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MEMO**PRE-CONSULTATION TARIFF METHODOLOGY**

The present memo contains a discussion of the responses to the pre-consultation on the tariff methodology conducted by Energinet during the period from 2nd July to 1st August 2018.

Four stakeholders have replied to the pre-consultation draft:

- Ørsted
- Juniper
- PGNiG
- Danish Agriculture & Food Council.

The former three responders are all significant shippers in the Danish gas transmission, while the Danish Agriculture & Food Council represents medium to large scale consumers internally in the Danish gas market.

Transparency

A common response among all replies is that transparency of the impact of the proposed method changes should be improved. It is difficult to assess the long term impact of the proposed method changes based on the examples provided given that flows in the coming years is likely impacted by the Tyra field renovations as well as potentially by the Baltic Pipe project.

Energinet acknowledges such concerns. The draft methodology application shows the impact solely on the resulting gas tariffs for the gas-year 2019/2020. That is during the Tyra-period and prior to the possible realisation of the Baltic Pipe project.

The reason for not including medium to long term projections have been discussed between Energinet and the Danish Utility Regulator (formerly Danish Energy Regulatory Authority), and Energinet has been instructed to illustrate the impact only on the first tariff year following the formal approval of the methodology. In the view of the Danish Utility Regulator, the tariff methodology application should not be conflated with a tariff forecast. Ideally, the methodology reflects universal principles, which should be assessed independently from how they impact tariffs in different future scenarios. Additionally, a tariff forecast would be highly influenced by the chosen assumptions on flow, cost base and methodological assumptions.

In order to provide stakeholders with an improved understanding, Energinet will aim to provide the gas market with an updated tariff forecast until the year 2025 that will be presented

on the Shipper Forum on 13th September 2018, after which it will be published on the company website.

It is regrettable that the tariff forecast has not been made available during the pre-consultation process. However, new demand forecasts for the Danish gas consumption is under preparation from the Danish Energy Agency, which Energinet is obliged to use in tariff projections. This forecast is expected to be made public during August 2018. It is Energinet's understanding that the updated demand forecast will have notable impact on resulting tariffs, and in the view of Energinet a forecast based on last year's demand forecast would give an incomplete picture of the latest knowledge on market development.

Scenario-based tariff modeling

Several replies to the pre-consultation material also notes, that resulting tariffs will very much depend on 1) the impact of the Tyra field close-down period both on volumes transported as well as on the cost base of the transmission system, and 2) the decision on Baltic Pipe, which in itself could double the regulatory asset base of the transmission system and would allow for significantly increased transit flows.

The uncertainty arising from different scenarios on Tyra and Baltic Pipe exacerbates the stakeholders' difficulties in assessing the impact of proposed changes to the tariff methodology.

Replies to the pre-consultation propose to alleviate such short-coming by supplementing the method application with a spreadsheet based tariff model that could serve two purposes:

1. Provide the stakeholders with an improved understanding of how the different scenarios impact tariff levels
2. Allow the stakeholders to perform their own impact assessment of changing the methodology beyond the revisions proposed by Energinet.

Again, Energinet finds this proposal to be justified given the above-mentioned potentially significant changes to flows and cost base. Consequently, the afore-mentioned tariff forecast published by the Shipper Forum on 13th September 2018 will be made inside an excel-based tariff model, which will be made public on the same date. The tariff model can be downloaded and manipulated by the gas market stakeholders in order to serve both purposes stated above.

Uniform capacity tariffs

The pre-consultation material contains the proposal to replace the current differentiated capacity tariffs with uniform capacity tariffs based on an ex post entry/exit split. This implies that Energinet also favours the uniform capacity tariff method above a capacity weighted distance methodology as described in the Regulation (EU) 2017/460 Network Code on Harmonised Transmission Tariff Structures for Gas (TAR NC).

This principle change to the tariff methodology has been exhaustively discussed in dialogue with the Shippers prior to submitting the pre-consultation material. As such it is less surprising that none of the replies appears to disagree with the proposed cost allocation methodology. One reply notes that the methodology is well-argued and caters to the needs of the Danish gas market.

Another reply notes that deviations from the principle in the approved methodology could undermine the commercial viability of the Baltic Pipe, and further remarks that the uniform capacity allocation methodology should be extended to new offshore infrastructure required to bring gas from Norwegian export system to the onshore system, which means that for the

purpose of tariff determination this section of Baltic Pipe project will be treated as an integral part of Danish transmission network. This solution is considered to be essential for facilitating cross-border trade and ensuring Baltic Pipe project feasibility as well as securing gas supplies to Danish market, as it enables reduction of “tariff pancaking” on Norway-Denmark and Norway-Poland routes. At the same time, it is worth noticing that joint management of uniform Danish tariff zone would also provide some cost synergies (among others in terms of balancing costs, IT systems costs or administrative expenses), which will benefit to the operator and to shippers, who are in the end bearing the costs of gas system operations through tariffs paid.

The same stakeholder also notes that documents released during the second phase of Baltic Pipe Open Season procedure (i.a. Information Package 2 and economic model attached) stated the following: Existing offshore gas pipelines will not be included in uniform cost allocation. – Otherwise, with falling production levels they would respectively increase tariff level in all the remaining system points and as a result these pipeline users would be cross-subsidised by other gas system users.

At the same time, a participant in the pre-consultation would like to stress that it is critically important that the decision not to implement an alternative, capacity weighted distance methodology (which is also allowed by TAR NC), is sustained in the final version of tariff model. Its application would lead to significant disproportions of cost burden on shippers due to extreme price differences – according to Energinet calculation presented in the Tariff Document the difference between lowest and highest tariffs would amount to 75%. With Danish gas system specifics, higher charges will apply mostly to transit and export system users, who are actually bringing the system significant benefits – especially when to take into account the scale of the Baltic Pipe project compared to current Danish network transmission volume. In this situation transit and export customers would pay excessive charges in order to ensure lower charges for domestic users, which will in fact result in undue cross-subsidisation of Danish consumers.

Based on the response above, Energinet concludes that the pre-consultation material should not be amended as regards the proposed cost allocation methodology.

5-year multiplier

The proposed methodology contains a section 3.5 on multipliers and seasonal factors that states:

“Energinet recommends maintaining the current multipliers for allocated capacity up to one year duration and to introduce a new multiplier for capacity allocation with duration > 5 years.”

One response notes that the introduction of a factor 0.9-0.95 for a contract period >5 years (above 5 years) is deviating from the User Group dialogue, in which ≥ 5 years (above or equal to 5 years) was always discussed, and is also favouring the Baltic Season Pipe contracts and could be regarded as discriminatory. Hence, it is strongly suggested to introduce the factor for the remaining years of all running contracts with a contract duration ≥ 5 years.

Another stakeholder remarks that it is extremely important for Energinet’s proposition of long-term multipliers introduction to be sustained and implemented into new tariff model. At the same time the stakeholder would like to emphasise that considering expected transportation costs via alternative routes, multiplier 0.95 may provide insufficient incentives for the capacity utilization of Baltic Pipe project. Therefore, it is essential that the lower value from the proposed range, that is 0.90, is chosen.

Alternatively, it is suggested to adopt the range for the multiplier proposed in the Tariff Document, with determining its exact value depending on contract duration. The possible pattern for contracts over 5 years might be 0.01 change along with each year of contract duration. The pattern could as a result be the following:

- 0.95 – 5-year contracts,
- 0.94 – 6-year contracts,
- 0.93 – 7-year contracts,
- 0.92 – 8-year contracts,
- 0.91 – 9-year contracts,
- 0.90 – 10-year and longer contracts.

In conclusion, the shipper also notes that the pre-consultation document does not specify multiplier value and the way of its application. It is expected that long-term multiplier will be introduced into the new tariff model and its final shape will allow the shippers with long term booking to obtain 10% discount (meaning application of 0.90 multiplier). This is particularly important for the long term capacity bookings made during the Open Season 2017 procedure. Multiplier at the level of 0.90 will increase competitiveness of the Baltic Pipe versus alternative routes and may secure high degree of utilization of Danish gas infrastructure in the future. At the same time, multiplier at the level of 0.90 will create balance between commitments already made by the Open Season 2017 shippers and benefits to the Danish gas market (expected decrease in transmission tariffs as well as additional income of Energinet).

Following the above-standing comments Energinet has amended the proposed methodology in the Final Consultation document. It is clarified that the long-term multiplier affects bookings with duration equal to or exceeding 5 (five) years. Similarly, the proposed range of the long-term multiplier is now stating: Energinet seeks mandate to set a stepwise increasing long-term multiplier within the range of 0.90 – 0.95 depending on duration (length) of bookings.

Storage discount

Two replies to the pre-consultation documents express support to the proposed storage discount of 100% applied to entry-exit points towards internal underground gas storages. There are no objections to the discount expressed in the pre-consultation.

One stakeholder additionally notes that any other costs of ensuring security of gas supplies borne by Energinet (i.a. costs of rights to commercial interruption, costs of filling requirements and purchasing storage capacity for use in an emergency situation) also should be excluded from transmission tariff cost base. Instead they all should be included in emergency supply tariff which should be covered solely by domestic end consumers, who are the only beneficiaries of emergency measures, and not transit customers.

Amendments to the proposed methodology

In a response, the fundamental entry-exit model is addressed. The stakeholder is of the fundamental opinion that capacity tariffs, which is applied in gas transmission (but not in electricity) is problematic since consumers pays for infrastructure and not for consumption exclusively. Therefore, capacity tariffs correspond to a security of supply tariff in the electricity market and it challenges the principle of cost reflectiveness.

Energinet does appreciate this viewpoint. However, the entry-exit capacity model is the European standard that is dictated by the TAR NC as well as an industry practice across Member

States. While some of its major benefits are less obvious in a local Danish gas market with declining gas demand and lack of congestion, it is worth noticing that the cost of historical infrastructure investments is not reduced, if the full capacity is no longer in demand. At the same time, the Baltic Pipe project is expected to utilize spare capacity in the existing system, underlining that the domestic market development may differ from the transit use of the system.

Energinet has proposed to maintain a commodity tariff (volume) that is relatively high share of combined revenues compared with the tariff structures in adjacent systems. In our view, the proposed tariff methodology constitutes the furthest emphasis on actual utilization that is practically and legally possible to be in compliance with TAR NC and the practice among Member State gas TSOs.

Concerns regarding increasing tariff levels

All replies to the pre-consultation express concerns over the future tariff level. Increasing tariffs reduces the competitiveness of the Danish gas transmission and of gas as a fuel in competition with substitute fuels.

Energinet shares such concerns. Several factors contribute to an increasing tariff trend in coming years, notably the Tyra shut-down that delimits internal supplies to the market and transit, as well as additional costs during the same period to safeguard supplies. Looking beyond the Tyra shut-down, gas is challenged domestically through the energy taxation schemes and technological improvements in the cost of sustainable energy. In case of the transmission system, attracting transit flow is key to ensuring that capacity is effectively utilized and that Danish gas consumers pay cost effective prices for their gas supply. Baltic Pipe, if realized, offers to increase transit on a long term basis with significant benefits to all system users. Strengthened interconnection to adjacent markets will aid by providing stronger price-linkage to a European gas market price.

Gas transportation tariffs provide a necessary basis for ensuring a balance between internal supply costs and transit tariffs. Energinet considers the present tariff methodology to be a central and important step towards safeguarding the interests of all users of the gas transmission system. Therefore, Energinet is grateful for the replies provided to the consultation process. The input and suggestions provided will aid the Danish Utility Regulator and ACER in the approval process.

Additions to the Final Consultation document and extended deadlines of the Final Consultation

Two sections are added to the Final Consultation document compared to the version put forward in the pre-consultation:

- 3.7 Results on cost allocation assessment
- 4.2.5 Non-transmission services (emergency supply services)

In section 3.7 the resulting comparison index of the cost allocation assessment is presented. It shows that the comparison index of uniform capacity tariff methodology yields lower cross-subsidisation (10%) than the capacity weighted distance reference price methodology 21% and further that uniform capacity tariffs are more robust to the historical and expected changes to costs and flows in the system than both the current differentiated capacity tariffs and the capacity weighted distance reference price methodology.

Section 4.2.5 notes that the present method application is delimited from describing the method for calculating emergency supply services, which is also provided by Energinet, but in a

separate accounting segment that primarily concerns purchase of emergency supply instruments from underground storages and interruptible consumers.

The deadline for the Final Consultation is extended to provide stakeholders a full two-month period to assess the tariff methodology from receiving the present version. The revised deadlines are:

- i) Shipper Taskforce attendees of the draft methodology, which is concluded
- ii) Pre-consultation process (1 month duration), also concluded: 2 July – 1 August 2018
- iii) Final consultation (2 months): 31 August – 1 November 2018**
- iv) Submission to DERA (5 months approval period): 8 November 2018
- v) Coming into force: from 1 October 2019

Energinet is cordially and warmly inviting all stakeholders to participate in this process.