GTE Investment Report

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Investment Report Introduction

Investment in gas infrastructure is vital for the effective current and future functioning of the gas market in Europe. The issue of investment is increasingly becoming a priority for Europe, particularly with Europe becoming progressively more import dependent. It is estimated that for OECD Europe more than 200 billion Euros of new infrastructure investment will be required by 2030. Without sufficient investment market liberalisation and the benefits of consumer choice will not be delivered. With this in mind it is vital that the investment climate in Europe is designed to encourage and facilitate the smooth and effective functioning of investment projects both nationally and internationally. In order to develop such conditions it is necessary to fully understand the investment climate within which infrastructure operators currently function, and from this identify any barriers faced and how such barriers could be removed.

GTE are encouraged by the Commission’s acknowledgement in the Strategic Energy Review of the urgent need for investment. GTE would like to see an investment climate across Europe that is predictable, stable, commensurate and complete. In order to support this aim GTE committed in its Green paper response to undertake the following actions:

1. To establish a new working group within GTE specifically dedicated to investment. This group will be chaired by a senior gas infrastructure executive, who will act as the focal point for all GTE discussions with stakeholders on this crucial topic. Key objectives and tasks of this work group will be:
    - To drive forward at a European level, where appropriate the co-ordination between infrastructure operators on future investments
    - To champion the removal of investment barriers throughout the EU
    - To identify differences in the legal frameworks and regulatory regimes, which impede investment in cross-border infrastructure
    - To develop and propose solutions for the removal of the identified impediments
    - To identify, share and publicise best regulatory practice in creating a conductive investment environment, including the promotion of effective cooperation among regulators and with infrastructure operators for cross-border projects
    - To work with the Commission on the Priority Interconnection Plan

2. To prepare a workshop on investment where further results from the survey conducted by GTE will be presented to the Commission, regulators and other relevant stakeholders, who will be invited to respond and input into these discussions

3. To bring forward the issue of investment in all of the energy markets of the ERGEG Gas Regional Initiative, in order that the real practical issues of investments may be considered and addressed.

In line with the commitment made GTE have set up an investment working group in order to focus entirely on the issue of investment. The first task of this working group was to organise a workshop to promote the intentions of the GTE investment working group, by publicly sharing the work plan for the group, as well as meeting the second commitment made in the Green paper response to share investment survey findings.

This report will begin by detailing findings from the investment survey, before moving on to explaining the Action Plan proposed for the Investment Working Group, along with feedback on this and the investment principles discussed during the workshop.

Section 1 GTE Investment Survey Findings

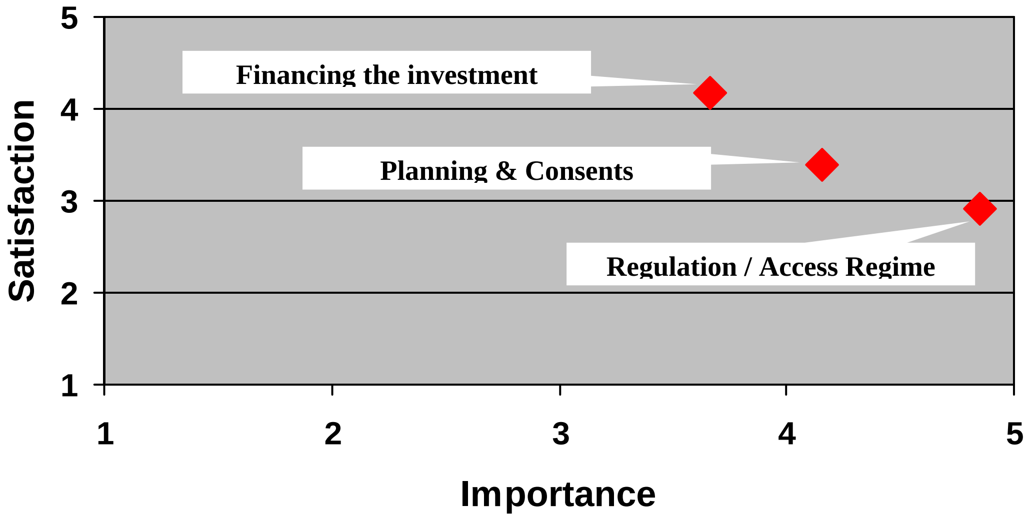
In acknowledgement of the importance of investment in gas infrastructure GTE undertook the survey of its members with the aim of identifying barriers to investment, and determine means by which such barriers could be overcome. The questionnaire asked for respondents' opinions on the effectiveness of current regimes and the barriers that they perceive from these. Respondents were also asked to rate the level of importance they place on, and satisfaction they have with, the planning and consents procedures, financing options and regulatory regimes.

A summary of the responses is detailed here. As differences may exist in some cases between domestic and non-domestic investments operators were asked to indicate whether responses referred to one or the other area and a separate section is included for each of these areas of investment.

Domestic Investment

The figure below demonstrates the overall ratings for Planning and Consents, Financing and Regulation/Access regime. It clearly indicates that domestic pipeline operators consider the regulatory/access regime to be of greatest importance for investment, yet this receives the lowest rating for satisfaction.

Figure 1: Importance and Satisfaction ratings for domestic investments



In addition to the quantitative responses summarised above, comments were sought from the operators on barriers to investment and areas for improvement. For each of the three areas the following results were obtained:

Planning and Consents

Nearly all respondents consider planning and consent to be important or very important; however few respondents were satisfied with the current procedures in place. Timing of the planning and consents process was by far the most frequently cited reason for dissatisfaction with current arrangements, both in terms of uncertainty and the lengthy duration of the process. Some comments were:

> *"the duration of the procedures prescribed makes a fast construction of transmission lines more difficult"*
> *"uncertainty of lead time involved for appeal procedures of different authorities"*
> *"Lengthy consultation process for determining the Mandatory planning, Lengthy consents/permits process"*
> *"for some procedures delays are not clear and/or respected"*

The existence of multiple approval layers was given frequently as a further dissatisfaction for pipeline operators.

The two improvements stated by the majority of operators were that the timelines for the process should be sped up and formalised, and a one stop shop created:

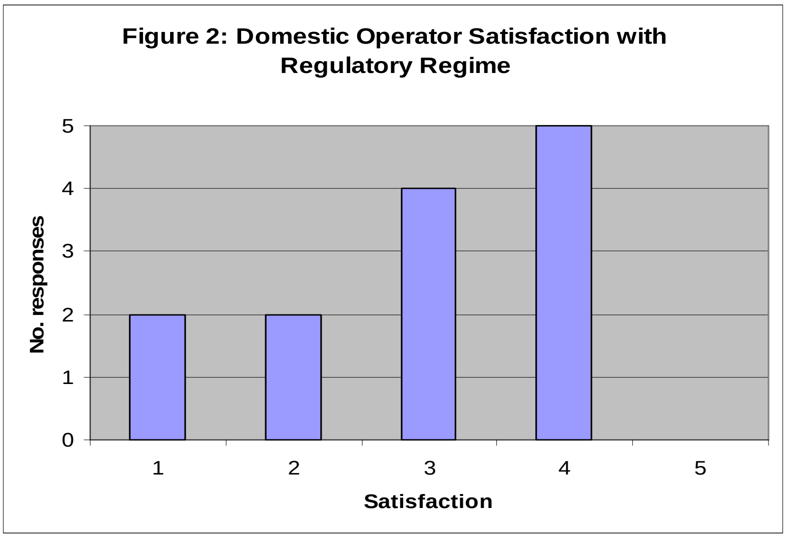
> *"Compliance by authorities to legally prescribed periods for decisions"*
> *"clear time limits need to be set with regard to the steps of the procedure"*
> *"One stop shop of planning through the control area manager"*
> *"Liaison between administrations at multiple levels"*

Financing the Investment

Almost all respondents stated that they were happy with the financing options available for investment. The barriers highlighted mostly concerned regulatory/legislative issues, which are discussed below.

Regulation/Access Regime

Almost all respondents indicated that regulatory regime was very important in terms of the viability of investing in domestic pipelines; however few stated that they were satisfied with the current regime, and in fact several were unsatisfied. Figure 2 below indicates the satisfaction ratings provided by respondents:



The most commonly stated barrier in terms of the regulation/access regime was the uncertainty of the regime in the future:

> *"uncertainty concerning legal and regulatory framework"*
> *"uncertainty in the treatment of investments in current and future regulatory regimes"*
> *"long-term instability of regulatory rules"*

The treatment of tariffs also emerged as concern:

> *"artificial low tariffs due to the current regulatory regime that distort competition"*
> *"the Regulator doesn't cover the investment through the tariff"*

Stabilising of the regulatory regime was the most commonly stated recommendation for improvement.

Domestic Conclusion

Whilst the responses received highlight that there are differing regimes across Member States for investment in domestic pipeline projects, responses consistently displayed comparative levels of dissatisfaction with the regimes as well as causes for this dissatisfaction.

The planning and consents process was considered across Member States and respondents to be very important. It was clear from the majority of responses that frustration with this often arose due to the uncertainty of the process, in particular with regards to the timings required for consents to be considered and granted. Operators from Member States with multiple approval layers also exhibited signs of frustration due to the timing involved with this. Resolution of these issues through the development of a one-stop-shop, and clear and standard timings and processes would help improve the situation and facilitate investment.

Uncertainty of the regulatory regime was clearly the biggest issue affecting investment decisions for respondents, and the lowest level of satisfaction was recorded in this area, with only four of the thirteen responses indicating satisfaction with the current regimes. The requirement for clear and stable regulatory conditions facilitating a favourable investment climate was cited repeatedly in all responses received. From this it is clear that TSOs feel such an environment has not been achieved, and this is currently a barrier to domestic pipeline operators making investment decisions. An example of this lack of clarity and instability in regulatory decision making emerged when one operator applied for a specific rate of return to reinforce a pipeline. In order to ensure the pipeline was operational on the same day as the operational commencement of a new LNG terminal the operator had to take the investment decision before the regulator decided on the conditions for the rate of return. Ultimately the regulator's decision was to grant the desired rate of return only to part of the investment according to granting rules that the operator was unaware of in advance. The existence of uncertain conditions such as this has a serious impact on operators taking investment decisions.

In conclusion, from the responses received in this survey, movement towards stable and predictable regulatory regimes across member states is essential in order to facilitate a positive investment climate in the future.

<u>Non-Domestic Investment</u>

Figure 3 below demonstrates the overall ratings for Planning and Consents, Financing and regulation/Access regime.

Figure 3: Importance and Satisfaction ratings for non-domestic investments

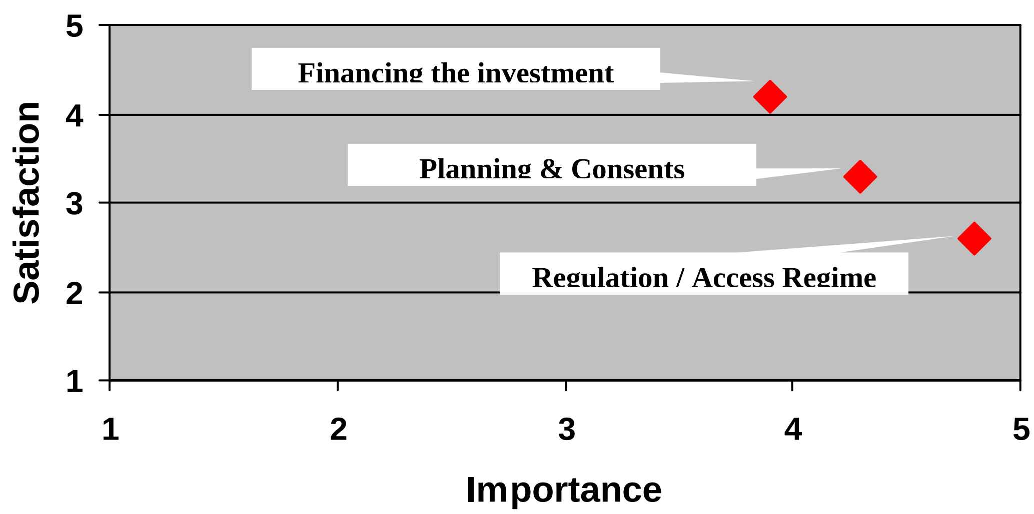


Figure 3 displays both the combined responses and the individual non-domestic scores, and is therefore very similar to the domestic results. As with domestic pipeline investments it clearly indicates that the regulatory/access regime is of greatest importance. It is interesting to note that financing is considered more important from the non-domestic responses, which corresponds with the qualitative responses received highlighting the importance of stable financing conditions for non-domestic investments. As there were only 4 specific non-domestic responses the following section picks out some of the specific non-domestic comments received.

Planning and Consents

The separate non-domestic responses cited the coordination of different regulatory authorities as a key issue.

> *"the number of regulatory or relevant authorities involved in determining the regulatory regime"*

One non-domestic specific response indicated that to resolve this:

> *"One challenge might be finding a practical and timely form of co-operation of respective regulatory authorities"*

Financing the Investment

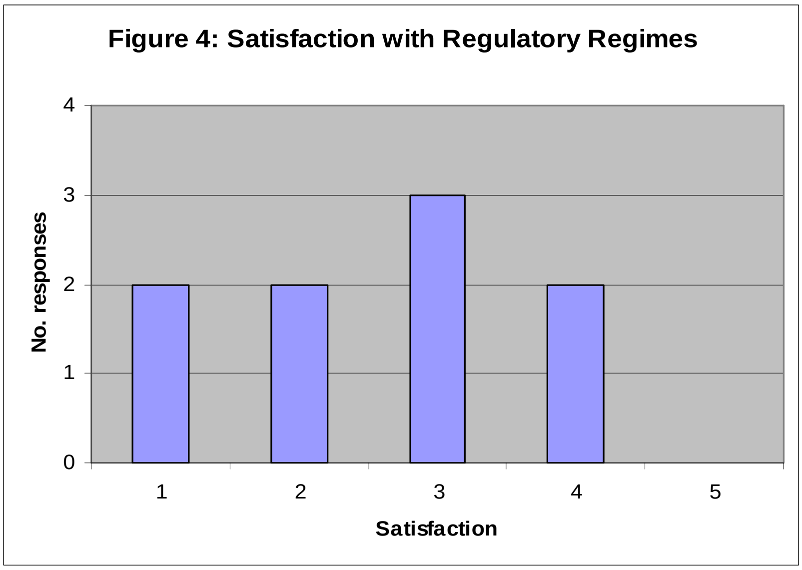
Almost all respondents stated that they were happy with the financing options available for investment. For the specific non-domestic responses financing emerged as being even more important than for domestic investments:

> *"with special regard to investments in this type of asset, which require a higher amount of capital for a longer lending period, the availability of attractive financing options is even more important"*

The barriers highlighted concerning financing arrangements mostly concerned regulatory/legislative issues, which are discussed below. A non-domestic response indicated that whilst they are satisfied with the current arrangements, as there is no regulation in this area and it is therefore stable and predictable, this could change in the future which would then become an issue

Regulation/Access Regime

All respondents indicated that regulatory regime was very important in terms of the viability of investing in non-domestic pipelines; however few stated that they were satisfied with the current regime. The satisfaction responses provided are indicated in the figure below:



Over an above the barriers highlighted in the domestic section the number of regulators involved in the process for non-domestic investments is also a serious problem.

From the majority of responses received stabilising of the regulatory regime would help with improving the current situation.

Non-Domestic Conclusion

As with the domestic results the non-domestic survey indicated that uncertainty of the regulatory regime was a serious issue for investment decisions. The requirement for a clear and stable regulatory environment facilitating favourable investment conditions was cited repeatedly in the responses received. This is even more serious for non-domestic investment where interaction with more than one regulator is required. The inconsistent application of article 22 was specifically mentioned, with the application process being considered non-transparent and unclear, leading to greater uncertainty in non-domestic investments. Operators indicated that cooperation between regulators is very important, and consistency of the cross-border approach to regulation is essential. Therefore the development of stable and predictable regulatory climates across member states is vital.

Financing also emerged as being more important for non-domestic investment decisions. Whilst financing options will be the same for both forms of investment, again there is increased risk associated with the non-domestic projects. This is largely due to the requirement for long-term stable cash flows to enable such projects. As with the domestic responses this links with the requirement for stable and predictable regulatory conditions that are able to provide guarantee for any investment made.

In conclusion most of the issues and concerns associated with domestic and non-domestic investment are the same; however non-domestic investment faces additional complications. By stabilising regulatory regimes and ensuring cross-border cooperation of regulators the investment risks faced could be vastly reduced.

Investment Survey Conclusion

The aim of the investment survey was to identify barriers to investment in both national and international gas infrastructure projects, and determine means by which these barriers could be overcome. The survey findings highlighted that whilst there are many different planning and regulatory regimes in place across member states the main issues with regards investment decision making are largely the same. From the responses provided it is clear that planning and consent, and to a lesser extent financing, are issues that can delay and complicate investment. However, movement towards a stable and predictable regulatory regime is essential if a positive investment climate is to be facilitated.

Section 2 GTE Investment Working Group Action Plan

Following the establishment of the GTE Investment Working Group a 2 year action plan was developed for the group. This plan was discussed during the investment workshop and comments were received from representatives of EFET and Eurogas. These responses are detailed in the workshop summary in the following section of this report.

The GTE Investment Working Group has identified 3 key elements for the proposed action plan. The first of these is to examine where we, as operators, can work better together. The group will consider publication of information by operators and the compatibility of regulatory regimes, gathering views from all market stakeholders. The intention is for this phase to be completed by June 2007. Following this an action plan will be developed.

The second element of the work plan is to consider current barriers to investment. This will be tackled by focussing on the positives in regulatory regimes, rather than the negatives. The aim of this phase of the work plan is to identify which elements from regulatory regimes are best in class, and following this to identify, share and publish regulatory best practice. A paper documenting the findings on these issues will be produced by March 2007, and the report will feed into the development of investment principles which we intend to finalise by December 2007.

The third element of the investment action plan is to work with the Commission on the Priority Interconnection Plan. GTE will seek to input into this process on a continual basis, the first step in this was to invite Commission representatives involved in the Priority Interconnection Plan to attend the investment workshop.

A diagram detailing this work plan and the associated time line is included on the following page.

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Figure 5 outlines the timeline associated with the proposed GTE working group action plan:

Figure 5: 2 Year Work Plan*		**2007**												**2008**											
Action	**D**	**J**	**F**	**M**	**A**	**M**	**J**	**J**	**A**	**S**	**O**	**N**	**D**	**J**	**F**	**M**	**A**	**M**	**J**	**J**	**A**	**S**	**O**	**N**	**D**
Paper identifying areas where TSO cooperation on investments can be improved to the market e.g. transparency or co-ordinated open seasons? Develop action plan unique and on-going																									
Implement Action Plan																									
External paper with realistic wish list and look for examples where the wish list is fulfilled																									
Develop Investment Principles (discuss at 2nd Madrid Forum 2007)																									
Provide initial input into PIP after 28/11 and continual input throughout process																									
Process review dates:																									
Following workshop																									
Following 3rd package (Jan 10th)																									
12th Madrid Forum																									
13th Madrid Forum																									
14th Madrid Forum																									
15th Madrid Forum																									

* Please note that the timeline indicated in this work plan may be subject to change following full review of the investment implications from the Commission's Strategic Energy Review.

Section 3 GTE Investment Workshop

On 28th November 2006 GTE hosted an investment workshop. Invitations to the event were sent industry wide with members of the Commission, regulators as well as industry representatives forming part of the 50-strong attendees.

The workshop included presentations on investment from the European Commission, the Dutch regulator, the German regulator and OGP, as well as preliminary responses to the proposed action plan from EFET and Eurogas. Pavel Telicka, a European rail coordinator for the Rail Baltica axis, also shared his experiences from the perspective of Europe-wide coordination.

GTE provided an update on findings from the investment survey as well as sharing the action plan for the newly formed investment working group.

The GTE action plan and survey findings are covered previously in this report, therefore this section will summarise the key elements of feedback on these and other discussions from the workshop.

Investment Principles for Discussion

Following the general presentations on investment, GTE presented and sought feedback on the working group action plan for investment and a number of questions on potential investment principles. The action plan has been detailed previously in this report, and the questions on principles for discussion were:

1. Should TSOs produce a long term statement (e.g. 10 years) on the future development of their network?
2. Should the establishment of new entry points and significant expansion of existing capacity be largely driven by market signals? How should open, transparent and non-discriminatory procedures be set for achieving this?
3. Should the framework allow for long-term binding commitments for this new capacity?
4. Which kind of analysis on the system capacity need should the TSO provide?
5. Are clear rules required on how TSOs invest, and what the responsibility of the regulators is?
6. Which role should TSOs play in the final decision on the level of capacity to be built?
7. What is a reasonable period for regulatory conditions for investment? How should a clear process to evaluate any change in the future, including appeals mechanism, be set?
8. Should regulators be required to coordinate with different countries for certain investments e.g. article 22 exemptions? In such cases should regulators work together to establish common conditions?
9. If agreement on such conditions cannot be reached, in particular for non-domestic investment, should it be possible to refer to a European coordinator to seek an equitable solution?

The questions presented were for discussion only and will be further developed in the coming year. At this stage it is worth noting that the topics relate to transmission activities and are not intended to cover situations where effective pipe to pipe competition exist, in these cases different arrangements are required, which provide operators with the ability to market price.

GTE concluded the presentation of this material by posing a number of questions to which Eurogas and EFET responded:

1. Would you prioritise investment?
2. What do you think of the proposed work plan?
3. Is there anything missing from the work plan?
4. Are you willing to support the work plan?

Eurogas – Margot Loudon

Eurogas presented preliminary responses to the questions posed by GTE. Some of the key points raised include:

- The Market as a whole should create conditions for delivering timely investments, and important elements of the market framework are
    - Regulatory clarity and predictability
    - A high level of market transparency to give market signals
    - Consultation by TSOs/DSOs on users' requirements
    - A regulatory regime that provides adequate returns to permit TSOs/DSOs to maintain an efficient and safe infrastructure
- Eurogas has some concerns over the general trend towards a low risk approach for investment by TSOs – there should be a more balanced approach between risk and reward
- New infrastructure should not necessarily be underpinned by binding financial commitments for the total capacity and throughout the lifetime of the project.
- The preferred method to determine new infrastructure investment requirement is open season but differing solutions may be appropriate depending on the circumstances and relevant market
- If problems materialize especially affecting cross-border transport, then we have to consider other ways forward notably closing the 'regulatory gap' and improved regional co-operation. Nor should an obligation to invest be excluded, as a last resort.
- Article 22 exemptions should be applied on a case by case basis (and not become obstacles to competition)

In specific response to the questions on investment principles an initial response was given, pending formal consultation within Eurogas:

- The framework can allow for but not require long-term binding commitments for new capacity

➔ Users would expect to see TSOs operate as businesses, prepared to balance risk and rewards, and not insists on full commitments for the life-time of a project and for the total capacity (Qu 3).
- Clear guidelines would be useful on how TSOs invest, but how would these fit in with ERGEG's own planned Guidelines? (Qu 5)
- In terms of the role TSOs should play in the final decision on the level of capacity to be built it is their decision and they cannot expect others to shoulder their responsibilities (Qu 6)
- In terms of process to evaluate change in the future Eurogas believe that there should not be automatic reopeners such as appeals mechanisms (Qu 7)
- Eurogas would require further information on why pipe-to-pipe competition should preclude the application of any investment principles developed

To conclude:

- Eurogas would consider investment to be a priority
- The work plan presented is worth discussing. Eurogas will consider additional suggestions over and above those presented
- Transparency is very important for Eurogas. They believe that the present publication requirements should be universally met, as well as additional requirements introduced

<u>EFET – Colin Lyle</u>

Key points raised by EFET:
- It is essential that regulated TSOs provide sufficient capacity to meet the needs of the market, therefore.EFET fully support investment as a priority.
- EFET agreed with Eurogas that there must be a balance of risk and reward, with investment in pipelines being a relatively safe form of investment for TSOs.
- There must be the right obligations and incentives on TSOs to build sufficient capacity to satisfy all reasonable demands and to meet the relevant Secuurity of Supply standards. TSOs should be awarded their full regulated rate of return if they achieve this even if the result is that there is some spare or surplus capacity available. If a TSO fails to provide the agreed level of capacity and congestion occurs or if lack of capacity leads to a failure to satisfy Security of Supply standards then the TSO must be penalised and the market participants and customers involved should be compensated.
- EFET agreed that there needs to be a greater emphasis placed on transparency. EFET's position is set out in the Gas Information paper available on <u>www.EFET.org</u> dated August 2006.
- In making judgements about investment decisions, in addition to improved information on the use of existing infrastructure there could be significant benefits from greater operational consistency and planning assumptions across Europe – for example a consistent definition of "peak day".

Elements missing from the work plan include:
- How to ensure that the correct incentives are in place to guarantee the right amount of capacity is created

- How to encourage TSOs to make as much capacity as possible available
- What sufficient capacity means in terms of SoS

Conclusions from the day

During the investment workshop there was a good level of consensus around the following topics:

- Investment is a priority for action
- The consequences of under investment are much more significant than a little over investment, hence when new capacity is created in response to market demand and commitments TSOs should consider building some spare capacity for further needs
- Transparency is fundamental and may require input from other market players
- Clarity on roles and responsibilities is essential
- “Regulatory uncertainty” at all levels needs to be mitigated
- The idea of “European co-ordinator” is worth exploring

Investment Report Conclusion

GTE considers investment to be fundamental to both the current and the future functioning of the gas market in Europe. GTE are encouraged that the Commission has acknowledged investment as a key issue, and following the participation of many key stakeholders at the investment workshop are pleased with the support offered by stakeholders to engage further on this important topic.

The investment survey provided some useful insights into the barriers faced in investment decision making, and served to illustrate the vital role of stable and predictable regulatory conditions in the facilitation of an effective investment climate. The findings from the survey, as well as the comments received from stakeholders during the workshop, will be used to feed into the action plan for the working group going forward. Specific feedback during the workshop on the action plan was very positive, and GTE will take on board the comments received, paying particular regard to the importance of transparency and the fact that when new capacity is created in response to market demand and commitments TSOs should consider building some spare capacity for further needs due to the consequences of under investment being much more significant than a little over investment.

In conclusion there is an urgent need for investment in both new and existing transmission capacity throughout Europe. This will only happen in an efficient and timely manner if all stakeholders work together to improve the investment climate. GTE intend to continue engagement with stakeholders on this important topic, in order to deliver on an action plan suitable to achieving this goal.