

# ACER Draft Framework Guidelines on rules regarding harmonised transmission tariff structures for gas

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A EURELECTRIC Response paper



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# EURELECTRIC Response to ACER Draft Framework Guidelines on rules regarding harmonised transmission tariff structures for gas

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## **EURELECTRIC Response to ACER Draft Framework Guidelines on rules regarding harmonised transmission tariff structures for gas**

### **Opening Remarks**

We welcome the opportunity to respond to this consultation. Setting transmission tariffs is a complicated issue, and is heavily inter-linked with the regulatory and price control regimes that apply in Member States and on the characteristics and gas flows of each transmission system. As these factors vary significantly across the EU, the degree of harmonisation that can be achieved may perhaps be limited by comparison with some of the other Network Codes that are envisaged, and the commercial implications on incumbent network users is likely to be greater. To this extent, the possibility of commercial disruption and distortion to network users' business operations vis-à-vis the status quo is likely to be greater in relation to the Tariff Network Code (TNC) than for any other Network Code. ACER should be mindful of this when publishing the final Tariff Framework Guidelines (TFG).

The degree of harmonisation should be limited to that necessary to avoid any detrimental effects on cross-border trade and any undue discrimination between network users, in both cases taking account of the need to preserve supply security. So these principles should be the primary objectives against which tariffs are assessed. It will not always be easy assessing tariffs against these primary objectives as there will invariably be elements of trade-off between them. To this extent, secondary objectives will also be necessary to provide a wider perspective on any trade-off.

Not surprisingly, network users may be unwilling to express a firm preference for policy options included in the TFG whilst not being able to assess how these will affect the tariffs that currently apply in the markets in which they operate. Clearly this is very difficult to do ex-ante and despite the Brattle Group's best efforts at calculating the cost benefits associated with the TFG policy choices, this can, at best, only be seen as a "ballpark" estimate based on some pre-defined assumptions. Brattle's analysis is, understandably, also restricted to the possible EU wide benefits of the TFG policy options and does not provide any estimate about how national markets will be impacted.

Therefore, our responses to the many questions raised in the consultation are largely subjective and lack the "detailed quantitative evidence tables and examples" ACER is seeking. We make no apology for this because, as a European trade association, it is not our role to analyse and understand the detailed tariff arrangements which apply in individual Member States, or assess the extent to which these achieve differing national objectives. Clearly our members may become aware of problems which arise from tariff setting in their national markets<sup>1</sup>, and have opinions on how proposals in the TFG would impact their national markets. These have helped to inform our responses to the

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<sup>1</sup> Although in many cases tariff setting is very opaque and so it is not always clear to our members how tariffs have been derived or what regulatory, or in some cases political, objectives they have been assessed against.

questions, but without actually applying the proposed policy options it is not possible to provide objective evidence about why these should, or should not, be applied.

That said, Brattle's analysis of the problems associated with tariff setting and the interaction between the possible policy options appears to be very thorough. To this extent, we would not expect there to be many other issues or problems arising from tariff setting which have not been highlighted in Brattle's report, at least as far as cross-border trade is concerned.

**1. General provisions. Scope, application, definitions and implementation (Chapter 1 of the draft Framework Guideline)**

**1.1. Please explain whether any of aspects of the application of the draft FG (NC) to existing contracts would cause disproportionate effects on gas business in relation to 3<sup>rd</sup> Package objectives? Please explain if any further definitions should be added for clarity of the FG (NC)?**

We do not understand how the TFG can be applied to all existing contracts unless their terms provide for change, which some may not. Also, national and/or cross-border tariffs may have fixed levels or structures<sup>2</sup> for a defined regulatory period extending well beyond the 1 year implementation envisaged. It is not clear how the TFG/TNG policy options would impact these.

Applying new policy options to existing contracts, to the extent this is possible, could have distortionary effects and could retrospectively undermine the business strategy or commercial position of network users who in, good faith, acquired capacity under preceding tariff arrangements. ACER should consider this carefully and allow for the possibility within the TFG of network users being able to relinquish existing capacity if they have been materially disadvantaged<sup>3</sup> by changes in the TNC. With this in mind, we think the 12 month lead time for implementing the TNC is overly ambitious, even without consideration of any TSO invoicing system changes that may be necessary. ACER should also consider allowing NRAs discretion, subject to ACER approval, not to require TSOs to apply any new tariffs resulting from the requirement to implement the TNC within a regulatory period in cases where the current regulatory period only has a short time left to run or if such tariffs risk creating significant distortions.

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<sup>2</sup> For example, capacity only charges, commodity charges, 50/50 cost allocation, fixed prices etc

<sup>3</sup> This would need to be subject to NRA assessment and approval.

**Please explain if any further definitions should be added for clarity of the FG (NC)?**

The definitions help to provide clarity but there are a number of issues which are not clear in the TFG. These are partly referred to in our answers below. But we would also refer ACER to the list of questions we submitted during the consultation period about how aspects of the TFG apply<sup>4</sup>.

**1.2. Please suggest the top-5 *core indicators* for monitoring the future EU-wide implementation of the future tariff FG (NC)?**

A possible top five of core indicators are:

- the extent of transparency provided over tariff methodologies and assumptions, the official language of the Member State and in English;
- the extent to which network users have transparency over tariff evolution with a reasonable degree of accuracy;
- the ratio between any under/over recoveries and allowed revenues;
- the extent capacity to which capacity reserve prices have acted as a barrier to cross-border trade; and
- the number of complaints, disputes and legal challenges initiated by network users on tariff issues;

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<sup>4</sup> Email from Stephen Rose (Chair of EURELECTRIC's Gas to Power Working Group) to Erik Rahou (ACER) dated 9/10/12 – some these questions have now been answered during a teleconference with ACER on 29/10/12

## **2. Cost allocation and determination of the reference price (Chapter 2 of the draft Framework Guideline)**

### **2.1. Transparency provisions**

#### ***2.1.1 Do you agree with the level of harmonization proposed for the transparency in relation to tariffication methodologies?***

The TFG provide a high degree of transparency around tariff calculation, methodologies and assumptions and highlight the importance of stakeholder consultation, which should be as broad as possible. This is a significant improvement on arrangements which currently exist in many parts of Europe. Often, the only way network users can currently get sufficient visibility on these issues is through a legal challenge, so the TFG should help to eradicate this obvious inefficiency.

Whilst transparency on tariff calculation, methodologies and assumptions is welcome, network users should also have access to sufficient information to make a judgement about whether tariffs are efficiently incurred. TSOs may be able to demonstrate tariffs are cost reflective, but if the costs are inefficient<sup>5</sup> distortion will still occur. Cost data, price control parameters and tariff assumptions need to be clear enough to enable network users to objectively compare<sup>6</sup> TSOs' capital and operational costs with those of other TSOs, or 3<sup>rd</sup> party providers. ACER should have a role in resolving disputes about the efficiency of TSOs' costs and ultimately in benchmarking TSO efficiency.

#### ***2.1.2 Would you support additional requirement(s) to ensure "reasonable and sufficiently" detailed tariff information? For example, one could consider including a provision such as: "the transmission system operators or relevant national authorities shall provide additional information if a significant tariff fluctuation is expected on a specific or on all entry- and exit points".***

TSOs should be required to provide sufficient information and explanation when justify all tariff changes. The quality and quantity of such information should not be dependant on the magnitude of any tariff changes.

TSOs should also be required to release the tariff model used to set transmission tariffs along with the assumptions which feed into it. This should help network users to take a view on tariff evolution, although even then this will be imprecise.

Tariff calculations, justification, assumptions and methodologies should also be published in the official language of the Member State and in English.

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<sup>5</sup> By comparison with adjacent markets, for example

<sup>6</sup> For example, on a €/dia, €/km and €/compressor station basis

## 2.2. Cost allocation and reference price setting methodology, general questions

### **2.2.1 Do you agree with proposed level of harmonization for the reference price setting methodology, aiming for same methodology for all types of network users per one entry-exit zone?**

Yes. Using the same methodology and assumptions for all types of network users in an entry-exit zone avoids the likelihood of discrimination and cross subsidy. We agree that the TFG should not seek to adopt a single harmonised methodology to apply throughout Europe. Whilst this may be a long term aspiration and the ultimate consequence of greater competition and market integration, practically it is not achievable at this stage and would be unduly disproportional.

We agree that regulated/reference prices at entry and exit points should aim to recover at least fixed costs. We also agree that recovery of costs that are driven mainly by the volume of flows (such as compressor fuel) could be recovered either through capacity services or through a specific commodity charge. Clearly, recovering costs which are mainly driven by the volumes of flow through a commodity charge is the most cost reflective approach. However, allowing an element of regulatory discretion<sup>7</sup> on this issue seems sensible and NRAs should also be allowed to adopt different approaches nationally compared to cross border.<sup>8</sup>

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<sup>7</sup> Subject to NRAs either side of the border consulting on this issue and allowing for the possibility of an ACER reference

<sup>8</sup> For example, including compressor fuel costs in tariffs cross-border capacity tariffs may be an appropriate way to facilitate cross border trade as it avoids any barrier to trade that may result from applying a separate commodity charge. However, this approach may not be as appropriate when setting national entry and/or exit prices, particularly at points where load factors are unpredictable.

## 2.3. Cost allocation and the Reference price setting methodology, detailed questions

### ***2.3.1 Do you agree with proposed option for setting reference prices for entry capacity i.e. to have methodology based on major cost driver (e.g. distance) unless use of equal tariffs can be justified?***

Reference prices for entry capacity should aim to be based on major costs drivers as this will ensure they are cost reflective.

Using a long run marginal cost methodology to set tariffs is one potential way in which distance could be used as a cost driver,<sup>9</sup> but it requires assumptions to be made about gas flows at certain entry and exit points. We do not think it is appropriate to apply this methodology throughout the EU (see 2.2.1 above) and so existing historic and average cost methodologies will continue to be used for the foreseeable future. These should aim to be as cost reflective as possible. But because of the difficulties of attributing historic investment costs to specific entry/exit points an equalisation approach to setting the reference prices should still be permissible, albeit subject to the caveats included in the TFG.

Average or historic cost methodologies may be better suited to meshed networks or ones with only a small number of entry points.

### ***2.3.2 Do you agree with proposed option for setting Reference prices for exit capacity i.e. to have methodology based on major cost driver (e.g. distance) unless use of equal tariffs can be justified?***

See 2.3.1 above.

The TFG seem to restrict the possibility of equalisation just to national exit points, whereas at entry the TFG state that equalisation can be applied to both national and cross-border entry points. We fail to see why such a distinction should apply. As one of the criteria for applying equalisation is that this should not detrimentally affect cross-border trade, it is surprising that cross-border points appear to have been excluded. We think the possibility of equalisation, if it can be justified, should apply equally to entry and exit points and to national and cross border points.

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<sup>9</sup> As in the GB tariff system

**2.3.3 Do you agree with the cost allocation principle that revenue from entry points should equal 50% of revenue from all entry and exit points?**

Yes. We consider this to be a pragmatic way of attempting to ensure there is no obvious discrimination between entry and exit network users or between national and cross border flows, bearing in mind the problems of achieving accurate cost reflectivity in entry-exit systems. However, we agree that NRAs should be allowed to deviate from this split if it significantly and detrimentally affects the cost reflectiveness of resulting network tariffs, or enhances supply security,<sup>10</sup> otherwise this could significantly distort competition within and between Member States.

In countries where a 50/50 split does not currently apply, implementing it is bound to result in “winners and losers”. Where a network user’s competitive position is undermined by such a change, or it is materially disadvantaged, the TFG should allow network users to apply to the NRA to surrender existing capacity they hold. The NRA should then be required to make a determination on any such request within a reasonable period.

**2.3.4 Do you agree with application of the proposed options for setting reference prices to all entry and exit points (without any separate mechanism for the domestic points, whilst ensuring no discrimination between domestic and cross-border network usage)?**

Yes, because this avoids any obvious discrimination.

As the TFG point out, albeit via a footnote, this does not mean that the same tariff structures need necessarily apply at entry and exit points (see also 2.2.1 above) just that the same methodology and consistent modelling assumptions must be used.

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<sup>10</sup> This must be thoroughly demonstrated, consulted upon with stakeholders and subject to an ACER opinion

## **2.4. Pricing of entry- and exit capacity on the transmission network to and from gas storage facilities (see also questions under '9' Locational signals)**

### ***2.4.1 Do you agree with proposed option to base tariffs for entry and exit capacity on the transmission network to and from gas storage facilities at an adequate discount to other entry and exit points on the TSO?***

No. We think that setting entry and/or exit tariffs to/from storage facilities at a discount (e.g. as a percentage discount to the standard reference price) is not cost reflective and may result in distortions.

Whilst it is true that many Member States discount entry/exit tariffs from/to storage facilities, this is as a result of the economic model or methodology, for example because storage is close to consumption or because the costs to TSOs of moving gas in and out of the grid at storage facilities is low.

Whether storage facilities provide benefits to a system and, if so, what an "adequate" discount should be, are matters for national determination. If their benefit were to be assessed on the basis of the avoided cost of pipeline investment, it would be equally appropriate to assess the benefits other entry points (such as LNG) and exit points (such as power stations). A long run marginal cost methodology seeks to do just this and so could represent an equitable basis for determining "adequate" discounts for all entry and exit points.

The original investment in existing storage facilities, and the pipeline sections they are connected to, may have already depreciated significantly, which may undermine the argument for them receiving a discount. Also, the TFG make a distinction between exempted storage facilities in terms of whether an "adequate" discount can be applied, which seems perverse if this discount is supposed to be cost reflective.

### ***2.4.2 Do you agree with harmonization of such a discount across all storage points in the EU?***

No. Storage facilities have different characteristics and purposes (e.g. seasonal, fast churn, system support) and so will provide different levels of benefit, if any, to the system. Requiring the TNC to provide reasoning why storage facilities may be priced at an "adequate" discount along with a methodology for determining this will be very difficult bearing in mind the different methodologies used to set tariff levels and regulatory regimes across Europe at this time. In our opinion this would be a disproportional step and one which would be better addressed at national level, possibly with guidance for ACER in the form of a Guideline of Good Practice.

### ***2.4.3 If you prefer harmonization for an 'adequate' discount, which level of such a discount applied to firm capacity level do you advocate?***

We do not prefer harmonisation of an “adequate” discount.

***2.4.4 What are your views on harmonization of tariff measures, leading to harmonization of transmission tariff levels across all storage points in the EU (instead of harmonizing a discount across all storage points in the EU)?***

We do not fully understand the question. In our view it is not possible to have harmonised transmission tariff levels across all storage points in the EU without seriously compromising the principle of cost reflectivity. We would discourage any measures which seek to specifically achieve this objective.

### **3. Revenue recovery (Chapter 3 of the draft Framework Guideline)**

#### **3.1. General – interdependency questions.**

***3.1.1 Do you agree that the current draft FG proposals on Reserve prices for short term products, on revenue recovery and on payable price are consistent together?***

Clearly ACER has considered the inter-relationship between short term reserve prices, under/over recovery and payable price. However, we are reluctant to agree that these are consistent as this may be interpreted as our agreeing to all the policy options ACER have proposed in these areas, which we don't.

***3.1.2 Are the current draft FG proposals on Reserve prices for short term products, on revenue recovery and on payable price properly addressing the ambition for the pricing of transmission capacity to strike the right balance between facilitating short-term gas trading on one hand and providing long-term signals for covering costs and promoting efficient investments on the other?***

No. A better balance between facilitating short term gas trading, providing long term signals for covering costs and promoting efficient investment would be to:

- introduce a clear and simple rule whereby the reserve price for short term bundled products is the same as for long term annual products, recognising the fact that the fixed costs of existing capacity are the same regardless of the duration of the capacity booked;
- ensuring that the bid price steps used in the multi-round ascending clock mechanism for long term capacity auctions correlate to the efficient investment costs of the TSO in making stepped quantities of incremental capacity available, so as to allow these network users to signal demand for incremental capacity in these auctions; and
- making the payable prices arising from long term capacity auctions fixed, or at least subject to a pre-defined escalator, so as to allow network users the option of hedging their exposure to bundled capacity price risk and to provide greater price certainty to network users and TSOs about any long term booking commitments necessary to underpin incremental investment.

## 3.2. Regulatory account

### ***3.2.1 Do you agree with the principle to set reference prices to minimise the difference between allowed and collected revenues?***

Yes. This is a sound regulatory principle for regulated monopoly businesses and helps TSOs to efficiently finance their operations, particularly investments.

### ***3.2.2 Do you agree with proposed level of harmonization of using the regulatory account?***

No. The TFG seem to be suggesting there should be a single regulatory account, with all under or over recoveries being smeared equally back to all entry and exit points. We are concerned about the potential cross subsidies that could arise from this approach and think there should be a requirement in the TNC for NRAs/TSOs to at least consider how and whether under or over recoveries could be effectively targeted back to the causing network users. A single regulatory account could, for example, lead to under any recoveries caused by network users acquiring heavily discounted short term bundled capacity being reconciled back to CCGT power stations, through exit capacity charges. This would not be cost reflective but may not be unduly discriminatory. However, without any method of targeting costs between entry and exit, or between national and cross border points, if it was considered unduly discriminatory there would be no way of preventing this.

In much the same way as the Balancing Network Code envisages a separate neutrality pot being created in Balancing Zones that adopt Variant 2,<sup>11</sup> so as allow TSOs' neutrality costs to be targeted back to those national exit points whose within day profiling is managed by the TSO, we think there should, at least, be separate regulatory accounts for entry and exit. This does not mean that under or over recoveries may not ultimately be targeted back equally to entry and exit points, but does mean that more effective cost targeting becomes a possibility.

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<sup>11</sup> End of day allocation is determined based on the day ahead nominations

**3.2.3 Do you agree that NRAs should determine or approve how often and how fast the regulatory account has to be reconciled on a national level, whilst preserving balance between timely cost recovery and sudden adjustments to tariffs?**

Yes. Adopting a standard reconciliation period regardless of the size or circumstances of the under/over recovery risks creating distortions and volatility in future transmission tariffs.

**3.2.4 What is your view on including the option to use the Regulatory Account (including the potential over-recoveries from auction premium) to contribute to solving congestion? How could this be done, especially in view of principles of non-discrimination and cost-reflectivity?**

Yes, particularly where the next available incremental capacity size is significantly above the existing interconnection capacity. However, having one single Regulatory Account would mean it is not possible to target auction premiums back to the interconnection point(s) whose congestion caused the over recovery to occur.

In our response to CEER's recent consultation on "Market-based investment procedures for gas infrastructure" we suggested that where allocation of incremental capacity at existing interconnection points is integrated to the long term CAM auctions, any congestion premium over and above the reserve price will occur as a consequence of incremental investment having been triggered.<sup>12</sup> If investment is not triggered, because the congestion premium reflects a demand for capacity higher than that being made available by the TSO, this could prompt the TSO to hold an Open Season a few months later. Unfulfilled bids from the auction could then be carried forward as binding bids in the Open Season.

### **3.3. Reconciliation of Regulatory accounts**

**3.3.1 Which option for the reconciliation of regulatory accounts do you prefer?**

Our preference would be for Option 1: reconciling the Regulatory Account through ex-post adjustments to future capacity reference/reserve prices. Commodity charges do not apply in a number of EU tariff regimes currently and making changes to TSOs billing systems to introduce them, in combination with adjustments to capacity charges or as standalone charges, solely to address potential under

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<sup>12</sup> Subject to the economic test being met.

recoveries seems disproportional<sup>13</sup>. It also avoids any potential for commodity charges to become barriers to efficient cross-border trade and flows for balancing purpose, both of which will become increasingly more important with greater renewables penetration in EU electricity markets.

**3.3.2 In line with the interdependency discussion above in question 3.1, what are your views on recovering revenues by means of a separate charge set at the start of the gas year with the aim of minimising the amount that goes into the regulatory account?**

See 3.1.1 above.

Option 2 is not entirely clear as it specifies two ways to reconcile: primarily by adjusting the reserve/regulated price (like Option 1) and secondarily by introducing a separate commodity or capacity charge. It is not clear if NRA can establish different percentages to be reconciled secondarily via a capacity or commodity or whether these separate secondary charges are applied to past or future flows.

To the extent a commodity charge is deemed to be an appropriate method for reconciling under or over recoveries which generate from sales of entry and/or exit capacity, we would prefer this to be by way of Option 2, although the TNC could perhaps cap the percentage of under recovery that can be reconciled via this commodity charge each year, so as to limit the risk of any material cross-subsidy between capacity and commodity discriminating against certain classes of user<sup>14</sup>. The commodity charge should also be set ex-ante and applied to future flows rather than set ex-post and applied to historic flows.

**3.3.3 Do you agree with application of the option on reconciling regulatory account to all entry and exit points (both domestic and cross-border)?**

Yes, although see 3.2.2 above.

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<sup>13</sup> Commodity charges, at least ex ante, could not be used to deal with over recoveries as this would involve a negative charge and create perverse flow incentives.

<sup>14</sup> Network users with high load factors at entry and/or exit points are likely to be disproportionately disadvantaged by reconciling under recoveries through commodity charges.

**3.3.4 Do you agree that the regulatory account should be recovered by splitting the total under- or over- recovery across all entry and exit points in the same proportion as set out in the cost allocation methodology? For example if the cost allocation methodology is a 50:50 split then 50% of all under- or over- recovery will be from the entry points and 50% from the exit points.**

No. TSOs/NRAs should at least consider the merits of seeking to reconcile under and over recoveries as cost reflectively as possible in accordance with the “causer pays principle”. When doing so a judgement needs to be made about the practicality and proportionality of any measures necessary to achieve this objective, as strictly applying the causer pays principle may disproportionately exacerbate price increases for existing capacity holders. Also, establishing who the “causer” is may not always be straight forward, in which case, reconciling under and over recoveries back to particular types or classes of network user may cause distortions, or undue discrimination.

Just because a 50:50 split is applied as the basis for the initial cost allocation of TSOs’ allowed revenues on which entry and exit tariffs are based<sup>15</sup>, this does not mean it is an appropriate basis for assessing how under or over recoveries should be reconciled. An ex-post assessment based on the “causer pays principle” should at least be considered.

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<sup>15</sup> The TFG provide for NRAs to change this split if it significantly and detrimentally affect the cost reflectiveness of resulting network tariffs

## **4. Reserve prices (Chapter 4 of the Framework Guideline)**

### **4.1. General**

#### ***4.1.1 Do you consider it sufficient to have rules on firm, interruptible and non-physical backhaul capacity products or are you aware of other capacity products that should be addressed in the FG?***

Yes. Harmonised rules for how reserve prices are applied for all the products defined in the CAM Network Code is necessary so as to minimise distortion arising to cross-border trade from disproportionate prices applying either side of an interconnection point. That said, non-physical backhaul capacity is not specifically defined in the CAM Network Code, so could be treated the same as any other interruptible product.

The greater the extent of integration of market areas the lower risk of this occurring, as reserve prices at specific cross border interconnection points will disappear as national markets are subsumed into wider regional markets.

### **4.2. Reserve prices (firm)**

#### ***4.2.1 Do you agree with proposed level of harmonization?***

No. The proposed level of harmonisation is too complex and could lead to different multipliers applying between different adjacent markets areas for products of the same duration. The TFG could, we think, also result in different multipliers applying to the entry and exit elements of short term bundled capacity reserve prices at the same interconnection point.<sup>16</sup>

Nor is it clear how the concept of setting the short term bundled capacity reserve prices to an average multiplier of one, or less, over a year applies in practice. To the extent ACER persist with this option they should include formulae and worked examples in the TFG to aid clarity.

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<sup>16</sup> The TFG do not force NRAs to agree a common multiplier as far as we can see, although consultation between adjacent NRAs and the possibility of an ACER opinion is envisaged.

**4.2.2 Do you agree with proposed option for the Reserve price for short-term products including the possibility that the national regulatory authority may decide to allow for higher short-term prices that may apply (via multiplier higher than one, but not higher than 1.5) if there is risk of significant under-recovery of allowed revenues?**

No. Due to the complexity and problems described above we favour adopting a pragmatic approach, whereby bundled capacity reserve prices for short term products defined under the CAM Network Code are set pro-rata to the annual reference price, i.e. without any multiplier being applied.

This would be easy to apply and would, in our opinion, minimise the risk discrimination between network users booking short term capacity (of varying durations) and those booking annual capacity, as the unit price of capacity per day is the same. It would also lessen the risk of material under-recoveries arising,<sup>17</sup> particularly in the absence of congestion.

Network users can increasingly be expected to profile their capacity bookings at interconnection points going forward. This capability may, in its own right, contribute to under recovery, as capacity is built to meet peak demand and TSOs allowed revenue has typically been set to be recovered based on annual capacity booking. To the extent under recoveries materialise, or the risk of under recovery is perceived to be high, it would still be possible to address these concerns via a flat bundled capacity reserve price. This could be done by making assumptions about the magnitude and profile of bundled capacity bookings in advance, and setting a flat capacity reserve price to recover the amount of allowed revenue based on these assumptions. This avoids any potential distortions that might arise from factoring these same profiled assumptions into the reserve prices of different short term products.

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<sup>17</sup> As has been seen in the GB and German markets, where short term capacity discounts have resulted in dramatic changes in network user's capacity booking strategies away from long term annual capacity to short term day ahead capacity.

A possible exception to the application of flat bundled capacity reserve prices to short term products is within-day capacity. Here, setting the reserve price at the short run marginal price<sup>18</sup> may be appropriate as it will minimise the risk of barriers to within day trading between adjacent market areas and facilitate the efficient use cross border flows for balancing purposes. As gas fired power stations are increasingly having to run more flexibly, due to greater renewables penetration of EU electricity markets, and as this trend is expected to accelerate in the coming years, we could support this approach. We do not think it would necessarily increase the risk of under recovery, as network users are unlikely to shift their capacity booking strategies entirely over to within day capacity just because the reserve price was low<sup>19</sup>. It also may generate more revenue for TSOs, as gas may flow which otherwise would not have.

***4.2.3 Do you agree with application of the proposal on short-term Reserve prices to entry and exit points where the Network Code on CAM applies, i.e. interconnection points only?***

Yes, although to the extent auctions apply to short term capacity at any other national entry or exit points, NRAS will need to consider whether it is unduly discriminatory not to apply the same arrangements.

***4.2.4 What criteria would you propose to set the Reserve price for short-term products that will be higher than the price of an annual product, to interconnection points?***

As stated in 4.2.2, we favour a flat short term capacity reserve price and do not think multipliers higher than one should apply.

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<sup>18</sup> This is expected to be close to zero.

<sup>19</sup> The spread between the two markets areas will determine the extent to which network users are prepared to pay a premium above the reserve price.

**4.2.5 *Would you agree with using Seasonality (or other criteria, which you may suggest) of the systems as criteria to set the Reserve price for short-term products that will be higher than the price of an annual product, to interconnection points?***

We are not fully convinced of the need for, or benefits of, seasonal factors. They risk adding further complexity, particularly when applied in conjunction with short term multipliers, but could be easier to harmonise either side of the border. Seasonal factors are likely to be based on the historic flows, which may not be an accurate indicator in future. As liquidity increases in EU markets and cross-border capacity is increasingly seen as a product used to arbitrage spreads between market areas, flow will become less weather dependent and predictable.

That said, if multiplication factors are to be applied to short term bundled capacity reserve prices we would prefer that seasonal factors are used instead of multipliers, similar to the concept of “revenue equivalence” proposed by ENTSOG in the CAM Network Code discussions.

**4.3. Reserve prices (interruptible)**

**4.3.1 *Do you agree with proposed option to set Interruptible Reserve prices at a discount to firm capacity where the discount is based on the likelihood of interruption, and to recalculate once a year?***

Yes. Setting interruptible prices based on the probability of interruption is required under the Gas Regulation. Applying a fixed discount(s) to the pro rata annual reserve price and adjusting this annually seems appropriate.

**4.3.2 *If you prefer a fixed discount, which level of such a discount applied to firm capacity level do you advocate?***

One possible way of providing harmonisation, recognising the difficulty in predicting interruption, is for the TNC to include three possible probabilities of interruption, high, medium or low, and to assign a fixed discount to each probability<sup>20</sup>. The TNC would then specify the circumstances which might lead to the probability of interruption being high, medium or low. For example, if all firm capacity was sold out and previous instances of interruption had occurred in the last year, the probability of interruption could be said to be high.

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<sup>20</sup> For example 80%/50%/20%

**4.3.3 Do you agree with application of the proposed option to entry and exit points where the Network Code on CAM applies, i.e. interconnection points only?**

Yes. National entry and exit points<sup>21</sup> should be out of scope of the TNC in this respect, although national arrangements for interruptible reserve/reference prices may need to be reviewed in light of the interruptible discounts in TNC.

**4.4. Reserve price (backhaul)**

**4.4.1 Do you agree with proposed level of harmonization?**

Yes, although backhaul capacity could be treated the same as any other interruptible product, albeit with maybe a different probability of interruption to interruptible capacity for physical forward flow.

**4.4.2 Do you agree with proposed option to set backhaul prices at a discount to firm capacity level so that Reserve prices reflect the level of actual marginal costs (= IT and administrative costs)?**

Yes. As backhaul capacity invariably reduces the operating costs of the system it may be more deserving of a discount than some interruptible capacity products. So applying a reserve price based on the actual marginal costs, which should be very low, seems appropriate.

**4.4.3 Do you agree with application of the proposed option on backhaul capacity pricing to entry and exit points where the Network Code on CAM applies i.e. interconnection points only?**

Yes, see 4.3.3 above.

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<sup>21</sup> Excluding interconnection points between market areas within the same Member State which are covered by the CAM Network Code

## 5. Virtual IPs

**Do you support the proposed option for Reserve price in Virtual IPs as EU-wide standard?**

Yes. Obviously the reserve price for virtual interconnection points has somehow to be established based on a combination of the reserve prices that previously applied when individual entry or exit points were in place. Requiring the TNC to elaborate further on this would be helpful. But how much added clarity or guidance can be given prior to deciding on whether to go ahead and implement a virtual interconnection point is not entirely clear.

## 6. Bundled capacity products

### 6.1. Reserve price (Bundled)

#### ***6.1.1 Do you agree with proposed level of harmonization?***

Yes. Harmonising how bundled and unbundled capacity prices are established and how tariff revenues are split between adjacent TSOs is sensible.

#### ***6.1.2 Do you agree with the proposed option that the sum of Reserve prices for unbundled capacity is used as bundled Reserve price?***

Yes.

#### ***6.1.3 Do you agree with application of specified the proposal to entry and exit points where the Network Code on CAM applies i.e. interconnection points only?***

Yes. Bundled products can only really be applied at cross-border points and capacity at national entry and exit points is rarely auctioned at present.

### 6.2. Do you support the proposed option for Reserve price (if unbundled) as the EU-wide standard?

Yes, although the TFG could be interpreted as saying that unbundled capacity resulting from a mismatch is auctioned at the adjacent capacity reserve price, i.e. unbundled entry capacity being auctioned at the exit reserve price. We do not think this is what ACER mean but if it is we fail to understand the logic behind this.

**6.3 The Network Code on Tariffs shall specify that the revenues from Reserve price of bundled capacity products shall be attributed to the TSOs proportionally to the Reserve prices of their respective capacities in the Bundled Capacity. The revenues from the auction premium from bundled capacity above the Reserve price shall be split according to agreement between the relevant national regulatory authorities. Furthermore, the Network Code on Tariffs shall in the case that no agreement is concluded before the auction, specify that the revenues from the auction premium shall be split equally between the TSOs.**

***6.3.1 Do you agree with proposed level of harmonization in that approach above?***

Yes. Harmonising how revenues received from auctions are apportioned between adjacent TSOs is appropriate.

***6.3.2 Do you agree with proposed option for splitting auction revenues from bundled products to the relevant TSOs?***

Yes. Splitting revenue received from auctioning bundled capacity (at least that element of it which equates to the reserve price) proportionally based on the entry and exit component reserve prices is logical.

We agree that any revenue received from premiums above bundled capacity reserve prices should be split based on the agreement of NRAs either side of the border<sup>22</sup>. If NRAs cannot agree, possibly because different tariff setting methodologies or entry/exit splits apply, a default rule will be necessary and a 50/50 seems pragmatic.

***6.3.3 Do you agree with application of the proposal to entry and exit points where the Network Code on CAM applies i.e. interconnection points only?***

See 6.1.3 above

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<sup>22</sup> This split should be driven largely by the relative costs either side of the border of the reinforcement necessary to relieve the congestion signalled by the auction premium.

## 7. Payable price

### ***7.1.1 Do you agree with proposed level of harmonization?***

Yes. Harmonising the payable price for bundled capacity at interconnection points between adjacent market areas avoids distorting trade between those market areas.

### ***7.1.2 Do you agree with the proposed option to set payable price equal to the current Reserve price for year in which capacity is used plus any premium?***

No. We think there is merit in providing network users with a reasonable degree of certainty about what the tariff prices for bundled capacity will be throughout the duration of the capacity acquired. This is particularly important when network users are being required to make binding commitments to underpin TSOs' investment in incremental capacity, which could be a possibility in the event of incremental capacity being integrated into the long term auctions.

As competition increases and markets become more correlated and integrated, network users will face significant risks by locking themselves in to long term contracts at fixed prices, and could end up with stranded capacity. However, the risk of stranded capacity also exists with floating payable prices and fixed auction premiums, but with fixed prices network users are at least able to decide how much price risk they are prepared to take. The recently introduced congestion management guidelines aimed at tackling contractual congestion will also ensure that network users who do secure long term capacity will not be able to frustrate other users from efficiently flowing gas between market areas.

Fixed prices, assuming network users are willing to make significant commitments to acquire long term capacity in the current uncertain market climate, could be said to heighten the risk of under recovery. This is because reserve prices will typically be expected to increase over time, in line with a TSO's allowed revenues or costs, as defined under its price control regime<sup>23</sup>. This risk could be largely avoided by allowing payable prices in long term auctions to escalate by the same escalators in the TSOs price control, as opposed to allowing the reserve price to adjust unchecked. In our view this represents a pragmatic compromise between providing network users with the ability to limit price risk and preventing the possibility of significant under-recovery.

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<sup>23</sup> Inflation is factored into TSOs' price control regimes as regulatory periods extend over a number of years

**7.1.3 Do you agree with the application of specified options regarding payable price to entry and exit points where the Network Code on CAM applies i.e. interconnection points only?**

Yes. See 6.1.3 above.

**8. Incremental capacity (no explicit chapter in draft FG, implications at least to chapters 2/3 foreseen).**

**8.1. Please provide evidence of concrete problems with the current arrangements for incremental capacities, whereas these problems affect tariff structures in EU.**

As a trade association, this is not something we are able to provide specific details on. However, lack of transparency and uncertainty about tariffs and their structure is often cited as a problem in EU Open Seasons. In particular, TSOs investment costs may be insufficiently transparent for network users to gauge the extent to which they are efficient. Also, network users often have to commit to finance incremental investment without knowing the tariffs or tariff structures that will apply.

**8.2. Please therefore consider if harmonization, or partial harmonization of any parameters in the “market test” is appropriate within Tariffication principles at EU-level?**

We expect the market test to be developed further in the coming months and refer ACER to our recent response to CEER’s consultation on “Market-based investment procedures for gas infrastructure”. To the extent incremental capacity allocation is integrated into the long term auctions under the CAM Network Code such that network users signal their demand for available and incremental capacity together, the bid price steps used in the multi-round ascending clock mechanism will need to correlate to the efficient investment costs the TSO would incur in making the stepped quantities of incremental capacity available. The same principle applies to Open Seasons, albeit the process will differ. In both cases, network users are able to signal their demand for capacity at specific bid step prices and the market test will determine how much incremental capacity is to be allocated based on a particular level of commitment.

**8.3. Are there any other elements required in the Network Code on transmission tariff structures, to accommodate incremental capacity offer (e.g. influence on regulatory accounts, regulatory periods length, requirement for a fixed for period of years tariffs).**

Incremental capacity tariffs will need to be assessed against the same tariff objectives as existing capacity. In order to incentivise efficient investment, a methodology which provides locational signals and expresses investment costs on a marginal basis would be preferable. However, not all incremental capacity is currently directly subject to a market test. Also, whilst tariffs for existing capacity continue to be calculated on an average or historic cost basis, adopting a different methodology for incremental investment could be distortionary. So we do not think this should not be mandated at this stage. A Guideline on Good Practice on how TSOs/NRAs calculate reference/reserve prices for Incremental Capacity could be help to ensure efficiency of incremental investment.

**9. Usage of locational signals (no explicit chapter in FG, implications at least to chapters 2/3/4 foreseen).**

**9.1. Please provide evidence of concrete problems with the current arrangements for locational signals.**

We do not have any evidence of “concrete” problems, but that does not mean they may not exist.

**9.2. Are there any other elements required in the Network Code on transmission tariff structures to accommodate locational signals?**

No. See 9.3 below.

**9.3. Please consider whether the chapter on ‘Reference price’ should have more options added in regard to use of locational signals. Please consider specifically how tariff structures can be used to signal investment for e.g. gas-fired power plants, storages, LNG terminals, etc.**

We do not think that the TFG should include further options regarding locational signals. In due course, TSOs/NRAs may move to adopt methodologies which routinely provide locational signals e.g. long run marginal cost. However, this will take time and has implications for the wider price control regime that TSOs operate under. So the TFG should not seek to harmonise use of such a methodology throughout the EU at this time.

Locational signals provided by transmission tariffs help to promote efficient flows and investment but are not the “be all and end all”. Clearly, low or high entry and exit transmission tariffs may help to incentivise investors in CCGTs, storage facilities and LNG terminals to locate at favourable, or not unfavourable, points on the system. But the reality is that these facilities can only be sited in places where other geographic and technical conditions apply and favourable transmission tariffs are likely to have a relatively minor contribution to the overall investment decision.

#### **9.4. Shorthaul as a form of ‘locational signal’ in e/e systems.**

##### ***9.4.1 Should the FG have a tariff structure in place to avoid the incentive for inefficient building of pipelines (to avoid the entry-exit system charges) described above?***

No. We do not think the TFG should include specific incentives, via the tariff structure or methodology, to avoid inefficient investment and have no views what these incentives could be<sup>24</sup>. However, we agree with the inclusion in Section 1.1 of the TFG of a tariff objective which requires tariffs to seek to provide incentives for efficient new investment, albeit this may be a secondary objective.

##### ***9.4.2 How could this tariff structure be designed?***

See 9.4.1. above.

##### ***9.4.3 Should there, in order to address risk of cross-subsidies and discrimination - be a limitation on the capacities that can be “shorthaul capacities”? Based on expert advice on current EU-practices, following options are proposed:***

Shorthaul tariffs, or discounts, are not universally applied across the EU. Where they are applied we think they exist only at national entry and exit points. We do not think it is appropriate to mention them in the TFG, or to try and define and any principles or restrictions around their use.

#### **9.5. Specific treatment of LNG (if any) considered, in view of considering specific storage treatment (see questions under 2.4).**

LNG facilities should be considered out of scope of the TFG, as should storage facilities. However, the entry and exit tariffs relating to storage and LNG facilities will be covered by the same tariff objectives, methodology and assumptions as cross-border points and so any specific treatment that is appropriate or necessary vis-à-vis any other class of entry or exit point should be assessed and determined consistently.

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<sup>24</sup> A long run marginal cost tariff setting methodology may help to avoid inefficient investment but applying this methodology across the EU has, rightly, been ruled out at this stage.

**9.5.1 Do you think that tariffs for entry and exit capacity from the LNG terminal could incorporate a discount relative to other entry and exit tariffs on the TSO, similar to the proposed option for underground gas storage?**

No. See 9.5 above.

**10. Effects Entry-Exit Zone mergers & Virtual IPs (no explicit chapter in FG, implications at least to chapters 2/3 foreseen).**

**10.1 Please provide evidence of concrete problems with the current arrangements for mergers of entry-exit zones at national level.**

Merging entry-exit zones will result in interconnection capacity between these two zones no longer being treated as bundled capacity TSOs' explicitly allocate. As such TSOs will no longer be able to recover allowed revenues from auctioning such capacity. Therefore a process will be required to adjust tariffs at the entry/exit points of the merged zone and a scheme will be needed to fairly compensate TSOs for lost revenue. Experience from electricity suggest that agreeing these tariff changes and compensation schemes is likely to be difficult and time consuming.

**10.2 Please advise, if there are alternatives or additional requirements within Tarification setting harmonization steps, to accommodate 'Effects Entry-Exit Zone mergers' (once there). Please consider the Initial (draft) Impact assessment, when answering.**

Unlike in the case of virtual interconnection points, we do not think the TFG or TNG should attempt to harmonise steps to accommodate the effects of entry-exit zone mergers. We do not think this would be proportional at this stage bearing in mind the absence of any mergers on the horizon.

**11. What additional tariff structure measures do you envisage could improve the network code?**

The TFG should seek to define a harmonised lead time for notification of tariff changes, both at national and cross border level. It should also specify that bundled capacity should be invoiced on a bundled basis by only one counterpart. Rules for how bundled reserve prices are set where currency differences apply either side of the border should also be included.

**12. Please share below any further comments concerning the draft Framework Guideline.**

**Please comment on any factual incorrectness of the attached Initial (draft) Impact Assessment, if possible with specific page references.**

We have no comments to make on the factual correctness of the Impact Assessment.



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