Publishing date: 30/03/2015

Document title: ACER Opinion 02-2015

ACER
Agency for the Cooperation of Energy Regulators

OPINION OF THE AGENCY FOR THE COOPERATION OF ENERGY REGULATORS No 02/2015

of 26 March 2015

ON THE NETWORK CODE ON HARMONISED TRANSMISSION TARIFF STRUCTURES FOR GAS

THE AGENCY FOR THE COOPERATION OF ENERGY REGULATORS,

HAVING REGARD to Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators[1], and, in particular, Articles 6(4) and 17(3) thereof,

HAVING REGARD to Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005[2], and, in particular, Article 6(7) thereof,

HAVING REGARD to the favourable opinion of the Board of Regulators of 25 March 2015, delivered pursuant to Article 15(1) of Regulation (EC) No 713/2009,

WHEREAS:

(1) Since 2003, rules regarding harmonised transmission tariff structures have been identified as a priority topic by the European Commission, stakeholders and regulators at several Madrid Fora. The Agency for the Cooperation of Energy Regulators ('the Agency') started the formal process of developing the Framework Guidelines on rules regarding harmonised transmission tariff structures for gas[3] (the 'Framework Guidelines' or 'FG'), after receiving the European Commission's invitation on 29 June 2012. The Framework Guidelines were adopted by the Agency on 29 November 2013.

(2) On 19 December 2013, the European Commission, having considered that the Framework Guidelines contribute to non-discrimination, effective competition and the efficient functioning of the gas market (each an objective of Regulation (EC) No 715/2009), invited the European Network of Transmission System Operators for Gas ('ENTSOG') to establish, based on the Framework Guidelines, a Network Code on harmonised transmission tariff structures for gas (the 'Network Code') by 31 December 2014.

[1] OJ L 211, 14.8.2009, p.1
[2] OJ L 211, 14.8.2009, p.36
[3] Decision No. 01/2013 of the Agency for the Cooperation of Energy Regulators of 29 November 2013

(3) In drafting the Network Code, ENTSOG extensively involved stakeholders in a transparent process by organising a series of "Stakeholders Joint Working Sessions" (SJWS), workshops, and public consultations. The Agency was represented at each of the SJWS and made several presentations explaining the reasoning behind the choices made in the Framework Guidelines.

(4) Throughout the process, ENTSOG cooperated closely with the Agency. ENTSOG published a draft Network Code on harmonised transmission tariff structures for gas for public consultation on 30 May 2014. To assist ENTSOG in finalising the Network Code, the Agency evaluated the draft Network Code's compliance with the Framework Guidelines and informally submitted a detailed preliminary opinion to ENTSOG on 31 July 2014. In addition, on 26 November 2014, following the publication by ENTSOG on 7 November of the Refined Draft Network Code on Harmonised Transmission Tariff Structures for Gas for its Stakeholder Support Process, the Agency suggested nine amendments to the refined draft Network Code, in order to improve the degree of compliance of the Network Code with the objectives of Regulation (EC) No 715/2009 in general and the Framework Guidelines in particular.

(5) ENTSOG officially submitted the Network Code to the Agency on 26 December 2014. The Network Code took partial account of the Agency's informal preliminary opinion, namely scope, objective and secondary adjustments to the cost allocation methodologies, but not of the suggestions made by the Agency in its letter of 26 November 2014.

(6) The present Reasoned Opinion evaluates the Network Code on the basis of the degree of compliance with the Framework Guidelines, including the fulfilment of the objectives set out in their Chapter 1.2. These include setting clear and objective requirements for harmonising the gas transmission tariff structures across the EU, to the extent that this is necessary to contribute to completion in and the efficient functioning of the internal gas market. The Framework Guidelines' objectives closely reflect Article 13 of Regulation (EC) No 715/2009, which requires transparent, cost-reflective and non-discriminatory tariffs to facilitate cross-border trade and avoid cross-subsidies,

HAS ADOPTED THE PRESENT REASONED OPINION:

The Agency acknowledges the significant work undertaken by ENTSOG in developing the Network Code. In particular, the Agency recognises the important role that ENTSOG's well-organised SJWS played in allowing a wide range of industry stakeholders to contribute to the process. Nevertheless, stakeholders expressed their concern about ENTSOG's internal decision-making process, which was perceived to have put too much focus on TSOs interests (the protection of TSO revenues) over the needs of market participants. Furthermore, the Agency values the cooperative and constructive working relationship with ENTSOG during this period, including a series of extensive bilateral meetings (with the Agency) and trilateral meetings (with the Agency and European Commission).

In reviewing the Network Code the Agency recognises some improvements in the Network Code, compared to the Framework Guidelines, in terms of structure and details. The Agency also recognises the time and effort ENTSOG has put into developing solutions to complex problems not always fully detailed in the Framework Guidelines. However, on a significant number of substantive issues, the Agency has serious concerns about the content of the Network Code as submitted.

The Framework Guidelines provide the boundaries within which the Network Code is expected to be developed. In a number of areas the Network Code diverges from the policy objectives defined in Regulation (EC) No 715/2009 and in the Framework Guidelines, and provides a lower degree of harmonisation. In other areas the Framework Guidelines identified issues to be further developed by ENTSOG, yet some of these issues have not been analysed by ENTSOG and therefore not converted into Network Code provisions.

These areas are presented below, taking each chapter of the Network Code in turn, with an indication of the assessed lack of compliance with the Framework Guidelines and Regulation (EC) No 715/2009. For each of these areas, the Agency asks ENTSOG to revise the wording in the Network Code to ensure its compliance with the Framework Guidelines and Regulation (EC) No 715/2009.

1. Scope of the Network Code - definition of transmission services

The Network Code is intended to apply to the tariffs levied by Transmission System Operators (TSOs) for transmission services offered at all entry and exit points on gas transmission systems. Section 1.2 of the Framework Guidelines explains that *"The Network Code on Tariffs shall propose and justify a consistent definition for transmission services in line with Section 1.3."*

Section 1.3 of the Framework Guidelines defines a transmission service as *"Any service necessary to transport natural gas through a transmission system, excluding balancing, flexibility, metering, depressurisation, ballasting, odourisation and any other dedicated or specific service."*

The Network Code introduces the following definitions:

- *"'dedicated services' means the regulated services other than transmission services provided by the transmission system operator to specific network users, or infrastructure operators, or at specific entry or exit points;"*

- *"'transmission services' means the regulated services provided by the transmission system operator to all network users within the entry-exit system for the purpose of transmission."*

Although the Agency acknowledges that the Network Code clarifies broad principles behind transmission and dedicated services relative to the *status quo*, the Agency considers that the Network Code does not contain a criterion with a sufficiently distinctive character, nor a limited list of dedicated services, nor a cap on revenues to be recovered from dedicated services relative to overall revenues. Article 4(3) of the Network Code specifies, in line with the Framework Guidelines, that *"The dedicated services revenue shall be <u>outside</u> of the application of the cost allocation methodology set out in Article 5(1) and reconciled in a manner other than the one set out in Chapter VI."* An open definition for dedicated services creates the scope for a potentially unrestricted proportion of allowed revenues to be recovered outside of the cost allocation methodology, potentially undermining tariff harmonisation across the EU.

During the Network Code development process, the Agency further clarified the intention of the Framework Guidelines to ENTSOG and requested changes in writing in its preliminary views to remedy the above concerns, stating that *"The Framework Guidelines include a definition for transmission services, with the aim of creating clarity over the services that shall be covered by tariff provisions. The FG requested additional analysis from ENTSOG. [...]The Agency would welcome a further attempt from ENTSOG at defining transmission services, as requested in the Framework Guidelines"*. In the Agency's view the Network Code remains misaligned with the Framework Guidelines in this regard.

2. Publication requirements

Overall, the Network Code does not provide a clear list of publication requirements, but obligations in connection with various chapters.

Chapter 4 of the Network Code concerns publication requirements. Article 24(2) of the Network Code specifies that *"The confidentiality of commercially sensitive information shall be preserved"*. Given that there are diverging views on what commercially sensitive information means in a regulated world, the Agency sees this as an inappropriately broad disclaimer which, absent any further criteria, could be used as a justification for stepping out of any one or more of the publication requirements. In the Agency's view the publication requirements contained in the Network Code should be non-negotiable and any derogation from meeting them should only be by exception and subject to specific criteria. The Agency finds the current Network Code provisions inadequate to limit such deviations from the general transparency obligations, as described in recitals (24), (25) Article 3(4) and Article 18(2) of Regulation (EC) No 715/2009.

Paragraph 2.3 of the Framework Guidelines deals with general publication requirements. The paragraph specifies a series of 'inputs for the cost allocation methodology' which should be published 'adjusted to the level necessary to run the methodology'. Chapter IV of the Network Code sets out extensive publication requirements relating to tariffs. However the requirements of Article 25 specify that, among other things, the parameters of the applied primary cost allocation methodology should be published 'as detailed in Article 6'. Article 6 specifies that *"The following parameters shall be used for the application of the primary cost allocation methodologies, where relevant"*.

The drafting of the Network Code could be interpreted as allowing certain pieces of information to be omitted from publication if not considered relevant to the derivation of tariffs. As confirmed during the SJWS and in the Agency's preliminary opinion, this was not the intention of the transparency requirements set out in the Framework Guidelines. Instead, the publication of certain important pieces of information, such as the Regulated Asset Base, was considered in the interests of transparency regardless of whether they were necessary to run the methodology. The Agency considers that the Network Code is not strict enough in this regard and invites ENTSOG to modify Article 25 to ensure that the intentions regarding transparency are fully satisfied.

3. Methodologies description

3.1. Main methodologies

3.1.1. Circumstances criteria

Section 3.2.1 of the Framework Guidelines specifies that "*Regarding assumptions related to capacity, the TSOs communicate capacity values for each entry and exit point in the system at reference conditions. Flows in the system may be used to characterise the capacity. However, unstable flow patterns decrease the quality of forecasts. The Network Code on Tariffs shall define in relation to unstable flow patterns what forecast quality cannot be used and provide appropriate proxies instead. [...] The capacity assumption shall be consistent with the economic signals expected from the chosen allocation methodology: (i) technical capacity shall be favoured in combination with allocation methodologies providing locational signals, while (ii) the application of booked capacity shall be limited to allocation methodologies that do not provide such signals*". The Network Code, in particular in its Article 8, fails to define unstable flow patterns and how this instability would impact the input to the allocation methodology.

Section 3.2.1 of the Framework Guidelines also requests that "*In determining the Network Code on Tariffs, ENTSOG shall further elaborate on the circumstances which should be taken into account in selecting a primary methodology and applying secondary adjustments, as well as on the consequences of the choices with regard to reaching the objectives of these Framework Guidelines. In particular, ENTSOG shall assess how the relevance of each methodology is affected by the following parameters:*

- *Status of the system (Production/Proportion of domestic/cross-border gas flows/Consumption);*
- *Dynamics of demand (congestion in the system);*
- *Topological considerations (age of the network, length of the pipeline)*".

Article 19 of the Network Code specifies the criteria for choosing a cost allocation methodology. Paragraphs 2 and 3 of Article 19 provide a redraft of the circumstances text specified in the Framework Guidelines, but a further elaboration of the circumstances and network characteristics that should lead to the choice of a particular methodology has not been provided.

In respect of the specific circumstances applying to the application of the postage stamp methodology, Paragraph 3.2.1.1 of the Framework Guidelines specifies that the difference between the average distance travelled by cross-border flows and the average distance travelled by domestic flows should not exceed a threshold, and that ENTSOG should determine this threshold in the Network Code. The Agency notes that in Paragraph 1(b) of Article 19, ENTSOG has selected a threshold of 50%, but the reasoning for this threshold has not been specified, and the potential conflict of setting the threshold at this level, with the criteria under Paragraph 1(a) - that at least two thirds of the amount of transmission capacity is used by domestic or by cross-border network users - is not examined.

As well as being a requirement of the Framework Guidelines, the importance of setting appropriate circumstances criteria was emphasised in the letter from the European Commission inviting ENTSOG to draft the Network Code[4]. The Commission letter requested further analysis of the 'circumstances' in selecting a primary methodology and applying secondary adjustments. This was further specified to ENTSOG in the preliminary views from the Agency, but the requirement has not been reflected in the Network Code.

3.1.2. Number of cost allocation methodologies

Section 3.3 of the Framework Guidelines requests that *"The Network Code on Tariffs shall specify that the choice of a cost allocation methodology is limited to the four primary cost allocation methodologies described below. In developing the Network Code, ENTSOG shall consider for each methodology consisting of more than one variant, whether it can be described as a single methodology (without variants), with a comparable level of detail and consistent with the FG objectives."*

The invitation letter from the Commission also requested an analysis of the impacts in developing the network code with or without variants, as specified in some of the primary methodologies.

Instead of streamlining the methodologies, or reducing them in number, the Network Code includes, in Section II, Article 15, an additional methodology, the "Asset allocation approach". On the basis of ENTSOG's Supporting Document, the Agency does not understand the value of this additional methodology. Further, this methodology appears to be in conflict with the principles set in Section 4.2 of the Framework Guidelines which specifies that, *"all entry and exit points will contribute to the reconciliation through an adjustment of the reference price (in order to avoid a situation whereby the adjustment of the reserve price or the regulated price at only one or a few entry or exit points where under- or over-recovery occurred exacerbates the problem of under recovery)."*

The Agency requests the revision of the circumstances used in selecting a methodology and the removal of the *"asset allocation methodology"*.

3.2. Secondary adjustments: benchmarking

Section 3.3.2.3 of the Framework Guidelines details the Agency's preferred approach to benchmarking. It sets several principles to be followed and includes an obligation to provide an objective justification when using benchmarking, including providing proof that "effective pipeline-to-pipeline competition" exists, based on national and EU competition law. It is also based on the notion that *"higher capacity sales at [the benchmarked] point would be expected to offset the need for increased tariffs at other points in order to collect allowed revenues"*. It further asks that *"in this process, neighbouring NRAs shall cooperate with each other in order to ensure a consistent and compatible approach across the Member States concerned"*.

[4] Letter referenced ENER.B2/TH/ossos s(2013) 4014383 - Ref. Ares(2013)3773211 - 19/12/2013

Section II, Article 18 of the Network Code does not reflect important aspects of the Framework Guidelines, including the requirement to cooperate with neighbouring National Regulatory Authorities (NRAs). Most importantly, Section II, Article 18 now states that *"where the forecasted capacity sales at the points at which the benchmarking is carried out are not expected to ensure obtaining the allowed revenue, the transmission system operator or the national regulatory authority, as relevant, may increase the transmission tariffs at other entry or exit points."*

This is in direct contrast with the provisions in the Framework Guidelines which intended that benchmarking would only be allowed if it benefitted the system as a whole and did not introduce the cross subsidy of the benchmarked point by other users of the network, as would be possible under Article 18.

The Agency is of the view that the use of benchmarking should be bound by the principles set in the Framework Guidelines, namely cost reflectivity and the avoidance of cross-subsidies, and that a decision to benchmark should only be taken following a consultation by the NRAs within the jurisdiction for the network points deemed to be in competition. Therefore, the Agency requests that only the provisions set out in the Framework Guidelines are included in the Network Code and the additional provisions introduced by ENTSOG deleted.

3.3. Single cost allocation methodology per entry/exit zone

Section 3.3 of the Framework Guidelines requires that *"One and the same primary cost allocation methodology shall apply to all entry and exit points on an entry-exit system."*

Article II, section 5.4 of the Network Code explains that *"In an entry-exit system where more than one transmission system operator is active, the national regulatory authority(-ies) shall take either of the following decisions:*

(a) all the transmission system operators within such entry-exit system shall apply the cost allocation methodology jointly;
(b) each of those transmission system operators shall apply the cost allocation methodology separately."

In providing this flexibility, Section II, Article 5(4)(b) deviates from the intended meaning of the Framework Guidelines. This deviation from the Framework Guidelines further impacts Articles 9 (on the Entry-Exit split) and 40 (on the pricing of capacity at a Virtual Interconnection Point) of the Network Code.

To avoid any unintended ambiguity in the wording of the Framework Guidelines the fact that the Network Code deviates from the Framework Guidelines was communicated to ENTSOG on several occasions throughout the Network Code development process, and communicated to stakeholders during the SJWS.

The Framework Guidelines consider that the perimeter of an entry/exit zone is the level where cost-reflectivity should be assessed, and costs allocated, acknowledging the case of a cross border entry-exit merger though, as mentioned in footnote 12 of the Framework Guidelines. By contrast, the Network Code allows that costs are allocated to subsets of the infrastructure constituting the entry/exit zone, following the ownership of parts of the network. The Agency observes that the Network Code therefore triggers the following deviations to the principles set in the Framework Guidelines:

- In terms of harmonisation: a setting of tariffs individually by each TSO is inconsistent with a fully-fledged entry/exit model where ownership structures are invisible to the shipper and a single cost allocation methodology applies;
- Regarding Ring-Fencing and Tariff stability: as a result of the application of revenue reconciliation to a subset of the network constituting the entry/exit zone, the contribution of users of the Entry/Exit zone to revenue reconciliation will depend on the subset of the network they are using. In addition, it will lead to greater tariff instability in each subset, as compared to the stability over the whole entry/exit zone.

The Agency is of the view that the Framework Guidelines provide a robust answer to the abovementioned issues. Absent an alternative proposal of comparable robustness, the Agency asks ENTSOG to revert to the approach prescribed in the Framework Guidelines.

4. Payable price

4.1. Fixed vs floating payable price

Section 8 of the Framework Guidelines states that "*The Network Code on Tariffs shall set out that, notwithstanding any reserve price adjustments determined by the provisions set out in Chapter 5, the payable price determined in a capacity auction shall be a floating price, which consists of the applicable reference price at the time when the capacity can be used plus the auction premium, if any.*"

In providing the options of both a fixed payable price and a floating payable price, Article 42 of the Network Code directly contradicts the approach of the Framework Guidelines. Article 42 specifies that the payable price for a given standard capacity product at an interconnection point shall be calculated in accordance with one of two formulas and goes on to specify a formula for calculating a fixed price, which includes the calculation of an indexation factor and a risk premium, as well as any auction premium, as applicable to the standard floating payable price. On a related point, the Agency notes that in Article 4, the Network Code also expands the rules set out in the Framework Guidelines concerning the recovery of allowed revenues via a commodity charge.

The Agency's concern with having a fixed payable price option within the Network Code has both a principled and a practical dimension, both of which have been conveyed to ENTSOG and stakeholders consistently throughout the Network Code development process, including at each of the SJWS.

The principled opposition is founded on the fact that the fixed payable price option, as specified in the Network Code, does not provide adequate safeguards against the risks of cross-subsidy between network users.

As detailed in the Justification Document[5], differing approaches to payable price may involve different distributional effects, potentially to the advantage of one system user over another. Notwithstanding changes to cost allocation methodologies, users on some form of fixed tariff will pay more or less than those on floating tariffs, depending on whether regulated revenues have increased or decreased, and on whether an under/over-recovery has been recorded in the previous regulatory year.

In order to avoid such a situation, the policy choice adopted in the Framework Guidelines – floating payable price - emphasizes the essential role of the cost allocation methodology in both revenue reconciliation and the allocation of under- and over-recoveries. Using the cost allocation methodology as the unique way for revenue reconciliation ensures that all users contribute to revenue reconciliation in an equal manner. In contrast, offering a fixed payable price excludes some users from this process, thereby increasing the risk of tariff instability for other network users, some of whom, particularly if they are newer market entrants, may not have been in a position to avail themselves of the longer term capacity price certainty.

The Network Code attempts to address these concerns by the introduction of the indexation and risk premium concept. Both are designed to mitigate the risk that users on fixed payable price contracts are subsidised by future users on floating payable price. However, the application of these concepts as drafted in the Network Code is subjective and considerable discretion appears to be reserved for individual Member States to reach decisions on the values to be applied. This is likely to lead to less harmonisation and, potentially, to higher risks of cross-subsidies between network users.

In the Agency's view a fixed payable price approach would only be viable if it tackled the risks of cross subsidy between users head on.

The Agency's practical opposition to the fixed payable price option in the Network Code regards the following concerns:

- how would the indexation reference be determined?
- what would be the methodology to determine the risk premium?
- how would the parallel offer of a floating payable price and a fixed payable price be reconciled with the capacity auctions, including where different payable price approaches are adopted at either side of an IP?

As noted in the Justification Document, the potential complexity of these interactions was another of the reasons why the Agency adopted a universal floating payable price approach in the Framework Guidelines.

Given that floating tariff regimes are current practice among a majority of EU Member States, that implementation of the Tariff Network Code is intended to deliver, among other things, more stable, predictable and transparent tariffs, and that TSOs operate within a regulated business environment, the Agency considers that ENTSOG has not demonstrated why

[5] ACER-JD-2014-G-01, 31 March 2014, p52

alternative payable price approaches are necessary, and, more specifically, that the downsides of allowing fixed tariffs in conjunction with floating would be outweighed by the benefits.

Where the Framework Guidelines offer a consistent and harmonised approach to payable price, the Network Code remains wide open. The solutions in the Network Code are multiple, inconsistent with the non-discrimination principles, which govern the other sections of the Network Code, and may be difficult to apply under the bundled capacity arrangements mandated by the Network Code on capacity allocation mechanisms at IPs. The Agency asks ENTSOG to remain within the principles detailed in both the Framework Guidelines and the Justification Document, and align the Network Code accordingly, both in respect of the payable price issue and to the restrictions placed on the use of a commodity charge to recover allowed revenues.

4.2.Multipliers

Section 5 of the Framework Guidelines specifies that "*NRAs may decide to apply multipliers*". This implies that although a range of maximum and minimum multipliers may be set, the choice to implement multipliers at all is voluntary.

Articles 28 and 29 of the Network Code suggest, however, the opposite; the combination of Articles 28(2) and 28(3), in particular, implies that a NRA shall decide on multipliers at the request of a transmission system operator.

The Agency considers that this part of the Network Code is misleading and should be amended in line with the Framework Guidelines.

Further, Section 5.1.2 of the Framework Guidelines sets the following ranges for multipliers:

Duration of the short term product	Multiplier range without congestion	Multiplier range with congestion
Quarterly and monthly	0.5 – 1.5	0.5 – 1
Daily and within day	0 – 1.5	0 – 1

The Agency determined the overall range for multipliers in a bid to minimise unnecessary distortions in the market: on the one hand the flexibility to lower multipliers to facilitate efficient gas trade and competition was considered to be desirable, while on the other hand, the possibility to increase multipliers to mitigate potential revenue shortfalls in the event of significant capacity profiling was also considered sensible.

Further, as the Agency observed in its Justification Document, *"of the 13 countries that contributed to its survey, nine apply monthly multipliers falling within the range of one to two (Figure 16). The harmonisation of multipliers around 1.5 thus seemed already a practice under which markets can function smoothly and efficiently".* This argument was broadly corroborated by ENTSOG during its consultation workshop, where they analysed that on average, the *cumulative* effects of the observed multipliers and seasonal factors in Europe were slightly above 2[6].

Article 29(2) of the Network Code introduces the possibility to apply a multiplier higher than 1.5. To establish the potentially higher cap, it introduces a systematic criterion, assessing variations of short-term capacity bookings against the average short-term capacity bookings, over a period of three years.

The Agency is opposed to the relaxation of the 1.5 cap for the following reasons:

Firstly, the need for the higher cap has not been convincingly demonstrated. An argument has been made that at some IPs the variability in capacity bookings would be such that an application of multipliers of 1.5 in combination with seasonal factors would not allow TSOs to recover their costs and would create a local revenue shortfall, but to our knowledge evidence that this has been a problem within the existing multiplier range has not been provided. Further, and as noted in the Agency's Justification Document, in such exceptional cases, the shortfalls would be fed into the revenue reconciliation mechanism and lead to an increase in all reference prices the following year, thereby mitigating any under-recovery issue.

The other reason for the Agency's concern with the Network Code proposal is that the formula used to determine the potentially higher multiplier is based on a global assessment of short-term bookings on the entry/exit system. It excludes yearly capacity products and is not based on the problematic characteristics of the network points the solution purports to solve. Such a solution could have the unintended consequences of permitting higher multipliers at all points on a network, potentially to the detriment of efficient short-term gas trades.

After having taken into consideration the deviation suggested by ENTSOG, the Agency has come to the conclusion that the Network Code attempts to answer a problem that was never fully characterised. For these reasons, the Agency asks ENTSOG to revise its proposal on multipliers and bring it in line with the Framework Guidelines.

5. Harmonisation of tariff setting year

Section 1.4 of the Framework Guidelines states that *"in determining the Network Code on Tariffs, ENTSOG shall carry out an impact assessment on harmonising the transmission tariff setting year, including downstream impacts, across all member states. The Network Code on Tariffs may also include provisions to harmonize the tariff setting year across the EU"*.

ENTSOG conducted the requested Impact Assessment[7]. In this study, ENTSOG considered three options: (1) Harmonisation of the tariff setting year so that the tariffs apply from 1 January to 31 December; (2) Harmonisation of the tariff setting year so that the tariffs apply from 1 October to 30 September; and (3) Status quo – no harmonisation of the tariff setting

[6] Consultation Workshop of 20 June 2014 Ref. TAR0317-14, "All presentations for the TAR NC CWS", slide 99
[7] Impact Assessment: Harmonisation of the Tariff Setting Year, TAR0410-14

year. ENTSOG concludes by recommending to *"maintain the status quo or in other words not to harmonise the tariff setting year".*

The Agency understands that relatively limited data on potential benefits was made available to ENTSOG to inform its analysis of the net effects of harmonising the tariff setting year. Nevertheless, the Agency recognises that the Network Code complies with the Framework Guidelines with respect to the request to carry out an impact assessment. The Agency also notes that as a result of its impact assessment, ENTSOG identified that *'a key request of the market is to have information relating to tariffs prior to the commencement of capacity auctions'.* This issue was not addressed in the Framework Guidelines; therefore the Agency commends ENTSOG for including the requirement in Article 27 of the Network Code, that 'at least the indicative reference prices and the binding multipliers and seasonal factors applicable for the tariff period following such auction' should be published 30 days ahead of the capacity auctions.

However, in its analysis of the issue, ENTSOG also identified that there was a strong relationship between the timing of the capacity auctions and the ability of TSOs to publish final tariffs ahead of the auctions. Having identified the importance of this issue for stakeholders, the Agency regrets that ENTSOG did not follow this up with a deeper analysis and a substantive proposal in the Network Code. The Agency considers that it would be appropriate for the Network Code to specify the publication period of binding tariffs and related multiplier information ahead of the capacity auctions, and that it would be appropriate to explore the possibility of optimised timing of the CAM auctions to facilitate such tariff certainty.

6. Pricing of interruptible capacity and non-physical backhaul capacity

Section 5.2 of the Framework Guidelines states that *"The Network Code on Tariffs shall set out that reserve prices for interruptible capacity be set at a discount to the reserve price of the firm standard capacity product with equivalent duration. The Network Code on Tariffs shall set out a methodology for determining reserve prices for interruptible capacity. The methodology shall meet the following criteria:*

- *At interconnection points where firm capacity is offered in both directions, the discount(s) for interruptible capacity shall adequately reflect the risk (likelihood and duration) of interruptions, so that if the risk is low, the discount shall also be low. TSOs shall publish their assessment of the risks of interruption. The discount is to be recalculated at least once a year;*
- *At unidirectional interconnection points where TSOs offer firm capacity only in one direction and capacity is offered in the other direction on an interruptible basis (non-physical backhaul capacity), the methodology for determining the reserve price shall be set to reflect the actual marginal (additional) costs that the TSO incurs to provide this service and shall not be below zero".*

Article 32 of the Network Code offers the possibility of applying *"a combination of ex-ante and ex-post discounts"* for interruptible capacity. As mentioned by the Agency in its preliminary views to ENTSOG, the Agency does not support the ex-post discount, as it goes against the congestion management principles, most importantly pushing the financial risk of interruption to shippers. In the Agency's opinion, an ex-post discount for interruptible capacity reflects the event of interruption, not the probability of interruption as specified in Regulation (EC) No 715/2009.

Further, in Articles 33 and 34, the Network Code sets the pricing of interruptible products proportionately to factors A (ex-ante discount) and B (ex-post discount) respectively. These factors are not defined in the Network Code. They come in addition to the factor "Pro", reflecting the probability of interruption of the product. The Agency considers that these factors are unjustified, arbitrary and contradict any further harmonization of interruptible products. Therefore, the Agency asks that these factors be removed from the Network Code.

In addition, Article 32(2) of the Network Code does not differentiate between interconnection points where firm capacity is offered in one and those in which it is offered in both directions: *"The calculation referred to in paragraph 1 shall apply to all standard capacity products for interruptible capacity regardless of the direction of the gas flow at a given interconnection point. This calculation shall also apply to interruptible capacity products offered in the direction opposite to the physical gas flow at unidirectional interconnection points where technical capacity is offered only in one direction as set out in Article 21 of Commission Regulation (EU) No 984/2013".*

As indicated to ENTSOG in the preliminary views, the Framework Guidelines, based on the rationale detailed in the Justification Document[8], requests non-physical backhaul products to be priced at marginal cost. In response, ENTSOG provided the example of a situation where such pricing could lead to unintended consequences, namely when it is possible to transport gas between two points, while only one of these points offers bidirectional firm capacity. The Agency agrees that in such situations, backhaul capacity priced at marginal cost at one point would be competing with interruptible capacity sold in the same direction at the other point. The Agency also notes that such contradictions should be transient, as such points should be merged eventually into a Virtual Interconnection Point, following the requirements from the network code on capacity allocation mechanisms[9].

Therefore, the Agency asks ENTSOG to revise its wording to better reflect the policy designed in the Framework Guidelines, while taking account of the temporary issue outlined above.

7. Incremental capacity

Chapter IX contains the provisions in the Network Code relating to incremental capacity. Article 44 of the Network Code deals with the f factor used in the economic test[10]. The f factor is the proportion of the forecast increase in allowed revenues associated with the incremental capacity which must be satisfied by the user commitment to pay for the capacity. Paragraph 2 deals with the 'so-called' 1-f, the proportion of the investment not financed by

[8] ACER-JD-2014-G-01, 31 March 2014, Annex K, p83
[9] See Article 19(9) of COMMISSION REGULATION (EU) No 984/2013 of 14 October 2013 establishing a Network Code on Capacity Allocation Mechanisms in Gas Transmission Systems and supplementing Regulation (EC) No 715/2009 of the European Parliament and of the Council
[10] For a definition of the economic test, see section 3.5.1 of the Framework Guidelines

the user commitment, and specifies that it shall be guaranteed through future bookings or tariffs paid by other users on the system. Paragraph 3 specifies that this shall also be the case in situations where parties walk away from the f user commitment.

The Framework Guidelines does not specify these provisions and the Agency considers that it is unnecessary and potentially misleading for the Network Code to do so. The Tariff Network Code is principally concerned with the allocation of allowed revenues by way of regulated transmission tariffs, not the determination of allowed revenues. It is elementary that all regulated revenues will be recovered through the cost allocation methodology. But decisions over the size of allowed revenues, and how regulated revenues may be affected by defaulting parties or future capacity bookings, is out of scope for the Tariff Network Code and primarily a matter for NRAs.

Article 47 of the Network Code deals with the tariff principles for incremental capacity. Paragraph 2 specifies that "in case the allocation of all incremental capacity at the reference price would not generate sufficient revenues for a positive economic test outcome, a mandatory minimum premium may be applied in the first auction in which the incremental capacity is offered. The mandatory minimum premium may also be applied in subsequent auctions when the capacity is offered that initially remained unsold or when capacity is offered that was initially set aside according to Article 8(8) and 8(9) of Commission Regulation No (EU) 984/2013.[…}"

Paragraph 3.5.2 of the Framework Guidelines specified that the default approach for applying a mandatory premium is to apply it to the tariff paid by those users booking capacity in the first auction in which the incremental capacity is offered, i.e. those triggering the investment. However, the paragraph also specified that, in determining the network code on Tariffs, ENTSOG "*shall consider alternative approaches, in addition to the default option, and that where such alternatives are consistent with the principles specified in the paragraph, ENTSOG shall include them in the Network Code*". The Network Code does not satisfy this requirement and presents an approach to tariff adjustments which has not been fully tested.

Paragraph 5 of Article 47 of the Network Code deals with the recovery of the mandatory premium. The paragraph specifies that in case initial commitments for contracting incremental capacity by network users are for any reason cancelled, the transmission system operator may charge the outstanding amounts resulting from a mandatory minimum premium for the initial contract duration to the respective network users. This provision was not included in the Framework Guidelines. Consistent with the concerns with Article 44 specified above, the Agency considers that the paragraph is unnecessary. The issue is again related to the determination of allowed revenues. If the costs are included in allowed revenues they will be recovered from network users in a manner consistent with the approved cost allocation methodology.

Paragraph 6 of Article 47 of the Network Code specifies that "*where a mandatory minimum premium is applied and the relevant national regulatory authorities have reasonable doubts whether future capacity bookings will generate sufficient revenues to cover the allowed revenues or target revenues associated with the incremental capacity beyond the* initial *time horizon for booking capacity, the part of the revenues following from the mandatory minimum* *premium shall be used for measures to mitigate possible future under-recovery with regard to the incremental capacity".*

This provision was not included in the Framework Guidelines. The Agency considers that this provision is inappropriate, because using the mandatory premium in this way is contrary to the purpose of the mandatory premium established in the Framework Guidelines, namely to recover allowed revenues relating to the incremental capacity project for the regulatory year starting from the delivery of the capacity. Putting the mandatory premium into an account, as seems to be implied by the Network Code, would entail recovering actual revenues from other users during this time, which would lead to cross-subsidisation and run counter to the intended purpose of setting an f factor in the first place. If this were not the case, TSOs would be fully exposed to the potential future under-recovery associated with insufficient capacity bookings, as the same money cannot be used to cover allowed revenues in two separate years.

The Network Code does not examine this issue. The Agency also notes that this concept was not discussed in ENTSOG's Tariff or Incremental workshops. The Agency considers that if there is significant doubt about bookings beyond the committed period, and whether a full recovery of costs is possible, this should be taken into account in setting the f factor in the first instance.

The Agency is also opposed to the adjustment of the depreciation period to reflect future volume risk as proposed in Article 47(6)(c) of the Network Code. This provision would also be inconsistent with the Framework Guidelines, which considers that the cost allocation methodology should be applied to network users in a non-discriminatory way. Applying different depreciation periods to different assets based on assumptions about future demand would appear to contradict this principle, leading to an over recovery of allowed revenues from users of the adjusted point – and the cross-subsidisation of other network users - while the shorter depreciation period was applied.

The Agency considers that all of the issues identified in this section represent misalignments with the Framework Guidelines and invites ENTSOG to amend the Network Code to address them.

Next to the misalignments pointed out and reasoned above, which have been the subject of ongoing discussion between ACER and ENTSOG, there are a number of other issues, which need to be considered by ENTSOG. These additional issues are detailed in Annex I which forms an integral part of this Reasoned Opinion.

Done at Ljubljana on 26 March 2015.

For the Agency:

Alberto Pototschnig
Director

Annex 1 – Additional misalignments between the Framework Guidelines and the Network Code

Reference					Issue description				
No.	Chapter	Article	Para.	Point	Code Text	Guideline Text	Type of issue	Topic	Opinion
1	III	21	1	(a)(iv)	*A consultation shall be conducted by the transmission system operator(s) or the national regulatory authority(-ies), as relevant, on the following: the comparison of the proposed primary cost allocation methodology against at least postage stamp methodology accompanied by the relevant information as set out in points (i) to (iii).*	*At the entry into force of the Network Code on Tariffs, NRAs, or where appropriate TSOs, shall launch a public consultation on the proposed methodology for determining reference prices.[...]In establishing the counterfactual, it is therefore important, that the primary data inputs and assumptions are applied consistently between the two methodologies. [...] For the avoidance of doubt, the Postage stamp methodology can be used for counterfactual purposes, even where the postage stamp methodology cannot be applied as the cost allocation methodology because of the restrictions specified in the 'Circumstances' criteria.*	Substance	Counterfactual	1. The NC shall specify that the consultation must take place at the entry into force of the network code on Tariffs. 2. The need to align assumptions between the chosen methodology and the counterfactual is lost in the NC. 3. The NC implies but does not state explicitly that the Postage Stamp methodology can be used for counterfactual purposes even when the methodology is not eligible.

2	III	23	*3(a) The cost allocation test shall be carried out as follows: (a) the transmission services revenue to be obtained from domestic network users at both entry and exit points shall be divided by the value of the relevant cost driver(s) for domestic network users [...] 5. Where more than one cost driver referred to in paragraph 3 is identified as relevant, the combination of such cost drivers shall be used taking into account the following: (a) the total number of cost drivers shall be minimised; (b) the relative importance of all the cost drivers shall be demonstrated; (c) where distance is used as a cost driver, the weighted average distance shall be used.*	*The test shall be based, inter alia, on: physical cost drivers in the system (such as, distance and capacity); the relative importance of cost drivers, if multiple cost drivers are identified for a system and emerge from a statistical analysis, as follows; o the relative importance of the cost drivers shall be proved; o additional cost drivers can be allowed if their explanatory value is significant; o the number of cost drivers applied in the test shall be limited.*	Substance	Cost allocation test	1. The NC does not specify that the test shall be based on physical cost drivers, such as capacity and distance. 2. The NC does not mention that the relative importance of cost drivers shall emerge from a statistical analysis.
3	X	50	*This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union. To the extent covered by this Regulation, Article 26 of Commission Regulation (EU) No 984/2013 shall not be applied as from the date referred to in the third subparagraph. This Regulation shall apply as from whichever of the following dates is the later: (1) 1 October 2017; or (2) the first day of the month following the date calculated as twenty four months as from the entry into force. This Regulation shall not affect the level of transmission tariffs foreseen in the contracts which are concluded before the entry into force of this Regulation where such contracts foresee no change of their level except for the indexation, if any.*	*The provisions in the Network Code on Tariffs, including those relating to or affecting the tariff levels, shall apply to all contracts from 1 October 2017 at the latest.*	Substance	Entry into force	1. The NC approach to implementation is more flexible than the one allowed in the FG. 2. The NC exempts certain contracts from the application of the code, where the FG states that it will apply to all contracts.

4					*Article 1.4 - The Network Code on Tariffs shall specify, that all information relevant to implementation monitoring shall be communicated by ENTSOG to the Agency pursuant to Articles 8(8) and 8(9) of Regulation (EC) No 715/2009. The relevant information, and associated timing of communication, shall be determined in full by the Agency in close cooperation with ENTSOG within three months after the entry into force of the Network Code on Tariffs. This information shall be subsequently updated when appropriate.*	Substance	Implementation Monitoring	The NC does not include any provision on Implementation monitoring.
6	I	2	4	*This Regulation shall be applied taking into account the specific nature of interconnectors, in particular with regard to having an effective revenue recovery mechanism.*		Wording	legal	The provision *"in particular with regard to having an effective revenue recovery mechanism"* should be deleted.
7	I	3		Whole definition section		Wording	legal	The following FG definitions are missing: tariff structure, bundled reserve price, costs, cost allocation methodology, cost driver, entry point, exit point, fixed cost, non-physical backhaul flows, payable price, price cap regime, regulated price, revenue reconciliation.

8	II	19		*1. The criteria for the application of the postage stamp methodology shall be as follows […] 2. The criteria for the application of the methodologies other than the postage stamp shall be as follows*	*The use of a postage stamp methodology should be limited to networks where one of the following criteria is met […] Where this is not the case, the selected methodology should be different from postage stamp and shall take account of the following considerations:*	Wording	legal	The NC should clarify that the non-respect of the first criteria excludes the use of postage-stamp.
9	IV	28	2	*A transmission system operator may propose to the national regulatory authority for approval […] The transmission system operator's right of proposal is without prejudice to the right of the national regulatory authority to take a decision on its own initiative.*	*NRAs may decide to apply multipliers.*	Wording	legal	The NC proposal would result, in some Member States, in granting new powers to TSOs.

11	V	37	2	*All of the transmission system operator's under- or over-recovery of the allowed revenue from transmission services shall be attributed to the regulatory account, unless otherwise decided by the national regulatory authority. Where incentive mechanisms on capacity sales are implemented in accordance with the decision of the national regulatory authority, only a part of the transmission system operator's under- or over-recovery of the allowed revenue from transmission services shall be attributed to the regulatory account. In such case, the residual part thereof shall be met by the transmission system operator.*		Wording	legal	The NC text implies that the default approach is for the costs of the TSO to be covered. This applies, however, "*insofar as such costs correspond to those of an efficient and structurally comparable network operator*" (R715/2009, Art.13). A clear reference to the regulation is missing.
12	V	38	3	*The reconciliation of the regulatory account shall be carried out in accordance with the applied cost allocation methodology. When the transmission tariffs are calculated for the next tariff period, the decision of the national regulatory authority referred to in paragraph 1 shall be taken into account.*	*The Network Code on Tariffs shall specify that NRAs determine or approve how often and how fast the regulatory account has to be reconciled, with a view to allowing for timely cost recovery and avoiding sharp adjustments of network tariffs.*	Wording	legal	The NC text reduces flexibility that was in the FG, for reconciliation with a floating tariff price, and specifically the option to reconcile the regulatory account in the year of the capacity's use.

ACER

Agency for the Cooperation of Energy Regulators

Publishing date: 30/03/2015

Document title: ACER Opinion 02-2015

We appreciate your feedback

Please click on the icon to take a 5' online survey
and provide your feedback about this document