Updated Project Proposal[1] for Incremental Capacity between Entry/Exit Systems of the Czech Republic ('CZ') and Austrian Market Area East ('AT')

This updated project proposal is elaborated by NET4GAS, s.r.o., registered in the Commercial Register maintained by the Prague Municipal Court, File No. C 108316, Company ID No. 272 60 364, with its registered seat at Na Hřebenech II 1718/8, 140 21 Prague 4 - Nusle ('N4G'), in coordination with Gas Connect Austria ('GCA'), pursuant to Article 28 (1) of Commission Regulation (EU) 2017/459 of 16 March 2017 establishing a network code on capacity allocation mechanisms in gas transmission systems and repealing Regulation (EU) No 984/2013 ('the NC CAM'). This project proposal is addressed to the Energy Regulatory Office, Masarykovo náměstí 5, 586 01 Jihlava, Czech Republic.

[1] This updated version of the Project Proposal submitted to the Energy Regulatory Office on 5 November 2020 reflects the fact of postponing the expected date of the auction of the incremental capacities to the year 2022 and submission of the updated Project Proposal by the Gas Connect Austria GmbH on 28 May 2021.

Table of Contents

A. Background: Description of Incremental Capacity Project[2]

N4G and GCA have conducted technical design studies for an incremental capacity project. The incremental capacity project aims to physically link the entry/exit systems of CZ and AT (Market Area East) by constructing a pipeline system between Břeclav (CZ) and Baumgarten (AT). The project's technical design parameters are as follows:

Technical Solution 1:

Parameter	Overall	CZ Section	AT Section
Technical Capacity	210,000 Nm³/h (0 °C)	210,000 Nm³/h (0 °C)	210,000 Nm³/h (0 °C)
Capacity Quality	Firm	Firm	Firm, freely allocable (FZK)
Interconnection Point	Reintal	Reintal	Reintal
Flow Direction	Bidirectional	Bidirectional	Bidirectional
Minimum Handover Gas Pressure in Direction from AT to CZ	53 barg	53 barg	53 barg
Minimum Handover Gas Pressure In Direction from CZ to AT	46.7 barg	46.7 barg	46.7 barg
Length of Pipeline	61 km	12 km	49 km
Aboveground Installations	-	-	Compressor station in Baumgarten
	-	-	Metering station in Baumgarten
	-	-	Cross border metering station
Cost Estimate	CZK 3,157.6 mn	CZK 649.7 mn[3]	CZK 2,507.9 mn[4]
Cost Estimate Accuracy	+/- 25%	+/- 25%	+/- 25%

[2] Information about technical solution on the Austrian side provided for reference only based on the draft project proposal from January 2020.

[3] Value updated since publication of the Draft Project Proposal for this project in January 2020 partly in order to reflect the expected cost of ensuring that the pipeline is ready to transport hydrogen, should such a need arise.

[4] Values provided for reference only, recalculated from EUR using an exchange rate of EUR/CZK = 26.

Technical Solution 2:

Parameter	Overall	CZ Section	AT Section
Technical Capacity	750,000 Nm³/h (0 °C)	750,000 Nm³/h (0 °C)	750,000 Nm³/h (0 °C)
Capacity Quality	Firm	Firm	Firm, freely allocable (FZK)
Interconnection Point	Reintal	Reintal	Reintal
Flow Direction	Bidirectional	Bidirectional	Bidirectional
Minimum Handover Gas Pressure in Direction from AT to CZ	53 barg	53 barg	53 barg
Minimum Handover Gas Pressure in Direction from CZ to AT	46.6 barg	46.6 barg	46.6 barg
Length of Pipeline	61 km	12 km	49 km
Aboveground Installations	-	-	Compressor station in Baumgarten
	-	-	Metering station in Baumgarten
	-	-	Cross border metering station
Cost Estimate	CZK 6,006.5 mn	CZK 870.7 mn[5]	CZK 5,135.8 mn[6]
Cost Estimate Accuracy	+/- 25%	+/- 25%	+/- 25%

B. Offer Levels for Bundled Capacity Products at Interconnection Point

Based on the above description of the incremental capacity project, setting aside an amount of 10% of the incremental technical capacity pursuant to Article 8 (8) of the NC CAM, and applying a gross calorific value of 11.19 kWh/Nm³ (0°C), the offer levels for bundled capacity products at the interconnection point are as follows:

[5] Value updated since publication of the Draft Project Proposal for this project in January 2020 partly in order to reflect the expected cost of ensuring that the pipeline is ready to transport hydrogen, should such need arise

[6] Values provided for reference only, recalculated from EUR using an exchange rate of EUR/CZK = 26

Offer Level 1:

Gas Year	Offer Level in Direction from CZ to AT (kWh/h rounded to integers)	Offer Level in Direction from AT to CZ (kWh/h rounded to integers)
2028/2029	2,115,000	2,115,000
2029/2030	2,115,000	2,115,000
2030/2031	2,115,000	2,115,000
2031/2032	2,115,000	2,115,000
2032/2033	2,115,000	2,115,000
2033/2034	2,115,000	2,115,000
2034/2035	2,115,000	2,115,000
2035/2036	2,115,000	2,115,000
2036/2037	2,115,000	2,115,000
2037/2038	2,115,000	2,115,000
2038/2039	2,115,000	2,115,000
2039/2040	2,115,000	2,115,000
2040/2041	2,115,000	2,115,000
2041/2042	2,115,000	2,115,000
2042/2043	2,115,000	2,115,000

Offer Level 2

Gas Year	Offer Level in Direction from CZ to AT (kWh/h rounded to integers)	Offer Level in Direction from AT to CZ (kWh/h rounded to integers)
2028/2029	7,553,250	7,553,250
2029/2030	7,553,250	7,553,250
2030/2031	7,553,250	7,553,250
2031/2032	7,553,250	7,553,250
2032/2033	7,553,250	7,553,250
2033/2034	7,553,250	7,553,250
2034/2035	7,553,250	7,553,250
2035/2036	7,553,250	7,553,250
2036/2037	7,553,250	7,553,250
2037/2038	7,553,250	7,553,250
2038/2039	7,553,250	7,553,250
2039/2040	7,553,250	7,553,250
2040/2041	7,553,250	7,553,250
2041/2042	7,553,250	7,553,250
2042/2043	7,553,250	7,553,250

The capacity offered in Offer Level 1 would be sufficient to cover the indicative demand for CZ-AT incremental capacity received in 2019 – and therefore N4G recommends focusing on Offer Level 1.

C. General Rules and Conditions for Binding Capacity Allocation Phase

During the binding capacity allocation phase, N4G and GCA will offer the incremental capacities in an annual yearly auction on the PRISMA capacity platform.

The general rules and conditions that a network user must accept to participate and access capacity in the binding capacity allocation phase of the incremental capacity process are set out in Annex 1 to this project proposal and the Network Code of N4G.

D. Timeline of Incremental Capacity Project

Milestone	Plan Date N4G
Auction participants to sign "Contract for provision of gas transmission service"	27 June 2022
Yearly capacity auction in July followed by economic test	4 July 2022
Withdrawal right date if permits and/or land rights are not secured (as per Sections 5.1. of N4G "Contract for provision of gas transmission service")	30 April 2026
Expected start of commercial operation of new infrastructure	4th Quarter 2028[7]

E. Parameters Defined in Article 22 (1) of NC CAM

N4G proposes for approval by the Energy Regulatory Office parameters for the economic test summarized in Sections i.)-vi.) below. Based on these parameters, we calculate that bookings exceeding a hurdle rate of:

- 28.68 GWh/d for Offer Level 1; and
- 63.82 GWh/d for Offer Level 2

[7] Value amended since the publication of the Draft project proposal in January 2020 to take into account the expected impact of various implementation risks following the review of the project's planning assumptions.

for each year of the 15-year booking period and under a fixed-price regime, would enable a successful economic test for the project.

i.) Reference Prices and Auction Premiums

N4G's proposed reference prices for this incremental capacity project are summarized in the table below. All prices are quoted in nominal terms and are subject to adjustments for inflation[8] in line with the Principle of the Price Regulation[9], chap. 10.3[10].

	Offer Level Capacity		Reference Prices (CZK/MWh/d/y)	
	kWh/h	MWh/d	Exit	Entry
Offer Level 1	2,115,000	50,758	3,387.8	512.83
Offer Level 2	7,553,250	181,278	3,387.8	512.83

Table 1

Once the incremental capacity is commissioned, the reference price shall be adjusted proportionally to the difference, irrespective of whether positive or negative, between the projected investment costs and the actual investment costs in line with Article 33 (2) of the NC TAR.

In addition to the abovementioned tariffs, flow-based charges described in the Principles of Price Regulation and set in the ERO's price decisions will be payable by the shippers. From the point of view of N4G, these charges are cost-neutral and shall therefore not be considered in the economic test.

N4G makes no advance expectations regarding the potential auction premia for the economic test, as these will be determined by the result of the capacity auction itself. N4G also does not assume any mandatory minimum premium.

ii.) Discount Rate

NET4GAS proposes that the nominal pre-tax discount rate of 8.32%, valid for the transit price cap regime in the 5th regulatory period, be applied for the economic test of this incremental project.

[8] The general terms "adjustment for inflation" or "indexation by inflation" here and throughout the document mean the application of the compound index of general inflation and the Market service price index (in Czech: index cen tržních služeb"), the structure of which is described in the Principles of the Price Regulation, chap. 10.3.

[9] "Zásady cenové regulace pro regulační období 2021-2025 pro odvětví elektroenergetiky, plynárenství, pro činnosti operátora trhu v elektroenergetice a plynárenství a pro povinně vykupující", published by ERO on 9 June 2020

[10] The stated prices are in the price level of the year t = 2022, ie the 2nd year of the regulatory period, resp. t = j + 1

iii.) Expected Inflation Adjustment

The reference prices in the Table 1 above, point i.), are expressed in the price level of 2022 and will be subject to inflation adjustments throughout the entire duration of the contract for gas transmission service in accordance with the ERO price decision setting the reference price for the auction of the incremental capacities between the entry-exit systems of the Czech Republic and Austria (Market Area East). The level of inflation throughout the duration of the contract is therefore uncertain. For the calculation of the economic test, we propose an assumed rate of inflation adjustment of 2% per year in line with the Czech National Bank targeting, and a possible assumption of such level being implicitly expected in the nominal reference WACC for the 5th regulatory period.

iv.) Present Value of Estimated Increase in Target Revenue

N4G calculates that the present value of the estimated increase in its target revenue associated with this project is:

- CZK 636.8 M for Offer Level 1; and
- CZK 1416.9 M for Offer Level 2.

These values are derived based on the expected costs and regulatory lifetimes of the infrastructure to be put in place, and in the case of Offer Level 2, also incorporate the estimated cannibalization effect (see below).

v.) F-factor

NET4GAS proposes an f-factor of 1.0 for each offer level of this incremental capacity project.

vi.) Cannibalization Effect

N4G notes that a portion of capacity reservations at the new interconnection point is highly likely to cannibalize reservations that could otherwise be made at the existing Lanžhot interconnection point in the direction towards the Slovak Republic – with the effect being more pronounced with higher bookings, such as those associated with Offer Level 2. From an economic point of view, such cannibalization represents an indirect cost to the project that should be taken into account in its economic test. We estimate that for Offer Level 2, this cannibalization effect would be 40% of the hurdle rate in GWh/d specified at the beginning of this Section E on page 6 of this document.

F. Exceptionally Extended Time Horizon as per Article 30 of NC CAM

N4G does not propose the use of such extended time horizon for this project.

G. Alternative Allocation Mechanisms Pursuant to Article 30 of NC CAM

N4G does not propose the use of any alternative allocation mechanisms.

H. Fixed Price Approach and Elements Set Out in Article 24(b) of NC TAR

N4G notes that the project will follow a fixed payable price approach. N4G proposes that the value of the RP parameter as defined in Article 24 (b) NC TAR be set at 0, and that the determination of the IND parameter defined in that same article will follow the same rules as set out in the current price decision of the Energy Regulatory Office (no.3/2021). For the purposes of determining the reserve prices for the auction held in 2022, the reference prices from Table 1 will be indexed by inflation to the price level of 2023 according to the rules set out in the Principles of Price Regulation.