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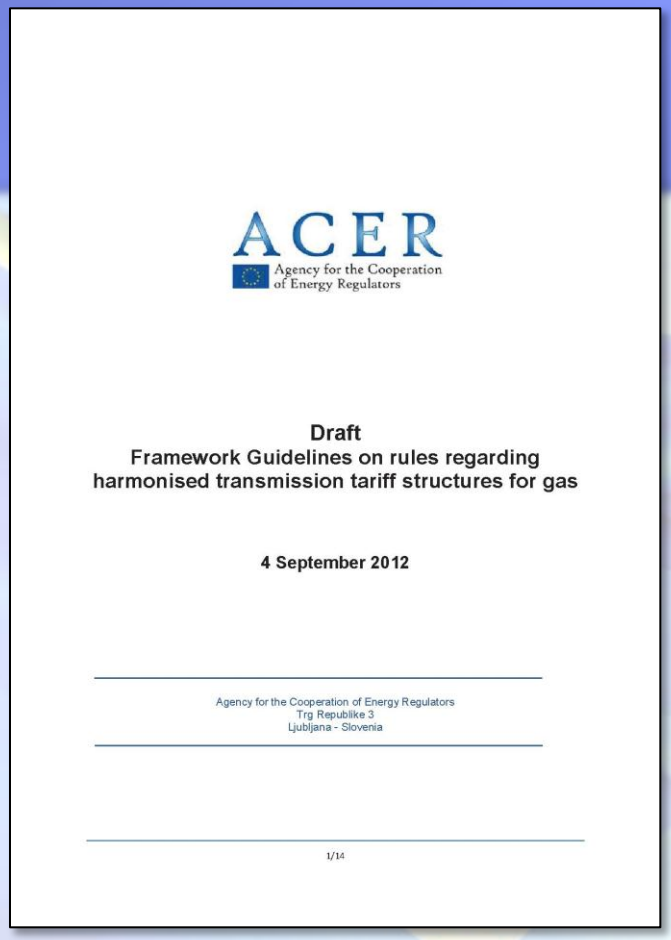
Introduction

Erik Rakhou, ACER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Draft
Framework Guidelines on rules regarding harmonised transmission tariff structures for gas

4 September 2012

Agency for the Cooperation of Energy Regulators
Trg Republike 3
Ljubljana - Slovenia

1/14

ACER Tariff Workshop, 18 September 2012

Agenda

- Process overview
- Next steps – consultation

Process overview

- Consultation on likely scope of the FG concluded on 26 March 2012
- Commission invitation to ACER to develop the FG received on 29 June (deadline 31 December 2012)
- ACER launched the public consultation on the draft FG Tariffs on 5 September, IIA published on 17 September
- Expert group meetings, including ENTSO-G and EC as observers
- ACER Stakeholder Workshop today on 18 September in Ljubljana to present the draft FG, and inviting substantiated with facts views

Next steps

- ACER offers stakeholder associations the possibility to have bilateral meetings or calls if needed
- Working level meetings with ENTSOG will continue also during the consultation period
- Consultation deadline: 5 November 2012
- Expected finalization of the FG until early 2013*

* To be formally confirmed with EC, once consultation is concluded

ACER's Tariff Framework Guidelines Consultation

An initial reaction

Nigel Sisman

Business Area Manager, Markets


Gasum
GASSCO
swedegas
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LATVIJAS GĀZE
ENERGINET.DK
LIETUVOS DUJOS
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FLUXYS
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eustream SLOVAK GAS TSO
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GRTgaz
TAG Trans Austria Gasleitung GmbH
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REN Gasodutos
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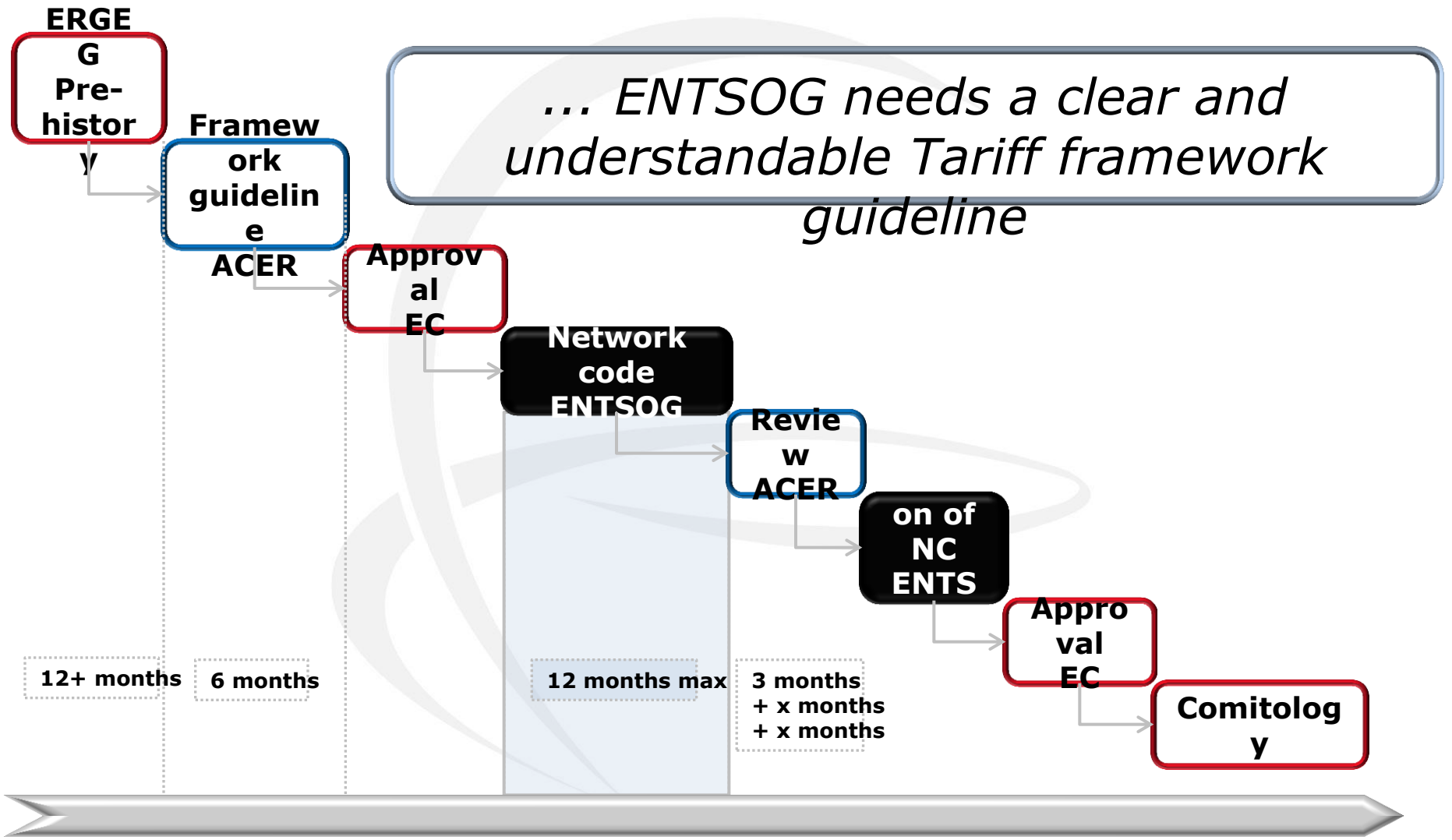
SNAM RETE GAS
DESFA

Network Code Development Process



Tariff rule development - project management

Scope	Resources	Timeline
To be managed to ensure focus and timely delivery	Limited – low appreciation of issues/ challenges imply significant resourcing necessary	Fixed – a political imperative

… beware interactions and competition with other activities

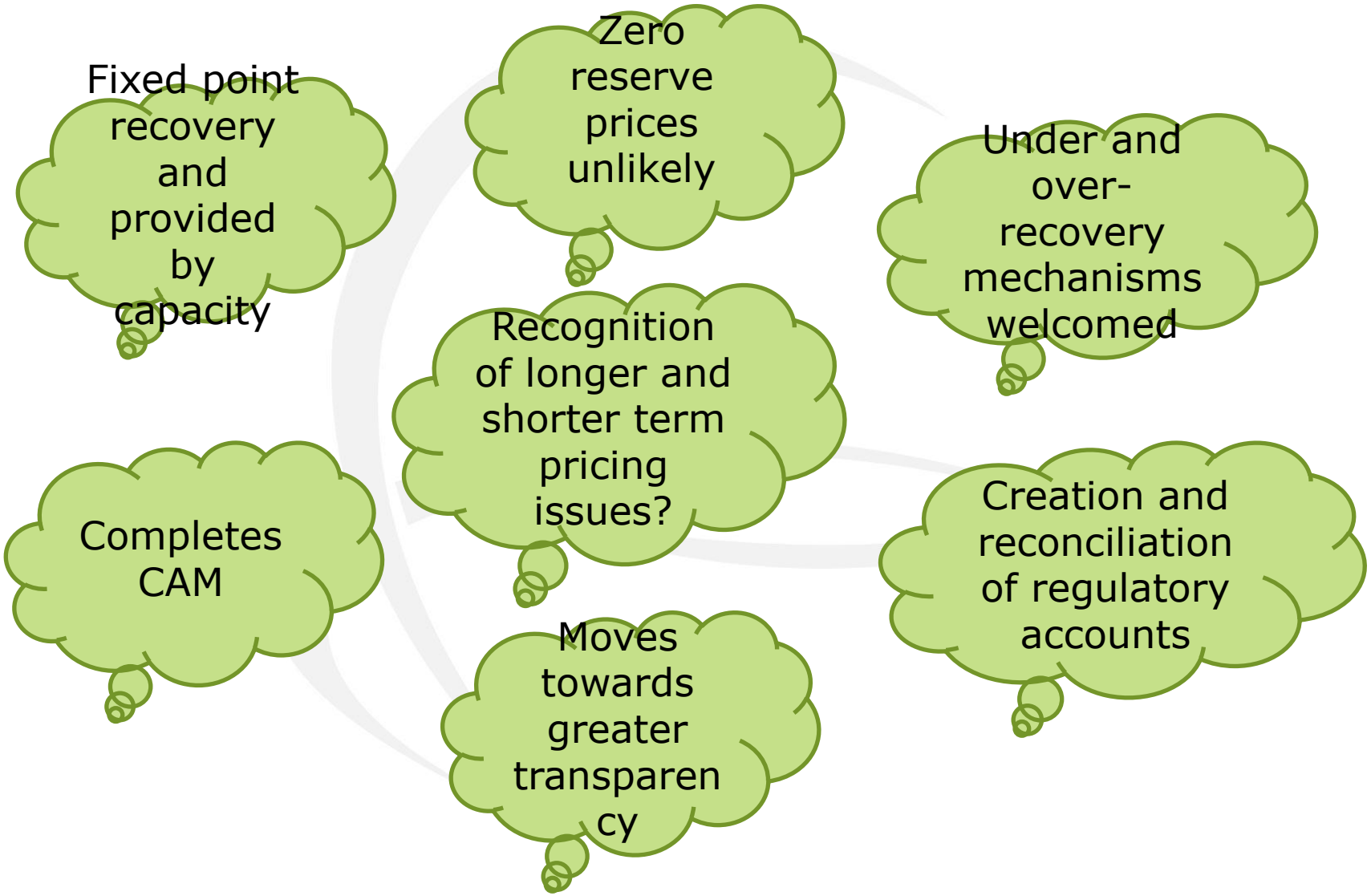
Tariff – What are the problems?

- Lack of transparency
- Cost allocation – entry/exit, domestic/x-border
- Discrimination & cost reflectivity
- Allowed revenue and cost (revenue) recovery
- Barriers and distortions

... The challenges appear many but only emerge at the next level

... Do we really understand the problems we are trying to fix?

Brainstorming the good points



… but the devil is in the detail and we may be mistaken?

Cost reflectivity	• An approximation? • Administered versus market based pricing?
Cost allocation pots	• Splitting costs domestic/x-border, entry/exit? • Basis for cost apportionment?
Fixed, variable and marginal costs	• Which costs are which? • What role for marginal costs in tariffs and reserve prices?
Regulatory accounts /pots	• Which costs go where? How many pots? • Ring fencing of regulatory accounts?
Backhaul	• Concepts not so obvious? • Which costs should be covered?
Multipliers	• Clarity about concepts? • Cost apportionment–multipliers, seasonal factors, 1.5 cap?
Implementation Timeline	• Inadequate timing? • Major price shocks may need sensible transition?

… and the new subject areas not covered in detail in the consultation

Incremental

Locational signals

Entry/exit mergers

Conclusions

- What are we trying to fix?
- When does economic purity make way for political pragmaticism?
- Let's focus on the priorities
- Let's reconsider the Implementation and Transition timeline
- ENTSOG resourcing a team to be at the heart of the development

entsog

fair partner to all

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Draft FG on tariffs
- cost allocation
- determination of reference price

Tom Maes
ACER Gas Tariff TF Co-Chair

ACER Tariff Workshop, 18 September 2012

Consultation and transparency

- Obligatory public consultation of methodologies for
  - determining the reference price
  - cost allocation
- Transparency shall be provided especially on
  - Capacity utilisation and subscriptions
  - Evolution of tariffs
  - Cost assumptions
  - Use of flow simulations
  - Locational signals
  - Cost-efficiency targets

Split between fixed and variable costs

- Reference price shall cover at least fixed costs
- Flow driven costs might be covered by
  - Capacity sales
  - Volume charge
    - Levied at TSO level
    - After due consultation of adjacent NRAs

Split between entry and exit

- Same methodology for all entry and exit points
- Entry and exit tariffs
  - Shall take into account major cost drivers e.g. distance
  - Equalisation (of domestic exits) only if duly justified
- Total allowed revenues equally split between forecast entry and exit capacity sales
  - Deviation from general rule only allowed if
    - Significant and detrimental effect on cost-reflectiveness
    - Non-discrimination between domestic and cross-border
    - No detrimental effect on cross-border trade
    - Due consultation of adjacent NRAs

Bilateral harmonisation - storage

- Bilateral harmonisation of methodologies for setting reserve prices at IPs remains possible if agreed between NRAs
- Adequate discount for entry and exit points to and from gas storage facilities

OGP

Harmonised transmission tariff structures

Initial views on Cost allocation

ACER Workshop
Ljubljana, 18 September 2012

Kees Bouwens, ExxonMobil

OGP

OGP International Association of Oil & Gas Producers

More about OGP: Our membership spans the globe and accounts for more than half of the world's oil output and about one third of global gas production. From our London office, we foster cooperation in the area of health, safety and the environment, operations and engineering, and represent the industry before international organisations, such as the UN, IMO and the World Bank, as well as regional seas conventions, such as OSPAR, where we have observer status. OGP Europe in Brussels represents before the EU OGP members who are active in Europe.

Key Objectives of FG/NC on Tariffs

OGP

- **Facilitate cross-border trade and competition**
  - Accumulation of entry-tariffs and exit-tariffs at IPs could act as a barrier to cross-border trade
  - OGP suggests to explore pro/cons of approach that predominantly allocates TSO costs to exit points
- **Promote new efficient investments**
  - FG/NC should address release of incremental capacity through integrated auction and harmonised economic test
- **Avoid cross-subsidies and undue discrimination**
  - FG/NC should address tariffs for existing capacity versus incremental capacity, and set rules for compensation payments between TSOs

Initial views on Cost allocation

OGP

- **Proper cost allocation not possible in entry-exit regime**
  - Distance is major cost driver for point-to-point tariff systems; consequence of entry-exit regime is that distance is eliminated
  - Gas Regulation prevents charges based on contract paths
- **Cost allocation to entry vs exit points needs evaluation**
  - No objective basis provided for 50% rule
  - Need to consider effect of entry charges on cross-border trade
- **Equalisation approach for domestic exit points reflects that all users have access to same virtual Hub**
- **Need to address economic test for new investments**
  - Define portion of investment to be carried by subscriptions
  - Avoid different regimes apply to existing and new capacity

Main issues for DSO's - GEODE

General remarks

- Scope Draft FG: DSO's Entry-/Exit-Points explicitly introduced in the scope of FG
  - DSO's will be **directly / indirectly affected** by FG / NC
  - It remains **unclear what exact impact** FG will have for DSOs

- Cost Allocation will directly affect the DSOs
  - But the Draft FG does not consider the impact of tarification for DSOs
  - *General principle:* The higher the Allocation Costs for Exit-Points, the higher impact for DSOs
    → 50-50 Rule in the current Draft is well-balanced
  - In MS different capacity systems exist for DSOs (ex-post / ex-ante)

Proposals

→ ***Unequal treatment / discriminations*** *of end consumers in TSO and DSO systems should be avoided*

→***The impact for DSO's tarification*** *must be considered*

→ ***DSOs should be explicitly included in the elaboration process of the FG / NC*** *(like in para. 1.2. FG Gas Balancing)*

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Comments on Tariff Issues

Alex Barnes
Tariff Expert Panel Member

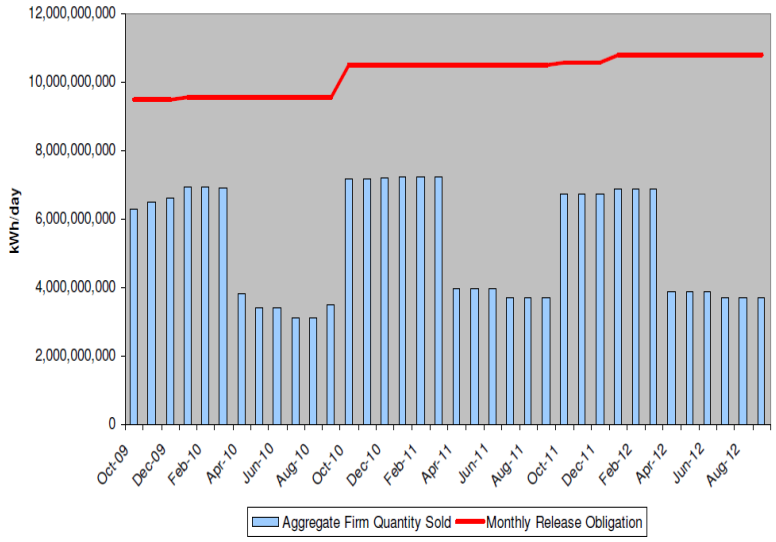
Meeting
Ljubljana, 18 September 2012

Cost Allocation issues

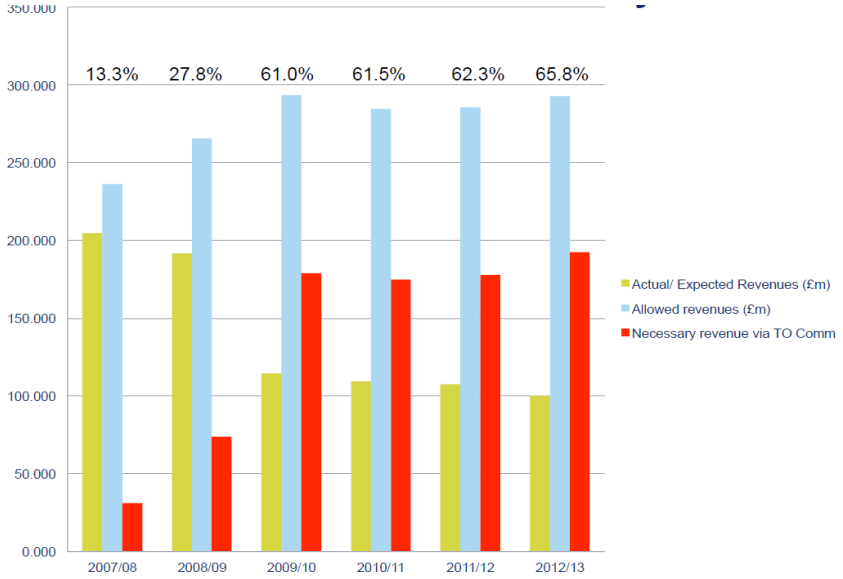
- Unlike a normal market the TSO always receives the revenue it is allowed under its Price Control
- Therefore cost allocation is complicated since marginal costing can lead to revenue under recovery (see following slide)
- An integrated system means it is complex to assign specific costs to a particular entry or exit point
- Virtual Interconnection Points – will be an average of the costs of the component interconnection points which could lead to distortions as shippers booking behaviour will no longer be driven by relative costs of the connection points
- Marginal pricing for backhaul could lead to cross subsidies if backhaul customers receive low cost firm service.
- Need for transparency so shippers can understand how costs can evolve
- True variable costs (e.g. compression) should be flow based
- Case can be made for greater share of costs on exit as gas that crosses borders also pays exit

Can pricing lead to cross subsidies? A case study.

GB Entry Capacity



GB TSO Revenues



- Availability of capacity plus pricing design of capacity impacts TSO revenue recovery
- How to deal with under-recovery without distorting competition / creating cross subsidies?

Key messages

- Tariff harmonisation requires series of explicit trade-offs – there is no single correct solution
- For example low or zero reserve pricing for capacity can facilitate trading but can also lead to cross subsidies between users
- Close linkage with the availability of capacity and structure of capacity allocation mechanism
- For example requirement for new capacity to include 10% to be held back for short term trading could lead to surplus capacity thereby creating incentives to book short term capacity leading to revenue recovery issues

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Draft FG on tariffs - Revenue recovery

Benoît Esnault, CRE
ACER Gas Tariff TF Co-Chair

ACER Tariff Workshop, 18 September 2012

What is the problem?

- Revenue recovery is a general principle
- Tariff calculation is based on assumptions in terms of capacity use and costs
- Individual tariffs depend on cost allocation
- Cost recovery principle is based on 2 logics
  - Revenue target with a remuneration adapted to the risks of under-revenues (price-cap regime)
  - Coverage of the allowed revenue based on actual costs + remuneration: requires to cover the gaps between allowed and actual revenues
- A mechanism allowing to recover the gaps ex-post has to be implemented
  - In case of over-recovery from auction premia, NRAs may decide to use them to reduce congestion.

What should this mechanism aim to achieve?

- Allow for timely cost recovery
- Avoid sharp adjustments of network tariffs
  - For instance a situation whereby the adjustment of the reserve price or the regulated price at only one or a few entry or exit points where under- or over-recovery occurred exacerbates the problem
- TSOs should be encouraged to reduce their costs

What is the proposed mechanism? (1/3)

➔ NRAs determine or approve at a national level:

- how often and how fast the gaps have to be reconciled
- which part of the under- or over-recovery will be logged on to the regulatory account

- A regulatory account will record the gaps between allowed revenues and actual revenues of the TSO
- This account will be reconciled on an ex-post basis via one of the two following mechanisms.

What is the proposed mechanism? (2/3)

- Option 1: Capacity approach
  - Under or over-revenue shall be recovered or redistributed back through an adjustment of the reserve / regulated prices applicable to every entry or exit points
  - All entry and exit points will contribute to the reconciliation

What is the proposed mechanism? (3/3)

- Option 2: Separate charge based on capacity and commodity
  - The amount to be recovered is allocated ex post,
    - primarily to the entry and exit points as part of either the reserve or regulated price
    - secondarily through a separate charge. This charge can be based either on gas flows (commodity) or on capacity bookings (capacity).
  - The separate charge is levied at a TSO level and applies to all entry and exit points.

Draft TAR FG: Initial Remarks (I)
Input from Laurent De Wolf, member of the AHEG

Draft FG is quite comprehensive and contains rules for all key aspects of the design of a tariff system

→ Enforcement of rules contained in FG will drive EU-harmonization of structure of gas transmission tariffs

Draft FG provides a good basis for implementation of CAM NC (contains rules on how auction reserve price of all types of products should be determined)

In its current version , draft FG does not provide clear guidance on *Incremental Capacity* or *Merger of E/E zones*

- But is it really in the TAR FG that these issues should be adressed first ?

Tariff structures are focused on recovery of allowed revenues and cost coverage and also on improving efficiency (IFIEC)

- Reference price for short term capacity reserve prices must reflect actual cost of *efficient* network operator
  - European Benchmark for gas TSOs is missing, which implies that all 39 TSOs in 23 Member States are efficient? ACER should be responsible for starting this benchmark
  - Proper incentives must stimulate TSOs to increase efficiency
  - Continuous improvement and Benchmarking are key levers
  - Inefficient TSOs have higher costs and higher tariffs which can hamper cross-border trade
- Under-recovery of revenues has to be prevented. Shared interest TSOs shippers and customers for balanced risk, low WACC and fair tariffs
- Extra revenues from congested IPs dedicated for eliminating congestion
- Harmonized tariff methodologies and periods (IFIEC prefers an equalization approach which set reference price and allowed revenues)
- Optimal entry/exit split for IPs to stimulate (bi-directional) trade
- Cross-subsidization must be prevented, however…
  - in a decoupled entry-exit system in combination with trading on virtual hubs and exchanges, 100% causer pay principle is not possible
  - even charges based on ‘distance’ from a ‘reference’ node are arbitrary
- Tariffs (methodology) must be transparent and easy to calculate

Draft TAR FG : Initial Remarks (II)
Input from Laurent De Wolf, member of the AHEG

Key challenges for a TSO to implement FG principles

- Managing the transition: what will the current LT contracts become ?
  - Network in captive markets → no major worry (since network users have to use the asset anyway !)
  - Network in non-captive markets (transit) → risk of changed behavior (leading to stranded assets)
- New cost allocation rules → there will be winners and loosers
  - What will be the loosers' reaction ?
- For many TSO's, TAR FG rules (as well as many provisions in CAM NC) will create higher uncertainty on sales volumes
- Short Term capacity at a low price: how to keep investment signals & maintain a high level of SoS ?
- 1 year implementation time for new and existing contract → seems extremely challenging !

Still unclear to me how much this harmonization will facilitate cross-border trade and a better working of the EU gas market ?

→ What is the opinion of a trader / network user on this ?

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Draft FG on tariffs
- reserve price structure

Markus Krug
ACER Gas Tariff TF Co-Chair

ACER Tariff Workshop, 18 September 2012

Firm standard capacity products – I

- Long-term products
  - reserve price = yearly reference price
- Short-term products
  - general rule: reserve price = lower or equal to the price set proportionately to the yearly reference price
  - Seasonal factors may apply
- Circumstances which allow for deviating from the general rule
  - If significant under-recovery is to be expected, multipliers higher than 1 may be applied
  - Multiplier shall not exceed 1.5
  - Seasonal factors can be higher than 1.5
  - NRAs to consult before adopting their decision

Firm standard capacity products – II

- Example
  - Year = yearly reference price (T)
  - Quarter = (T/365)*number of days in the quarter*[multiplier]*[seasonal factor]
  - Month = (T/365)*number of days in the month*[multiplier]*[seasonal factor]
  - Day = (T/365) *[multiplier]*[seasonal factor]
  - Rest-of-the-day: (T/8760)* number of (remaining) hours in the day*[multiplier]

Firm standard capacity products – III

- The Network Code shall develop
  - A methodology for determining seasonal factors
  - A concept for determining multipliers for short-term products for cases when deviating from the general rule

Interruptible and non-physical backhaul standard capacity products

- Reserve price shall be set at a discount to the firm product with equivalent duration
- Interruptible products
  - Discount shall adequately reflect the risk of interruption
  - Low risk = low discount and vice versa
  - Recalculation once a year
- Non-physical backhaul products
  - Discount shall be set so that the reserve price reflects the level of marginal cost of providing the service

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Steve Rose

Chair of Eurelectric's Gas to Power Workgroup

ACER Consultation Workshop

Framework Guidelines on Harmonised Tariffs
Ljubljana, 18 September 2012

FG Tariffs – Initial Observations

- Opinions expressed today are not the official views of Eurelectric at this stage but are provided to aid discussion
- FG seems very positive on transparency and consultation
- Applicability split between IPs and non IPs seems sensible
- Ten objectives for tariff setting may be too many minus a hierarchy
- What does "apply to existing contracts" really mean
- NRA discretion on cost drivers and entry/exit split seems sensible
- Caution against reconciling regulatory accounts via commodity charges (Option 2) particularly with floating reserve prices
- Reserve price for < 1 year capacity and multipliers seems overly complicated
- Ex ante reserve price for interruptible based on risk of interruption pragmatic but complicated
- Floating reserve prices pragmatic but could be banded or indexed to provide an element of certainty

Reserve Prices

- Setting non annual firm reserve price seems overly complicated:
  - seems to allow for one NRA to set a zero reserve price and the other to set a reserve price 1.5 x the pro-rata annual rate
  - NRA's should aim for a harmonised approach, but this could be difficult where interconnection applies across multiple market areas
  - what does cost reflectivity mean: SRMC, Avg Cost, Option Value
  - could day ahead reserve price could be > monthly pro-rata
  - multipliers require TSOs to pre-judge demand for capacity using assumptions about past bookings/usage and seasonality
  - as hub liquidity increases capacity will be seen more as a means for optimising spreads between markets, which are less predictable
- Setting interruptible reserve prices seems pragmatic:
  - ex-ante approach generally preferred to ex-post
  - interruptible only offered by auction when firm sold out (CAM Code 6.1.2 and 6.1.8) so probability of interruption could be high
  - may need to distinguish between auctioned and over-nominated interruptible

FG Tariffs: Reserve Prices

for discussion in stakeholder workshop on 19.9.2012

- Same cost allocation methodology applicable to Domestic and I/C points.
  - To take account of major cost drivers – eg Distance.
- Reserve Prices set to cover at least fixed costs.
  - What are fixed costs?
  - Should these be based on forecast flows, capacity bookings or capacity obligations?
- Unit prices for Quarterly, Monthly, Daily products less than or equal to Annual prices.
  - Does this facilitate a 'desirable' level of capacity bookings?
  - Seasonal factors – how and when should they be applied?
- Interruptible - discounted to reflect the risk of interruption
  - Is the quantity & timing of product release relevant fundamental to tariffs?
  - Should any discount be on a point by point basis?
  - Is the risk of interruption practicable to predict – might this depend on timing of release?
- Back-haul (non physical) – priced at marginal costs (ie IT/administration)
  - Is this product clearly defined?

Debra Hawkin

VIPs and bundled products

- Reserve prices for virtual interconnection points
  - Based on the combination of the reserve prices set for the individual entry or exit points
  - NC shall elaborate the combination mechanism

- Reserve prices for bundled capacity products
  - The sum of the reserve prices for entry and exit points
  - Reserve price for unbundled firm capacity shall equal the reserve price of the capacity from which it originates
  - Same splitting rule as in CAM NC

Enabling CAM: Payable price, bundling and VIP (J. C. Romagosa)

Payable price: reserve price at time of use of capacity and fixed auction premium

- Reserve price based on LRMC methodology vs. gas flow and congestion evolution in the medium term
- Does it foster long-term capacity contracts?

Bundled capacity: reserve price for bundled capacity is the sum of reserve prices at entry and exit point

- Need for tariffs harmonization at both sides of IP?
- Premium split between TSO: In proportion to the reserves prices or equally (50/50)

Virtual Interconnection Point (VIP):

- Discriminatory for existing contracts?
- Compensatory system between TSO's

Exploration of ad-hoc issues (J. C. Romagosa)

Incremental capacity:

- Integrated auctions for existing and incremental capacities or separated?
- Easier to achieve: harmonized market test, transparency in costs, TSO must be pro-active in determining potential incremental capacities
- Under recovery risk. Positive externalities (SoS,…)

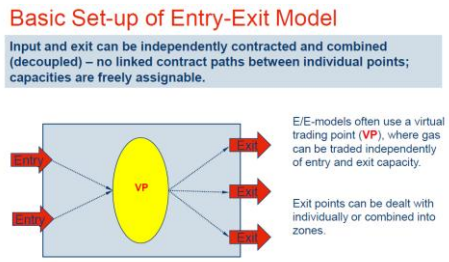
Locational signals: specific tariff measures for addressing decisions on locating gas-fired power plants, LNG plants,…

- Premium: Cost allocation mechanism could be enough
- Discount: Discriminatory for other clients?. Gas system policy or another kind of national policy?

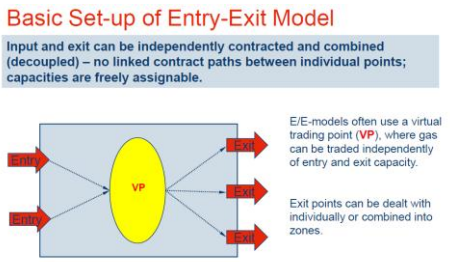
Effects of E/E zone mergers:

- Only one balance zone and tariff structure
- Revenue recovery: compensation system between TSO
- Under recovery risk

Introducing the 3 additional topics: tariff implications of mergers entry-exit zones; incremental capacity and locational signals.



Chapter 5.9 draft IIA



In EC letter ACER is invited to consider in the Impact Assessment if tariff structure principles for Incremental Capacity should be developed. Incremental capacity is defined as capacity that is provided (by investment) on top of capacity at an existing IP, by means of various mechanisms including a 'market test'. A market test may set out what the criteria for providing incremental capacity can be. Another approach to provide incremental capacity could, for example, be a network development plan or simply an investment decision by a TSO. In a workshop of GRI North-West, 4th June 2010, an illustrative overview of market test thresholds was presented by TSO representatives.

Chapter 5.10 draft IIA

TSO	Minimum commitment (= market test threshold)
EGT	min.80%>15 years max.5%<5years (last OS), future minimum commitment depends on circumstances/framework
WGT	future commitment depends on framework
Thyssengas	future commitment depends on framework
GUD/GTS	10 years each shipper (Last IOS), future commitment depends on framework
Ontras	future commitment depends on framework
DEP	future commitment depends on framework

TSO	Minimum commitment (= market test threshold)
Energinet.dk	70% of capacity, 10 years
Fluxys	Economic test
Gaslink	NRA and Gaslink make an investment plan
GRTGaz	10 years each shipper
GRTGaz DT	10 years each shipper
Swedegas	Not applicable
National Grid	NPV Revenue over 8 years > 50 % of costs

In EC letter ACER is invited to consider in IA if locational signals should be developed in the Network Code on transmission tariff structures. Locational signals are considered to contribute to shippers using the system in a way which minimises future costs.
Locational signal will a priori automatically result from a cost-allocation methodology, which takes into account the main cost drivers (such as a distance). For some specific entry or exit points or situations, such as e.g. shorthaul and/or gas storages and/or LNG terminals, additional specific measures can be taken to encourage/discourage the usage of the network at that particular location.

Chapter 5.11 draft IIA

First reaction on Tariff - FG

- **Infrastructure development** requires
  - Demand
  - Tariffication based on economics
  - Stability

- **Cost allocation**: avoid discriminatory shifts of costs between Cross border and inter-zonal points (IPs) and non-IPs

- **Political driven interventions**: avoid undue discrimination as there is competition between different sources of flexibility and competition between market participants

- **Issues to be considered**
  - Potential E/E-Tariff discounts
  - Zone Mergers
  - Incremental Capacity
  - Locational signals

- **Harmonisation**: “One-size-fits-all” approach not necessary and could even be counter productive as it reduces flexibility to react on regional issues

Enabling CAM: Payable price, bundling and VIP (J.C. Romagosa)

Payable price: reserve price at time of use of capacity and fixed auction premium

- Reserve price based on LRMC methodology vs. gas flow and congestion evolution in the medium term
- Does it foster long-term capacity contracts?

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- Integrated auctions for existing and incremental capacities or separated?
- Easier to achieve: harmonized market test, transparency in costs, TSO must be pro-active in determining potential incremental capacities
- Under recovery risk. Positive externalities (SoS,…)

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- Discount: Discriminatory for other clients?. Gas system policy or another kind of national policy?

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- Revenue recovery: compensation system between TSO
- Under recovery risk

FG Tariffs: Incremental, Locational signals, effects of E/E mergers

for discussion in stakeholder workshop on 18.9.2012

- Incremental
  - Could potential Tariffs NC be extended to apply to incremental capacity release?
  - Should associated incremental tariffs be developed at the same time?
  - Market test/commitment and appropriate TSO renumeration?
  - Do incremental tariffs and application process provide useful information to the market
- Locational signals
  - Are already part of proposed methodology.
  - Are additional tariff adjustments necessary/helpful for storage/LNG facilities?
  - Do short-haul tariffs improve efficiency?
- Entry/Exit Zone mergers
  - Tariffs would change – is this appropriate?
  - Compensation payments between TSOs may be necessary but TSO/NRA decision?

Debra Hawkin

Thank you for your attention!

www.acer.europa.eu

Tariffs - Enabling CAM

(p.s. This slide of Entsog was not shown at the workshop due to technical problems)

CAM NC contains only tariff rules considered essential for implementation of other NC provisions

- Regulated tariffs = the reserve price for firm and interruptible auctions (in line with CAM FG)
- Split of revenues from bundled products
- Treatment of over and under-recovery
- **"Revenue equivalence principle"** to reduce cross-subsidy between groups of users and minimise risk of significant under-recovery

These are intended as temporary provisions until the forthcoming TAR NC comes into force

- Draft Tariff FG covers topics such as the payable price, bundled revenues, auction premium split etc.