



Energetický regulační úřad
Masarykovo náměstí 5
586 01 Jihlava

In Prague, February 19, 2024

Subject: Comments and suggestions NET4GAS, s.r.o. to the public consultation process pursuant to Article 26 of Commission Regulation (EU) 2017/460 (NC TAR)

Dear,

the company NET4GAS, s.r.o. below presents its suggestions and comments on the ERO document submitted to the public consultation process pursuant to Article 26 of Commission Regulation (EU) 2017/460 (NC TAR) launched on 18/12/2023.

1. PRESERVING THE DUAL REGULATORY REGIME (i.e., A COMBINATION OF REVENUE CAP AND PRICE CAP) DOES NOT REFLECT THE GRAVITY OF TSO'S BUSINESS RISKS OR THE FUTURE UNCERTAINTIES AS TO GAS FLOWS

Comment on p. 8, chapter 7.1 of the NC TAR paper

Rationale:

Legal and regulatory arguments for introducing a single revenue-cap regime

We propose introducing a comprehensive solution in the form of a single revenue cap – i.e., the regime in place in the overwhelming majority of EU member states – that would cover the entire transmission system of NET4GAS. The dual price regulation system currently enforced in the Czech Republic is rather unique. Its introduction was being justified at the time by (historically) large transit flows from the Russian Federation. However, this reason no longer applies; at the same time, the assets operated by NET4GAS doubtlessly still hold strategic value for the Czech Republic – not only from the point of view of security of supply (of natural gas), but also in terms of their use value within the context of what is known as sector-coupling (i.e., the creation of interconnections between the gas and the electricity grids), including the future transition to low-carbon gases and hydrogen.

The need for the proposed change to price regulation was triggered by the Russian aggression in Ukraine; the restriction or outright suspension of Russian gas supplies to several EU member states; the intention of the European Union (and of a number of individual member states, the Czech Republic among them)



to overall reduce Russian gas imports; and the subsequent substantial decline of the transit role previously played by the transmission system of the Czech Republic. Final customers in the Czech Republic were among those who benefited from this transit role for decades.

As a consequence of the said changes, market uncertainty has greatly increased. Because of this, any forecasts or assumptions of the kind on which price regulation is necessarily based, and on which the revenues of NET4GAS depend, have become very unreliable.

The dual price regulation regime does not provide adequate protection against the current uncertainty in the market. Consequently, if the dual regime were to be preserved, a situation may arise in which the revenues from the gas transmission business in the Czech Republic will not cover economically justified costs, depreciation, and reasonable profit. In this respect, NET4GAS wishes to point to Fitch Ratings's estimate according to which the (anticipated) book loss of NET4GAS for 2023 will exceed CZK 1.5bn (the official figure will be published following standard procedure after the annual statements have become available). For a transmission system operator, i.e., an entity fully subject to price regulation, this situation is absolutely unsustainable (and presumably also without precedent anywhere else in the European Union).

Keeping the dual regime in place only exacerbates the uncertainty for the gas transmission business, and the risk that NET4GAS will generate book loss also in 2025. This will ultimately worsen NET4GAS's bargaining position when it comes to raising the necessary funds from financial institutions over the coming years.

NET4GAS wishes to add that the introduction of a single revenue-cap regime:

- (i) would substantially mitigate the negative impact of risks described further below in this document (with the exception of the comment in Section 8, which is relatively independent on the introduction of a single revenue cap), since the consequences of those issues could still be resolved via the regulatory account even if the Energy Regulatory Office decided not to accommodate the relevant comments in the individual case; and
- (ii) would moreover allow the Energy Regulatory Office to pursue additional priorities within the gas transport business. These could include ensuring competitive tariff levels and preserving incentives for the underground storage of natural gas in the form of a 100% discount on gas transmission into / from UGS, as briefly discussed in the comments in Section 4 and Section 3.

2. KEEPING THE PRICE CAP REGIME IN PLACE, IN COMBINATION WITH AN OVERLY OPTIMISTIC PLAN FOR RESERVED CAPACITY, EXACERBATES THE RISK OF LOSS ON THE TSO SIDE

Comment on p. 9, chapter 7.2 of the NC TAR paper

Rationale:

The given figure for total planned transit capacities (i.e. 190 GWh/day/year), which was used for calculating prices in the CWD model for 2025, appears overly optimistic, given what we know today. We believe that one cannot expect capacity reservations between grids on this level for 2025, in particular for the following reasons:

- A. The volume of Russian gas transported across Ukraine remains at a high level, as a consequence of which gas supplies from Ukraine to Slovakia via the border point Velké Kapušany frequently exceed 400 GWh/d.



Attaining 190 GWh/d in transit capacity reservations is unlikely unless Russian gas transports across Ukraine were to be curbed substantially (which would presumably lead to increased gas transit across the Czech Republic so as to be able to supply the southeast of Europe). Given the current state of knowledge, a scenario is more likely in which the transit of Russian gas across Ukraine will be preserved even after 2024, which would mean that the potential for gas transit across the Czech Republic remains highly limited.

This can also be inferred from current information on the still valid contracts for Russian gas supplies e.g. to Slovakia (set to expire only in 2028) and to Austria.

- B. Nor is the current situation in the gas markets conducive to greater activity in the segment for gas transit across the Czech Republic, given the following in particular:
- i. high gas transmission prices in Germany because of the introduction and gradual increase of the new gas storage neutrality charge, which has of 1 January 2024 been set at 1.86 EUR/MWh also at the exit points from Germany into the Czech Republic, and which is expected to apply until March 2027,
 - ii. the enormous drop in demand for gas across all of Europe;
 - iii. the brisk development of alternative sources of gas in the Mediterranean, curbing the potential for gas transits via Slovakia to Italy; and
 - iv. only limited gas transit needs at the Waidhaus exit points in the direction of Germany where the issue of the capacity bottleneck of the German north-south connection has been alleviated *inter alia* thanks to supplies from alternative sources, including France.
- C. Also because of the above reasons, the level of actual cross-system capacity reservations in 2023 (when the consequences of the gas flow changes in Europe in the wake of the Russian-Ukrainian conflict already made themselves fully felt) stood at merely 64 GWh/day/year (excluding the capacity which was left deliberately unpaid by OOO Gazprom export).
- D. Nor does the result of the most recent auction of annual transmission capacities suggest any major potential for gas transit business, given that the total reservation at cross-border exit points for the gas year 2023/24 amounted to 28.8 GWh/day. In other words, the reservation of annual transit capacities was even smaller than in the preceding gas year 2022/23.
- E. But even if there arose, against current expectations, a higher demand in the market for gas transit via the Czech Republic, the potential for such transit may be limited by the low level of fixed transmission capacity at the exit border point VIP Brandov from Germany to the Czech Republic. This capacity deficit was caused by changes made to the way in which the German transmission system is organized, whereas these changes are an expression of the desire to transition away from Russian gas supplies. Whether the said capacity deficit can be overcome is dependent, in particular, on the construction / upgrade of the Rehden and Wittenburg compressor stations in Germany – planned only for 2027-2029.



NET4GAS notes that this overview of potential influences on the volume of transit flows in 2025 is far from exhaustive. In any case, the upshot is that – unlike during the period before the Russian aggression in Ukraine – no reliable prediction whatsoever is possible with respect to future gas transit flows.

Despite the stated reasons, which in the short term of the following years indicate rather reduced volumes of transit flows through the Czech Republic, there are, especially in the medium and longer term, positive signals about the possibilities of higher use of natural gas, which are mainly connected with the transition from coal to gas, or, for example, with the use of gas power plants as a substitute for coal-fired power production in Germany (to be achieved by 2030). In this context, the German government has announced an ambitious plan to finance support for the construction of gas-fired power plants with a capacity of 10 GW (out of an estimated total additional capacity need of 25 GW), which should then be converted to burn hydrogen later on (2035-2040). Even in the Czech Republic there are indications of the need for the production of electricity from gas at the level of up to 4 GW by 2030.

Moreover, whether a given forecast will be fulfilled is dependent upon circumstances outside NET4GAS's control. And yet, if the dual regulatory regime is preserved, NET4GAS fully bears the risk that the forecast of transit flows is not fulfilled. By contrast, the single revenue cap proposed in the comment in Section 1 above substantially reduces the risks associated with a wrong forecast.

We propose adjusting/lowering the planned volume of reserved cross-system capacity to a realistic level.

3. KEEPING THE PRICE CAP REGIME IN PLACE AND APPLYING A 100% DISCOUNT ON TRANSMISSION TO/FROM GAS STORAGE, ALLOCATED ALSO TO BORDER EXIT POINTS, INCREASES THE RISK FOR THE TSO THAT THIS DISCOUNT WILL NOT BE PAID BY CUSTOMERS

Comment on p. 12, chapter 7.4 of the NC TAR paper

Rationale:

Applying a 100% discount on transmission to/from underground gas storage facilities in excess of the mandatory minimum discount of 50% under the law and then reallocating this discount to the border exit points of the system increases the risk that grid costs included in the price-cap regime will remain uncompensated. The thus reallocated costs amount to CZK 377 million. In the (highly likely) event of cross-system capacity reservations below the level used in the CWD model for consultations (190 GWh/day/year), the TSO will suffer the financial consequences of such an enormous discount being granted, without receiving any compensation. This risk is being aggravated by the application of the tariff benchmark (cf. the comment in Section 4). I.e., even in the hypothetical event that the planned transit capacity of 190 GWh/day/year will be attained, the discount will not be fully recovered, to the detriment of the TSO. The same situation arose already in 2023, and will arise also in 2024 – i.e., the TSO had to bear (and will again have to bear) a part of the costs (associated with the low transit volumes) of the 100% discount granted on transmission to/from UGS.



We propose adjusting/lowering the planned volume of reserved cross-system capacity to a realistic level (cf. the comment in Section 2) and applying only the mandatory minimum discount of 50%, or else introducing a single revenue-cap regulatory regime (cf. the comment in Section 1).

4. APPLYING A TARIFF BENCHMARK WHICH LOWERS BORDER POINT TARIFFS BELOW THE LEVEL FOLLOWING FROM THE CWD REFERENCE PRICE METHODOLOGY WILL VERY LIKELY RESULT IN FURTHER AGGRAVATION OF THE LOSS WHICH THE TSO INCURS FROM THE PRICE CAP REGIME

Comment on p. 12, chapter 7.4 of the NC TAR paper

Rationale:

Using a price benchmark with other countries / transmission routes which results in a decrease of prices compared to the reference prices following from the CWD model will further exacerbate the TSO's risk associated with stranded costs under the price cap model. Reducing the tariffs to the level of the benchmark further increases the potential loss from the capacity reservation shortfall. It also results in the *de facto* elimination of the promised risk premium within the price cap regime – in actual fact, following the tariff benchmarking, the implied level of WACC, corresponding to the relevant transit revenues from reserved capacities at 190 GWh/day/year, drops below the WACC level for the revenue-cap regime (6.51%). In order to eliminate this risk associated with the tariff benchmark, the volume of actually reserved transit capacities would have to exceed the (already overvalued) plan of 190 GWh/day/year (cf. the comment in Section 2) by another 27%.

The possible positive impact of using an optimal price benchmark for reducing tariffs, which would potentially lead to an increased volume of capacity reservations and higher transit revenues, cannot, in our opinion, be sufficient to compensate for the risk of a continued insufficient volume of revenues to cover the relevant operating and capital costs in the price cap regime.

Regarding price comparisons between countries in general, we believe that, for example, the ratio of the distribution of regulated revenues between entry and exit points (E/X split) is unusually low in the Czech Republic and could be increased. This move could, under certain circumstances (gas surplus on the domestic market), have the potential to increase the volume of transport through exit cross-border points.

On grounds of the changes in gas flows across the Czech Republic, which manifest themselves in uncertainty as to capacity reservation planning and in difficulties as to setting optimal benchmarks for transit fees which would minimize the cost risk of the TSO, we propose introducing a single revenue-cap regulatory regime (cf. our comment in Section 1).

5. THE FIGURE GIVEN IN THE PLAN FOR RESERVED CAPACITIES AT THE EXIT POINTS OF THE SYSTEM IS UNDERVALUED

Comment on p. 11, chapter 7.3 and on p. 12, chapter 7.4 of the NC TAR paper



Rationale:

Utilization of the total planned reserved capacity at the exit points of the system at 503.62 GWh/day/year for the CWD model is undervalued: the current contractual capacities of DSOs as reflected in the (inter-)connection agreements amount to 1,442.75 GWh/day/year, and the corresponding allocation of total costs/revenues of the system and the prices for customers within the system ought to be higher than proposed.

This relatively significant difference in exit capacities on the side of DSOs thus contrasts with the choice of a very optimistic plan of reserved capacities for 2025 on the side of transit against reasonable expectations based on actually booked capacities for 2024 or the previous year 2023.

Our experience so far from the negotiations on the necessary capacities between the transmission system and the distribution systems shows that distribution system operators are interested in having the current capacities from concluded contracts (i.e. 1,442.75 GWh/day/year) still available in the future.

We propose adjusting (i.e., increasing) the planned volume of reserved capacity for customers within the system so that it corresponds to the level established by the (inter-)connection agreements.

6. THE PROPOSED REGULATION MERELY SUGGESTS A QUALITATIVE LINK BETWEEN REVENUE-CAP AND PRICE-CAP REGIMES, BUT PROVIDES NO QUANTITATIVE GUARANTEE THAT THE TSO WILL ATTAIN THE LEVEL OF REVENUES NEEDED TO COVER ITS COSTS WITHIN THE MINIMUM SCOPE OF CRITICAL INFRASTRUCTURE

Comment on p. 9, chapter 7.2 of the NC TAR document

Rationale:

For the event that the risks of a negative development in the realm of cross-system transmission capacity reservations were to materialize in 2025, the consultation paper contains no quantification, and in fact no detailed description of the method for determining the level of revenues needed to cover the costs within the minimum scope of critical infrastructure, such that the TSO continues to be able to fulfil its duty to ensure the safe, reliable, and cost-effective operation, maintenance, upgrade, and development of the transmission system, and such that no parts of the system will have to be decommissioned which could be utilized in the future for sector-coupling and for the transition to low-emission gases and hydrogen.

We propose that the final ERO decision within the meaning of Art. 27 (4) NC TAR also include a concrete quantification or description of the manner in which revenues under the revenue-cap regime and the price-cap regime will be linked in order to ensure a level of revenues that guarantees coverage of the costs within the minimum scope of critical infrastructure.

7. THE PROPOSED ONE-YEAR TERM OF VALIDITY FOR TARIFFS (2025) DOES NOT PROVIDE CUSTOMERS WITH THE DESIRABLE LONG-TERM OUTLOOK ON PRICING AND DOES NOT PROVIDE ADEQUATE MID-TO-LONG-TERM ASSURANCES NEEDED FOR THE OPERATION OF THE TRANSMISSION SYSTEM



Comment on p. 9, chapter 7.1 of the NC TAR paper

Rationale:

The proposal limits the validity of tariffs to only one year (2025), citing the uncertainty regarding future transit flows across the Czech Republic which is caused by objective reasons. This uncertainty notwithstanding, the described procedure is not optimal in terms of providing customers with a more reliable outlook on prices; worse still, it is ill-suited to answer the future uncertainty of the TSO regarding the configuration of a more long-lasting, more stable regulatory and pricing framework. This uncertainty has influence on the approach taken by rating agencies and banks toward their rating of the company, causes issues in terms of securing and planning future operational and investment financing, but also limits the company's prospects in terms of the settlement of its existing liabilities.

We propose introducing a single revenue-cap regulatory regime (cf. the comment in Section 1) or, alternatively, providing regulatory guarantees for the coverage of costs within the minimum scope of critical infrastructure (cf. the comment in Section 5) for a longer term in the future.

8. UNCERTAINTY REGARDING THE COVERAGE OF COSTS OF INFRASTRUCTURE WITH THE EXISTING EXEMPTION FROM THE THIRD-PARTY ACCESS OBLIGATION (GAZELA PIPELINE), AND ITS REGULATORY STATUS

Comment on p. 7, chapter 6.2 of the NC TAR paper

Rationale:

The consultation paper confines itself to a description of the legal state of affairs in connection with the exemptions from the third-party access and ownership unbundling requirements which were granted in the past with respect to the Gazela pipeline. In awareness of the fact that corresponding exemptions for the upstream OPAL pipeline have since been revoked in Germany, and that the costs associated with the Gazela infrastructure remain uncompensated as a consequence of the change of gas flows within the EU and the transition away from Russian gas, the consultation paper gives no indication of a change in the regulatory approach that would respond to the new situation, but instead leaves the burden of stranded costs and the risks associated with the further operation of this piece of infrastructure firmly on the shoulders of the TSO.

We are of the opinion that the exemptions from third-party access and from ownership unbundling must be analysed with a view to the circumstances under which they were granted. Looking at the context of events which have occurred on the part of NET4GAS since the time at which the exemptions were granted, we believe that there are no longer any reasons for giving a regulatory treatment to this particular part of infrastructure that differs from that applying to the rest of the transmission system. First and foremost, the certification of NET4GAS as independent transmission system operator also extends to the Gazela pipeline. The independence of NET4GAS has ensured that gas suppliers would enjoy equal terms of access to the capacity offered by the Gazela pipeline.



It was understood from the beginning that the Gazela pipeline was part of a concept that comprised also the German OPAL pipeline, i.e., a gas pipeline between Greifswald on the German Baltic seaboard and Olbernhau / Brandov at the Czech-German border that was built during the same period as the Gazela pipeline. This perception of the Gazela pipeline was shared also by the ERO; in its final decision on the matter of the temporary reduction of the third-party access duty (pp. 7-8 of ERO decision 02786-5/2011-ERU of 28 July 2011).

The temporary reduction for Gazela was granted only after the exemption from the third-party access duty was granted by the German regulatory authority for OPAL in 2009. In its own decision in matters of the temporary reduction for Gazela, the European Commission repeatedly referenced the OPAL decision.

To illustrate this point, we may point e.g. to para. (56) of the above-mentioned Commission decision in which the EC – in its assessment of how long the temporary reduction should last – explicitly stated that “the duration of the exemption for Gazelle must be limited to the exemption for OPAL”. For this reason, the Commission called for a shortening of the temporary reduction for Gazela from 23 years (as originally awarded by the ERO) to 22 years (as awarded by the German regulatory authority for OPAL); the ERO accommodated this call by the Commission in its second decision on the matter.

Above all, one needs to recognize that the role played by the Gazela pipeline in the Czech transmission system is similar to that played by the OPAL pipeline in the German transmission system. There exists a technological connection between the Gazela pipeline and the regulated grid and it may serve domestic transmission in an environment that is subject to dynamic change (and can in the future also be used for transporting hydrogen). NET4GAS believes that if the same circumstances compelled the German regulatory authority to include GASCADE’s 80% of the OPAL pipeline into the RAB, then a corresponding step should also be considered with respect to the Gazela pipeline within the Czech context.

Incidentally, such approach fully aligns with the proposal for regulatory changes submitted by NET4GAS, according to which the RAB includes *all* parts of the transmission system, i.e., including the Gazela pipeline. In addition, we would like to add that 10% of the capacity of the Gazela gas pipeline has never been subject to the exemption from third-party access. Therefore, the related share of costs should be included in the standard regulatory regime already now.

One must also take into account the close link, outlined earlier above, between the exemption for OPAL and the temporary reduction for Gazela, which was expressly acknowledged in, and to some extent formed the basis of, the respective decisions. This link was strong enough for the duration of the temporary reduction for Gazela to be set such that it would not exceed the duration of the exemption for OPAL even by just one year. Seeing as the exemption for OPAL has now been revoked, NET4GAS finds it self-evident that the temporary reduction for Gazela has likewise lost its justification; from the point of view assumed by the Commission, it should in fact no longer be upheld.

In other words, seeing as the German regulatory authority has decided to revoke the exemption from the duty to grant third parties access to the majority of transmission capacity offered by OPAL, the approach of ERO with respect to the exclusion of Gazela from a regulatory regime that would guarantee cost



coverage runs counter to the logic behind the coordinated approach taken by the member states based upon which the Gazela pipeline was built and the exemptions were granted.

We propose including the costs of the Gazela pipeline in the regulatory regime that would guarantee the coverage of these costs, because the original assumption of standard operations referenced in the consultation paper no longer applies according to which the pipeline would have served the exclusive purpose of transiting gas from the OPAL pipeline to the south of Germany; it may therefore be potentially used also for the future gas supply needs of the Czech Republic or the future transport of zero-emission gases – cf. Chapter 6.3 of the consultation paper (Hydrogen Readiness of the Transmission System). For the rest, the European Commission also concluded that the Gazela pipeline will improve the security of supply for the Czech Republic, provided that the new Brandov border point will be considered, for the purposes of trading gas from / to Germany, as one common entry/exit point alongside the existing Hora Svaté Kateřiny entry/exit point.

CONCLUSION

We believe that **under the current circumstances – i.e., poor predictability and prevailing risks following from the level of transit flows – the logical and optimal solution would be to introduce a single revenue-cap regime, as it would preserve much-needed stability for the TSO but would neither interfere with the rules of legislation nor cause any cross-subsidization.**

When considering the overall context of the price competitiveness of transit through the Czech Republic and in order to strengthen the motivation for capacity reservations, we find that, for example, the level of our multipliers is comparatively low and probably does not create an appropriate economic incentive for gas traders to reserve longer-term capacities. It would also be worth considering whether such an incentive could be some form of the price advantage (some kind of the seasonal factor) when booking longer-term annual capacities (more than just one following year). We would suggest starting a more detailed discussion on these topics in connection with the preparation of the next NC TAR consultation.

Notwithstanding the current effect of low transit gas flows which may be expected to continue in the short term, i.e., over the next few years, we perceive a positive future for international gas transmission in the longer term as Europe transitions away from coal to natural gas (e.g. as a consequence of the growing importance of gas power plants) and, eventually, to zero-emission gases. A substantial part of current gas infrastructure thus may be utilized in the not too distant future for the transport of zero-emission gases or, as the case may be, the transport of CO₂ (cf. the upcoming EC communication on industrial carbon management for the EU), as can be seen, for instance, from the concrete steps that are being taken toward the implementation of the “KernNetz” – Germany’s hydrogen network – by removing obstacles and putting into place rules for its future financing. In view of the specific conditions under which the Czech Republic operates, the country ought to follow the same path and fulfil the decarbonization strategy and goals to which it committed, which includes supporting the transformation of its gas infrastructure.

FORMAL COMMENTS



p. 10, chapter 7.3, p. 14, chapter 7.4 of the NC TAR paper

Reference model and target model differ *inter alia* in the respective volume of total revenues whereas the reference model does not contain any risk premium for the price cap regime (target revenues), so that the prices set using this model correspond to a single revenue-cap regime with limited risk and a WACC of 6.51% (however, the preceding chapter 7.2 speaks of a dual regime and a price cap with a WACC of 9.35%). Nor can this difference in revenue be found in the comparison of approximate reference prices in chapter 7.8.

p. 15, chapter 7.8 of the NC TAR paper

The chapter ought to also contain a comparison of reference prices as per Art. 8 NC TAR and of the resulting target prices after benchmarking as per Art. 6 (4) (a) NC TAR.

p. 3, chapter 2 of the NC TAR paper

The second sentence is presumably supposed to read as follows:

“The consultation paper sets out the proposal for a methodology with which to set transmission tariffs and relevant regulated prices for transport services, for public consultations.”

p. 22, chapter 8.3., graph 5 of the NC TAR paper

As per the price decision, the proper designation of the DSO is “EG.D” (as opposed to E.OND).

Best regards,

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Regulatory Affairs
NET4GAS, s.r.o.