



Draft Guidelines of Good Practice on Open Season Procedures (GGPOS) An ERGEG Public Consultation Paper

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1 Background

- (1) Article 5 of (Gas) Regulation 1775/2005/EC calls on Transmission System Operators (TSOs) to provide for efficient capacity allocation mechanisms (CAM) and congestion management procedures (CMP). In the context of the discussion of the European Commission's draft explanatory notes (DEN) of on Article 5, paragraph 1 - 5 as well as Annex 2.1 and 2.2 of Regulation 1775/2005/EC the 11th Madrid Forum (May 2006) identified the necessity to further clarify the role of open season procedures.
- (2) At the Forum the European Commission indicated that it may request the advice of ERGEG on how certain elements of the current guidelines annexed to the Regulation could be further clarified on the basis of the final version of the explanatory notes on CAM and CMP and in the light of the forthcoming discussions on the draft explanatory notes on transparency requirements.
- (3) ERGEG declared its willingness to develop guidelines to help ensure that open season procedures are conducted in a non-discriminatory and transparent manner and result in efficient outcomes.
- (4) This document is ERGEG's draft guidelines on open season procedures (GGPOS), for public consultation until the 19th January 2007. It identifies what is an open season procedure and how it should be conducted. Open season procedure generally consists of a two step process; an open assessment of market demand for a specific proposal (first step) and a subsequent phase of capacity allocation (second step).

2 Role of open season procedure

This section outlines the general role of open season procedures.

- (5) Availability of sufficient infrastructure remains a key requirement for energy security and the development of a competitive internal market in natural gas. To foster competition, **infrastructure, in addition to being sufficient, should be sold at conditions that fit the market's needs** (this can be identified via transparent consultations) and **should be accessible on a non-discriminatory basis** (thanks to well-functioning capacity allocation procedures).

- (6) The **provision of sufficiently available capacity at first calls for efficient use of existing capacities** by the application of appropriate congestion management mechanisms to avoid contractual congestion.
- (7) Beyond short-term needs and with specific regard to transmission in the sense of the scope of the Regulation 1775/2005, Directive 2003/55/EC provides that **system operators are responsible for ensuring the long-term ability of the system to meet reasonable demands for the transportation of gas**¹. In case existing congestion management mechanisms do not remain sufficient to meet long term congestion²; this has to be sorted out by the existing system operator by adding new capacity i.e. by undertaking investments (new project or enhancement of existing projects)³.
- (8) Long term congestion can be identified either by the System Operator (SO), the national regulator or shippers – ideally it ought to be identified before it actually occurs since building new infrastructure typically takes a number of years. In case of domestic investment, the needs or expansion may also be addressed by national long term planning.
- (9) It can be assumed that properly unbundled system operators in pursuing the interests of a network operator would invest in new infrastructure at conditions fitting market needs and on a non-discriminatory basis provided the investment is economically viable and appropriate incentives are in place. If an SO does not have the necessary financing to make an investment, or is not willing to invest, outside investors should be permitted to finance the project.

¹ Article 2.4 of Directive 2003/55/EC obliges TSOs to “*develop the transmission system [...] and ensure the long-term ability of the system to meet reasonable demands for the transportation of gas*”. Article 8 of Directive 2003/55/EC moreover requires TSOs to “*develop secure, reliable and efficient transmission facilities*”. Achieving security, reliability and efficiency requires a number of steps. One of them is to ensure that transmission facilities are capable of meeting market demand.

² Requests exceeding capacity offer not only for short term peak periods but on a long term basis (physical or contractual congestion).

³ See as well explanatory notes of DG Energy & Transport on Article 5, paragraph 1 - 5 as well as Annex 2.1 and 2.2 of Regulation 1775/2005/EC.

- (10) Open seasons are a transparent market test that allow a project sponsor (i.e. the party proposing the project) to gauge how much infrastructure the market wants, and are therefore a useful way for SOs to meet the task assigned to them by the Directive 2003/55/EC). Open seasons have two additional advantages: they allow SOs or other project sponsors to consult future users regarding the terms capacity should be sold at, and they can be used to allocate capacity on a non-discriminatory basis.
- (11) An open season can be initiated in a variety of ways, i.e. when a system operator autonomously decides to enhance the system, when a new infrastructure is going to be built by a project sponsor or when the relevant regulatory authority imposes it. Another way to start an open season is at the initiative of shippers by notifying the SO of market demand. If the SO does not respond appropriately, shippers could notify the relevant regulatory authority of any refusal of access to existing infrastructures. When the number of refusals of access is relevant (the relevant regulatory authority could define at national level what “relevant” means) and the relevant regulatory authority sees that there is a physical congestion, taking also into account the provisions of article 21.2 of Directive 2003/55/EC, they may indicate to the market that there is a need for new investments and require the SO to initiate an open season process.
- (12) The open season should be conducted by the sponsor of the project (who sells capacity on the primary market). Depending on whether operation has been separated from ownership, this can be the system operator or the party who holds the capacity rights. Although the sponsor of the project conducts the open season, the relevant regulatory authority should oversee the open season so as to ensure that it fulfils its intended purpose. The present guidelines delineate how the relevant regulatory authority ought to be involved.

3 Application

- (13) The guidelines apply to “new infrastructure” understood in analogy to Directive 2003/55/EC (Art 2 para 3, Art 22 para 1 and 2) and encompass all infrastructure – i.e. transmission, distribution, LNG and storage facilities – not completed by the entry into force of Directive 2003/55/EC

- (14) The guidelines apply to investments authorised or licensed by competent authorities after the guidelines come into force.
- (15) ERGEG's recommendations are not legally binding and consequently no requirement can be made under them that contravene national or European legislation.

4 Guidance on Open Season Procedures

- (16) The rest of the document outlines ERGEG's initial view on potential guidelines for open season procedures. Views are welcomed on the scope and content of these requirements.

4.1 General structure of open seasons

- (17) Open season procedures generally consist of a two-step process starting with an open assessment of market demand for a specific proposal (first step) and a subsequent phase of capacity allocation (second step). Open seasons do not preclude a specific type of capacity allocation mechanism (auction or pro rata) but are instruments preceding the following capacity allocation allowing the system operator⁴ to assess the market demand for the subsequent allocation.

4.2 First Step: proposal to shippers

- (18) Prior to the open season the sponsor should consult with system users to assess how much capacity the market needs and under what terms (price, contract duration; firmness etc.). In parallel, the sponsor should evaluate economic and technical constraints. The SO should have estimates of how much capacity it can create and of the cost of putting in place such capacity.

⁴ In the sense as defined in Directive 2003/55/EC for "transmission system operators" (Art 2.4) the term "system operator" shall mean a natural or legal person who carries out the function of system operation (either transmission, storage or LNG) and is responsible for operating, ensuring the maintenance of, and, if necessary, developing the system and, where applicable, its interconnections with other systems, and for ensuring the long-term ability of the system to meet reasonable demands for the transportation of gas.

- (19) Afterwards and prior to the start of the open season, the sponsor should forward the details of the open season it plans on conducting to its relevant regulatory authority, if legally provided or otherwise agreed. This will allow the relevant regulatory authority to verify that the proposal made by the sponsor is reasonable and non-discriminatory, conforms to the present guidelines, and in particular broadly reflects market demand and technical and economic constraints. If the relevant regulatory authority has any questions regarding the sponsor's proposal, they should be resolved before the beginning of the open season.
- (20) The sponsor then needs to inform potential users about its proposed project. This should be done before the start of the bidding period so as to allow system users to study the proposal before having to file requests for capacity. The sponsor's open season notice should be sufficiently publicized to attract interest from third parties and to permit their meaningful participation. Avenues used to publicise the notice should include national and international media, the sponsor's website and if agreeable the relevant regulatory authority's website. The open season notice's goal should be to give bidders as much information as possible on the sponsor's project and therefore the service the bidder is being proposed. For a typical transmission investment this might include at least:⁵
- the general route of the proposed project, including receipt and delivery points, and any alternative routes under consideration;
 - the minimum and maximum capacity and operating pressure of the project, its in-service date and the possibility and in-service dates of further expansions.
 - how to request capacity;
 - arrangements in place to ensure the confidentiality of information received from bidders ;
 - the start and end of open season-period; the period shall be long enough to attract a maximum of market participants and should be adapted to the size of the project, a minimum period should be three months;
 - For each considered route and for each expansion size under consideration, the sponsor would also need to inform users about: available contract lengths, which need to be compatible with competition law; in any case the SO shall offer short term capacities to the market;

⁵ Open seasons notices for LNG and storage investments should follow as close a format as possible while taking into account the technical differences between transmission facilities relative to LNG and storage facilities (for example, LNG facilities cannot have more than one "route").

- available capacity types (firm/interruptible);
 - minimum lot size;
 - the receipt and delivery pressure for all points;
 - information on capacities available upstream and downstream of the project;
 - quality specifications;
 - a description of the balancing regime
 - the estimated cost of the project;
 - the indicative tariff to be applied including the underlying methodology to derive tariffs; notice has to be given to the fact that tariffs for short and long term capacities may be different; given the requirement of Art 4.2 of Regulation 1775/2005 it has to be assured that *“transportation contracts signed with non-standard start dates or with a shorter duration than a standard annual transportation contract shall not result in arbitrarily higher or lower tariffs not reflecting the market value of the service”*.; the variation of the tariff against the allocation of total short and long term capacities (function) has to be indicated in the open season process for the entry and exit point(s) of a system;
 - creditworthiness guarantees;
 - the allocation rules that will be applied in case the demand indicated in the open season can not be fully met (auction/pro rata)- if contract duration or any other factors should influence the allocation, those factors should be mentioned;
 - the date for the subsequent capacity allocation;
 - the date by which bidders will be asked to sign a binding agreement;
 - the date by which the sponsor will file for construction and operating permits.
 - any remaining elements of the transportation contract necessary for system users to assess services is on offer;
- (21) The open season shall allow interested parties to indicate the amount and type of capacity (delivery and receipt points; contract duration, firmness) they would like for each projected route and expansion size under consideration. For planning purposes, interested parties should also inform the sponsor about the expected upstream transportation-system or source of gas/supplier and downstream transportation system they will rely on.

- (22) The open season will also allow users to comment on any modifications to the sponsor's proposal that would better accommodate their needs; including at a minimum modifications regarding:
- the date of commencement of service;
 - the service duration (in years; long term/short term);
 - the types of services on offer (firm/interruptible services);
 - the intake and offtake points ;
 - the amount of capacity made available at each point.
- (23) If the open season reveals that there is not enough demand for its proposed project, the sponsor should still be able to go ahead with the investment if it believes that sufficient demand will eventually develop and if it is ready to take on the financial risks associated with the project (i.e. that consumers do not carry the risk of potentially stranded assets). If the open season reveals that there is too much demand for its proposed project, the sponsor should still be able to amend the size of its project and conduct another open season based on this new proposal, unless it is not technically or economically viable.

4.3 Second Step: Capacity Allocation following Open Season

- (24) Market tests allowing the project sponsor to gauge how much demand exists in the market and what terms for the sale of capacity would best fit the market are essential. But to be truly effective, these tests must be followed by a non-discriminatory allocation of capacity. This section sets a timeline and general principles aimed at guaranteeing such an allocation.
- (25) After the conclusion of the first step the sponsor shall offer within the following capacity allocation step capacity according to the demand initially committed – e.g. via a non-binding pre-contractual commitment (Letter of Intent) signed during Step 1 – by market participants in the open season.

- (26) In order to ensure non-discrimination the maximum lot size offered within the capacity allocation shall reflect the results of the open season. Whether a capacity allocation mechanism (pro rata or auction) is applied is subject to the result of the open season (i.e. whether capacity is oversubscribed) and the respective national legislative requirements, if any.
- (27) Project sponsors shall not only take into account long term capacity bookings to design the total investment but also shorter term bookings. As far as legally foreseen or voluntarily agreed this shall be done in close cooperation with the national regulatory authority. Otherwise the application of open seasons procedures would mean that any new capacity would be booked long term, which could be a barrier to competition.
- (28) In all cases the mechanism applied should be non-discriminatory and objective. In particular, existing and future system users should be treated equally.
- (29) Once capacity has been allocated to the various bidders the winning bidders, if satisfied with the sponsor's proposal, enter into a binding pro-forma agreement with the sponsor. In this agreement and thanks to the additional information the sponsor has gained throughout the bidding process, the sponsor is able to provide bidders more information on the nature of services offered than during the open season; this includes information on the tariff that will eventually be applied. The level of information in the agreement should reflect the level of information available to the sponsor at the time of signing. The sponsor may require potential system users to provide bank guarantees/and or a fee up to an amount corresponding to certain parameters of the transportation contract (e.g. committed capacity). If the sponsor does not subsequently deliver the specified capacity financial compensation should be made available to the bidders in accordance with any contractual arrangements in place.

4.4 Results of the open season and transparency

- (30) The following results shall be made public:
- investment decision made by the project sponsor (route and capacity of project including all entry and exit points, timing of work and estimated in-service date);
 - names of prospective shippers and percentage of total capacity gained;

- tariff and contract duration.
- (31) Additional information on the terms of agreement between shippers and project sponsor shall be made available to the relevant regulatory authorities on request.
- (32) Relevant regulatory authorities may evaluate the extent to which the results of the open season may be relied upon by considering the size of the proposed infrastructure, and the potential to expand its capacity depending on the level of market demand, especially in case of infrastructure projects crossing borders. To make such a determination, the project sponsors should provide information concerning the proposed capacity, costs and expansion possibilities of the infrastructure involved.

4.5 Coordination with adjacent system operators

- (33) Adjacent system operators should endeavour to make coordinated open season including coordinated capacity allocation. The results of this coordination should be reported to the relevant regulatory authority(ies) involved. Such coordination is likely to require more detailed consideration in the light of cross border pipelines. Information that arises in one market for example is likely to impact on neighbouring markets. Market players in one market therefore have a legitimate interest in the information processes in neighbouring markets. When making an open season, the sponsor should coordinate with the adjacent system operator to ensure that:
- the use of new capacity is not impeded by the lack of available capacity upstream and/or downstream;
 - that shippers wanting to participate to the open season are not impeded by the lack of available capacity upstream;
- (34) If the project is linked to another project proposed by an adjacent system operator, ensure that the timing of the open seasons are compatible and that the capacity allocation method and the terms of contracts, including the tariff structure for the proposed services are compatible.

5 Invitation to Interested Parties to Comment

- (35) This document sets out ERGEG's draft guidelines on open season procedures. ERGEG invites stakeholders to comment on issues raised in this paper and in particular on the recommendations and issues for consultation pointed out in the document.
- (36) Responses should be received by **19 January 2007** and sent by email to:
openseason@ergeg.org.
- (37) Any questions on this document should, in the first instance, be directed to:
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- (38) Unless marked as confidential, all responses will be published by placing them on the ERGEG website. If there is anything confidential please include it in a separate annex to your main response.

6 Recommendation and Issues for Consultation

- (39) The ERGEG invites stakeholders to comment on issues raised in the text.
- (40) Specifically ERGEG would like responses to the following questions:
- a. **Questions on the application of the GGPOS:** *Are there new infrastructures which the guidelines should not apply to and if so why? In particular, do you believe open seasons, or guidelines on open seasons, may not be useful/may be counterproductive (for example by imposing unnecessary regulatory burden and/or costs):*
- *for small investments (and in particular minor upgrades to a facility)*

- *for investments inside an existing transmission network (as opposed to investments at an entry or exit point)*
 - *when the investing SO is properly unbundled from upstream and downstream market players and therefore could have appropriate incentives to maximise the amount of capacity provided to the market*
 - *when the market is characterised by the competitive provision of infrastructure – for example the provision of LNG and storage facilities/services could fall into this category*
 - *in the case of investments that are partially or totally exempt from rTPA, and alternative solutions for TPA are put in place by the project sponsor, e.g. a if at least a certain percentage of capacity is subject to TPA, or if marginal capacity increase is available on demand (it should be noted that the application of Article 22 is not the subject of this document)*
 - *in cases where market-based prices already provide sound investment signals, so that investment signals translate into actual investments and there is transparent consultation processes to ensure that the capacity provided meets market needs, and that non-discriminatory capacity allocation procedures are in place*
- b. **Questions on the first step of the procedure, i.e. the proposal to shippers:** *Are there any major items missing from the information requirements outlined in this section? Are the information requirements outlined above too prescriptive? If so, why and in what circumstances would they not be appropriate? In particular, in the special cases mentioned under point 40a, assuming that it would indeed be advisable to conduct an open season, would the amount or type of information exchanged between the sponsor and bidders need to be different?*
- c. **Questions on the second step of the procedure, i.e. capacity allocation following the open season:** *Are the requirements outlined in this section too prescriptive and if so in what circumstances or is there additional information that should be made available?*
- In particular, in the special cases mentioned under point 40a, assuming that it would indeed be advisable to conduct an open season, would the amount or type of information published need to be different?*

- d. ***Questions on coordination with adjacent system operators: Are there any other areas where there is a need to co-ordinate open season procedures?***