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ENTSOG RESPONSE TO ACER TARIFF SCOPING CONSULTATION

Executive Summary

ENTSOG welcomes ACER's consultation on the „Scope and main policy options for Framework Guidelines on Harmonised Tariff structures", which sets out important aspects of tariff structures in a clear and balanced manner. ENTSOG is happy to contribute its views.

ENTSOG recognises that tariff structure objectives are strongly interrellated and some of them are conflicting and should be weighed against each other.

Weighing tariff principles is primarily a task on a system level. The inclusion in the scope of a tariff framework guideline on an EU level should be considered only where tariff structures have a clear impact on cross-border trade. The integrity of general tariff principles, such as recovery of actual costs incurred, appropriate return on capital investment and incentives for new investments have to be safeguarded.

ENTSOG agrees that cross-border and inter-zonal interconnection points are within the scope. Intra-zone downstream points and interconnections with LNG, storage and production are out of scope. This is notwithstanding that, of course, the high level allocation of cost recovery to these classes of points needs to be non-discriminatory.

An issue worth addressing in a tariff framework guideline is the relative pricing of capacity products of different durations. Here, ENTSOG has defined the „revenue equivalence principle" of reserve prices, which balances short and long term system usage. It allows network users to procure capacity as they identify a need, without incentives to either hoard capacity or to shift bookings to the short term. Therefore, it has the least distortionary effect and optimises both short and long term efficiency.

With many of the further issues listed by ACER, ENTSOG is still struggling to identify the cross-border problems that are to be adressed with harmonisation on an EU level. It may even be that harmonisation is counter-productive, as principles such as cost-reflectivity often require a bespoke approach. There are good arguments for all the cost allocation methodologies listed in the ACER policy options. The application of specific methodologies may often depend on the topology and characteristics of a given system.

ENTSOG clearly objects to any pricing of capacity products such that required revenues cannot be attained from capacity charges in the period for which they are set. This is particulary the case for the pricing of day-ahead capacity at short term marginal costs or at a discount, or reserve prices proportional to annual tariffs. In addition ENTSOG is not in favour of the pricing of interruptible capacity at a substantially lower price than firm capacity, particularly while firm capacity is still available.

Introduction

ENTSOG welcomes the opportunity to respond to ACER's „Scope and main policy options for Framework Guidelines on Harmonised Tariff structures" document, which sets out important aspects of tariff structures in a clear and balanced manner.

ENTSOG's response consists of two sections, along the structure of ACER's document:

In section I, ENTSOG puts forward general remarks on the principles and objectives of tariff structures, on issues and their interrelations, and on the scope of a framework guideline on tariffs.

Section II, provides specific comments on the policy options set out in the ACER consultation document. The consultation questions posed by ACER are addressed along with the response where they pertain.

I. Scope and Objectives

Question 3: Based on the Gas Regulation, are there further principles to be added?

Question 4: How would you interpret the above principles and objectives? Which objective would you consider to be the most important for achieving an EU internal market for gas? How would you rank the rest of the objectives? Please provide justification.

ENTSOG agrees with the general principles that tariff structures should comply with, which are enshrined in Regulation 715/2009. Aims of tariff structures listed by ACER include:

- Efficient gas trade and competition
- Avoid cross-subsidies and undue discrimination
- Deliver cost reflective charges and ensure cost recovery
- Allow for market signals and incentives enabling efficient infrastructure development (investment); this includes safeguarding of security of supply
- Be transparent, stable and visible in the long term

The aims of security of supply and tariff stability are not explicitly mentioned in Regulation 715/2009, but they certainly can be derived from the aim of long term efficiency and may be added to the tariff structure objectives.

These objectives of tariff structures have to be assessed collectively. Policy decisions on different design elements of tariff structures to support these aims cannot be looked at discretely, because they are strongly interrelated. For example decisions on the payable price for a capacity product determined in an auction, which may be taken to foster stability of capacity prices, cannot be separated from a decision concerning revenue safeguard measures (e.g. over and under recovery mechanisms), which may in turn affect the stability of total costs to users.

The optimal way to satisfy the objectives may differ, depending on system specificities. Currently, the introduction of the entry-exit transportation model across the EU and the expected CAM network code necessitate the redesign of tariff structures. This redesign provides insights into the challenges involved in attaining the objectives. In designing entry-exit tariff systems, there is always the aim to minimise any cross-subsidisation and maximise cost-reflectivity, both locational and between long and short term system usage. But in fact, it has to be noted that an entry-exit-system itself may lead to a certain level of cross-subsidisation between short-haul and long-haul transports within an entry-exit zone in favour of the latter.

ACER tends to put a lot of focus on Regulation 715/2009's tariff structure requirements. Of course, a tariff framework guideline will have to be in line with these. However, it is primarily TSOs and NRAs on a system level who are addressed by the Regulation in their design decisions and who must weigh conflicting principles against each other. Only when cross-border transports are hampered by a lack of harmonisation, should harmonised policy decisions be considered within a tariff framework guideline/network code on tariff structures. In this instance, there is an opportunity to harmonise tariff structures, which can facilitate a better functioning internal market.

Besides the above cross-border tariff structure principles, Regulation 715/2009 also contains general tariff principles. In any policy decision taken in a framework guideline on tariff structures, utmost care has to be taken to ensure these general principles. These are:

- Appropriate return on investment
- Provide incentives for investment
- Recovery of actual costs incurred
- System integrity
- System improvement
- Facilitate efficient gas trade and competition within-zone (or through zone mergers)
- Avoiding cross-subsidies within-zone

The safeguarding of these strongly interrelated general tariff principles is to be considered as a prerequisite for any tariff structure decisions – both on a national level as well as on EU level. TSOs need assurance that any tariff policy decision on an EU level will not jeopardise these important principles; or even some of them, as they are closely connected. Therefore any framework guidelines would have to contain appropriate safeguards.

Question 1: What other issues should be dealt with in this Framework Guideline? What is the evidence for including these issues? Please provide justification.

Question 2: What are the most important problems that relate to tariff structures? Do the problems identified by you relate to the lack of harmonised approaches?

ENTSOG agrees that **efficient use of and access to the system** should be an important consideration for ACER and ENTSOG when working on tariff structures. This means that all available capacity is

offered to users both in the long and in the short term on a full cost-reflective basis. Here, indeed, the pricing of different capacity durations is important. ENTSOG has identified a principle for an efficient pricing of capacity durations relative to each other, which is inherently incentive neutral as to the time of capacity procurement, namely the "**revenue equivalence principle**". This principle puts flat bookings and profiled bookings on an equal footing and allows for capacity usage across all time frames, thereby minimising cross-subsidies. [1]

"Cheap" short term capacity is not necessary to close gaps in hub prices. Any holder of long term capacity can consider bookings as sunk costs and close any price spread (accounting for a possible commodity charge).

Any tariff structure decision for the efficient use of the system should be taken such that – including in market area mergers fostering competition – the general tariff principles are not endangered (e.g. cost recovery).

ENTSOG also agrees that **undue discrimination** should be avoided. Tariffs should be cost-reflective and cross subsidies between cross border and domestic network usage should be minimised. Transparent and detailed methodologies for the calculation of the Entry and Exit Tariffs should apply. Such methodologies do not need, however, to be harmonised across the EU: there are several approaches which are capable to avoid such cross-subsidies.

The issue of price pancaking, i.e. the claim that transports across several entry-exit zones add up to higher charges than they create costs, has to be thoroughly examined. In entry-exit systems, there may actually be an inherent problem that leads to disproportional advantages for long-haul transports across the entry-exit system. Where this disproportionality occurs, shorter transports have a higher tariff weight relative to the distance transported and longer transports have a lower weight. Consequently, there may be something that one could call "reverse pancaking", which means that a transport across large merged zones would be less cost-reflective than a transport over several separated zones. In conclusion, ENTSOG believes that it has **not yet been substantiated that price pancaking is in fact hampering cross-border transports**, and with the new CAM regime of standardised bundled products and concurrent auctions (addressing transaction costs and avoiding capacity gaps), also for **contractual pancaking it is questionable whether this really constitutes a problem.**

Concerning **incompatible pricing**, ENTSOG struggles to identify the problem that is to be solved with harmonisation. It is unclear how charges at an IP as such, derived from methodologies complying with tariff principles at either side, could be incompatible; taking into account that the charges just add up. As is pointed out correctly in ACER's document, the provisions of the CAM NC for bundled services at IPs will enhance transparency to the benefit of shippers. Cost allocation methodologies should only be covered in a tariff framework guideline if clear benefits outweighing costs can be demonstrated (i.e. if their harmonisation fosters the internal market).

[1] THINK (2012) have acknowledged in their report on "EU involvement in gas and electricity grid tariffication" that care has to be taken in the pricing of long and short term capacity and have pointed to the issue of substitution of long term bookings by short term bookings, which jeopardises cost recovery and entails distortionary effects.

It should be noted that on an EU level and arguably also on lower levels there is competition of routes and thus tariff competition, which needs to be accounted for. The mechanistic application of a given – uniform – cost allocation methodology would lead to sup-optimal results and may put an operator out of business at a location or on a route, which is certainly not an efficient outcome. It should still be possible to set tariffs at competitive levels. In conclusion, the necessity for a one-size-fits-all harmonisation of cost approaches or locational pricing seems not to be very strong. Instead, TSO-NRA cooperation seems appropriate. This is further elaborated in section II below.

Under or over recovery of allowed revenues is certainly a primary concern to TSOs. However, ENTSOG would like to note that the regulation of allowed revenues is clearly out of scope. Then, over and under recovery mechanisms will have to be out of scope as well, because in regimes where no allowed revenues are set (based on legitimate design decisions, e.g. in price cap regimes), allowed revenue would have to be defined in the first place to enable over and under recovery mechanisms. A price cap would de facto become a revenue cap. This would clearly change the character of the core regulatory regime, which ENTSOG does not support. Consequently, if the determination of allowed revenue/tariffs is out of scope, general harmonisation of over and under recovery would have to be out of scope as well. However, it is essential that a potential tariff framework guideline states that tariff structures would be set such that the required revenues are fully recovered (as ensured through the over and under recovery safeguard clause in the CAM Network Code).

In principle, over and under recovery should only occur due to bidding in excess of the regulated tariff, and due to unanticipated demand fluctuations. However, with respect to under recovery that occurs due to systematic flaws in setting capacity tariffs ex-ante (such as arbitrarily low reserve prices on short term capacity), these flaws should be corrected and reserve prices should be set such that required revenues can be attained. If they are not attained, however, necessary over and under recovery mechanisms need to be in place in revenue cap systems on a national level, while in price cap systems, volume risks should be reflected in appropriate rates of return. This is particularly the case for certain types of transmission assets over which flows are highly unpredictable, e.g. due to the evolving energy mix.

Risk and uncertainty is a primary concern for shippers and TSOs. In today's dynamic environment, improvements in long term stability and visibility of the regulatory framework and tariffs will foster the internal energy market. Here, TSOs welcome the opportunity to work with network users and regulators to look at how uncertainty in tariffs could be mitigated. Measures such as market area mergers or changes of or within allowed revenue/price regimes also have an impact on levels of specific tariffs – here regulatory commitment and stability is important.

Booking behaviour is certainly one of the most important determinants of specific tariff levels and stability. Booking behaviour implications have to be kept in mind in all decisions on tariff structures. When users are enabled to signal their capacity requirements (e.g. via pricing according to the revenue equivalence principle), this contributes to mitigating tariff and regulatory framework volatility and ensures the delivery of proper signals to TSOs for the development of transmission capacity and thereby the overall efficiency of the gas system.

ENTSOG would like to highlight that the enforcement of an entry-exit system with locationally differentiated pricing could be hampered if binding long-term contracts for users were not in place,

in particular in systems where there is spare capacity. Users might change their locational use of the system to optimise their payments, which in turn endangers cost recovery and tariff stability and from an operational point of view could lead to a big change in flow patterns. Thus, it is imperative to safeguard network users' binding long-term contracts.

Mitigating risk and uncertainty requires long term stability, and long term stability requires enabling users to enter into commitments with TSOs. How this can be fostered will be elaborated below under the relationship of reserve prices.

Question 5: What are your views on the proposed scope and application regarding:

-Entry and exit points

-Determination of the annual reference price

-Mechanisms to deal with over- and under-recovery of allowed revenues and the definition of the clearing price?

Please justify your answer.

According to Regulation 715/2009, Art 7, network codes concern themselves with cross-border issues. In line with this, ENTSOG agrees with the scope outlined by ACER. **Cross-border and cross-market area interconnection points are certainly within scope**, while domestic downstream points and network interconnections with storage, production, and LNG are out of scope. This is notwithstanding that the high level allocation of costs to be recovered at these classes of points needs to be non-discriminatory (as provided for in Art 13 of Regulation 715/2009).

(Annual reference price: please refer to Q7 below)

It should be kept in mind, however, that decisions on the allocation of costs to be recovered from groups of points indirectly impacts interconnections with storage, production, and LNG as well as domestic downstream points. Costs that are not recovered from one group of points will have to be recovered from the other group. Here the principle of cost reflectivity, such as non-discrimination of domestic and cross-border transports, becomes relevant. Care has to be taken that tariff structure rules on cross-border interconnection points do not inadvertently lead to shifts in costs between these points and other classes of points. Such shifts should be avoided by proper cost allocation to cross-border and domestic points on a system level.

Design decisions which are seemingly only of structural character sometimes impinge on core aspects of regulatory regimes. As stated above, **over and under recovery mechanisms** are such a case in point. The setting of global tariff *levels* (as opposed to structures), which ACER calls determination of allowed revenues, is out of scope and should be the task of each NRA. ENTSOG agrees and assumes that ACER does not intend to impose revenue caps across the EU and that price cap regimes would continue to be possible (see above, answer to questions 1 / 2).

Question 6: Regarding the issue of compensation payments between TSOs within cross-national entry-exit zones, do you consider that:

i. No harmonisation is required.

ii. The rules establishing compensation payments should be harmonised at EU level.

iii. Guidelines of good practice on the issue would suffice. Please provide guidelines suggestions.

iv. Other option: _____. Please provide justification.

v. I don't know.

As cross-border entry-exit zones are currently tried out, there may be merit in learning from the experiences gained from them. Generally, the circumstances of specific cross-border zone mergers are likely to call for case-by-case assessment of cost recovery questions. While national NRAs are in charge of the setting of TSO remuneration, TSOs should be in charge of managing the details of a zone merger including the re-distribution of costs from the loss of chargeable points, which are within the zone after a merger (in close dialogue with their respective NRAs). In that respect, ACER shall consider that any rules defined in a tariff framework guideline should be compatible with newly merged zones in the future and it shall not hamper or dis-incentivise any future zone mergers (with a view to the general tariff principles of Art. 13 Regulation 715/2009). The ACER reconciliation process of article 8 of Regulation 713/2009 is in place in cases of disagreement between NRAs (who may have to approve TSO merger arrangements).

II. Policy Options

1. Determination of a reference price (locational cost allocation)

Question 7: Do you agree that transmission tariffs shall be based on reference prices as described above?

ENTSOG agrees that the allocation of costs to points takes place in successive steps, one of which is the determination of some reference value, from which reserve prices of capacity products at a given location are then determined. How such a reference value is set should be decided based on network and regime specifics.

An annual reference price as a concept is useful for the determination of reserve prices for different capacity products by applying multipliers. It appears natural to calculate reference prices on this basis because

- costs are often defined on an annual accounting basis,
- network transmission capacities are mainly designed to meet annual peak loads,
- the auction sequence of the CAM network code prescribes first the auctioning of capacities as a yearly product (up to 90%) and any further capacities as sub-annual products.

Question 8: Which option would you find appropriate to determine the reference price? Please justify your answer.

Question 9: Regarding the cost concepts, do you consider that:

i. No harmonisation is required.

ii. The rules should be harmonised, along the following lines:

_____. Please provide justification.

iii. Guidelines of good practice would suffice, along the following line:

_____. Please provide justification.

iv. Other option: _____. Please provide justification.

v. I don't know.

Question 10: Could two different cost concepts be applied on the two sides of an interconnection point without hindering cross-border trade? Please justify your answer.

The different methods for determining the reference price are ways to allocate costs to locations. The different approaches, no matter if it is LRMC, individual cost based, matrix, distance to reference node, or equalisation are providing drivers for such locational cost allocation. They are not determining the overall level of a TSO's cost recovery, which is regulated via the "allowed revenue" or other remuneration regulation by each NRA.

In economic theory, long run marginal costs provide incentives for efficient system usage and system development. LRMC allocate costs for incremental capacity to those who benefit from it. However, one has to bear in mind that the LRMC calculation is complex and resource intensive, whereas the usage of average costs is simple, transparent and workable. In some systems, it certainly makes sense to look at the effect of capacity additions on the costs, while in other systems an average cost approach, complemented with an adequate incentive mechanism for new investments, may fully suffice. In some cases, LRMC may be beneficial; in other systems the advantages and resource savings of an application of e.g. average costing may outweigh any such effect. Also, hybrid systems are conceivable, where parts of systems are priced based on LRMC, while in other parts the benefits from such an approach do not warrant the higher costs. Considerations of competition for routes between TSOs also need to be made.

ENTSOG does not see a reason why the different systems should not co-exist on either side of an IP. It is difficult to make a case for the harmonised application of one or other approach, which may be warranted in a specific system for good reasons. ENTSOG agrees that throughout Europe, gas transmission systems have very different characteristics which can justify having various cost allocation methodologies. Therefore, the decision on the application of any of the described methods should be made on a case by case basis, depending on system properties.

Question 11: Regarding the issue of cost allocation, you consider that:

i. No harmonisation is required.

ii. Methodologies for allocating a TSOs costs between cross-border and domestic usage should be harmonised across Europe

iii. Methodologies for allocating a TSOs costs between cross-border and domestic usage should be established on a more local basis, subject to guidelines of good practice.

iv. If cost allocation methodologies are to be set on a local basis, do you agree with the criteria set out above for assessing the methodologies?

Question 12: Do you consider potential cross-subsidies as a concern in relation to the coexistence of different cost allocation methodologies?

Please justify your answers.

A certain level of cross-subsidisation is characteristic of almost all entry-exit-systems, because the booking/usage of entries and exits is decoupled and independent from point-to-point distances and usage of the system; the level of cross-subsidisation depends on system specificities.

The different approaches to determining locational differentiation of capacity prices all have specific advantages and have to be assessed based on the system specifics they are applied to. The **individual costs based approach, the matrix approach, the reference node approach** and the **equalisation approach** are each methods to implement locational signals into tariffs. Each of the approaches gives a slightly different balance to the tariff criteria of Art 13 Regulation 715/2009. These slightly different balances should fit with the network and regime characteristics currently in place.

Also adjustments to the pure application of a given method may be warranted in certain cases. For instance, this may be the case when in merged market areas TSOs lose marketable points. Furthermore, where competition of routes exists, this also has to be taken into account. In addition, short haul tariffs to avoid direct connections being built may become necessary. Objective criteria based on point characteristics may warrant differentiation even for points with similar locations. For example, end consumer exits with a high predictability may cause less costs to a system when compared to cross-border interconnection points with non-predictable profiles, even if they have similar locations.

Across the EU, individual decisions have been taken to strike a balance between different goals. For example, differentiation by location may be more cost-reflective, while uniformity may be based on the reasoning of “cross-region fairness” or level playing fields for end users. Practical considerations for grouping or uniformity of locational pricing include transparency, workability of calculation and ease of application, especially in the case of points where tariff differences would be minimal.

Conclusion

ENTSOG agrees with ACER that different system characteristics may call for different approaches to reach the aims of **transparency, non-discrimination and effective contribution to market integration.** Again, ENTSOG does not see a reason why the co-existence of different allocation methodologies at cross-border points should per se hamper cross-system usage or create cross-subsidisation. However the methodologies would have to comply with tariff principles in themselves.

Therefore, harmonisation should only be considered if it can be demonstrated that the benefits clearly outweigh the costs involved. Throughout Europe, gas transmission systems have very different characteristics, which can justify the presence of various cost allocation methodologies, and indicate that harmonisation would not be beneficial.

2. Relationship of reserve prices for different product durations and interruptible / backhaul

Question 13: Regarding the issue of reserve prices for short term products, do you consider that:

i. No harmonisation is required.

ii. The rules should be harmonised, along the following lines:

_____. Please provide justification.

iii. Guidelines of good practice would suffice, along the following line :

_____. Please provide justification.

iv. Other option: _____. Please provide justification.

v. I don't know.

Question 14: What are your views on the proposed policy options? Would you suggest other options? Please provide your reasons.

Question 15: What are in your view the advantages/disadvantages of each of the options?

Question 16: Should seasonal factors be applied?

Short term prices proportional to yearly reference price

The application of the same unit price for different capacity durations would provide a strong incentive to system users to optimise their bookings by waiting for sub-annual products to reduce their capacity booking volume, depending on the risk of capacity availability. Users would not signal peak requirements to the TSO anymore, but in effect would only be charged by the volume transported. Such a pricing structure, in which for example the sum of shorter capacity product charges is equal to the charge for a longer capacity product consisting of these shorter capacity products, offers in effect a discount: this is due to the fact that closer to the flow users can fully profile their bookings as they then know their short term requirements. Such a discount is arbitrary (prohibited by Art. 14 (2) 715/2009) and has the following effects:

- The reduction of capacity sales volume requires the raising of the unit price for capacity, in turn driving even more users to short term optimisation, leading to a vicious circle. This is particularly the case where there is little expectation of congestion. (Contractual congestion is expected to be alleviated across the EU due to CMP and CAM).
- Network users who require flows for relatively flat profiles (e.g. industrial customers) and book accordingly would be at a disadvantage compared to peaky users, resulting in a cross-subsidy between classes of system users.

- A substitution of longer term bookings by sub-annual products harms the identification of physical congestion: Given that bookings would move towards reflecting short term usage only, users would not indicate peak capacity requirements to the TSO and investment signals would be lost. This would undermine the sound evolution of the European gas transmission network.
- Tariffs would become volatile and unit prices would go up, due to necessary adjustments corresponding to the evolution of booking volumes which would more closely align to usage volumes.
- A discount on sub-annual capacity destroys the value of it and therefore negatively affects the secondary market for capacity, which is an effective CMP measure.
- The pricing of sub-annual capacity at a discount will not particularly benefit new entrants and small system users, but rather bigger system users who have the resources to take part in all the auctions necessary for optimising shorter term bookings.

Most importantly, applying the same unit price for different capacity durations would be a move away from the logic that the costs of a transmission system are determined mainly by the peak capacity. Due to the fact that most costs are fixed in the long run, users should be charged according to their peak flow requirements signalled to the TSO (because these determine the sizing of the system). A pricing system based on fully optimised profiled bookings, which would be a charge on actual flow volumes, counters that logic and would constitute a pay-as-use system.

Cheap short term capacity is furthermore not necessary to close gaps in hub prices. Any holder of long term capacity can consider its bookings as sunk costs and close any price spread (taking into account a possible commodity charge).

Short-run marginal cost pricing and discounts on short term capacity

The considerations of the preceding paragraphs hold even more weight for the application of short term marginal prices or discounts on short term products offered in auctions. Experience, particularly from Great Britain, where bookings before the year at many points is at levels of only 40% of flow requirements, and increasingly also from Germany, where demand for longer term products is very weak, shows that the flight to short term products does in fact takes place where such pricing occurs. This has extremely detrimental effects on the avoidance of cross-subsidisation and deprives the market and TSOs of timely and efficient investment signals. When congestion occurs, it is too late and capacity prices will spike inefficiently, while at the same time it is unclear whether congestion will persist.

It should furthermore be noted that, in contrast to electricity, where only a small proportion of commodity is exchanged cross-border, a great proportion of natural gas crosses (often several) borders. Without cost-reflective charging for such cross-border transports, domestic end-consumers would be left paying for transports across their market areas – clearly an unpalatable situation, both economically and politically. Finally, an attempt to recover revenue shortfalls with a dedicated commodity charge will hamper cross-border flows, because it adds a volume dependent cost to flows, which has the effect of a tax.

Again, the argument that this option fosters short term efficiency of commodity markets may not be strong: Holders of longer term capacity can regard them as sunk costs and close any price spread (taking into account a possible commodity charge). Therefore, this measure is not even necessary to achieve short term efficiency and competition aims.

Short term marginal pricing may work within a congested system where prices will go up sufficiently to recover costs and make up for lower recovery in off-peak periods. However, in cases where there is no congestion (which is a general EU policy aim, e.g. through the SoS-Regulation and the Connecting Europe Package), there will most likely be insufficient revenue recovery at interconnection points.

Revenue Equivalence Principle

ENTSOG considers the revenue equivalence principle of flat vs. profiled bookings, defined in its draft CAM network code, to be the only pricing structure that complies with articles 13 and 14 (2) of Regulation 715/2009. It provides for the requirement that cross-subsidies shall be avoided, and that shorter duration contracts than a standard annual contract shall not result in arbitrarily higher or lower tariffs that do not reflect the market value of the service. Based on these provisions, ENTSOG has defined the revenue equivalence principle, which introduces a non-arbitrary and reasoned approach to setting the tariffs for different product durations. The revenue equivalence principle is based on the following considerations:

- It is designed to be incentive neutral as to the time of capacity procurement considering the preferences of the network users to take or avoid risks of unavailability of certain capacity products at the time of the expected transport. It allows system users to procure capacity according to their identified need by minimising any undue incentives to book capacity before such a need is identified and minimising any undue incentives to wait for sub-annual capacity auctions after such a need is identified (enabling investment signals).
- The revenue equivalence principle seeks to avoid cross-subsidies between network users. That means that users who require highly variable gas flows, the levels of which are only known shortly before the actual gas flow, will be able to match capacity bookings to their requirements by building a highly variable product profile. They accordingly shall pay capacity unit prices reflecting the value that these sub-annual capacity products have to them. The unit prices need to be higher than for long term capacity products, in order to avoid cross-subsidies, because the users of sub-annual products procure less units of capacity to cover their peaks.
- The revenue equivalence principle is a tariff structure feature that allows for recovery of required capacity revenues *ex-ante*, in order not to create a systematic need for corrective mechanisms *ex-post*, which will have distortive effects.

The below table summarises the main features of the policy options:

Policy Options Overview	Allows identification of physical congestion (investment signals)	Contributes to cost-reflectivity	Avoids cross subsidies between network users by profile
Revenue equivalence principle	**+**	**+**	**+**
Same unit price for different capacity durations	**- -**	**-**	**-**
Marginal costs or discount on short term capacity	**- -**	**- -**	**- -**

Question 16: Shall seasonal factors be applied?

Seasonal factors may be an interesting instrument to be considered to efficiently steer user booking behaviour. Seasonal factors can be combined with the revenue equivalence principle, as the condition of equality of profiled vs. flat bookings shall hold on average across a year, and not for individual shorter term products. Seasonality rules on a European level, however, should allow for addressing usage characteristics of points and systems and the changeable character of user behaviour, which is a function not only of capacity prices but also of exogenous factors such as market, economic and climatic conditions. Therefore, rigid rules prescribing seasonality on a European level, even a rule like “high prices in times of high capacity demand”, may not necessarily foster cross-border trade in all cases and at all times.

Conclusion

ENTSOG considers the revenue equivalence principle in the relationship of reserve prices for different product durations to be a core element highly relevant for the achievement of the 2014 internal market aim. ENTSOG would be happy to include a methodology for the revenue equivalence principle in a network code on tariff structures, and to work out design details for its implementation.

- *Question 17: Regarding the issue of reserve prices for interruptible and non-physical backhaul capacity, do you consider that:*
- *i. No harmonisation is required.*
- *ii. The rules should be harmonised, along the following lines:*
- *_____. Please provide justification.*
- *iii. Guidelines of good practice would suffice, along the following line:*
- *_____. Please provide justification.*
- *iv. Other option: _____. Please provide justification.*

- *v. I don't know.*

Pricing of interruptible / non-physical backhaul will strongly depend on the character of products. The point in time when interruptible will be sold is crucial (before or after firm is sold out). CMP measures that will be introduced (short term UIOLI/oversubscription) will also have a significant impact on interruptible capacity.

An offer of interruptible capacity at zero reserve prices (option 2), particularly while firm capacity is still available, undermines firm capacity bookings and risks massive distortions, analogous to the explanation given above for the pricing of different product durations, but with a more extensive impact. The efficient usage and development of the system would be put in jeopardy. Here, the same considerations are relevant as pertaining to the offer of firm short term capacity at short-run marginal reserve prices or discounts. Particularly as long as firm capacity is still available, a zero reserve price for interruptible capacity is therefore not acceptable to TSOs.

In principle, ENTSOG agrees that the pricing of interruptible capacity shall aim at reflecting the likelihood of interruption. The options 1 and 3 put forward by ACER for the pricing of interruptible are good practice in a number of markets and are worth discussing. However, given the uncertainties with respect to the design of interruptible products and CMP measures, at this stage harmonisation seems not to be feasible.

3. Definition of the payable price

Question 18: Would you suggest other options?

Question 19: What are your views on the proposed policy options? Would you prefer one option over the other? To what extent can this preferred option be uniformly applied? Please explain.

Question 20: Do you consider that different approaches could be applied for one bundled capacity product?

In a regime where the clearing price determined in an auction is fixed as the payable price of the contract in question over the lifetime of the respective capacity product ("fixed capacity prices"), this may give users certainty on capacity prices over this timeframe for the contract in question. However, there may not be equal certainty on *total* transportation costs, because if the required system costs are not recovered with the clearing prices from capacity auctions, they have to be recovered at another location or at another point in time, with the potential for associated distortions and cross-subsidies. Fixed capacity prices, to provide the desired certainty, require a very stable underlying regulatory regime, as well as a stable booking behaviour.

Fixed capacity prices may lead to different prices depending on the time of capacity procurement. Certainty on capacity prices is only provided for holders of a specific contract, a later auction may offer a similar service at another price.

Fixed capacity prices and also the indexing options may be sensible where entry-exit systems are static. However, this is often not the case and changes in entry-exit systems do occur (e.g. loss of interconnection points due to zone mergers, flow changes, booking level changes). These changes have a bearing on the definition and perimeter of capacity rights and therefore the underlying costs of entry-exit capacities. To remain cost-reflective, the prices for capacity rights then have to change, too. Entry-exit capacity is not a statically defined transport right linked to a physical infrastructure, and changes in the definition of entry-exit capacity will have to result in tariff changes to safeguard cost-reflectivity.

A changeable regulated tariff plus an auction premium may reduce need for other dedicated over and under recovery mechanisms. In some regimes, allowed revenues are not defined (e.g. price caps) and therefore dedicated revenue correction does not fit to these systems at all. Regulated tariffs, in any case, should be set in a way that there is no possibility legally for shippers to terminate long-term contracts if the underlying regulated tariff changes upon regulatory decisions.

Conclusion

ENTSOG is of the opinion that an isolated harmonisation of the payable price may jeopardise other aims of tariffs and may impinge on core properties of regulatory regimes which are out of scope (allowed revenues). Therefore, harmonisation should only be considered if it can be clearly demonstrated that the benefits outweigh the costs, i.e. if harmonisation advances the internal market. Again, ENTSOG does not see a reason why the co-existence of different methodologies at cross-border points should not be possible. This becomes even clearer when one considers that across the EU there will be different currencies payable for bundled products at borders anyway, and these currencies are also subject to changes.

4. Over and under recovery mechanisms

Question 21: Regarding the issue of recovery of allowed revenues, do you consider that:

i. No harmonisation in required.

ii. The rules establishing this relation should be harmonised at EU level. Please provide harmonisation suggestions.

iii. Guidelines of good practice on the issue would suffice. Please provide guideline suggestions.

iv. Other option: _____. Please provide justification.

v. I don't know.

Question 22: Should there be a cap on the percentage of revenues to be recovered through a commodity charge? If so, then please provide proposals for how this could work in practice.

We also invite any further suggestion you may have concerning the Framework Guidelines on harmonised transmission tariff structures relating to issues which are either not considered in

the scoping document or mentioned but not considered for further analysis. Please reason your answer.

If the setting of capacity prices is done in an ex-ante way allowing for recovery of costs, the need for over and under recovery mechanisms may be reduced to forecasting errors and bidding in excess of the reserve price in auctions. ENTSOG would again urgently warn against the introduction of reserve price setting approaches that systematically cause the need for ex-post revenue correction, particularly the setting of short term capacity reserve prices at short-run marginal costs or zero.

In all over and under recovery mechanisms the timing of the cash flow of TSOs is of paramount importance. Operators have to serve their debt obligations, and there is a time value to money, so it is not only relevant that they recover costs, but also when they recover these.

When redistributing over recovery to system users via capacity tariffs (which would not be possible in a price cap regime), care has to be taken not to introduce perverse incentives. When a shipper, in an auction for capacity at an IP, has a big market share and is sure to get back (part) of the auction premium he is bidding (through the reduction of later capacity prices at this IP through an over recovery mechanism), he can outbid any competitor at low risk.

As explained above, over and under recovery mechanisms are not possible in regimes where no allowed revenue is set (e.g. price cap regimes). Without impinging on these regimes, harmonisation on an EU level should not be pursued.

A commodity charge should not be used to correct any systematic flaw in the ex-ante setting of reserve prices. There is a danger that such a usage acts as a tax on nominating gas flows and introduces tariff uncertainty and volatility. Capital costs should not be accounted for in a commodity tariff (if it is used at all). Such may better reflect the character of fixed (capital) and variable (operational) costs.

Depending on the allowed revenue or price regulation design, a commodity charge, if not properly designed, induces a volume risk. On the other hand, pure capacity tariffs may put fuel gas price and volume risk on TSOs in regulatory systems where this is included in allowed revenues for setting capacity charges. This can also be mitigated by properly designing the allowed revenue regime.

Conclusion

A full harmonisation of the method of over and under recovery mechanisms would only make sense when being tackled concurrently with many other aspects of regulatory regimes, including those out of scope according to ACER. ENTSOG believes these mechanisms could be better designed at national levels rather than being harmonized at an EU level, keeping however the principle of TSO's revenue safeguard and setting tariffs ex-ante in a way to minimise the need for any ex-post correction. However, it is essential that a potential tariff framework guideline states that tariff structures would be set such that the required revenues are fully recovered (as ensured e.g. through the over and under recovery safeguard clause in the CAM Network Code).