the estimated increase in allowed revenues of the TSO.

The test is formulated as follows and is passed if:

PVUC ≥ f • PVAR

Where:

PVUC is the Present Value of expected network users' commitments (incoming cash flow), which is the auction or allocation clearing price multiplied by the capacity volume commitment for each year where such commitment is obtained, discounted with the cost of capital to its present value.

PVAR refers to the present value of the estimated potential increase of the TSOs' (yearly) allowed revenue, which is attributable to the investment, during the economic life of the new asset. The Network Code on Tariffs shall require TSOs to make their best efforts to provide a reliable estimate.

f is the fraction of PVAR that needs to be underwritten by user commitments to pass the test. (In circumstances where f is determined to equal zero, the completion of the economic test is not required.)

3.5.1.2. Criteria to be considered when setting the "f" parameter

The "f" parameter can be determined on an individual project basis, but shall be subject to approval at a Member State level by relevant NRAs. When setting the "f" parameter, the following criteria shall be taken into account:

- Duration of network users' commitment period compared to the economic life of the asset; (The longer the commitment period relative to the asset life is, the more can be underwritten by investors, which may justify a higher "f" parameter);

- Capacity set aside for short term bookings, which is at least 10% according to the Network Code on Capacity Allocation Mechanisms; (This may result in a lower "f" parameter, considering that the 10% or part of it will be booked only short term.);

- Positive externalities which may justify a lower "f" (e.g. improvement of competition, improvement of security of supply, investment useful for other points in the network and not just the one where it creates capacity).

3.5.1.3. Single economic test

The Network Code on Tariffs shall specify that a single economic test shall be published, incorporating the aggregate investment requirements of all involved TSOs and NRAs relating to a given capacity project. Only those investment costs directly relating to the incremental capacity should be included. Where NRAs involved determine different "f" factor values, NRAs shall cooperate to determine an aggregate "f" factor value.

If the distribution of PVAR and the PVUC between the TSOs does not allow one of them to meet its specific investment requirement (based on its assessment of "f"), while the single test is passed, TSOs and NRAs may decide to modify the distribution of revenues between the TSOs (by a cost sharing agreement or a different split of the bundle reserve price).

In case of external financial support (e.g. subsidies from the EU), the PVAR should be lowered according to the amount received.

3.5.2. Determination of the price at which users can request incremental or new capacity

The Network Code on Tariffs shall specify that, when determining the minimum price at which network users can request incremental capacity, the reference price as determined by the cost allocation methodology shall apply.

In the specific case, and only in the case, where selling all the incremental or new capacity offered at the reference price would not generate sufficient revenues to pass the economic test with the value of the "f" parameter defined on the basis of the criteria set out in section 3.5.1.2, NRAs may decide to adjust the minimum price at which participants can request capacity. This adjustment shall ensure that the economic test is passed if all the incremental or new capacity offered is subscribed.

The Network Code on Tariffs shall define how this adjustment shall be implemented, taking account of the following principles:

1. Preserving the financial integrity of the economic test;

2. Avoiding cross subsidy between network users;

3. Compatibility with the cost allocation methodology;

4. Avoiding fragmentation of reserve prices at the same entry or exit point.

Applying a premium to the tariff paid by those users booking capacity in the first auction in which incremental capacity is offered (those users triggering the investment) would be consistent with these principles and should be the default option.

In determining the Network Code on Tariffs, ENTSOG shall consider alternative approaches, in addition to the default option. Where such alternatives are consistent with the principles above, ENTSOG shall include them in the Network Code on Tariffs. Where any alternative approaches result in the application of a premium to the reserve price paid by users other than those triggering the investment during the first auction of incremental capacity i.e. by other future users at later auctions, NRAs shall determine a maximum number of yearly auctions for which the minimum premium should apply.

II. Background

The Incremental Proposal consists out of two legal drafting processes: an amendment to the NC CAM on issues related to the offer of incremental and new capacity and the drafting of the NC TAR on issues related to tariffs for incremental and new capacity and the economic test. The Business Rules compiled in this document make up the second part of the Incremental Proposal and are the basis for provisions of the TAR NC.

III. Business Rules

1. Economic Test principles and formula

1.1. The Economic Test is a mathematical calculation to assess the economic viability of incremental/new capacity projects and will be applied to the results of the binding phase of the capacity allocation process of each offer scenario;

1.2. The Economic Test compares the present value of binding network user commitments (PVUC) with a specified share of the present value of the increase in allowed revenues associated with a given offer scenario (PVAR);

1.3. For every offer scenario of a given incremental or new capacity project, the NRA shall endorse the parameters of the economic test and the formula to be applied;

1.4. The economic test is positive, meaning that the next steps of the project's deployment can be pursued, if PVUC is equal to or exceeds the specified share of PVAR for a given offer scenario:

$$PVUC \geq f \times PVAR;$$

1.5. *For a given incremental/new capacity project, the offer scenario with a positive economic test result enabling the highest amount of incremental/new capacity shall be used as basis for pursuing next steps of the project deployment;*

2. Setting of f-Factor

2.1. The share of PVAR that needs to be covered by PVUC for a given offer scenario in order to pass the economic test is defined by the level of the f-Factor;

2.2. The f-Factor for each offer scenario shall be approved by the relevant NRA;

2.3. With respect to the f-Factor, the NRA shall specify and take into account the following factors:

2.3.1. To which extent a reservation quota for technical capacity for short-term auctions is to be applied to the incremental or new capacity;

2.3.2. To which extend positive externalities would occur through an investment or a capacity optimisation benefitting the market or system as such;

2.3.3. An assumption of the extent to which the incremental or new capacity will also be demanded by network users after the initial capacity allocation horizon;

2.4. While the share of PVAR that is defined by the f-Factor is to be covered by revenues generated through the initial booking of the incremental or new capacity, the recovery by the TSOs of the remaining part of PVAR shall be guaranteed through the revenue recovery mechanisms as defined in the Tariff NC;

2.5. The recovery of the non-upfront committed part of PVAR shall either be covered by future capacity bookings of the incremental or new capacity or, if future bookings do not occur, by either other network users at other points of the system or through other appropriate revenue recovery mechanism established by the NRA or the Member State;

2.6. The recovery mechanism as described in 2.5 shall also apply for the case if (parts of) the initial bookings are for any reason cancelled.

3. Combination into Single Economic Test

3.1. Following the determination of PVAR and f-Factor for a given incremental or new capacity project for each of the involved TSOs individually, the parameters shall be combined into a Single Economic Test for bundled capacity products with one specified level of PVAR and one f-Factor per combined offer scenario;

3.2. The f-factor of the Single Economic Test shall be defined in a way that allows all involved TSOs to cover the upfront defined share of their respective PVAR. The level of network user commitment for the bundled capacity product required to pass the Single Economic Test shall reflect at least the highest level of network user commitment required by one of the involved TSOs to cover the individual defined share of PVAR;

3.3. The parameters of the Single Economic Test shall be proposed by the involved TSOs to the relevant NRAs for approval;

3.4. TSOs and NRAs may consider mechanisms for a redistribution of revenues, if all parties agree and if such a redistribution of revenues could potentially lead to a decrease in the level of network user commitment required to pass the Single Economic Test;

3.5. Discussions on a potential redistribution of revenues can be considered in the following ways:

3.5.1. Ex-ante approach: Upfront agreement on redistribution of revenues is reached before the binding user commitments are received in the Single Economic Test;

3.5.2. Ex-post approach: If the Single Economic Test is passed, no redistribution of revenues is necessary. If the Single Economic Test is not passed but the outcome of the test would be sufficient for at least one of the involved TSOs, an agreement on revenue redistribution could be made between TSOs and approved by NRAs (TSOs having enough PVUC to pass their share of the economic test could agree to redistribute the excess revenue they earn compared with their PVAR to TSOs not passing their test);

3.5.3. Integrated iterative approach: In an Open Season Procedure, the need for a potential redistribution of revenues and potential agreement on a redistribution of revenues will be discussed between NRAs and TSOs based on the binding user commitments. If necessary, an additional round of binding commitments may be conducted by the involved TSOs.

4. Publication requirements

4.1. For a given incremental or new capacity project, the following information shall be made public by the involved TSOs, referring to the approval of the relevant NRA:

4.1.1. PVAR for each offer scenario;

4.1.2. The f-Factor to be applied to each offer scenario and any justification provided by the NRA;

4.1.3. The estimated and indicative projection of tariffs that is used in order to calculate PVUC for each offer scenario and for each IP;

4.2. *The involved TSOs shall publish the information stated above with a lead-time of at least one month (in accordance with CAM NC art. 11.8) before the binding phase of the capacity allocation procedure in a transparent and open manner on the respective websites of the TSOs;*

4.3. *The involved NRAs shall publish their approval to the economic test parameters defined in 4.1 with a lead-time of at least two month before the binding phase of the capacity allocation procedure.*

5. Tariff issues

5.1. *The minimum price at which network users can request incremental capacity is the reference price resulting from the cost allocation methodology;*

5.2. *As an exception to the previous paragraph 5.1 in the specific case where selling all the incremental or new capacity offered at the reference price would not generate sufficient revenues to pass the Economic Test, the following tariff adjustments can be applied:*

5.2.1. *Adjusting the reference price for all capacity users at the IP;*

5.2.2. *Adjusting the reference price, except for those users who booked capacity before the investment decision was taken;*

5.2.3. *Introducing a minimum premium (positive or negative) on the reference price for users participating to the process;*

5.3. *When introducing such tariff adjustments for incremental or new capacity, NRAs shall ensure the following criteria are met:*

5.3.1. *Preserving the financial integrity of the economic test;*

5.3.2. *Avoiding cross subsidy between network users;*

5.3.3. *Compatibility with the cost allocation methodology;*

5.3.4. *Avoiding fragmentation of reserve prices at the same entry or exit point;*

5.4. *Since the payable price for booked capacity is set at the regulated tariff at the time of the usage of the capacity increased with the auction premium, if any, the PVUC parameter in the economic test needs to be based on an assumption of what the regulated tariff will be in future tariff periods. The payable price shall be calculated through the cost allocation methodology for each future tariff period (until the end of the user commitment period) by making the relevant assumptions in terms of future capacity, the network, future costs, taking into account if relevant the adjustment under 5.2;*