

## EFET response to ENTSOG questionnaire on the Refined Incremental Proposal



21 November 2014

Question 1: Do you consider that the Incremental Proposal development process carried out by ENTSOG was appropriate, given the regulatory framework provided? In particular, was the level of stakeholder engagement appropriate? If there is room for improvement, please inform us about possible suggestions for improvement.

Yes	
<p>On balance, the level of stakeholder engagement has been appropriate. We appreciate the efforts of ENTSOG to involve stakeholders on a continuous basis and to produce high quality supporting documents, explaining the reasoning behind ENTSOG's decisions. In addition to these documents, however, a marked-up version comparing the initial incremental capacity draft with the refined proposal would have been helpful.</p> <p>In terms of content, <b>we welcome and support the fact that ENTSOG have included a fixed price option for the payable price for incremental capacity (Art. 17(20))</b>. It is disappointing that ACER closed down further discussion of solutions allowing for greater degree of predictability for tariffs for incremental capacity, such as fixed tariffs, fixed tariffs with indexation, fixed tariffs within a certain band, etc. To reiterate, floating tariffs for incremental capacity would require shippers to make open-ended financial commitments with no visibility whatsoever on the tariff for the newly developed capacity, for which they are taking development risk. This risks undermining the efficiency of the incremental capacity process.</p>	

Please complete the tables below, indicating whether you support the selected section of the Incremental Proposal, having regard to the process carried out and ENTSOG's aim to reflect the views of the majority of users during the development process. Please indicate the level of support by filling out one of the four following categories: Support, Partially support, No support, Neutral/no response.

*Please indicate your support for section 1: The articles of the existing CAM NC (Articles 1-20 & 21-28 of CAM NC)?*

Support	Partially support	No support	Neutral / No response
	√		

Please provide brief reasoning for your responses, if you wish

**Article 3**

We welcome the revised definitions of an 'economic test' (Art. 3(19)) and an 'open season procedure' (Art. 3(22)). We also agree with the deletion of the definition of a 'bidding ladder', which, in our opinion, was confusing and partially misleading.

**However,**

**Article 8(8)**

With respect to Art. 8(8), we do not think that it is necessary to have quotas of capacity set aside for the annual quarterly capacity auctions, given that the quantity of incremental capacity that is offered is variable and therefore, can meet the legitimate needs of shippers. All shippers are able to participate in the auctions and/or open seasons, and, subject to the economic test being passed, the requested capacity will be allocated. Furthermore, the implementation of Congestion Management Procedures prevents hoarding or market foreclosure as a result of long-term booking.

The inclusion of such quotas also impacts directly the functioning of the economic test by effectively increasing the f-factor. Whilst this issue has been partially recognised in the drafting of Article 44(1)(a) of the proposed TAR Network Code, it would be simpler to delete the requirement for quotas for incremental capacity.

**Article 11(8)**

In relation to Art. 11(8), one month should be a minimum advance notification period for TSOs to inform network users about the amount of capacity to be offered for each year for

the upcoming annual yearly capacity auctions. A minimum of one month is required for shippers to be able to prepare their bidding strategies and to gain the necessary internal approvals. The larger the potential commitments, the more time commercial companies would require to gain such approvals. Therefore, the text should state that one month is a minimum, and that TSOs should use at least 'reasonable endeavours' to give more notice.

Furthermore, we recognise the improvements made to Art. 27 of the draft TAR Network Code, in particular the new Art. 27(2), which requires at least the publication of indicative prices prior to the annual yearly capacity auctions. If indicative prices are the best ENTSOG can offer for now, however, the TAR Network Code should also include a 'best endeavours' obligation on TSOs to publish final reserve prices which closely equate the previously published indicative prices.

Despite these improvements, however, it would still be difficult for shippers to make informed decisions about how much incremental capacity to bid for, which would undermine the functioning of the economic test. Whilst Article 47(1) of the draft TAR Network Code attempts to remedy this deficiency by requiring publication of reference prices for incremental capacity based on 'relevant assumptions', it is highly questionable how reliable such published prices will be, as they rely on assumptions about capacity bookings and systems usage several years into the future. For example, the first year of capacity to be allocated will be at least 3 to 5 years after the date of the allocating capacity auction. Without ring-fencing the financial contribution provided by those shippers taking the long-term commitments that allow incremental capacity to become available - by means of fixed tariff - the risk is that the function of the f factor is ignored and made null. In a situation where in the year when the new capacity becomes available bookings at other points in the system decrease, the actual contribution to the marginal costs to deliver the incremental capacity would go beyond the level required by the f-factor, potentially to a point where the economic test would have not been passed.

#### **Article 17(20)**

Art. 17(20) states that 'successful network users shall pay the clearing price of the specific auction, which may be a fixed or variable price.' Whilst the drafting is correct within the context of the CAM Network Code and the proposed TAR Network Code, the use of a variable price will undermine the functioning of the economic test (see above).

We support ENTSOG's inclusion of fixed prices for incremental capacity. Variable prices would require shippers to sign an open-ended financial commitment for capacity bookings over several years, a number of years in advance of the date when the payable price will become certain. This increases the commercial risk for shippers and therefore, will inhibit bidding for incremental capacity. The solution is to allow a greater degree of predictability for tariffs for incremental capacity, such as fixed, fixed with indexation, fixed within a certain band tariffs, etc. If fixed tariffs were not included in the proposal, we would not have been able to support this section.

*Please indicate your support for section 2: General provisions (Art. 20a of CAM NC)*

Support	Partially support	No support	Neutral / No response
√			

Please provide brief reasoning for your responses, if you wish

We welcome the amendments to Art. 20a, in particular the incorporation of Art. 20a(6), which gives mandate to ACER to adjudicate when a decision on the joint capacity allocation procedure and/or on the required parameters for an incremental capacity project cannot be reached among the national regulatory authorities concerned. Furthermore, the new Art. 20a(2) and Art. 20a(3) also make it clearer when open season procedures will be applied instead of auctions.

*Please indicate your support for section 3: Demand assessment for incremental capacity (Art. 20b of CAM NC)*

Support	Partially support	No support	Neutral / No response
	√		

Please provide brief reasoning for your responses, if you wish

There should be a requirement for demand assessments to be carried out on an yearly basis, as opposed to the current requirement for demand assessments to take place only in even-numbered years (Art. 20b(5)).

Furthermore, whilst we recognise the organisational challenges for TSOs associated with the development of offers of incremental capacity, TSOs should be required to consider all capacity requests in good faith on a 'reasonable endeavours' basis, irrespective of due dates for non-binding indications.

TSOs should also endeavour to respond to any requests from shippers for capacity in a timely manner. The current draft requires TSOs to respond to non-binding demand indications within 8 weeks of receiving them (Art. 20b(3)). We would urge TSOs to respond as quickly as possible, and to use the two-month deadline as a maximum, not as a target deadline.

With respect to Art. 20b(4), whilst we recognise the role that payments, such as Preliminary Works Agreements, can play in enabling TSOs to conduct project scoping and planning work where the outcome of such work is uncertain, it must be made clear that such fees are subject to regulatory consultation and approval, and can only be charged for activities that are not already covered by a TSO's Allowed Revenue. Otherwise, there is a risk that TSOs will be able to charge shippers twice for the same activity.

Please indicate your support for section 4: Design phase for incremental capacity (Art. 20c of CAM NC)

Support	Partially support	No support	Neutral / No response
	√		

Please provide brief reasoning for your responses, if you wish

TSOs should be subject to provisions on ‘best endeavours’ to publish the parameters of the auction or open season for incremental capacity at least 2 months before the auction or the binding open season phase.

The design phase for incremental capacity does not seem to contemplate time for a public consultation, while the definition of the f element, at the very least, cannot be defined disregarding the views of market players, due to the broad implications it may have on all network users.

The harmonisation of TSOs’ schedules in relation to incremental capacity projects is currently not required. Clear requirements for the alignment of schedules should be incorporated in the design phase for incremental capacity provisions of the incremental capacity proposal (Art. 20c).

Information on the timing of realisation of new infrastructure should include the possibility for coordination of commissioning dates of both the commissioned infrastructure and related downstream/ upstream infrastructure. Without an incentive to optimise development costs that will be incurred by TSOs during the development phase, a formal coordination mechanism between the upstream system and the downstream system, as well as the shippers making the long-term commitment, allowing the incremental capacity to become operational, becomes an essential part of an efficient development mechanism.

Please indicate your support for section 5: Auctioning of incremental capacity (Art. 20d of CAM NC)

Support	Partially support	No support	Neutral / No response
	√		

Please provide brief reasoning for your responses, if you wish

Whilst the text appears to be clearer than the previous version, there remain concerns among some of our members about inconsistencies or conflicts that would arise in its practical implementation. It will therefore be important to work through the implications of this new text with market participants, so that the wording can be further improved before submission to Comitology.

*Please indicate your support for section 6: Open Season Procedures (Art. 20e + Art. 20f of CAM NC)*

Support	Partially support	No support	Neutral / No response
√			

Please provide brief reasoning for your responses, if you wish

Art. 20e should be consistent with the approved by regulators TPA exemption timescale, i.e. recognising that for TPA-exempt infrastructure capacity bookings of up to 25 years should be allowed.

*Please indicate your support for section 7: Economic Test principles and Tariff principles (Art. 43-47 of TAR NC)*

Support	Partially support	No support	Neutral / No response
	√		

Please provide brief reasoning for your responses, if you wish

**We welcome the fact that ENTSOG have included a fixed price option in the refined incremental capacity proposal. This is essential for making the incremental process work.**

We would encourage the adopting of a harmonised fixed tariffs approach for incremental capacity, as opposed to floating tariffs, as fixed tariffs could encourage longer-term commitments by network users. The use of floating tariffs will undermine the functioning of the economic test. Shippers will be required to sign an open-ended financial commitment for capacity bookings over several years, a number of years in advance of the date when

the payable price will become certain. This increases the commercial risk for shippers and therefore, will inhibit bidding for incremental capacity. The solution is to allow a greater degree of predictability for tariffs for incremental capacity, such as fixed, fixed with indexation, fixed within a certain band tariffs, etc. Such ideas have not been given sufficient consideration during the recent Stakeholder Workshops and have (so far) resulted in only an 'option' for TSOs to provide network users with the choice for a fixed tariff. The draft TAR Network Code should, therefore, create the obligation on TSOs to fix the payable price for the duration of the incremental capacity booking.

An additional and related obstacle to making long-term commitments is the anticipation of stranded incremental capacities, which may result from an f-factor that is set too low, or from other mechanisms to socialise the costs of investment.

#### **Article 43**

We have three main concerns with respect to the way the economic test is defined:

First, defining the f-factor as one figure entails giving the cost estimate underlying the economic test a significance that it does not have and it cannot have. Any credible cost estimate entails a contingency element that cannot be ignored. When complex projects are realised, normally part of this contingency turns into actual costs and more rarely in actual savings. For this reason, it would be wise to define the f-factor as a band, rather than as a single value. This would also help to avoid the need to run additional bidding rounds, as the band would allow a 'pass' in a broader range of booking combinations.

Second, defining the f-factor has implication on the tariff paid by the overall pool of network users of the relevant entry/exit system. Therefore, any decision in this regard shall not be taken without first running a public consultation. The risks of creating an unbalanced situation by setting the wrong f-factor is too high for such a decision to be taken without the market having a say.

Lastly, there is lack of clarity regarding the economic test. The principle should be harmonised, while the parameters should be fixed on a case by case basis. The launch documentation contained formulae on how the economic test works, but they have not been included in this ENTSOG proposal. We propose to include them in the final version. Where the discount rate is different from the WACC (weighted average cost of capital), this has to be fully justified and approved by the regulator, subject to industry consultation.

#### **Article 44**

Defining the f-factor has implication on the tariff paid by the overall pool of network users of the relevant entry/exit system. Therefore, a balanced approach is needed and the f-factor should be set in full consultation with the industry. We would like to highlight that too low an f-factor creates the risk of stranded capacities that are to be paid by the community of shippers, and that may hamper cross-border trade by rising IP tariffs. We should also caution against setting too high an f-factor, because this may make it difficult to pass the economic test even when investment in incremental capacity is economically efficient.

**Article 44(1)(b)**

Whilst we agree that it is important that externalities be taken into account when setting the f-factor (e.g. security of supply), it remains the case that shippers will be required, at some point, to pay the difference between revenues raised via capacity bookings and the allowed revenue associated with incremental capacity. For this reason, any externalities should be explained and justified. It is also important to explain how any shortfall in associated allowed revenues will be covered. This is particularly important, given the proposals for floating tariffs in the TAR Network Code.

**Article 44(2):**

Whilst we fully support the concept that TSOs should be able to recover their allowed revenues and earn the approved regulated return on their investments, this article appears redundant, given the other articles in the TAR Network Code which enable the TSOs to recover their revenue.

**Article 44(3):**

Article 44(3) puts all the risk on network users and removes all financial responsibility from TSOs regarding already engaged costs in case of a project failure. There should be a stronger financial incentive for TSOs to complete their project successfully. If not, this would be an incentive for TSOs to minimise the cost of projects that would be on the limit of the economic test, to get shippers involved, in order to get a chance to get additional revenues, as there is no risk for TSOs in case the budget is insufficient to complete the project.

**Article 45:**

Whilst we support the concept, we have reservations about the drafting of Article 45 of the TAR Network Code. Article 45 allows for different TSOs to have a combined economic test, and for redistribution of revenues between TSOs in the event that the economic test is not passed for one TSO in an investment involving two or more TSOs. This is to be welcomed. However, the drafting only says that transmission system operators 'may submit to the relevant national regulatory authorities for co-ordinated approvals the mechanisms for a redistribution of revenues from incremental capacity' (Art. 45(4)). This is potentially too weak and could prevent the realisation of investment that could further the internal gas market. Therefore, we propose that Article 45 should be strengthened to require the relevant parties to use 'best endeavours' to agree, with the possibility of adjudication by ACER or the EU Commission in the event of continued failure to agree.

It is not clear how this mechanism would impact revenue recovery of each involved TSO. This mechanism should not lead to a higher risk of tariff increases for shippers because of an investment project supported only by neighbouring TSOs.

**Article 46:**

We support the intention of this article, but we do not see how it will work in practice with regards to the estimated reference prices for the time horizon of the initial offer of incremental capacity (Article 46(1)(a)). It is highly questionable how reliable such estimates will be as they rely on assumptions about capacity bookings and systems usage several years into the future. For example, the first year of capacity to be allocated will be at least 3 to 5 years after the date of the allocating capacity auction. Given uncertainties about future system usage and booking behaviour, the projections referred to in this article will be of little value.

In addition, TSOs should be required to publish details of their investment costs and the



assumptions on which these are based, and network users should be invited to comment on these estimates. Investment costs are of particular relevance for the outcome of the economic test, and if they are inefficient or kept artificially high, they could jeopardise the success of an open seasons, to the detriment of competition.

**Article 47:**

The revised Art. 27 of the draft TAR Network Code requires the publication at least of indicative prices prior to the auctions. If indicative prices are the best ENTSOG can offer for now, the TAR Network Code, however, should at least include a 'best endeavour' obligation on TSOs to publish final reserve prices which closely equate to previously published indicative prices.

Despite these improvements, however, it would still be difficult for shippers to make informed decisions about how much incremental capacity to bid for, which would undermine the functioning of the economic test. Whilst Article 47(1) of the draft TAR Network Code attempts to remedy this deficiency by requiring publication of reference prices for incremental capacity based on 'relevant assumptions', it is highly questionable how reliable such published prices will be, as they rely on assumptions about capacity bookings and systems usage several years into the future. For example, the first year of capacity to be allocated will be at least 3 to 5 years after the date of the allocating capacity auction.

**Article 47(6)(c):**

TSOs and NRAs need to consult on this approach, if they decide to adopt it. Some limits must be introduced, as this article opens the way for subsidisation of projects by other users, and its relation with the f-factor is not clear. This mechanism should not be another risk weighing on global tariff levels.