

AM.49 Case Story
“Recommendations for improvement of the gas pricing methodology based on EU best practice)”

Small-scale project

1. The idea

During the SEMISE fact finding mission to Armenia in autumn 2009 the idea of small scale projects to be implemented by the SEMISE team was presented at various state institutions and national companies. The national gas company Armrusgazprom was planning to revise the existing gas tariffs and submit calculations to the Public Service Regulatory Commission (PSRC). PSRC has developed and approved the gas tariff calculation methodology long ago – in 1999, so perhaps it was time to revise it. Armrusgazprom asked the SEMISE to revise and evaluate the existing tariff calculation methodology and to propose some recommendations for the development of a new methodology or amendments to the existing gas pricing methodology approved by the Regulator in Armenia.

2. Implementation

The SEMISE team has received an application for the assistance in revision of the existing Gas pricing methodology keeping in mind the best practices from gas transportation pricing methodologies in the EU, with the focus on similar gas supply features (one way gas flow, simple structure of the grid, etc.). SEMISE experts were also asked to propose some recommendations for the development of a new methodology or amendments to the existing methodology. Finally, in order to improve the knowledge of the beneficiary on the gas transportation pricing principles it was planned to arrange a workshop to the personnel of the company and also to other stakeholders.

There were organised two SEMISE experts’ missions to Yerevan. The first one was dedicated to the analysis of the situation in the natural gas sector, meetings with local experts, specialists of the Armrusgazprom company, as well as to discussions with all the interested parties of the main issues. SEMISE experts arranged a special meeting at the energy regulator’s premises and had a good discussion about the existing gas pricing methodology, regulator’s role in the natural gas sector and on the needs to revise the existing methodology.

Though the natural gas tariff calculation methodology which today is in force in Armenia has been designed in 1999, the structure of methodology and its components are fully compatible with the EU practice and requirements to set up tariffs. It covers all elements essential in setting of tariffs: determination of required revenue, separate detailed

description for CAPEX and OPEX, cost analysis including functional separation, classification of costs, and determination of customer classes and allocation of costs. The methodology lists the main customer classes and allows application of differentiation of tariffs based on consumption, capacity, time and connection terms. In addition methodology envisages set up of separate tariffs for distribution, dispatch and retail. The rate of purchased gas price, separated from the service rate according with the methodology is to be established in all tariffs.

SEMISE experts arranged a special workshop where they presented the EU best practices in calculation of the gas transportation tariffs to the beneficiary and other stakeholders, showing advantages and disadvantages of different approaches, presenting success stories, failures and their reasons. Several concrete examples from the Central European and Baltic countries were presented.

The general conclusion after analysis of the existing natural gas pricing principles and practice in Armenia was that the existing gas tariff calculation methodology though passed a decade ago is rather progressive: it is consistent with the EU best practice schemes and is applicable for setting tariffs which correspond to the needs of pricing objectives and customers' structure. However, in practice the methodology is not fully applied as a set of tariffs and approach to calculate them differs from that described in the methodology. The present tariff structure does not provide for the right pricing signals and its revision is necessary.

During the second mission, SEMISE experts presented their proposals what should be done in order to improve the existing natural gas pricing schemes.

2. Results achieved

SEMISE experts have concluded that the existing gas tariff calculation methodology is rather progressive: it is consistent with the EU best practice schemes and is applicable for setting tariffs which correspond to the needs of pricing objectives and customers' structure. However, in practice the methodology is not fully applied as a set of tariffs and approach to calculate them differs from that described in the methodology. Therefore it was recommended:

- ✓ Carry out full functional unbundling of accounts and assess present cost allocation for all activities: storage, transmission, distribution and sales;
- ✓ Set pricing objectives and provide trade-offs among them taking into account the present customers' structure and economic situation;
- ✓ Provide allocation of costs based on the selected pricing objectives;
- ✓ Based on the cost structure, selected pricing objectives and tariff structure calculate an example;
- ✓ Assess results of the example calculation and reconsider adjustments (if appropriate) of the gas pricing methodology and submit new tariffs' plan.



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These recommendations were taken positively by the Beneficiary. In the letter signed by the head of Economic Department of the Armrusgazprom company it was stated “... *the recommendations provided by the SEMISE experts will be definitely applied when calculating natural gas prices in Armenia and when revising the existing gas pricing methodology*”.

3. The future

We will be waiting for the changes in the natural gas pricing scheme applied in Armenia.