Mr. Alberto Pototschnig
Director, ACER
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1000 Ljubljana, Slovenia
by e-mail

Brussels, February 2013
Ref: 13GIE014

Subject: Draft Framework Guidelines on rules regarding harmonized transmission tariff structures for gas

Dear Mr. Pototschnig,

With this letter, I want to draw your attention to one very important aspect of the currently drafted framework guideline on tariffs. The members of GIE are seriously concerned that the envisaged pricing for short term capacity will lead to massive distortions within the European gas infrastructure market.

First of all, let me remind you that GIE explicitly supports the development of an integrated European gas market and is of the opinion that cross border trade is an important tool to achieve this goal. The number of cross border and import points has almost doubled during the last 10 years. At the same time, congestion was reduced via investments in cross border capacity. GIE also supports a balanced mixture of short-term and long-term booking possibilities in order to allow network users to react on market signals. Finally, GIE believes that tariff structures should not hinder cross border trade.

But all these measures (investment in capacity, flexible durations and pricing) need to take into consideration the needs of all market participants including infrastructure operators. There is no justification for beneficial treatment for some market participants at the expense of others. GIE is concerned that discrimination may occur because the FG supports short term capacity booking, profiling and day-ahead booking in an unacceptable way, shifting substantial economic risk towards TSO and even giving room for free-rider behavior:

- Indeed, network users should have the possibility to book short term capacity based on their portfolio or to react on market signals. But such short term booking increases the utilization risk for TSOs with the risk that fixed costs are not covered. Please note that there is no possibility for TSOs to react on this asymmetric risk by, for example, limiting the offered capacity. Taking into consideration the risk profile of the TSO, short term booking should be more expensive than long term booking.

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- But according to the current draft of the framework guideline, short term booking should even be cheaper. The argument for this approach is quite often the "optimal use of capacity", but this argument fails because sufficient capacity is already there[1]. For a network user, the risk for not receiving the requested capacity on ashort term basis is limited as long as there is no congestion (which is often the case). In addition, short term booking will be rewarded by lower tariffs. As a consequence shippers are somehow invited to optimize against the TSO and pay too little or even nothing at cross border points.

- Such optimisation by network users shouldn't be seen as a misuse, in fact it is a somehow rational reaction to the given regulatory environment. Under-recovery at a cross border point will be a direct consequence of this pricing structure.

- The FG foresees a mechanism for revenue recovery, but this will not solve the problem of under-recovery. One can assume that network users will show in a given year "n+1" the same booking behavior as in the previous year "n". Cost not covered in year n will be shifted to year "n+1", but will not be fully recovered in "n+1" as network users will again book just "cheap" short term capacity. In addition, costs not recovered of year "n+1" (and partially "n") will be shifted to year "n+2". It is in this respect absolutely irrelevant which recovery mechanism (capacity, commodity, number of regulatory accounts) is chosen, under-recovery is a direct consequence of the pricing for short term capacity and the booking behavior implied by it.

- Necessary price increases to cover costs of previous years will pile up, resulting in increasing difficulties to recover revenues. They could be even detrimental as they may additionally incentivise short term optimisation of network users (via the booking behavior described above). There are two possibilities to solve this self-feeding mechanism: to "write off" unrecovered costs (but this is not in line with the regulation), or to earn them elsewhere. As a consequence, there is a huge risk that costs not earned cross-border in the mid- or long term have to borne downstream or at domestic exits. This may impact negatively also storage and LNG terminals.

- Moreover, the above described cumulative effect may lead to even higher gas prices for end consumers. First of all, there is no proof (or legal obligation) that cheap cross-border transmission will lower the market based gas prices at trading points. Secondly, as for the infrastructure costs, it has to be mentioned that stakeholders during the workshop 23 January 2013 requested explicitly that recovery should be done downstream only (arguing that downstream users are, in terms of Security of Supply, the beneficiary of overdesigned infrastructure). Their proposal is of

[1] Price differentiation is for example an important instrument in the airline business to optimize costs to the benefit of customers and airlines. But airlines can vary the size of airplanes used for specific flights. Cross border capacity is built to cover peak demand and can't be adjusted.

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course not in line with the comparative test to avoid cross-subsidies, but as said earlier, there is a risk that costs not earned cross border points have to be borne downstream or at domestic exits.

- GIE is afraid that from a TSO's perspective, the only economic instrument to manage risk under a cheap-short-term-regime is to keep offered capacities low or even reduce existing capacities. Such decisions shouldn't be seen as a misuse, in fact it would be a somehow rational reaction to the given regulatory environment.

The unduly beneficial treatment for short term capacity booking, profiling and day-ahead booking will invite network users to adjust their booking behavior, potentially ending up in a free-rider mentality; the resulting systematic under-recovery at cross border points will in turn reduce TSOs' incentives to invest in cross-border capacity. As a consequence, the FG will not necessarily lead to more market integration but to a discriminatory reallocation of risks and benefits.

Based on the above mentioned arguments GIE requests higher tariffs for short term bookings compared to long term booking, insofar as this reflects the risk profile of a regulated infrastructure provider. The redistribution of too high revenues can be more easily done compared to the hypothetical recovery of unrecovered costs (see above). And last but not least, GIE suggests that the multipliers for short term capacity should be flexible and recalculated from one year to another, in order to adapt to the changing transmission environment.

I remain at your disposal for any question or remark you might have.

Sincerely yours,

Jean-Claude Depail
GIE President

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