

Analysis of Decision Document for Stakeholder Support Process on Refined Draft Incremental Proposal

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1. Introduction

This document accompanies the refined draft Incremental Proposal, reference INC00200-14, to be submitted to the Agency for Cooperation of Energy Regulators (ACER). The document is for information purposes only; it is not part of the Incremental Proposal and should not be interpreted as a commitment from ENTSOG nor an interpretation manual.

The refined Incremental Proposal has been prepared by ENTSOG, an organisation currently comprising 44 Transmission System Operators and 3 associated partners from 26 European Countries, in line with its duties under Articles 6 and 7 of the Regulation and following the receipt of the invitation letter dated 19 December 2013 sent by the European Commission (EC) to draft an incremental proposal amending the network code for Capacity Allocation Mechanisms (CAM NC) and delivering a part of the TAR NC on the parts concerning incremental capacity.

This document shall not be construed as part of the refined draft Incremental Proposal, nor should it be considered to give rise to any specific right or obligation whatsoever to ENTSOG or any of its members as to any stakeholders.

The purpose of this document is to clarify the chosen policy approaches, decided upon by ENTSOG, in relation to significant topics in the refined draft Incremental Proposal. It explains the refinements comprising the refined draft Incremental Proposal, further to the public consultation on the initial draft Incremental Proposal held between 28 May and 30 July 2014 (ref. INC00164-14).

The Incremental Proposal is written as a legal document, similar in style to the version that will eventually become law once the final Incremental Proposal has passed through a review by ACER and the comitology process pursuant to Regulation (EC) No 715/2009 ('the Regulation'). The refined draft Incremental Proposal does not contain explanatory material. ENTSOG has therefore produced this decision analysis document to explain, where deemed necessary, the rationale for certain decisions made during the preparation of the Incremental Proposal including where relevant a short analysis of the issue at stake.

In the case of any doubt, the wording of the refined draft Incremental Proposal itself takes precedence over this accompanying document.

ENTSOG has sought, as far as possible, to amend the CAM NC in line with the ACER guidance to ENTSOG on the development of amendment proposals to the Network Code on Capacity Allocation Mechanisms on the matter of incremental and new capacity and the ACER Framework Guidelines on rules regarding harmonised transmission tariff structures for gas.

1.1. Organisation and timing

The timescales for this process are set out fully in ENTSOG's project plan and revised project plan, both available on the ENTSOG website.

The majority of the work on the documents has been carried out by members of ENTSOG's Incremental Capacity Advisory Kernel group in the Capacity Working Group, with support from its technical sub-groups (kernel groups).

1.2. Consultation and expertise

In line with its internal process and in compliance with the Regulation, ENTSOG has engaged extensively with market participants and participated in events in order to publicise the process and encourage full stakeholder involvement, both prior to and throughout the whole process.

In the network code project plan consultation, all market participants were invited to register to participate in the process of developing the Incremental Proposal. Market participants, representing all levels of the gas value chain, including producers, traders, network users, and end users, expressed strong support for ENTSOG's process and stated that they were very satisfied with the level of interaction between ENTSOG and stakeholders during the code development.

Additionally, ENTSOG has held regular working level discussions with ACER and the EC in order to clarify the intent of the Regulation and the ACER Guidance. It has aimed to ensure, as far as possible, that the ACER Guidance is compliant with the provisions of the Regulation and in line with the FG. It should also remain robust, technically and legally workable, supported by

stakeholders, and contribute to non-discrimination, effective competition and efficient functioning of the market pursuant to Article 6 (2) of the Regulation.

1.3. Stakeholder views

In accordance with the Regulation and ENTSOG's statutes, stakeholders' views have been integral to the decisions made during the development of the Incremental Proposal and as such are described throughout this document when explaining the rationale for the options selected.

Detailed information on the stakeholder comments received is published on the ENTSOG website.

2. Scope and Objectives

The objective of the Analysis of Decisions Report (AoD report) is to provide explanations for why certain consultation inputs and feedback provided by stakeholders on a bilateral basis or at the public workshops held by ENTSOG have been incorporated in the refined draft incremental proposal and why others have not.

Each theme is therefore divided into different sections: As a start, ENTSOG elaborates and summarises the stakeholder feedback received on the specific issues. This is followed by a reference to the relevant sections in the ACER Guidance or the Tariff FG explaining the requirements set out by the regulators and subsequently by an analysis comparing and evaluating stakeholder views, ACER requirements and the position of ENTSOG. Finally, each theme ends with a conclusion that is explaining the outcome in the sense of requirements defined in the refined Incremental Proposal

3. Rationale for policy choices within the Draft Incremental Proposal

On 28 May ENTSOG launched a public consultation on the initial draft Incremental Proposal. The consultation closed on 30 July. The 21 consultation responses formed key input for ENTSOGs

Incremental Capacity Advisory Kernel Group in the process of refining the draft Incremental Proposal.

The 21 respondents indicated good support for the scope and substance for the draft Incremental Proposal. The majority of respondents expressed support to most of the approaches taken by ENTSOG. Stakeholders also raised some issues of concern that they would seek to address in the draft Incremental Proposal. In this context, ENTSOG decided that the most efficient and effective way to address stakeholder feedback was review the issues by topic. The questions therefore built on the summarised responses as illustrated by the Report on analysis of responses to the incremental proposal (Document INC 0185-14).

3.1.1. Subject matter, Scope and Definitions of CAM NC amendment

ADDITIONAL DEFINITIONS PROPOSED TO CAM NC

➤ Stakeholder feedback

A large group of stakeholders commented on the additional definitions to CAM NC that were suggested by ENTSOG in the initial Draft Incremental Proposal. The majority of the responses regarding the definitions aimed at providing suggestions on how to improve the definitions in order to clarify the underlying concepts.

Regarding the definition of the term 'open season procedure', some stakeholders suggested the deletion of the definition while others requested a clarification of the definition to specifically include also a non-binding phase. For the term 'bidding ladder' it became clear that a different understanding of the term exists among stakeholders and ENTSOG.

➤ Requirements from TAR FG and Guidance on Incremental Capacity

The TAR FG and the ACER Guidance provide draft definitions for most of the terms used to explain the general concepts included in the documents. ENTSOG has taken these definitions as a basis for the definitions taken in the refined Incremental Proposal.

➤ Analysis of issue

ENTSOGs understanding of the consultation feedback is that there is no general disagreement with the underlying concepts of the additional proposed definitions to the CAM NC. ENTSOG has taken into account the consultation feedback in order to refine the definitions in a way that allows a better understanding of these concepts.

Regarding the definition of ‘open season procedures’ ENTSOG is of the opinion that a definition does help to clarify the concept and agrees to the point raised by some stakeholders that a non-binding phase should be prescribed as a mandatory step of an open season procedure. This is especially important as the non-binding phase allowing a constant interaction of TSOs, network users and regulators is the major difference between an open season procedure and the standard ‘auction-based’ incremental capacity process.

Regarding the term ‘bidding ladder’, ENTSOG wants to avoid misunderstandings among stakeholders and TSOs, especially as the term was only used to describe a combination of capacity products over a certain period of time. ENTSOG is of the opinion that the concept of auctioning different incremental capacity offer levels in parallel to each other can be explained sufficiently clear without such a definition.

Regarding the differentiation between incremental capacity and new capacity, the process set out in the refined Incremental Proposal does not provide any different treatment of the two concepts. For this reason, such a differentiation is not needed.

➤ Outcome and conclusion

ENTSOG has clarified the additional definitions in CAM NC and has deleted the definitions for new capacity, which was integrated into the definition of incremental

capacity, and bidding ladder, for which the concept is explained in the respective articles.

3.1.2. Articles 4-20 and 21-28 of CAM NC

APPLICATION OF SHORT TERM RESERVATION QUOTAS TO INCREMENTAL CAPACITY

➤ Stakeholder feedback

Some consultation respondents stressed that a short term reservation for incremental capacity would not be efficient as it might impose an obstacle to passing an economic test if incremental capacity cannot be booked in the initial auction and can thus not increase the value of user commitment. Furthermore, incremental capacity should be based on the demand of network users meaning that either the demand for the reserved share of incremental capacity cannot be fulfilled in the initial auction or that the reserved incremental capacity needs to be offered in addition to the actual demand, which might not be needed in the end.

It was however also stressed by individual stakeholders that a short term reservation of incremental capacity would help new market entrants to gain capacity and thus increase competition in a market.

➤ Requirements from TAR FG and Guidance on Incremental Capacity

The TAR FG require that TSOs and NRAs shall take into account the short term reservation of capacity when setting the level of the f-factor. Furthermore, CAM NC is already defining a minimum reservation quota of 10% for 'new' capacity, which is now re-defined as incremental capacity.

➤ Analysis of issue

ENTSOG understands the argumentation provided by a large group of stakeholders for not including a short term reservation for incremental capacity. A reservation of

incremental capacity for short term capacity auctions would increase the level of uncertainty on future demand for the incremental capacity and therefore imposes an obstacle for passing an economic test.

Nonetheless, ENTSOG notes that a short term reservation for 'new' capacity is included in the existing CAM NC and that the discussions on this issue have been concluded at the time of the drafting of the CAM NC. Furthermore, the ACER Guidance and the bilateral feedback of ACER and EC make clear that short term reservation quota also for incremental capacity is required in order for the Incremental Proposal to be acceptable to them. In the context of the proposed amendment of CAM NC on incremental capacity, the only change to this article is substituting the term 'new capacity' with the term 'incremental capacity, in order to align it with the definitions used.

➤ Outcome and conclusion

Based on the argumentation above, ENTSOG has decided not to change the mandatory quota for the reservation of incremental capacity for short term auctions of at least 10%.

3.1.3. General provisions – Article 20a of CAM NC

CHOICE OF OPEN SEASON PROCEDURES OR AUCTIONS

➤ Stakeholder feedback

A few stakeholders requested the subject matter and scope of CAM NC to define auctions and open season procedures on an equal level instead of providing an auction default with an alternative open season procedure only in case of specific circumstances. The proposed concept included a clear separation of cases by a 'Chinese Wall' between a standard auction approach for 'simple' incremental capacity project that involves only two entry-exit systems and a flexible open season approach for more complex 'mega-projects' involving several IPs or entry-exit systems along a route.

It needs to be highlighted that other stakeholders responded in opposition to this proposal, requesting a clear limitation of open season procedures and a default auction approach.

➤ Requirements from TAR FG and Guidance on Incremental Capacity

The ACER Guidance requests a default auction approach for the allocation of incremental capacity and an alternative for open season procedures in cases where auctions do not seem to be a robust approach due to the high complexity of a project. Furthermore, the ACER Guidance is asking ENTSOG to elaborate on this principle by providing clear criteria that can be applied in order to decide on whether to apply an open season procedure.

➤ Analysis of issue

ENTSOG has followed the request of the ACER Guidance to define clear criteria for choosing an open season procedure. These criteria are aiming at evaluating the complexity of a project, giving the possibility to address specific requirements of more complex projects in an open season procedure.

ENTSOG is not of the opinion that a 'Chinese Wall' between a standard auction approach for simple project and an open season approach for complex mega-projects is in the interest of the majority of stakeholders. ENTSOG thinks that the NC should provide criteria that provide enough flexibility to apply the best suitable procedure for each individual project.

➤ Outcome and conclusion

ENTSOG has made the criteria for choosing an open season procedure more clear in order to make the choice more mechanistic. This approach allows TSOs to apply the most suitable procedure for each project while at the same time avoiding inconsistencies between the involved TSOs.

3.1.4. Demand assessment for incremental capacity – Article 20b of CAM NC

FREQUENCY OF DEMAND ASSESSMENT FOR INCREMENTAL CAPACITY

➤ Stakeholder feedback

A large group of stakeholders stressed in their feedback to the public consultation that the proposed bi-annual demand assessment for incremental capacity is not sufficient as it could lead to long time gap between the demand indication and the actual availability of capacity. While stakeholders supported in general the principle of a standardised demand assessment across the EU, they were not aligned on what an appropriate frequency for such a demand assessment would be. The proposals made by stakeholders included among others a 'direct-response bases', a 'best-effort approach' and an annual demand assessment.

➤ Requirements from TAR FG and Guidance on Incremental Capacity

The ACER Guidance provides the three criteria that should lead to the offer of incremental capacity if met, which have been taken into account by ENTOSOG in the Incremental Proposal. In addition to this, ENTOSOG in co-operation with stakeholders during the Stakeholder Joint Working Sessions developed the process of a standard demand assessment report. The demand assessment report will suggest offer levels for incremental capacity based on the three criteria given in the ACER Guidance. The demand assessment report shall be compiled and published in a co-ordinated way across the entire EU with the aim to aggregate the demand of several network users in order to make a potential project more efficient.

➤ Analysis of issue

ENTOSOG considers that a bi-annual demand assessment is the most efficient frequency, as this would suit best to the time required for a usual incremental capacity project. A bi-annual demand assessment would thus prevent an overlap of different incremental capacity projects for a single TSO which could influence each other.

ENTSOG does however also understand the position of stakeholders requesting a more frequent possibility to trigger an incremental capacity project. In case a network user is willing to commit for capacity resulting out of an investment, TSOs should be willing and obliged to assess whether this capacity can be provided to the network user within an appropriate time frame.

For the reasons stated above, ENTSOG regards a combination of a standard process and a direct-response process as the most efficient way to address the demand of network users for incremental capacity.

➤ Outcome and conclusion

ENTSOG concluded that the proposed bi-annual demand assessment should be kept as a standard way to trigger potential incremental capacity projects based on the aggregation of demand for incremental capacity of all network users. This standard process should be conducted in a co-ordinated manner between neighbouring TSOs and within a specified time frame defined in the NC.

In addition to this standard process, the refined Incremental Proposal also foresees a possibility for network users to trigger incremental capacity projects on an individual basis. The Incremental Proposal requires TSOs to respond to each received non-binding demand indication within a period of 8 weeks with the following merit order:

1. Whether the indicated demand can be included in an incremental capacity project currently being conducted;
2. If (1) is not the case, whether the indicated demand is sufficient to initiate an incremental capacity project solely based on the indicated demand;
3. If (2) is not the case, in which demand assessment the indicated demand will be taken into account.

In order to avoid inefficient technical studies for projects based on the demand indicated by a single network user which might not actually lead to a capacity commitment, the Incremental Proposal still foresees the possibility for TSOs to charge study costs to network users requesting an incremental capacity project. The fees paid by these network users will be reimbursed if the incremental capacity is actually contracted once offered. This procedure is compatible with point 1.7 of Annex I of Regulation (EC) 715/2009.

In close co-operation with stakeholders, ENTSG developed this combination of a standard and a 'direct response' process and believes that it provides enough flexibility for network users for indicating demand for incremental capacity.

Frequency of demand assessment

- ENTSG sees it as impossible to have a credible full incremental process within 12 months, meaning that incremental process would potentially overlap while interactions may prevent a stable set of data and parameters from being established
- In contrast, a demand assessment every two years would enable in most cases that the previous incremental cycle closes before a new one opens



STAKEHOLDER INVOLVEMENT IN THE INCREMENTAL PROCESS

- Stakeholder feedback

A large group of stakeholders expressed the opinion that the level of stakeholder involvement along the incremental process as set out in the initial draft Incremental Proposal i should be extended.

A proposal that was made by most of these stakeholders is the inclusion of a public consultation of the relevant parameters of an incremental project in order to allow network users to provide input to the design of the project.

➤ Requirements from TAR FG and Guidance on Incremental Capacity

The ACER Guidance calls for an efficient and transparent process to be defined for the offer and allocation of incremental capacity as an amendment to CAM NC. Besides this general remark, no clear requirement for a public consultation of the parameters of an incremental capacity project is included in the ACER Guidance.

➤ Analysis of issue

ENTSOG is committed to drafting a transparent process and supports the involvement of network users in the process of designing incremental capacity projects in an efficient manner which allows network users to provide input but at the same time does not lead to unnecessary delays of the process.

Besides this, the level of network user involvement would potentially differ for individual projects based on the level of complexity and the effects of a project for the system and the market. Thus, it might be necessary to define a longer project development timeframe which allows sufficient co-ordination between TSOs, network users and regulators for more complex projects. ENTSOG is therefore of the opinion that the Incremental Proposal should provide enough flexibility to use the tools provided in the regulation in the most efficient way for each individual incremental capacity project. Furthermore, the Incremental Proposal does provide a process for more complex projects which includes an iterative co-ordination between TSOs and network users, being the open season procedure.

➤ Outcome and conclusion

Based on the consultation feedback, ENTSOG has decided to include an obligatory public consultation of stakeholders in the refined Incremental Proposal. The consultation aims at gathering from network users clear indications on the key-factors to be taken into account in the design phase of an incremental capacity project and allowing them to provide suggestions on how to improve a potential incremental capacity project. Moreover, the consultation permits a cross-border coordination of the demand assessment reports and provides a definite indication on the allocation procedure to be adopted.

This obligatory consultation shall be conducted jointly by either the involved TSOs or the involved NRAs as applicable before the actual design phase of an incremental capacity project.

3.1.5. Design phase for incremental capacity – Article 20c of CAM NC

LIST OF DELIVERABLES FOR AN INCREMENTAL CAPACITY PROJECT

➤ Stakeholder feedback

Some stakeholders indicated that the process leading to the actual economic test parameters and offer levels is not clear and that the Incremental Proposal is missing a clear list of deliverables for TSOs and NRAs along the process.

➤ Requirements from TAR FG and Guidance on Incremental Capacity

The ACER Guidance provides a detailed list of issues that should be subject to coordination among the involved TSOs of an incremental capacity project and the information that should be provided to the respective NRAs for approval before the final economic test parameters are published to the market.

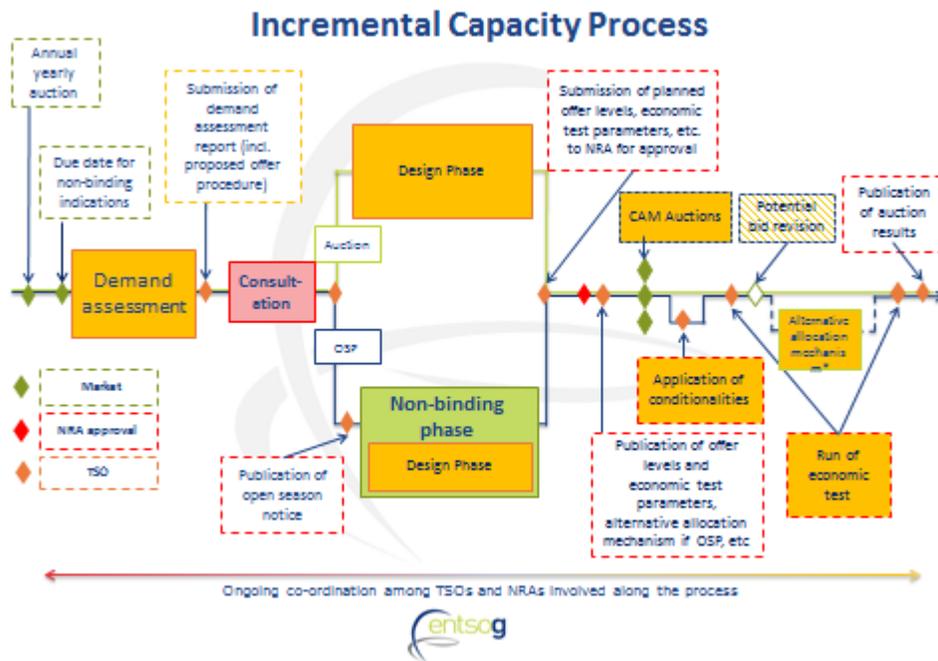
In addition, the TAR FG require transparency on parameters of the economic test.

➤ Analysis of issue

A clear definition of the process steps to be taken in an incremental capacity project is also in the interest of ENTSG and the feedback provided by some stakeholders on this issue has been taken into account.

➤ Outcome and conclusion

ENTSG has clarified the entire process for offering incremental capacity in the refined draft Incremental Proposal and has also included clear lists of deliverables at the respective steps of a project.



3.1.6. Auctioning of incremental capacity – Article 20d of CAM NC

PARALLEL AUCTIONING OF INCREMENTAL CAPACITY OFFER LEVELS

➤ Stakeholder feedback

The public consultation of the initial draft Incremental Proposal proved that the concept of auctioning different offer levels for incremental capacity in parallel to each other in order to assess the optimal level of capacity is supported by a clear majority of the stakeholders. It was stressed that TSOs should use best effort to set the offer levels properly and thereby to reduce the total number of offer levels needed for a single incremental capacity project.

Besides this, some stakeholders stressed that in some cases a separate offer of incremental and existing capacity might have a merit and that such functionality should be foreseen for open season procedures.

➤ Requirements from TAR FG and Guidance on Incremental Capacity

The ACER Guidance clearly requires an integrated offer of incremental and existing capacity in the annual yearly capacity auction in order to ensure that the same service for the same period of time will have the same value for network users if acquired at the same time.

The ACER Guidance furthermore defines a number of parameters that need to be fulfilled by the allocation procedure to be defined in the CAM amendment. These parameters are best met in a concept of parallel auctioning of different offer levels (parallel bidding ladders).

➤ Analysis of issue

Taking into account the auction simulations conducted with stakeholders during the drafting process of the Incremental Proposal, ENTSOG agrees that a parallel auctioning of different offer levels for incremental capacity in the annual yearly capacity auction is the most efficient way to allocate incremental capacity. This mechanism allows the testing of different levels of incremental capacity and provides the possibility to allocate available capacity irrespective of whether the economic test for the offer levels containing incremental capacity is met or not. Furthermore, this concept of auctioning incremental capacity is supported almost unanimously by stakeholders, ACER and TSOs.

➤ Outcome and conclusion

The refined draft Incremental Proposal foresees parallel auctioning of different offer levels according to the concept of parallel bidding ladders that was foreseen in the ACER Guidance.

BID REVISION FOR INCREMENTAL CAPACITY AUCTIONS

➤ Stakeholder feedback

Most stakeholders support a function in the auction procedure that allows a revision of bids in case the economic test for an offer level containing incremental capacity is not met. Based on the proposals for such a mechanism made by ENTISO, the majority of stakeholders also supported a principle according to which a full auction for an offer level is repeated, if the offer level resulting in the highest level of capacity with a positive economic test outcome cleared with an auction premium for at least one of the yearly standard capacity products.

Furthermore, most stakeholders also agreed to repeating such a principle as long as possible if the conditions for applying a repeated auction are met, in order to get to the most efficient auction outcome.

➤ Requirements from TAR FG and Guidance on Incremental Capacity

The ACER Guidance does not prescribe a possibility for network users to revise their capacity bids in case the economic test is negative, however it asks ENTISO to consider whether such a function would be of benefit while at the same time avoiding too many interventions into the general principle of the ascending clock algorithm.

➤ Analysis of issue

ENTSOG has considered a bid revision principle and tested it together with stakeholders in one of the Stakeholder Joint Working Sessions for the Incremental Proposal. The conclusion of ENTSOG is that an actual revision of a bid is not the most suitable procedure as this would affect the principle of the ascending clock algorithm as defined in CAM NC. However, the same effect could be reached by repeating an auction if specific criteria are met, thus allowing network users to place different bids for the same capacity again.

The logical condition from ENTSOG's point of view is that a repeated auction should only be conducted if the outcome of the initial auction is that network users are acquiring incremental capacity at a premium while a higher offer level resulted in a negative economic test. In such a case, network users could have obtained more capacity at a lower price, potentially at lower or equal total costs.

➤ Outcome and conclusion

The Incremental Proposal foresees that in case the highest offer level with a positive economic test outcome cleared at a premium, the next higher offer levels with an initially negative economic test outcome would be auctioned again.

This principle should be repeated as long as the condition for a repeated auction is met.

3.1.7. Open Season Procedures – Articles 20e and 20f of CAM NC

CONDITIONAL COMMITMENTS IN OPEN SEASON PROCEDURES

➤ Stakeholder feedback

The concern raised by most of the stakeholders responding to this issue in the public consultation was that conditions between binding commitments of network users should not be limited to the allocation of incremental capacity but should persist until the completion of the incremental capacity project. Thus in case of a delay at one of the

involved interconnection points of a project, the respective network user could make use of the condition initially submitted in the allocation procedure.

➤ Requirements from TAR FG and Guidance on Incremental Capacity

The ACER Guidance states that *“conditional commitments, for instance across a number of years requested, including or excluding bids at other IPs, or for a minimum amount of capacity required (fill-or-kill) can be obtained in an open season procedure”*.

This deviation from the auction methodology defined in CAM NC is explicitly accepted by ACER.

➤ Analysis of issue

ENTSOG supports the inclusion of conditions between capacity commitments as a possibility in the Incremental Proposal. Open season procedure will primarily be used for incremental capacity projects that are of a more complex nature and most likely involving more than one IP. In such a case, ENTSOG believes that it is very reasonable to link the capacity commitments between the involved IPs as the value of the capacity for a network user is most likely linked to the allocation of capacity at all IPs (e.g. transportation routes or consistent blocks of capacity in time).

Besides such a typical case for conditions between capacity commitments, multiple other conditions could potentially be raised by network users in the allocation procedure. Given the fact that the standard allocation procedure also in an open season procedure is an auction based on CAM NC, this leads to complexities within the auction process that the CAM NC algorithms cannot resolve. Furthermore, the conditions needed for a project are very much dependent on the nature of a project and will be indicated by network users already in the non-binding phase of the open season procedure.

➤ Outcome and conclusion

ENTSOG included the possibility of submitting conditions between capacity commitments in open season procedures in the Incremental Proposal. The Incremental Proposal however does not specify what kind of conditions would be allowed, but provides sufficient flexibility to apply those conditions that are needed for a respective incremental capacity project. In order to ensure that the conditions raised in an open season procedure are not discriminating other network users or a posing a clear obstacle to the allocation of capacity, the actual condition principles are subject to the approval of the relevant NRAs. Network users will be able to indicate their conditions between their capacity commitments within the non-binding phase of the open season procedure and the respective TSOs will then be able to include this condition in the allocation notice, requesting the approval of the respective NRAs.

ALTERNATIVE ALLOCATION MECHANISM IN OPEN SEASON PROCEDURES

➤ Stakeholder feedback

Most stakeholders indicated no support for the default allocation procedure in an open season procedure being the annual yearly capacity auction according to CAM NC. It was stressed that in open season procedures, the allocation of capacity should be conducted on a case-by-case basis without defining a default. Furthermore, a 'willingness-to-pay per year' principle as in the annual yearly capacity auction was not regarded to be the most efficient way of allocating incremental capacity, as it does not promote long term commitment for capacity.

It was agreed that the alternative allocation mechanism foreseen in the initial draft Incremental Proposal does provide the possibility to apply an allocation rule that is based on contribution to 'net present value', however this was regarded to be only a second best solution to address the problem.

It must be stressed that individual stakeholders also responded in contrast to this, stressing that standard auctions should be the only way how capacity is allocated. A pro-rata approach was rejected as a principle.

➤ Requirements from TAR FG and Guidance on Incremental Capacity

The ACER Guidance requires that the default allocation rule in open season procedures shall be based on a willingness-to-pay principle. Furthermore, the only alternative to this could be an allocation rule that is using a pro-rata approach, only to be applied in case the willingness-to-pay allocation rule is demonstrated to be impractical, as it would not lead to the most efficient auction outcome.

➤ Analysis of issue

ENTSOG supports the position of stakeholders whereas pro-rating could potentially also be impractical in case of open season procedures and would not lead to a more efficient auction outcome. An alternative to a default auction based on willingness-to-pay should take into account the complexities coming along with conditions between capacity commitments in open season procedure.

In cases where a network user is requesting incremental capacity for a long time period with a condition between the respective annual yearly products, it should be ensured by the respective NRA that a capacity request for a single annual yearly product at a higher price could not lead to failure of an entire incremental capacity project.

➤ Outcome and conclusion

ENTSOG has included a default allocation procedure for open season procedures being the annual yearly capacity auction in the Incremental Proposal. Thus, incremental capacity would in any case be initially offered in the annual yearly capacity auction, regardless of whether an open season procedure is conducted or not. In case of open season procedures, the Incremental Proposal does however foresee that an alternative allocation rule shall be applied if the results of the annual yearly capacity auction, taking into account the conditions between commitments, did not lead to a positive economic test for at least one of the offer levels containing incremental capacity. In such a case, the respective TSOs and NRAs should be allowed to apply an alternative allocation rule to the capacity commitments received in the annual yearly auction, taking into account

the conditions between capacity commitments and the higher contribution of long term capacity commitments to the economic viability of the incremental capacity project.

ENTSOG did not define a clear alternative allocation rule in the Incremental Proposal but is of the opinion that such a rule should be set on a case-by-case basis by the respective NRAs and should be published before the actual offer of incremental capacity as a backup.

3.1.8. Economic Test Principles – Articles 42 to 45 of TAR NC

FACTORS INFLUENCING THE F-FACTOR

➤ Stakeholder feedback

The main point raised by stakeholders on the economic test and especially on the level of the f-factor is transparency on the factors and assumptions that influenced the values of the test. It was stressed that stakeholders have a high interest in understanding the reasoning for a specific f-factor and want to be involved in defining it.

Taking into account that bundled capacity products would include different requirements on both sides of an IP, it was highlighted that f-factors at two sides of an IP should be set consistently by the respective NRAs in order to avoid that an economic test fails because of missing cross-border co-ordination.

Regarding the factors that shall be taken into account by the respective NRA when setting the level of the f-factor, it was furthermore suggested not only to take into account positive externalities but also negative ones and that externalities taken into account by the NRA should be justified.

➤ Requirements from TAR FG and Guidance on Incremental Capacity

The TAR FG define the level of the f-factor shall be set per incremental project and shall be subject to the approval of the respective NRA at a Member State level. The factors

that should be taken into account when setting the level of the f-factor are also clearly defined in the TAR FG, being the duration of capacity commitment compared to the economic lifetime of an invest, the capacity reserved for short term auctions and positive externalities resulting from an investment to the market or the system.

The TAR FG furthermore requires NRAs to co-ordinate in order to define a single economic test with a single f-factor.

➤ Analysis of issue

ENTSOG concludes that the level of the f-factor should not be set on a project basis but on an offer level basis, meaning that different f-factors for the different offer levels of an incremental capacity project need to be allowed. This is due to the fact that different capacity increases could be non-proportionally linked to different investment costs.

Regarding the single economic test, the level of the f-factor for such a test is automatically to be derived from the underlying individual f-factors of the involved TSOs, as all involved TSOs need to be able to recover their respective share of the present value of the increase in allowed revenue or target revenue. An adjustment of the single economic test f-factor would basically be an adjustment of the underlying individual f-factors, unless the distribution of revenues from the bundled capacity product is changed.

➤ Outcome and conclusion

ENTSOG included the principle of the economic test and the factors influencing the level of the f-factors as defined in the TAR FG. Besides publishing the economic test parameters, the Incremental Proposal also calls upon NRAs to make public their considerations taken for the setting of the parameters. Furthermore, ENTSOG believes that transparency on the economic test ensures a co-ordinated setting of f-factors across the border.

GUARANTEE MECHANISMS FOR 1-F

➤ Stakeholder feedback

Regarding the share of 1-f and the principles foreseen to guarantee the recovery of this share of the increase in allowed revenue or target revenue, it was highlighted by stakeholders that any recovery mechanism should avoid possible discrimination between network users of different countries.

Besides this, it was also stressed by individual stakeholders that more focus should be given to guarantee mechanisms for 1-f in order to avoid that costs are socialised if future bookings of the incremental capacity do not occur. Some stakeholders noted that the Incremental Proposal in general is putting too much emphasis on the guarantees for the 1-f share.

➤ Requirements from TAR FG and Guidance on Incremental Capacity

The TAR FG do not explicitly cover guarantee mechanisms for the 1-f share of the present value of the increase in allowed or target revenue, however the TAR FG state that this share should be covered by future capacity bookings, either at the point where incremental capacity was offered or at other points via the revenue recovery mechanism.

➤ Analysis of issue

In order to avoid unnecessary socialisation of costs from investments, a clear merit order in the recovery mechanisms for the share of the increase in allowed or target revenue attributable to the incremental capacity should be defined in the NC. This merit order should define that the primary source of revenue for this share should be future bookings of the capacity initially offered as incremental capacity at a respective IP. Only to the extent such bookings do not occur after the initial offer of incremental capacity, tariffs at other IPs paid by other network users should be used to recover the revenue attributable to the investment. As an alternative to this, ENTSG also proposes that the

respective NRA or a Member State could define an appropriate recovery mechanism that is guaranteeing the revenue, e.g. via subsidies or financial guarantees.

➤ Outcome and conclusion

ENTSOG has defined in merit order in recovery mechanism for the share of 1-f which gives a priority to future bookings of capacity at the respective IP and to the extent such future bookings do not occur, allows a socialisation of costs among network users or an alternative guarantee mechanism to be established by the NRA or Member State.

POTENTIAL REDISTRIBUTION OF REVENUES BETWEEN TSOs AT AN IP

➤ Stakeholder feedback

The public consultation of the initial draft Incremental Proposal indicated that a majority of stakeholders supports an ex-ante approach for a redistribution of revenues in order to have certainty on the economic test parameters before the economic test is held. In addition, some stakeholders stressed that an ex-post redistribution of revenues should not be allowed at all or should at least be carefully assessed as network users might be wanting to withdraw or amend binding commitments if the economic test parameters are changed after the test was held.

It was furthermore stressed by individual stakeholders that a redistribution of revenues should only be discussed at a TSO/NRA level and that undue cross-subsidies should be avoided in any case.

➤ Requirements from TAR FG and Guidance on Incremental Capacity

The TAR FG define that in the specific case where the single economic test for an incremental capacity project is passed while the specific requirements of a single TSO cannot be met, TSOs and NRAs may decide to redistribute revenues between the involved TSOs in order to allow a project to proceed towards commissioning. Such a

redistribution of revenues may be conducted by a cost sharing agreement or a different split of the bundled reserve price.

➤ Analysis of issue

As the single economic test can only be set in way that it can only have a positive outcome if all TSOs involved are able to cover their respective requirements defined by the individual f-factors, a situation where a single economic test is positive while one of the underlying economic tests is negative cannot occur. Nonetheless, a redistribution of revenues could help to lower the f-factor of the single economic test and thus increase the chances of passing a single economic test.

Discussions on a redistribution of revenues should therefore be based on the parameters of the individual economic tests of the involved TSOs, either before the single economic test is conducted to reduce the f-factor ex-ante or after it has been conducted in order to reduce the f-factor ex-post. NRAs and TSO could especially consider such an approach if the two f-factors at both sides of an IP are very different, e.g. if one TSO has a rather low f-factor due to high positive externalities in the respective system, while the other TSO has a rather high f-factor as the benefits from the investment are mainly realised in the adjacent market.

ENTSOG furthermore sees advantages in both approaches for a redistribution of revenues: while an ex-ante agreement on a redistribution of revenues allows more certainty for TSOs and network users on the parameters of the single economic test, it could also lead to delays in the process as such agreements could require long-lasting negotiations at a Member State level that are not within the sphere of influence of the involved TSOs. On the other hand, an ex-post agreement on a redistribution of revenues could imply that parameters of the single economic test are changed after the test was held, however it would make sure that such long-lasting discussions are based on specific data that indicate the actual requirements and are only held if actually necessary.

The third approach for a redistribution of revenues that was initially foreseen in the initial draft Incremental Proposal is not included in the refined draft Incremental

Proposal. This approach was characterised by an iterative agreement on a redistribution of revenues during the binding phase of an open season. Due to the default allocation procedure in open season procedures being the annual yearly auction, ENTSOG did not regard this approach as functioning anymore.

➤ Outcome and conclusion

ENTSOG defined the possibility of redistributing revenues between TSOs in the Incremental Proposal in order to potentially decrease the f-factor of the single economic test. Two possible approaches for such a redistribution of revenues are foreseen in the amendment of CAM NC: an ex-ante agreement before the single economic test is held and an ex-post agreement after the single economic test was held.

3.1.9. Tariff principles for incremental capacity – Article 46 of TAR NC

FIXED VS. FLOATING TARIFFS

➤ Stakeholder feedback

Stakeholders indicated in the public consultation and during the Stakeholder Joint Working Sessions that floating tariffs for incremental capacity would impose a strong barrier to passing economic tests for incremental capacity projects, as network users would be reluctant to commit for capacity for up to 25 years in the future at an unknown price. Besides naming a clear preference for a fixed tariff option for incremental capacity, stakeholders also suggested to at least provide some kind of certainty on floating tariffs by e.g. limiting the frame in which tariff can float.

➤ Requirements from TAR FG and Guidance on Incremental Capacity

The TAR FG section on reserve prices defines that the payable price for capacity as determined in the capacity auction shall be floating. It is furthermore specified that this approach for setting the payable price shall also apply for incremental capacity.

The TAR FG therefore provide no option for a fixed tariff for capacity.

➤ Analysis of issue

ENTSOG understands the request of network users for a fixed tariff option for incremental capacity due the comparably lower level of price certainty in a floating tariff regime. ENTSOG is especially concerned that providing only a floating price option for incremental capacity against the clear request from stakeholders could undermine the efficiency of incremental capacity processes in general as a mechanism to reduce congestion at IPs or to establish capacity based on the demand of network users.

➤ Outcome and conclusion

The refined draft Tariff NC allows an option for fixed prices in general, thus also being applicable for incremental capacity. No separate provisions on this issue are proposed in the incremental section of the NC.

TARIFF ESTIMATIONS TO BE USED FOR THE ECONOMIC TEST

➤ Stakeholder feedback

The public consultation of the initial draft Incremental Proposal and the feedback given at the Stakeholder Joint Working Sessions clearly indicated that network users require a very high level of certainty and predictability on the tariffs to be paid for the incremental capacity. As stated above, most stakeholders requested fixed tariffs for incremental capacity which are announced before the economic test is conducted, thus making estimated tariffs for the economic test unnecessary. It was stressed that only such a fixed tariff approach would allow network users to commit for a long term period in order to make an incremental capacity project viable.

Due to the lead time for commissioning of incremental capacity, most stakeholders accepted that at least in case of floating tariffs for incremental capacity, estimations of

the tariffs to be paid at the time of the use of the capacity need to be made in order to calculate an economic test. Such estimated tariffs should be as reliable and exact as possible and the methodology and assumptions taken for the estimation should be transparent to the market.

➤ Requirements from TAR FG and Guidance on Incremental Capacity

The TAR FG require that TSOs should publish with an appropriate lead time before the economic test is held, among others an estimated projection of tariffs for the bundled yearly capacity products including an explanation of how these tariffs have been calculated.

➤ Analysis of issue

ENTSOG understands the concerns of network users regarding the certainty of tariffs and the price risks associated with long term capacity commitments in case of unknown tariffs at the time of contracting capacity. For this reason, fixed price options for transmission tariffs are foreseen in the TAR NC, however the analysis and discussions on this issue are based in the drafting work stream of the TAR NC and will not be repeated in the Incremental Proposal work stream.

Regardless of the tariffing principles used for incremental capacity, a tariff needs to be used for the calculation of the economic test which can only be based on an estimation as the actual investment costs and thereby the increase in allowed or target revenue is not certainly known at the time of the offer of the incremental capacity. These estimations should be made by the respective TSOs in the most detailed way possible and should take into account the incremental capacity to be provided. It is clear that assumptions will have to be taken that are based on the specifics of each project, therefore a clear manual for how tariffs should be estimated cannot be provided in a NC.

➤ Outcome and conclusion

The refined draft Incremental Proposal foresees that tariffs for incremental capacity shall be estimated by making all necessary assumptions, taking into account the incremental

capacity to be provided. Furthermore, TSOs shall be obliged to publish the estimated tariffs alongside with the other economic test parameters before the economic test is held and shall furthermore provide explanation on the methodology used to calculate the estimated tariffs.

TARIFF ADJUSTMENTS FOR INCREMENTAL CAPACITY

➤ Stakeholder feedback

The main concern raised by stakeholders on the principles for tariff adjustments for incremental capacity was that tariffs should be known before the economic test is held and an ex-post adjustment of the tariffs after the allocation of incremental capacity should not be allowed. An ex-ante adjustment of tariffs for incremental capacity for cases in which the economic test can in theory not be passed at the reserve price was welcomed by stakeholders and the application of a mandatory minimum premium was regarded as a workable solution.

Regarding such a mandatory minimum premium, it was stressed by most stakeholders that a negative premium to reduce the price of incremental capacity would be inconsistent with the condition allowing a tariff adjustment and would furthermore discriminate against network users holding existing capacity at the IP. Other stakeholders were of the opinion that a negative premium for incremental capacity could be beneficial as it would reward long term capacity commitments and could thus help passing an economic test.

An adjustment of the depreciation rate for an investment as a mechanism for adjusting the tariff for incremental capacity was regarded to be too specific for a NC by some stakeholders, while other stakeholders were supporting such an approach under the condition that it would not undermine the incentives for long term capacity commitments.

➤ Requirements from TAR FG and Guidance on Incremental Capacity

The principle of tariff adjustments for incremental capacity is foreseen in the TAR FG. It is limited to cases in which the allocation of all incremental capacity at the reserve price would in theory not allow a positive economic test and should be subject to NRA approval. Any tariff adjustment should only be allowed if it preserves the financial integrity of the economic test, avoids cross subsidies between network users, is compatible with the cost allocation methodology and avoids fragmentation of reserve prices at the same interconnection point.

The mechanism to be used as a default is defined to be a mandatory minimum premium on top of the reserve price for the bundled capacity product. ENTSOG is asked to consider alternative mechanisms to this default, provided that these alternatives are in line with the mentioned requirements.

➤ Analysis of issue

ENTSOG concludes that the decision on whether a tariff adjustment for incremental capacity is required can only be based on the estimation of the reference price for incremental capacity, as the actual tariff is unknown at the time of the calculation of the economic test.

In case a tariff adjustment is necessary based on the economic test parameters, a mandatory minimum premium on top of the bundled reserve price is also regarded by ENTSOG to be the most appropriate solution. Furthermore, ENTSOG is of the opinion that the theoretical non-passing of the economic test at the reserve price should not be the only condition allowing for a tariff adjustment but that such a principle would also be of benefit in cases where NRAs expect future contracting of the incremental capacity to be too uncertain. In such cases, a mandatory minimum premium could be used to mitigate the risk of future under-recovery and could be passed back to the market in case such under-recovery does not materialise.

The mechanism to pass back revenues from such a mandatory minimum premium in case future bookings of the incremental capacity do occur to a sufficient level should be

defined in the NC. ENTSOG foresees that this could be done by e.g. including revenues from the mandatory minimum premium in the revenue recovery mechanism, by placing revenues from the mandatory minimum premium in a specific regulatory account or by adjusting the depreciation rates of the investment in line with the outlook for capacity contracting in order to pay back the costs of the investment earlier.

➤ Outcome and conclusion

ENTSOG defined a mandatory minimum premium to be the only mechanism used for the adjustment of tariffs for incremental capacity. The condition for applying a tariff adjustment is either the case in which an economic test can in theory not be passed at the reserve price and the case where NRAs regard future contracting of the incremental capacity to be too uncertain.

Furthermore, the refined draft Incremental Proposal includes mechanism on how to take into account revenues from such a mandatory minimum premium in the revenue recovery mechanism.