Contribution from Snam, GIC and Crédit Agricole Assurances, to the **Public consultation n°2019-013 of 23 July 2019** relating to the new tariff for the use of natural gas transmission networks GRTgaz and Teréga and the **Public consultation n°2019-014 of 23 July 2019** regarding the next tariff for the use of Storengy, Teréga, et Géométhane natural gas underground storage infrastructures

As investors in the gas transmission and storage infrastructure sector in France, across Europe and other regions, we welcome the opportunity to contribute to the ATRT7 and ATS2 public consultations issued by the Energy Regulatory Commission (CRE) earlier this year and share our international investors' perspective alongside a set of relevant concerns.

Since the acquisition of Teréga by Snam, GIC, and EDF Invest in 2013, the company, together with its shareholders[1], has taken material steps to improve its performance by improving technologies as well as introducing innovative solutions to meet new market needs and improve security of supply. Since 2013, the company invested 951 million euros, resulting in a range of key milestones feeding into the broader sector performance. In particular, the company:

- Contributed to the set-up of a competitive and efficient single gas market area (Trading Region France) in 2018;
- Invested in a range of projects enhancing security of supply and enabling the improvement of the utilization rate of Teréga's storage capacity from 80% in 2013 to 100% in 2015, and the peak capacity offered to the market by 25% across the same period; and
- Promoted a successful transition from a merchant to a regulated regime for storage, contributing to enhance security of supply in the interest of final consumers.

The considerations framed below are to be interpreted in the context of promoting investors incentives to support value creation in the gas sector in France. This is particularly relevant at a time where the sector is facing unprecedented changes. In this context, we had previously engaged with the regulator to highlight the need for the regulation to recognise **the increased risk assessment for the gas sector and support the timely achievement of energy transition goals** through adequate

[1] In early 2015, Predica, a subsidiary of the Crédit Agricole Assurances group, acquired Terega's capital on the basis of an increased enterprise value reflecting the increase in value resulting from the development strategy taken forward by shareholders since 2013.

regulatory provisions. We reiterate some of the considerations below, alongside the key concerns associated.

1. **Energy transition, new challenges for the gas sector and increased assessment of risk**

Since the last regulatory period, the risk assessment for the sector has increased due to a number of concurrent factors. These include stagnating and volatile gas demand driven by low carbon prices due to inefficient ETS scheme design, increasing competitive pressure from renewable generation driven by subsidies, the progressive shift from the long-term contract model to gas hubs across Europe, and the broader discussion on the role of the gas value chain within the future energy systems. In terms of the latter, the main drivers of the discussion have been the steep decrease in the technology costs associated with renewable generation and the increased interest towards environmental outcomes among policy makers and the public, resulting in unprecedented policy commitment towards the decarbonisation of the economy as a whole. In order to achieve the targets, the energy system will need to progressively integrate increasing amounts of variable renewable and inflexible nuclear generation while enabling the decarbonisation of heating and transport. The greater variability in electricity supply, due to increased renewable generation and exacerbated peaks in electrical demand could potentially result in higher system costs. At the same time, achieving decarbonisation will increase the need for system flexibility. While traditional sources of flexibility such as conventional coal generation are expected to reduce in capacity, the gas sector, together with technology options such as demand side response and energy storage, is expected to play a key role in ensuring supply reliability. These considerations are particularly relevant in the context of France, where the substantial share of inflexible nuclear generation capacity combined with the expected increase in intermittent RES capacity, will pose significant burden on the energy systems in terms of flexibility.

We note that these challenges are acknowledged both by CRE, in its public consultation documents and its report on gas decarbonisation[2], and by the Ministère de la Transition Écologique et Solidaire, in its letter to CRE earlier this year[3]. In particular, the focus in France has been placed on biomethane development **and reaching the green gas target of 10% of natural gas demand by 2030, which we fully support.** Our shareholder vision is indeed more broadly aligned as **we envisage an energy future where consumers' bills are lower, energy is decarbonised and innovation is encouraged, supporting growth and prosperity.** In order for the gas sector to support and actively enable the cost-effective and timely delivery of environmental outcomes through grid decarbonisation and the promotion of supply-side sector coupling solutions, **the sector requires new investment focused on innovation and optimized to minimize the impact on consumers, accelerating the process of decarbonisation of the gas grids. This would need to be further backed by regulatory changes supporting a higher degree of integration in system planning**.

Considering all the above, we note that **the provisions set out in the public consultation do not entail the right level of incentives for the operators to undertake these investments and implement innovative solutions, driving efficient and smart future gas networks.**

[2] Comité prospective "Le verdissement du gaz", CRE July 2019 – http://www.eclairerlavenir.fr/wp-content/uploads/2019/07/Rapport-GT1-BD-INTERACTIF.pdfinsert link.
[3] https://www.cre.fr/content/download/21245/file/180718_CP_2019-013_ATRT7_Courrier.pdf

2. **The regulatory provisions in the public consultations should be consistent with the existing framework and predictable in order to protect existing and future investment while supporting the energy transition.**

Investors (existing or potential) need visibility on the return on their investments. As investors specialised in infrastructure, we assess our investment value with a long-term perspective. A stable and predictable regulatory framework, together with an adequate value of capital remuneration are key components to our investment decisions and legitimate protection of the long-term value of our assets. As mentioned, the current market conditions determine a materially higher assessment of risk for the gas infrastructure industry compared to the previous regulatory periods. The expectation is that the regulatory environment will therefore guarantee protection for existing and future investment throughout ATRT7, so that the energy networks can continue to deliver in the years to come and promote energy transition. In this context however, we note that the provisions included in the public consultation documents do not provide an adequate protection for the value of the capital invested or the right incentives for the operators to introduce innovative solutions, contributing to shaping efficient and cutting edge future energy networks. We set out below the underlying arguments.

The envisaged investment remuneration does not reflect a long term vision for the sector

The provisions related to capital remuneration raise significant concern for Terega's shareholders as the implied value range (3.6-4.4% for transport) fails to determine a fair level of capital remuneration, therefore introducing unnecessary uncertainty into the sector, **negatively affecting its financial attractiveness and potentially the quality and reliability of the service.** While it is difficult to reconcile how CRE obtained the value range for the transport sector (3.6%-4.4%), we note that the methodology used by CRE's technical advisors, potentially driving the downward shift of the value range, shows elements of discontinuity with respect to the existing regulatory arrangements. In particular, some of the underlying assumptions for the reduction in the suggested level of the allowed cost of equity may be worth further analysing, including those on: i) the calculation of the values for the ERP; ii) the beta calculation, in relation to the use of a set of benchmarks failing to capture sector-specific risks and a biased time-horizon; iii) the calculation of the risk-free rate that seems to be based on a non-representative benchmark time-horizon, which is incompatible with both the nature of the assets and the assumptions used by CRE in previous regulatory periods. We are also concerned that CRE did not seem to take into account the differences in the operators' debt structure when setting the reference values for capital remuneration, violating the principles of cost-recovery. In particular, the level envisaged for the cost of the debt at 2.5% would result in a failure to adequately assess Teréga's financial expenses by 80 bps. This would result in more than €40M of financial charges not covered by CRE's suggested cost of debt over the next 4-year period. Accordingly, should the public consultation provisions be adopted by CRE in its deliberation, Teréga credit rating could be at risk.

A sudden change in the remuneration rate for storage infrastructure

Finally, as shareholders of Teréga, we would like to raise that the ATS1 framework, setting the level of remuneration rate at 5.75%, was defined less than 2 years ago after extensive discussions between market actors, CRE and the concerned operators. **The sudden and substantial change of the storage remuneration rates implied in the consultation** does not constitute a sufficient protection of the investment and **has a detrimental impact in terms of long term regulatory uncertainty**. We would also like to highlight that the introduction of regulation for storage had already determined a significant reduction of Teréga's revenues (17% year-on-year in 2018). The level of the envisaged storage remuneration, does not seem aligned to the principles of remunerating performance and does not properly reflect the risks associated with the storage activity, both from an industrial and financial point of view, as it fails to factor in the risks associated with market spreads fluctuations and increasing competition from flexibility sources.

3. **The remuneration rate for the next regulatory period should reflect the increased risk assessment for the sector and reward performance**

In summary, we consider that the proposed cuts in remuneration rates for both the transport and storage sectors are broadly misaligned with market conditions. This is especially concerning at a time when the gas sector is facing unprecedented challenges and substantial investment will need to occur in order for the networks to become greener and more resilient, in support of the transition process of the whole energy system. Notably, the provisions for capital remuneration embedded in the consultation would put France **below the remuneration level of other countries with similar regulatory frameworks** and at the level of countries where investors' profitability is also driven by incentives mechanism missing in France. We consider that the value range proposed fails to factor in and address the new challenges for the sector, instilling investment uncertainty, and would be inconsistent with the ambition of France to maintain a cutting edge level infrastructure, supporting economic prosperity in France and across Europe.

Similarly, the discussion on the potential treatment of new assets from a remuneration point of view, including the indication that future remuneration is likely going to be 100-150bps lower than historic remuneration, does not seem to be consistent with the purpose of supporting economic prosperity within the principles of a just transition. In contrast, the approach presented gives a negative signal to the market that investment in the French gas sector is intended to be scaled down as a whole, despite the policy commitments embedded into national green gas targets and a number of French Authorities' official statements. While the letter sent to CRE by the Ministry for the Ecological and Inclusive Transition of France in July 2019 defines the high level objectives of reaching the ambitious net zero targets by replacing the natural gas with green gas as well as reducing gas consumption, the provisions embedded into the consultation fail to provide the incentives for decarbonising the gas networks, neither through capital remuneration nor other mechanisms. While our objective as shareholder is not to increase network capacity, we do consider that rewarding capital in a fair way is necessary to ensure high standard performance as well as supporting the new decarbonisation objectives.

4. Conclusion

Our expectation as shareholders would be that the **level of remuneration for the transport sector should be higher than the indicated upper bound value range of 4.4%, not deviating substantially from the current levels (5.25%), so that the remuneration of capital allows an efficient level of investment to support decarbonisation, reflects the principles of methodological continuity and the increased risk assessment for the sector**. Finally, we would expect the **remuneration for storage to be set at least 1% premium to transport**, reflecting high sector performance to date, the very recently negotiated regulatory process, and the sector's significant contribution to security of supply.

We would welcome the opportunity to engage further with the process and we hope that our considerations could support CRE in contextualising the broader discussion on the regulatory provisions for the period ahead.

For Snam,

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For GIC,

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