Ørsted

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Case number: ACM/14/023224 25 May 2018

ACM Consultation on NC TAR implementation

Our ref. petbi

Dear Madam / Sir

Ørsted welcomes the consultation on the implementation of the Commission Regulation (EU) 2017/460 of 16 March 2017, establishing a network code on harmonized tariff structures for gas (NC TAR) into Dutch regulation.

As you are aware, the Ørsted has been active for a long time in the Dutch gas and energy market. Over the years we have made significant long term investments in infrastructure serving the Dutch gas market, as well as undertaken long term transport capacity commitments as required by GTS and the regulation. Currently, we hold long term transport commitments serving both storages and the LNG receiving terminal (Gate). The annual costs and the overall commitments can be significantly affected by the NC TAR.

The implementation on NC TAR and setting of tariffs should be based on a number principles as laid down the Regulation 715/2009, including cost reflectiveness, provide incentives for investments, facilitate efficient trade and competition, be transparency, provide interoperability, be non-distortive for cross border trade, include benchmarking and be non-restrictive for liquidity. Furthermore, under Dutch administrative law a number of general principles of good administration are laid down. These are party codified in the General Administrative Act (Awb), including the principle of careful preparation (section 3:2 Awb), the principle of proportionality (section 3:4 Awb), and the principle of proper reason (section 3:46 Awb

Whereas we generally are supportive of the approach for implementation as proposed by ACM, we a have one significant disagreement. We disagree with the proposal to change the Entry/Exit split to 50/50. We found GTS's arguments for a 0/100 split (as opposed to current 40/60) convincing. It would safeguard Dutch security of supply, maintain TTF liquidity and fundamental role as reference point for Europe's gas markets and maintain high transit flows. At the same time external analysis by Brattle showed that this would also lower the overall cost to the Dutch consumer. However, we recognize that the proposal met strong opposition. We therefore find that the current 35/65 split should be the absolute maximum Entry/Exit split - with the possibility of adjusting tariffs if benchmarks indicate this. Hence, we disagree with ACM's proposal to *increase* the Entry/Exit split to 50/50. This is argued by ACM on the principle of cost reflectivity, disregarding other fundamental principles for setting the tariffs, and is furthermore based on an *assumed* cost split between Entry and Exit of 50%.

In disagreeing we find that the ACM draft proposal on the Entry/Exit split is not cost reflective and it does not take due account of the fundamental principles for setting the tariffs. Furthermore, ACM has not produced any analysis underpinning their proposal that would satisfy the requirements for Good Principles, as set out in the Dutch General Administrative Act.

We further elaborate our views below, but the main points are;

- There are no legal requirements in NC TAR to opt for a 50/50 Entry/Exit split. Rather, the EU-regulation stipulates a range of principles (cf. article 13 of Regulation 715/2009) that should be taken into account, including
    - **Cost reflectivity**. This principle requires a clear view and analysis on how costs are built up – and how they should be divided. ACM fails to make this analysis. ACM assumes that Entry/Exit costs are divided 50/50. However, the analysis (see below) clearly demonstrates that a cost reflective the Entry/Exit split should be 39/61.
    - **Benchmarking of tariffs**. As shippers in an LNG terminal we are exposed to competition from other North West European LNG terminals. ACM has – without any analysis – opted not to look at benchmarking. When we compare the Gate tariffs with other facilities it appears that Gate is more expensive. Gate shippers are facing an uneven playing field to the detriment of Dutch security of supply. We find that these differences clearly warrant that ACM considers if the Benchmarking should lead to a specific LNG Entry tariff. This would comply with article 6.4 a)-c) in NC TAR.

Our points of view are further elaborated in the following sections.

Cost reflectivity:

Cost reflectivity can be can be based on several criteria, for instance the overall capacity split between Entry and Exit (as is the case for German Ontras), the number of entry and exit points etc. This will typically lead to an Entry/Exit split below the current split.

If we *refrain* from making the above considerations on the actual configuration of the system – and only look at the costs, we must consider how the costs of the High Pressure grid (HTL) and the Medium Pressure grid (RTL) should be divided. In order to make an estimation of the entry/exit split, we consider the ratio of costs in the GTS HTL system (the main gas transmission system) and RTL system (the regional high pressure gas transmission system). As the RTL system is designed for Exit use (only 2 entry points and 415 Exit points) and gas cannot move from the RTL to the HTL system, it seems fair to assume that costs related to the RTL system should be allocated to the Exits. Despite the fact that the number of Exit points and overall capacity in the HTL system is larger for Exit than for Entry, we conservatively assume that the HTL system is split 50/50 between Entry and Exit.

GTS have reported the costs for the HTL and RTL system separately in the annual reports of 2016 and 2017 for GTS (HTL) and GGS (RTL), which can be found on the GTS website. The value of the asset base is published on the balance sheet and the depreciation costs are published on the profit and loss account. The annual Capex cost can be calculated by applying the relevant WACC. **OPEX is published on the profit and loss account under "Other operating expenses". By adding the OPEX to the CAPEX** we can find the total costs for GTS and GGS. We then assign the GTS costs to both entry and exit, whereas the GGS costs can

be fully assigned to exit. From this, the entry exit split can be determined as illustrated in the table below (2017 numbers).

Tabel 1: Cost of the HTL & RTL system (million € - WACC of 4% – without storage discount)

	HTL System (50/5 Entry/Exit)	RTL system (10 Exit)	Entry %	Exit %
Capex	390	80		
Opex	560	169		
Total	949	249	**39%**	**61%**

The above calculation shows that even when only applying a principle of cost reflectivity without any consideration of the overall configuration of the system, the immediate Entry/exit split should be **maximum 39/61.**

Conversely, by applying a 50/50 split the NC TAR implementation *is not* cost reflective.

Finally, a decision to change to a 50/50 entry-exit with grave economic consequences for the shippers, and without any substantive reasons not only violates article 13 of Regulation 715/2009 and section 12f of the Dutch Gas Act, but the principles in the Dutch Administrative Act, including the principle that a decision must be based on proper reasons, careful preparation and proportionality

Benchmarking of tariffs.

When considering LNG, Gate is of key importance for the gas supply to the Netherlands – and to the wider North West European market. Together with the pipeline imports, LNG represents one of the main alternatives for global gas supply to the Netherlands that could be used to cover potential further reductions in the indigenous production. Due to its way of operation, it provides the possibility to connect the Dutch gas market with LNG sources worldwide and to cover for possible shortages in case of pipeline import disruptions.

The supply of LNG to Gate is however dependent on the cost exposure. It competes strongly with other LNG facilities in continental Europe. In the neighboring countries, Belgium/France, the Entry tariff is lower than Gate. Furthermore, in the case of France a separate LNG-discount has been employed – and the French Entry-Exit split is approx. 30-70. It is not expected that the implementation of the TAR NC in France and Belgium will lead to major changes. As regards to the UK then the issue is a little more unclear. Currently, the LNG Entry points rely on either cheap long term bookings (entered into at a time with low/zero reserve prices) or short term bookings with zero reserve price. This has the effect that LNG can enter with only paying the volume tariff.

Given the competition Gate faces and the important additional security of supply that LNG provides for the Dutch gas market, we encourage ACM to investigate implementing a benchmark for LNG entry bringing it on par with the rest of Continental Europe.

Tariffs shall provide incentives for investments in gas transmission

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Regulation 715/2009 stipulates that the tariff system shall provide incentives for new investments and interoperability. GTS is responsible for making the investments, but GTS and the regulation has required that the market participants underwrite the investments via long term commitments and take the full risk for changes in the cost of the system. This has been done via firm long term transport bookings. For this system to work, it is imperative that the market participants are faced with a stable and predictable regulatory environment, where changes are only made after careful consideration and for good cause.

ACM's proposal to shift the Entry/Exit burden to 50/50 will imply a massive reallocation of payments among the shippers.

For Ørsted as a shipper in Gate, the Entry cost has already increased with more than 30% since 2012 and with the proposed 50/50 split, the cost will almost have doubled by 2020. This is clearly not in line with the principle of providing incentives for investments in gas transmission, as shippers cannot rely on a stable and predictable regulatory regime. Furthermore, we find it unfair and against the principles of the General Administrative Act (proportionality) to implement the shift in Entry/Exit burden without taking into account the long-term investments made in the form of capacity bookings of the Gate shippers

Tariffs shall facilitate efficient gas trade and competition & Tariffs shall not restrict market liquidity or trade across transmission system borders

In the ACM draft decision, only limited reference is made to the above principles of efficient trade, competition, and market liquidity. However, maintaining the status of TTF, attracting additional volumes, and underpinning the Dutch gas market was the main reasons for GTS' proposal for a 0/100 split. Ørsted is still in agreement GTS on this point. By moving in the opposite direction, ie increasing the Entry/Exit split, we are concerned that this will make trade less efficient, less competitive and reduce Dutch market liquidity.

In <u>conclusion</u>, we hope that ACM will take due account of the above considerations in drafting their final decision on implementing the NC TAR and change the proposed Entry/Exit split to a maximum of 40/60, with an additional consideration of employing benchmark regulation to entry from LNG terminals.

We are at your disposal for any clarifications – and we look forward to participate in the process also after 28 May.

Yours sincerely
Ørsted

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