Comments by TS CR on the Consultation Document pursuant to Article 26 of Commission Regulation (EU) 2017/460 of 16 March 2017 establishing a network code on harmonised transmission tariff structures for natural gas

19 February 2024

Within the framework of the public consultation on the methodology for the development of tariff items for the use of the transmission system in the Czech Republic as required by Commission Regulation (EU) 2017/460 of 16 March 2017 establishing a network code for harmonised structures of transmission tariffs for natural gas, the Energy Regulatory Office invited all interested parties to send their comments and suggestions on the published consultation document by 19 February 2024. Association for District Heating of the Czech Republic (TS CR) applies the following comments to the consultation document:

General comment:

The Consultation Document contains obvious tools to shift costs from the transit portion of the transportation to the transportation to the end customers in the Czech Republic. The Consultation Document assumes the need to operate the system and thus the assets and costs as built for approximately 13 times the transit flows assumed today, but financed primarily by the end customers in the Czech Republic. Thus, the methodology clearly allows discrimination against end customers in the Czech Republic.

Although we understand that the transmission system operator has been in a problematic economic situation in connection with the Russian aggression in Ukraine, it is not possible to solve these problems by socialising costs into prices for end customers in the Czech Republic. Moreover, the TSO's behaviour in the years leading up to the war in Ukraine can be seen as not very responsible, especially in terms of the proportion of debt in its assets or in overlooking the risk arising from the use of the system by one large customer and at the same time investing heavily in favour of that customer. Historically, the transmission system operator has not shared its high profits from international gas transport with customers in the Czech Republic, so we see no reason why it should now pass on to them its economic problems caused by the decline in international gas transport.

The contracted capacity will occupy 7.6% of the total technical capacity at the transit outputs in the expected direction of use of the Brandov-Lanzhot transit system and no significant improvement can be expected in the long term. It is clear that with such low planned capacity utilisation, some assets must be conserved and removed from the RAB. This process of identifying redundant assets that can be curtailed and conserved should start immediately so that the results can already be reflected in the tariff setting for 2025. Instead, however, the Energy Regulatory Office assumes a de facto continuation of the status quo of 2024 for 2025, which is in clear contradiction with its obligation to protect the legitimate interests of its customers under the Energy Act.

The Energy Regulatory Office's approach, which completely ignores the problem of unused assets, ultimately leads to the uncompetitiveness of gas transportation through the Czech Republic and to the undermining of the competitiveness of certain industries and electricity production, which in turn will inevitably lead to a further decline in gas consumption and thus gas transportation, and again to a further increase in prices for capacity. The transmission system operator is thus entering a spiral that will lead to completely unacceptable results for customers in the Czech Republic in the medium term. We therefore ask the Energy Regulatory Office to immediately start taking steps to reverse this development, in the first place by adapting the capacity of the transmission system to the long-term demand for gas transport.

Specific comments:

Comment on Chapter 7.1

The general basis for the methodology of setting reference prices should be primarily to protect the interests of customers in the Czech Republic. These customers cannot fairly be asked to bear the costs of a system whose transport capacity exceeds their needs by many times. For example, the Capacity4Gas project would be built almost exclusively for international transport and the capacities built under it are essentially unusable by domestic customers. It is therefore not possible to 'melt down' the costs of this project on domestic customers, even under depreciation. The transmission system operator built this project at its own risk, based on the coverage of a long-term gas transit contract, which is, moreover, still in force. It is therefore not possible to effectively eliminate the transmission system operator's business risk and ensure that it privatises its profits and, if business risk materialises, socialises the losses associated with its business, and this in a situation where it does not even take adequate steps to reduce its unsustainable operating costs and conserve unnecessary parts of the system for the long term.

For its assertion, "In the case of the provision of gas transportation service, the risk associated with historical capacity bookings by the main Russian customer (GPE) cannot be fairly priced, which has already manifested itself and, with a probability approaching certainty, would continue to manifest itself in the form of deliberate non-performance of transportation contracts and complete failure to pay, and would therefore lead to uncovered costs to the transmission system and a lack of funding." The Energy Regulatory Office has not provided any concrete evidence. On the contrary, Fitch Ratings' press release issued on 5 January 2024 shows that it upgraded Net4Gas' rating and commended the Energy Regulatory Office for helpfully increasing the company's regulated revenues in 2024 to CZK 4.2 billion, compared to its expected CZK 3.2 billion. Fitch Ratings is therefore not nearly as concerned about Net4Gas' financial health as the Energy Regulatory Office, which is remarkable to say the least. Moreover, Net4Gas is state-owned through ČEPS, a.s., and a shortage of funds is therefore effectively out of the question.

On the statement "This risk can only be appropriately diversified with the participation of other users of the system." We note that the Energy Regulatory Office itself states a few lines above that this risk will continue to manifest itself in the form of deliberate non-performance of transmission contracts and complete failure to pay with a probability approaching certainty. But then this is not 'risk diversification' but simply passing on the costs to domestic customers. We need to call a spade a spade.

The Energy Regulatory Office further states, "Using/planning for uncovered GPE capacity for pricing under a separate price cap regime for transit would lead to a looping problem where the risk premium (in WACC) associated mainly with the credit risk in question and the corresponding transit prices would have to be set at a level reasonably guaranteeing actual cost recovery." This statement is not based on truth. The upper limit for setting tariffs would remain the competitiveness of the transmission system internationally. There would therefore be no 'looping'. The transmission system operator can continue to realise profits from gas transport, it has all the prerequisites to do so. If it fails to contract this transport, this should be its problem, not the problem of customers in the Czech Republic. Moreover, this is in a situation where the transmission system operator refuses to preserve at least part of its obviously unnecessary assets and thus reduce unnecessary costs.

The Energy Regulatory Office further states, "On the other hand, it is also natural that the revenues in the future resulting from any actual payment of GPE liabilities on the basis of legal recovery of the claims in question will be recovered in the regulated prices." However, there is hardly adequate legislative authority to do so and, moreover, in a number of cases, it will already be customers other than those who are supposedly being refunded (for example, switching from gas to other fuels) or, on the contrary, customers who are not paying these costs today because they have yet to start using gas. This is therefore a clearly discriminatory approach.

CWD's reference price methodology is fine in principle, but it should be applied to the range of assets that are actually needed to ensure gas transportation and exclude assets that clearly exceed the needs of customers in the Czech Republic and the needs of international transit many times over.

We support the Energy Regulatory Office's proposal to retain the dual regulatory regime in place through a revenue cap for intra-system customers and a price cap for inter-system customers. At the same time, however, we require that this decoupling is real and that any failure to achieve revenue from international transport in 2025 is not subsequently passed on to domestic customers in subsequent years. We propose that only the range of assets that are actually needed by CR customers should be included in the revenue cap.

Comments on Chapter 7.2

We fundamentally disagree with the following proposition:

"These two regimes will form a common regulatory system and will be appropriately linked so that in the case of low inter-system gas flows, the transmission system operator will be assured of adequate revenues to cover the costs of the necessary scale of critical infrastructure and, conversely, in the case of increased inter-system gas flows, a defined portion of the revenues regulated under the price cap will be included in the regulatory account."

Effectively, this means that only the cap on allowed revenues will be applied to the entire system, as the lower revenues from international transport will probably be passed on to customers in the Czech Republic anyway, it will just happen in the next period. If the Energy Regulatory Office wants to proceed in this way and effectively guarantee the transmission system operator's total revenues, it is unjustified to apply a WACC of 9.35% under the price cap regime when the transmission system operator will effectively have the risk fully covered. This can only be accepted if the two regulatory regimes (revenue cap and price cap) remain strictly separated and thus domestic customers are not effectively liable for any unrealised revenues in international transport.

Comment on Chapter 7.3.

It is not at all clear how the Energy Regulatory Office arrived at the amount of regulated revenues of CZK 6 316 million. Furthermore, it is not clear how and on what basis the split between revenues for intra-system use of CZK 4 178 million and for inter-system use of CZK 2 138 million was determined..

There is also no information on the allocation of assets between these two types of use and the inclusion of reasonable profit and depreciation related to these assets in the transport prices for customers in the Czech Republic. There is also no quantification of the proportion of assets that are actually used or the proportion of transport capacity used. Thus, in its current form, the consultation fails to fulfil its basic function, as the Energy Regulatory Office has only presented the results, but has completely failed to be transparent about how it arrived at them.

Fitch Ratings' report "Fitch Upgrades Net4Gas's IDR to 'BB', Unsecured Notes to 'BB+'; off RWP; on Positive Outlook" dated 5 January 2024 shows that the Energy Regulatory Office is very favourable towards the transmission system operator. Fitch Ratings upgraded the transmission system operator's rating and commended the Energy Regulatory Office for its favourable upgrade of the company's 2024 regulated revenues to CZK 4.2 billion, up from the expected CZK 3.2 billion:

"We estimate that the 2024 tariff decisions will materially increase NET4GAS's allowed regulatory revenues to around CZK4.2 billion, higher than our prior expectation (CZK3.2 billion) and the CZK2.2 billion expected for 2023. This demonstrates the supportive attitude of the Czech regulator (ERO), which constructively reacted to the unprecedented changes in gas flows by accounting for the security of supply from NET4GAS's dual-use (internal and transit) infrastructure."

Comment on Chapter 7.4.

Total income including risk premium is shown as EUR 6 694 million. This clearly does not correspond to the total revenue figure of CZK 6 316 million. We therefore ask for an explanation of this difference. If it is the 'risk premium', we request assurances that this premium will in no way be passed on to domestic customers in the event of lower than planned gas transit.

Comment on Chapter 7.6.

In our view, the pricing principles chosen for the 2025 reference period place an unreasonable burden on domestic customers, who are forced to pay two-thirds of the revenues of a system whose capacity exceeds their actual needs by many times. The first step is to assess the extent of the transmission system needed under the new conditions and to conserve redundant parts of the system and reduce system costs. If the transmission system operator wants to continue to operate the transmission system to its current extent, it should do so on its own account and not on behalf of domestic customers whose interests the Energy Regulatory Office is supposed to protect. Chapter 8.1 states that, as a result of changes in gas flows from the German transmission system to the Czech Republic, the transmission system operator GASCADE plans to cease commercial operation of the border transfer station Hora Svaté Kateřiny - Olbernhau II in the course of 2024. It is therefore clear that foreign system operators are behaving economically and do not want to operate unused pipeline capacity. The Energy Regulatory Office should put appropriate pressure on the Czech transmission system operator to behave in the same economic way.