



EUROPEAN COMMISSION
DIRECTORATE-GENERAL FOR ENERGY

Directorate B - Internal Energy Market
Acting Director

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ACER
The Director
Mr Alberto Pototschnig
Ljubljana
Delivered by e-mail

Subject: Framework Guidelines on rules regarding harmonised transmission tariff structures for gas

Dear Mr Pototschnig,

I am writing to you ahead of the official transmission of the framework guidelines on rules regarding harmonised transmission tariff structures (FG TAR) by ACER. The Commission recognises the efforts made with regard to the harmonisation of the reserve prices for short term standard capacity products; the outcomes achieved are very much welcome. However, I would like to take the opportunity to share with you some concerns with regard to the level of harmonisation the FG TAR is set to achieve in particular as regards cost allocation/determination of the reference price.¹

Based on preparatory scoping work by ACER and a study by THINK started in 2011, the Commission sent you on 29 June 2012 a letter inviting ACER to start the work on developing the FG TAR. In this letter we outlined that it should contribute to non-discrimination, effective competition and the efficient functioning of the market while aiming to achieve cost-reflectivity, the avoidance of cross-subsidies, the promotion of efficient new investment, and greater transparency. In your letter of 17 December 2012 you explained that the development of the FG TAR will need some additional time due to the complexity of the issue and the corresponding additional analysis needed, to which we responded favourably, granting an extension of 3 months until 31 March. The Commission reiterated in its response the need to present a FG TAR that is sufficiently ambitious in its own right to contribute towards the fulfilling of EU's objective of creating an internal market in gas and that is underpinned by a robust impact assessment setting out the strategic decisions assessed and ultimately adopted by ACER.

¹ In applying a cost allocation methodology each entry and exit point is attributed a tariff for the annual firm capacity product. The tariff for the annual firm capacity product is the reference price for setting the reserve prices for capacity products of shorter duration and interruptible capacity. Where auctions are used, the reference price is used as the reserve price for the annual firm capacity product.

Based on the latest drafts of the FG TAR received, we are concerned in particular that it is not ambitious enough with regard to the harmonisation of the determination of the price for an annual firm capacity product (cost allocation methodologies²) as it is not foreseen that the Network Code (NC) further elaborates on the harmonisation of cost allocation methodologies as such.

Cost allocation / Determination of the reference price

We are concerned that by not addressing cost allocation methodologies in a "bottom up" approach, instead reverting to a "top-down" test to replace that process, ACER is not taking the necessary step to ensure that transmission tariff setting across the EU becomes non-discriminative, transparent, comparable and, if needed, adjustable within a logical structure.

In our view the objective of rules on cost allocation is not only to reduce the possibility of cross-subsidies between domestic and cross-border network users but a broader one as cross-subsidy between any type of network user on the level of transmission system operators (TSOs) will have an effect on cross-border gas trade. We, however, support the approach taken in the FG TAR to use the same methodology to determine the price for all entry points and exit points of the entry-exit system in order to avoid discrimination between network users. In this context we would nevertheless welcome further explanations why the possibility to have a different cost allocation methodology for entry points than for exit points is needed.

The NC TAR needs to introduce a bottom-up approach which lays out a set of tariffication methodologies describing the principles to be followed when applying the respective methodology and identifying criteria when a certain methodology should or should not be applied. That said we are not against including a "cost allocation test" in order to identify whether a certain cost allocation methodology leads to discrimination between cross-border and domestic type of network users, as long as the NC TAR also provides for a bottom up approach addressing the different cost allocation methodologies. This bottom up approach should be based on the assessment of the cost allocation methodologies currently used in the EU Member States.

Furthermore, we are of the opinion that the question how much of the allowed revenue is captured from Entry tariffs and how much is captured from Exit tariffs (Entry-Exit split) is part of the cost allocation methodology. The appropriateness of an Entry-Exit split may differ with respect to the cost allocation methodology chosen and the network topology.³ In this regard, ENTSOG in the development of the Network Code should together with stakeholders assess for each cost allocation methodology whether the capture of the allowed revenue should start from the general principle of a 50:50 split between entry and exit, or whether a band-width as currently proposed in the FG TAR needs to be introduced as a 50:50 split would lead to cross-subsidies.

ACER therefore should ensure in the FG TAR that the subsequent NC TAR:

² The methodology that determines the share of the TSO's (allowed) revenues which is to be collected from the expected sale of transmission services at entry and exit points.

³ See minutes of the 7th Meeting of Ad hoc Expert Group on Harmonised Gas Tariff Structures on 22 January 2013
http://www.acer.europa.eu/The_agency/Organisation/Expert_Groups/EG_on_Harmonised_Gas_Tariff_Structures/Meetings/7th_EG_Gas_Tariff/default.aspx.

- lists a limited number of cost allocation methodologies⁴ that fulfil the objectives of the FG and can be used for setting the tariffs of a TSO;
- describes how each cost allocation methodology determines the tariff for the different capacity products including the annual firm capacity product:
 - by providing rules on the appropriate Entry-Exit split;
 - by identifying for each tariff methodology the input parameters and cost drivers that are used;
 - specifying what the cost drivers refer to (e.g. what level of capacity and which capacity, distance from where to where, flows and their direction);
- describes under which circumstances (e.g. large system, transit system, predictability of flow) each cost allocation methodology can be used; taking into account how each cost allocation methodology delivers in achieving the objectives of the FG (e.g. avoiding cross-subsidy; facilitate competition, transparency, providing locational signals, cost-reflectivity).

The exact number of cost allocation methodologies to be listed, the question whether methodologies can be combined for the determination for Entry and Exit tariffs and under which circumstances, the level of detail needed in describing the methodologies and the criteria to apply it, could be developed by ENTSOG together with stakeholders in the development of the NC. In light of the close co-operation between ACER, ENTSOG and the Commission, it should be underlined that the FG is only an intermediate step to develop the NC. The adoption of the legally binding NC TAR will still take at least two years. During this process ACER will have an important role in scrutinizing the NC text drafted by ENTSOG. However in order to do so the FG TAR needs to give ENTSOG a clear mandate.

The approach requested hereby respects the subsidiarity principle. The Third Energy Package gives a clear mandate to develop harmonised rules on tariffs. Nevertheless the Gas Regulation states that NCs shall, if appropriate, take into account regional special characteristics. It also states that tariff rules shall reflect the genuine system needs and should take into account the resources available to the TSO. Our aim is not to disregard the national specificities. In fact, we consider that the NC TAR should limit the choice of how and when to apply certain cost allocation methodologies in order to prevent the occurrence of cross-subsidy and discrimination with cross-border effects. The impacts of widely varying cost allocation methodologies on cross-border trade is significant and numerous discussion among market players and regulatory authorities have been brought to the Commission's attention in this context⁵. To be also noted that

⁴ Such as Equalisation approach, so called distance to the Virtual Point methodologies, Matrix etc.

⁵ These include the Shannon LNG terminal case in Ireland; Portugal questioning the differences of cross-border and domestic exit tariffs in Spain; discussions between Italian and Austrian national regulatory authority on the cost allocation methodology applied to the Austrian Entry-Exit system and the calculation of tariffs for conditional capacity at the French entry point Oltingue in the framework of the open season for the development of South-North gas interconnection capacity (reverse flow from the Passo Gries Interconnection Point to Oltingue Interconnection Point).

stakeholders claimed distortive effects (differentiation of treatment of users) from differentiation between the entry points i.e. higher increases of tariffs on one of the entry point than on the other. Furthermore, stakeholders asked not to limit as such the possibility of an equalisation approach

A bottom-up approach should create full clarity as to the methodology, assumptions, specifics etc. applied in any given Entry-Exit system. Furthermore, this would also provide a transparent framework on the basis of which complaints in any given tariff structure can be addressed. We acknowledge that the harmonisation of the different methodologies and the criteria when one shall apply which model will nevertheless need to leave room for certain flexibilities with regard to e.g. new developments or changes in the Entry-Exit system. We are also aware of the fact that in reality it is almost impossible to achieve a full cost-reflectivity and that therefore a certain amount of cross-subsidy between network users is likely to happen, especially with regard to the introduction of Entry-Exit systems. This, however, needs to be transparent, controlled and based on specific and objective criteria to be developed in the NC TAR.

We furthermore note that the FG TAR does currently not address whether the tariff calculation for new investments should be done on the basis of project costs for these investments or whether the investment costs need to be rolled into the overall revenue of a TSO and the tariffs are then set accordingly to the general cost allocation methodology. The NC TAR should lay down rules under which circumstances a project-based cost allocation can be applied taking into account the possibility of a cross-border cost allocation introduced by Article 13 of the Regulation on Guidelines on trans-European energy infrastructure.

Other comments on the FG TAR

In addition to the issues set out above we consider that certain amendments relating to the sections on transparency, mitigating measures and definitions would be necessary.

As regards transparency with regard to tariffs, we are of the view that it is of utmost importance that it includes not only the kind of services and the costs that the respective network tariff includes but also the parameters on how the underlying Regulated Asset Base and the Operational costs are calculated (Investment Costs, Depreciation Period, Rate of Return, Efficiency Benchmarks etc.). That said, we note that this is without prejudice to the national authorities competence to set the allowed revenues.

Furthermore, the FG TAR should provide more clarity on the concept of mitigating measures. In our view rules on transition over a reasonable period of time seem to be needed at least in cases where prices make a significant change. The FG TAR currently provides for this possibility but does not set the criteria under which circumstances and how NRAs shall apply these measures. The FG TAR could describe this in more detail or could ask ENTSOG to develop a methodology under set criteria.

We also invite ACER to consider addressing the timing of the setting of gas tariffs.

With regard to ACERs monitoring task, ACER should consider to be less descriptive in the FG TAR.

We furthermore invite ACER to consider revising the definition section and consider defining concepts rather in the FG itself (e.g. equalisation approach, multiplier, seasonal factor, transmission tariffs). ACER should also consider distinguishing between the regulatory period and the period when a certain tariff structure applies. Furthermore,

clarity should be provided how the rules apply to the different regimes (price cap, revenue cap, rate of return) mentioned in the FG.

Finally, with regard to chapter 5 "Revenue recovery" we would welcome further explanation with regard to the objectives to be achieved.

We thought it would be helpful for transparency reasons to transmit these comments to you in writing ahead of the Board of Regulators discussion of 20 March 2013.

Yours sincerely,



Jan Panek

c.c.: Walter Boltz