Disclaimer

This working level paper contains the feedback that ENTSOG was able to gather on a working level basis within the short time granted by ACER for submission of comments. It is not intended to be exhaustive nor considered as the final position of ENTSOG regarding the final Tariff Framework Guideline to be published by ACER at the end of March 2013. This document has not been through ENTSOG's internal governance process.

ENTSOG Working Level Paper: Response to ACER's Proposed Updates to the Draft Tariff Framework Guideline

Introduction

ENTSOG welcomes the opportunity to respond to the proposed changes to the draft tariff framework guideline as outlined by ACER during the public workshop in Ljubljana/Brussels on the 23rd of January, the document published on the 31st of January and the 'Open House' session on the 4th of February. ACER has put forward new proposals or modifications with regards to indicators, transparency, cost allocation, gas storage, revenue recovery, reserve prices and the payable price. While ENTSOG appreciates the fact that ACER has sought views from stakeholders on its amendments to the framework guideline, the time given was not sufficient to fully consider the impact of changes and therefore ENTSOG provides its initial view on the amendments in the form of an ENTSOG working level paper.

Price Cap Regimes

ENTSOG would like to have clarification about the application of the tariff framework guideline to price cap regimes. Price cap regulation sets a cap on the price that the transmission system operator can charge. Under this regulatory regime the price is set for a particular regulatory period (which may be one year) and during that regulatory period the TSO takes volume risk and is not guaranteed an amount of revenue.

Indicators

The issue of monitoring and the specification of indicators have been discussed by ENTSOG and ACER in relation to some of the other network codes. ENTSOG does not believe that it is appropriate for a framework guideline to introduce in the network code a subsequent task regarding the monitoring of the implementation, foreseen as a separate point under the Regulation, and therefore set indicators with respect to that implementation. ENTSOG, for its part, does not want to fetter its discretion with regards to the future monitoring activity that it will carry out. The uncertainty over market developments and the impact of the final elaborated tariff network code mean that it would be inappropriate to specify indicators in the framework guideline for inclusion in the network code.

In terms of the collection of information and gathering of data, it appears that ACER is requesting ENTSOG to collect information from the TSOs that they already provide to the NRAs so that ENTSOG can then submit it to ACER. ENTSOG believes that it is more efficient and correct if the data goes from the NRAs to ACER, especially in cases where some of the data may be confidential.

Transparency

ENTSOG supports the provision of reasonable information to aid transparency and believes that TSOs already publish substantial and wide ranging amount of information that fulfil the transparency requirements. New transparency requirements should be carefully evaluated to ensure that any implications have been considered and to avoid unintended consequences. ENTSOG's members are happy to provide useful information in line with Article 13 of Regulation, to support network users in the management of their exposure but there should be a balance between the cost of providing information and the usefulness of the information to network users.

ENTSOG is concerned about the usefulness of the assumptions on capacity utilisation, subscriptions and costs to network users and wonders if this information should only be disclosed to NRAs on confidential basis. In particular, with regards to the assumptions on costs where the information is commercially sensitive these should be retained by the TSO and provided only to the NRA, and should not be published. Where the information relates to listed companies it is not possible or appropriate to freely disclose this information ahead of the institutional dates fixed in the financial calendar as it could be damaging to a company’s

financial position or even could be against the securities regulation. NRAs are in charge of fixing and controlling a TSO's efficiency and this should guarantee cost control while transparency is ensured through the publication of Annual Reports. In terms of the assumptions on capacity utilisation and subscriptions, the release of this information could negatively affect or bias capacity allocation processes resulting in altered auctions outcomes (CAM NC design) and as such could hamper competition between pipelines. This information should be confidential and provided only to NRAs.

The new transparency provisions drafted by ACER set out a large amount of information to be provided to network users to aid them in making reasonable estimates of pricing calculations. In order not to confuse network users with a wide array of information it may be wise to link the provision of information to the cost allocation methodology chosen by the TSO/NRA. The TSO would only provide information relating to the parameters used in their cost allocation methodology or pricing calculation.

Where the drafting refers to 'a reasonable estimation on the evolution of tariffs over the next regulatory period', it may be clearer to refer to 'over the current regulatory period' as it would be difficult for TSOs either under a revenue or price cap regime to make tariff predictions over the next regulatory period as the word 'next' suggests that the price control/regulatory settlement has not been negotiated yet.

It is extremely difficult to accurately predict the evolution of tariffs due to the different variables that impact on the tariffs even from year to year. ENTSOG would like to propose the inclusion of a sentence with regards to the provision of information and any liability in terms of how that information is used, e.g. 'such information shall be provided in an indicative basis without any further warranty given by the TSO in terms of its usage and the decisions based on that usage'.

Where information is set/approved by NRAs e.g. the WACC and its components, the publication of this data should provide enough transparency to stakeholders so that they can ascertain that the parameters were selected based on reasonable market based assumptions.

The tariff calculation consists of multiple steps and deals with a huge volume of different information, which is already provided to and approved or checked by NRA. Even if the shipper had all information currently listed by ACER, they would probably not be able or have the resources to either recalculate the tariffs or to forecast future developments. TSOs may decide to publish the data as outlined in the tariff framework guideline or alternatively they may

publish a forecast of price evolution best information available for the remaining years in their current regulatory period.

Cost Allocation

Although it is not clear specifically where the cost allocation problem exists or the extent of it, ENTSOG would like to support ACER in finding a practical and proportionate solution to it. ACER's new proposal is to have a range of 25-50% of revenue being earned at the entry points with the remainder being earned from the exit points. ENTSOG believes that a range is better than having a default rule. While ENTSOG doesn't agree with cross subsidisation, there is a concern that a strict rule/test would be extremely difficult to implement across Europe. When ACER applies the 25-50% range, a TSO may choose to adopt a 50/50 cost allocation split and in such case the application of test would not be necessary.

Changes to the cost allocation rule still falls short of addressing the issue where there are two entry/exit zones with different numbers of TSOs that are competing at the same points, such as in Germany. This could mean that by applying the proposed range of cost allocation splits per entry/exit zone the respective TSOs will have to set their individual tariffs for each and every point jointly. Considering the fact that TSOs have to set their tariffs individually and must ensure full cost-recovery for their business, then complete flexibility concerning the cost-allocation rule is necessary. Alternatively, an exemption from a fixed cost-allocation split (range) should be possible for TSOs in such a situation.

Currently in the Greek transmission system cost are allocated based on a pure cost-reflective allocation principle. Approximately only 10% of the Required Revenue is allocated to the Greek entry points, while the remaining 90% is allocated to the exit points. Having an arbitrary allocation of costs between entry and exit points which will result in higher tariffs at the Greek market entry points, is destined to affect competition and provide incorrect market signals.

The tariff framework guideline should also expressly include the possibility for NRAs to set tariffs by benchmarking them against other tariffs where appropriate as is foreseen in article 13 (1) of Regulation 715/2009.

Where the tariff framework guideline refers to the setting of tariffs using forecast allowed revenue and forecast subscriptions/technical capacities, it does not make allowance for setting the reference and regulated prices via tariff benchmarking in a price cap regime.

Potential Impact of Cost Allocation and Transparency Provisions

If some of the proposed tariff arrangements set out in the draft tariff framework guideline, such as the cost allocation split (which requires increased transparency for some TSOs), are applied then there is a risk that this could produce effects in contradiction to EU competition law. Due consideration should indeed be given to the fact that all TSOs, particularly those within a merged entry-exit zone where they have to agree on prices at a particular point, could at a certain point be considered as unintentionally entering into an agreement or concerted pricing practices which produce anticompetitive effects and possibly infringe upon Article 101 TFEU (EU Competition Law).

Gas Storage

For an optimum design of the methodology for the pricing of entry and exit to and from gas storages, ENTSOG would like to highlight that some flexibility is needed at a national level due to the following reasons:

• Characteristics of the national network, the location of the storage site relative to major areas of consumption, infrastructure added to connect the site and the connection policy in each country vary widely. If there is a favourable connection policy for storage then they are already receiving a benefit from the system in the absence of other favourable treatment.

• System specifics and gas storage capacity contribution for ensuring appropriate gas delivery to end users of the system may be considered when pricing the entry and exit capacity from and to gas storage facilities.

• In some systems storage may provide only minor capacity for covering the peak demand and the impact on the transmission system usage could be considered as minor. In other systems storage provides a significant contribution to covering peak demand.

• A harmonised methodology might not be the most appropriate option since some TSOs already apply specific methodologies that consider the impact of storage. A harmonised approach in these cases would create multiple favourable treatments.

ENTSOG shares ACER's view that efficient investments, efficient use of the network and efficient trade and competition are improved by storages but thinks that in order to reach those aims,

national gas system specificities should be taken into account when designing the methodology for transmission tariffs that takes account of gas storages. Flexibility on a national level is required, since a common approach could lead to undesirable cross-subsidies.

ENTSOG proposed gas storage text:

'The Network Code on Tariffs shall determine principles for the application of transmission tariffs for entry and exit points to and from gas storage facilities, set or approved by the relevant NRA, taking into account that the resulting tariffs will reflect the role of gas storages in the functioning of the internal market.'

Revenue Recovery

ACER's new proposal is to have just one option for revenue recovery at IPs, i.e. via capacity payments only using a single regulatory account. In addition, at non-IPs another approach could be used, for example, a separate payment could be used to recover revenue in conjunction with the capacity payments.

ENTSOG believes that there should be flexibility for TSOs to recover their revenue in a way that is most effective for their national system including having more than one regulatory account e.g. if there are two different but justifiable regulated tariff methodologies within an entry-exit zone, then two separate regulatory accounts could be used for each methods. This will prevent the risk of increasing capacity prices which only serve to exacerbate an under recovery situation. Therefore, ENTSOG suggests the following text for the tariff framework guideline:
"The default rule for under recovery is via capacity payments, however this does not preclude other options being agreed at a national/regional level particularly if it is considered that increasing capacity charges would not meet the objective of resolving an under recovery situation. For example, if it is agreed that a TSO asset provides security of supply benefits and/or market integration benefits to end users then there could be an option for end users to address this under recovery situation."

The rule for domestic points, where NRAs may decide to use alternative methodologies for recovering revenue, this should also be applied at cross border points where necessary.

In relation to the revenue recovery section of the framework guideline, it is not clear how a regulatory account would work as the concept of over or under recovery is not applicable in a

price cap regime. TSOs are not protected from volume risk and all revenue earned is retained by the TSO. ENTSOG would like to propose some drafting changes to the revenue recovery section to allow for consideration of price cap regimes.

'The Network Code on Tariffs shall set out that irrespective of the regulatory regime applied, with the exception of a price cap regime, the following rules shall be complied with. Under a price cap regime where allowed revenue under and over recoveries do not apply; only auction premiums, where earned, shall be logged to the regulatory account.'

Reserve Prices

(a) Short term capacity

One of the aims of the tariff framework guideline is to mitigate against the risk of undue discrimination particularly with regards to cross border and domestic network users as was explicitly mentioned in the Commission's invitation letter. However, the current proposal on the setting of reserve prices for short term capacity increases the risk of undue discrimination between different types of network users (i.e. flat versus profiled) rather than mitigating against it. ENTSOG welcomes the inclusion of a floor price for the tariffing of the short term capacity products but is concerned about the level of the floor. ENTSOG believes that the floor price for any short term capacity product should always be one or more than one. A floor price of 0.5 for quarterly and monthly is too low because of the cross subsidies that it would inevitably create between different network users and **a floor of zero for daily and within day is completely unacceptable**. In particular, within non-congested networks the fact that multipliers for short term capacity on average are less or equal to one does not make sense given that it results in non-reflective pricing for short-term contracts. In such instances, short term contracts do not help to reduce congestion on the system so pricing capacity at a discount only creates network uncertainly and revenue under-recovery.

The multipliers proposed in the tariff framework guideline are much lower than those currently in use by the majority of TSOs across Europe. In particular, the cap and floor for daily prices set out in the tariff framework guideline differ considerably from those in use across Europe as outlined in the table below. In uncongested systems, a potential floor of zero and cap of 1.5 for daily and within day multipliers will create significant under recovery of revenue (or inability to recover revenue in a price cap regime) and will result in significant increases to reference prices/annual tariffs.

Table 1. European Average Daily Multipliers

Table of Average Daily Multipliers	**Applicable European Countries**
Daily multipliers of less than 1 on average	United Kingdom
Daily multipliers of 1 on average	Germany and Romania
Daily multipliers of more than 1 but less than 1.5 on average	Italy and Hungary
Daily multipliers of more than 1.5 but less than 2.0 on average	Austria, Belgium, Denmark and Greece
Daily multipliers of more than 2.0 but less than 2.5 on average	France, Poland and Spain
Daily multipliers of more than 2.5 on average	Czech Republic, Ireland, Netherlands and Slovakia
Average daily multiplier across Europe (including the UK)	**2.0**

These 'new' multipliers could have serious consequences in terms of cross subsidies between different network users, tariff volatility for the market and the timing of revenue recovery or the irrecoverable shortfall of revenues for TSOs. Gas transmission systems have been built to meet peak demand and facilitate the business needs of network users. Therefore, all network users should make a contribution to paying for the network regardless of whether they use it for a day, a month, a year or multiple years. Even if the short term multiplier is one, where IPs are uncongested, there could still be serious revenue recovery issues because of profiling of capacity bookings in line with flows in the absence of any risk of the capacity not being available.

The revenue recovery section of the draft tariff framework guideline states that 'The Network Code on Tariffs shall specify that the determination of the reference prices for the interconnection points between entry-exit zones and of the regulated prices for the other points shall seek to minimise any gaps between the revenues which the TSO is entitled to obtain on the basis of the applied regulatory regime and the revenues actually obtained by the TSO.' However, the drafting in the reserve prices section of the states that 'for quarterly and monthly products, the Network Code on Tariffs shall set out that if significant over-recovery is to be expected NRAs may decide to allow for multipliers lower than one, but not lower than 0.5' and 'the Network Code on Tariffs shall set out that if significant under-recovery is to be expected

NRAs may decide to allow for average multipliers higher than one, but not higher than 1.5. If the principle for setting tariffs under a revenue cap regime is to minimise any gaps between the allowed revenue and actual revenue then calculating tariffs where you expect a significant under or over recovery of revenue is in contradiction to this principle. If you calculate tariffs and expect an under recovery based on those tariffs then whether the under recovery is significant or not you should recalculate your tariffs to close the gap. If you expect an over recovery after calculating your tariffs this means that you should also recalculate your tariffs to close the gap.

Where a price cap regime is applied and a cap on short term multipliers is introduced this would result in inappropriate revenue shortfalls which the TSO is unable to recover and would lead to stranded assets. In such cases price cap TSOs should be able to recover this revenue shortfall due to the cap on short term multipliers without turning a price cap regime into a revenue cap regime.

In systems with spare capacity, uncongested IPs, and without longer term contracts (subject to Ship-or-Pay clauses during the whole life of the contract), users can change the location of their contracts to optimise their payments. From an operational point of view could lead to big changes in flow patterns. Thus, it is imperative that in such cases multipliers are always higher than one. As a result ENTSOG, continues to advocate the use of the revenue equivalence principle (REP) with regards to the pricing of the short-term products, which is cost-reflective, in the sense that avoids over- and under- pricing of short term products and hence, reduces the risk of market manipulation by users profiling , putting the TSO's revenue at risk.

At a certain (type of) entry or exit point(s), the reserve price shall apply to all network users without any discrimination and differentiation ex ante and ex post.

(b) Non-physical backhaul capacity

ACER has put forward two drafting options for the pricing of non-physical backhaul capacity. Having examined both options ENTSOGs view is that the tariffs for this product should comprise the following:

- the reserve price for interruptible capacity;
- include any supplementary costs for providing the service;
- duly take into account any reductions in costs for flows in the direction in which the TSO offers the technical capacity;

- the final tariff for non-physical backhaul should never be lower than zero.

ENTSOG proposes the following wording for the pricing of non-physical backhaul:

Non-physical backhaul capacity is an interruptible product and therefore the methodology for determining its reserve price shall firstly be set the same as interruptible capacity for comparable physical points. The methodology shall then take into account additional costs, if any, for providing the service and shall duly reflect reductions in cost, if any, for flows in the direction in which the TSO offers the technical capacity for determining the reserve price for non-physical backhaul capacity. The resulting reserve price for non-physical backhaul shall not be lower than zero.

Payable Price

The proposal by ACER is that the payable price would be the floating regulated tariff plus a fixed auction premium. ENTSOG would like TSOs to have the flexibility to offer either floating prices or a fixed price as the payable price. For example, if shipper feedback at a national level suggests that more capacity bookings would be made if shippers were sure of a fixed price, the TSO (and indeed the NRA) may consider this a better option to secure revenue and reduce the risk of under recovery.

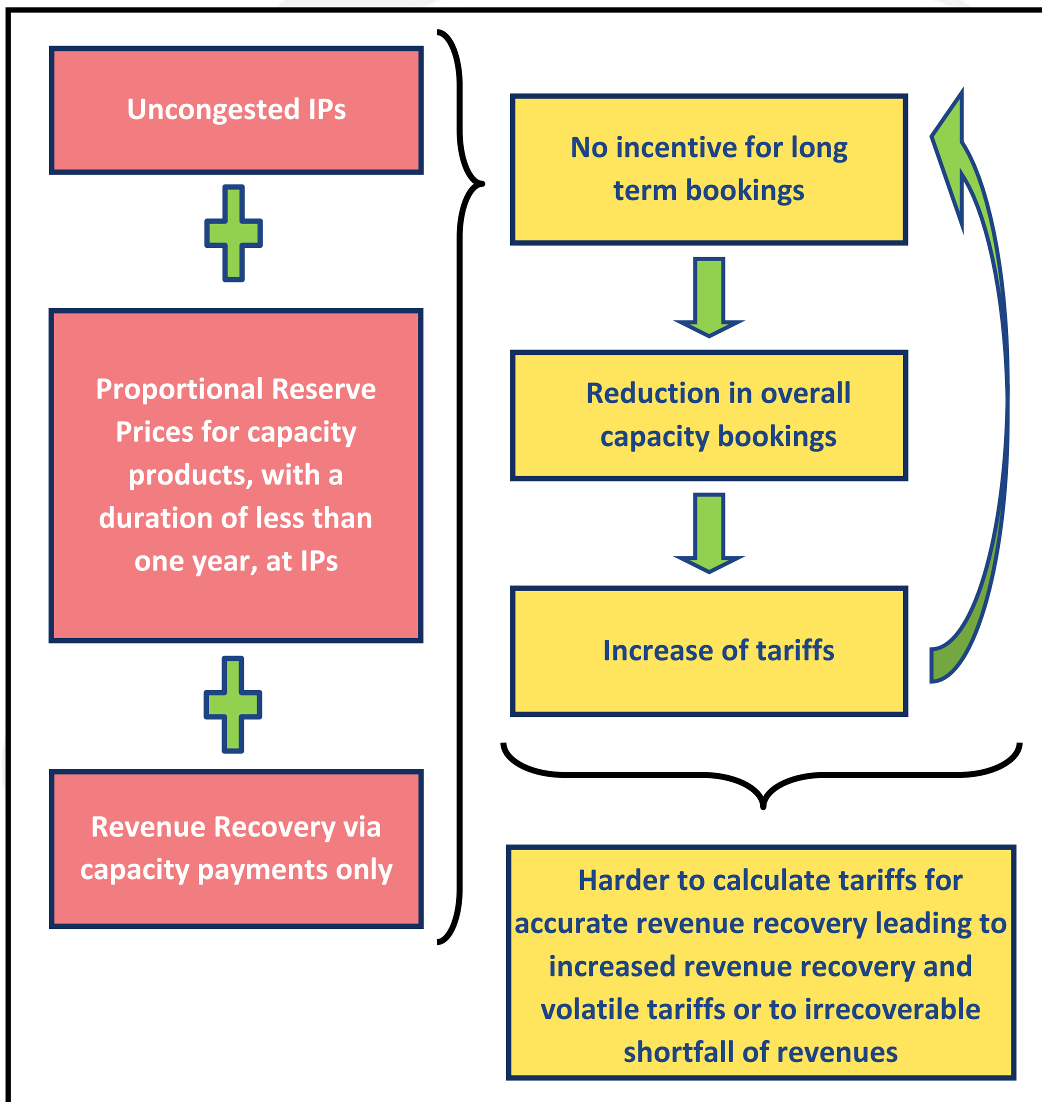
Incremental Capacity

ACER is contemplating whether minor aspects of incremental capacity could be included in the final tariff framework guideline. ENTSOG has looked at the issue of incremental capacity and its initial response is that it is difficult to isolate minor aspects for consideration in the final framework guideline because of the complicated nature of the topic. Incremental capacity is made up of many interrelated issues which should be considered together rather than looking at minor aspects in isolation. ENTSOG's initial view is that this topic should be considered carefully as a whole and that the tariff framework guideline should not preclude the development of some European incremental capacity rules in the future.

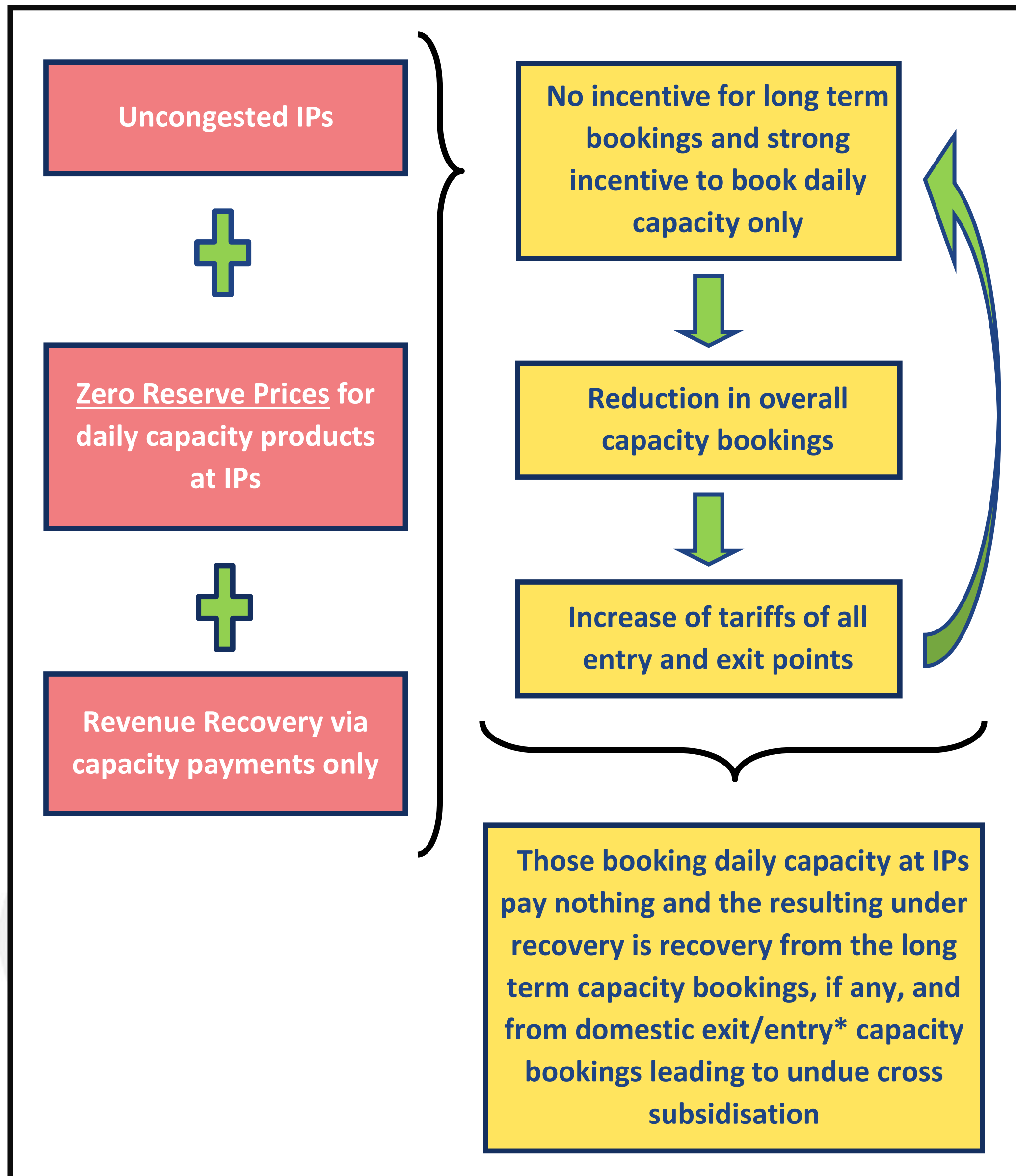
Interdependencies

ENTSOG recognises that there are interdependencies within the tariff framework guideline and is concerned about some of these interdependencies.

1. Reserve prices for short term capacity and revenue recovery - assuming proportional pricing and revenue recovery via capacity payments only.

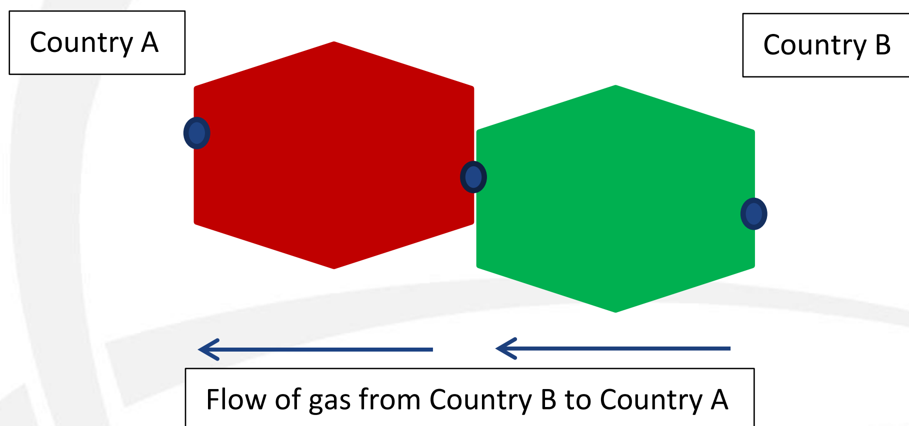


2. Reserve prices for short term capacity and revenue recovery - assuming zero reserve pricing and revenue recovery via capacity payments only.



*Domestic entry is entry from a non-cross border point

There are also concerns about the interdependency between the reserve prices and the impact of the cost allocation split on the treatment of revenue recovery. The draft tariff framework guideline states that the cost allocation methodology must be applied to the regulatory account for the treatment of under/over recovery. If a TSO has a 25/75 entry/exit cost allocation split then if there is under/over recovery of revenue this must be done using the 25/75 cost allocation split. Taking an example of a network user that is transporting gas from country B to country A. Where, Country B has the following characteristics i.e. a cost allocation split of 25/75 for entry/exit, no congestion at the IPs and zero reserve prices for both daily and within day capacity. Country A buys daily capacity for zero and transports gas for free through country B. Country B under recovers its revenue and then that under recovery is split 25/75 between entry and exit points.



The annual tariff increases for all entry and exit points both cross border and domestic but the daily and within day prices at IPs remain at zero. The result is that those booking annual capacity at IPs and any non-IP capacity will pay increased tariffs to cover the shortfall caused by the network users transporting gas through country B for free. While this may seem like an extreme example it is possible given the proposed rules in the tariff framework guideline. If the daily and within prices were not zero but were very low then you would have a similar effect with a disproportionate amount of revenue being recovered from annual capacity bookings, if any, and domestic exit capacity bookings in a revenue cap regime or not being recovered at all in a price cap regime.

Other Considerations

ENTSOG is concerned about the implementation timeline of twelve months in the draft tariff framework guideline and the absence of any transition period for the considerable changes to transmission tariff structures being proposed in the framework guidelines.

The periodic nature of annual tariff calculations and the substantial content of the tariff framework guideline suggest that it would be practical to have an implementation timeline of eighteen months with a proviso that the tariffs would come into force at the next annual tariff calculation after the implementation period has been completed.

In addition to this implementation timeline and with due attention to the minimisation of tariffs shocks for network users, where a TSO must make considerable changes to its transmission tariff structure a transition period would be allowed for those changes to occur smoothly over a number of years. For example, if a TSO currently has a cost allocation split of 80/20 for its entry/exit system and if it were to change this split due to proposed new rules in the tariff framework guideline/network code then this should be done in stages:

Year 1 – move to 70/30 entry/exit split
Year 2 – move to 60/40 entry/exit split
Year 3 – move to 50/50 entry/exit split

This gradual move to a new cost allocation split would ensure that although network users would experience tariff changes they would not experience them all in one go and would have advance warning of the changes coming over a three year period.

In general transition periods will be necessary where TSOs have to make considerable changes to their transmission tariff structures in order to avoid significant tariff shocks for the market. In addition to the cost allocation rules, the proposed rules on revenue recovery (e.g. recovery via capacity payments only) and reserve prices (e.g. much lower multipliers than are currently in place) may create significant changes to the transmission tariffs which should be managed smoothly over a number of years to reduce the impact of significant tariff fluctuations.

TSOs are concerned about the impact of the future regulation based on the Tariff framework guideline with regards to existing entry and exit capacity contracts. This impact depends on the different civil law for national systems. The introduction of the Tariff network code may

precipitate price changes and this can create new termination rights for shippers. This issue isn't mentioned by ACER in the 'Open House Material'. Therefore, we would appreciate it if ACER could consider this issue.