

The Council of European Energy Regulators
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International
Association
of Oil & Gas
Producers

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OGP response to CEER Blueprint on Incremental Capacity

The International Association of Oil & Gas Producers (OGP) welcomes the invitation to participate in the CEER-ACER joint workshop on incremental capacity that was held on 3rd of June 2013, and the opportunity to respond to the CEER Blueprint on Incremental Capacity. OGP supports the joint efforts by CEER and ACER to develop principles and processes for the identification and allocation of incremental capacity. We believe a market-based approach to investment procedures in gas transmission capacity is important for the creation of a functioning internal gas market for Europe.

The CEER Blueprint is an important milestone and provides a sound basis to take this project forward into a legally binding framework. We have noted that rules regarding incremental capacity are included on the European Commission's annual priority list for the development of framework guidelines and network codes for 2014 as well as in ACER's 2014 work programme. Irrespective of the legal framework the European Commission will choose for this topic, we consider it essential that stakeholders will be involved and consulted during the process in the same manner as for the development of network codes. Given the number of interdependencies between the tariff network code and incremental capacity we recommend that ENTSOG is invited to develop the rules for both topics in a coordinated manner.

General

OGP supports market-driven investment procedures for gas transmission capacity that aim to meet market demand for new capacity in a timely manner without undue discrimination between users of existing capacity and incremental capacity, while limiting the risks of overinvestment and stranded assets. We are generally supportive of the key principles for market-driven investment processes as outlined in paragraph 2.3 of the Blueprint. We have noted that Frontier Economics has undertaken a comparative study on market-driven investment procedures versus central planning, and their study confirms that market-driven procedures score better.

OGP prefers a process for identification and allocation of incremental capacity that is simple, compatible with the recently adopted CAM network code and that would also be suitable for dealing with new capacity, and we believe this is feasible.

When to offer incremental capacity

We agree with the Blueprint proposal to only offer incremental capacity when there is potential demand. This should normally be identified in the Ten Year Network Development Plan (TYNDP) process. The two additional triggers proposed in the

Blueprint (long term capacity sold out and network users' genuine request) avoid that potential demand is not included

The Blueprint does not explicitly address that when the offer of incremental capacity is made it is a binding offer of firm incremental capacity. Existing capacity is offered under the CAM auctions as firm capacity, but it seems that the offer of incremental capacity is not always binding on the side of transmission system operators. In our view it would help to provide clarity that the offer of incremental capacity is binding, subject only to the passing of the market test.

How to offer incremental capacity

The Blueprint proposes to use integrated auctions as the preferred option to offer incremental capacity in straightforward hub-to-hub settings, and limit open season procedures to situations where there is no straightforward hub-to-hub setting.

OGP supports the use of auctions for the allocation of existing capacity when existing capacity is limited (mid- and short-term capacity). When capacity is scarce, auctions allow this capacity to be allocated to the user who values it most. However, incremental capacity should not be scarce because transmission system operators are obliged to build sufficient capacity to accommodate all economically reasonable and technically feasible demands for capacity, in accordance with Article 13, paragraph 2 of Directive 2009/73/EC. This implies that an integrated auction for incremental capacity should normally clear at the reserve price when all demand for capacity is satisfied.

OGP can agree with the Blueprint proposal of integrated auctions to offer incremental capacity in straightforward hub-to-hub settings. In order to avoid ambiguity and to ensure a straightforward implementation of the rules we would suggest also considering a capex ceiling to limit integrated auctions to relatively simple capacity expansion projects. At this stage we also state our preference for the 2nd technical design option proposed in the Blueprint because it offers more flexibility to shippers and it allows for a more efficient allocation of available capacity. However we believe the auction design should be further detailed and tested in consultation with stakeholders.

For the more complex projects OGP supports the Blueprint proposal of using an open season procedure to bring a project to the investment stage. In the proposed 1st technical design the capacity is allocated in accordance with the CAM network code. This would require some additional rules to ensure that parties participate in the open season procedure when they want to acquire capacity (avoid 'free rider' effects) or provide incentives to network users that trigger the investment. At this stage we have a slight preference for the proposed 3rd technical design as being the most flexible and offering the best chances to meet the investment trigger while providing the participants to the open season more guarantees to access the desired quantity of capacity. However, as in the case of integrated auction, we believe that the technical design of the open season process should be further developed and tested in consultation with stakeholders.

We also believe that the criteria for when to apply open season procedures versus integrated auctions need to be further defined

Design principles of the economic test

OGP supports the proposed economic test of using a net present value approach. The economic test should be designed to establish whether there is an '*economically reasonable and technically feasible*'¹ demand for capacity. The economic test should address which portion of the investment costs is expected to be recovered from the initial capacity bookings (parameter *f*), which portion of the costs is expected to be recovered from later capacity bookings and whether positive externalities should be taken into account and hence whether part of the investment costs should be socialised. The economic test should be set in advance and be fully transparent to network users so that it is clear what level of initial commitments would be required to pass the investment threshold.

Cross-border coordination issues

We support the Blueprint proposal to apply a single economic test when incremental capacity is offered as bundled capacity at interconnection points. Differences in the economic framework on both sides of an interconnection point are inevitable but it should be avoided that the investment threshold is passed on one side of the interconnection point but not on the other side. In our view the cost of incremental capacity should be bundled and the economic test should be applied to the bundled costs and the revenues should be allocated pro-rata to the division of the investment costs. National regulatory authorities should be coordinating the economic test conditions on both sides of an interconnection point and should be empowered to decide on cost-sharing arrangements, when appropriate, to better align the costs and benefits between adjacent transmission systems.

Implications for rules on transmission tariff structures

We support the possibility of a fixed price for the duration of the users' long-term commitment to encourage network users to underwrite the required investments, in particular when capacity is offered using open season procedures. In these cases network users would like to avoid exposure to excessive tariff fluctuations, which could be resolved by fixed forward tariffs or tariffs indexed with inflation, inter alia in view of the contribution that such scenarios would make to security of supply and enhanced competition.

In cases where floating reserve prices are applied, we agree with measures to avoid that expansion of capacity at a congested interconnection point would result in discrimination between new users and users which hold unused capacity from earlier auctions for which they paid an auction premium. This matter may require an asymmetrical approach. When incremental capacity would result in lower tariffs due to economies of scale, these benefits should be distributed among all network users contributing to these economies of scale. This avoids cross-subsidies between existing and new network users. On the other hand, when there are no economies of scale and incremental capacity would require a relatively high investment, the national regulatory authority should have the flexibility to set a minimum price for

¹ In accordance with Article 13, paragraph 2 of Directive 2009/73/EC

incremental capacity at a level above the reference price in order to protect existing capacity holders from an unjust tariff increase.

We are at your disposal to provide any further information you might require on these issues at your earliest convenience.

Best regards

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About OGP. The International Association of Oil and Gas Producers (OGP) represents the interests of companies engaged in the exploration and extraction of oil and natural gas, as well as national and other related industry associations. OGP membership spans the globe and accounts for more than half of the world's oil output and about one third of global gas production. From our London office, we foster cooperation in the area of health, safety and the environment, operations and engineering, and represent the industry before international organisations, such as the UN, IMO and the World Bank, as well as regional seas conventions, such as OSPAR, where we have observer status. OGP Europe in Brussels represents before the EU OGP members who are active in Europe.