

**19th round of Informal Russia-EU Consultations on EU Regulatory Topics  
&**

**12<sup>th</sup> meeting of the EU-Russia Gas Advisory Council's  
Work Stream on Internal Market Issues (WS2 GAC)**

**combined with**

**ENTSOG Workshop on "Incremental Proposal" (CAM NC amendment)**

**31 January 2014**

**E-Control Headquarters  
(Rudolfplatz 13A, A 1010 Wien, Austria)**

**MINUTES**

The agenda is attached to the minutes.

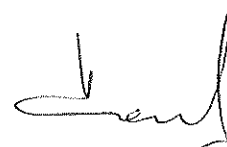
**1. Greetings / Opening remarks by Co-Chairmen**

Mr. Boltz and Mr. Konoplyanik gave short opening remarks and presented the agenda. It was clarified that this meeting represented a joint workshop with ENTSOG on financeability and TSO cross border coordination issues in the framework of the coordinated open seasons approach within ENTSOG "Incremental Proposal" and as these two major issues were presented in the "Strawman" proposal as discussed at WS2 meeting in Saint-Petersburg 10-11.09.2013.

**2. Financeability Issues within Coordinated Open Seasons Approach**

The meeting started with an extensive presentation by Mr. Wiekens on various aspects of the economic test as part of the ENTSOG Incremental Proposal. The presentation was circulated to the participants and covered the economic test formula, factors influencing the level of the f-factor, coverage of 1-f, publication requirements and the single economic test.

After Mr. Wiekens' description of the factors influencing f, Co-Chair Mr. Konoplyanik and Mr. Barnes asked how an f factor equal to 1 was compatible with the mandatory 10% short-term reservation quota. Mr. Heidelberger responded that the basic idea behind the economic test formula was setting up a template reflecting the rationale applied by an investor and said that if a shipper was interested in realizing a particular infrastructure project, nothing would prevent him from a unilateral commitment to take all the capacity at the given conditions. Mr. Esnault added that the f-factor represents the level of



risk to be covered and explained that in a given case of over revenues, these could either be invested or expressed in reduced tariffs.

Co-Chair Mr. Konoplyanik then asked more explicitly who would actually pay/take the risk for the additional 10% capacity that need to be built but cannot be used by the shipper who is ready to commit to the rest of the capacity. While Mr. Esnault stated that there are different mechanisms to deal with this risk, Mr. Kovacs explained that having capacity available exclusively for competitors is a clear and non-negotiable goal. Co-Chair Mr. Konoplyanik then argued that building additional 10% capacity might as well lead to unused capacity in the market. Mr. Kovacs said that even if this might occur at times, new investments must be fit and ready to accommodate the peak. Mr. Wood said that while the proposed model might work in some countries, it could represent a problem in other countries, particularly in transit countries.


During Mr. Wiekens' explanation of the single economic test principle, Co-Chair Mr. Boltz stated that it was important not to neglect the new EU infrastructure regulation in this context particularly with respect to PCIs. He explained that PCIs assume to have legally binding cross border cost allocation/sharing procedures in place and that it is highly likely that most cross border projects will be built via the PCI mechanism in the future (as we see in the TYNDP already today). Therefore, the single economic test principles as laid out by ENTSOG (slides 13-17) should stronger reflect the particularities of PCIs according to Mr. Boltz.

The meeting continued with a presentation by Mr. Sisman on tariff issues. Referring to the skepticism repeatedly voiced by the Russian side towards floating tariffs in the past, Mr. Sisman said it would be wrong to think that fixed tariffs could be the ideal solution. He explained the two generic approaches proposed by ENTSOG for the calculation of the PVUC under a floating regime (standard vs. case by case approach) and named possible approaches/assumptions in this context. In this context, Mr. Sisman stressed that selecting the right approach will ultimately depend on the complexity of the project. He also described various possible approaches/adjustment mechanisms in case the assumed tariff was wrong in the calculation.

Co-Chair Mr. Boltz then expressed his preference for an approach in which TSOs estimate tariff developments in order to help shippers decide if they want to buy capacity. Co-Chair Mr. Konoplyanik subsequently proposed that the approaches presented by ENTSOG could be expanded by adding more possibilities. Mr. Sisman responded that additional proposals are welcome but would need to be tabled rather soon. According to Mr. Konoplyanik a possible proposal could be to have all network users carry the burden in order to avoid that the entire risk is borne by the shipper who is not entitled to use the whole capacity. In this context, Mr. Konoplyanik asked whether a 'ring fencing' approach could be a possible approach in this respect. Mr. Boltz responded that 'ring fencing' might be a possibility in very big projects but not for smaller additions of capacity. Mr. Boltz also explained that TSOs have the right to cost recovery even if some users are granted a discount. Therefore flexibility is very important and the principle of floating tariffs is the most suitable in this context according to Mr. Boltz.

### **3. TSO Cross-Border Coordination Issues within the Coordinated Open Seasons Approach**

Co-Chair Mr. Konoplyanik introduced his presentation by stating that incremental and new capacity are two fundamentally different cases and, thus, need to be treated differently. According to Mr. Konoplyanik this particularly applies to the underlying allocation mechanisms. As mentioned in the past, incremental (small amounts of new capacity) should be allocated via auctions, whereas new capacity (large volumes) should be subject to coordinated open seasons. In this context, Mr. Konoplyanik expressed concern over the current EU approach as it seems to suggest an auction based mechanism for coordinated open seasons. In Mr. Konoplyanik's view this would not work with large volumes of new capacity given its long-term character.



Co-Chair Mr. Konoplyanik also criticized that the ACER guidance was not clear when it referred to 'offering capacity' in the context of new capacity as in his view new capacity is not 'offered' but comes into play as a result of a market test (bottom-up procedure). Mr. Heidelberger explained that TSOs do not offer capacity without taking feedback from the market on board and therefore the term 'offer' includes information gathered from the market beforehand.

Co-Chair Mr. Konoplyanik noted that there is also a general lack of clarity when it comes to coordinated open seasons and other issues in the context of new capacity (such as the 10% quota and who would finance it, when to choose open seasons instead of auctions, etc.) and urged the involved parties to find the right balance between flexible and concrete approaches in order to provide sufficient clarity. This is particularly important in the context of project financing as financial institutions will want to properly evaluate all risks involved according to Mr. Konoplyanik.

Mr. Konoplyanik also outlined the different understandings of the market test and the economic test and noted that in ENTSOG's proposal the economic test is an integral part of the market test whereas the Strawman paper developed by joint case study working group considers the market test and the economic test to be separate procedures, e.g. while market test presents a result of summarized demand of market players (potential shippers) for the capacity (non-legally binding indications of their appetite for the capacity), economic test provides the result of a feasibility study by TSO of how this summarized market demand can be covered and what will be the economics of developing the new capacity adequate to cover in full this summarized market demand for it.

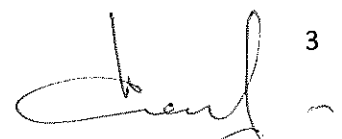
In his presentation, Mr. Konoplyanik also referred to ENTSOG's proposals of specific circumstances in which to opt for open seasons instead of auctions. He noted that it was not clear whether the triggers listed represented an exhaustive or an open list. He also proposed to let shippers decide which allocation procedure to use.

Mr. Konoplyanik finally challenged the concept of 'non-discrimination' as currently applied by the EU side criticizing that it does not sufficiently take the differences between various actors into account.

Mr. Barnes was then given the floor to continue presenting a number of open issues with respect to capacity allocation and the associated 'willingness to pay' principle. Mr. Barnes explained that the proposed 'willingness to pay' principle looks at bids on a period by period basis and does not take the entirety of the shipper's bid into account. According to Mr. Barnes, this will eventually lead to a situation where a shipper willing to pay a high price for a short period (e.g. 1 year) will be allocated capacity for that period, whereas a shipper willing to pay a lower price but for a significantly longer period (e.g. 15 years) will lose the race in the periods where the other shipper is willing to pay more. Given that the shipper who wants to book for a longer period will either want to book the entire period or not book at all, the project risks not going ahead due to the withdrawal of the bid for the longer period according to Mr. Barnes (-> 'fill or kill'). This is why the NPV test was suggested by Mr. Barnes as a more suitable approach for capacity allocation given that it takes account of the overall commitment towards an investment. Mr. Boltz said that the example showcased by Mr. Barnes was quite drastic and that it would be more realistic to assume having one shipper bidding a slightly higher price for e.g. 12 years and another shipper bidding a slightly lower price for e.g. 14 years. In this case, the proposed approach would perform quite well.

Mr. Konoplyanik argued in favor of a project based approach in the case of new capacity (NPV test) and said that the system based approach (willingness to pay) would work better for incremental capacity. As a consequence, the willingness to pay principle should be applied to the short term 'trade world' whereas the term 'readiness to pay' (equal to 'willingness to pay' multiplied by non-commercial risks) would better suit the long-term 'investment world' of new capacity as to Mr. Konoplyanik.

In terms of the project size, Mr. Konoplyanik criticized the 'pro rating' approach proposed in the ACER Guidance as it seems to discriminate against those shippers who have the highest financial burden. This



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would certainly be the case if 'pro rating' is understood as proportional reduction of booked capacity by traders (short term) and shippers/producers (long term) according to Mr. Konoplyanik.

Mr. Konoplyanik then introduced the subject of ring fencing and asked whether new capacity projects could be 'ring fenced'. In this context, he proposed the establishment of a separate TSO in such projects in order to avoid the heavy burden of TSO coordination along the project route. Mr. Barnes specified that a separate TSO would only need to coordinate with the TSOs it connects to on either end of the project but would not need to coordinate with each TSO along the project route. Mr. Kovacs stated that the matter can be further examined and discussed, however, the entry-exit zones along the route must be respected and no additional layer on top of these existing zones should be created. Mr. Boltz added that a solution would be to establish the new TSO as a chain of new additional national TSOs along the route in order to respect the current layout of the existing entry-exit zones.

The issue around the f-factor and 10% capacity quota was then taken up again by Mr. Konoplyanik, asking the EU side how the situation  $f < 1$  will be covered. He stated that the size of  $f < 1$  might potentially be very large and therefore the question of how to cover this gap is urgent. In this context, Mr. Konoplyanik quoted a report by Frontier Economics which says that at least 30% could remain uncovered in a situation  $f < 1$  and said that this is of pressing concern as projects could not be financed under these circumstances. Mr. Konoplyanik then presented a number of options that could help finance this gap such as direct EU funding, EU financial institutions, internal EU cross-subsidies and said that this was not an exhaustive list but should be further discussed in order to find a solution.

Mr. Barnes returned to the issue of tariffs and raised a number of questions to be discussed with respect to the tariff methodology. He particularly referred to the principle of floating tariffs and asked whether new capacity projects should be ring fenced in case the size of the new capacity was disproportionate to the size of the entry exit zone (as discussed earlier). He also asked how long term commitments can be secured if a shipper cannot be sure about the price in the long run due to floating tariffs. Mr. Barnes added that there was a fundamental difference between a commodity-top-up-charge and a floating-capacity-charge stating that in contrast to the commodity-top-up-charge, the only option with the floating capacity charge (as proposed here) was not to book capacity if the price does not fit.

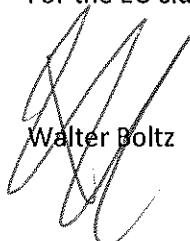
The meeting came to an end at this point.

Mr. Konoplyanik's and Mr. Barnes' presentation was circulated to the participants.

#### 4. Concluding Remarks/Summary/Follow-Up Proposals by Co-Chairman

It was decided to hold another work stream 2 meeting before the next GAC meeting on 10 June. To this end a number of dates will be proposed in the coming days and a suitable date will be chosen based on the availability of key participants.

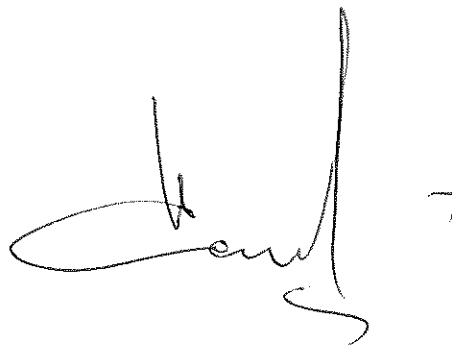
For the EU side:



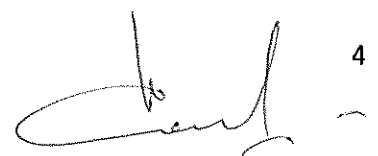
Walter Boltz

Brussels, 15 May 2014

For the Russian side:



Andrey A. Konoplyanik



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**AGENDA**

<b>New Capacity &amp; Coordinated Open Season (COS) Issues of the ENTSOG "Incremental Proposal"</b>		
<b>Time</b>	<b>Items</b>	<b>Presenters</b>
<b>Morning Session  10:00 – 12:30</b>	<p><b>5. Greetings / Opening remarks by Co-Chairmen</b></p> <p><b>6. Financeability issues within COS approach, incl.:</b></p> <ul style="list-style-type: none"> <li>- Shipper's NPV and/or other criteria in economic test ,</li> <li>- F-factor (cost coverage, socialization of costs, who decide on F, who cover 1-F, guarantees for 1-F, etc.),</li> <li>- 10% quota (who cover, etc.)</li> <li>- willingness-to-pay vs readiness-to-pay,</li> <li>- system-based vs project-based tariffs, floating tariffs, tariffs ring-fencing, etc.</li> <li>- non-discriminatory booking of existing vs new capacity,</li> <li>- Role of project promoters in project financing, construction, etc</li> <li>- etc.</li> </ul>	<p>W.Boltz A.Konoplyanik</p> <p>N.Sisman, M.Wiekens, J.Ingwensen, A.Barnes, A.Konoplyanik</p>

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<b>Working Buffet lunch 12:30 – 13:30</b>		
<b>Afternoon Session  13:30 – 16:00</b>	<p><b>7. TSO cross-border coordination issues within COS approach, incl.:</b></p> <ul style="list-style-type: none"> <li>- Independent TSO for New Capacity (ITSO),</li> <li>- ring-fencing of cross-border ITSO,</li> <li>- ITSO &amp; ist relations with project promoters/shippers,</li> <li>- prevention of 2 types contractual mismatches,</li> <li>- etc.</li> </ul> <p><b>8. Concluding remarks/Summary/Follow up proposals by Co-Chairmen</b></p>	<p>N.Sisman, M.Wiekens, J.Ingwensen, A.Barnes, A.Konoplyanik</p> <p>W.Boltz A.Konoplyanik</p>

