

## **EFET response to ENTSOG questionnaire on the Refined Draft Network Code on the Harmonised Transmission Tariff Structures for Gas (TAR NC)**

**21 November 2014**

- 1. Do you consider that the TAR NC development process carried out by ENTSOG was appropriate, given the regulatory framework provided? In particular, was the level of stakeholder engagement appropriate? If there is room for improvement, please inform us about possible suggestions for improvement.***

### **No**

Whilst consultation with stakeholders has been carried out, there is widespread concern of inadequate engagement by ENTSOG with regard to addressing the issues raised by stakeholders. Of the large number of concerns we raised at best only about a third have been accepted and then often only in part.

The process however, was organised professionally with web streaming of the Stakeholder Joint Workstream meetings to its usual high standard, which enabled interested parties who were not able to travel to Brussels to follow and participate in the debate.

We recognise that ENTSOG was prepared to table discussions at Stakeholder Joint Workstream meetings on issues which were important to stakeholders, despite some of these seeming to conflict with the Framework Guidelines or the views of ENTSOG's members themselves.

ENTSOG's launch document and analysis of decisions documents were also of a high standard.

The overall outcome, however, raises serious concerns about the structure and governance of the institutional process. Network Code development must be able to adapt to support a sustainable gas market. The failure of the current draft to achieve this lies both in the way that the Framework Guidelines were justified and applied as well as the internal ENTSOG decision making process that gives priority to the views of TSOs over the needs of market participants.

**2. Please indicate your support for Chapter 1: General Provisions (Articles 1 – 3)?**

**Do not support**

EFET would like to have been able to support the scope of the Tariff Network Code and the entire package of measures laid out in Chapters 1 – 10, and could have done if a significant proportion of the forty six concerns we raised in our response to the previous consultation had been satisfactorily addressed.

Disappointingly however, this is not the case. Whilst we recognise there have been improvements, which we list below, these are insufficient to make the Tariff Network Code fit for purpose. We have also identified new concerns which have crept into the latest text, which again we list below.

In our opinion the Tariff Network Code fails to meet the required levels of clarity, efficiency and harmonisation for us to be able to support it as a package. As such we feel compelled at this late stage to propose a radical revision of the Code to focus, at least initially, on those areas containing measures that are of an obvious and immediate benefit to the market. In that context, we would suggest the Code concentrates on Chapter 3, regarding consultation requirements, and Chapter 5, regarding transparency. If amended in line with our comments below, changes in these areas will make real improvements in the degree of understanding and trust associated with the tariff setting by TSOs throughout the EU.

Additionally, a revision of the Code as suggested should enable it to achieve a more rapid and trouble-free passage through comitology, as well as enabling implementation sooner than would otherwise likely have been the case.

As regards the other chapters that we propose should not be included at this point, we would make the following comments.

Firstly, these measures largely describe things which TSOs/NRAs across the EU could address if they chose to do so. As currently drafted in the Code, there is little attempt at harmonisation and therefore no clear cut added value associated with these chapters. So despite there being some aspects within them which we support we do not think they should be included in the Tariff Network Code as currently drafted, at least for now. Left unchanged these chapters continue to contain measures which are insufficiently clear and distortive. We are not prepared to accept the unforeseen risks and consequences which might arise from accepting them as drafted, or to legitimise distortions by binding them in EU legislation. We assume that ENTSOG and NRAs would agree that it is important to avoid such a danger.

Moreover, in our opinion, including these chapters will not make instances of distortion or discrimination materially less likely than if the Tariff Network Code excluded them. To the extent network users do experience distortions or discrimination there are already articles in the Gas Directive and Regulation which enable them to challenge this.

Secondly, for the avoidance of doubt, we are not suggesting that the areas considered in these chapters are simply forgotten. Rather, we take the view that they should be discussed and proposals developed further, as part of a more ambitious plan to create a sustainable model for transmission network access and charging for the future. Such a model should recognise the problems of stranded assets, long-term capacity overhanging the market, capacity requirements driven principally by security of supply needs and the need for greater efficiency of cross-border flows and market integration. In our opinion this will require far greater levels of harmonisation than the current Tariff Network Code has been able to achieve so far. Ambitious solutions driven by the need to achieve a single energy market will be needed, whilst duly recognising the legitimate interests of both network users and TSOs.

EFET is committed to working collaboratively with ENTSOG and/or ACER and/or the Commission to develop such a model. Implementing a de-scoped Tariff Network Code will allow more time and attention to be dedicated to these critical problems next year. We therefore implore the Commission to seriously consider this approach in preference to pressing on with trying to implement the Tariff Network Code in its current form complete with all its uncertainties, inefficiencies and imperfections.

### ***3. Please indicate your support for Chapter 2: Cost Allocation Methodologies (Articles 4 –20)?***

#### **Do not support**

EFET does not support the revised cost allocation chapter. We are not convinced the combined package of diverse provisions contained within it represents enough change to the tariff setting processes currently followed by Member States to warrant their inclusion in binding EU legislation.

This chapter still contains distortions which ENTSOG has failed to rectify, for example flow based charges can still be levied in monetary terms or in-kind. As we pointed out in our response to the previous consultation and which ENTSOG recognises in its analysis of decisions document, this presents an uncontrollable risk for network users of allocation mismatching and imbalances where flow-based charges are applied in monetary terms on one side of an IP and in-kind on the other side. This is particularly pronounced in situations of single sided nominations. So rather than legitimise this distortion by grudgingly acquiescing to both options because some TSOs are unwilling to compromise on a harmonised solution, we think it is preferable to stay silent on this issue for now.

Similarly, in the absence of any attempt in the TAR NC to harmonise or restrict the cost allocation methodologies currently in use across the EU, or to harmonise the approach to cost determination, we see little benefit in affording them the cherished status of legally binding obligations. Most of the methodologies contain elements of optionality which, depending on which option you choose, can make a significant difference to the tariff outcomes and create discrimination. However, once included within the Tariff Network Code, Member States would find it easier to defend themselves

against any apparent discrimination by simply pointing out that their respective TSO or NRA was compliant with one of the methodologies specified therein.

Other areas where we still consider this chapter to be deficient are the continued acceptance of two forms of calculating distance, the additive approach to rescaling (where ENTSOG's concerns about negative reference prices can easily be overcome by introducing a minimal reference price rule into the model) and the absence of annual reviews and an ACER opinion on the use of benchmarking.

We are also disappointed that ENTSOG has failed to adopt our proposal that the Tariff Network Code should, by default, exempt storage facilities from entry and exit capacity charges. Reading the analysis of decisions document it seems that the principal reason for this is due to the fact that this may lead to significant cross-subsidies and/or under-recovery of the respective TSO revenue. However, we continue to believe that applying capacity charges to gas flows injected and withdrawn from storage amounts, in itself, to cross-subsidy and discrimination, as these charges will be levied twice for the same molecule of gas. Including a default exemption from capacity charges starts from the presumption of non-discrimination and provides greater incentives for TSOs/NRAs to properly evaluate the net costs and benefits of storage, rather than starting from an acceptance of discrimination and relying on TSOs and NRAs to remove this based on an assessment against partly subjective criteria.

Finally, we recognise and welcome the efforts made by ENTSOG to tighten the definitions of "transmission services" and "dedicated services" to prevent Member States from applying the costs associated with non-transmission services to the tariffs paid by network users at transmission entry and exit points. Whilst we feel that ENTSOG has largely achieved this through amending these definitions, we are concerned that the inclusion of the new Article 20.2, relating to alternative capacity-based or commodity-based charges, allows NRAs to introduce new transmission tariffs/levies which appear not to be covered by the cost allocation methodology or the consultation requirements of Chapter III, and whose association with transmission services revenue (or allowed revenue) is unclear, e.g. German downstream L to H gas conversion levies and Italian CV<sub>OS</sub> commodity charges. The fact this new Article has been introduced at this late stage reinforces our view that the Code has failed to meet the required levels of clarity, efficiency and harmonisation we would have expected of it.

To the extent a national regulatory authority sets or approves alternative capacity-based charges for specific capacity products or alternative commodity-based charges, calculated other than as set out in Article 4(2), these should be non-discriminatory and subject to a dedicated consultation to determine that their provision will enhance the efficient use of the transmission system and/or avoid cross-subsidies between network users or classes of network user. The consultation should also make clear how any over or under recovery from such charges is to be reconciled, where relevant.

***4. Please indicate your support for Chapter 3: Consultation Requirements (Articles 21 -23)?***

**Do not support**

EEFT recognises and welcomes the improvements made to the requirements specified in this chapter and sees consultation as one of the key components of a de-scoped Tariff Network Code.

Including within the scope of the consultation a harmonised postage stamp counterfactual, dedicated services charges, the complementary revenue recovery charge and the risk premium associated with use of a fixed payable price is welcome and appropriate. However, exempting TSOs using the postage stamp from applying a different counterfactual is an unwelcome omission, which seems odd as ENTSOG “understands and supports the principle behind stakeholders arguments” for a different counterfactual being applied.

We are surprised that ENTSOG has chosen to ignore our proposal to consult on the cost allocation methodology at least every four years rather than simply reviewing it. ENTSOG’s argument against undergoing a consultation similar to that envisaged under Article 20 is that “the consultation process is quite time-consuming and burdensome”. We do not find this argument credible given the importance the cost allocation methodology has in determining the efficiency of cross-border flows.

Finally, due to the critical role the cost allocation test has in highlighting potential discrimination between national and cross-border tariffs, we continue to believe that TSOs or NRAs should fully justify how the cost drivers used in the test have derived, and to seek an opinion from ACER on these. Requiring ACER to express an opinion upfront on the cost drivers will lessen the chance of tariff discrimination in favour national network users impeding development of the single energy market.

***5. Please indicate your support for Chapter 4: Publication Requirements (Articles 24 -27)?***

**Partially Support**

EEFT recognises and welcomes the improvements made to the requirements specified in this chapter and sees publication requirements and transparency as the key components of a de-scoped Tariff Network Code.

Publishing, for each tariff period, the transmission services revenue, under/over recovery and justification of tariff charges, along with estimates of tariff changes for the remainder of the regulatory period, will enable network users to gain a better understanding of tariff determination and evolution, partly de-mystifying the current tariff setting black box.

We also welcome the fact that ENTSOG has recognised the importance of TSOs publishing their tariff models to enable network users to do their own analysis of possible tariff evolution. However, we

are concerned that ENTSOG envisage TSOs releasing only a “simplified” tariff model and that “sensitivity analysis” enabling network users to estimate the possible evolution of tariffs can be published as a substitute to the model. The goal behind requesting TSOs to release their tariff models is to ensure network users can exactly replicate the tariffs they are obliged to pay, and project tariff changes going forward based on their own assumptions. Providing a “simplified” model suggests to us that this goal may not be achievable and “sensitivity analysis” suggests to us that network users will not be able to challenge the assumptions on which a TSO’s estimates of tariff evolution are based. We therefore repeat our call for TSOs to publish working tariff models, in the official language(s) of the Member State and in English, populated with the actual information used to derive the transmission tariffs and whose structure enables network users to easily override the actual and forecast information used to populate it in order to make their own predictions about future tariff evolution.

We are pleased that ENTSOG has recognised the importance to network users of multipliers and seasonal factors being known prior to the annual capacity auction date and for these to remain firm throughout the first capacity year. However, we remain deeply frustrated that ENTSOG has not been able to engineer a solution that would enable firm reserve prices for the first capacity year to be published prior to the annual capacity auction. Instead only indicative prices are being made available. Whilst we recognise that publishing firm annual capacity reserve prices in advance of when these would be normally made available creates more complexity and may diminish tariff setting accuracy, we do not consider this an insurmountable problem provided the implicit cash flow implications are properly addressed. Time will tell how accurate TSOs indicative prices will be and whether these will give network users sufficient confidence to bid in the annual or quarterly capacity auctions. But our fear is that by failing to address this obvious inefficiency the Tariff Network Code will create a situation where network users are only prepared to bid in monthly, daily and within day capacity auctions. If indicative prices are the best ENTSOG can offer for now, we think the Tariff Network Code should at least include a best endeavours obligation on TSOs to publish final reserve prices which closely equate to previously published indicative prices.

## ***6. Please indicate your support for Chapter 5: Reserve Prices (Articles 28 –34)?***

### **Do not support**

EFET welcomes the fact that the link between multipliers and instances of congestion (as inadequately described the CMP guidelines) has been removed. We also cautiously welcome the removal of interruptible capacity discounts solely on an ex-post basis. However, we are concerned that the formula for setting discounts on a combined ex-ante and ex-post basis could incentivise TSOs to deliberately under estimate the probability of interruption, or the “A” factor, to a greater extent than would be the case for exclusively ex-ante discounts. That said, under either scenario, TSOs should include information about their flow scenarios and detailed network configurations in the explanations given about how the probability of interruption has been calculated, but this has not specifically been included in the refined Tariff Network Code drafting.

However, we do not support the extension of multiplier beyond the 1.5 cap as proposed in this chapter. Completing the single energy market, which the Tariff Network Code is intended to help achieve, is not predicated on ensuring an unrealistic level of revenue stability for monopoly TSOs. So we cannot accept a situation where it legitimises short term capacity prices being set at five times the price of annual capacity, even if setting shorter term multipliers at this level is linked to a pre-defined formula.

As the formula can be based on the forecast amount of contracted capacity as well as the actual amount, TSOs can easily adopt a pessimistic forecast to disincentivise short term booking, thereby creating a self-fulfilling prophecy. To compound matters further, the seasonal factor can be set to a power of two even at the maximum multiplier of five, meaning the combined disincentive to book short term products is even larger. In light of this, we think our previous request for multipliers in excess of 1.5 to be subject to ACER's opinion is even more necessary if ENTSOG continue to insist higher multipliers are needed to ensure TSO revenue protection or financial stability.

To think that the market will be able to reveal the value of short term capacity when multipliers are set at five times the annual cost of capacity is unrealistic, and this undermines one of the fundamental principles underpinning the CAM Network Code. It will be ironic if the Tariff Network Code drives network users back to booking flat annual strips of capacity which they do not need because of overly high short term multipliers and seasonal factors, despite the efforts of the Commission and ACER to reduce contractual congestion through the CMP guidelines.

***7. Please indicate your support for Chapter 6: Revenue Reconciliation (Articles 35 –38)?***

**Do not support**

The extent of any revenue under or over recovery that builds up in the regulatory account during the course of tariff and regulatory periods will be a major driver of tariffs changes in future. So we consider it essential for TSOs to publish this information on a quarterly basis (as opposed to annually on the occasion of tariff changes each tariff period).

Also, where sub-accounts to the single regulatory account apply, TSOs should publish annually the amount of any under or over recovery by sub-account. This will help parties to better understand the degree of cross-subsidy that may be occurring between different classes of user as a consequence of having a single regulatory account. At present there is no obligation on TSOs to publish this information at all, which could create a climate of suspicion as potentially distortionary cross subsidies will remain opaque.

Finally, the revenue reconciliation provisions specified in this chapter apply only to revenue from transmission services, not to revenue from dedicated services. Reconciliation of dedicated services revenue should be subject to the same frequency and degree of transparency as reconciliation of transmission services revenue. Any over or under recovery related to a specific dedicated service

should typically be dealt with by means of the same charge in following tariff periods, except where approved otherwise by NRAs due to exceptional circumstances.

***8. Please indicate your support for Chapter 7: Pricing of Bundled Capacity and Capacity at Virtual Interconnection Points (Articles 39 –40)?***

**Neutral/No Response**

***9. Please indicate your support for Chapter 8: Clearing Price and Payable Price (Articles 41 –42)?***

**Partial Support**

EFET strongly supports ENTSOG’s inclusion in the refined Tariff Network Code of a fixed payable price option, complete with pre-defined indexation mechanisms, risk premiums and conditions associated with its use. This is a proportionate measure which recognises the overwhelming desires of stakeholders whilst at the same time addressing ACER’s concerns about different network users paying different prices for capacity, or not contributing sufficiently to a TSO’s ongoing costs of providing transmission services. EFET would prefer to see TSOs being required to offer a fixed price option alongside a floating price option. However, this needs to be considered in context of any existing floating price long-term capacity contracts and the need to prevent undue discrimination, which a potential stop-loss reset mechanism (see our response to Chapter 10) may overcome.

If fixed price options remain ruled out of the final Tariff Network Code however, EFET would strongly prefer to see a de-scoped Tariff Network Code which stays silent on the issue of payable price, rather than one which includes just a floating payable price.

***10. Please indicate your support for Chapter 9: Incremental Capacity (Articles 43 –47)?\****

**Neutral/No Response**

See our response to the Incremental Proposal - stakeholder support process questionnaire.

***11. Please indicate your support for Chapter 10: Final and Transitional Provisions (Articles 48 –50)?***

**Do not support**

EFET is disappointed ENTSOG has chosen not to accommodate the overwhelming wishes of stakeholders for a one-off capacity reset mechanism. However, the fact that ENTSOG is not willing to accept the underlying assumptions behind why stakeholders feel a reset mechanism is necessary does not mean they will fall away, or that stakeholders will give up on finding ways to satisfactorily address them.

EFET accepts, for now, that there has not been sufficient discussion about how a reset mechanism might be structured to alleviate some of the concerns expressed by TSOs and ACER for it to be included in the Tariff Network Code. Hence we propose a radical de-scoping of the Tariff Network Code to focus only on those chapters which obviously add value. Consideration of a reset mechanism should then take place in the wider context of developing an ambitious plan to create a sustainable model for transmission network access and charging for the future. A de-scoped Tariff Network Code has the added advantage of being able to be implemented before the October 2017 date currently envisaged in the Tariff Network Code.

If our proposal is ignored and the current Tariff Network Code is implemented, complete with amendments introduced before and during comitology over which stakeholders may have little transparency or ability to challenge, we fear that the problems underpinning the need for a reset will become worse than they currently are.

Therefore, in the absence of radical de-scoping we strongly urge ENTSOG to include an ongoing “stop-loss” reset right similar in structure to that which currently exists in Belgium. In the Belgian example networks users are entitled to reset existing capacity, in whole or in part, if the reference price at an entry or exit point increases by >30% in real terms over a three year period preceding the date of termination. Further consideration is needed about whether such price increase threshold and period are appropriate at EU level, or whether the price increase threshold should be set lower or the period set longer. However, whilst such a mechanism does not replace the need to develop an equitable one-off reset mechanism it would, at least, provide backstop protection to existing capacity holders against bearing the risk of unreasonable tariff rises brought about as a consequence of implementing the Tariff Network Code, or for any other reason. The current Belgian price increase threshold exceeds the initial level of mitigating measures currently included in the Tariff Network Code and far exceeds the levels of tariff increases ACER repeatedly claim network users can expect to see in future, so on this basis it is unlikely ever to be triggered. Nevertheless it would provide the necessary degree of reassurance to network users that if their worst case fears are realised they will be able to mitigate this risk. It will also provide substance to regulators repeated assurances that expectations of price increases of this magnitude are without foundation, despite evidence to the contrary already existing.