

2nd ACER Webinar on Gas Transmission Tariffs

8 September 2020 from 15.00 to 16.00

Does the
NC TAR allow
for the limitation
of undue cross-subsidies?

- First part – 30 minutes
 - » Introduction (by the Agency)
 - » Presentation of EFET
 - » Presentation of Eurogas
- Second part – 30 minutes
 - » Q&A between the audience and the speakers

- Limiting undue cross-border cross-subsidies is a key objective of the NC TAR.
- In particular, striking the right balance between the tariffs to be paid by **domestic consumers** and **transit users** is of key importance.



- The NC TAR addresses this point with:
 - » **Clearly stated regulatory objectives:** Tariffs shall result from a cost allocation aiming at ensuring non-discrimination and preventing undue cross-subsidies;
 - » A **cost allocation assessment** allowing to check that tariffs are consistent with cost drivers (distance, capacity, commodity);
 - » **A harmonised comparison tool:** the CWD Reference Price Methodology is described in the NC TAR and has to be compared with the chosen RPM.

- **Positive note:** The implementation of the NC TAR allowed to open up the debate across Europe on this important topic.
- This question is one of the most challenging to address as it combines two difficulties:
 - » **A complex quantitative assessment:** how **cost-reflective** are the tariffs? Are domestic and cross-border users paying their fair shares?
 - » **A qualitative assessment:** how to reconcile this objective with the **other legitimate objectives** of the NC TAR (transparency, non-discrimination, non-distortion of cross-border trade, predictability...)?
- This led to complex discussions during the implementation of the NC TAR.

- Among the main conclusions of its IMR, the Agency notes that cross-subsidies could be better controlled with a more elaborated regulatory framework on:
 - 1. Regional networks** (limits between transmission and local networks are unclearly defined at a EU level)
 - 2. Non-transmission charges recovered by TSOs** (storage, LNG, gas quality conversion...)
 - 3. Inter TSO Compensation** mechanisms (the consistency between the ITC and the respective RPMs of the involved TSOs is not always assessed. Risk of distortion between consumers)
 - 4. Volume risk** (risk assessment substantiating potential premium, identification of the assets at risk)
 - 5. Flow scenarios** (selection of “relevant flow scenarios” should be justified. How does it allow to better reflect the use and the costs of the transmission system?)
 - 6. Tariff adjustment based on benchmarking** (it should only relate to situations where several supply routes are in competition).

- The Agency would like to thank EFET and Eurogas for accepting our invitation to contribute to this webinar.
- The Agency hopes that this debate will allow stakeholders, NRAs and TSOs to share their views on such cost allocation issues.
- The Agency invites the speakers to give their views on these topics and to share their suggestions for addressing these issues.

ACER webinar on gas transmission tariffs, 8 September 2020

Cross-subsidy in tariff methodologies

EFET Gas Tariff Group

EFET

European Federation
of Energy Traders
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Cross-subsidy as a relevant objective

- Avoiding cross-subsidy is a relevant objective as it may distort the nature of competition, but:
 - transmission is a monopoly activity, so the nature of competition is not always straight forward;
 - cross-subsidy through tariffs may be a pragmatic way of recognizing positive externalities or resolving other market inefficiencies;
 - transmission costs are a pass through for shippers/traders to a greater or lesser degree.
- Cross-subsidy should be considered holistically alongside other relevant objectives of the tariff methodology, such as:
 - reproducibility and forecastability of the resulting tariffs;
 - cost reflectivity;
 - non-discrimination; and
 - not to distort cross-border trade.
- No “one-size fits all” method of cost allocation can be applied to complex entry/exit systems and cross-subsidy may be tolerated, or promoted, for political, or societal, reasons.

Types of cross-subsidy in tariff methodologies

- Cross-subsidy is linked with cost-reflectivity and, arguably, can occur in many forms:
 - classes of end user – e.g. between domestic, industrial and CCGT end users;
 - types of infrastructure – e.g. between storage and LNG;
 - temporal – e.g. between short term and long term tariffs, via multipliers and seasonal factors;
 - types of shipper – e.g. between predominantly intra-system and cross-system shippers;
 - member states – e.g. between interconnected countries, through the entry/exit split;
 - gas sources – e.g. between natural gas production and LNG;
 - gas routes – e.g. through benchmarking;
 - gas qualities – e.g. between L and H gas networks and in relation to biomethane (and H2 in future); and
 - past, current and future system users – e.g. through legacy contracts and substantive over/under recoveries.
- The TAR NC includes various provisions intended to highlight and avoid general cross-subsidies:
 - the cost allocation assessment (Art 5);
 - the CWD comparator methodology (Art 8);
 - the need for inter-TSO compensation mechanisms (Art 10);
 - regulatory accounts (Art 19); and
 - mandatory minimum auction premiums (Art 33).
- Transparency and objective justification during the consultation are vital for identifying cross-subsidies which are adversely distorting competition, incentivizing inefficient investment (past or future) and discriminating against certain parties.

EFET's view on specific cross-subsidy identified in ACER's report

- Regional networks (Germany, France, Italy, Spain)
 - Support ACER guidance on how to define regional networks and the criteria for their assessment (e.g. dia, pressure)
 - NRAs should assess the existence of regional networks and allocate their costs to domestic users
 - Storages and CCGTs connected to regional networks that have an internal market role should not be discriminated against
 - Regional networks should, ideally, be reclassified as distribution asset, but this may be complex and time consuming
- Charges for costs unrelated to transmission (Italian and French Storage - Italian, Spanish, Greek and Lithuanian LNG)
 - In principle they should be avoided, but can be the “lesser of two evils”
 - Where applied, charges should be targeted at the beneficiary of the positive externality (e.g. domestic users)
 - May be appropriate as a short term temporary fix, but should be reviewed regularly and should not just become the norm
- Volume risk from fluctuating cross-border flow (Austria, Slovakia)
 - Transit flows need to be substantial and risk must be material, justified and applied to the relevant asset costs at risk
- Benchmarking (Slovakia)
 - Used sparingly at IPs only, with full transparency over competing routes and the impact on TSO revenues and other tariffs
- Reconciliation of under/over recoveries (Belgium)
 - Discourage large build ups through incentives and more frequent (quarterly) and detailed (sub-accounts) reporting



ACER TAR NC Webinar II

Cross-subsidies

Online - 8 September 2020

Wholesale Market Committee

Critical areas - Regional networks

Relevant when regional networks are present

Cost allocation must remain cost reflective to the extent possible (e.g. France, Italy)

- We are fairly agnostic on the legal nature of regional networks and on their allocation into TSOs' RAB however:
- It would be useful to clarify the definition in the TAR NC
- The inclusion of regional networks in the RAB should not lead to a cross system vs intra system use cross-subsidisation or higher tariffs at IPs
- Italy (inclusion in the RAB with a more pronounced entry-exit cost allocation split) and France (exclusion from the RAB) have chosen alternative but equally valid paths
- We note that with the increase of local production (of hydrogen and biomethane) and the possibility of bi-directional flows, regional networks may play a role in providing additional flexibility to the overall transmission systems hence the separation of their function may prove more challenging

Critical areas - non-transmission service charges

Relevant in the context of non-transmission service revenues

Positive externalities may justify elements of cross-subsidisation

- While the principle of cost reflectivity must be the guiding driver to avoid the emergence of cross-subsidies, some **examples of cross-subsidies delivered positive value to the market and to consumers**:
 - France: storage facilities' under-recovery are recouped via a tariff component charged at the exit points of French end-users. This resulted in the opening up of the flexibility market and market based valuation of flexibility resources.
 - Italy: a mechanism similar to the above is applied to revenues of storage facilities and regulated LNG Terminals allowing for similar positive developments to those observed in France.
 - Spain: a charge at domestic exit points is used to recover the cost of an unused LNG Terminal whose construction was mandated by the Government for SO's needs.
- When similar situations emerge, it is important that the choice of NRAs is motivated by appropriate cost benefit analysis and with an assessment of the impact on the overall welfare.

Critical areas - Volume risk premium

Relevant when a volume risk premium is applied

TSOs remuneration must remain as defined in art. 13 of the Gas Regulation (e.g. Slovakia)

Volume risk needs to be:

- **Relevant:** when transit volumes are dominant
- **Based on evidence:** linked to a proven potential significant underutilisation of the system
- **Based on costs:** limited to non-depreciated assets only and in the absence of disproportionate asset revaluation
- **Based on benchmarks:** NRAs should ensure the premium is proportionate to the risk faced by the operator
- **Adjusted ex-post:** following the observation of actual volumes

In addition, revenues derived from a volume risk premium should be:

- Entirely set aside to compensate lack of future revenues
- Transparently accounted for
- Subject to periodic review so that in case the volume risk has not materialised, they can be given back to the system users

Essentially a volume risk premium opens to a risk of temporal cross-subsidies between current and future shippers. Similar considerations apply in case of early or progressive depreciation of TSOs' assets or in the case there is a need to add the cost of decommissioning as an additional tariff component. In this context, the TSOs' reserves and their return on equity should be looked into before any drastic market interventions.

Critical areas - how to treat new technologies?

Relevant when new technologies enter the market, e.g. biomethane, hydrogen

TAR NC is a key enabler of an efficient integrated internal market.

Should it depart from the level playing field approach?

- The NC TAR's fundamental objectives are to **ensure a level playing field and avoid market distortions to achieve an efficient integrated internal market**
- As such, TAR NC does not allow cross-subsidies between different users

How to treat new technologies? Should the TAR NC depart from a level playing field approach and allow cross-subsidies? What would be the consequence of that on market efficiency?

- The TAR NC does not explicitly address the treatment of existing assets in the transition to gas decarbonisation.
- A vicious circle of **spiralling tariffs (as a consequence of further underutilisation as a consequence of tariff increases) should be avoided** through:
 - Policy clarity on the future role of r-gas and d-gas
 - Coordinated decommissioning or mothballing of stranded infrastructure which is not critical for security of supply
 - Explicit compensation outside network tariffs
 - Forward-looking and integrated gas and power network planning
 - Recognize the value of new infrastructure developed on a merchant basis
 - Avoid accelerated depreciation of TSO infrastructure
 - Accounting unbundling

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Q&A session

- Please submit your questions in the chat.
- To the extent possible, we will group similar questions.
- We will distribute them to the speakers.