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Assessment of Projects of Common Interest

In this document, ACM explains in what ways it is safeguarded in the Netherlands that projects of common interest are carried out in a timely manner.

Background

Under Article 13, paragraph 1 of Regulation (EU) 347/2013 on guidelines for trans-European energy infrastructure of April 17, 2013 (hereafter: the Regulation), Member States and national regulatory authorities ensure that appropriate incentives are granted when a project promoter incurs higher risks for the development, construction, operation or maintenance of certain projects of common interest.

Article 13, paragraph 6 of the Regulation stipulates that each national regulatory authority publish its methodology and the criteria used to evaluate investments in electricity and gas infrastructure projects and the higher risks incurred by them. With this document, ACM has implemented this obligation, both for electricity and for natural gas.

The investments to which Article 13, paragraph 6 of the Regulation refers concern projects of common interest (hereafter: PCIs), which are mentioned in the first paragraph. A PCI, as defined in Article 2, paragraph 4 of the Regulation, is a project necessary to implement the energy infrastructure priority corridors and areas set out in Annex I of the Regulation, and which is part of the Union list of projects of common interest referred to in Article 3 of the Regulation.

Assessment of investments

In the Netherlands, PCIs are developed by Gasunie Transport Services B.V. (hereafter: GTS) or TenneT TSO B.V. (hereafter: TenneT). GTS is the transmission system operator for natural gas, and TenneT is the transmission system operator for electricity. There are generally speaking three moments when investments come to ACM's attention: first, when such are mentioned in the quality and capacity document (hereafter: KCD); second, when ACM draws up its recommendations regarding the usefulness and necessity for a particular investment; and third, when a network operator submits a proposal for compensation of an investment.

For investments of national interest, the necessity is demonstrated by the fact that such investments are listed in the National Coordination Scheme (*Rijkscoördinatieregeling*, hereafter: RCR).

Each network operator for natural gas and electricity must draw up a KCD every two years. In these KCDs, network operators elaborate, among other things, what investments they plan to do for expanding the network[1], and commit themselves to these.

ACM will approve TenneT's KCD, insofar as it concerns TenneT's performance with regard to

[1] Section 21, paragraph 2, part e, of the Dutch Electricity Act, and Section 8, paragraph 2, part e of the Dutch Gas Act.

the quality of supply and operational network security, if, in ACM's opinion, it turns out that TenneT is sufficiently and effectively able to realize its own objectives[2]. GTS will only notify ACM of deviations from its plans in the KCD, should any such arise[3]. ACM does not assess individual investments of network operators (or the risks thereof), but gives an assessment of how they come to such necessary investments.

With regard to the PCIs, TenneT and GTS have the option to receive a compensation for the investment expenditures through the auction revenues or through the tariffs[4].

Compensation of investment expenditure through auction revenues - TenneT
If TenneT opts for compensation through the auction revenues, TenneT will then use the funds it received from the auction of interconnection capacity. TenneT has these funds in a separate account, and, under Regulation 714/2009, it must remain available for maintaining and/or increasing interconnection capacities. If TenneT pays for the investment expenditures with the auction revenues, then, by definition, there are no additional risks within the meaning of Article 13 of the Regulation. After all, the expenditures are compensated at the moment of initial operation, meaning the revenues and/or costs can no longer have any risks (additional or otherwise).

Compensation of investment expenditure through auction revenues - GTS
The way GTS may use the auction revenues for paying for investments has been laid down in the GTS Method decision 2014-2016[5]:

"GTS can submit to ACM proposals for investments aimed at reducing congestion. These investments can only be eligible for compensation if ACM has approved such in advance. In its assessments of such proposals, which are realized based (in part of fully) on funds from the auction revenue account, ACM will attach great importance to the degree to which the proposed investment sufficiently helps reduce structural congestion, and, importantly, can be executed within a reasonable time frame. In order to prevent compensating twice, the revenues from auctions on interconnection points will be deducted from the amount to be activated for the investment in question. If ACM rules that there are no investments for which auction revenues can be used efficiently, ACM can decide to take into account the revenues as part of its annual tariff decision. Revenues from year t can be taken into account starting from year t+2."

If GTS pays for the investment expenditures with auction revenues, then, by definition, there are no additional risks within the meaning of Article 13 of the Regulation. After all, the expenditures are compensated at the moment of initial operation, meaning the revenues and/or costs can no longer have any risks (additional or otherwise).

[2] Section 21, paragraph 8, part e of the Dutch Electricity Act.
[3] Section 8, paragraph 6 of the Dutch Gas Act.
[4] GTS and TenneT can also claim a European subsidy. However, such a subsidy will never cover all investment expenditures or all costs.
[5] GTS Method decision 2014-2016, reference ACM/DE/2013/204152.

Payment using transmission tariffs
If TenneT and GTS only partially use the auction revenues or not use them at all, they will submit the investment (or the remainder thereof) together with a tariff proposal. The way TenneT and GTS pay for investments through the tariffs is laid down in method decisions. For the period 2014-2016, ACM has already set the method decisions for both TenneT and GTS. In them, ACM explains how it determines the annually permitted turnover of a TSO in this regulatory period. ACM explains below how PCIs that will come into operation in the current regulatory period (2014-2016) will be assessed.

Every year, TenneT and GTS submit a tariff proposal in which they take into account the method decision. This is a proposal for the tariffs of the following year. The statutory basis thereof is Section 41b, paragraph 1 of the Dutch Electricity Act for TenneT, and Section 82, paragraph 3 of the Dutch Gas Act for GTS. In a tariff proposal, GTS and TenneT[6] have the opportunity to submit a proposal for a special expansion investment. An expansion investment is an investment in the construction or expansion of the network. ACM assesses the tariff proposal, and lays it down in a tariff decision, possibly after several changes. If an expansion investment is submitted together with the tariff proposal, ACM will follow the "NMa Policy Rule on the assessment of efficient costs of special investments[7]." Using this policy rule, ACM determines the efficient costs through a rough or integral assessment of the expenditures of an investment. Expansion investments are not just assessed *ex post* on efficiency. These investments are also assessed *ex ante* on usefulness and necessity, or are part of an integration plan that has been set in accordance with Section 3.28 of the Spatial Planning Act (*Wet ruimtelijke ordening*).

Assessment of the risks
If PCIs are compensated through the tariffs, ACM uses the WACC (weighted average cost of capital) for determining the compensation for investment expenditures. The WACC is a weighted average of the cost of debt and the cost of equity, based on a gearing set by ACM[8]. The WACC enables efficient businesses to make a reasonable return on invested capital that is needed as compensation for the moneylenders. In energy regulation, the WACC is applied as a percentage of the assets, and encompasses both a compensation for debt, as well as one for equity. ACM sets a single WACC for the entire regulatory period of a TSO. The WACC is determined for the entire portfolio of the TSO, and thus does not make any distinction between certain types of investments, since a TSO does not attract capital for each individual investment. ACM is aware of the fact that setting the WACC at the right level is of the utmost importance. If the WACC is too high, TSOs will earn a return that is higher than reasonable, leaving customers paying too much for their services. If the WACC is too low, TSOs will earn a return that is lower than reasonable. In that case, they would not be able to pay their moneylenders a compensation that

[6] On July 1, 2011, the compensation scheme for significant investments, originally laid down in Section 41b, paragraph 2 of the Dutch Electricity Act, was replaced with the compensation scheme for expansion investments. PCIs cannot be significant investments time-wise.
[7] NMa Policy Rule on the assessment of efficient costs of special investments of 27 December 2011.
[8] Annex – Explanation of the method for the WACC, ACM/DE/2013/204226.

is in line with market conditions. If the WACC is too low, and the TSOs' capital needs must be financed or refinanced, moneylenders will not be willing enough to make capital available. This may endanger necessary investments, and, by extension, security of supply[9].

ACM can only assess the risks of PCIs if the project promoter provides ACM with all of the relevant information in a verifiable manner. Risks cannot be assessed using incomplete information. Pursuant to Article 13, paragraph 2 of the Regulation, ACM will, in its decision to grant incentives, take into account (in particular) the project's positive externalities that apply regionally or those that apply to the entire Union. Following that same paragraph, a step-by-step approach must be taken. ACM will analyze the risks that project promoters face. ACM additionally analyzes the measures that these project promoters have put in place to reduce these risks. Furthermore, ACM analyzes the justification of the risk profile in light of the net positive effects of the project compared with a lower-risk alternative.

In view of these analyses, project promoters must provide information that are critical to the assessment of an investment's risks:

1. *Preconditions for the planned investment*
   The project promoter must demonstrate that the planned investment qualified as a PCI. Investments that are not listed on the Union list of PCIs, as referred to in Article 3 of the Regulation (the PCIs defined under Regulation 1391/2013), do not fall under Article 13.

2. *WACC*
   The project promoter must demonstrate that one or more risks are not already compensated through the current method for determining the WACC. That is because the WACC offers a compensation for non-diversifiable risks.

3. *Specific risk of the project promoter and measures for risk mitigation*
   The project promoter must explain what the specific risk entails, and whether any measures have been taken to mitigate that risk or whether any mitigation options with regard to that risk exist.

   The risk that is relevant within the context of Article 13 of the Regulation is the specific risk that the project promoter incurs with regard to the rate of return of the planned investment. ACM interprets this as follows: a risk within the meaning of Article 13 of the Regulation is the risk for an event that is sufficiently likely to occur, and over which the project promoter has no control, and which, if it were to occur, it would have a significant and negative effect on the rate of return of the planned investment, and for which the project promoter has no instruments available to limit the harm. Limiting potential harm could include hedging or insurances. In that context, any potential effects on the project promoter can only be assessed in light of the existing regulatory framework. A potential risk is therefore not relevant insofar as existing economic measures and, in particular, regulatory measures for

[9] GTS Method decision 2014-2016, reference ACM/DE/2013/204152.

risk mitigation are already available. Such measures include, among other options, funding through the auction revenues.

In this context, ACM emphasizes that higher risks of investments can only exist if there is an actual risk to the rate of return within the existing regulatory framework. Therefore, the project promoter must substantiate how and why a potential risk can lead to an actual, increased risk to the costs or revenues of the project promoter (for example, by presenting an expected cash flow analysis).

4. *Risk quantification*
   The project promoter must demonstrate the impact and the likelihood of the risk. Only if the risk is estimated as extraordinarily high can ACM consider additional incentives. In order to be able to make this estimation, the project promoter must provide a monetary estimation of his risk, taking into account the existing regulatory framework. In its assessment, ACM will pay particular attention to project-specific details. This means that, according to ACM, a project-specific incentive can only be considered if the additional costs (or expected lower revenues) that are sufficiently likely to occur are significant compared with the project's total costs.

5. *Comparable investment plans*
   The project promoter must demonstrate that the risk of the PCI is higher than the risk of a comparable investment. This can only be done on a case-by-case basis. ACM will use, for example, the following parameters as criteria for a comparable investment:

   Concerning natural gas:
   - for pipelines: investments with a comparable diameter and maximum operating pressure;
   - for gas compressors of other measures to promote or safeguard the safety and efficiency of the system or to enable bi-directionality: comparable measures in the sense that they have a comparable function and that their performances are comparable.

   Concerning electricity:
   - for high-voltage overhead lines: capacity in MW, voltage in kV and technology (for example AC or DC, alternating current or direct current)
   - for measures or installations that are needed to promote or safeguard the safety and efficiency of the system: comparable measures in the sense that they have a comparable function and that their performances are comparable.

6. *Positive net benefits of the planned investment*
   The project promoter must demonstrate that the risk profile of the planned investment is justified in light of the regional and Union-wide positive effects (external or internal) of the infrastructure project, and in comparison with the positive effects of an alternative with a lower risk. When demonstrating these positive effects, the project promoter must use the

cost-benefit analyses that are drawn up in accordance with Article 11 of the Regulation. Insofar a final cost-benefit analysis is not ready yet or has not yet been published, the project promoter must use the most recent cost-benefit analysis. ACM re-emphasizes that the risks the project promoter takes into consideration must concern the project-specific risks.

Summary: the information and documents that are to be provided by the project promoter

The step-by-step approach as explained above can only be used if all relevant information is made available by the project promoter in a verifiable manner. This information that is to be provided concerns at least the following:

- Proof of status as a PCI
- Description of the risk that must be taken into account with existing or available measures for risk mitigation
- Quantitative (monetary) estimation of the risk (impact and likelihood)
- Explanation of to what extent the described risk is higher than the risk of a comparable investment
- Cost-benefit analysis based on the requirements in Article 11 of the Regulation.

ACM may ask for additional information.

This document may be altered if circumstances change or if new information or new insights emerge.