

ENTSOG response to THINK public consultation

THINK Topic 6 – DRAFT Version V2: “EU involvement in electricity and natural gas transmission grid tariffication”

ENTSOG would like to thank THINK for the opportunity to comment on its draft report entitled: “EU involvement in electricity and natural gas transmission grid tariffication”. The draft report is balanced and identifies many of the issues previously pinpointed by gas TSOs. We are particularly pleased that the economic trade-offs involved in some of the policy decisions are clearly stated.

ENTSOG would like to reiterate the following positions that it has put forward on other occasions.

1. Investment climate

For new investments to come on stream, even if there is adequate user commitment, the risk-reward ratio for the investor must be set correctly within the regulatory regime. The rate of return must be commensurate with the cost of capital. The draft THINK report gives examples on how some regulators are aiming to achieve this, e.g. by allowing a premium on new investments, which could serve as models for other national regulators. ACER might firstly play a role in identifying where national regulatory agencies put too much emphasis on slashing transportation/asset costs at the expense of wider internal energy market interests, and secondly in fostering successful practices for incentivising new infrastructure.

Preference should be given to the underwriting of investments by market demand, in the form of long term commitments by system users who book long term capacity. However, the draft report also states that “Adequate investments may also include projects that are socially desirable but not profitable from the isolated investor’s point of view.” From gas TSO’s perspective, these are for instance investments in security of supply which are not sufficiently underwritten (adequately booked long-term) by the system users to warrant infrastructure investment. We would like to question whether some EU rules and



involvement may not be warranted, if national regulatory regimes do not foresee coverage of the gap in the underwriting of investments (i.e. cost allocation to system users with direct benefits from the capacities or services provided).

2. Merging of market areas

ENTSOG fully agrees that market area mergers involve significant trade-offs, which are well-reflected in the draft THINK report, and therefore calls for a careful case-by-case analysis of the costs and benefits before any mergers. Tariff issues are secondary to the technical/physical issues associated with the offer of de-coupled entry-exit capacities (The Nordic power sector provides a recent example where in Sweden in 2011 a larger market area was broken up into multiple zones, reflecting the underlying physical infrastructure). Nevertheless, the tariff issues also need to be examined, particularly from a cross-border perspective. On an EU level, there may need to be some assistance in resolving some of these issues.

3. Capacity products

“Chain-link-products” are a capacity allocation issue, not primarily a tariff issue. In the CAM network code, ENTSOG does not foresee a linking of auctions, because it is discriminatory in nature (capacities would be tailored to those who can use a certain route and exclude other system users competing for the same capacity). They also counter the hub-to-hub logic of the Third Package, and risk fragmenting the capacity market. Additionally a secondary market in capacity enabled by the TSOs and other CMP arrangements may free up capacity for subsequent reallocation to the system users having the highest willingness to pay. Thus, those not securing their desired capacity allocations in the initial long term capacity auctions will have several options available to secure their capacity requirements. Furthermore, ENTSOG anticipates that additional attention will be given to determine the rules and processes that might be associated with the provision of incremental capacities beyond those currently supported by the existing gas transmission network infrastructure. These processes need to build upon lessons learned from the experience of open season and other market test based approaches. Finally, in the longer run, when markets are matured, enhanced market linkage mechanisms may develop, as presented in ENTSOG’s response to the CEER Target Model consultation.



4. Pancaking

“Pancaking” (i.e. the claim that transports across several entry-exit zones add up to higher charges than they create costs) has to be looked at carefully: In entry-exit systems, there may actually often be an inherent, systematic problem that leads to disproportional advantages for long-haul transports within the entry-exit system. Where the above disproportionality occurs, shorter transports have a higher tariff weight relative to the distance transported and longer transports have a disproportionately lower weight. Consequently, there may be something that one could call “reverse pancaking”, which means that a transport across merged zones would be less cost-reflective than a transport over several separated zones is. The European gas system both delivers long-distance transports, as well as shorter distance transports. Given that with the size of a market area, the inherent cross subsidies become bigger, and that the gas transport system in different countries serves different purposes, such cross-subsidies should be included in the considerations of costs and benefits of mergers.

5. Short- and long term capacity pricing

ENTSOG particularly supports the draft report’s findings with regard to the pricing of long term versus short term capacity products. We agree with the conclusion that discounts on short term capacity will lead to significant market distortions and may jeopardise the aim of “2014”, as well as undermine the European gas system’s role of delivering long-distance transports. A pricing arrangement that does not allow for proper cost recovery through capacity charges, due to a flight of users to “cheap” short term capacity, will be distortive by introducing cross-subsidies. Furthermore, with a flight from longer term booking, timely signals for efficient investments are lost.

Therefore, ENTSOG has put forward its revenue equivalence principle. This pricing scheme is aimed at creating an aggregate equivalence of flat bookings versus profiled bookings for short term products. It is inherently incentive neutral and consequently allows system users to procure capacity when they identify a need for it. It shall minimise any undue incentives either to hoard capacity, or to massively substitute longer term for short term products. ENTSOG will codify this principle in the CAM network code, which should then become binding on an EU level.