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Expediente: CIR/DE/003/19 ID: SW315Q Copia auténtica

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Comisión Nacional de los Mercados y la Competencia
Alcala 47,
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By email only

30 September 2019

Reference: Shell's response to CNMC's consultation on the methodologies to calculate transport, distribution and LNG infrastructure services tariffs with reference CIR/DE/003/19

Dear Sir/Madam,

Shell welcomes the opportunity to respond to the CNMC's on the gas tariffs' methodologies to calculate transport, distribution and LNG infrastructure services which includes the implementation of EU TAR 2017/460. We consider this reform to be a cornerstone to the development of the Spanish Gas and LNG market and a key determinant on the success of the LNG market reform (referring to the Access and Connections, as well as, Balancing circulars).

On that basis, we want to flag our general concern on the limited stakeholder engagement and industry wide discussion in the development of the proposal. We acknowledge that this is mainly due to the limited competencies the CNMC held until earlier this year, and the resulting tight TAR implementation timelines. Nonetheless, as the proposed methodologies will not be revised throughout the regulatory period (and the CNMC has no proposed a reopener clause) the limited industry-CNMC engagements may lead to higher risks of undesired outcomes in the Spanish gas market. If negative impacts where to materialise, it may undermine the effective operations of the market to the detriment of gas consumers and lead to underutilisation of oversized LNG infrastructure capacities.

Generally, we are concerned that the CNMC doesn't have the legal powers to set charges which brings additional uncertainty as the government will implement a methodology. The biggest immediate challenge being that there is currently no public information in relation to what the Ministry's proposal and the timeline to implement it will be.

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Noting the above, we have seen a negative difference between the CNMC's policy development and consultation process and that by other National Regulatory Agencies, where regulatory best-practice may not have been followed. The level of engagement and clarity of the consultation documents aren't comparable to best practice, also the expectations set by TAR do not appear to be fulfilled i.e. justification for multipliers and grounded cost assumptions. These shortcomings have limited the opportunity of market participants to fully and effectively assess the CNMC's tariff methodology proposal (including the Liquified Natural Gas (LNG) tariffs methodology).

Below we provide more specific comments on the CNMC's proposed structure as covering the principles of the methodology, multipliers, impacts on the power market, allocation of deficit and exceptional costs, and LNG methodology.

Overarching principles affecting the entire proposal

Explicit tolerance for under recovery – Our understanding of the CNMC's proposal is that it aims to deliver zero deficit on a yearly basis and any under recovery for the year will be recovered in the subsequent tariff period. We understand the constraints that the CNMC faces on the back of RDL 8/2014. However we consider that the based on Art. 59 and 61 of the beforementioned RDL the CNMC should operate within the constraints set by it in order to provide relative tariff stability year on year.
The abovementioned RDL provide a 10% headroom before any tariffs need to be increased for any one year deficit, as well as providing a 15% headroom for aggregated system deficits. In particular this headroom, could be used to manage the transition period to the new tariffs' methodology.

The above constraints do allow the CNMC to create a buffering mechanism to minimise tariff volatility over the regulatory period by creating clear rules providing buffers of under and over recovery where no changes may be necessary.

That said, we consider that the CNMC and Ministry should consider removing the obligations set under RDL 8/2014 in relation to the system's deficit. This constraint is no longer relevant as the tariff setting responsibilities and obligations of the gas system costs to be fully recovered are now with the CNMC.

Defining interruptible capacity products - In relation to interruptible capacity we consider that an ex-ante discount provides a more valuable commercial incentive as it simplifies its pricing in commercial operations. Instead, an ex-post discount has less value as the discount has to be priced -in as a probability of interruption.

Defining the split between the variable and fixed terms – We understand the rationale to include true variable costs as part of the variable term of the specific tariff. The costs included in this term, for the transmission network tariffs, is solely operational gas. However, it is

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unclear whether this term will include other true variable costs such as CO2 emission allowances and regulated entities margins associated with any incentive regimes. In general, it is our view, that where there are arguments for costs to be classed as fixed or variable, the default option should be to be classed as variable. In particular, as if this doubt exists it suggest that there is not the high degree of certainty of the level of cost to be incurred over the regulatory period.

Defining the basis for gas demand and supply volumes forecasts – We consider that the CNMC's approach should be flexible year on year in order to account of the likely impacts of the energy transition in Spain and Europe. To this effect, we consider that the proposed approach to base on the expected utilisation volumes is anchored on past volumes is not appropriate.

A forward-looking element should be included in this assessment, in particular in the context of continuous policy change such as the closure of coal power plants and future closure of nuclear, as well as global market responses to the energy transition. As an example, the increasing global LNG supplies as well as the likely increase of gas demand from the Spanish power market should be considered for the affected services. This without considering the expected positive LNG infrastructures utilisation impacts that the CNMC's own reform is likely to deliver.

Considerations for the planned 4 years convergence period between methodologies – Generally we are supportive of a smooth conversion period. However, as the proposal is based on the CNMC consulted allowed revenue values, there is uncertainty about what the decision will be and its impacts on tariffs. In addition, as consulted the allowed revenue decision is also likely to include a transition period. Therefore, it is important that this period is accounted for when considering the above-mentioned deficit flexibility in order to mitigate price volatility. To achieve this and provide certainty to the market, it might be appropriate to include a ceiling on tariff increases over the regulatory period e.g. no higher than 10% versus the true indicative values.

Structure of tariffs to final customers – In principle we do not disagree with the proposed structure as we are relatively agnostic in this regard. That said, we are concerned in the proposed retroactive nature that the annual reassessment of a final customers annual gas demand might have. We are strongly supportive of regulatory best practice to avoid retroactive impacts. This is concerning for the long-term viability for industry and power generation using natural gas as a fuel. The retroactive assessment and billing for tariffs differences is likely going to bring undesired incentives and unnecessary challenges. Some of the challenges are:

- **Industrial sector economic decisions based on a potential change in tariff level** – Final consumers can face very significant volatility between their year on year gas

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consumption due to a plethora of factors. However, most significant of all is likely to be the macro-economic cycle. On the switch years between expansive and contracting cycles industry might be either provided an initial positive cash-flow (when transitioning from recession to expansion) or a negative cash flow. The latter, in periods of recession might not only help reduce the viability of the business, but also mean there might be bad-debt from bankrupt industrials which might increase system wide deficits.

As a last point, moral hazard might be developed by the current proposal. Some industrials who know they aren't viable for whatever reason, might exploit lower gas prices to increase revenues with the knowledge they will not be able to fulfil their future debt.

- **Encourages further disconnections from the main gas system** – In order to avoid this uncertainty associated with back-charges, industrials maybe further encouraged to disconnect from the gas system by entering commercial supply contracts with tanker truck service providers.
- **Potential increase in power prices and/or capacity withholding** – Gas based power generation may be affected by perverse incentives. For example, generators may submit higher prices to the power market in order to account for the potential risk of being moved to a different gas consumption band. This in turn may at best increase power prices to Spanish consumers and at worse, prompt the exit of gas power generation from the power market. Also, other perverse examples could encourage generators to undertake maintenance at the end of the period in order to ensure that they are not rebranded or to very sharply increase prices at the end of the year to cover the additional retroactive costs of the year's consumption.
- **Reduced certainty on the costs of business operations where gas is an input** – The lack of certainty for intensive gas consumers is likely to lead to an increase of operational costs making businesses comparatively less competitive.

Therefore, we propose that the best alternative to maintain the main elements of the current proposal, and mitigate the abovementioned impacts, is that the re-banding affects the following year i.e. is not retroactive. We acknowledge that this may mean there are relative winners and losers year on year, but this is time limited to one year. Alternatively, the assessment could be done on bi-annual basis to limit this temporal benefit.

Multipliers proposals

We believe that intraday multipliers should be, at a minimum simpler, and do not understand the reasoning behind having twenty-four separate multipliers which differ for transmission entry and exit points and LNG services (i.e. regasification and tank storage). Our understanding is that the intraday multipliers proposed in Tables 11 and 81 of the consultation actually represent

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coefficients, from which the twenty-four separate intraday multipliers are derived. This results in intraday multipliers at transmission entry points which individually and on average do not exceed the typical limit of three specified in Article 13.1(b) of the TAR NC. However, in the case of multipliers at transmission exit points and LNG services (albeit multipliers for these are not covered by the TAR NC) the intraday multipliers are, in some case individually and on average, greater than three.

Intraday multipliers should be the same for transmission entry and exit points and for LNG services and should apply at a constant rate, regardless of the number of hours within the day that the capacity/service is booked for. Shippers would therefore be charged the same intraday hourly tariff (determined by multiplying the yearly tariff calculated on an hourly basis by a single intraday multiplier) regardless of whether they book two hours of capacity or twenty. Unless specifically justified, this single intraday multiplier should be less than or equal to three. Where the unnecessary complexity is most sharply going to be felt is for gas-power generation. Where Intraday multipliers will have a direct impact on power balancing prices as CCGT is the power system balancing technology.

Therefore, the current transmission network proposal doesn't appear to be consistent with the requirements set in Art. 28(3)(a) in general and in particular in relation to point i of the article.

Moreover, in relation to LNG multipliers (i.e. on regasification and tank storage) this should be one or very close to one for all durations below annual bookings. The global nature of the LNG market, where significant activity takes place in the short-term, once a cargo is directed to Europe Spain mainly competes on price with other European terminals. Therefore, having comparatively higher tariffs due to multipliers to deliver in Spanish terminals decreases the country's attractiveness. Hence, short-term multipliers should not exist.

Also, the intraday multiplier proposal both for pipe and LNG capacities are in contradiction with a daily gas balancing regime. Also, it may interfere with the daily balancing activities of network users as it may be cheaper for participants to be imbalanced than contracting ID capacity. In practice this means that the SO would be left with the imbalance to manage inducing potentially higher balancing costs for the system. Whilst at the same time, undermining the residual role of the SO as required by the EU's BAL code.

Impacts on the power market

Multipliers' impact - The CNMC's proposal, for short-term products and most significantly intraday capacities doesn't appear to account for the impact on the gas-powered electricity generators. The most extreme example where no consideration to the interaction between the markets appears to be taken is over the six-hour misalignment period between the gas a power day, from which two main impacts may derive:

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1. **Contestability of the power market** – Independent gas-power generators are likely to be price-out of the power market due to the high-costs of short-term capacity. This type of gas-power generators tends to acquire short-term capacity in order to generate as long as the price is at or above its marginal costs. However, if the tariffs, due to the intraday multipliers, increases their cost they will be less competitive. This is concerning, where less efficient generators operate because of the distortion caused by tariffs. This is most likely to be the case if the less efficient generator is part of a large gas portfolio which allows them to better optimize.
2. **Higher wholesale power prices** – Following from the point above, the impact that multipliers have on the costs of dispatch of gas-powered generation (the marginal technology) will lead to higher costs for final electricity consumers. The higher costs will come both from intraday power market prices and real-time costs of balancing services.

Guaranteeing a level playing field for large scale gas-powered generation – The tariffs burden on gas-power generation should consider fair and effective competition at both domestic and the pan-European level. We consider that the proposal doesn't take competition in to account because:

- **Lack of national level fair competition** – Under the current proposal, at least one CCGT will continue to face an unequal gas tariffs burden which provide them with an unfair advantage over others.
- **Lack of pan-European fair competition** – The European power market is continuing its drive to become a single power market. The latest developments of which are the implementation of the Electricity Balancing Guidelines starting this year. In a context where Spanish gas power-generation is faced with comparatively higher costs than other EU competitors. This will likely in part be due to high tariffs and unnecessarily high multipliers. This in turn will not only affect the viability of the Spanish power plants, but decrease their gas consumption which will further impact the level of cost recovery of gas tariffs.

Management of deficits and exceptional costs

Socialisation of historic investment cost on oversized LNG infrastructure – We disagree with the proposal suggesting including the costs of the investment of Musel, the RCS incentive and a court ruling on investment as a cost to be recovered through the regasification tariffs. The main reasons for our disagreement are:

- The increased regasification cost will impact PBV's marginal price passing to customers a significantly higher cost even if the gas used for their supply is sourced through Spanish piped gas.

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- The increase regasification cost will continue to put downward pressure on the utilisation of Spain's oversized LNG infrastructure, and resign the Musel terminal to be hibernated until decommissioned. This also minimises the regulated costs recovery due to sub-optimal utilisation of the infrastructure due to the interaction between supply and demand i.e. lower price leads to higher demand.
- The decision of investment in the infrastructure was undertaken at that moment in time by the government considering of the expected needs of the final beneficiaries; the Spanish consumers.

The alternative recovery mechanism of these costs is to recover them the final consumer exit point. This will avoid the above described challenges, optimising the use of the Spanish system and minimise costs to all current and future consumers. Other benefits of this approach are that SoS from LNG would be maximised through the market (having a wide number of supply sources, unlike piped gas) which ultimately benefit final consumers.

Otherwise, in order to protect the viability of the gas system and maintaining the desire to keep the charge at the LNG section of the value chain – all these costs should be recovered through truck loading tariffs, or regasification to truck loading activities only. The rationale being that these activities are encouraging disconnections from the gas system raising its risk of viability of the gas system (more on this can be found in the section below). Even though, this is not an explicit cost it of tanker truck loading, is however implicit through disconnections and/or reduced consumption.

This said, in particular with reference to the costs associated to the investments in el Musel terminal which was decided by central government, it might be appropriate to cover the costs from the central government's budget. This would remove the distorting effect that it will have on the operation of the gas system.

Recovering annual system wide annual deficits or distributing surpluses – As it is clearly acknowledged tariff costs are always passed through to final consumers either directly (i.e. through final consumer tariffs) or indirectly (i.e. the summation of the value-chain costs). Therefore, the preference of how these costs are charged should be based on economic efficiency, including the minimisation of costs to final consumers.

Therefore, in order to minimise the impact of price formation where prices at the PVB are set at the margin, as expected in an efficient market, costs for gas accessing the PVB will have a direct impact on this price which will impact all consumers. On the other hand, where the tariff is recovered at the exit point each customer will only pay their fair share of the cost.

LNG tariffs methodology

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Valuing SoS as part of LNG entry tariffs to the PVB – We consider that the methodology should include recognise the SoS value that LNG terminals to the Spanish gas system. In the context of Spain being highly dependent on LNG for its supply, whilst also having limited indigenous gas as well as having underground storages with limited injection and withdrawal capabilities. We consider that this rationale clearly justifies a discount at the entry to PVB tariff for LNG, as foreseen in Art.9.2 of TAR.

Widening the scope of the gas system regulated activities to include tanker truck loading - We consider that ensuring the appropriate scope of regulated activities is a key component to foster the efficiency of the natural monopoly that is the gas system. It is apparent, in the Spanish gas system that an updated definition of the scope of regulated activities is necessary. Specifically, we identify a case for expanding the scope of regulated activities bringing tanker truck loading in scope of a regulated activity.

The reason being that commercial logistics of tanker truck loading of LNG are undermining the benefits to the market of the natural gas monopoly infrastructure network. This is being done by serving customers whose costs of supply through tanker trucks is lower than those through the network, which are broadly governed by regulated tariffs and charges. This behaviour putting at risk the long-term viability and efficient cost sharing of the gas system.

Bringing the tanker truck-loading activity for domestic consumption into scope of the natural monopoly. In practice, this would mean extending the concept of a virtual pipeline which currently exists in parts of the distribution network, to LNG provided directly from LNG plants. Once this is done, the costing of this services be to mimic the cost that would mean serving a customer through a pipeline if this excited (extending the proposed methodology), therefore being cost reflective of the opportunity cost to the system and helping signal areas where potential network expansion may be appropriate.

Introducing LNG intraday storage capacity products – Building on our response to the Access and Connections circular we advocate for the introduction of intraday LNG storage capacity as a natural extension to the introduction of the balancing circular. We consider that the multiplier for this product should be the same as for the day-ahead as the sole value of acquiring intraday capacity is to manage imbalance risk.

Bunkering activity is not part of national demand – As argued in our response to the consultation on Access and Connections, we are concerned about the misalignment of interpretation of what constitutes national demand between CORES and the CNMC. Specifically, CORES consider that small scale bunkering operations should be counted towards Spanish national demand, therefore becoming relevant for shippers' strategic reserves' obligation.

We do not agree with CORES assessment as the majority of LNG for bunkering operations is used as fuel for sailing through non-Spanish waters (e.g. a cruise ship sailing through the

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Mediterranean). If, however, the CNMC agrees with CORES view, slots for small scale LNG (e.g. bunkering) should be available at the same time as unloading slots, as we consider there shouldn't be discrimination of different sources of national demand.

On that basis **we would welcome the CNMC made a clear an unambiguous statement in this regard.**

Charging for LNG loading slots - We consider that there should be a charge for large scale LNG loading slots. Specifically, we propose that that the same charges for unloading should apply for reloading of ships with a capacity above 25 million cubic metre. The reason for that threshold is that there are ships with a capacity of approximately ~20 million cubic meters dedicated to bunkering activities in the Mediterranean. The rationale for charging for large-scale reloading slots (i.e. above 25 million cubic meters) is that they will utilise infrastructure for at least the same if not longer time than for unloading of equivalent sizes. Where there is a clear opportunity cost of the physical slot not being utilised for unloading activities.

The revenue received from these activities can then be utilised to further support cost recovery of the LNG infrastructures, allowing the reduction of LNG tank storage and regasification tariffs.

Removing unnecessary LNG tariffs transition periods – We consider that there shouldn't be any transition period and that the new methodology should start to apply in its entirety from the 1st October 2020. Our view is that the proposed transition periods provide limited value to the whole reform of the Spanish system, as it requires several system changes across market participants adding extra costs to its implementations. Costs which will ultimately be reflected in consumers bills.

Finally, we welcome the CNMC's proposal principles aiming to ensure the viability of the gas system. The CNMC's proposal has a significant value in supporting the Spanish gas system through existing challenges and those likely to emerge through the energy transition, where gas will be fundamental – appropriate tariffs are key part of the puzzle to supporting the transition.

Also, we want to thank the CNMC for the engagement with market participants through EFET and Sedigas which helped with a better understanding of the CNMC proposals.

If you have any questions regarding our response, please do not hesitate to contact me.

Yours sincerely,

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