

5th SJWS for the Incremental Proposal

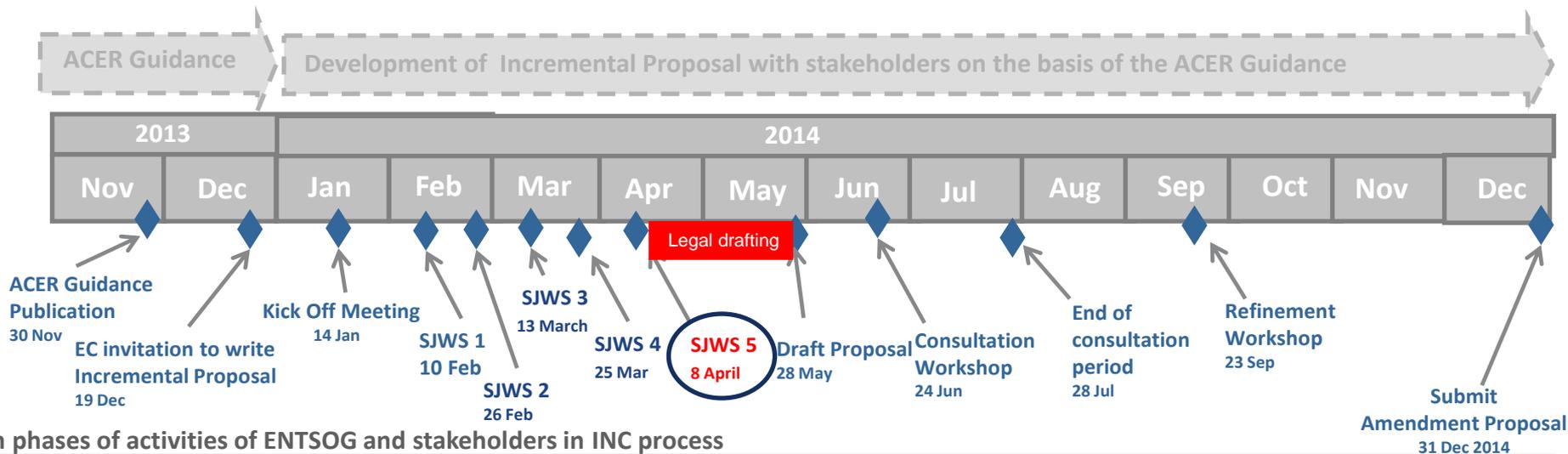
8 April 2014

**Mark Wiekens
Advisor, Market Area**

Agenda

No.	Description	Time
	Welcome coffee	10:00-10:30
1.	ENTSOG opening and project overview	10:30-10:45
2.	Prime Mover presentation GIE	10:45-11:00
3.	Cross-border and Information Provision ➤ Discussion	11:00-11:30
4.	When to offer and Auction procedures ➤ Discussion	11:30-12:15
	Lunch Break	12:15-13:15
5.	Prime Mover presentation IFIEC	13:15-13:30
6.	Economic Test ➤ Discussion	13:30-14:15
	Coffee Break	14:15-14:30
7.	Prime Mover presentation OGP	14:30-14:45
8.	Tariff-related issues ➤ Discussion	14:45-15:15
9.	Prime Mover presentation WS2 GAC/Gazprom export LLC/Gazprom Marketing & Trading	15:15-15:30
10.	Open Season Procedures ➤ Discussion	15:30-16:15
11.	Conclusions	16:15-16:30
Next Incremental event: 24 th June 2014 → Consultation Workshop for the Incremental Proposal		

Timeline for incremental proposal Development and consultation overview



Main phases of activities of ENTSOG and stakeholders in INC 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				
Stakeholders		Kick-off Meeting	SJWS 1	SJWS 2	SJWS 3	SJWS 4	SJWS 5	Consultation period 28 May – 28 July		Refinement Workshop	SSP

- SJWS 1**
- Coordination Requirements
 - Information Provision
 - Economic Test
 - Tariff-related issues

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

- SJWS 3**
- Coordination Requirements
 - Information Provision
 - Economic Test
 - Tariff-related issues

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

- SJWS 5**
- All segments of the Incremental Proposal
 - Outstanding issues to be presented
 - Conclusions

Stakeholder involvement so far

- 1 Kick Off meeting (January)
- 5 productive and engaging Stakeholder Sessions (February – April)
- 5 Prime mover meetings
- Many good discussions and interventions from a wide range of stakeholders, platform operators, TSO pilot, etc.
- Both via the SJWS (physical and via Webcast), Prime mover meetings...

...But still a lot to do!



Phases in ENTSOG's Incremental Proposal Development



STAKEHOLDER INVOLVEMENT	One KICK OFF MEETING	5 STAKEHOLDER JOINT WORKING SESSIONS (Feb - Apr)	REFINEMENT WORKSHOP 24 September 2014
	PROJECT PLAN CONSULTATION	FORMAL CONSULTATION 28 May – 28 July	STAKEHOLDER SUPPORT PROCESS 7 Nov – 21 Nov
	LAUNCH DOCUMENTATION	CONSULTATION WORKSHOP 24 June 2014	
	INFORMAL, BI-LATERAL and ADHOC INTERACTIONS AS REQUIRED THROUGHOUT THE PROCESS		

Immediate next steps: Transpose the business rules into legal text



- Topic identified from Guidance
- Topic introduced in “Launch Documentation” and at Kick Off Meeting
- Topic presented at SJWS 1 & 2
- No policy options ruled out at this step
- Stakeholder input received
- Business rules formulated based on stakeholder feedback on SJWS 3 & 4
- No policy options ruled out at this step
- Stakeholder input received
- Some topics revisited at SJWS 5
- Further refinement of business rules
- Business rules transposed into draft Incremental Proposal text
- Texts consolidated into draft Incremental Proposal for consultation

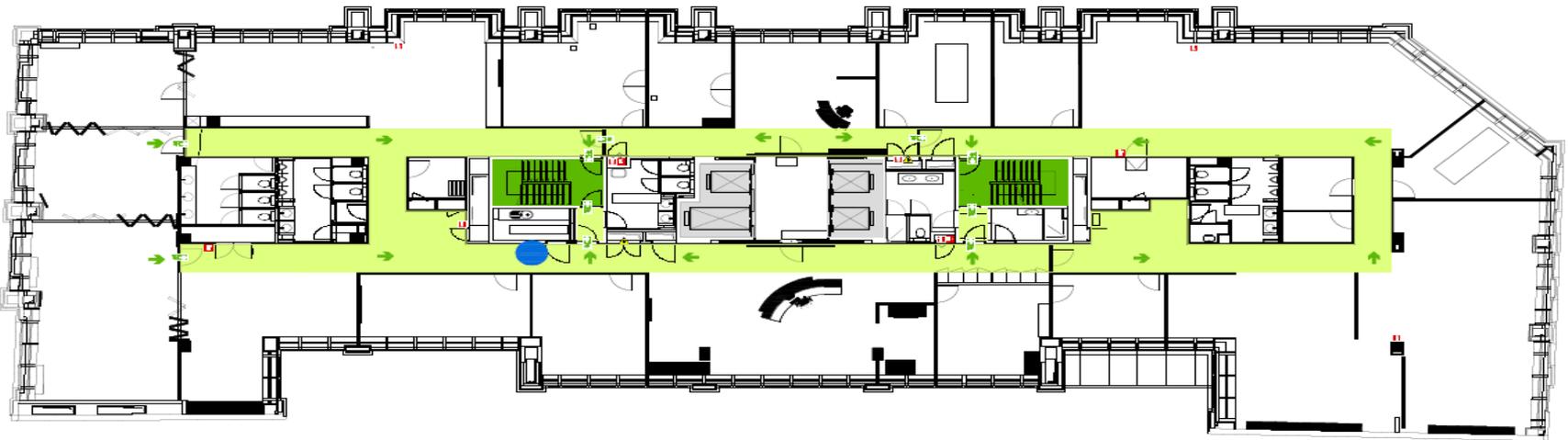
*Draft
Incremental
Proposal for
consultation
28 May 2014
+
Supporting
Document*

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
ALARM DRUKKNOP
ELECTRICAL ROOM



SORTIE DE SECOURS
NOODUITGANG
EMERGENCY EXIT



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

+2

ENTSO-G: 5th Stakeholder Joint Working Session for the Incremental Proposal

8 April 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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1. **Prime Mover Presentation GIE**
2. Cross Border Co-Ordination and Information Provision
3. When to Offer Incremental/New Capacity
4. Auction Procedures
5. Prime Mover Presentation IFIEC
6. Economic Test
7. Prime Mover Presentation OGP
8. Tariff Issues
9. Prime Mover Presentation Gazprom
10. Open Season Procedures

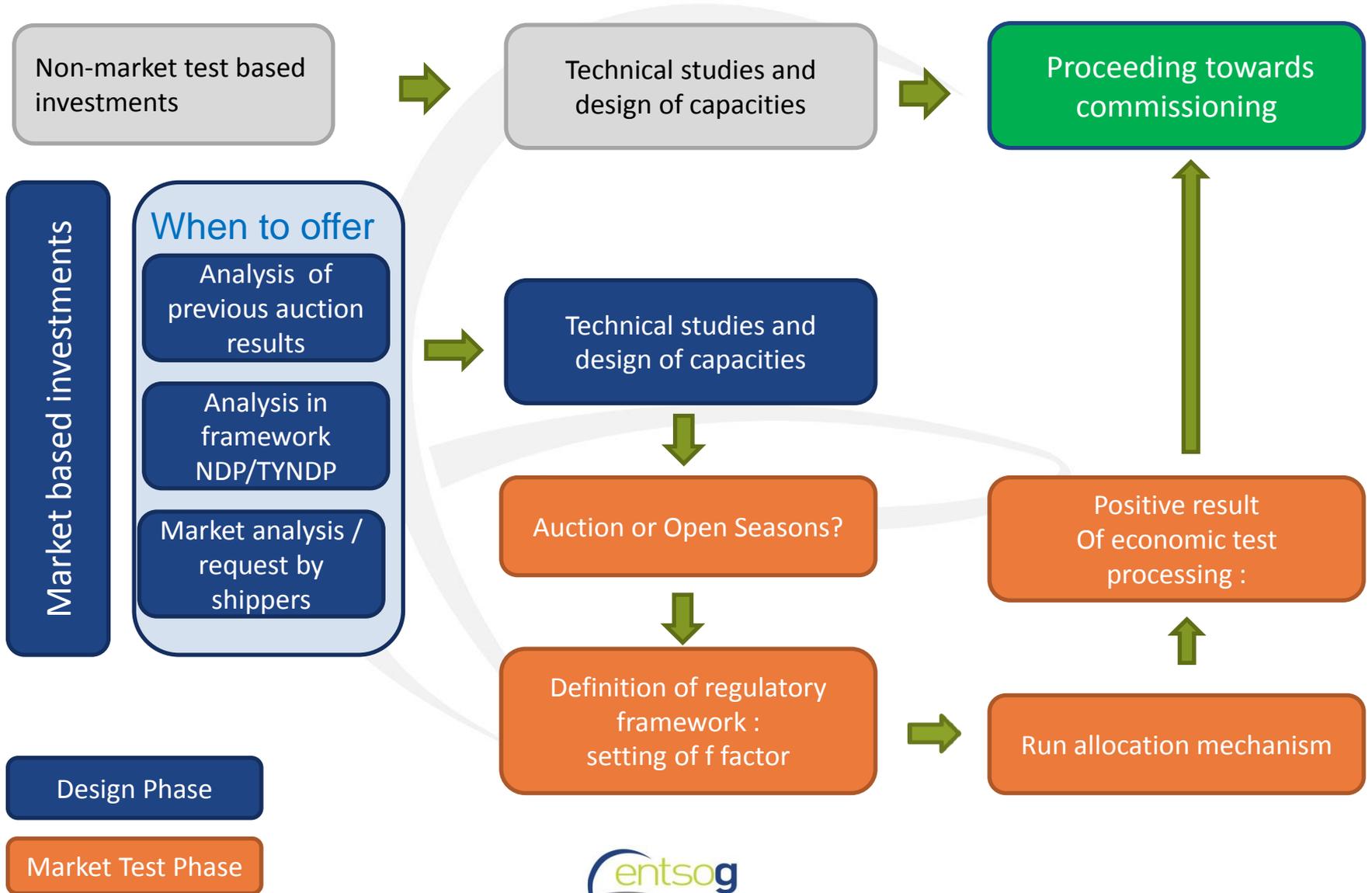
Prime Mover Presentation GIE



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High level process diagram



Additional Business Rules Co-Ordination Requirements

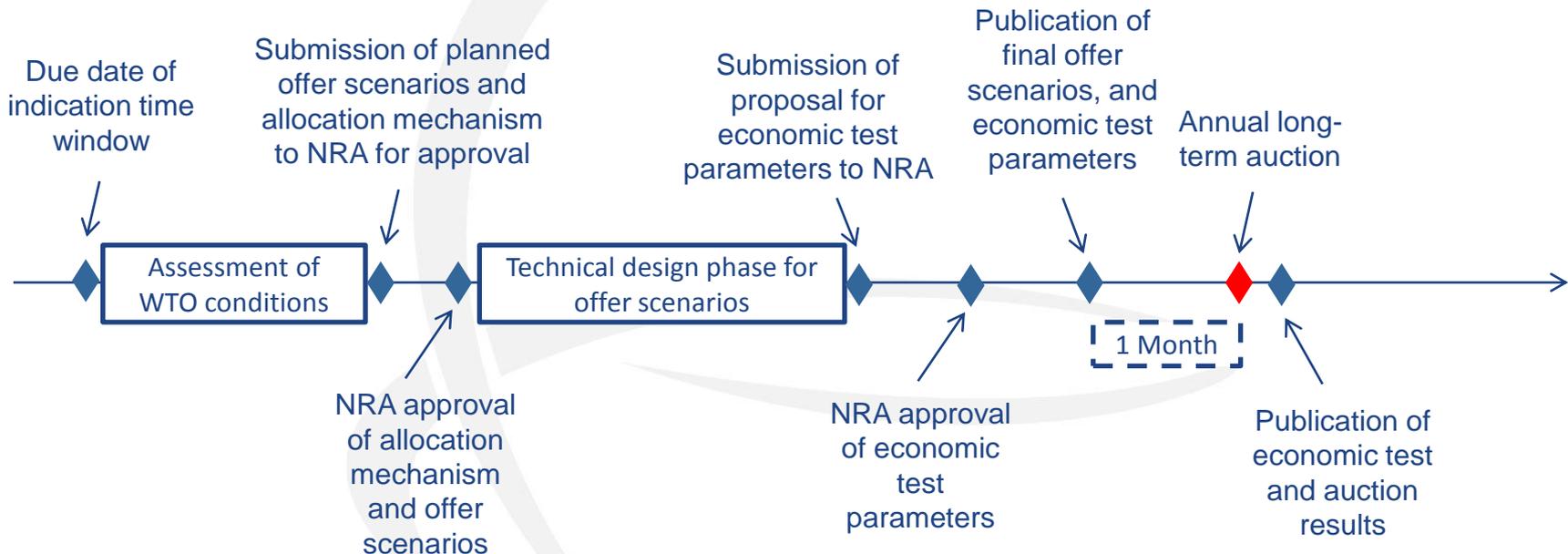
1.7.

NRAs involved at IP's subject to incremental or new capacity shall coordinate with one another. They shall at least commonly agree on the following items, including selection of auction or OSP, final Offer Scenario(s), single economic test approach, allocation rule if relevant, regional coordination if relevant

- The new business rule makes explicit the role of a NRA in interaction with adjacent NRA

Process steps: auctions

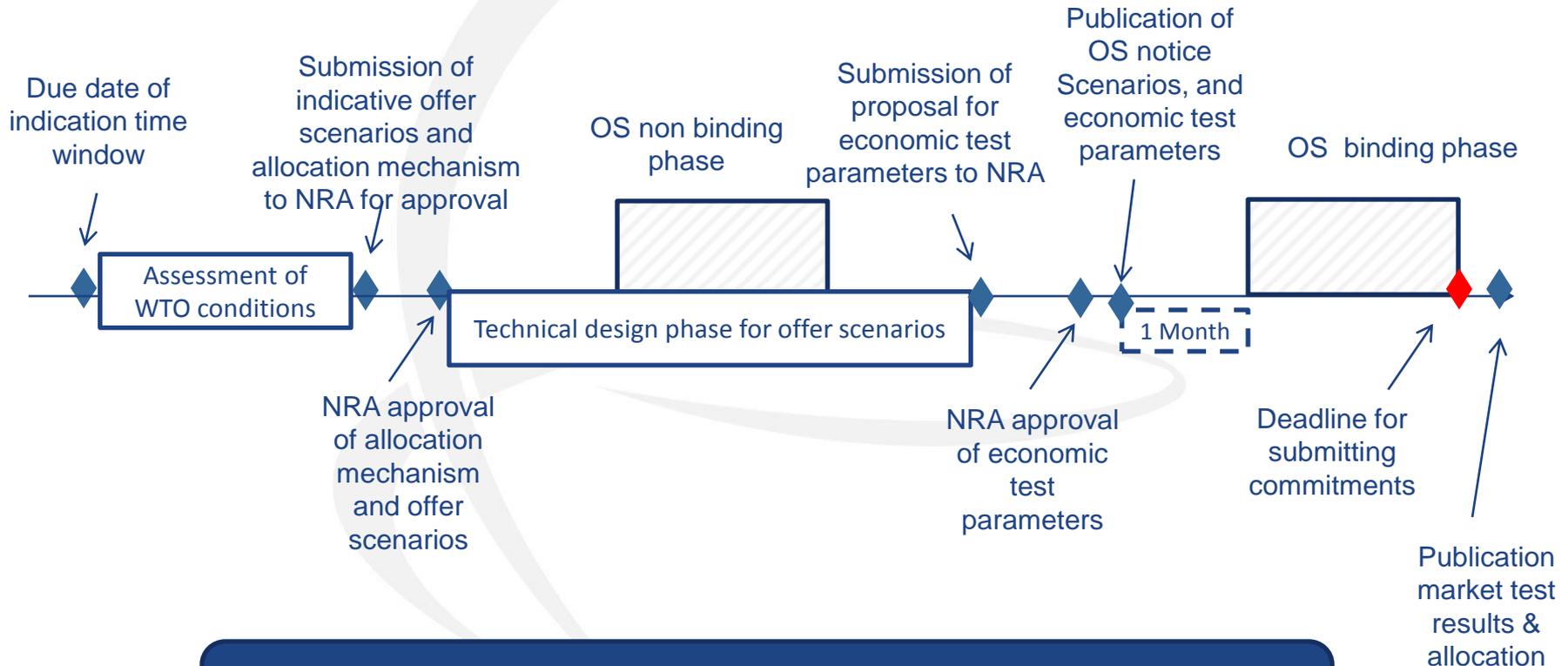
The following timeline shows the main process steps in case an auction is chosen as allocation mechanism:



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

Additional requirements for multi-IP projects

- Bundled capacity is an efficient way to protect network users by ensuring full coordination
- However, in case of projects linking several IPs, additional coordination may be required
- This is commercially handled via conditionalities of an Open Season Process
- Co-ordination of FIDs as well as commercial date alignment is required

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

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- premier TRANSMISSION
- gaslink
- BGE (UK) Ltd.
- nationalgrid
- Interconnector
- gasunie
- jordgas transport
- ENERGINET DKK
- swede gas
- GASSCO
- EG
- Võrguteenus maagaas
- LATVIAS GAZE
- Amber Grid
- ontras
- gasunie
- gasunie
- Open Grid Europe The Gas Wheel
- nowega
- Thyssengas
- creos
- FLUXYS
- bayern
- terraneis bw
- FLUXYS
- 3·G
- eustream
- GRTgaz
- SWISSGAS
- TAG
- GAS CONNECT AUSTRIA
- Pligovodi
- Infrastrutture Trasporto Gas
- plinacro
- SNAM RETE GAS
- enagas
- REN Gasodutos
- NERGAS
- GAZ system
- UKRTRANGAZ
- TRANS-GAZ
- BULGARTRANS-GAZ
- FAMA
- DESFA

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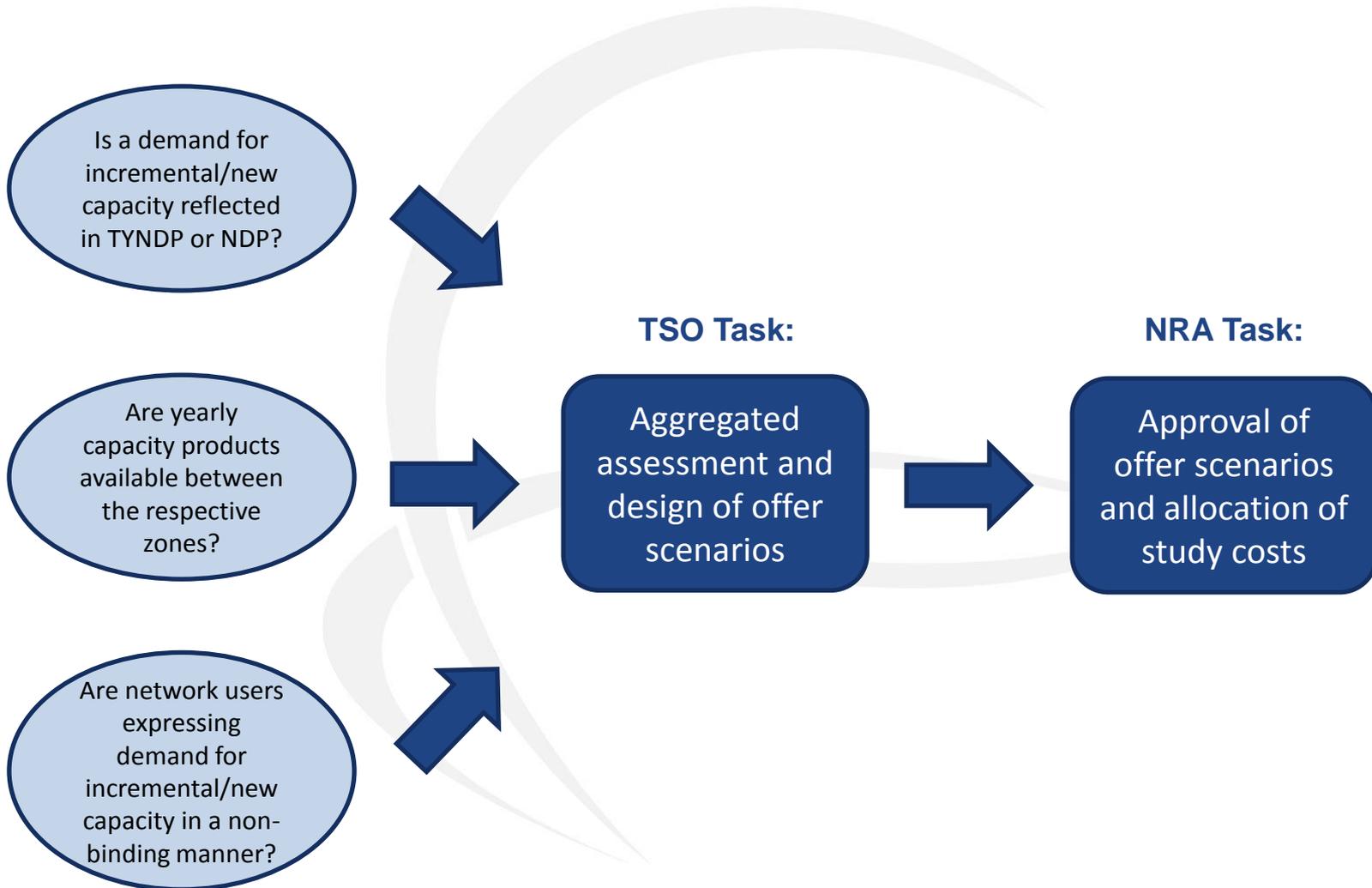
When to launch the offer process?

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 scenarios



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 scenarios
- 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 are still under discussion:

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



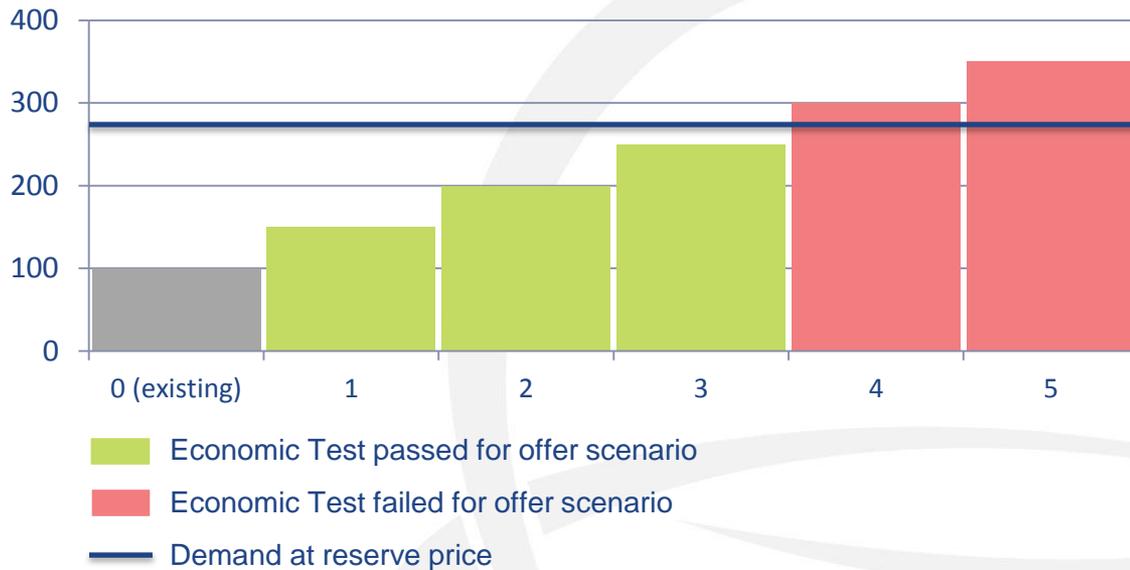
2 Due-date approach

- Specified 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

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Possible principle for bid revision



Actual demand at reserve price is higher than the level of capacity offered in the highest offer scenario that is resulting in a positive economic test outcome!

For network users, a higher offer scenario at the reserve price might be preferable to the successful lower offer scenario at a premium

In such a case, bid revision could be allowed by:



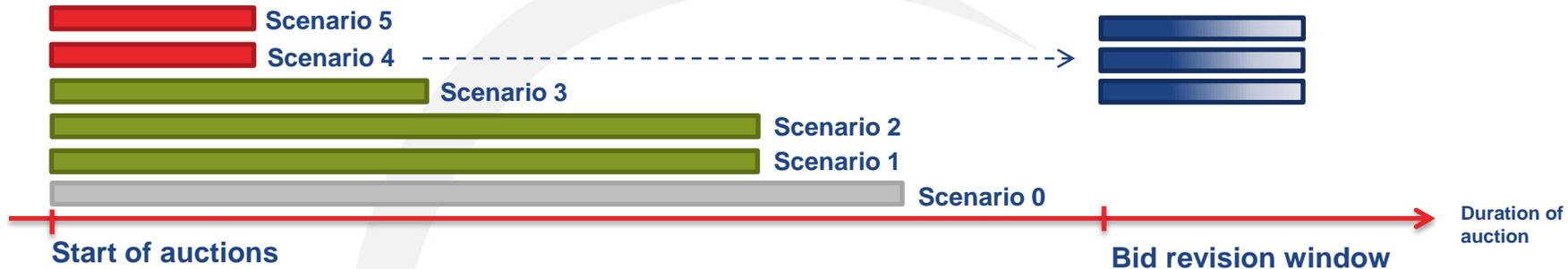
Repeating the auction for the next highest offer scenario

and/or



Auctioning additional offer scenarios with capacity levels above the successful offer scenario

Timing for bid revision



- **Once the auctions for all offer scenarios have cleared**, the TSOs will assess whether the conditions for bid revision are met (highest positive offer scenario cleared at a premium)
- If this is the case, the TSOs will repeat the auction for the next highest offer scenario
- If possible, the TSOs can also auction additional offer scenarios with capacity levels above the highest successful offer scenario
- Parallel bidding ladders could also be applied in the bid revision window

Additional considerations

- Bid revision should be open to those auction participants that placed bids in the initial auction and to new participants
- Procedure to be applied in case a premium occurs in the bid revision auction
 - Allocate according to the auction results, accepting the premium
 - Another bid revision window according to the same principles

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Network Code on Incremental Capacity ENTSOG SJWS 5

IFIEC-CEFIC response on Incremental Capacity proposal

Dirk-Jan Meuzelaar

Brussels, April 8th 2014

The Gas Directive 2009/73/EC aims at safeguarding the interest of gas consumers (1)

Gas transport infrastructure = Key Success Factor

- Competitive prices
 - Our Performance Indicator!
 - Goal: competitive, liquid Internal Energy Market (IEM)
 - **Concern: current proposals enhance dependence and interests major suppliers which will not lead to more efficient prices**
- Efficiency gains
 - Efficient cost of the required infrastructure
 - But infrastructure should also be effective
 - **Concerns: allowed revenues not part of Network Code; current Economic test too cumbersome**

The Gas Directive 2009/73/EC aims at safeguarding the interest of gas consumers (2)

- Security of Supply & Sustainability
 - Sufficient transport capacity available to facilitate liquid IEM
 - **Concern: Strict compliance with unbundling obligations**
 - Current Economic test detrimental for new entrance players**
 - Capacity primarily to consolidate position of pivotal suppliers**
- Higher Standards and Services
 - Transparency and deductibility
 - **Concern: conditions Open Season Procedures are not transparent**

CEFIC/IFIEC are concerned that the current proposals will to more dependence of pivotal suppliers and not to necessary price reductions; The energy market still will be ruled by the strongest instead of the fittest

Economic test not in the interest of end-consumers

This test is more an indicator than a threshold

$$PVUC \geq f * PVAR$$

- Long term commitment of Users in setting the f-factor is over valued and externalities are under valued;
- Positive externalities e.g. security of supply should be main drivers of the economic test;
- More short term bookings are natural development of mature commodity markets;
- Short term bookings do not affect total demands (no volume risks).

Security of demand should be stimulated by more confidence of gas market and competitive commodity prices

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

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

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

Open Season Procedures (OSP) risks are under estimated

- **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:** erecting a separate TSO for realizing a dedicated large cross border project to make the project financeable and provide tariff certainty, will lead to higher dependence and lower competition. This is not a contribution to realizing an IEM.

Conditions Incremental (IC) & New capacity (NC)

Preliminary position of IFIEC/CEFIC

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

- **Capacity:** ample transport capacity is pre-requisite for efficient IEM;
- **Stimulation New entrance players;** decrease long term dependence by more short term capacity (we prefer 30 percent);
- **Regulation:** any IC/NC within EU under regulated regime (TPA, strict unbundling);
- **TPA:** no exemptions from Third Party Access within EU (IEM);
- **Obligation:** TSOs are responsible for sufficient capacity. TSOs should invest in case of shortage or congestion;
- **Shorter depreciation periods:** only by strong conditions to safeguard end users for paying more than once for same grid;
- **No 'cross border fly-over TSOs'** leading to complex regulation and increasing dependency.

We still have concerns that the proposal will insufficiently contribute to the goals set in the 3rd package / Gas Directive

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PVAR to PVRR

Economic test formula used so far:

$$PVUC \geq f * PVAR$$

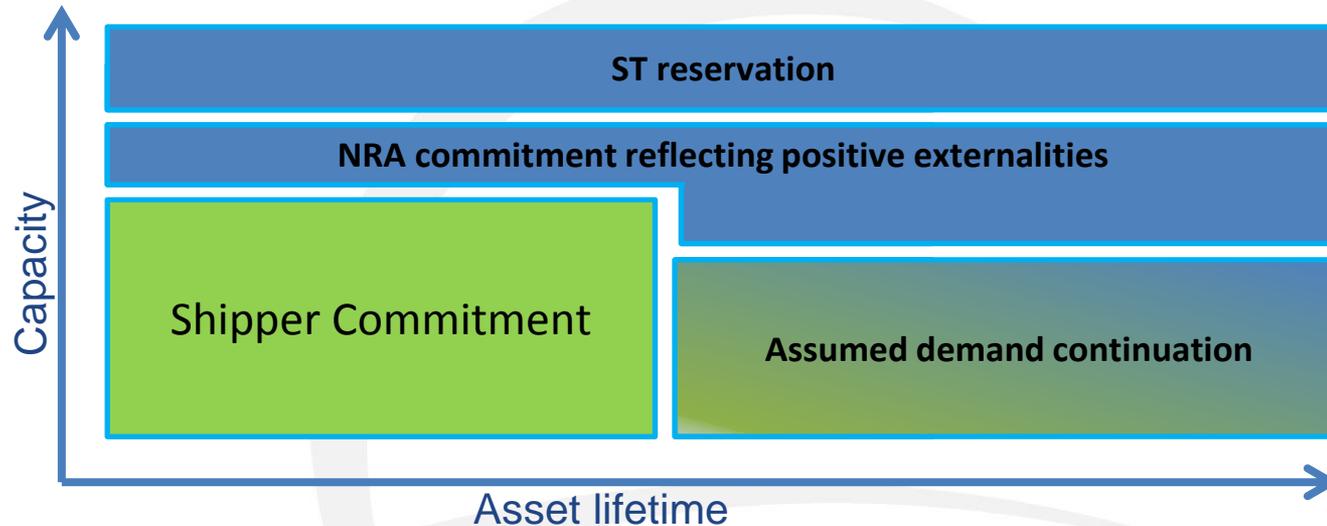
- “PVAR” = Present Value of increase in Allowed Revenues related to the respective capacity expansion
- The term ‘Allowed Revenues’ is defined in the TAR FG as *“The maximum level of revenues set or approved by the NRA that a TSO is allowed to obtain within a defined period of time for undertaking its 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

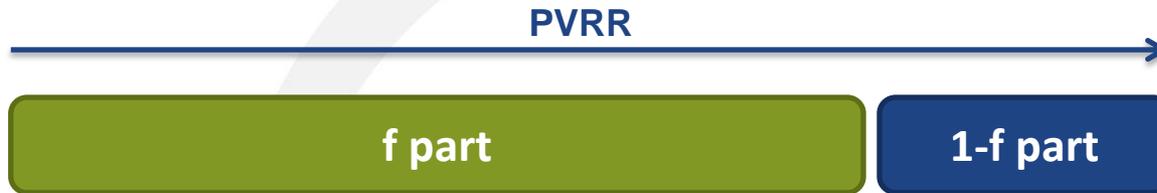


Market underwritten part of investment for which investment recovery is guaranteed by market

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

Recovery of PVRR

The share of the investment not covered by upfront user commitments guaranteed via the regulatory framework or other appropriate payment guarantee mechanisms.



f part

= Will be recovered by upfront commitments from network users

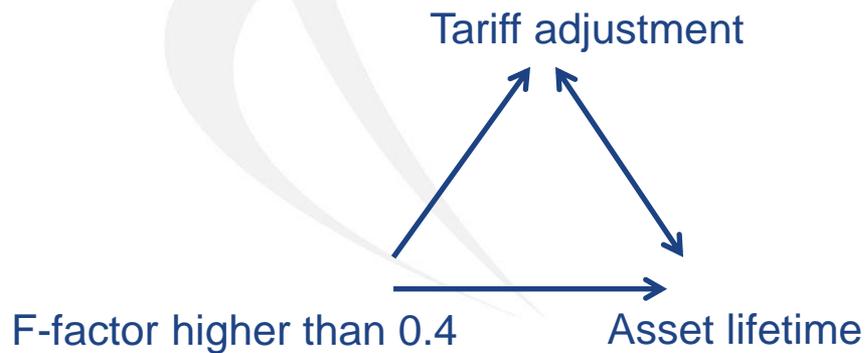
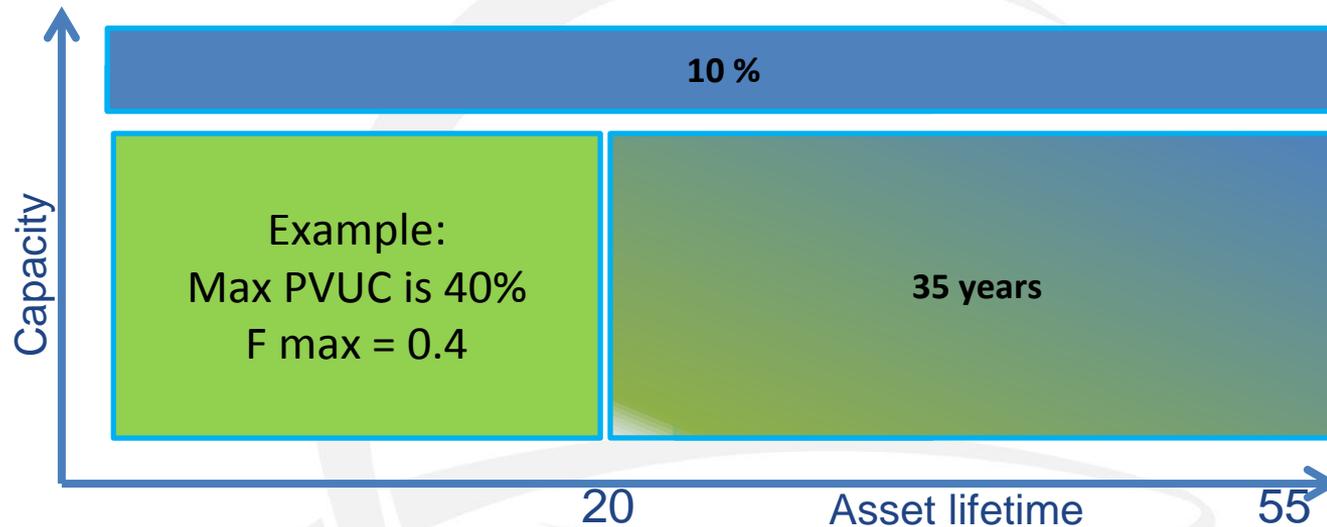
1-f part

= Will be recovered by either:

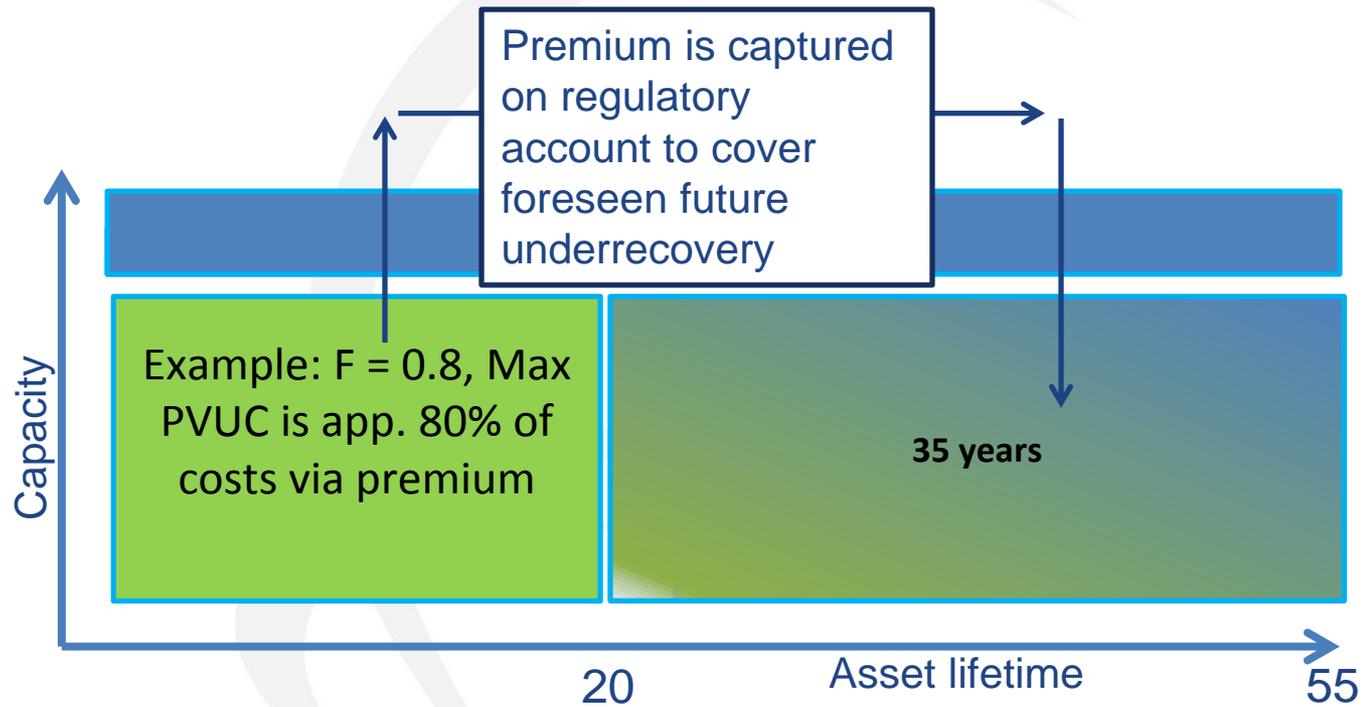
- Future bookings of the incremental/new capacity (being demand continuation or capacity reserved for short term)
- Tariffs payed at any other point(s) via socialisation
- Any other financing through appropriate payment guarantee mechanisms established by NRAs or Member States
- If non of the above can be ensured, the costs associated with 1-f needs to be decreased either by increasing f or by decreasing PVRR through e.g. EC subsidies

Base Case

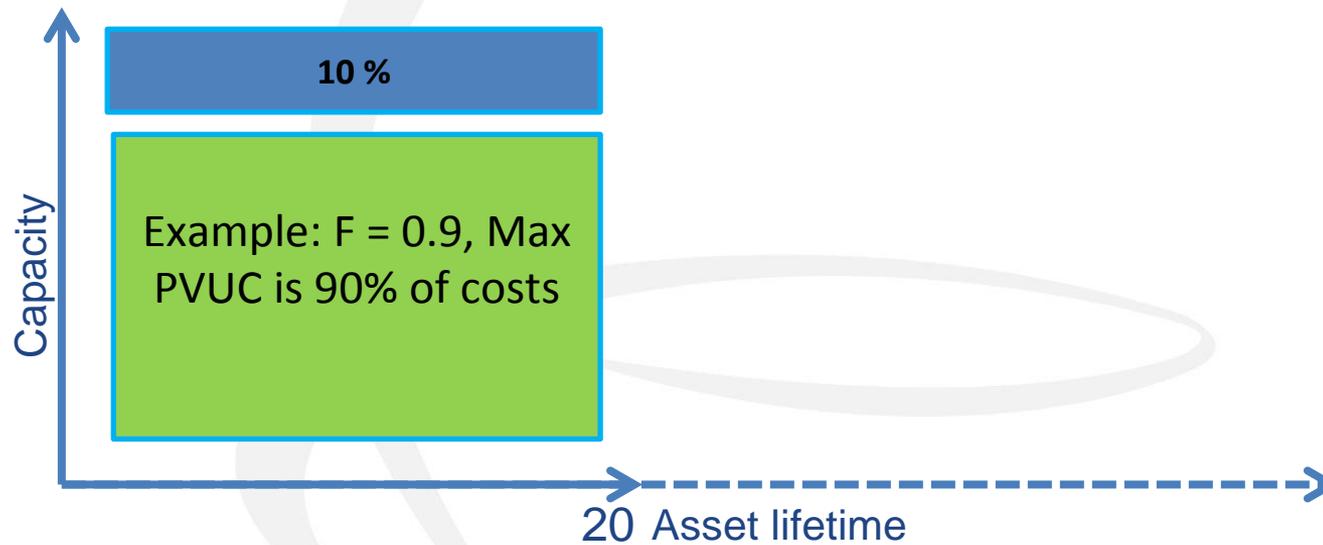
F-factor is limited if Economic Test is to be passed at reserve price



Case 1: Tariff adjustment



Case : Depreciation adjustment



Adjusting depreciation to future outlook

One mechanism for increasing PVUC/decreasing 1-f is an adjustment of depreciation times:

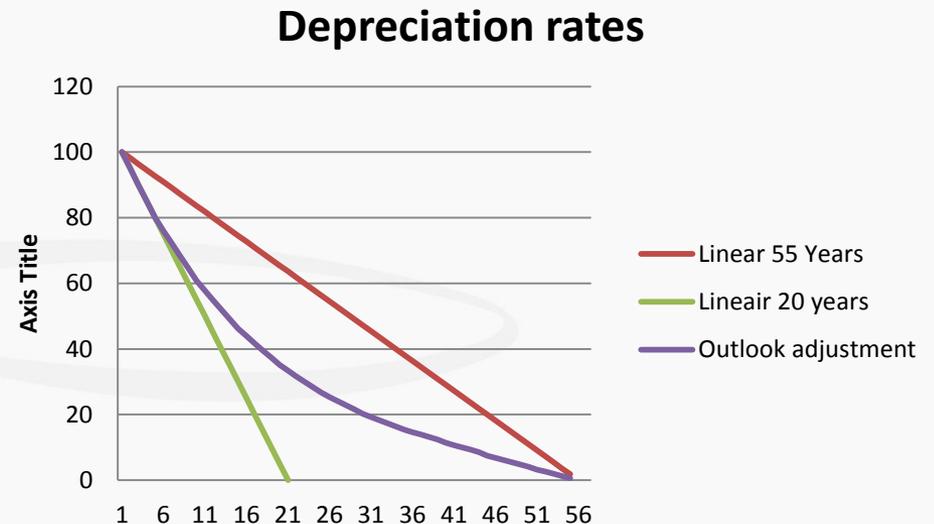
Outlook after FID and construction is

- 20 years of potential capacity income of which 10 years committed
- > 20 years of depreciation

Outlook after FID is

- 5 years construction
- 20 years of potential capacity income of which 10 years committed
- Improved outlook each regulatory period of 5 years

-> Adjustment of depreciation rate over 55 years of regulatory methodology



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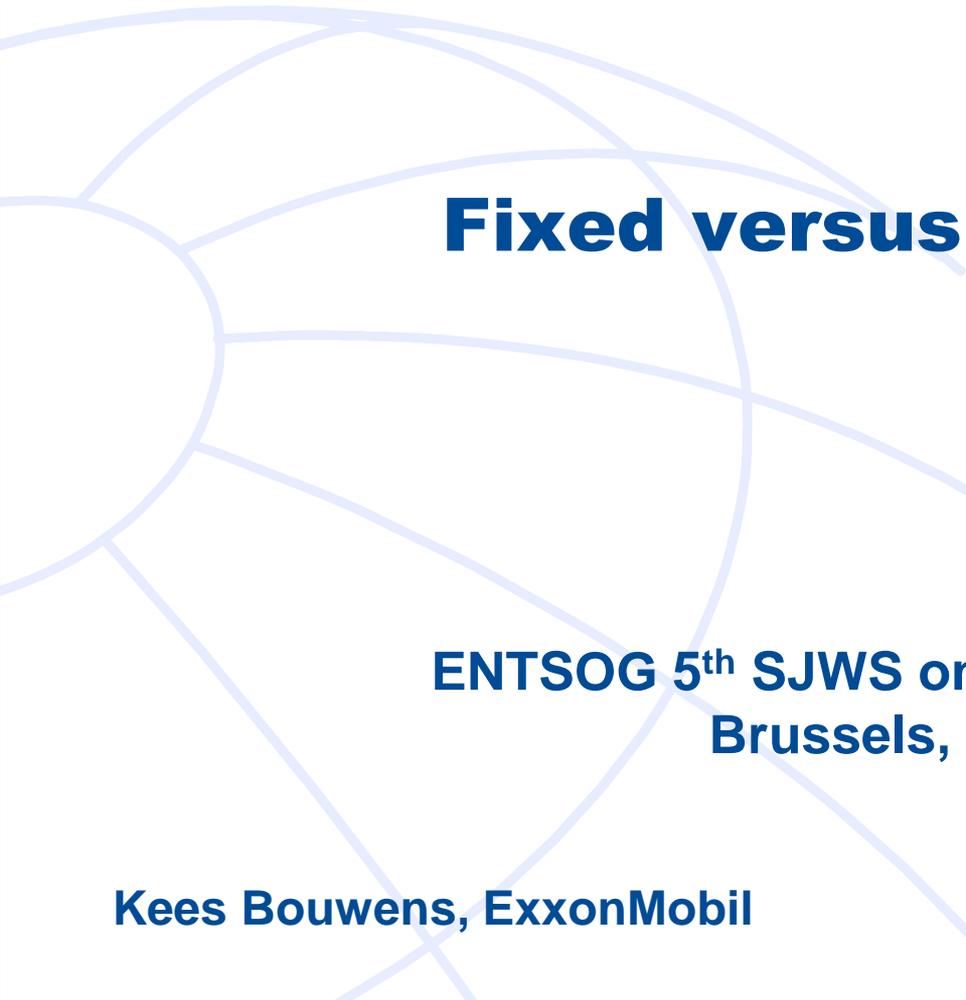
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A decorative graphic on the left side of the slide features several overlapping, light blue curved lines that resemble the arcs of a globe or a stylized sun. The lines are thin and create a sense of depth and movement.

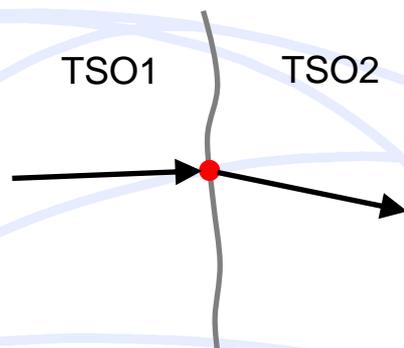
Fixed versus floating price

**ENTSOG 5th SJWS on Incremental Proposal
Brussels, 8 April 2014**

Kees Bouwens, ExxonMobil

- **Investments in incremental or new transmission capacity come as different projects**
- **Two extreme examples are presented to demonstrate that different projects need different rules**
 - Network code should be sufficiently flexible to deal with all potential projects for incremental and new capacity

TSO2 adds compression to expand capacity

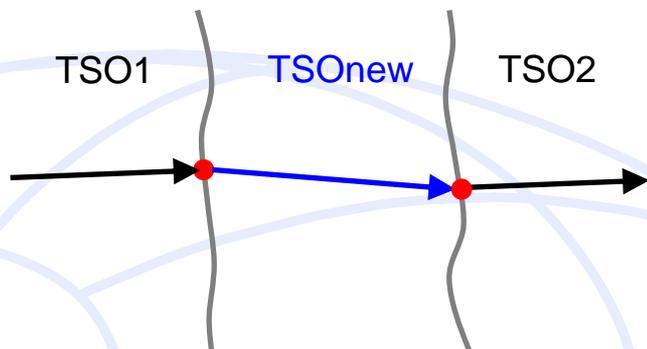


	TSO1	TSO2
reserve price	10	10
capacity	150	100 → 140
demand	120	120

- **In this example, a ‘floating’ tariff seems appropriate**
 - Network users booking additional capacity are subject to changes in cost allocation of the existing system
 - Exit tariff for TSO1 could be reduced due to improved IP utilisation

Project 2 – New interconnector

TSOnew to develop new interconnector between 2 existing systems



	TSO1	TSOnew	TSO2
reserve price	10	30	10
capacity	150	120	140
demand	120	120	120

- **In this example, tariff charged by TSOnew can be ‘fixed’**
 - Project can be financed when $PV_{UC} = PV_{AR}$ (f -factor = 1) and booking period matches depreciation period
 - TSOnew does not have captive customers
 - ‘Fixed’ tariff could be a flat or indexed rate, set at time of booking or some time thereafter (e.g. FID, financial close)
 - Another approach is to ring fence the project and apply a ‘floating’ price (TSOnew acts as ‘contractor’ for NUs) but this could limit expansions
 - Could be alternative to the Article 36 exemption route

Recommend to allow 'fixed' price



- **Network code should be sufficiently flexible to deal with all potential projects for incremental and new capacity**
 - TSO shall build sufficient capacity to accommodate all economically reasonable and technically feasible demands for capacity (Art. 13.2)
- **ACER guidance provides flexibility on several points e.g.**
 - Offer can be triggered by user indications as well as TYNDP
 - Facilitates both auction process and open season procedure
 - Economic test can be passed for f -factor from 0 up to 1
- **Network code should provide flexibility to allow a 'fixed' price for incremental and new capacity**

Thank you for your attention !

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Precondition for tariff adjustment

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

- Each economic test scenario should be designed in a way that the test can be passed if all incremental/new capacity on offer is allocated
- Default option (as stated in TAR FG) should be the application of a premium in the first year incremental/new capacity is on offer
- Alternative approaches are to be developed by ENTSOG (Sustainable depreciation)

Mechanisms for tariff adjustment

Approach	Advantage	Disadvantage
<p>Minimum premium for those participating to incremental process</p>	<ul style="list-style-type: none"> ➤ User that booked long-term capacity before investment was triggered are protected from tariff increases through investment 	<ul style="list-style-type: none"> ➤ Reduces willingness for long-term commitment as future offers will be cheaper
<p>Adjusting reference price for all users at the IP, except for those that have booked before initial offer</p>	<ul style="list-style-type: none"> ➤ User that booked long-term capacity before investment was triggered are protected from tariff increases through investment 	<ul style="list-style-type: none"> ➤ Complexity due to at least two different reference prices for the same product
<p>Adjusting reference price for all users at the IP</p>	<ul style="list-style-type: none"> ➤ Clear and simple process (one reference price for all users) 	<ul style="list-style-type: none"> ➤ Affects users that booked long-term capacity before investment was triggered

Merit Order?

Merit Order of tariff adjustment mechanisms:

1. Introducing a minimum premium
2. Adjusting the reference price except for those network users booking capacity before the initial offer
3. Adjusting the reference price for all users

Alternative:

- No merit order but application of mechanism based on individual assessment of requirements

Fixed vs. floating tariffs

- Fixed tariff as well as floating tariffs are possible following currently published Tariff Business Rules, but issue is still under discussion in Tariff work stream
- Incremental Proposal will reflect the principles defined for the TAR NC on fixed vs. floating tariffs
- As an assumption, Art 26.2 of NC CAM is used

Art 26.2 of NC CAM

The payable price determined in a capacity auction can be either a fixed price or a variable price or be subject to other arrangements provided for in the applicable regulatory regime. The fixed price shall consist of the applicable tariff at the time of the auction plus the auction premium. The variable price shall consist of the applicable tariff at the time when the capacity can be used plus the auction premium. The arrangements can be different for the capacities in a bundled product on either side of an interconnection point.

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7. Prime Mover Presentation OGP
8. Tariff Issues
- 9. Prime Mover Presentation Gazprom**
10. Open Season Procedures



**Prime Movers' vision on
intermediate results of
ENTSOG “Incremental Proposal”
*(why justified concerns of long-term
shippers / promoters of new capacity
are not yet taken into account?)***

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

**5th JSWS on ENTSOG “Incremental Proposal” (CAM NC amendment),
Brussels, ENTSOG, 08 April 2014**

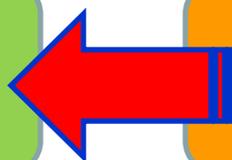


Creating new capacity in unbundled gas market: how to minimize investment risks & uncertainties to tolerable level for all parties in gas supply chain

	Bundled gas market	Unbundled gas market
Pricing mechanism	Cost-plus	(1) Net back replacement value (price indexation), (2) Spot/futures pricing
Who takes investment risk	End-users	Shippers & TSOs
Who manage capacity & commodity markets	VIC = in one face producer & supplier (commodity) & TSO (capacity)	Producers & traders (commodity) & TSO (capacity) => different parties in term commodity & capacity contracts
Comparative value of investment risks	Bundling minimizes invest. risks in creating new capacity (no contractual mismatch)	Unbundling objectively (by definition) increases invest. risks due to potential mismanagement of two markets (risk of contractual mismatch)

Economic background of our position & proposal

Demand for TSO coordination / cooperation /JV (between & within IPs) to provide for financeability of creation of new capacity





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

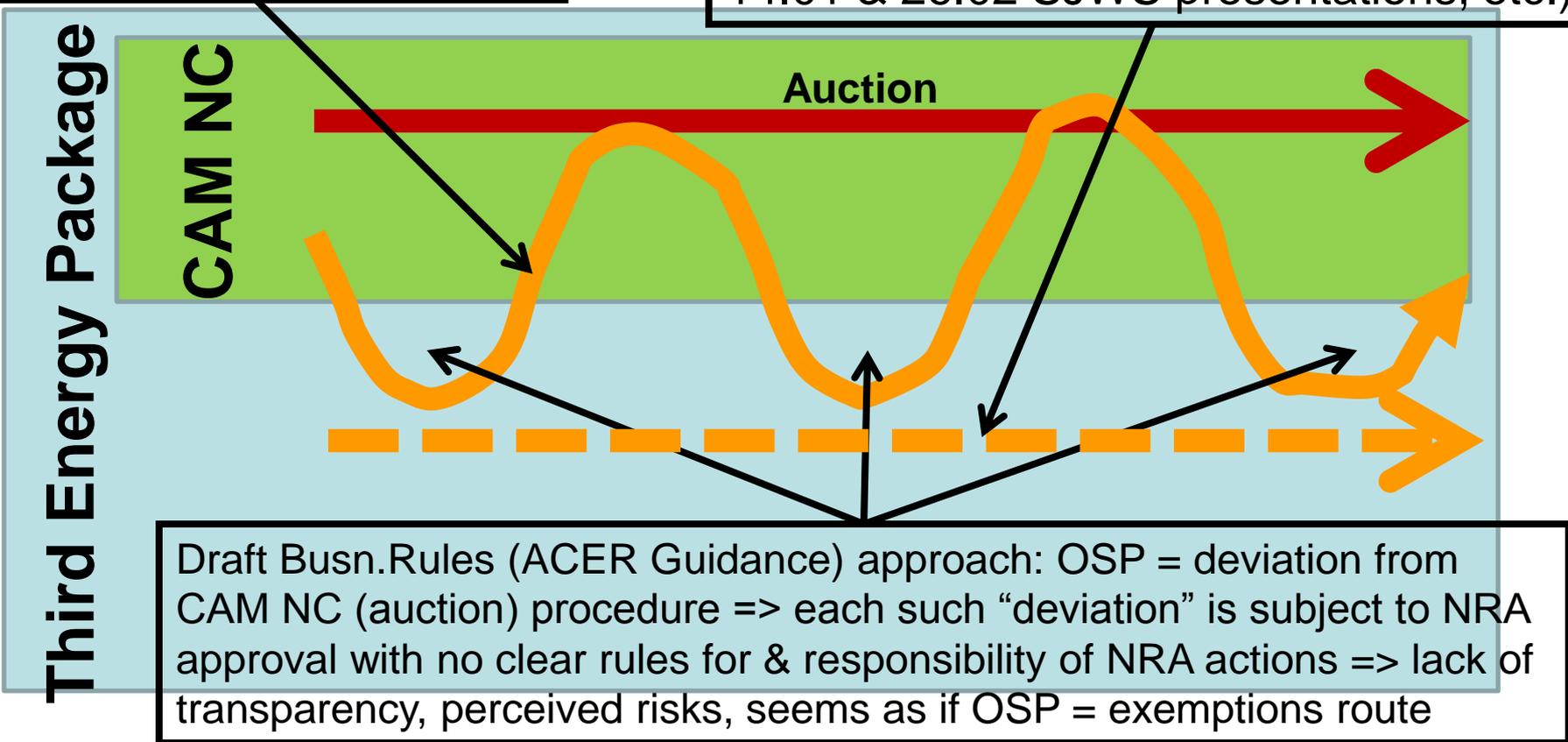
- “Auctions are the default mechanism for the allocation of incremental/new capacity” (Business Rules, art.III.1.5), but:
 - Incremental/new capacity = yet non-existing capacity,
 - To allocate non-existing capacity you should first create it, but CAM NC deals with existing capacity only => implementation 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 2nd/3rd 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

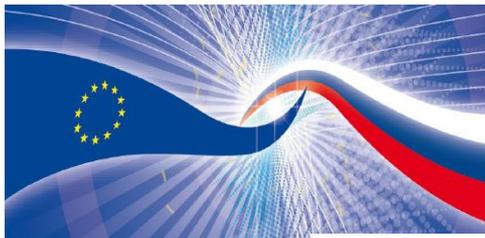
OSP (Strawman-based proposal)

- 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...

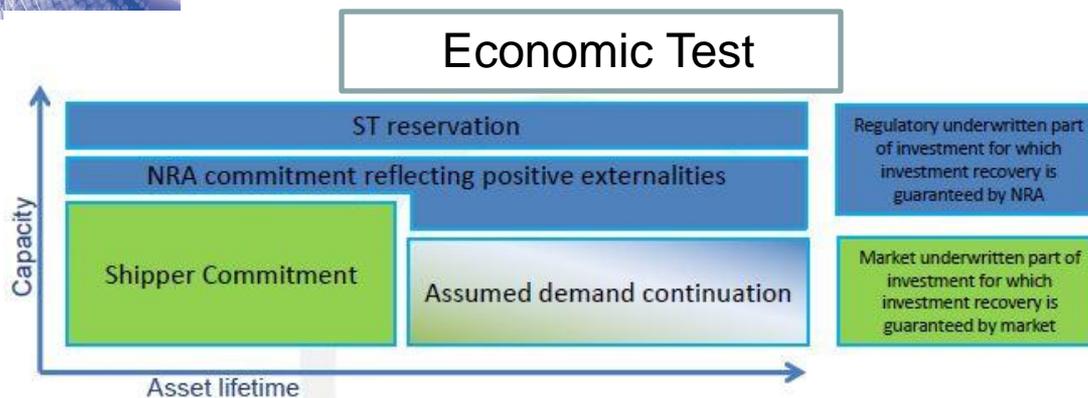
CAM NC + draft NC HTTS

- 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



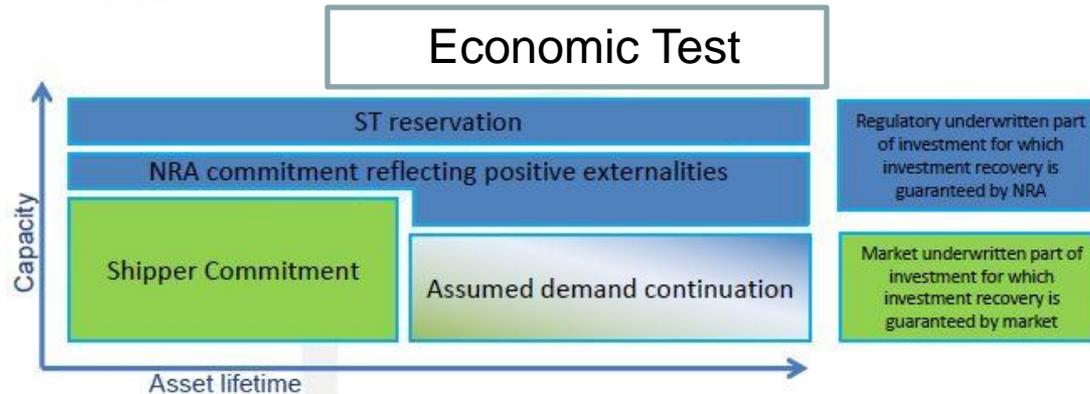
Floating Tariff Problems for Incremental / New capacity



- 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



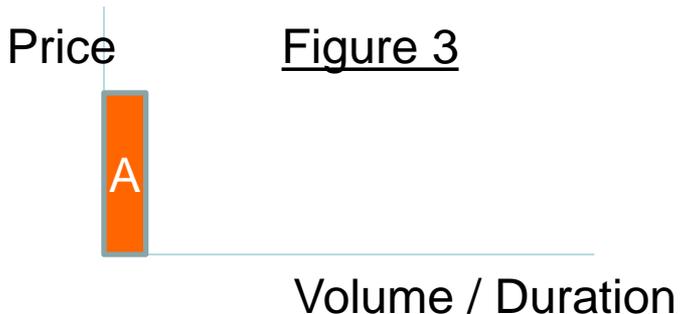
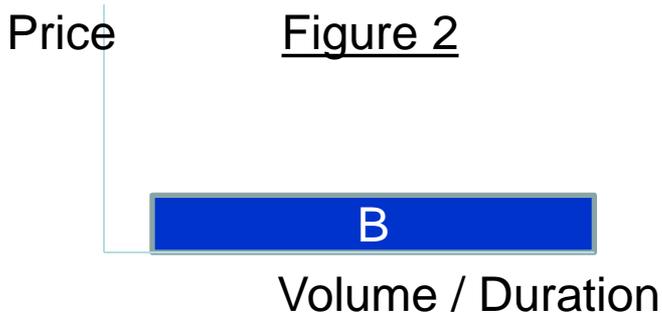
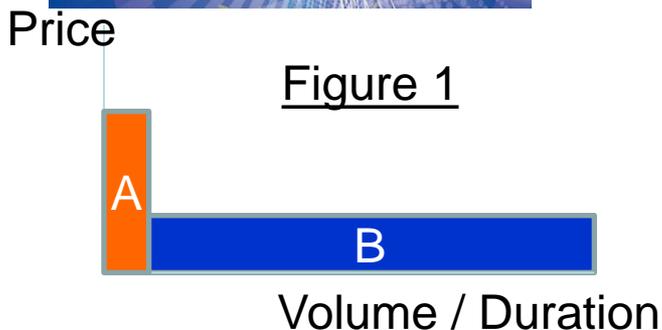
Potential Solutions to Floating Tariff Problems



- 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 2nd 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

Thank you for your attention

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- premier TRANSMISSION
- gaslink
- nationalgrid
- Interconnector
- BGE (UK) Ltd.
- ENERGINET DKK
- jordgas transport
- gasunie
- GRtgaz
- ontras
- gasunie
- Open Grid Europe The Gas Wheel
- nowega
- Thyssengas
- creos
- FLUXYS
- bayern
- terraneis bw
- FLUXYS
- GRTgaz
- SWISSGAS
- TIGF
- Infrastrutture Trasporto Gas
- pligovodi
- plinacro
- SNAM RETE GAS
- REN Gasodutos
- enagas
- Gasum
- GASSCO
- swede gas
- EG
- Vörguteenus maagaas
- LATVIAS GAZE
- Amber Grid
- GAE system
- UKRAINE UKRTRANGAZ
- eustream
- 3.E
- GAS CONNECT AUSTRIA
- TRANS-GAZ
- BULGARTRANS-GAZ
- FAMA
- DESFA

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- 10. Open Season Procedures**

Applicability of Open Season Procedures

- *Open Season Procedures are applicable when an auction process does not appear to be a robust approach. Example of such situations are provided in the Business Rules chapter 6*

Products on offer in Open Season Procedures

- *Extended booking horizon*
- *Joint offer of existing and incremental/new capacity*
- *Conditional commitments*

Principles and processes for the use of Open Season Procedures

7.

- 7.1. *The NRAs from the adjacent markets involved in the open season procedures shall monitor the Open Season Procedures until the technical conclusion of the project.*
- 7.2. *Open Season Procedures shall always aim to satisfy all expressed market demand as long as it passes the Economic Test described in article 9.*
- 7.3. *The Open Season Procedures shall offer capacity in a way that is accessible to the market in a transparent manner and on a non-discriminatory basis.*
- 7.4. *The Open Season Procedure shall consist of two phases: A preparatory, non-binding phase and a binding phase.*
- 7.5. *To ensure the transparency of Open Season Procedures, the TSOs in cooperation with the relevant NRA shall consult all relevant stakeholders on the Open Season Procedure;*
- 7.6. *A notice describing the different steps of the Open Season Procedures shall be publicised by the TSO to attract interest from stakeholders and be available at least in English. The notice shall contain at least the following general information:*

Principles and processes: The OS Notice

7.6 The notice shall contain at least the following general information:

- 7.6.1. *The start and end dates for making non-binding offers;*
- 7.6.2. *How to make non-binding offers;*
- 7.6.3. *How and when the Economic Test parameters will be determined*
- 7.6.4. *The procedure that will be applied to decide the level of allocated capacity to be allocated;*
- 7.6.5. *The allocation rules that will be applied in case the demand indicated in the open season cannot be fully met;*
- 7.6.6. *The date on which capacity allocations will be directed/assigned to open season participants;*
- 7.6.7. *The date by which open season participants have to sign a binding agreement;*
- 7.6.8. *Rules for the identification of the start date of the new or incremental capacity and the related rights and liabilities;*
- 7.6.9. *Drafts of the legally binding agreements;*
- 7.6.10. *The procedures and timetable for the ensuing regulatory approvals;*
- 7.6.11. *Regional coordination aspects;*
- 7.6.12. *Mechanisms to deal with cost-overruns;*
- 7.6.13. *Penalties applied to the TSO if capacity is not delivered on time;*

Outcome of SJWS 2 & 4

- A default allocation rule was deemed necessary
- Discussion on a merit order of 3 possibilities
 1. Willingness-to-pay per year
 2. Willingness-to-pay per user
 3. Alternative allocation rule
- Different point of views among stakeholders on this proposal

Refined suggestion supported by regulators

- Default rule is willingness-to-pay per year
- Fall back allocation rule to be applied if willingness-to-pay per year leads to a failed economic test. Different allocation rules can be used, but the method chosen must be:
 - Transparent
 - Non-discriminatory.
 - Taking into account the higher contribution of longer term booking to the economic viability of the project
 - Described in the Open Season notice (Information Memorandum)
- The NRA must ensure that this is the case

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Concluding remarks

**Next event:
Consultation workshop 24th June 2014
at ENTSOG offices**

**Mark Wiekens
Advisor, Market Area**

