



CEER Blueprint for Incremental Capacity

Madrid Forum, 17.-18. April 2013

Context of the Incremental Blueprint

The Challenge:

Follow up to CEER Gas Target Model – calls for studying European processes for the identification of incremental capacity

The Environment:

Network Code on Capacity Allocation (of existing capacity) close to operational, bundled capacity ahead, Tariff FG, dynamic market environment with uncertainty in future supply and demand

The Task:

22. Madrid Forum requested presentation of a “blueprint” by CEER at the 23. Forum

The Blueprint Development:

Round tables, public consultation, close co-operation with ACER, ACER-commissioned Frontier Economics study



CEER Public Consultation

CEER Evaluation of Comments paper (December 2012) conclusions:

Blueprint objective:

- *Meet market demand for capacity while limiting the risk of stranded assets*



Key principles:

- *Clarity on when incremental capacity would be offered*
- *Design of the investment procedure as consistent as possible with auctions used for existing long term capacity*
- *Strong cross-border coordination to ensure project design is consistent and fits the market's needs*
- *Transparency on costs calculation and tariff setting*
- *Decision to invest based on the results of an economic test, known in advance by network users*



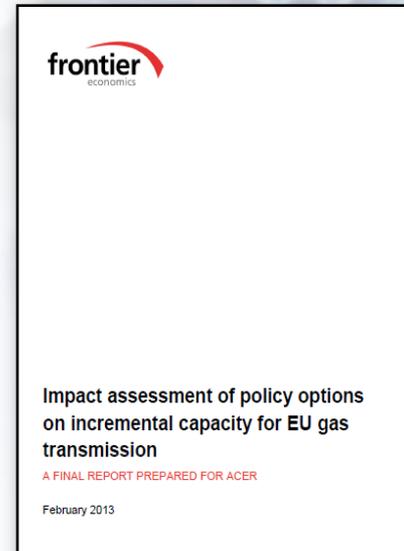
Frontier's Impact Assessment of options on incremental capacity (IC)

Process:

- *EC letter to ACER (June 2012): invitation to also assess IC within FG Tariff*
- *ACER tender & contract with Frontier Economics (Nov. 2012)*
- *Consultancy study steered by ACER/CEER, ENTSO-G, EC*
- *Release of final report in Feb. 2013*

Results & conclusions:

- *Study indicates benefits of a harmonised EU approach on IC (e.g. a faster provision of IC to the market)*
- *A **holistic treatment** of IC beyond Tariffs & Transparency is needed → strong links to NC CAM, TYNDP, EIP (e.g. CBA)*
- *Two proposals (on publication requirements and payable price) are being admitted in FG Tariff*
- *Assessed design options for IC (related to timing of the offer of IC, allocation method & economic test) fed into the drafting of the CEER blueprint*



Scope and Elements of Blueprint

Scope as CAM NC: Capacity at IPs...

...between entry-exit zones, between or within Member States, is encompassed by blueprint procedures.

Other network points...

...to storage, production, LNG, could be locations for blueprint procedures if supported by infrastructure operators and NRAs but not the focus of this work.

New capacity...

...where no IP exists between entry-exit zones also to be based on blueprint process.

Where investments are physical...

...however, blueprint principles also to be applied to assess capacity optimisation trade-offs (e.g. substitution, LT overbooking) where this is relevant.

Pure planning-based infrastructure...

...does not necessarily require economic test – blueprint principles optional. Capacity from such projects (e.g. to fulfil SoS standards) becomes “existing” capacity: no issue with marketing in CAM NC long-term allocation.

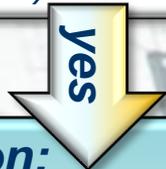
The Blueprint Structure

First phase question:

*Is there likely to be demand for incremental/new capacity?
(see criteria on next slide)*



Design, coordination, and offer of incremental/new capacity is inefficient and not needed. Existing capacity allocated according to CAM NC as usual.



Second phase question:

a) Is capacity needed for hub-to-hub transport,

or

b) is conditional capacity across more than two hubs likely to be taken up / a project of big size and great complexity required.



Second / third phase

Offer of incremental capacity integrated into the CAM NC algorithm (or new capacity offered in a CAM NC algorithm). Economic test applied to bidding ladders. Allocation according to auction.



Open Season; products and timings compatible with CAM NC; allocation rules needed for particular situations.

When incremental / new capacity shall be offered

Question of first phase:

Is there likely to be demand for incremental or new capacity, such that design and coordination of an offer and running the process is worthwhile?

One of following three criteria can initiate second phase:

- *Long term capacity at connection is sold out from year of first potential incremental offer for three subsequent years*
- *TYNDP and/or national NDPs indicate a long term physical transport requirement at connection, in the sense that more than one scenario show undersupply*
- *Shippers give non-binding indication through a defined window to TSO/NRA that they are willing to commit to capacity levels above existing capacity over long term (possibly beyond CAM NC 15 year allocation period)*

How incremental capacity shall be offered (1/3)

Question of second phase:

Is it feasible to integrate the incremental offer, economic test and allocation into the CAM NC algorithm?

Yes: *For settings where existing capacity between two entry-exit systems is to be enhanced: Integration into CAM NC allocation is the preferred option*

Not straightforward: *For more complex settings where conditional capacity demand extends over more than two entry-exit systems or project complexity and size warrant this: Open Season with products and timings compatible with CAM NC is more suitable*

How incremental capacity shall be offered (2/3)

Integration of incremental capacity offer into CAM NC long term allocation

Design decision on details to be taken; either:

- a) single bidding ladder
- b) parallel bidding ladders

Advantages:

- a) Minimal adjustments to the CAM allocation algorithm;
- b) allows for differentiated demand curves per increment and implementation with individual reserve prices when these are needed to pass economic test

Price step	Price	Y1		Y6		IC=0		Y5		IC=50		IC=0		Y6		IC=50		etc
		Supply	Demand															
21	2.0	150		150		150	200	150	200	150	200	150	200	150	200	150	200	
20	1.9	150		150		150	200	150	200	150	200	150	200	150	200	150	200	
19	1.8	150		150		150	200	150	200	150	200	150	200	150	200	150	200	
18	1.7	150		150		150	200	150	200	150	200	150	200	150	200	150	200	
17	1.6	150		150		150	200	150	200	150	200	150	200	150	200	150	200	
16	1.5	150		150		150	200	150	200	150	200	150	200	150	200	150	200	
15	1.4	150		150		150	200	150	200	150	200	150	200	150	200	150	200	
14	1.3	150		150		150	200	150	200	150	200	150	200	150	200	150	200	
13	1.2	150		150		150	200	150	200	150	200	150	200	150	200	150	200	
12	1.1	150		150		150	200	150	200	150	200	150	200	150	200	150	200	
11	1.0	150		150		150	200	150	200	150	200	150	200	150	200	150	200	
10	0.9	150		150		150	200	150	200	150	200	150	200	150	200	150	200	
9	0.8	150		150		150	200	150	200	150	200	150	200	150	200	150	200	
8	0.7	150		150		150	200	150	200	150	200	150	200	150	200	150	200	
7	0.6	150		150		150	200	150	200	150	200	150	200	150	200	150	200	
6	0.5	150		150		150	200	150	200	150	200	150	200	150	200	150	200	
5	0.4	150		150		150	200	150	200	150	200	150	200	150	200	150	200	
4	0.3	150		150		150	200	150	200	150	200	150	200	150	200	150	200	
3	0.2	150		150		150	200	150	200	150	200	150	200	150	200	150	200	
2	0.1	150		150		150	200	150	200	150	200	150	200	150	200	150	200	
1	0	150		150		150	200	150	200	150	200	150	200	150	200	150	200	

Source: Frontier based on an ENTSOG illustration

How incremental capacity shall be offered (3/3)

Open-Season Procedure

For capacity demand across more than two hubs, and/or big and complex projects, Open Seasons could be run.

- Products and timings to be aligned with CAM NC
- Same economic test applied to binding capacity requests as if integrated in CAM NC long term allocation
- Allocation mechanism needed when one “lumpy” project size step is oversubscribed, but next size not economic:
 - Ex-post allocation in CAM NC, or
 - Pro-rating, or
 - Shippers provide full demand curves, allocation according to willingness-to-pay

Economic Test

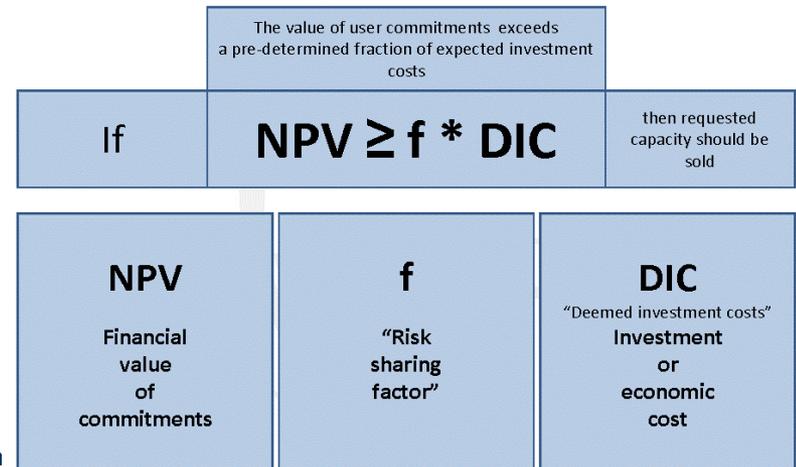
...looks whether financial value of future commitments from shippers covers adequate proportion of projected infrastructure cost.

...parameters of the economic test are to be coordinated and published before bids for incremental capacity are taken.

Single economic test for bundled capacity:

- *Threshold parameter harmonisation not efficient due to differences: network topology (investments required), market setting (e.g. presence of captive demand), regulatory framework (e.g. depreciation, WACC)*
- *NRAs and TSOs cooperate in setting the parameters*

Conceptualising the market test within a regulatory framework*



* Please see ENTSOG policy paper INC0016-12 Policy note on market test and regulatory framework for more information

Cross-border coordination

TSO coordination on technical aspects:

- Achieve consistent project design allowing for the maximisation of the offer of bundled products

TSO coordination on procedural aspects:

- Coordinated information provisions
- Single point of contact for shippers
- Joint publication of the results of the investment process



Sharing of information between TSOs/NRAs on economic aspects:

- How investment costs were calculated
- How the risk of delays are dealt with in the respective regulatory framework and how the liability regimes are designed
- What is the magnitude of external benefits and, if appropriate, how it was taken into account in the design of the investment process
- How tariffs were set

Tariff Issues

Starting point is the use of usual reference prices at existing IP, as per Tariff Structures FG

Toolbox potentially necessary to address issues:



Socialisation of cost:

- *Positive externalities charged from consumers by RAB roll in. Can be made explicit by changing 1-f in the formula or quantifying surrogate cash flows*

If cash flows to be expected from reference price unlikely to pass econ. test:

- *Raise reference price for all / for new shippers*
- *Apply minimum auction premium*

Discrimination between existing shippers and new shippers:

- *If existing shippers are locked into high premium, and incremental is allocated at reference price, premium for existing shippers could be adjusted*

Uncertainty about evolution of regulated price:

- *Transparency important*
- *Fixed or indexed prices to be applied for incremental only? Requires under/over recovery mechanisms*

Way forward

- **CEER blueprint paper to be published after Madrid**
- **Public CEER/ACER Workshop on 6 June 2013**
- **Written feedback from stakeholders welcome**
- **Work to be continued under ACER label as of 2014**