



Publishing date: 28/02/2019

Document title: Agency Report - Analysis of the Consultation Document for Czech Republic

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Agency Report

Analysis of the Consultation Document on the Gas Transmission Tariff Structure for the Czech Republic

NRA: Energetický regulační úřad
TSO: NET4GAS

28 February 2019

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1. ACER conclusion

- (1) Energetický regulační úřad ('ERU') proposes to apply a capacity weighted distance ('CWD') methodology as the reference price methodology ('RPM'). The proposed entry-exit split results in 20.35% of the revenues allocated to entries and 79.65% of the revenues allocated to exits. ERU proposes to apply a 50% discount at entry points from and exit points to storage facilities. A commodity-based transmission tariff is used at exit points to recover the costs driven by the quantity of the gas flow. No non-transmission tariffs are proposed.
- (2) The Network Code on Harmonised Transmission Tariff Structures for Gas ('NC TAR') foresees a cost allocation assessment ('CAA'). The CCA index calculated by ERU varies between 11% and 14% depending on the considered year, above the 10% threshold laid out in Article 5(6) of the NC TAR. This result is caused by ERU putting in place provisions to protect Czech final consumers from an excessive volume risk related to transport of gas across the Czech entry-exit system (as required by Article 7(d) of the NC TAR). As explained in this document, while volume risk mitigation would provide an adequate justification for this result, further information is still required to ensure that the cost reflectivity requirement is met.
- (3) This mitigation of volume risk leads ERU to propose two distinct regulatory regimes, one for the parts of the Czech transmission system used to supply Czech consumers (national transmission) and the other for those parts used to flow gas to neighbouring countries (international transmission). ERU intends to apply a revenue-cap regime on national transmission and a price-cap regime on international transmission. In order to reflect the volume risk, ERU adds a risk premium to the remuneration rate applied to the assets used for international transmission. This difference of treatment induces additional complexities, in particular to assess the cost-reflectivity of the proposed transmission tariffs.
- (4) The Agency, after having completed the analysis of the consultation document pursuant to Article 27(2) of the NC TAR, concludes that the consultation contains the required information listed in Article 26(1), with the exception of an assessment against the criteria related to transparency, cost reflectivity and non-distortion of cross-border trade (pursuant to Articles 7(a),(b) and (e) of the NC TAR), of some information on the flow-based charges and of information on the fixed payable price approach.
- (5) Regarding the compliance of the proposed transmission tariff with Article 7, the Agency considers that:
 - ERU needs to improve the transparency of its transmission tariff methodology, with a simplified tariff model allowing stakeholders to understand its RPM.
 - The consultation document does not include an adequate justification of the way costs are allocated to national or international transmission. ERU considers that international transmission faces a volume risk and applies a risk premium to the corresponding part of the transmission service revenue. ERU did not publish the methodology used to assess the volume risk (and consequently to determine the risk premium). Without this information, the Agency cannot conclude its analysis with respect to the requirements of cost reflectivity. Provided that the costs are properly reflected by the transmission services revenue set by ERU, the chosen

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RPM appears compliant with the other requirements listed in Article 7 of the NC TAR, regarding the prevention of undue cross-subsidisation, non-distortion of cross-border trade and mitigation of volume risk.

- For the sake of tariff stability, ERU intends to implement a mechanism that would lead to a tariff increase equivalent to the annual inflation rates from 2020 to 2025 and to transfers of revenues between these years. The Agency considers that this mechanism does not comply with the requirement of cost reflectivity and it potentially complicates the functioning of the regulatory account.

- (6) Regarding the flow-based transmission tariffs, ERU decided to use both flow and distance as cost drivers. The Agency considers that this does not meet the criteria set in Article 4(3) of the NC TAR, as it is not calculated on the basis of forecasted or historical flows, or both, and not set in such a way that it is the same at all entry points and the same at all exit points.
- (7) The Agency notes that a fixed payable price approach is offered to network users while, in accordance with Article 25 of the NC TAR, this option is only possible under a price-cap regime or in some allocation processes where incremental capacity is offered.
- (8) The Agency recommends ERU to include the following elements as part of its motivated decision:
- an assessment of the RPM against the criteria in Article 7(a),(b) and (e) of the NC TAR,
 - further justifications and data regarding the costs allocated to national and to international transmission, respectively, the risk premium and the settings of the regulatory account, to allow a proper assessment of the RPM against the cost-reflectivity requirement;
 - the share of the allowed or target revenue forecasted to be recovered from commodity-based transmission tariffs;
 - all information listed in Article 26(1)(e) of the NC TAR on the fixed payable price approach;
 - an updated simplified model, so network users can use the model to reproduce and forecast the tariffs.
- (9) The Agency also recommends ERU to:
- calculate reference prices covering the yearly allowed and target revenues without excessive transfers from one year to another;
 - set the flow-based charge in such a way that it would be the same at all entry points and at all exit points in accordance with the Article 4(3) of the NC TAR;
 - only offer a fixed payable price approach at cross-border exit points where the only applied regulatory regime is a price cap.

2. Introduction

- (10) Commission Regulation (EU) 2017/460 of 16 March 2017 establishes a network code on harmonised transmission tariff structures for gas (NC TAR).
- (11) Article 27 of the NC TAR requires the Agency to analyse the consultation documents on the reference price methodologies for all entry-exit systems¹. This Report presents the analysis of the Agency for the transmission system of the Czech Republic.
- (12) On 2 October 2018, ERU forwarded the consultation documents (in Czech) to the Agency. The English translation of the consultation documents was published on 25 October 2018. The consultation was launched on 1 October 2018 and remained open until 31 December 2018. On 31 January 2019, the consultation responses and their summary were published. The Agency has taken these into consideration for this analysis. Within five months following the end of the final consultation, and pursuant to Article 27(4) of the NC TAR, ERU shall take and publish a motivated decision on all the items set out in Article 26(1).
- (13) A number of bilateral exchanges to collect additional information took place between ERU and the Agency. While ERU provided information in a timely manner following the requests of the Agency, it did not provide sufficient evidence to assess the appropriateness of the proposed RPM.

Reading guide

- (14) In Chapter 3, this document first presents an analysis on completeness, namely if all the information listed in Article 26(1) has been published. Chapter 4 focusses on compliance, namely if the RPM complies with the requirements set out in Article 7 of the code, if the criteria for setting commodity-based transmission tariffs as set out in Article 4(3) are met and if the criteria for setting non-transmission tariffs as set out in Article 4(4) are met. Chapter 5 includes other comments. 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?

- (15) 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.
- (16) Article 26(1) of the NC TAR requires that the consultation document be published in the English language, to the extent possible. The Agency remarks that the consultation document was published in English as well.
- (17) Most of the information in Article 26(1) of the NC TAR was published, with the most notable exception of an explicit assessment² against the criteria of transparency, cost reflectivity and non-

¹ With the exception of Article 10(2)(b), when different RPMs may be applied by the TSOs within an entry-exit zone.

² See Chapter 14, page 68, in ERU consultation document.

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distortion of cross-border trade, as provided, respectively, by Article 7(a),(b) and (e) of the NC TAR (see Section 4.1). In addition, some information on the flow-based charges and on the fixed payable price approach is missing (see Section 4.1.2).

- (18) As explained later in this document (Section 4.1.2), ERU intends to apply a revenue cap regime and a price cap regime to different parts of the Czech transmission network, and thus defines an allowed revenue and a target revenue for these respective parts. Article 26(1)(c)(i)(2) requires that the share of the allowed or target revenue forecasted to be recovered from flow-based transmission tariffs is included in the consultation document. Nonetheless, ERU intends to implement a flow-based charge without defining the share of the corresponding revenue as part of the allowed or target revenue. On the contrary, the expected revenue derived from the flow-based charges is defined separately³. This is not in line with the combined reading of Articles 3(6), (11), (14) and 4(3) of the NC TAR. As explained later in the document (Section 4.1.2), ERU should clarify the regulatory regime applied to this share of revenues.

Table 1 Checklist information Article 26(1)

Article	Information	Published: Y/N/NA
26(1)(a)	the description of the proposed reference price methodology	Yes
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 	Yes
26(1)(a)(ii)	the value of the proposed adjustments for capacity-based transmission tariffs pursuant to Article 9	Yes
26(1)(a)(iii)	the indicative reference prices subject to consultation	Yes
26(1)(a)(iv)	the results, the components and the details of these components for the cost allocation assessments set out in Article 5	Yes
26(1)(a)(v)	the assessment of the proposed reference price methodology in accordance with Article 7	No assessment regarding Art. 7(a), (b) and (e)
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)	Yes
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 	Incomplete. The share of the allowed or target revenue forecasted to be recovered from

³ See ERU consultation document, tables 24, 25 and 26, page 71

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		such tariffs is not provided
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) • the indicative non-transmission tariffs for non-transmission services provided to network users 	Not applicable
26(1)(d)	the indicative information set out in Article 30(2);	Yes
26(1)(e) 26(1)(e)(i) 26(1)(e)(ii) 26(1)(e)(iii) 26(1)(e)(iv)	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: <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 	Incomplete. The information in the 3 rd and 4 th bullet is missing

4. Compliance

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

- (19) 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) No 715/2009 and lists a number of requirements to be taken into account when setting the RPM. As these overlap, in the remainder of this chapter, the Agency will take a closer look at the five elements listed in Article 7 of the NC TAR.
- (20) As the concepts of transparency, cost reflectivity, non-discrimination, cross-subsidisation and cross border trade are closely related, the Agency concludes with an overall assessment. Special attention is paid to the allocation of revenues between domestic and transit routes.

4.1.1 Transparency

- (21) **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.
- (22) The CWD methodology, as described in the NC TAR, is relatively easy to understand and allows users to reproduce and forecast the reference prices, provided that the relevant inputs and calculation steps are all published.

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- (23) In this respect, the Agency finds that the simplified tariff model provided by ERU, as required by Article 30(2)(b) of the NC TAR, could be improved. The Agency considers that network users would not be able to reproduce the calculation of reference prices. The reference prices are presented, but it is not shown how they are calculated. Although most of the relevant information (revenue, capacities and distances) is included in the consultation document, it would be better if these were included in the model.
- (24) The Agency further considers that network users are given a forecast of reference prices and are able to modify some of the assumptions in the model. However, in order for network users to be able to reproduce the calculation of reference prices, they should be allowed to adjust more assumptions in the model.
- (25) The Agency recommends that ERU improve the tariff model and publish an enhanced version when taking the final decision.
- (26) As explained later in the document (Section 4.1.2), the Agency recommends that ERU publish additional information in line with Article 30(1) of the NC TAR, necessary properly to assess the cost-reflectivity of the proposed transmission tariff and asset split. ERU should provide sufficient information to justify which regulatory regime is applied to each asset.

4.1.2 Cost-reflectivity

- (27) **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.
- (28) The transmission network in the Czech Republic can be considered a relatively simple network. There are basically two large transit pipelines bringing gas from Slovakia to Germany, a pipeline bringing gas to Poland and a few small branches for domestic distribution. Finally, there are a number of storage facilities. There is also a planned second interconnection point to Poland ('Hat'), which is expected to be commissioned in 2023.
- (29) The limited complexity of the system allows distance to be taken into account in the choice of RPM. As ERU proposes to use the CWD methodology, the Agency considers that the complexity is adequately reflected in the choice of the cost drivers.

4.1.2.1 Distinct regulatory regimes for national and international transmission

- (30) ERU is seeking to put in place a methodology to protect Czech final consumers from an excessive volume risk related to transports across the Czech entry-exit system (see also Section 4.1.4). To do this, ERU proposes to implement a three-part system, where transmission costs are divided into three categories (ERU uses the first two cost shares as a basis for calculating capacity reference prices):

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- A first share relates to national transmission, i.e. to the parts of the transmission network used to supply Czech domestic consumers⁴. ERU intends to apply a revenue-cap regime to these costs and determines an allowed revenue to cover them. Potential over or under-recoveries will be reconciled through a dedicated regulatory account. According to ERU, the allowed revenue will increase from 1,635 million CZK in 2020 to 1,871 million CZK in 2025.
- A second share relates to international transmission, i.e. the parts of the transmission network used to transport gas through the Czech Republic⁵. ERU intends to apply a price-cap regime to these costs and to add a risk premium to the remuneration rate applied to the corresponding assets. This risk premium is intended to reflect the volume risk, which is considered to be higher for international transmission. According to ERU, the target revenue will increase from 4,744 million CZK in 2020 to 5,263 million CZK in 2025. Approximately 10% of this target revenue is derived from the application of the risk premium⁶.
- A third share will be recovered through flow-based charges. ERU expects flows to increase very significantly between 2020 and 2025. If this forecast is correct, the variable costs of the Czech transmission system will also increase. Given the importance of these changes and the level of uncertainty, the use of flow-based charges should allow the TSO to recover these additional variable costs if the flows actually increase (this avoids over- or underestimating the capacity-based charge based on a poor flow forecast). According to Article 4(3) of the NC TAR, these flow-based charges shall only be used to recover costs mainly driven by the gas flows. The Agency understands, thanks to its exchanges with ERU, that this will be the case. However, it is not clear from the consultation document that this condition is fulfilled and whether a revenue-cap or a price-cap regime applies to this share of costs. According to ERU, this portion of the transmission services revenue based on flows will increase from 461 million CZK in 2020 to 1,622 million CZK in 2025⁷. For such an increase to be acceptable, ERU will have to demonstrate that it reflects an actual change in variable costs.

(31) Such a three-part system seems particularly complex. Additional information would be required to ensure that costs are properly reflected. Therefore:

- The Agency recommends that ERU clarify and publish the methodology by which it allocates costs to national or international transmission, ideally asset by asset.
- The Agency recommends that ERU clarify the nature of the costs recovered through the flow-based charge and the regime applied to them as required by Article 4(3) of the NC TAR.

⁴ virtual delivery points into distribution networks, delivery points of virtual storage facilities, delivery points of customers directly connected to the transmission network, cross-border entry points into the transmission network to the extent required for supplying customers in the Czech Republic

⁵ cross-border exit points from the transmission network, cross-border entry points into the transmission network, but without the part needed for supplying customers in the Czech Republic

⁶ The risk premium is an additional remuneration rate summed to the WACC (according to ERU, the risk premium will be 1,46% between 2021 and 2025 while the WACC will be 6,72%)

⁷ Assuming usage rate of the contracted capacity at the Lanžhot interconnection point of 80% in 2020 and 2021 and of 90% between 2022 and 2025.

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- The Agency invites ERU to provide further justification for the value of the risk premium. This premium must reflect the volume risk, i.e. the risk of temporary or permanent under-utilisation of the transmission network. If this risk were to materialize, a share of the network costs could not be recovered. The risk premium should reflect both this share of costs and the likelihood of network under-utilisation (in particular by taking into account the current long-term bookings).

4.1.2.2 Benchmarking

- (32) In its consultation document, ERU states that its price-cap regime currently applied to international transmission is “underpinned by international comparisons of transmission tariffs (benchmarking)”. Article 6(4)(a) of the TAR NC offers the possibility to adjust the RPM by benchmarking “so that the resulting values meet the competitive level of reference prices”. However, the Agency considers that this approach is not consistent with ERU’s choice to shelter Czech domestic consumers from the volume risk induced by international transmission. A choice must be made between an increase in the price applied to international transmission, justified by a risk of future under-utilisation, and a price decrease to ensure a sufficient market share compared to competing routes.
- (33) The Agency understands, through its exchanges with ERU, that only a volume risk mitigation (and no benchmarking) will be implemented during the next regulatory period.

4.1.2.3 Regulatory account

- (34) Given the complexity of the proposed tariff system, the Agency recommends that ERU provide additional explanations on the functioning of the regulatory account to clarify that its settings are consistent with the splits defined by ERU between international and national transmission and between capacity-based and commodity-based charges. The Agency understands that, according to the current Czech regulation, any potential over or under-recovery falling within the scope of its revenue-cap regime is reconciled exclusively through an adjustment of “the price for distribution capacity booking”. This does not meet the requirement set in Article 20(1) of the NC TAR, as the reconciliation of the regulatory account is not carried out in accordance with the RPM. The Agency understands that this deviation may be an unavoidable side effect of the volume risk mitigation mechanism. ERU should nonetheless provide further justifications as to why this would be the case.

4.1.2.4 Mitigation of tariff volatility

- (35) ERU expects significant changes in the Czech transmission system by 2025, with new flow patterns and the commissioning of new assets (e.g. the C4G pipeline between 2021 and 2023, the national Moravia pipeline and the STORK II pipeline in 2022). These changes could lead to tariff instability, which could adversely affect the functioning of the market. To avoid this phenomenon, ERU proposes:
- to calculate the average costs of the TSO between 2020 and 2025 (net present value using a discount rate equal to inflation⁸), and

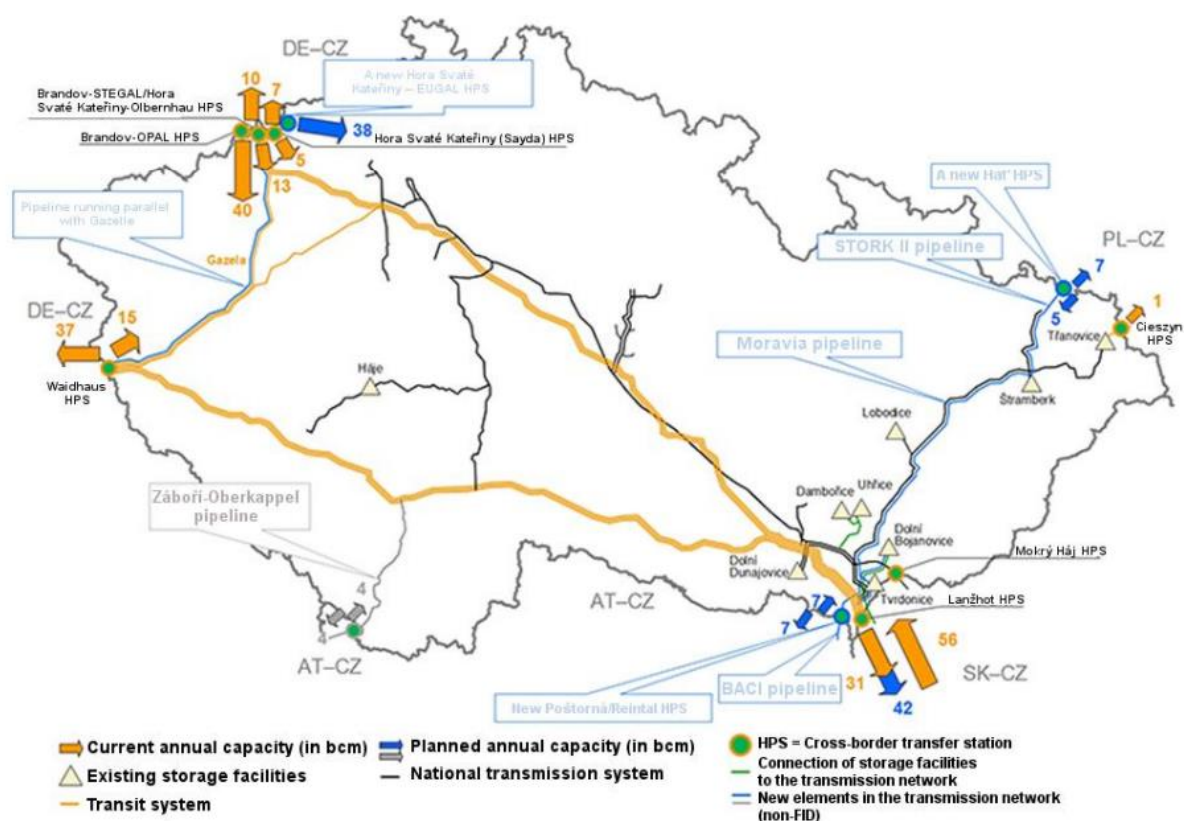
⁸ ERU uses a rate of 2,3% as an annual inflation assumption between 2020 and 2025.

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- to set the reference prices so that an annual increase equivalent to inflation would allow to cover this average net present value between 2020 and 2025.

(36) The Agency understands the purpose of this mechanism and acknowledges that high tariff instability could be detrimental to market functioning. Nonetheless, the Agency considers it particularly difficult to undertake such a calculation, from 2020 to 2025, when a new regulatory period will begin in 2021. Many parameters are still unknown (WACC, amounts of investments, etc.). In addition, this mechanism anticipates the tariff increase due to infrastructures that will come into service during the next regulatory period. The Agency considers that the proposed mitigation mechanism does not comply with the requirement of cost reflectivity and it potentially complicates the functioning of the regulatory account.

Planned developments of the Czech transmission system⁹:



4.1.2.5 Conclusion

(37) During the preparation of this document, ERU cooperated with the Agency, answering questions and providing further clarifications. However, given the level of complexity of the tariff system proposed by ERU, the Agency cannot assess its cost reflectivity at this stage. ERU will have to provide additional data, in particular to justify which shares of costs are allocated respectively to national or international transmission. ERU must also demonstrate that the risk premium is well

⁹ Consultation document published by ERU, figure 6, page 27

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proportionate to the actual level of volume risk. Further information is also needed regarding the flow-based charge and the settings of the regulatory account.

- (38) Moreover, given the evidence provided and the level of uncertainties, the Agency considers that the pricing adjustment proposed by ERU to mitigate the tariff instability between 2020 and 2025 does not allow properly to reflect the transmission costs for a given year and should thus be removed or adjusted.

4.1.3 Cross-subsidisation and discrimination

- (39) **Article 7(c)** of the NC TAR requires the RPM to ensure non-discrimination and prevent undue cross-subsidisation. One instrument to evaluate this is the cost allocation assessment (CAA, Article 5 of the NC TAR).
- (40) The Agency has not identified discrimination resulting from the application of the RPM proposed by ERU. For this analysis, the Agency defines 'discrimination' as '*applying different rules to comparable situations or the same rule to different situations*'. The Agency concludes that the allocation of all transmission costs via a single RPM to all entry-exit points minimises the possibility of forms of discrimination not allowed by the NC TAR.
- (41) The result for the capacity cost allocation comparison index is presented for the years from 2020 up to and including 2025. The result varies between 11% and 14% (which means that shippers flowing gas across the Czech Republic will pay a higher unit capacity price than shippers supplying Czech consumers).
- (42) ERU also calculates the result when the risk premium is not included in the calculation. In this case the result is 1.7%. The Agency does not agree with ERU that the risk premium should not be included, as the allowed and target revenues do include this parameter. However, the Agency finds it a proper justification to have some degree of cross-subsidisation above the 10% threshold to take volume risk into account (see also Section 4.1.3), provided that the costs are properly allocated between the "revenue cap" and the "price cap" regimes and that the risk premium is well proportionate to the level of volume risk (as explained in Section 4.1.2).

4.1.3.1 Conclusion

- (43) The result of the capacity cost allocation assessment, above the 10% threshold, is clearly explained by the volume risk mitigation. Provided that the costs are properly reflected by the transmission services revenue set by ERU and that the risk premium is well proportionate to the level of volume risk (as explained in Section 4.1.2), the proposed RPM methodology does not seem discriminatory or to induce undue cross-subsidy.

4.1.4 Volume risks

- (44) **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.

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- (45) The Agency first assessed, in line with Recital 6 of the NC TAR, that it is indeed the case that the Czech TSO transports significantly more gas into other systems than for consumption into its own entry-exit system. The consultation document includes a chart¹⁰ that shows the gas consumption in the Czech Republic and the gas that flows into and out of the country. The gas transit flows across the Czech Republic constitute the predominant portion and are three to four times larger than the country's gas consumption.
- (46) Based on the information provided in the consultation document, the Agency agrees that a significant volume risk may be induced by the dominant role of cross-border flows in the Czech transmission system.
- (47) As previously explained in Section 4.1.2.1, ERU proposes to use both a revenue-cap regime and a price-cap regime. The price-cap regime is applied to the transit part (entry IPs, excluding the volumes needed for supplying customers in the Czech Republic, and exit IPs).
- (48) The Agency understands that the sum of the target revenue (excluding the portion of revenue derived from the risk premium) and of the allowed revenue enter in the reference price calculation using the CWD methodology. The specific revenue derived from the risk premium is then directly allocated to the exit interconnection points. The Agency considers the latter as incompliant with Article 6(3) of the NC TAR, which requires that the same RPM shall be applied to all entry and exit points in a given entry-exit system¹¹. The Agency understands that this deviation may be an unavoidable side effect of the volume risk mitigation mechanism. ERU should nonetheless provide further clarity to explain why no other option could work.

4.1.4.1 Conclusion

- (49) Provided that the costs are properly reflected by transmission services revenue set by ERU (as explained in Section 4.1.2), the Agency considers that the proposed RPM methodology seems adequate to mitigate the volume risk identified.

4.1.5 Cross-border trade

- (50) Article 7(e) of the NC TAR requires that the RPM ensure that the resulting reference prices do not distort cross-border trade.
- (51) ERU proposes to use a 20.35/79.65 entry-exit split to optimise the outcome of the cost allocation assessment and to minimise discontinuities in the level of reference prices.
- (52) When looking at the input data, the shares of forecasted contracted capacity is 46% for entry points and 54% for exit points. The proposed transmission tariff leads to a situation where it is relatively

¹⁰ Consultation document published by ERU, chart 2, page 15.

¹¹ As the RPM is defined as 'the methodology applied to the part of the transmission services revenue to be recovered from capacity-based transmission tariffs with the aim of deriving reference prices' and the risk premium is part of the transmission services revenue. That is because the transmission services revenue is defined as *the part of the allowed or target revenue which is recovered by transmission tariffs* and the risk premium is part of the target revenue to be recovered from (capacity-based) transmission tariffs.

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cheaper to book capacities in the direction of dominant flows, and relatively more expensive to flow gas in the opposite direction (e.g. Entry Lanžhot to Exit VIP Waidhaus would sum up to 2,220.28 CZK/MWh/d/y whereas Entry VIP Waidhaus to Exit Lanžhot would be 4,012.30 CZK/MWh/d/y).

Table 2 Sum of entry and exit reference prices at various routes

<i>From entry ↓ to exit →</i>	VIP Brandov	Lanžhot	VIP Waidhaus	Cieszyn	Hat'
VIP Brandov	-	3,956.16 (795.45 + 3,160.71)	2,534.33 (795.45 + 1,738.88)	5,528.53 (795.45 + 4,733.09)	5,459.42 (795.45 + 4,663.97)
Lanžhot	3,875.52 (481.40 + 3,394.13)	-	2,220.28 (481.40 + 1,738.88)	5,214.48 (481.40 + 4,733.09)	5,145.37 (481.40 + 4,663.97)
VIP Waidhaus	4,245.71 (851.59 + 3,394.13)	4,012.30 (851.59 + 3,160.71)	-	5,584.67 (851.59 + 4,733.09)	5,515.56 (851.59 + 4,663.97)
Hat'	3,602.58 (208.45 + 3,394.13)	3,369.17 (208.45 + 3,160.71)	1,947.33 (208.45 + 1,738.88)	4,941.54 (208.45 + 4,733.09)	-

- (53) Overall, the CWD methodology as described in the NC TAR is relatively easy to understand and fits the level of complexity of the Czech system. There is a certain degree of cross-subsidisation which can be justified as it is the result of the methodology to handle the volume risk from the transit pipelines.
- (54) Most of the entities that responded to the ERU public consultation consider the tariff increase on connections with storage facilities to be excessive. They advocate for a higher tariff discount, as allowed by Article 9(1) of the NC TAR (suggesting 70% to 100% discounts instead of 50% in ERU proposal). ERU should assess whether the importance of Czech storage facilities at the regional level is such that the proposed tariff increase on connections with storage would potentially have an adverse impact on cross-border trade.

4.1.5.1 Conclusion

- (55) The Agency considers that ERU has chosen an RPM which, in principle, properly reflects the complexity of the Czech transmission system. As explained earlier in this document (Sections 4.1.1 and 4.1.2), some improvements are nevertheless needed in terms of transparency, so that stakeholders can understand the RPM and to ensure that allowed and target revenues reflect actual costs.
- (56) The Agency recommends ERU to assess the regional impact of the proposed tariff increase on connections with storage facilities.

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

- (57) 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) of the NC TAR are met.
- (58) 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. ERU proposes to apply commodity-based transmission tariffs. Table 3 shows the capacity/commodity split¹².

Table 3 Capacity/Commodity split

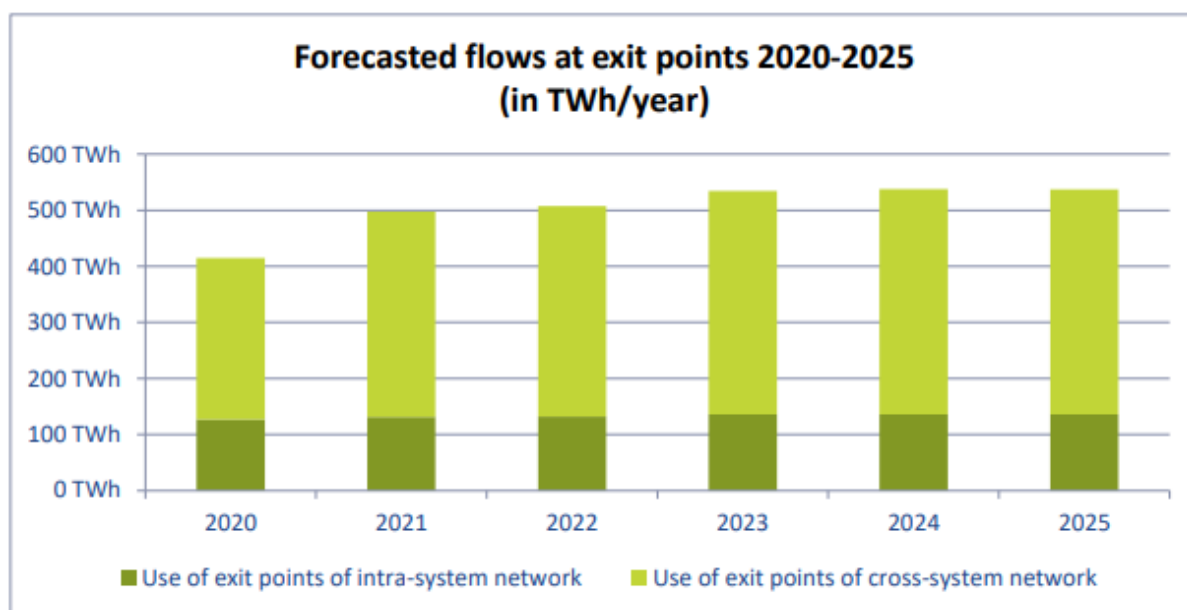
	2020	2021	2022	2023	2024	2025
Capacity	93.26%	85.96%	80.44%	80.79%	81.14%	81.48%
Commodity	6.74%	14.04%	19.56%	19.21%	18.86%	18.52%

- (59) The NC TAR allows for two types of commodity-based transmission tariffs: a flow-based charge and a complementary revenue charge. ERU proposes to apply a flow-based charge at exit points only.
- (60) The flow-based charge should be levied for the purpose of covering the costs mainly driven by the quantity of the gas flow. The Agency understands from its exchanges with ERU that it proposes that costs incurred in the operation of compressor stations be recovered via the flow-based charge. These costs consist of:
- Cost of gas and electricity bought for running compressor stations;
 - Cost of the tax on the gas for fuelling compressor stations (fuel gas);
 - Cost of emission allowances.
- (61) ERU justifies the increasing share of transmission services revenue covered by a flow-based charge from 2020 to 2025 by expecting significant additional flows from the Brandov VIP to the Lanžhot cross-border point. However, the Agency considers that ERU should more explicitly confirm that the flow-based charge will only cover costs driven by the quantity of gas flow¹³. The Agency recommends ERU to elaborate on this in its final decision.

¹² The increase in the commodity share is due to the fact that the C4G project is becoming operational and related to this the fuel cost increase.

¹³ ERU consultation document states that "The model is strictly geared towards actually incurred costs on the basis of actually expected flows" (page 75). It will be important to clarify how potential under or over-recoveries due to differences between expected and actual flows will be taken into account in the regulatory account.

Forecasted flows at exit points 2020-2025 (TWh/year)¹⁴



- (62) Furthermore, ERU decided to use both forecasted flows and distance as cost drivers for the flow-based charge, after analysing the outcome of the commodity cost allocation comparison index¹⁵. Therefore, the proposed flow-based charge does not meet the criteria set in Article 4(3) of the NC TAR, as it is not calculated on the basis of forecasted or historical flows, or both, and not set in such a way that it is the same at all entry points and the same at all exit points.

Table 4 Criteria Article 4(3a)

Criteria	Y/N?
levied for the purpose of covering the costs mainly driven by the quantity of the gas flow	Partially substantiated
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	No
expressed in monetary terms or in kind	Yes

- (63) Therefore, the Agency considers that ERU should set the flow-based charge in such a way that it would be the same at all entry points and at all exit points in accordance with the Article 4(3) of the NC TAR.

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

- (64) 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.
- (65) ERU proposes not to make use of non-transmission tariffs.

¹⁴ ERU consultation document, chart 9, page 64

¹⁵ The outcome is 66% when the flows are used as a cost driver and 0% if both distance and flows are used as cost drivers.

4.4 Are the criteria for offering a fixed payable price as set out in Article 25 met?

- (66) Article 25 of the TAR NC stipulates that a fixed payable price approach can only be offered in two cases:
- for incremental capacity and existing capacity offered in the same auction under a non-price-cap regime;
 - for all capacities under a price-cap regime.
- (67) Given the tariff methodology proposed by ERU, a revenue-cap regime applies to the portion of cross-border entry capacity used to supply Czech consumers. Only cross-border exit capacities are exclusively under the scope of a price-cap regime.
- (68) In an entry-exit system, a same entry capacity can be used successively to supply domestic consumers and to transport gas to a cross-border exit. It is not possible to ensure that the price-cap regime applies to a specific booking at an entry point. Therefore, the Agency considers that a fixed payable price approach can only be offered at cross-border exit points.

5. Other comments

- (69) ERU informed the Agency that in addition to the tariffs in the consultation document, there is also a capacity overrun fee for directly connected customers. The fee is not cost-based, but used as an incentive not to overrun the capacity. The Agency agrees with ERU's assessment that this fee does not fall within the scope of the NC TAR.

Annex 1: Legal framework

(70) 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.*

(71) 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.
- (72) 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.

(73) 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 non-discriminatory 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.

(74) 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.

(75) 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 non-transmission 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
NRA	National Regulatory Authority
TSO	Transmission System Operator
EC	European Commission
EU	European Union
MS	Member State
NC TAR	Network code on harmonised transmission tariff structures for gas
IP	Interconnection Point
VIP	Virtual Interconnection Point
RPM	Reference Price Methodology
CWD	Capacity Weighted Distance
CAA	Cost Allocation Assessment
RAB	Regulated Asset Base
OPEX	Operational Expenditures
CAPEX	Capital Expenditures



Publishing date: 28/02/2019

Document title: Agency Report - Analysis of the Consultation Document for Czech Republic

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