ENTSOG: 3rd Stakeholder Joint Working Session for the Incremental Proposal
13 March 2014

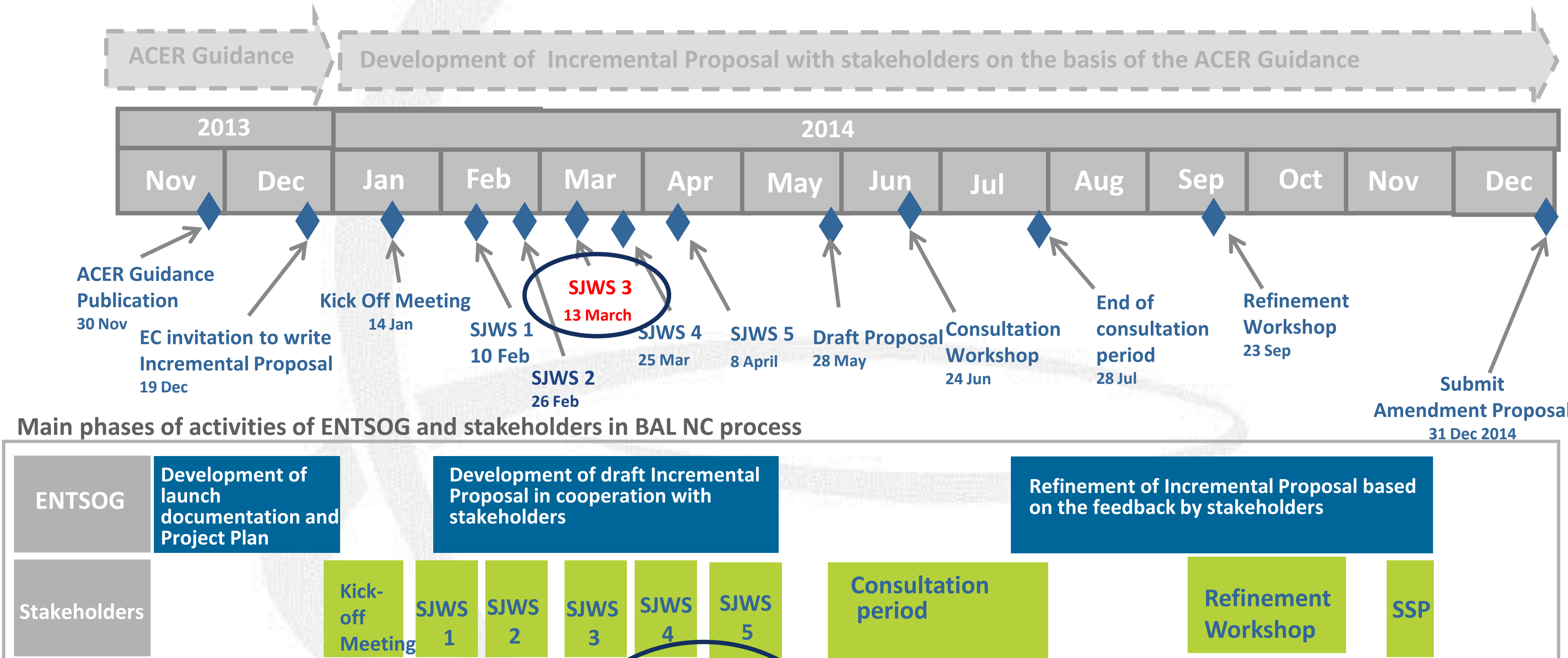
3rd SJWS for the Incremental Proposal

13 March 2014

Mark Wiekens

Advisor, Market Area

Timeline for incremental proposal
Development and consultation overview



SJWS 1
- Coordination Requirements
- Information Provision
- Economic Test
- Tariff-relaed issues

SJWS 2
- When to Offer
- Auctions
- Open Seasons Procedures

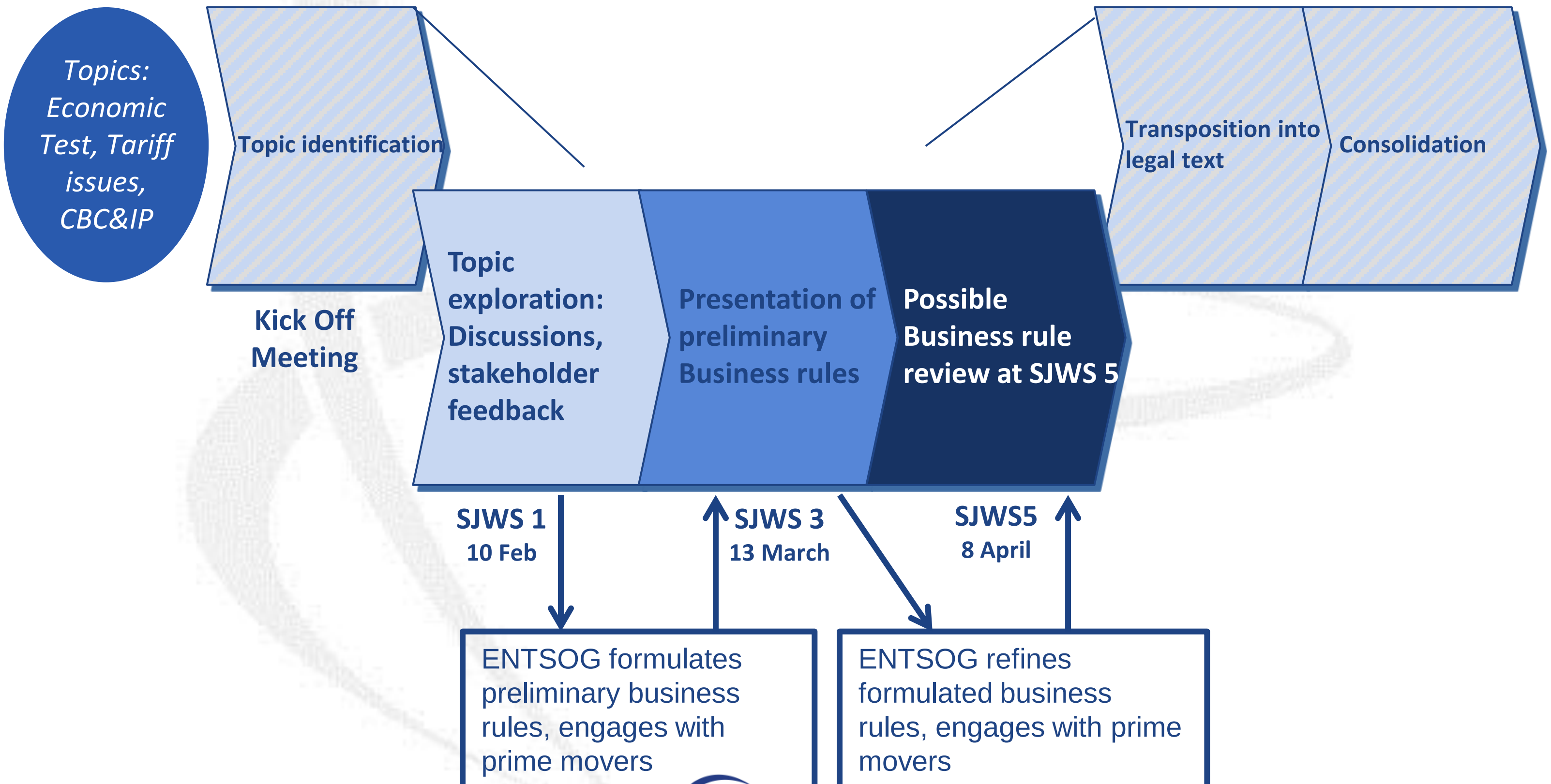
SJWS 3
- Coordination Requirements
- Information Provision
- Economic Test
- Tariff-relaed issues

SJWS 4
- When to Offer
- Auctions (including auction simulation)
- Open Seasons Procedures

SJWS 5
- Content to be confirmed

Economic Test – from topic identification to legal text

EXAMPLE



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Agenda for today

No.	Description	Time
	Welcome coffee	**10:00-10:30**
1.	ENTSOG opening and introduction	10:30-10:45
2.	Economic Test ➢ ENTSOG presentation of draft Business Rules ➢ Presentation of Stakeholder views ➢ Discussion	10:45-12:30
	Lunch Break	**12:30-13:30**
3.	Tariff Issues ➢ ENTSOG presentation of draft Business Rules ➢ Presentation of Stakeholder views ➢ Discussion	13:30-14:45
	Coffee Break	**14:45-15:00**
4.	Cross Border Co-Ordination and Information Provision ➢ ENTSOG presentation of draft Business Rules ➢ Presentation of Stakeholder views ➢ Discussion	15:00-16:15
5.	Conclusions	16:15-16:30

Housekeeping – recall general information

- Fire escape
  - In case of alarm: Down the staircases close to the entrance – through the lobby – meeting point in front of the mosque

- Attention to the wires from webcast people

- Webcast – questions via mail possible before and during the webcast

- The SJWS discussions (including webcast) are reserved for the stakeholders, but notes and presentations will be available for the press and the public shortly after the meeting

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4 Observers from EU affiliate countries
- Gassco AS (Norway)
- Swissgas AS (Switzerland)
- GA-MA AD (FYROM)
- Ukrtransgaz (Ukraine)

SJWS 3 Incremental Proposal

Economic Test

13 March 2014

Agenda

1. **Revisiting topic exploration**
2. Draft business rules: economic test principles and formula
3. Draft business rules: setting of f-factor
4. Draft business rules: combination into single economic test
5. Draft business rules: publication requirements
6. Conclusions

Summary of topic exploration 1/4

The **Economic Test** is passed, if:

PVUC ≥ **f-factor** x **PVAR**

With the factors being:

PVUC = Present Value of User Commitment, reflecting the value of user commitment (based on tariff assumption, possible premium and user demand) discounted by the cost of capital

f-factor = Reflecting the share of PVAR, that needs to be covered by PVUC in order to pass the economic test

PVAR = Present Value of Allowed Revenues*, reflecting the increase in allowed revenues induced by an investment discounted by the cost of capital

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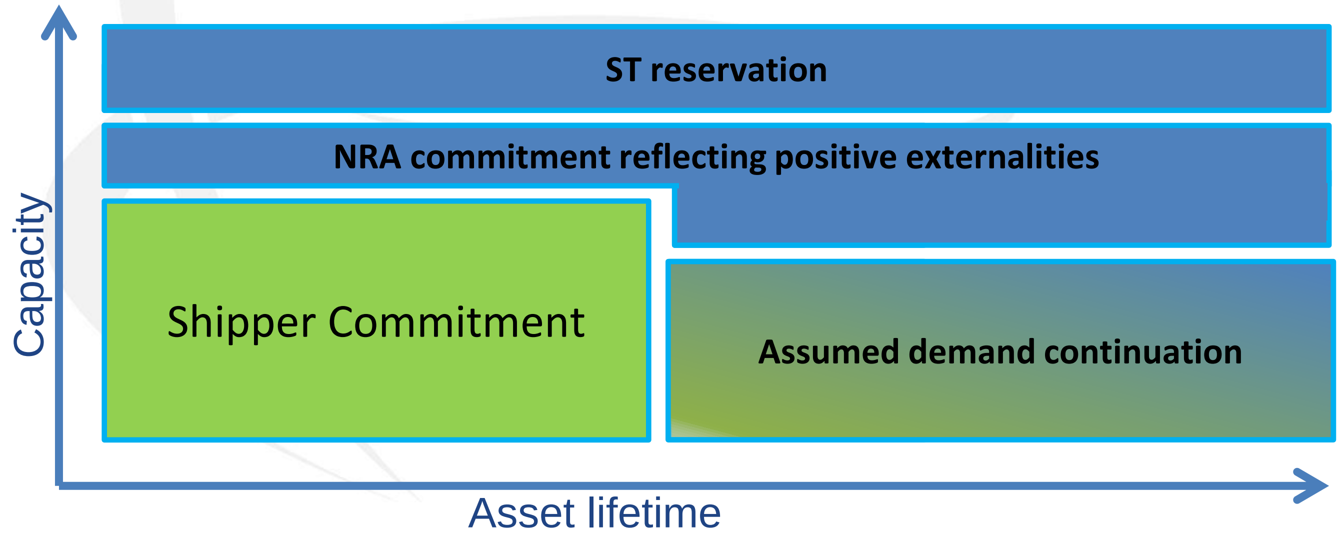
* Allowed revenues equal to regulated revenues in price cap regimes

Summary of topic exploration 2/4

- When setting the f-factor for a given incremental/new capacity project, the NRA shall take into account:
  - To which extend a short term reservation quota is applicable
  - Whether positive externalities arise due to the investment
  - Whether the demand can be assumed to continue after the initial booking horizon



Summary of topic exploration 3/4

How to recover PVAR for an investment?

PVAR

f part | 1-f part

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 socialication
- Any other financing through e.g. EC subsidies
- If none of the above can be ensured, f needs to be defined at a level of 1

Summary of topic exploration 4/4

After agreement on parameters of economic test between individual TSOs and their respective NRA, the parameters of all involved TSO shall be combined into a **single economic test**.

- Single economic test needs to reflect the requirements of all involved TSOs!
- As a default, the level of user commitment for a bundled product to pass the single economic test is the lowest minimum level of user commitment to pass the individual economic tests on both sides of the IP
- The f-factor reflecting this requirements is a mathematical calculation based on the combined PVAR, the tariff split and the minimum level of user commitment

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- **If all parties agree**, a redistribution of revenues can potentially decrease the level of user commitment required to pass the single economic test.

Agenda

1. Revisiting topic exploration
2. **Draft business rules: economic test principles and formula**
3. Draft business rules: setting of f-factor
4. Draft business rules: combination into single economic test
5. Draft business rules: publication requirements
6. Conclusions

Economic test principles and formula 1/3

1.1. *The Economic Test is a mathematical calculation applied in the context of incremental/new capacity projects to each offer scenario after the binding phase of the capacity allocation process;*

- ‘Offer scenario’ shall be defined as a specified level of (incremental/new and existing) capacity offered in an auction or an open season procedure
- In an auction, each bidding ladder will reflect one 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);*

- The specified share of PVAR will be defined by the f-factor
- ‘Allowed revenues’ is primarily linked to revenue cap regulatory regimes; the final proposal needs to define that – in the context of the economic test – allowed revenues can be replaced by ‘regulated revenues’

Economic test principles and formula 2/3

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;*

- TSO and NRA shall agree on the parameters of the economic test for each offer scenario
- Further explanation in section 2 on the setting of the f-factor

1.4. *The economic test is positive and therefore passed if PVUC is equal to or exceeds the specified share of PVAR for a given offer scenario*

- Defines the formula as provided in the ACER Guidance:

$$\mathbf{PVUC} \geq \mathbf{f} * \mathbf{PVAR}$$

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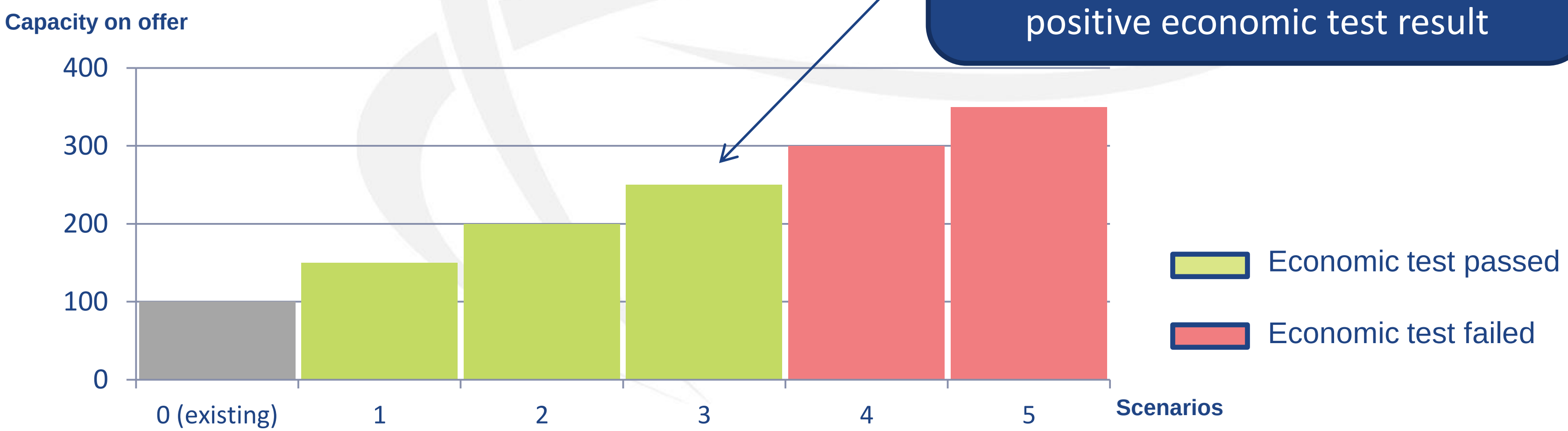
Economic test principles and formula 3/3

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

- Highest positive offer scenario shall prevail:

In this example, scenario 3 would be the offer scenario resulting in the highest amount of capacity with a positive economic test result



Agenda

1. Revisiting topic exploration
2. Draft business rules: economic test principles and formula
3. **Draft business rules: setting of f-factor**
4. Draft business rules: combination into single economic test
5. Draft business rules: publication requirements
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Setting of f-factor 1/4

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;*

- TSO and NRA shall agree on the parameters of the economic test (being the assumed PVAR, the f-factor and the tariff assumption and thereby implicitly the required level of user commitment)
- The NRA shall examine the factors influencing the f-factor and approve the parameters based on this assessment

Setting of f-factor 2/4

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;

- When approving the f-factor for a given offer scenario, the NRA shall also specify to which extent the factors 2.3.1. – 2.3.3. influenced the level of the f-factor

Setting of f-factor 3/4

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 of the remaining part of PVAR shall be guaranteed to the TSO through the regulation mechanisms;

2.5.

The recovery of the remaining 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 payment cover mechanism established by the NRA or the Member State;

- PVAR associated with an investment shall always be recovered by the TSO through the means described in 2.5.
- If no mechanism to ensure the recovery of the 1-f part of PVAR is available, the f-factor shall be defined at a level of 1

Setting of f-factor 4/4

2.6.

The recovery mechanism as described in 2.5. shall also apply for the share of PVAR defined by the f-factor if the initial booking or parts of the initial booking are for any reason cancelled.

- It can be the case the initial network user commitments for incremental/new capacity are for any reason cancelled (e.g. bankruptcy of a network user)
- For this reason, also the f part of PVAR needs an additional guarantee for TSO to be recovered
- In case a commitment is cancelled for any reason, the value of the commitment suddenly becomes a part of the 1-f section of PVAR
- The mechanism described in 2.5. shall therefore - in such a case - also apply to this part of PVAR

Agenda

1. Revisiting topic exploration
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4. **Draft business rules: combination into single economic test**
5. Draft business rules: publication requirements
6. Conclusions

Single Economic Test 1/3

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;

- As a default, the single economic test shall be defined in a way, that all involved TSOs can cover their respective share of PVAR if the single economic test is passed

- The minimum level of network user commitment to pass the single economic test is therefore the lowest minimum level of user commitment to pass the individual economic tests on both sides

Single Economic Test 2/3

3.3.

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

- After agreement on the individual parameters of the economic tests of all involved TSOs, the TSOs shall propose to the relevant NRAs the parameters of the single economic test 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;

- A redistribution of revenues can e.g. be performed by a different split of the bundled reserve price or by a cost-sharing agreement

- All involved parties shall agree to the use of such mechanisms

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Single Economic Test 3/3

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.

Agenda

1. Revisiting topic exploration
2. Draft business rules: economic test principles and formula
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4. Draft business rules: combination into single economic test
5. **Draft business rules: publication requirements**
6. Conclusions

Publication requirements 1/2

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;

- Information described in 4.1.1. – 4.1.3. is necessary for network users to understand the minimum requirements in order to pass the economic test
- The publication of the parameters can be conducted once they have been approved by the relevant NRAs

Publication requirements 2/2

4.2.

The involved TSOs shall publish the information stated above with a lead-time of at least one month before the binding phase of the capacity allocation procedure in a transparent and open manner on the respective websites of the TSOs;

- The information defined in 4.1. shall be published in due time, given the approval of the NRA for the parameters (in line with NC CAM Art.11)

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 months before the binding phase of the capacity allocation procedure.

- In order to ensure a timely approval of the NRAs, NRAs should also be bound to a deadline for approving the parameters of the economic test

- Two month lead time gives TSOs the possibility to prepare the publication of the economic test parameters

Agenda

1. Revisiting topic exploration
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5. Draft business rules: publication requirements
6. **Conclusions**

Conclusions

- The economic test is a mechanism to test whether the market is willing to commit for an investment
- TSOs need to have mechanisms in place to recover the costs of an investment that are not covered by upfront (or later) user commitments
- A single economic test shall allow network users to bid for bundled capacity, knowing the required level of commitment to pass the economic test
- The single economic test needs to take into account the requirements of all involved TSOs
- Transparency is crucial for network users to be able to make informed bids

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SJWS 3 Incremental Proposal

Tariff Issues

13 March 2014

Agenda

1. **Revisiting topic exploration**

2. Draft business rules for tariff-related issues

3. Conclusions

Summary of topic exploration 1/3

Tariff FG requires:

An adjustment of tariffs for incremental/new capacity should be considered when selling all incremental/new capacity would not generate sufficient revenue to pass the economic test

- First option for tariff adjustment is the application of a premium already at the start of the auction or open season
- ENTSOG has developed alternatives to this approach and presented those at the first SJWS
- The following alternatives could be considered in case a tariff adjustment is necessary:

Summary of topic exploration 2/3

Approach	Advantage	Disadvantage
Adjusting reference price for all users at the IP	➢ Clear and simple process (one reference price for all users)	➢ Affects users that booked long-term capacity before investment was triggered
Adjusting reference price for all users at the IP, except for those that have booked before initial offer	➢ User that booked long-term capacity before investment was triggered are protected from tariff increases through investment	➢ Complexity due to at least two different reference prices for the same product
Minimum premium for those participating to incremental process	➢ User that booked long-term capacity before investment was triggered are protected from tariff increases through investment	➢ Reduces willingness for long-term commitment as future offers will be cheaper
Discount for those participating to the incremental process	➢ Rewarding for network users committing long-term and thus underpinning the investment	➢ Disadvantage for users holding existing capacity

Summary of topic exploration 3/3

Which tariff to use for the calculation of PVUC in the economic test?

Tariff FG: "…An estimated projection of tariffs for the bundled yearly capacity products of the capacity expansion(s) considered…"

- Due to floating tariffs, the tariff invoiced at the time of usage can be different from the tariff at the time of the allocation of the capacity
- For the calculation of PVUC, TSOs must therefore estimate the projected tariff development for the time of the initial booking horizon

Possible procedures for this tariff estimation are:

- Applying the tariff at the time of the allocation, assuming stable tariffs
- Calculation of an "as-if" tariff based on the circumstances at the time of the allocation, assuming the investment is already in place
- Estimating tariff development based on expected future cash flows associated with an investment in the respective years

Agenda

1. Revisiting topic exploration

2. **Draft business rules for tariff-related issues**

3. Conclusions

Business Rules tariff issues 1/4

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

- As for existing capacity, the reference price is for incremental/new capacity is subject to floating tariffs
- TSO and NRA will therefore agree on an estimation of projected tariff development for the calculation of PVUC in the economic test
- The level of user commitment required to pass the economic test is therefore based on the tariff assumption
- The estimation can differ from the payable price invoiced at the time of usage (in both directions)

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Business Rules tariff issues 2/4

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.

- In case the estimated tariff is not sufficient to pass the economic test in theory, the principles in 5.2.1. – 5.2.3. can be applied
- Principles in 5.2.1. – 5.2.3. are in line with the alternatives proposed by ENTSOG in SJWS 1

Business Rules tariff issues 3/4

5.3.

When introducing such tariff adjustments for incremental or new capacity, NRA's 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 and exit point.

- NRAs shall take into account these principles when deciding on one or more of the mechanisms defined in 5.2.
- Principles 5.3.1. – 5.3.4. fulfill the requirements set out in the Tariff FG with regards to tariff adjustment

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Business Rules tariff issues 4/4

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.

- In line with the considerations in 5.1., the tariff used for the calculation of PVUC shall be based on an estimation of projected tariff development

- TSOs and NRAs shall make relevant assumptions for the estimation, leaving flexibility for deciding on the most appropriate way for calculating the estimated tariff projection

Agenda

1. Revisiting topic exploration
2. Draft business rules for tariff-related issues
3. **Conclusions**

Conclusions

- A tariff adjustment is only necessary if the estimated tariff projections for an offer scenario are not sufficient to pass the economic test without a premium, even if all capacity on offer is allocated
- Questionable whether the estimated tariff projection is meaningful, if it cannot cover the increase in allowed revenues associated with an investment
- Necessity of tariff adjustment may therefore be low in practice
- The estimation of tariff projections for the entire initial booking horizon can be very complex and is dependent on specific circumstances (e.g. remaining network of the TSO, regulatory regime, etc.)
- TSOs and NRAs therefore have to agree on a mechanism that is most appropriate for a specific investment

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SJWS 3 Incremental Proposal

Cross Border Co-Ordination and Information Provision

13 March 2014

Agenda

1. **Revisiting topic exploration**

2. Draft business rules for cross border co-ordination

3. Draft business rules for information provision

4. Conclusions

Summary of topic exploration

- ACER Guidance provides a non-exhaustive list of minimum requirements for cross border co-ordination and information provision

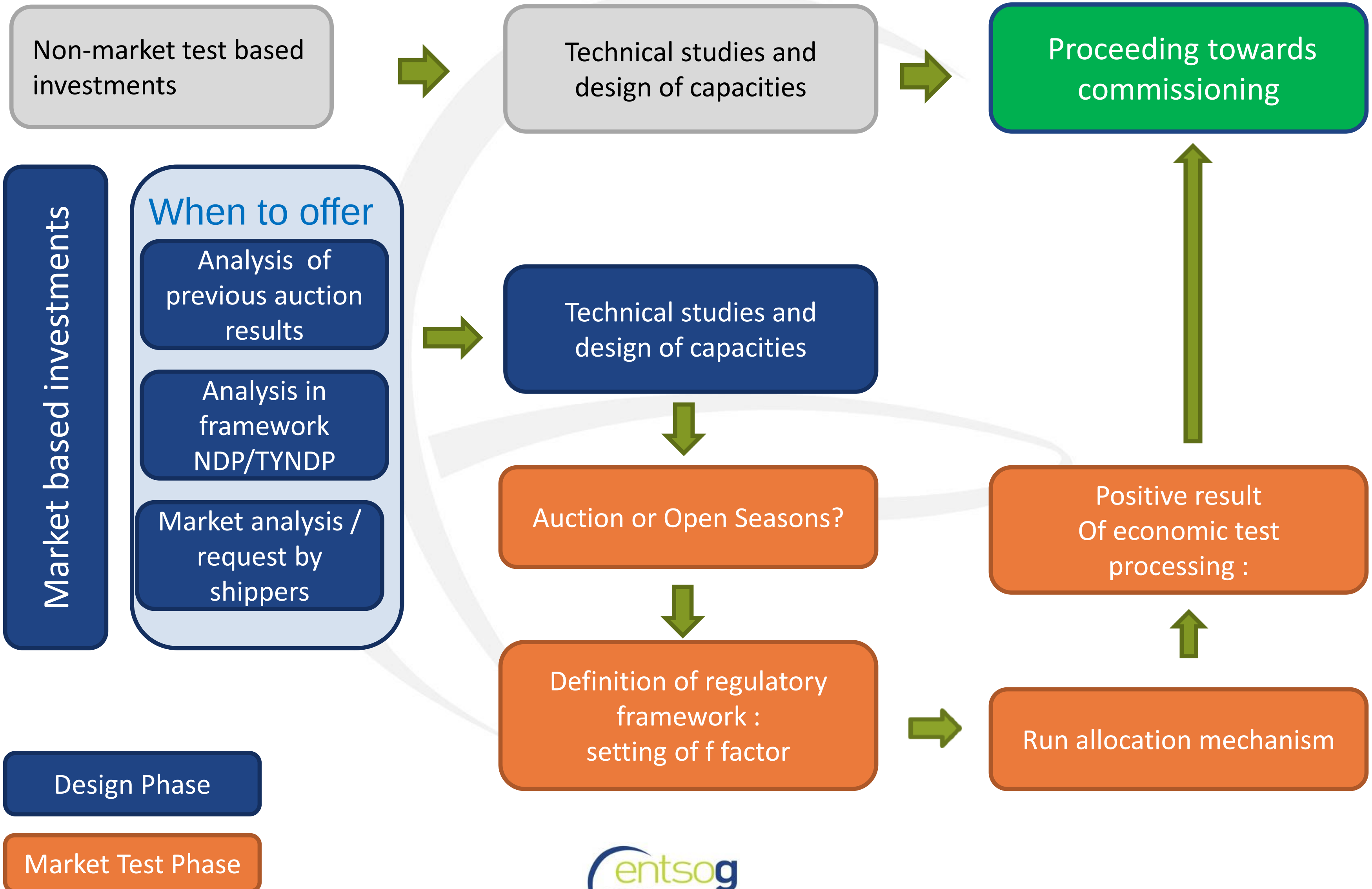
- ENTSOG presented process overview and elaborations on co-ordination and information provision at SJWS 1

  - Two phases approach for incremental/new capacity projects, with a technical design phase and a market test phase with possible overlaps

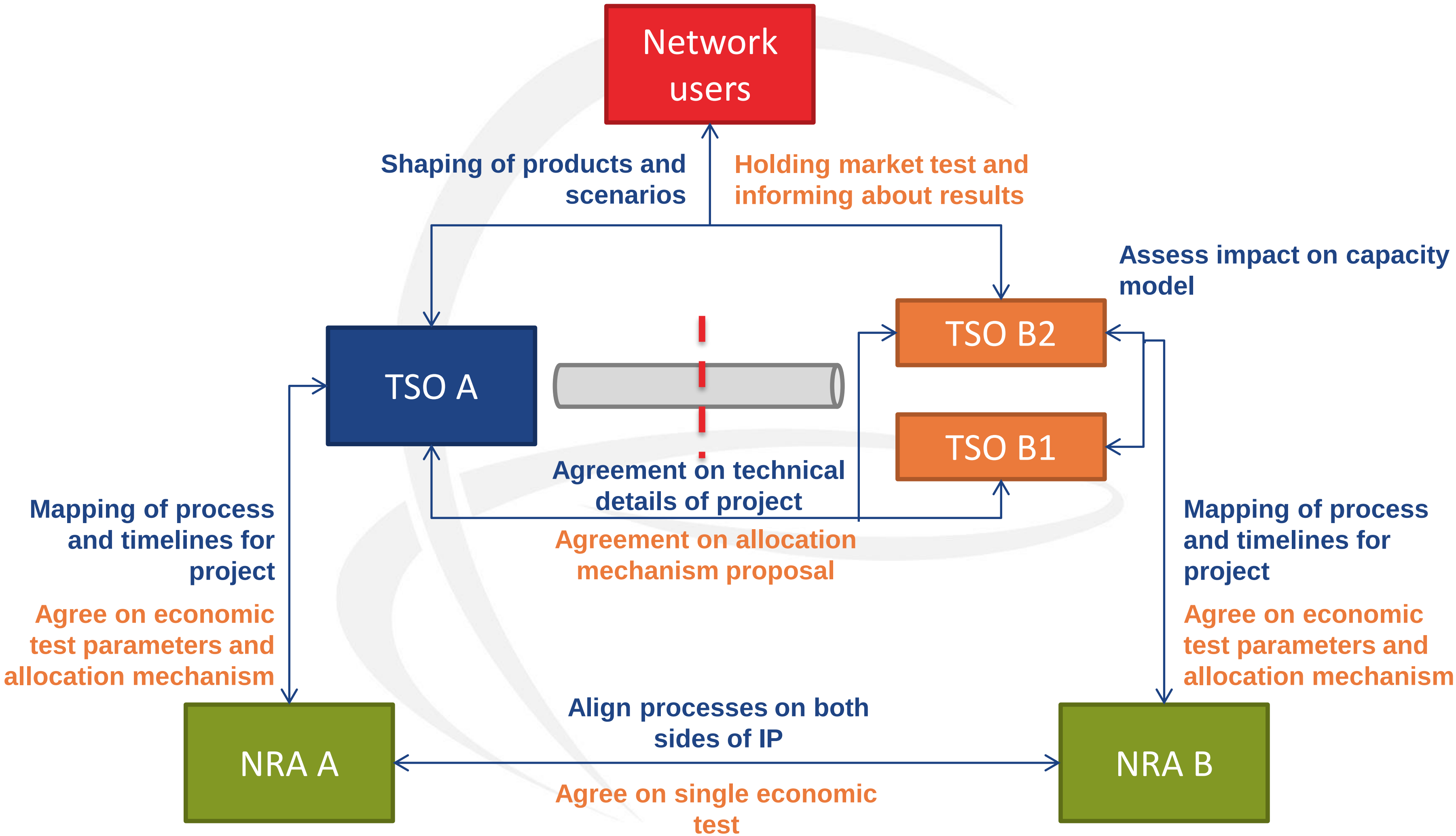
  - TSOs and NRAs coordinate bundling of capacity products when designing incremental/new capacity offer scenarios

  - Interaction between TYNDP/NDP, auctions and non-binding indications needs to be taken into account in the co-ordination process for incremental/new capacity projects

High level process diagram



Interaction between stakeholders



Design Phase
Market Test Phase

Agenda

1. Revisiting topic exploration

2. **Draft business rules for cross border co-ordination**

3. Draft business rules for information provision

4. Conclusions

Business Rules Co-Ordination Requirements 1/3

1.1.

TSOs and NRAs involved in an incremental/new capacity development process shall co-operate and co-ordinate their activities throughout the process;

1.2.

In the process of designing offer scenarios and conducting technical studies, TSOs shall agree on characteristics of the products to be combined into bundled capacity;

- Amended CAM NC should provide minimum co-ordination requirements but leave flexibility for specifics of projects
- Co-ordinated levels of capacity increment is ensured by obligation to offer incremental/new capacity as bundled products

Business Rules Co-Ordination Requirements 2/3

1.3.

For the offer of incremental/new capacity at an IP, TSOs shall aim at delivering harmonised capacity levels, single offer and commissioning timeframes, and a consistent policy in case of delays. Furthermore, TSOs shall provide co-ordinated points of contact for network users during the incremental/new capacity process;

- Requirements in 1.3. are applicable to all incremental/new capacity projects, regardless of the complexity and size
- Additional co-ordination can however be required for complex and large projects for which an open season procedure will be used

1.4.

When designing the products and quantities to be offered, TSOs shall address market views;

- Market parties shall be able to submit comments throughout the whole process

Business Rules Co-Ordination Requirements 3/3

1.5.

Auctions are the default mechanism for the allocation of incremental/new capacity, however in case the conditions for using open season procedures are met (as will be described in the Business Rules on Open Season Procedures), TSOs involved shall commonly propose an open season procedure to the respective NRAs for approval;

- Open Season Procedures can be used for more complex and large investment projects
- The criteria for when to propose an OSP is defined in the respective section of the business rules

1.6.

As further described in the section on the single economic test, TSOs and NRAs involved in a given incremental/new capacity development process shall co-ordinate a single economic test.

- Combination into single economic test can result in close co-ordination necessity (e.g. in case of redistribution of revenues)
- Further elaboration in the economic test section of the business rules

Agenda

1. Revisiting topic exploration
2. Draft business rules for cross border co-ordination
3. **Draft business rules for information provision**
4. Conclusions

Business Rules Information Provision 1/4

2.1.

TSO shall report to their respective NRA whether non-binding demand indications for incremental/new capacity have been received. Furthermore, TSOs shall assess the non-binding indications received and recommend to the respective NRA whether or not these non-binding indications justify an incremental/new capacity process;

- The TSO assessment whether non-binding indications are sufficient to trigger an incremental/new capacity shall be confirmed by the NRA, ensuring network users that requests are considered appropriately

2.2.

TSOs involved in a given incremental/new capacity development process shall provide to the respective NRAs the planned offer scenarios including the respective capacity levels and investment costs for approval;

- Business rules 2.1. and 2.2. are in line with the ENTSOG proposal to propose planned offer scenarios to NRA for approval

Business Rules Information Provision 2/4

2.3.

In case of open season procedures for the allocation of incremental/new capacity, the involved TSOs shall prepare and propose to the relevant NRAs the features of the open season procedure, including the allocation rules to be applied;

- TSOs shall propose to the NRAs the concrete features of a planned OSP
- TSOs involved shall agree on an allocation mechanisms to be applied in the OSP for NRA approval

2.4.

For a given incremental/new capacity development process the involved TSOs shall propose to the respective NRAs a timeline for the project development until the final commissioning of the incremental/new capacity for approval;

- Project development process subject to NRA approval

Business Rules Information Provision 3/4

2.5.

For a given incremental/new capacity development process the involved TSOs shall propose to the respective NRAs all the necessary parameters that constitute the economic test for approval on the basis of binding network user commitments;

- Further details on information provision are to be defined in the section on the economic test

2.6.

Following the approval for the offer scenarios and the economic test procedure by the relevant NRAs, the involved TSOs shall make public the information stated in 2.2. – 2.4., with a lead time of one month before the auction or beginning of the binding phase of the open season procedure;

- Planned offer scenarios, features of Open Season Procedure and project development timeframes shall be made public one month before binding phase
- In line with current CAM NC provisions on information about auction quantities

Business Rules Information Provision 4/4

2.7.

The information described in 2.5 are to be published according to the provisions in the economic test section;

- Further details on information provision are to be defined in the section on the economic test

2.8.

TSOs shall make public the aggregated provisional results after the allocation procedure in accordance with Art. 11.10 of NC CAM unless another date has been specified and published.

- Art. 11.10. of NC CAM foresees a deadline of 24 hours after the end of an auction for the publication of results

- In case of incremental/new capacity, 24 hours might not always be suitable (e.g. due to operative clearing constraints, the calculation of the economic test or because of approval mechanisms within the Member State)

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Agenda

1. Revisiting topic exploration
2. Draft business rules for cross border co-ordination
3. Draft business rules for information provision
4. **Conclusions**

Conclusions

- Intense co-ordination between TSOs and NRAs is necessary in order to ensure an efficient process and ensure appropriate addressing of market needs
- Bundling of capacity products implies co-ordinated levels of incremental and project timelines
- Information provision is crucial for network users to make informed bids
- TSOs shall make public all relevant information with an sufficient lead time, subject to receiving all necessary approvals from NRAs and other authorities in due time

Tariff Network Code
ENTSOG SJWS 3

IFIEC-CEFIC response on
Incremental proposal

Dirk-Jan Meuzelaar

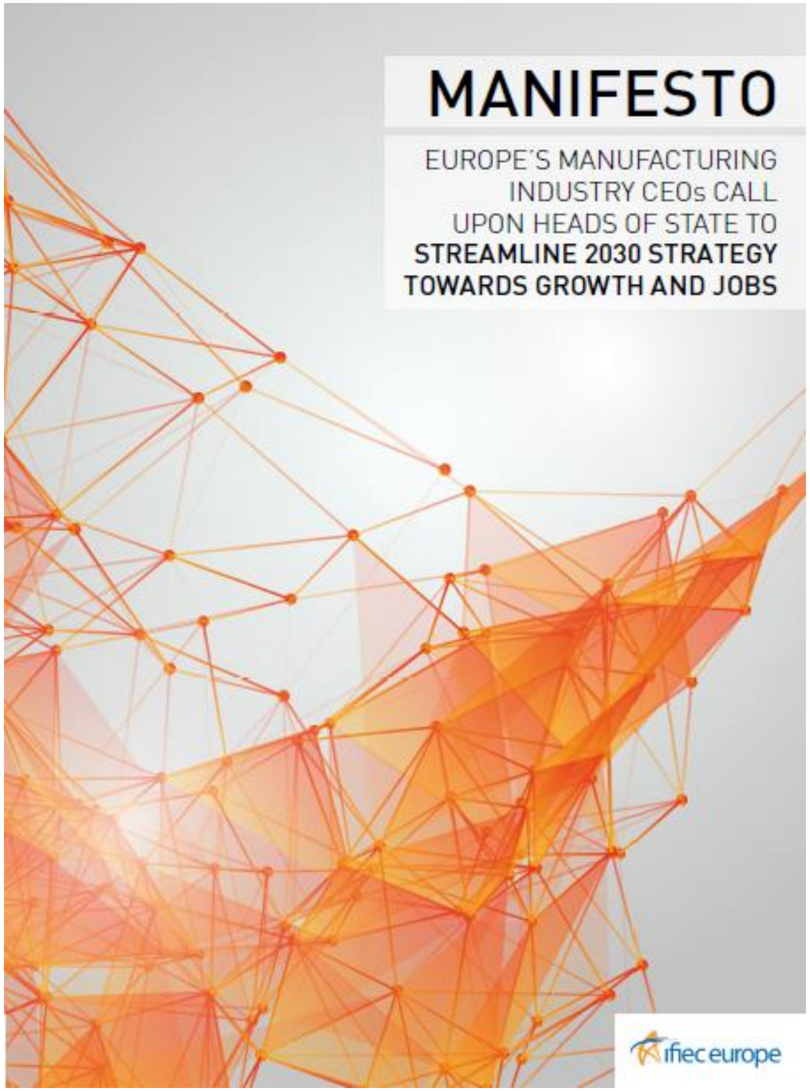
Brussels, March 13th 2014

ifiec europe securing competitive energy for industry cefic

The European industry is facing serious challenges

More than 150 CEOs will send a wake-up call to the heads of State

- Industry's share in GDP is down to 15,1%
  - It accounts for 80% export and 80% in private research and innovation
- Since 2008 3,5 mln jobs are lost in manufacturing
  - Each job in manufacturing create 2 jobs in service sector
- Gas prices are 2-4 times higher in the EU than in the US
  - The Energy Intensive Industry is a price taker and cannot pass additional costs to its mainly global customers



The European gas market is facing serious challenges
A new equilibrium is urgently needed

4 MARCH 2014

IHS **CERA Insight**

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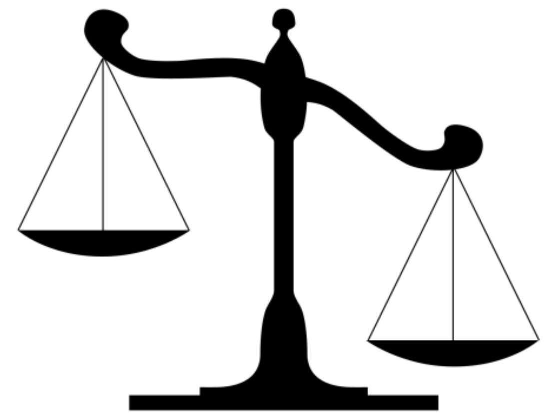
Russia: Looking east and west for natural gas markets

Russia is now long on gas supply

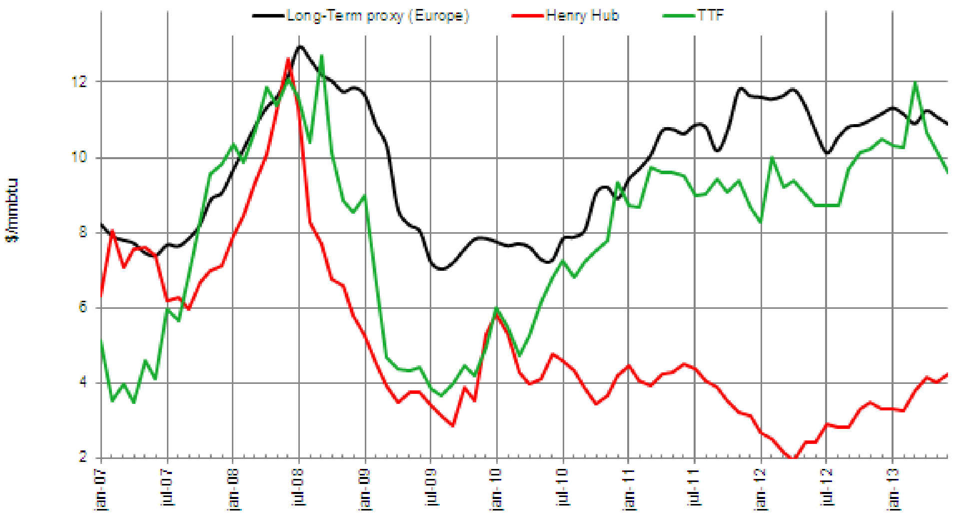
- **Russia today is once again long on gas, with the initial "next generation" of gas now onstream.** Indeed, Russia's problem now is too much supply and not enough demand.

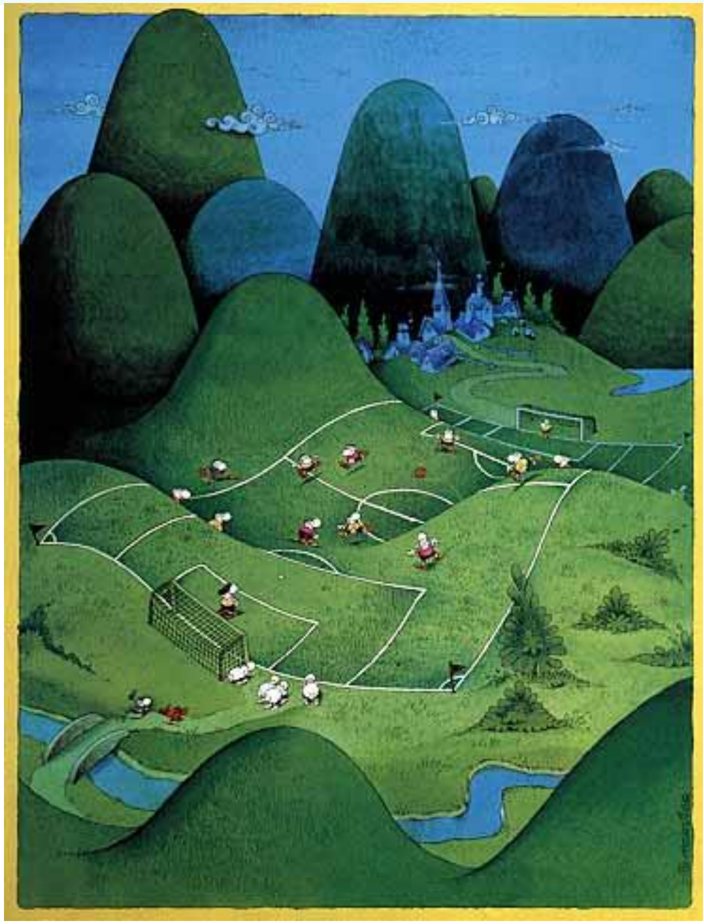


- Negative spark spreads in power sector
  - Many efficient gas power plants are mothballed
  - Many efficient CHPs are switched off
- Coal fired plants are running flat out

Does the incremental proposal contribute to restore the level playing field and reduce the risks of market dominance?*)

We need sufficient gas transport infrastructure to facilitate competitive market leading to efficiency gains and price reductions*)…..
….for restoring the level playing flied





CEFIC/IFIEC doubt that the current proposals will give enough confidence to meet the required conditions

***) as promised in the Directive 2003/55/EC**

Does the economic test give confidence for building the required investments?

$$PVUC \geq f * PVAR$$

User Commitment is subject to Allowed Revenues that determine the efficient costs and cost effectiveness, however

Allowed Revenues are not part of the FG and NC!

Allowed Revenues = RAB * WACC + special services

- RAB: NPV of depreciated value based on regulated tariffs
  - Investment costs
  - Depreciation periods
  - Depreciation methodology
  - Revalidation assets (also for commercial reasons)
- WACC: return on equity and debts, based on actual financial markets
  - Risk premium for debt capital
  - Return on equity
  - Indexation and inflation

TSOs are having cold feet for Stranded costs and under-recovery

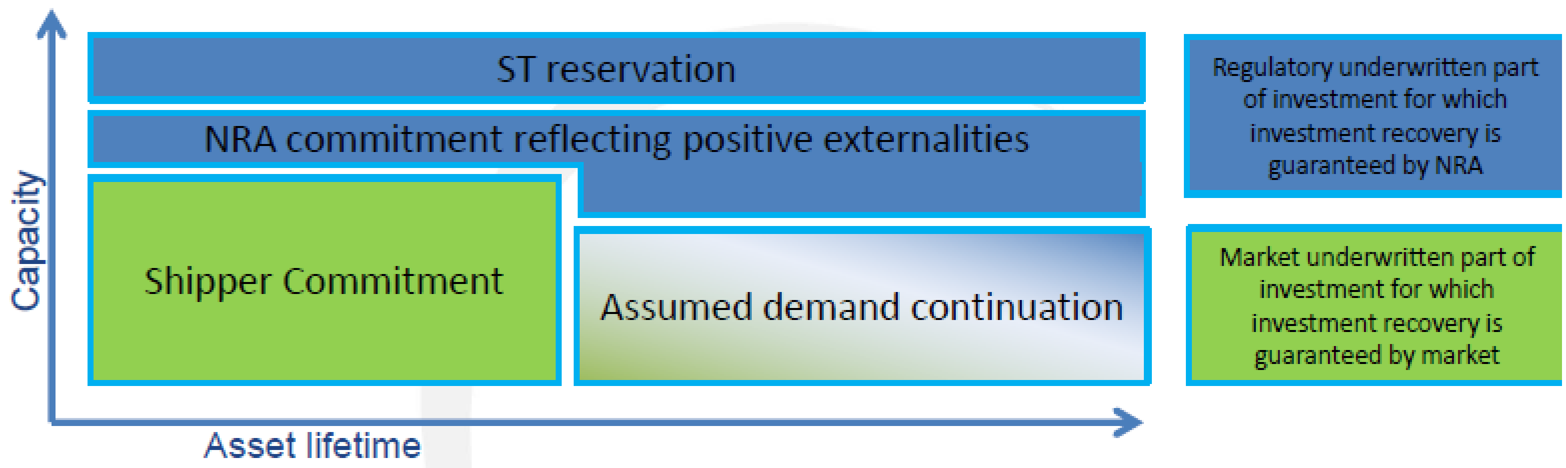
Who are committed in the precondition to pass the economic test for new and incremental capacity

TSOs heavily involved, but not committed to pay the bill
Shippers involved and committed, but transfer their bill to the consumers
Producers involved, but try to transfer upfront all commitments to consumers
Consumers hardly involved, but fully committed to pay the bill

IFIEC and CEFIC representing the consumers are involved in the Incremental proposal, but we are not convinced that this proposal will be in our benefit. We will be reluctant to give our commitment

The long term commitment of Shippers or Users in setting the f-factor is overvalued and externalities are undervalued

Increased competitiveness and security of supply are only qualified as ‘positive externalities



- Positive externalities, e.g. security of supply or more competition, should be the main drivers for the economic test instead of user commitment (higher f-factor instead of lower);
- Ample availability of short term bookings (more than 10%), stimulating new entrance and increased competition, should be rewarded.

User commitment is not affected by more short term bookings

More ST-bookings = natural outcome of mature markets:

- Most end-consumers do not book their own transport capacity. Hence, no distinction between supplier and shipper;
- Large end-consumers have different suppliers and frequently switch between them;
- Large end-consumers are averse for Mark to Market risks.

Short term bookings do not affect total demand:

- Volume risk for shippers does not increase
  - TSOs or DSOs are regulated monopolies
- Price risk is and could be managed by financial derivatives

Risks of Open Season Procedures (OSP) are underestimated and will not contribute to reduce risk market dominance

- **Transparency**: OSPs are flexible but not transparent;
- **Level Playing Field**:
  - OSP conditions easily set by current dominant market parties;
  - OSP + long term economic tests detrimental for new entrants: capacity is allocated first to those shippers with highest PV;
- **Third Party Access**: new OSP-capacity will easily lead to request for exemptions (not “fill or kill” but “exemption or exit”) as many examples have shown;
- **New TSO**: a separate TSO crossing different border for realizing a dedicated project to make the project financeable and provide tariff certainty, will lead to higher dependence and lower competition. This will not contribute to a more competitive EM.

Referring to OSP in US does not stand

- In US investments are triggered by supply and not by demand
- US would never accept foreign dependence of energy and its transport

Could shorter depreciations periods trigger new investments?

- Shorter depreciation periods are only acceptable on the condition that strong legal safeguards are provided that:
  - Shorter depreciation periods only applies for new capacity
  - New capacity is part of regulated asset of the TSO of an European member State
  - After depreciation period the assets may not revalidated
  - Profit due to increase of the book value of all assets should be reimbursed to end-users

We will never accept to pay more than once for the same steel

Conditions Incremental (IC) & New capacity (NC)

IFIEC/CEFIC welcomes any IC/NC-investment if the following conditions are fulfilled:

- More than 10% of IC/NC should be offered Short Term
  - 30% is a fair share
- All IC/NC within EU (IEM) should be part of regulated regime
- No exemptions from Third Party Access within EU (IEM);
- TSOs must provide cost analysis to expand the investment in order to connect it to alternative sources of gas
- No fly-overs: any investment in IC/NC should be part of the regulated system and should have proper connections to the hub(s) / balancing zone(s) of passing Member States ;
- Tariffs should be based on efficient investment costs (CAPEX) and operational costs (OPEX)

IFIEC/CEFIC are involved but not convinced nor committed

- IFIEC/CEFIC are involved in the incremental proposal process,
- We are not convinced that the current proposals contribute to the aims of the IEM,
- We are very reluctant to give our commitment if proposed regulation conditions and criteria are being met and applied.