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Agency Report

Analysis of the Consultation Document on the Gas Transmission Tariff Structure for Estonia

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26 September 2019

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1. ACER conclusion

- (1) The Estonian National Regulatory Authority ('NRA'), Konkurentsiamet, has carried out the consultation on the reference price methodology ('RPM') for Estonia. The proposed methodology is a postage stamp methodology. However, the proposed tariffs are derived not only by using this postage stamp methodology, but are also based on a broader scheme applicable to the Finish, Estonian and Latvian networks ('FINESLAT') for the integration of their markets. The complete methodology used to set tariffs for this region includes the following elements:
 - A common entry tariff of 142.77 €/MWh/d/y is set at all entries from Russia and to the Lithuanian entry point to Latvia.
 - Zero tariffs at the IPs within the FINESTLAT zone.
 - An inter-transmission system operator ('TSO') compensation mechanism ('ITC') agreement applied to the revenue collected from entries. This revenue covers the variable costs and additional revenue of the three FINESTLAT TSOs that is distributed between TSOs.
 - Finally, a postage stamp methodology solely applied to domestic exits, applied per Member State ('MS') individually.
- (2) Based on this methodology a share of the TSO revenue is allocated to entries, while the remaining revenue is allocated to domestic exits. The split of the revenue between the entries (based on the agreed entry tariff and subject to the ITC mechanism) and the exits (allocated based on the proposed postage stamp) is 9-91%. A further exit tariff from Estonia to Russia is not discussed in the Estonian consultation. The NRA clarified that this point is not in use, while the ENTSOG TP shows that there are both flows and booking in the 2016-2019 period¹. The information provided in the consultation implicitly suggests that an asset split is performed to set the tariff at the exit point to Russia.
- (3) The revenue allocated to entries from all TSOs is gathered and re-assigned to TSOs on the basis of two criteria:
 - First, TSOs are compensated for the compression costs of their whole networks. This represents 13.8% of the revenue recovered from entries.
 - Second, the remaining 86.2% of the revenue recovered from entries is assigned to TSOs based on the domestic consumption of each involved MS.As a result of this ITC and of the setting of an agreed tariff to entries, the Agency understands that the postage stamp methodology is only applied to exits, while tariffs for entries to the FINESTLAT zone are agreed between the different parties and are subject to an ITC mechanism. The costs allocated to entries, and therefore compensated via the ITC, are related to compression costs and other non-specified costs.
- (4) The methodology and the calculations proposed by the Estonian NRA to set tariffs are not compliant with the Network Code on Harmonised Transmission Tariff Structures for Gas ('NC TAR') and are based on multiple exceptions that contradict the basic principles of the NC TAR. The Agency fails

¹ See Figure 1 of the Report where both flows and bookings in the Estonian exit points to Russia are shown.

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to recognise an RPM that is applied consistently to all points of the network in order to allocate the revenue of the TSO on the basis of capacity-based tariffs².

- (5) Tariffs at domestic points are calculated using a postage stamp methodology. The input used for this calculation is not based on a contracted capacity forecast but on a flow forecast (i.e. the domestic consumption of Estonia). This suggests that the final tariffs are commodity- and not capacity-based and raises questions about the underlying implementation of an entry-exit model in the Estonian network, as required by Article 13 of Regulation (EC) 715/2009, of the Network Code on Capacity Allocation Mechanisms in Gas Transmission Networks ('NC CAM') and of the Network Code on Gas Balancing of Transmission Networks ('NC BAL'). A proper implementation of the entry-exit model and of the standard capacity products is a prerequisite for the development of an RPM compliant with the NC TAR requirements. The Agency could not verify the capacity or commodity nature of the tariffs proposed in the Estonian consultation document at entry IPs, at domestic exits and at the exit IP to Russia, absent appropriate description of the Estonian capacity regime.
- (6) The Agency regrets that the information made available to it for the purpose of producing this Report is insufficient for a full assessment of these mechanisms. This is because the tariff consultation on the RPM is incomplete and does not comply with the minimum requirements of the NC TAR to allow a proper assessment of the proposed methodology. In addition, the ITC has not been consulted³ and the details made available to the Agency are insufficient to assess its impact.
- (7) Pursuant to Article 27(2) of the NC TAR, the Agency has analysed the compliance of the proposed methodology to calculate tariffs, including both the proposed postage stamp methodology and the ITC. Based on the available data, the Agency concludes that:
- The consultation document is incomplete and does not contain the required elements listed in Article 26(1) of the NC TAR. These include the indication of the duration of the regulatory and tariff periods, a simplified model for the calculation and forecast of tariffs, the details on the target revenue that is an input to the RPM, the details on the capacity input to the RPM, the details on the scope of application of the RPM to points of the system, the calculation of the cost allocation assessment⁴ ('CAA') and a meaningful comparison of the proposed tariffs with those derived using the capacity weighted distance ('CWD') methodology.
 - The methodology used to calculate tariffs is not compliant with the requirement of transparency as it does not allow reproducing and forecasting reference prices. The Agency could not

² On an email sent to the Agency on 25 September 2019, the NRA explains that a '*network user wishing to input or off-take a specific quantity of gas from the transmission system at entry or exit points shall submit nomination or re-nomination to the TSO in conformity with the standard communications protocol. Making nomination, network user take obligation to pay for nominated capacity. Tariffs are the same approved reserved prices (as no congestions not foreseen and there is no auction)*'. In the view of the Agency, this approach suggests that tariffs are indeed based on commodity, that is, on the flows nominated by users, and not on the contracted capacity. The NRA note clarifies that this approach is applicable to all points of the network.

³ The NRA and the TSO communicated to the Agency during a bilateral telco that the ITC was discussed between Estonia, Finland, Latvia and Lithuania together with stakeholders in 2017. The TSO agreement was later discussed between the NRAs of Estonia, Finland, Latvia in 2018. The Agency notes that such discussions did not include a public consultation.

⁴ Throughout this document, 'CAA' is used to refer to the capacity cost allocation comparison index described in Article 5(3)(c) of the NC TAR.

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conclude that the methodology used to calculate tariffs is compliant with the requirements related to cost-reflectivity, cross-border subsidisation, cross-border trade and volume risk. Setting a tariff for the exit point to Russia outside the RPM seems arbitrary and could be discriminatory, as not all tariffs are derived from the same methodology.

- The criteria for setting the commodity charge are not applicable. The Agency nevertheless remarks its concern about the application of commodity tariffs at domestic exits as referred to in paragraph (5) above. Such an approach is incompliant with Article 4(3) of the NC TAR.
- The criteria for setting the non-transmission charges are not applicable.

- (8) While the Agency favours regional integration of markets, it regrets that such integration takes place at the price of incompliance with the NC TAR. The Agency provides in this Report several recommendations to achieve compliance with the NC TAR to be applied both regionally and nationally in Estonia.
- (9) First and foremost, and following the possibility of domestic tariffs being commodity-based, the Agency remarks that the obligation fully to implement the Third Energy Package, including the entry-exit model, precedes the implementation of the NC TAR. The NC TAR assumes the prior implementation of an entry-exit system for capacity sales, for which the appropriate metering infrastructure should be in place⁵.
- (10) Second, the Agency encourages the NRAs to repeat the consultation on the RPM and to consult on the proposed ITC. While the latter requirement is not laid out in the NC TAR; it can be inferred from a joint reading of Articles 10 and 11 of the NC TAR. The Agency regrets that a consultation on the ITC was not carried out prior to or in parallel to the national tariff consultations of the FINESTLAT market zone. Such consultations could take place within a period of one year. This time should allow clarifying among the parties involved in the process what are the realised and expected flow patterns within the FINESTLAT market zone (including those in the Baltic connector). Additionally, and given the role of future infrastructure to come online (such as the GIPL pipeline in 2022-23), a review of the flow patterns would be again necessary in 2023-24. These consultations should be based on greater coordination between the parties involved, and should aim at harmonising the regulatory and tariff periods to manage the reconciliation mechanisms appropriately.
- (11) Third, regarding the consultation on the ITC, the Agency remarks that the consultation:
- Should be compliant with the requirements listed under Article 10(3) of the NC TAR applicable for the ITC.
 - Should clarify the costs that are subject to the ITC. Ideally, the consultation should include an assessment of the assets that are used across the market zone along the steps proposed in Chapter 5.
 - Should assess the mechanism to redistribute the costs that are subject to the ITC. These costs should be allocated across the market zone to the beneficiaries of the merger along the steps proposed in Chapter 5. Such mechanism should allow better to achieve the principle of avoiding

⁵ This can be complemented by profiling of exit point flows based on statistical forecasts of the utilisation of the network.

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cross-subsidisation between the cross-system and intra-system flows, as required by Article 10(3) of the NC TAR, and between the FINESLAT networks.

- (12) Fourth, a common tariff set for entries can be compliant with the NC TAR (e.g. by applying benchmarking⁶ or by setting an entry-exit split that allocates the required amount of revenue to entry points⁷). However, the approach adopted should maintain the compliance with other requirements of the NC TAR, in particular with the transparency obligations that allow network users to reproduce and forecast tariffs. The recommendations provided in paragraph (14) below aim at ensuring this requirement.
- (13) Fifth, the application of zero tariffs to certain points is compliant as these points will be no longer bookable. However, such decision should be accompanied by a proper compensation of the missing revenue for the involved TSOs to avoid undue cross-subsidisation. Article 10(3)(a)(i) of the NC TAR requires that 'an effective ITC' complies with this condition. An assessment for such compensation has not been completed by the NRAs of the FINESLAT market zone.
- (14) Regarding the consultation on the proposed postage stamp methodology, the Agency recommends to the NRA to:
- Derive the tariff for the exit point to Russia using the RPM. Pursuant to Article 6(3) of the NC TAR, the RPM should be applied to all points of the network.
 - Clarify the duration of the regulatory and tariff periods. The information provided by the NRA is not clear as regards to the duration of both periods. Such uncertainty hinders the possibility to reproduce and forecast tariffs, as required by Article 7(a) of the NC TAR.
 - Provide a simplified model for the calculation of reference prices. This is a requirement of Article 30(2)(b) of the NC TAR. The calculation should include the details of the ITC and should allow calculating how the revenue of the TSO is split between entries and exits.
 - Provide clarity on the target revenue that is an input to the RPM. The consultation document suggests that the tariff and regulatory periods can be modified upon the request of the TSO and it is not clear how such TSO-triggered changes relate to the possible under- or over- recovery of the TSO nor to the risk and the target revenue of the TSO.
 - Provide the calculation of the CAA. This is a requirement according to Article 26(1)(a)(iv) of the NC TAR.
 - Provide the calculation of the CWD methodology in a way that allows understanding the relevance of distance as a cost driver in the Estonian network. This is a requirement according to Article 26(1)(a)(vi) of the NC TAR.
 - Clarify whether the tariff at domestic exits (and more generally, at all points of the system) is a capacity or commodity tariff. In the past, domestic tariffs were commodity-based. The consultation uses a commodity value to calculate the forecasted contracted capacity at domestic exits, without explaining how this parameter is converted to capacity.
 - Provide a comparison of the proposed tariffs with the past and future tariffs. This is a requirement of Article 30(2)(a) of the NC TAR.

⁶ The Agency provides guidelines for the application of benchmarking in the Agency Report on the Analysis of the Consultation Document for Slovakia ([link](#)).

⁷ Such option would require the application of an equalisation adjustment to entry points if the network includes more than one entry point.

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- Assess the proposed period for amending the tariffs of the TSO against the requirements of the NC TAR. This is an exceptional measure presented by the NRA in the consultation that can be applied for a period of up to two months.
- (15) The Agency regrets that, after several requests, the NRA provided limited information, which ranged from the partial English translation of the consultation, to insufficient clarifications on the calculations of the ITC, the split of revenue to entries and exits and the setting of an exit tariff to the exit point to Russia. Regarding other requirements such as calculation of the CAA⁸ and the CWD methodology, the NRA did not accede to the request of the Agency to provide further information. Moreover, based on the currently foreseen timeline, the NRA will have no time to take into consideration the remarks made in this Report, as an input to its motivated decision on the RPM as foreseen by Article 27 of the NC TAR, since such a decision is planned to be issued four days after the deadline for the publication of this Report.

⁸ After declining the requests of the Agency and after a draft of this Report had been completed, the NRA provided a calculation of the CAA which results in a value of 161.4%. This figure is significantly above the 10% stated in the Article 5(6) of the NC TAR requiring justification. It is outside the normal thresholds and the Agency cannot use it to assess the proposed tariffs as it seems to suggest a high degree of cross-subsidisation.

2. Introduction

- (16) Commission Regulation (EU) 2017/460 of 16 March 2017 establishes a network code on harmonised transmission tariff structures for gas (NC TAR).
- (17) Article 27 of the NC TAR requires the Agency to analyse the consultation documents on the reference price methodologies for all entry-exit systems⁹. This Report presents the analysis of the Agency for the transmission system of Estonia.
- (18) On 28 May 2019, the Estonian NRA forwarded the consultation documents to the Agency. The consultation was launched on 27 May 2019 and remained open until 26 July 2019. On 26 August, the consultation responses and their summary were published and forwarded to the Agency. The Agency has taken these into consideration for this analysis. In particular, the Agency notes that the response provided by the Lithuanian NRA points out similar issues related to the Estonian consultation as those presented in this Report.
- (19) Article 27(4) of the NC TAR provides a deadline of five months following the end of the final consultation, for the NRA to take and publish a motivated decision on all the items set out in Article 26(1) of NC TAR. Following the timeline communicated to the Agency, the NRA intends to take this decision by the end of September, a date that would not allow taking into account the vast majority of the comments provided in this Report¹⁰.

Reading guide

- (20) Chapter 3 presents the analysis on completeness, namely whether all the information referred to in Article 26(1) of the NC TAR has been published. Chapter 4 focusses on compliance, namely whether the RPM complies with the requirements set out in Article 7 of the NC TAR, whether the criteria for setting commodity-based transmission tariffs as set out in Article 4(3) are met, and whether the criteria for setting non-transmission tariffs as set out in Article 4(4) are met. Chapter 5 includes other comments relating to the regional market integration process. This document contains two annexes, respectively the legal framework and a list of abbreviations.

3. Completeness

3.1 Has all the information referred to in Article 26(1) been published?

- (21) Article 27(2)(a) of the NC TAR requires the Agency to analyse whether all the information referred to in Article 26(1) of the NC TAR has been published.
- (22) Article 26(1) of the NC TAR requires that the consultation document should be published in the English language, to the extent possible. The Agency remarks that the English version of the consultation document was not initially published as part of the consultation. Upon request of the

⁹ With the exception of Article 10(2)(b), when different RPMs may be applied by the TSOs within an entry-exit zone.

¹⁰ In its initial calculation, the NRA foresaw that the Report of the Agency was due by the end-date of the national consultation and not two months after this date, as prescribed by Article 27(3) of the NC TAR.

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Agency, the NRA provided on 26 June 2019 an English translation that was made publically available. The Agency remarks that, unlike the consultation in the national language, the consultation in English did not last for two months.

- (23) Overall, the information in Article 26(1) of the NC TAR has not been properly published. The Agency recommends to improve the transparency when publishing the final decision, as it is a crucial step for reaching the objectives of the internal market and the implementation of the code.

Table 1 Checklist information Article 26(1)

| Article | Information | Published: Y/N/NA |
|---|---|---|
| 26(1)(a) | the description of the proposed reference price methodology | Not sufficient. |
| 26(1)(a)(i) 26(1)(a)(i)(1) 26(1)(a)(i)(2) | the indicative information set out in Article 30(1)(a), including: <ul style="list-style-type: none"> the justification of the parameters used that are related to the technical characteristics of the system the corresponding information on the respective values of such parameters and the assumptions applied | Incomplete |
| 26(1)(a)(ii) | the value of the proposed adjustments for capacity-based transmission tariffs pursuant to Article 9 | Not applicable |
| 26(1)(a)(iii) | the indicative reference prices subject to consultation | Yes. Although the duration for which they are applicable is unclear. |
| 26(1)(a)(iv) | the results, the components and the details of these components for the cost allocation assessments set out in Article 5 | No. See footnote 8 |
| 26(1)(a)(v) | the assessment of the proposed reference price methodology in accordance with Article 7 | Assessment not supported by evidence |
| 26(1)(a)(vi) | where the proposed reference price methodology is other than the capacity weighted distance reference price methodology detailed in Article 8, its comparison against the latter accompanied by the information set out in point (iii) | Based on a simplification that does not allow a comparison with the proposed postage stamp methodology. |
| 26(1)(b) | the indicative information set out in Article 30(1)(b)(i), (iv), (v) | Yes |
| 26(1)(c)(i) 26(1)(c)(i)(1) 26(1)(c)(i)(2) 26(1)(c)(i)(3) | where commodity-based transmission tariffs referred to in Article 4(3) are proposed <ul style="list-style-type: none"> the manner in which they are set the share of the allowed or target revenue forecasted to be recovered from such tariffs the indicative commodity-based transmission tariffs | Not applicable |
| 26(1)(c)(ii) 26(1)(c)(ii)(1) 26(1)(c)(ii)(2) 26(1)(c)(ii)(3) 26(1)(c)(ii)(4) | where non-transmission services provided to network users are proposed: <ul style="list-style-type: none"> the non-transmission service tariff methodology therefor the share of the allowed or target revenue forecasted to be recovered from such tariffs the manner in which the associated non-transmission services revenue is reconciled as referred to in Article 17(3) | Not applicable |

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| | | |
|---|--|---|
| | <ul style="list-style-type: none"> the indicative non-transmission tariffs for non-transmission services provided to network users | |
| 26(1)(d) | the indicative information set out in Article 30(2); | <p>No.</p> <ol style="list-style-type: none"> The simplified model is not provided. The formula provided to calculate tariffs is not entirely accurate. The duration of the tariff period is unclear. The comparison with previous and future tariffs is not provided. |
| 26(1)(e) 26(1)(e)(i) 26(1)(e)(ii) 26(1)(e)(iii) 26(1)(e)(iv) | <p>where the fixed payable price approach referred to in Article 24(b) is considered to be offered under a price cap regime for existing capacity:</p> <ul style="list-style-type: none"> the proposed index; the proposed calculation and how the revenue derived from the risk premium is used at which interconnection point(s) and for which tariff period(s) such approach is proposed the process of offering capacity at an interconnection point where both fixed and floating payable price approaches referred to in Article 24 are proposed | Not applicable |

4. Compliance

4.1 Does the RPM comply with the requirements set out in Article 7?

- (24) Article 27(2)(b)(1) of the NC TAR requires the Agency to analyse whether the proposed reference price methodology complies with the requirements set out in Article 7 of the NC TAR. This article refers to Article 13 of Regulation (EC) 715/2009 and lists a number of requirements to take into account when setting the RPM: transparency, cost reflectivity, non-discrimination, cross-subsidisation and cross-border trade.
- (25) In the case of Estonia, the tariff setting calculation is partly determined by a market integration process (FINESTLAT) in which the Finish, Estonian and Latvian gas transmission networks are involved. This analysis starts by presenting the scope adopted by the Agency to complete the assessment of the RPM. The remainder of the section assesses the compliance of the proposed tariff setting mechanism. The section concludes with an analysis on the requirements listed in Article 7 of the NC TAR.
- (26) The consultation carried out by the Estonian NRA is based on a market integration scheme that involves the FINESTLAT networks. A brief and incomplete description of this setting is provided in the Estonian consultation document and in the Memorandum of Understanding between the three involved NRAs plus the Lithuanian NRA that is included as part of the consultation documentation.

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- (27) The market integration scheme includes the following elements relevant for the setting of gas transmission tariffs:
- A common entry tariff of 142.77 €/MWh/d/y set to all entries from Russia and to the Lithuanian entry point to Latvia.
 - Zero tariffs to the IPs within the FINESTLAT zone.
 - An inter-transmission system operator ('TSO') compensation mechanism ('ITC') agreement applied to the revenue collected from entries. This revenue covers the variable costs and additional revenue of the three FINESTLAT TSOs that is distributed between TSOs.
 - A national methodology applied individually per MS to set the tariff for exit points. Estonia applies a postage stamp methodology to its domestic exits.

4.1.1 Preliminary considerations on the analysis of the Agency

- (28) In this context, this Report assesses the compliance of the regional and national tariffication schemes to cover all the applicable tariffs in Estonia.

4.1.1.1 Article 11 does not exempt from full compliance with the NC TAR

- (29) The standard application of the NC TAR is based on Article 6(3) which prescribes that *the same methodology shall be applied to all entry and exit points in a given entry-exit system*. There are two articles covering exceptions to this rule, Article 10 of the NC TAR, applicable to entry-exit system within a Member State where more than one TSO is active, and Article 11 of the NC TAR, applicable to entry-exit system covering more than one Member State. In the case of the FINESTLAT market zone, the latter article applies. Article 11 of the NC TAR allows the following options:
- Apply the same RPM jointly by all MSs.
 - Apply the same RPM separately by the involved MSs.
 - Apply different RPMs separately by the involved MSs.
- (30) In its consultation document, the Estonian NRA argues that it applies the postage stamp methodology separately (second option above). The Agency notes that while this option can be used for the purpose of integrating the three market zones, such process should maintain compliance with the rules of the NC TAR. Overall, the proposed mechanism has significant transparency shortcomings related to the proposed postage stamp methodology and to the proposed ITC. This impedes visibility over the calculation of tariffs and makes it difficult to assess the impact of tariffs. Also, the proposed postage stamp methodology is only applied to domestic exit points with tariffs at entries not being derived using the postage stamp methodology, as required by Article 6(3) of the NC TAR and being subject to the ITC. In addition, it remains unclear from the Estonian consultation document whether the same RPM is actually applied per MS, as the regulatory and tariff periods, and the revenue reconciliation do not seem to be harmonised across countries. Finally, it remains unclear whether the structure of domestic tariffs (being based on capacity or on commodity) is harmonised across the FINESTLAT market zone. Following these issues, it appears to the Agency that the MSs in the FINESTLAT market zone apply a different RPM in such a way that the proposed approach is not fully compliant with Article 11. These aspects are discussed individually in this Report, questioning the compliance of certain aspects with the NC TAR, and warning that the chosen design can potentially lead to market inefficiencies within the integrated market zone. In addition to this, the Agency remarks that the choice to apply different

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RPMs per MS leads to very different domestic tariffs per network, which can further increase the inefficiencies within the region.

4.1.1.2 No consultation has been carried out on the ITC

- (31) The specific application of Article 11 of the NC TAR, particularly in the form proposed in the FINESTLAT zone, leads to the need to apply an ITC mechanism to guarantee revenue recovery for the TSOs. Article 11 of the NC TAR, however, does not refer explicitly to the option of applying an ITC mechanism. It is instead Article 10 of the NC TAR which describes this option. An ITC is justified if tariffs might not lead to TSOs recovering their allowed or target revenue. TSOs might not achieve full revenue recovery of the proposed tariffs in the FINESTLAT zone, particularly due to the common tariff proposed for entries and the zero tariff for the intra-zone IPs. For this reason, the Agency considers that the application of an ITC to the FINESTLAT market zone is justified on the basis of a joint reading of Articles 10 and 11 of the NC TAR, in particular with a view to Article 10(3) of the NC TAR, which describes relevant principles for '*an effective ITC*'.
- (32) At the same time, the Agency notes that, according to Article 10(5) of the NC TAR, the establishment of an ITC requires such a mechanism to be consulted at the same time as the RPM. In addition, Article 10(3) of the NC TAR lays out several requirements that the ITC should comply with:
- The ITC should prevent detrimental effects to the revenue recovery of the TSOs.
 - The ITC should avoid cross-subsidisation between intra-system and cross-system network use.
 - The ITC should ensure that the costs included in the mechanism correspond to those of an efficient TSO.
- (33) The Agency regrets that the ITC mentioned in the Estonian consultation, which is applicable to the FINESTLAT market zone, has not been consulted nor assessed against the criteria laid out in Article 10(3) of the NC TAR¹¹. While the requirement to consult is only mentioned in Article 10 of the NC TAR, the same reasons that justify such consultations apply for Article 11 of the NC TAR (despite that Article 11 does not repeat the provisions related to the ITC). In addition, both Articles 10 and 11 fall under Chapter II of the NC TAR, on '*Reference Price Methodologies*' which is subject to transparency and consultation requirements¹².

¹¹ See footnote 3.

¹² Recital 2 of the NC TAR states that a crucial step in reaching the objectives of market integration, enhancing security of supply and promoting the interconnection between gas networks, '*is to increase the transparency of transmission tariff structures and procedures towards setting them. Therefore, it is necessary to set out the requirements for publishing the information related to the determination of the revenues of transmission system operators and to the derivation of different transmission and non-transmission tariffs. These requirements should enable network users to understand better the tariffs set for both transmission services and non-transmission services, as well as how such tariffs have changed, are set and may change*'. In addition, Recital 3 of the NC TAR states that '*the obligation to consult on the proposed reference price methodology should be laid down [serves to] achieve and ensure a reasonable level of cost reflectivity and predictability (...) of transmission tariffs*'. The Agency therefore understands that the TAR NC sets requirements to consult on all aspects related to the '*derivation of transmission tariffs*' with the aim of ensuring cost-reflectivity. Such obligations apply to the ITC, as it is a crucial element determining the cost-reflectivity of tariffs and it works in conjunction with the RPM itself.

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4.1.1.3 The Agency's analysis looks at both national and regional elements

- (34) In the absence of a complete assessment of the RPM and the ITC provided in the Estonian consultation document, the Agency provides an assessment of the methodologies used to calculate tariffs, which include the postage stamp methodology, the ITC and the tariffs set at entries and intra market zone IPs. All these elements fall under Chapter II of the NC TAR. Article 27(2) of the NC TAR requires that the Agency analyse *whether the proposed reference price methodology complies with the requirements set out in Article 7.*

4.1.2 Proposed tariff setting methodology for Estonia

- (35) The following section assesses the four main components used to set tariffs regionally and for Estonia.

4.1.2.1 Common entry tariff of 142.77 €/MWh/d/y for the FINESTLAT zone

- (36) The consultation proposes a tariff of 142.77 €/MWh/d/y to be applied at entries to the FINESTLAT zone, that is, to IPs with Russia and Lithuania. The consultation argues that the tariff is set at the proposed level to match the average EU gas transmission tariff for firm entry capacity at cross-border IPs¹³.
- (37) Once the tariff at entries is set, based on forecasted flows, it is possible to calculate the revenue to be recovered from entries. The remainder of the allowed or target revenue per TSO is allocated to exits using a tariff that is calculated using the postage stamp RPM. In the consultation document, the Estonian NRA proposes an entry-exit split of 9-91%, which corresponds to the amount of revenue forecasted to be recovered using the common entry tariff (9%), and the revenue forecasted to be recovered using the RPM (91%). The Agency notes that the calculation of this split is not explained in detail in the consultation, thus not allowing the users to reproduce the calculation of tariffs or to forecast them.
- (38) The Agency remarks the NC TAR foresees several tools to arrive to a common entry tariff, such as the adjustment of the entry-exit split, the application of benchmarking¹⁴, or the application of equalisation when applying the same RPM to different entry-exit zones jointly. In all cases, the revenue that is not allocated to entry points is allocated to exit points. Such instruments, however, require the application of the RPM to all points of the networks, and to fulfil transparency provision, to allow network users to reproduce and forecast tariffs on the basis of well-defined tariff and regulatory periods.
- (39) In the case of the FINESTLAT zone, setting a single entry tariff to the market zone is possible. However, the Agency regrets that the consultation is not compatible with the transparency requirements laid down by the NC TAR. The Agency understands that the features that were

¹³ Page 7 of the consultation document states that: *the mean yearly capacity product entry price in the European Union is 128.44 €/MWh/day in year and the standard error of this mean calculation is 14.33 €/MWh/day in year – thus, in total 142.77 €/MWh/day in year.* This information is consistent with the analysis of the Agency provided in the Market Monitoring Report 2018 (see page 45): [link](#).

¹⁴ The Agency provides guidelines for the application of benchmarking in the Agency Report on the Analysis of the Consultation Document for Slovakia ([link](#))

described in the consultation document lead to the RPM being applied only to domestic points and that tariffs at entries are set outside this RPM. The Agency recommends the NRA to review the compliance of the proposed calculation for deriving tariffs, so that the agreed entry tariff for the FINESTLAT market zone is accompanied by clear and well described steps explaining how the RPM is applied to all points and how different adjustments are applied to arrive at a common entry tariff.

4.1.2.2 Zero tariffs to the IPs within the FINESTLAT zone

- (40) With the purpose of promoting cross-border trade across the FINESTLAT zone, the tariffs at IPs within the zone are removed. While the tariff consultation refers to this measure, it does not assess its impact. The removal of tariffs at specific points implies that the revenue associated to these points is not recovered by the users of these points. This revenue will therefore be recovered from other points, potentially leading to undue cross-subsidisation between network users. The Agency provides a conclusion on these effects in the next section.

4.1.2.3 ITC mechanism

- (41) The consultation document refers to an ITC mechanism that is applied to all the revenue recovered from the common entry tariffs of 142.77 €/MWh/d/y set for the FINESTLAT zone. The details of this calculation are not included in the consultation document, although a simple excel file was submitted to the Agency by both the NRA and the TSO.
- (42) The revenue from entries is gathered and later allocated to TSOs according to two criteria.
- First, each TSO is compensated fully for its compression costs. The figures provided to the Agency by the NRA and the TSO show that for 2020 the aggregated compression costs of the TSOs is expected to represent €2.4m out of the €17.9m that are forecasted to be recovered from entries. This implies that 13.8% of the revenue recovered from entries account for compression costs.
 - Second, the remaining €15.5m representing 86.2% of the revenue collected at entries is allocated to each TSO in proportion to the share of consumption associated to its network compared to the total consumption of the FINESTLAT region.
- (43) While not explained in the consultation document nor in the clarifications received by the Agency, it seems that the revenue corresponding to the 142.77 €/MWh/d/y tariff set at entries is not calculated on the basis of costs of specific assets. As explained in the previous paragraph, a first part of this revenue is used to recover the compression costs of each TSO, while the remaining 86.2% is allocated to each TSO in proportion to its share of consumption. At last, the remainder of the costs of each TSO that are not subject to the ITC are recovered from their respective domestic exit points.
- (44) The Agency regrets that the ITC has not been consulted. As part of the consultation document, the NRA included a Memorandum of understanding dated November 2017, which does not provide the details of the ITC¹⁵. To the Agency's knowledge, there is no NRA Decision on this mechanism and

¹⁵ See footnote 3.

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it is therefore not clear whether the proposal could be appealed. The Agency recommends the NRAs participating in the market integration process to launch a consultation on the proposed ITC with the aim of providing a joint NRA Decision. Such consultation should address the following points:

- (45) First, the costs that are subject to the ITC. The current proposal applies to variable costs (13.8%) and to other unspecified costs (86.2%) without providing a justification for how such amounts have been set. The Agency understands that such figures result from setting the tariff to entry points to 142.77 €/MWh/d/y. However the TSO clarified to the Agency that an assessment had not been performed to evaluate the share of costs that should be included in the ITC. The cost benefit analysis described in Chapter 5 provides guidance for a joint assessment of transmission assets used within the regional market zone. This assessment should allow identifying the costs that should be logged into the ITC mechanism and should take into account the gas flows within the FINESLAT market zone¹⁶. The allocation of these costs should be distributed to the beneficiaries of the integration to ensure cost-reflectivity of the mechanism as described in the next point.
- (46) Second, the calculation to redistribute the costs that are subject to the ITC. The proposed ITC is designed in such a way that it provides compensation in cases where a TSO bears no costs¹⁷. This is because the TSOs' costs are mostly related to the cost drivers of capacity and distance, while the criteria for distributing the revenue logged into the ITC is based on the gas consumption. Both aspects, the costs drivers of capacity and distance on the one side, and domestic consumption on the other, are not necessarily correlated, and are particularly not correlated in cases where a network is used to transport gas to neighbouring networks (cross-system use of the network). The Estonian TSO clarified to the Agency that no assessment had been carried out of the situations where the ITC lead to compensating TSOs in the cases where they bear no costs. The Agency recommends that the redistribution of the revenues that are subject to the ITC is assessed against Article 10(3)(a) of the NC TAR and is in line with Chapter 5. Such an assessment should provide clarity on the potential cross-subsidisation resulting from the ITC.
- (47) Third, the joint consultation should aim at the harmonisation of the tariff and regulatory periods and should touch upon the regulatory accounts of the TSOs involved to ensure that that reconciliations are performed under similar conditions across TSOs.

¹⁶ The NRA provided the Agency with a scenario of forecasted flows in the FINESLAT market zone. This scenario shows that there are 2 TWh flowing from Lithuania to Finland and that Finland flows 5 TWh to the Latvian storage and back to Finland. These flows imply that the Latvian and Estonian networks are being used to transport gas to Finland, however the ITC foresees no compensation for such flows. This example shows that there are costs associated to the flows in the FINESLAT market zone that don't receive a compensation. Both the Estonian NRA and TSO clarified that this aspect had neither been discussed, nor assessed when designing the ITC mechanism as it would have complicated the negotiations between the different parties.

¹⁷ The Agency provides the following examples of cases:

- Should the Latvian exit to and entry from storage be discounted, it is not clear whether such discount is born only by Latvian users or by users of the FINESLAT market zone. In the former case, Latvian users would cross-subsidise neighbouring users if these were to use the Latvian storage.
- Should users of the Russian system access the Latvian storage, the Finish TSO could receive a compensation even if not bearing any costs for the service.
- Should users in the Lithuanian network access the Latvian storage, the Finish and Estonian TSOs would receive some compensation even if not bearing any costs for the service.

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4.1.2.4 Proposed postage stamp RPM

- (48) Following the market integration set up, the NRA proposes to apply a postage stamp methodology. This RPM is applied only to domestic exits and allocates the revenue that is not allocated to entry points. In the case of Estonia this amounts to 91% of the TSO revenue. Since entry tariffs are set outside the RPM and tariffs at intra-zone IPs are removed, there is no other option but to apply the postage stamp methodology, as the relevant revenue is allocated to a single tariff applicable to domestic exits¹⁸. The Agency observes several shortcomings in the consultation that are related to the RPM and, consequently, to the broader market integration scheme.
- (49) First, the NRA's assessment of the proposed methodology against Article 7 of the NC TAR and Article 13 of Regulation (EC) 715/2009 is insufficient as it is limited to a single sentence per requirement, stating compliance without providing any supporting evidence.
- (50) Second, it is not clear whether the proposed tariffs for domestic points is a capacity or a commodity tariff. In the consultation document there is no capacity forecast that is used as an input to the RPM for domestic exit point¹⁹. At the same time, the calculation provided²⁰ shows that domestic consumption (and not the forecasted contracted capacity) is used to derive the domestic exit tariff. This amounts to domestic tariffs being calculated on the basis of a commodity forecast. The Agency recommends the NRA to clarify in its Decision, whether the tariff for domestic exits is capacity or commodity based²¹, and to provide clarity on the calculation used, including any conversion factors that could be used (e.g. to convert capacity and commodity terms as an input to the RPM). The NRA should also strive to commit to a deadline by which a basic capacity regime is introduced.
- (51) Third, the consultation is missing the CAA. Article 5(c) of the NC TAR provides the formula to calculate the capacity cost allocation comparison index. This ratio is not included in the consultation document. Instead, the NRA provides the intra-system/cross-system revenue split, which is only an intermediate step for the cost allocation assessment. The final ratio, the capacity cost allocation comparison index, is not provided in the consultation document. Upon repeated requests by the Agency, the NRA responded that the CAA was indeed calculated, yet the CAA was not provided in the consultation document as its calculation was uncertain²². The information provided both in the consultation document and bilaterally is non-compliant with Article 26(1)(a)(iv) of the NC TAR. The instrument is designed to quantify the degree of possible cross-subsidisation between the cross-system and intra-system use of the network. In the case of Estonia, this would allow assessing the impact of setting zero tariffs to IPs within the FINESTLAT zone, as the revenues to be recovered at these points should be recovered elsewhere, like at domestic points and/or via the ITC. In the

¹⁸ Such conclusion is achieved assuming that there is a policy objective of having an equalised tariff for domestic exits. Should this not be a requirement of the methodology, tariffs for domestic points could be differentiated according to cost drivers, for example by using a CWD methodology.

¹⁹ See page 3 of the consultation document.

²⁰ See page 6 of the consultation document.

²¹ The TAR NC prescribes that transmission revenue *should be recovered by capacity-based transmission tariffs* (Article 4(3)) and that as an exception *a part of the transmission services revenue may be recovered only by the commodity-based transmission tariffs* (Article 4(3)). Pursuant to Article 3(a), the complementary revenue recovery charge *shall be levied for the purpose of covering the costs mainly driven by the quantity of the gas flow*. The Agency remarks that these costs cannot amount to 91% of the TSO costs which are allocated to domestic points.

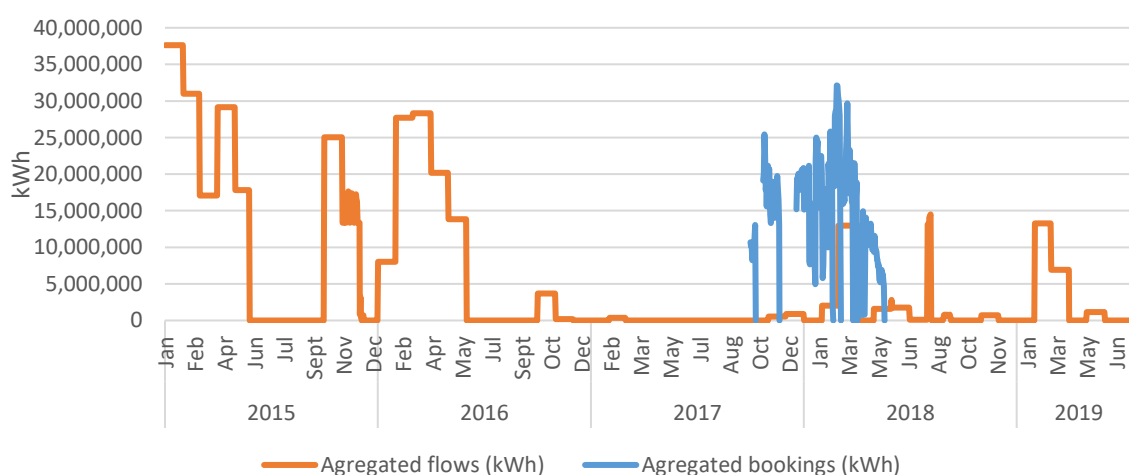
²² See footnote 8.

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absence of such an instrument, neither the RPM, nor the ITC can be assessed against the requirements of Article 7 of the NC TAR.

- (52) Fourth, the comparison with the CWD methodology provided in the consultation document does not allow deriving any conclusions about the impact of distance as a cost driver, as the methodology is based on a gross simplification of the network – by removing three intra-zone IPs and grouping three IPs with Russia. The calculation results in two identical tariffs of 2.01€/MWh for entries and 2.01€/MWh for domestic exits. The Agency understands the concerns raised by the TSO in a trilateral discussion with the NRA indicating that the capacity forecast to be used in the CWD methodology could be difficult to calculate and later to compare to flows resulting from the zero tariff applicable to points within the FINESTLAT region. Nevertheless, the Agency considers that the calculation of the CWD methodology could offer possible scenarios that render the comparison with the proposed tariffs meaningful. The Agency however considers that the calculation provided in the consultation document does not serve the purpose of providing a counterfactual to the proposed tariffs, as laid out in Recital 3 of the NC TAR.
- (53) Fifth, the consultation document does not mention the tariff to be set at the exit point to Russia. The NRA clarified to the Agency that this point is currently not being used and that for this reason the tariff at this point is not relevant. At the same time, the NRA explained that a tariff could be set at this point to match the tariff set to entries (142,77 €/MWh/d/y), while not clarifying if the potential revenue from such a point would be subject to the ITC²³. The Agency notes that, contrary to the explanations provided by the NRA, the ENTSOG TP shows both flows and bookings at this point. This can be observed in Figure 1 below. The information provided in the consultation document suggests that an asset split is performed to set the tariff at this point. The Agency cannot confirm this point. Following this information exchange, and based on the missing information in the consultation, the Agency concludes that the tariff to the exit point with Russia should be set following the NC TAR, in particular, that the same RPM shall be applied to all point of the network, as laid out in Article 6(3) of the NC TAR.

Figure 1: Aggregated bookings and flows at exit points from Estonia to Russia, 2015-2019. Source: ENTSOG TP.



²³ The MoU for the FINESTLAT market integration signed between the Baltic TSOs states on page 4 that 'Latvian and Estonian NRAs should agree on tariffs setting methodology for Misso exit point'. The Agency remarks that such approach could be incompatible with the NC TAR if the tariff is set outside the RPM.

4.1.3 Compliance with the requirements set out in Article 7

- (54) In the absence of the information required for the consultation and based on the partial information received on the ITC, the analysis on the compliance of the proposed tariffs with Article 7 of the NC TAR could not be completed for the requirements on cost reflectivity, non-discrimination, cross-subsidisation and cross-border trade. The analysis shows that the proposed methodology for setting tariffs is incompliant with the transparency requirements.

4.1.3.1 Transparency

- (55) **Article 7(a)** of the NC TAR requires that the RPM aim at ensuring that network users can reproduce the calculation of reference prices and their accurate forecast. In the context of the Estonian consultation, the tariffs are determined by the postage stamp methodology and by the additional market integration setting, including the ITC. The absence of clarity regarding the links between these elements results in the incompliance with the transparency requirements. The Agency finds the simplified tariff model has not been published as required by Article 30(2)(b) of the NC TAR. As a result, network users are not able to reproduce the calculation of reference prices. The Agency further considers that network users would not be able to forecast the reference prices. This conclusion is based on the following points.
- (56) First, the duration of the regulatory and tariff periods is not clearly explained in the consultation document²⁴. The information provided is inconsistent and therefore creates uncertainty regarding the validity and the calculation of tariffs. This aspect becomes even more relevant in the context of the FINESTLAT integration as this missing information is likely to impact the calculation of tariffs applicable in other networks. The Agency recommends the NRA to define in its motivated decision the duration for the regulatory and tariff period, or at least, the conditions that would lead to a change.
- (57) Second, the consultation document refers to special conditions that would trigger a change in the proposed tariffs. These conditions are not listed in the consultation document. The NRA clarified to the Agency that such change in tariffs would consist of a period of up to two-months during which the NRA replaces the existing tariffs with the purpose of correcting any deviation in the tariff levels. Such option is not compliant with the NC TAR, which foresees a regulatory account for the purpose of reconciling revenues. The Agency recommends the NRA to assess in its motivated decision the compliance of such mechanisms with the NC TAR.
- (58) Third, the consultation document does not provide a simplified tariff model as required by Article 30(2)(b) of the NC TAR. In a bilateral exchange, the NRA clarified that the consultation document already provides a formula to calculate tariffs, and that the tariff at entries is fixed; for this reason, a further model would not be required. In the view of the Agency, the tariff formula can be

²⁴ Page 5-6 of the consultation states that the tariffs have to be effective for at least one year and that the maximum regulatory period is five years.

Page 11 of the consultation states that the proposed tariffs are in force from 1.1.2020 to 30.9.2020

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challenged²⁵. In addition, the consultation document does not provide key explanations, such as the calculation of the revenue split between entries and exits (which in this case corresponds to the split between the RPM and the ITC). In the absence of such a calculation, it is not possible to forecast the revenue that will be used as an input to the RPM. The Agency recommends the NRA to include in its motivated decision a tariff model allowing to calculate tariffs. Such model should include the required steps related to the ITC and to the split of revenues between entries and exits.

- (59) Fourth, the NRA proposes to derive the forecasted capacity input to the RPM from the annual consumption, which is estimated at 5.3 TWh. Based on this figure, the NRA forecasts the booked capacity at entries following the formula $5.3 \cdot 1000 / 366 = 14.48$ GWh/day/year. The Agency notes that this value refers to a yearly commodity value that is translated into capacity by dividing it by the number of days in a year. The value does therefore not refer to the contractual reality of the network and does not reflect actual capacity bookings at domestic exits. The NRA does not provide an explanation of how this conversion is calculated, nor any explanation of how the capacity is booked at domestic exits. The Agency recommends the NRA to clarify in its motivated decision the contracted capacity input used to derive tariffs and the conversion factors that are used for this purpose. The fact that domestic tariffs, accounting for 91% of the recovered revenues, can be based on commodity raises concerns because domestic exit capacities used to supply end consumers might not be clearly metered. This would inhibit the proper implementation of the entry-exit model for in the Estonian network, together with the implementation of the NC CAM and NC BAL.
- (60) Fifth, the NRA does not provide sufficient information on the target revenue that is an input to set tariffs. Article 26(1)(a)(i) of the NC TAR requires that the consultation include the information and justification on the parameters that are an input to the RPM. The consultation document refers to an increase of 60% for tariffs applicable by 2020²⁶. The increase is a result of changes in the capital and operating costs of the TSO in relation to the Baltic interconnector and costs related to the strengthening of the Estonia-Latvia connection. The Agency notes that these amounts have been preceded by increases in the target revenue of the TSO amounting to 141%, from €9.6m in 2017 to €23.23m in 2020. It is unclear in the consultation document how the increase in the target revenue of the TSO is translated into tariffs, and what the periodicity of this update is, as the NRA provides no information on the duration of the regulatory and tariff periods. In addition, the consultation document suggests that the tariff and regulatory periods can be modified upon the request of the TSO and it is not clear how this relates to the possible under- or over- recovery by the TSO nor to the risk and the target revenue of the TSO. The Agency recommends the NRA to

²⁵ The formula provided for calculating the tariffs provided in the consultation is:

$$T_{exit} = \frac{R_S}{CAP_{exit}^{intra}} - T_{entry}$$

| | |
|----------------------|--|
| T_{exit} | exit price applied to the user (agreed upon by the Finnish, Estonian and Latvian system operators) |
| R_S | forecasted target revenue of the system operator; |
| CAP_{exit}^{intra} | forecasted network use capacity; |
| T_{entry} | entry price applied to the supplier (uniform entry price in Finland, Estonia and Latvia). |

This formula seems to hold only in the case where booked capacity is the same at entries and at exits. Such assumption does not hold in many EU networks. In addition, it is not clear how this formula takes into account the ITC, the proposed benchmark tariff set at entries and the tariff set to the exit point to Russia.

²⁶ See page 10 of the consultation document.

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clarify these aspects in the motivated decision following the requirement Article 26(1)(a)(i) of the NC TAR and the requirement of Article 7 of the NC TAR, requiring the RPM to allow network users to calculate and forecast tariffs.

- (61) Sixth, the consultation document does not provide a comparison with the prevailing tariffs nor a comparison with the remaining tariff periods of the regulatory period. The Agency recommends the NRA to include this information in its motivated decision. This is a requirement pursuant to Article 30(2)(a) of the NC TAR. Such information requires a clarification on the duration of the regulatory and tariff periods, as referred to in paragraph (56) above.

4.1.3.2 Cost-reflectivity

- (62) **Article 7(b)** of the NC TAR requires the RPM to take into account the actual costs incurred for the provision of transmission services, considering the level of complexity of the transmission network.
- (63) Due to the partial information made available on the ITC, and the limited assessment of the proposed postage stamp methodology, the Agency cannot complete its assessment on the compliance of the proposed tariffs with the principle of cost-reflectivity. For this reason, the Agency cannot conclude that the proposed tariffs are compliant with the NC TAR. At the same time, the Agency observes that, following the remarks made in the sections above, there are elements of the proposed tariffs that question its compliance with the requirement of cost-reflectivity. The Agency looks forward to completing this analysis once the full ITC mechanism is consulted by the NRAs involved in the FINESLAT market integration.

4.1.3.3 Cross-subsidisation and non-discrimination

- (64) **Article 7(c)** of the NC TAR requires the RPM to ensure non-discrimination and prevent undue cross-subsidisation.
- (65) One instrument to evaluate the compliance with the principle of cross-subsidisation is the cost allocation assessment (CAA, Article 5 of the NC TAR). The result for the capacity cost allocation comparison index is neither provided in the consultation document, nor was it made available to the Agency by the NRA following repeated requests²⁷.
- (66) Based on the argument provided by the Agency on cost-reflectivity in paragraph (63) above, the Agency cannot complete its assessment on the compliance of the proposed tariffs with the principle of cross-subsidisation.
- (67) Regarding the principle of non-discrimination, the Agency cannot conclude that the proposed tariffs are compliant with this requirement, and based on the information currently available to the Agency it seems incompliant. This is the result of the NRA not providing a tariff for the exit to Russia, as discussed in paragraph (53) above.

²⁷ See footnote 8 of this document.

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4.1.3.4 Volume risk

- (68) **Article 7(d)** of the NC TAR requires that the RPM ensure that significant volume risk related particularly to transports across an entry-exit system is not assigned to final customers within that entry-exit system.
- (69) The Agency could not conclude on the compliance with the requirement related to volume risk as an assessment of the magnitude of cross-border flows has not been made part of the consultation.

4.1.3.5 Cross-border trade

- (70) **Article 7(e)** of the NC TAR requires that the RPM ensures that the resulting reference prices do not distort cross-border trade.
- (71) Based on the argument provided by the Agency on cost-reflectivity in paragraph (63) above, the Agency cannot complete its assessment on the compliance of the proposed tariffs with the principle related to cross-border trade.

4.2 Are the criteria for setting commodity-based transmission tariffs as set out in Article 4(3) met?

- (72) Article 27(2)(b)(2) of the NC TAR requires the Agency to analyse whether the criteria for setting commodity-based transmission tariffs as set out in Article 4(3) are met.
- (73) The use of commodity-based transmission tariffs is an exception. Only part of the transmission services revenue may be recovered by commodity-based transmission tariffs. Estonia proposes not to apply commodity-based transmission tariffs. The Agency nevertheless remarks its concern about the proposed tariffs for the Estonian network being commodity-based as described in this Report.

4.3 Are the criteria for setting non-transmission tariffs as set out in Article 4(4) met?

- (74) Article 27(2)(b)(3) of the NC TAR requires the Agency to analyse whether the criteria for setting non-transmission tariffs as set out in Article 4(4) are met.
- (75) In the consultation document it is proposed not to make use of non-transmission tariffs.

5. Other comments: the regional ITC

- (76) The Agency acknowledges that an ITC agreement is necessary to enable the FINESTLAT member countries to make progress towards a truly integrated regional gas market, especially if greater focus is put on keeping stable and predictable revenues, while implementing zero tariffs between their respective networks. It also acknowledges that developing a regional ITC is a complex task.
- (77) As explained in its Report on the Lithuanian transmission tariff, the Agency considers that the current ITC mechanism is not sufficient to prevent cross-subsidies on the long run, as it is not based on an assessment of the costs that are used by cross-border users. Therefore, the current design

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can only be transitory towards a more established ITC setting. In this context, the Agency would consider it meaningful the following steps for creating a sustainable ITC mechanism in the future:

- (78) First, the transmission assets jointly used within the regional market zone and their associated costs should be identified to ensure an acceptable level of cost-reflectivity at a regional level. Such an assessment should be based on a forecast of the flows across the FINESLAT market zone, and these costs should be logged into the ITC mechanism.
- (79) Second, the ITC mechanism should ideally aim at allocating these costs in a manner that is in line with the distribution of the benefits of the market integration. In this way, the ITC mechanism would be sustainable as it could be used both for existing costs and for new investments. In addition, the cost-reflectivity principle promoted by the NC TAR would be safeguarded, since this kind of mechanism would allow to allocate efficient costs (and exclude sunk costs of over-dimensioned infrastructures) to their beneficiaries.
- (80) The last step in this process would be to adjust the domestic exits of each TSOs within the regional market, to allow them to recover their allowed or target revenue from domestic users after the contribution of cross-border users to the ITC mechanism has been established.

Annex 1: Legal framework

Article 27 of the NC TAR reads:

1. *Upon launching the final consultation pursuant to Article 26 prior to the decision referred to in Article 27(4), the national regulatory authority or the transmission system operator(s), as decided by the national regulatory authority, shall forward the consultation documents to the Agency.*

2. *The Agency shall analyse the following aspects of the consultation document:*

(a) whether all the information referred to in Article 26(1) has been published;

(b) whether the elements consulted on in accordance with Article 26 comply with the following requirements:

(1) whether the proposed reference price methodology complies with the requirements set out in Article 7;

(2) whether the criteria for setting commodity-based transmission tariffs as set out in Article 4(3) are met;

(3) whether the criteria for setting non-transmission tariffs as set out in Article 4(4) are met.

3. *Within two months following the end of the consultation referred to in paragraph 1, the Agency shall publish and send to the national regulatory authority or transmission system operator, depending on which entity published the consultation document, and the Commission the conclusion of its analysis in accordance with paragraph 2 in English.*

The Agency shall preserve the confidentiality of any commercially sensitive information.

4. *Within five months following the end of the final consultation, the national regulatory authority, acting in accordance with Article 41(6)(a) of Directive 2009/73/EC, shall take and publish a motivated decision on all items set out in Article 26(1). Upon publication, the national regulatory authority shall send to the Agency and the Commission its decision.*

5. *The procedure consisting of the final consultation on the reference price methodology in accordance with Article 26, the decision by the national regulatory authority in accordance with paragraph 4, the calculation of tariffs on the basis of this decision, and the publication of the tariffs in accordance with Chapter VIII may be initiated as from the entry into force of this Regulation and shall be concluded no later than 31 May 2019. The requirements set out in Chapters II, III and IV shall be taken into account in this procedure. The tariffs applicable for the prevailing tariff period at 31 May 2019 will be applicable until the end thereof. This procedure shall be repeated at least every five years starting from 31 May 2019.*

Article 26(1) of the NC TAR reads:

1. *One or more consultations shall be carried out by the national regulatory authority or the transmission system operator(s), as decided by the national regulatory authority. To the extent possible and in order to render more effective the consultation process, the consultation document should be published in the English language. The final consultation prior to the decision referred to in Article 27(4) shall comply with the requirements set out in this Article and Article 27, and shall include the following information:*

(a) the description of the proposed reference price methodology as well as the following items:

(i) the indicative information set out in Article 30(1)(a), including:

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- (1) *the justification of the parameters used that are related to the technical characteristics of the system;*
 - (2) *the corresponding information on the respective values of such parameters and the assumptions applied.*
- (ii) *the value of the proposed adjustments for capacity-based transmission tariffs pursuant to Article 9;*
- (iii) *the indicative reference prices subject to consultation;*
- (iv) *the results, the components and the details of these components for the cost allocation assessments set out in Article 5;*
- (v) *the assessment of the proposed reference price methodology in accordance with Article 7;*
- (vi) *where the proposed reference price methodology is other than the capacity weighted distance reference price methodology detailed in Article 8, its comparison against the latter accompanied by the information set out in point (iii);*
- (b) *the indicative information set out in Article 30(1)(b)(i), (iv), (v);*
- (c) *the following information on transmission and non-transmission tariffs:*
 - (i) *where commodity-based transmission tariffs referred to in Article 4(3) are proposed:*
 - (1) *the manner in which they are set;*
 - (2) *the share of the allowed or target revenue forecasted to be recovered from such tariffs;*
 - (3) *the indicative commodity-based transmission tariffs;*
 - (ii) *where non-transmission services provided to network users are proposed:*
 - (1) *the non-transmission service tariff methodology therefor;*
 - (2) *the share of the allowed or target revenue forecasted to be recovered from such tariffs;*
 - (3) *the manner in which the associated non-transmission services revenue is reconciled as referred to in Article 17(3);*
 - (4) *the indicative non-transmission tariffs for non-transmission services provided to network users;*
- (d) *the indicative information set out in Article 30(2);*
- (e) *where the fixed payable price approach referred to in Article 24(b) is considered to be offered under a price cap regime for existing capacity:*
 - (i) *the proposed index;*
 - (ii) *the proposed calculation and how the revenue derived from the risk premium is used;*
 - (iii) *at which interconnection point(s) and for which tariff period(s) such approach is proposed;*
 - (iv) *the process of offering capacity at an interconnection point where both fixed and floating payable price approaches referred to in Article 24 are proposed.*

Article 7 of the NC TAR reads:

The reference price methodology shall comply with Article 13 of Regulation (EC) No 715/2009 and with the following requirements. It shall aim at:

- a) *enabling network users to reproduce the calculation of reference prices and their accurate forecast;*
- (b) *taking into account the actual costs incurred for the provision of transmission services considering the level of complexity of the transmission network;*
- (c) *ensuring non-discrimination and prevent undue cross-subsidisation including by taking into account the cost allocation assessments set out in Article 5;*

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- (d) ensuring that significant volume risk related particularly to transports across an entry-exit system is not assigned to final customers within that entry-exit system;*
- (e) ensuring that the resulting reference prices do not distort cross-border trade.*

Article 13 of Regulation (EC) No 715/2009 reads:

1. Tariffs, or the methodologies used to calculate them, applied by the transmission system operators and approved by the regulatory authorities pursuant to Article 41(6) of Directive 2009/73/EC, as well as tariffs published pursuant to Article 32(1) of that Directive, shall be transparent, take into account the need for system integrity and its improvement and reflect the actual costs incurred, insofar as such costs correspond to those of an efficient and structurally comparable network operator and are transparent, whilst including an appropriate return on investments, and, where appropriate, taking account of the benchmarking of tariffs by the regulatory authorities. Tariffs, or the methodologies used to calculate them, shall be applied in a nondiscriminatory manner.

Member States may decide that tariffs may also be determined through market-based arrangements, such as auctions, provided that such arrangements and the revenues arising therefrom are approved by the regulatory authority.

Tariffs, or the methodologies used to calculate them, shall facilitate efficient gas trade and competition, while at the same time avoiding cross-subsidies between network users and providing incentives for investment and maintaining or creating interoperability for transmission networks.

Tariffs for network users shall be non-discriminatory and set separately for every entry point into or exit point out of the transmission system. Cost-allocation mechanisms and rate setting methodology regarding entry points and exit points shall be approved by the national regulatory authorities. By 3 September 2011, the Member States shall ensure that, after a transitional period, network charges shall not be calculated on the basis of contract paths.

2. Tariffs for network access shall neither restrict market liquidity nor distort trade across borders of different transmission systems. Where differences in tariff structures or balancing mechanisms would hamper trade across transmission systems, and notwithstanding Article 41(6) of Directive 2009/73/EC, transmission system operators shall, in close cooperation with the relevant national authorities, actively pursue convergence of tariff structures and charging principles, including in relation to balancing.

Article 4(3) of the NC TAR reads:

3. The transmission services revenue shall be recovered by capacity-based transmission tariffs. As an exception, subject to the approval of the national regulatory authority, a part of the transmission services revenue may be recovered only by the following commodity-based transmission tariffs which are set separately from each other:

(a) a flow-based charge, which shall comply with all of the following criteria:

- (i) levied for the purpose of covering the costs mainly driven by the quantity of the gas flow;*
- (ii) calculated on the basis of forecasted or historical flows, or both, and set in such a way that it is the same at all entry points and the same at all exit points;*
- (iii) expressed in monetary terms or in kind.*

(b) a complementary revenue recovery charge, which shall comply with all of the following criteria:

- (i) levied for the purpose of managing revenue under- and over-recovery;*
- (ii) calculated on the basis of forecasted or historical capacity allocations and flows, or both;*

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(iii) applied at points other than interconnection points;

(iv) applied after the national regulatory authority has made an assessment of its cost-reflectivity and its impact on cross-subsidisation between interconnection points and points other than interconnection points.

Article 4(4) of the NC TAR reads:

4. The non-transmission services revenue shall be recovered by non-transmission tariffs applicable for a given nontransmission service. Such tariffs shall be as follows:

(a) cost-reflective, non-discriminatory, objective and transparent;

(b) charged to the beneficiaries of a given non-transmission service with the aim of minimising cross-subsidisation between network users within or outside a Member State, or both.

Where according to the national regulatory authority a given non-transmission service benefits all network users, the costs for such service shall be recovered from all network users.

Annex 2: List of abbreviations

| Acronym | Definition |
|-----------------|---|
| ACER | Agency for the Cooperation of Energy Regulators |
| CAA | Cost Allocation Assessment |
| CAPEX | Capital Expenditures |
| CBCA | |
| CWD | Capacity Weighted Distance |
| EC | European Commission |
| ENTSOG | European Network of Transmission System Operators for Gas |
| EU | European Union |
| FINESLAT | Market integration zone involving Finland, Estonia and Latvia. |
| IP | Interconnection Point |
| MS | Member State |
| NC BAL | Commission Regulation (EU) No 312/2014 of 26 March 2014 establishing a network code on gas balancing of transmission networks |
| NC CAM | Commission Regulation (EU) 2017/459 of 16 March 2017 establishing a network code on capacity allocation mechanisms in gas transmission networks |
| NC TAR | Commission Regulation (EU) 2017/460 of 16 March 2017 establishing a network code on harmonised transmission tariff structures for gas transmission networks |
| NRA | National Regulatory Authority |
| OPEX | Operational Expenditures |
| RAB | Regulated Asset Base |
| RPM | Reference Price Methodology |
| TSO | Transmission System Operator |
| VIP | Virtual Interconnection Point |



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