

22 January 2007

Response to ERGEG consultation of 6 December 2006: Draft Guidelines of Good Practice on Open Season Procedures (GGPOS), an ERGEG Public Consultation Paper

EFET is keen to ensure that Open Season Procedures are utilised and carried out in a manner that is beneficial to the market and market players.

EFET welcomes a discussion on such an important issue. An Open Season, if conducted in a transparent and non-discriminatory fashion and used in conjunction with market information, is one tool to help Transmission System Operators (TSOs) determine the future need for investments. However, it may not become the only process guiding TSOs in their obligation to meet reasonable capacity demand growth.

There are a number of key principles that EFET considers important when considering Open Season procedures.

- It is EFET's understanding that an Open Season is an umbrella for two processes; information gathering and capacity allocation.
- Coordinated and timely decisions are essential with scope for users to demand additional processes.
- The process should allocate appropriate risks to users and to TSOs and requires approval and commitment from Regulators as well.
- Capacity investment should not be limited where such investment is economic and efficient.
- The principles for allocation of capacity must be known at the outset of the process.
- Although it is a heavy process, a frequent (e.g. every 2 years) repeated exercise is necessary in order to test and to meet changing users' requirements/needs.

Given these key principles, we have detailed some general comments on the consultation rather than tackle the specific questions.

Assessment of future capacity requirements

Open Seasons can be used in many circumstances; however, EFET considers that the detailed process described in the guidelines is only appropriate for major new infrastructure.

We would expect that the primary way a TSO (and other developers) would assess the future capacity needs for its infrastructure is through market analysis.

This analysis would use both current and forecast demand (which for a TSO will be heavily dependent on the extent of its pipeline connections to end consumers) and the expected sources of supply (e.g. from major new gas fields and import infrastructure projects which are generally known well in advance). The existing use of capacity and existing forward sales of capacity and the capacity prices (where these are market related) or otherwise existing tariffs at which these are already achieved may also provide important information that could be taken in to account.

The Open Season may be a useful additional tool that can be used to help assess future market expectations and/or ensure that at least the requirements of existing market participants and new entrants are fully met when the project size is determined. This is particularly the case when there are difficulties assessing the demand for larger infrastructure projects.

Indeed, the TSO may also wish to consider whether there is any hidden demand from players unable to make early commitments to capacity, but are likely to want capacity in short term allocations.

Coordination

We note the discussions in the Guidelines on TSO coordination. EFET believes that coordinated processes are absolutely essential for infrastructure investment that relies on investments involving connecting networks and other impacted markets.

Any potential reliance issues should be assessed early in the process and there must be a requirement to cooperate. Such cooperation has many benefits, including a better ability to narrow down expected tariff levels, provide more certainty on start dates and possibly create some synergies for TSOs from the more efficient use of existing infrastructure. It may, for example, allow for the more efficient investment by optimising design issues such as pipe sizes and compression levels.

Regulators also have a strong role to play in coordination with their adjacent homologues. This could include interactions on cross border issues, and the provision of timetables for decisions.

The decision to invest

Regulators will have a significant role in development consistent models for pricing and investment tests. The agreement of such rules will provide a better risk balance for participants in the Open Season process and for TSOs.

Market analysis is important for the assessment of risks that different market participants are willing to undertake. TSOs will wish to ensure that the investment is justifiable; Regulators will wish to ensure that the level of investment is not too low (causing constraints), or too high (exposing consumers to additional costs in the case of regulated assets). But Regulators should accept that once they agree on a project, TSOs are not penalised in case the project does not lead to the expected use of the new capacity delivered by the project, in which case Regulators then will accept a general increase of the tariffs.

For this reason, EFET believes that the market should understand the broad economic test that would apply to the investment decision. This would provide greater certainty for all parties and allow any negotiations between Regulators and TSOs to focus on more difficult marginal decisions.

Capacity allocation

EFET would expect that subject to published economic tests, user demand for new long term capacity will be met.

It should also be noted that an Open Season is itself not an allocation process, nor is there evidence that Open Seasons carried out so far have led to increased competition because the processes have been poorly designed and lacked clarity with respect to the role of the Regulators, insufficient coordination and unreliable timetables. Exactly how allocation will be carried out must be known before any Open Season process begins.

Potential users of new capacity might be asked at one extreme (or in one phase) just for non-binding expressions of interest, in which case there is no binding commitment from the TSO or from the shipper. At the other extreme (or in a later phase) the TSO asks potential participants for firm commitments, in which case the TSO must provide at least all the capacity that has been requested by the shippers. There is also the possibility to have rounds of interest where the tariff may move in line with the demand levels, which is in line with the existing UK very long-term allocation model.

As currently described, the Guidelines appear to allow undue discretion to the TSO in determining allocation. If there is a two step process then the basis of the final tariffs and the rules for allocation must be available at the first stage if meaningful expressions of interest are to be made. The current wording in the draft does not clearly provide for this even at the second phase, where auctions are still possible in order to allocate the capacity or where capacity reductions are possible on a pro-rata allocation.

In the second step, the (regulated) TSO must offer at least all the capacity that has been committed by the participants. New players might also wish to have capacity in the longer term, and if the market analysis shows that the total physical capacity required may be more than indicated by current individual players then the capacity built by the TSO should be at this higher level. A presumption of investment will reduce the chance of having to use pro-rata mechanisms which may leave all parties unsatisfied or encourage false signals through over-demanding capacity in a pro-rata process in order to ensure the desired level of capacity is obtained.

It should never be acceptable for the TSO to build infrastructure with less capacity than the participants have said that they need, and normally capacity should be the incremental size larger than the combination of shipper committed demands and market analysis.

The design of the Open Season must also ensure that there are not undue regulatory barriers to the timely construction of sufficient capacity, either through delays or through the lack of incentives and penalties on the TSO regarding their meeting all reasonable demands for firm capacity at any time.

Applicability

Open Seasons of the type described in this guidance note should be reserved only for major new infrastructure expansion for which market analysis needs to be complemented.

However, EFET does not believe that these guidelines should apply automatically to projects that are applying for exemption under Article 22 of the Second Gas Directive. There may be circumstances in which project developers do not wish to involve other parties. Article 22 requires that project developers satisfy national regulators and the European Commission that they meet the exemption criteria including that the project benefits competition. In such circumstances it should be up to developers to justify why they have not held an open season in accordance with the guidelines. This approach is consistent with the idea of using regulation only where necessary, and not imposing unnecessary regulatory burdens.

Major new infrastructure developments entail large costs for TSOs and risks for TSOs and system users. In many circumstances the market analysis and a well designed long term allocation mechanism could provide sufficient certainty on the economic decision to invest. However, where the level of uncertainty is high an Open Season could allow significant risk reductions if there is clear Regulatory guidance on acceptable risk levels for TSOs.

The Open Season procedure would be counterproductive for small or incremental projects or for investment to enhance the internal

transmission system in response to normal changes in internal demand levels or flow patterns. Having an Open Season for these projects appears to be a costly and time consuming approach that could be avoided by having better ways for users to signal long term incremental demand for capacity, and as said before, TSO have to meet reasonable capacity demands for domestic purposes.

Conclusion

EFET supports better Guidelines for Open Season procedures. Our comments reflect some concerns about the use and design of such procedures that may be counterproductive to the aim of efficient investment and the development of further competition.

There is a role for Open Seasons in the investment decision, but participants should expect to have greater clarity on the costs and expected outcomes from such procedures if they are to deliver better outcomes than in the past.

EFET Gas Committee