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SUBMISSION OF APPLICATION FOR AMEND- MENT OF THE DANISH UTILITY REGULATOR'S DECISION ON THE ESTABLISHMENT OF A JOINT MARKET ZONE OF 14 FEBRUARY 2022

CONSULTATION DOCUMENT

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1. Introduction

In pursuance of section 36a(1) and section 40(1) para (1) of the Danish Gas Supply Act (*Gasforsyningsloven*)¹ and section 2(1) para (1) of Executive Order no. 822 of 27 June 2014 on rules for submission of applications for approval of prices and terms and conditions, etc. for natural gas supply, Energinet must submit methodology approval applications to the Danish Utility Regulator for its prices, terms and conditions, etc. for access to the transmission system. Pursuant to the Danish Gas Supply Act, Energinet Gastransmission A/S (CVR no. 39315084), represented by the Regulatory Affairs unit of the Energinet Group (independent public enterprise) (CVR no. 28980671), must thus submit a methodology application to the Danish Utility Regulator for approval.

The submitted methodology application concerns an amendment of the Danish Utility Regulator's 'Decision on the establishment of a joint market zone' of 14 February 2022 with terms and conditions in accordance with Gastransmission A/S's 'Application for approval of establishment of a joint market zone' of 15 September 2021. The methodology and the fundamental principles for the establishment of a joint market zone of 15 September 2021 are otherwise maintained.

The submitted application for an amendment is a result of discussions with the Danish Utility Regulator regarding the interaction between the revenue cap regulation of Gastransmission A/S applicable as of 1 January 2023 and the Danish Utility Regulator's methodology approval of 14 February 2022, in which reference is made to the then break-even regulation (strict cost plus regulation or "hvile-i-sig-selv-regulering") of Energinet, including of Gastransmission A/S.

Energinet finds that the current apparent uncertainty about Gastransmission A/S's charging of a non-transmission tariff through the application of a risk-adjusted return on the invested capital in the upstream part of the Baltic Pipe can be resolved by a new decision from the Danish Utility Regulator, after which there will no longer be any doubt as to the regulatory framework.

Energinet is of the opinion that the Danish Utility Regulator's processing of this application should only concern the request for an amendment of the Danish Utility Regulator's methodology approval, so that the reference to section 2 of Executive Order no. 816 of 27 June 2016 on economic regulation of Energinet.dk and the principle of inclusion of necessary costs for efficient operations and a necessary return on capital are omitted from the decision and are replaced by a reference to the current revenue cap regulation of Gastransmission A/S.

The methodology application will refer extensively to the application for approval of a joint market zone of 15 September 2021 and the Danish Utility Regulator's decision of 14 February 2022, respectively, as the present application only concerns the above specifications of individual and delimited elements in the Danish Utility Regulator's decision on the establishment of a joint market zone.

The application for an amendment of the Danish Utility Regulator's decision on the establishment of a joint market zone was submitted for consultation in the period 18 August to 8 September 2023. A consultation procedure has been conducted for the Danish application and an unofficial translation of the document into English. In case of discrepancies between the Danish and the English versions, the Danish version will prevail.

The legal basis for the application is enclosed in Appendix 1. The Danish Utility Regulator's decision of 14 February 2022 on the 'Establishment of a joint market zone' is enclosed as Appendix 2. [Consultation responses to Energinet's consultation procedure for the application are enclosed as Appendix 3. Energinet's consultation memo is enclosed as Appendix 4.]

¹ Consolidation Act no. 423 of 19 April 2023

Energinet requests the Danish Utility Regulator to approve the applied for changes to the Danish Utility Regulator's decision of 14 February 2022 to the extent that the Danish Utility Regulator finds that they require approval.

2. Background

The background for the Baltic Pipe project is described in detail in 'Application for approval of a joint market zone' of 15 September 2021 and the Danish Utility Regulator's 'Decision on approval of a joint market zone' of 14 February 2022, respectively.

The following thus only describes the relevant background regarding the applied for amendments to the joint market zone model.

2.1 Gastransmission A/S's application for approval of a joint market zone of 15 September 2021

On 15 September 2021, Energinet Gastransmission A/S, represented by the Regulatory Affairs unit of the Energinet Group (independent public enterprise), submitted an application for approval of a methodology for the establishment of a joint market zone. The submitted methodology application contained three elements:

1. establishment of a new virtual entry point to the Danish entry-exit system, called Entry North Sea,
2. conclusion of the Availability Agreement and
3. that the new entry point will be part of a joint balancing zone.

This application for approval only concerns amendments in relation to item 2 concerning the conclusion of an Availability Agreement.

At the time of the submission of the application for approval of the methodology for the establishment of the joint market zone, ongoing restructuring discussions between Energinet and the Danish Energy Agency meant that it had not been clarified where ownership of the upstream facilities assets was to be placed in the Energinet Group. However, Energinet notes that it has precisely made reservations in the application about any restructuring in Energinet's organisation.

The methodology approval application entails the establishment of a joint market zone for the part of the Baltic Pipe connecting the Norwegian gas system with the Danish transmission system. This part of the Baltic Pipe is also called the EP II Branch Pipeline.

The EP II Branch Pipeline is subject to negotiated access pursuant to the Executive Order on Negotiated Third Party Access (Opstrømsbekendtgørelsen)², while the transmission system is subject to 'regulated access' pursuant to the Danish Gas Supply Act and other regulation in EU law.

The methodology constitutes a supplement to the current Danish market model under which network users can purchase transport through the upstream part of the Baltic Pipe (the EP II Branch Pipeline) and the transmission system as one single capacity product with one single tariff.

The upstream activities are placed in the Upstream Unit, while the transmission activities are placed in the Transmission Unit. The Upstream Unit and the Transmission Unit are organisational

² Executive Order no. 1410 of 16 December 2019 on access to upstream pipelines and upstream facilities as well as on the prices and terms for such access.(Executive Order on Negotiated Third Party Access)

entities in Gastransmission A/S with independent accounting segments. As part of the joint market zone, the Transmission Unit and the Upstream Unit enter into an agreement on the provision of availability of the capacity in the EP II Branch Pipeline, i.e. an Availability Agreement. A draft Availability Agreement was enclosed with the application of 15 September 2021.

The Availability Agreement lays down the terms and conditions under which the Upstream Unit (Gas opstrøm) makes the full capacity in the EP II Branch Pipeline available to the Transmission Unit (GAS TSO). The provision of availability means that the Transmission Unit (Gas TSO) can offer the capacity in Entry North Sea. The Availability Agreement also establishes a division of operational responsibility and risks between the parties to the agreement.

It is stated in Energinet's application of 15 September 2021 for approval of the establishment of a joint market zone that the Transmission Unit pays a price for the availability of the capacity in the EP II Branch Pipeline that reflects the costs of the EP II Branch Pipeline plus a reasonable return on the invested capital.

When the Transmission Unit purchases the full capacity in the EP II Branch Pipeline for a period of 15 years, the Transmission Unit must thus pay all depreciation and operating costs for the EP II Branch Pipeline as well as a reasonable return for the period concerned. If the Transmission Unit does not utilise the full capacity in the EP II Branch Pipeline, but part of it is resold to third parties through negotiated third-party access, the revenue generated from this must be used to reduce the Transmission Unit's total payment correspondingly.

As a result of the dialogue with the Danish Utility Regulator on this application for an amendment, Energinet has specified Energinet's handling of revenue generated through the allocation of capacity through negotiated third-party access in accordance with the Executive Order on Upstream Activity, see section 3.1.

2.2 The Danish Utility Regulator's decision on the establishment of a joint market zone of 14 February 2022

With the Danish Utility Regulator's decision of 14 February 2022, the Danish Utility Regulator approves the methodology submitted in Gastransmission A/S's application with a number of terms and requirements that go beyond the submitted methodology application.

It follows from the Danish Utility Regulator's approval of the joint market zone that the Danish Utility Regulator has made an assessment of the compatibility of the methodology described in the application with applicable national legislation and legislation in EU, including the network codes.

It is stated in the decision that

“The Danish Utility Regulator approves the submitted methodology application of 15 September 2021 (Appendix 1) for approval of the establishment of a joint market zone for the Danish part of the Baltic Pipe with a new virtual entry point called North Sea Entry, including the conclusion of an Availability Agreement (Appendix 2) as proposed in the submitted application, and that the new entry point will be covered by the Danish/Swedish balancing zone.

The decision has been made pursuant to section 36 a(1), section 40(1) para (1), of the Danish Gas Supply Act and section 28 c(2), section 11, of Executive Order no. 816 of 27 June 2016 on economic regulation of Energinet.dk, as well as section 2(1) para (1) of Executive Order no. 822 of 27 June 2014 on rules on the

submission of applications for approval of prices and terms and conditions, etc. for natural gas supply.”

It should be noted separately that the basis on which the decision has been made includes the break-even regulation of Energinet, which, as of 1 January 2023, has been replaced by revenue cap regulation of Gastransmission A/S, see Danish Act no. 2211 of 29 December 2020, in accordance with which the new economic regulation of Energinet is introduced; and Executive Order no. 1609 of 28 December 2022 on revenue cap regulation and regulatory accounts for transmission system owner.

The Danish Utility Regulator’s summary of the decision on pages 46 and 47 includes the following observations:

“The Danish Utility Regulator finds that the establishment of a joint market zone is generally compatible with applicable national legislation and legislation in EU law, after which Gas TSO will handle both transmission and upstream activities in the subsidiary Gastransmission A/S.

On this basis, the Danish Utility Regulator can approve the submitted application for approval of a joint market zone for the Danish part of the Baltic Pipe with a new virtual entry point at North Sea Entry as well as a new entry/exit point at Faxe. The Danish Utility Regulator also approves the conclusion of an Availability Agreement as proposed in the submitted application, and that the new entry point will be covered by the Danish/Swedish balancing zone.

In continuation of the approval and as part of the Danish Utility Regulator’s supervisory tasks, the Danish Utility Regulator requests Energinet to submit documentation for the following: 1) that Energinet’s performance of the activities is in compliance with the requirement for separate accounting in section 12(1) of the Danish Act on Energinet (*Lov om Energinet*), 2) that the envisaged Availability Agreement is concluded at arm’s length and in accordance with the transfer pricing rules, see section 28 c of the Danish Gas Supply Act, and 3) that the pricing in the Availability Agreement only includes necessary costs for efficient operations and a necessary return on capital, see section 2 of Executive Order no. 816 of 27 June 2016 on economic regulation of Energinet.dk. On the basis of the reporting, the Danish Utility Regulator will assess the specific use of the methodology described in the application submitted.” (Energinet’s underlining)

It should be noted separately that, in its decision, the Danish Utility Regulator has laid down requirements and conditions for the methodology approval that go beyond Gastransmission A/S’s methodology approval application, regarding “3) *that the pricing in the Availability Agreement only includes necessary costs for efficient operations and a necessary return on capital, see section 2 of Executive Order no. 816 of 27 June 2016 on economic regulation of Energinet.dk.*”

In the following, a description is provided of further elements in the Danish Utility Regulator’s decision of special relevance to the application for amendments.

It follows from the reproduction of Energinet’s application regarding the Availability Agreement in the decision that

“Gas TSO pays a price for availability of the capacity in the EP II Branch Pipeline. According to Clause 4.1 of the Availability Agreement, the price corresponds to the costs of investment and operation of the EP II Branch Pipeline plus a

reasonable return on the invested capital calculated over the service life of the pipeline (the cost+ principle). It follows from Clause 4.1 of the Availability Agreement that the price is calculated in accordance with the principles laid down in Appendix 4.1 to the Agreement. Appendix 4.1 has not been enclosed with the application as it has not yet been prepared. However, the contents of the Appendix are not of importance to this decision, as the decision concerns whether the methodology for the establishment of a joint market zone submitted in the application is compatible with applicable national legislation and legislation in EU law, including the network rules. It has thus been presupposed that the Availability Agreement is concluded at arm's length and in accordance with the transfer pricing rules, see section 28 c of the Danish Gas Supply Act, and that the pricing in the Availability Agreement only comprises necessary costs for efficient operations and a necessary return on capital; see section 2 of Executive Order no. 816 of 27 June 2016 on economic regulation of Energinet.dk. Reference is made to the consideration of this question in the grounds for the decision, which show that the Danish Utility Regulator will assess the specific use of the methodology described in the application."

In the Danish Utility Regulator's decision, the Danish Utility Regulator deals expressly with the regulatory categorisation of the upstream activities connected with the EP II Branch Pipeline, including whether these may be regarded as non-transmission services.

In Article 3 para (15) of NC TAR, 'non-transmission services' means "the regulated services other than transmission services and other than services regulated by Regulation (EU) No 312/2014 that are provided by the transmission system operator". NC TAR, Article 4, lays down rules on transmission and non-transmission services and tariffs.

In its decision, the Danish Utility Regulator assesses that costs connected with upstream activities in the EP II Branch Pipeline constitute costs for non-transmission services, see NC TAR, Article 4(4).

The Danish Utility Regulator also assesses the compatibility of the Availability Agreement with the then economic regulation of Energinet, see section 2 of Executive Order no. 816 of 27 June 2016 on economic regulation of Energinet.dk, i.e. that Energinet only includes necessary costs for efficient operations and a necessary return on capital.

2.3 The Danish Utility Regulator's decision of 12 May 2022 on partial approval of a tariff methodology for the Danish transmission system

In Energinet's interpretation of the Danish Utility Regulator's decision on the establishment of a joint market zone of 14 February 2022, Energinet has also used the Danish Utility Regulator's decision on 'Partial approval of tariff methodology for the Danish gas transmission system' of 12 May 2022 as interpretative support for the use of the Danish Utility Regulator's decision on the establishment of a joint market zone.

The Danish Utility Regulator's decision contains a reproduction of the grounds and conditions for the approval of the market zone and the Availability Agreement. For example, the Danish Utility Regulator's decision of 14 February 2022 shows that

"On 14 February 2022, the Danish Utility Regulator approved the establishment of a joint market zone. In its decision, the Danish Utility Regulator approved the inclusion of the EP II Branch Pipeline (the upstream pipeline), which connects the Danish system with Norwegian Europipe II, in the Danish joint market zone as well as the establishment of the virtual entry-exit point 'Entry North Sea'. The Danish Utility Regulator also approved the Availability Agreement between Gas

TSO and Gasopstrøm under Energinet Gastransmission A/S subject to a number of conditions. The Availability Agreement makes the capacity in the upstream pipeline available to Gas TSO in return for payment. The Danish Utility Regulator decided that the agreement should be governed by the rules on arm's length and transfer pricing, and that Gas TSO could only recover the necessary costs of efficient operations and a necessary return on capital." (Energinet's underlining). (Pages 11-12)

"With the approved methodology, Energinet aims to enable easy market access for shippers (network users) and to ensure efficient operation of the two systems. Energinet notes that a decisive element in the market zone is that only one uniform tariff should apply to the system as a whole. Energinet wants Gas TSO's recovery of costs related to the purchase of availability of capacity in the upstream pipeline from Gas Opstrøm under the Availability Agreement⁶ to be included in the tariff methodology." (Page 30).

"As a condition for approval [of the joint market zone], the Danish Utility Regulator also imposed a requirement on Energinet regarding economic regulation of the costs for the non-transmission service. Thus, the Availability Agreement between Gas TSO and Gasopstrøm only involves the recovery of necessary costs in connection with efficient operations and a necessary return on capital resulting from the purchase of capacity to be made available in the upstream pipeline. Furthermore, the Availability Agreement must be in conformity with the arm's length and transfer pricing rules, and Energinet must keep Upstream and Transmission separate for accounting purposes." (Energinet's underlining). (Page 81).

"The additional requirements for Energinet as set out in the Danish Utility Regulator's decision of 14 February 2022 on the establishment of a joint market zone, which includes approval of the Availability Agreement, economic regulation requirements and requirements for segment accounts for Gasopstrøm and Gas TSO, must be considered in addition to this decision." (Page 94).

Energinet notes that the requirements in the decision of 14 February 2022 were, on the face of it, slightly differently worded in the tariff decision of 12 May 2022, including that "the Danish Utility Regulator decided that the agreement is to be governed by the arm's length and transfer pricing rules and that Gas TSO could solely recover necessary costs of efficient operations and a necessary return on capital." (Energinet's underlining).

In the enclosed application for an amendment, Energinet has used as a basis that the "necessary costs of efficient operations" stated in the decision of 14 February 2022 aims precisely at the recovery of costs by the Transmission Unit (Gastransmission A/S). In fact, Energinet does not find it possible both to conclude an availability agreement at arm's length and in accordance with the transfer pricing rules (requirement 2 in the decision of 14 February 2022) and to apply a necessary return on capital in the pricing (requirement 3), i.e. a break-even return.

2.4 New economic regulation of Gastransmission A/S as of 1 January 2023

By Act no. 2211 of 29 December 2020 to amend the Danish Act on Energinet, the Danish Electricity Supply Act (*Lov om elforsyning*) and the Danish Natural Gas Supply Act (*Lov om naturgasforsyning*), as amended, new economic regulation of Energinet was introduced from 1 January 2023. Pursuant to the Act, the Danish Utility Regulator is authorised to lay down further rules on the calculation and adjustment of the revenue cap and the duration of the regulatory period for the gas transmission system operator.

In December 2022, the Danish Utility Regulator issued an Executive Order on revenue cap regulation and regulatory accounts for the transmission system owner with effect from 1 January

2023 and with effect for the revenue cap for 2023 in accordance with the Act, see Executive Order no. 1609 of 28 December 2022. The Executive Order does not apply to upstream activities, i.e. the EP II Branch Pipeline, as it is subject to the Executive Order on Upstream Activity.

Energinet also notes that, at the time of the decision in February 2022, it was clear that Gas-transmission A/S would switch to revenue cap regulation as of 1 January 2023 in accordance with the principles stated in Act no. 2211 of 2020.

Following the submission of the application of 15 September 2021, Energinet has implemented a restructuring of the Energinet Group, which included a transfer of the gas system operator activities in Energinet Gas TSO A/S to Energinet Systemansvar A/S, thus establishing one joint system operator in Energinet.

Energinet Gas TSO A/S concurrently changed its name to Energinet Gastransmission A/S, where the gas transmission activities and the gas upstream activities were placed in two different entities, i.e. the Transmission Unit and the Upstream Unit.

As a result of the restructuring, the Availability Agreement has been replaced by an internal service-level agreement, as the upstream and transmission activity areas are now handled by the Upstream Unit and the Transmission Unit, which are located in the same legal entity – and not in two separate legal entities. This means that an Availability Agreement in the conventional legal sense cannot be drawn up.

3. Application for amendment of the Danish Utility Regulator's approved decision on the establishment of a joint market zone of 14 February 2022

3.1 The changes contained in the application

Energinet finds that the current apparent uncertainty about Gastransmission A/S's charging of a non-transmission tariff through the application of a risk-adjusted return on the invested capital in the upstream part of the Baltic Pipe can be resolved by a new decision from the Danish Utility Regulator, after which there will no longer be any doubt as to the regulatory framework.

Energinet wants the methodology approval to be changed on the following specific points:

- All references to section 2 of Executive Order no. 816 of 27 June 2016 on economic regulation of Energinet.dk and the principle of inclusion of necessary costs for efficient operations and a necessary return on capital are to be omitted from the decision.
- It is to be approved that the pricing in the Availability Agreement is based on recovery of the Upstream Unit's costs for efficient operations of the upstream activities and a risk-adjusted return on the invested capital, so that this applies to the gas transmission activities pursuant to section 37 d of the Danish Gas Supply Act.

The changes contained in the application and the background for these are elaborated on in the following.

As a result of the dialogue with the Danish Utility Regulator on this application for an amendment, Energinet has also specified in the Availability Agreement with appendices Energinet's handing of revenue generated through the allocation of capacity through negotiated third-party access in accordance with the Executive Order on Upstream Activity. In accordance with section 2.4, the Availability Agreement has been replaced by an internal service-level

agreement. Pursuant to requirements in the Danish Utility Regulator's decision of 14 February 2022, Energinet must submit documentation that the Availability Agreement is concluded at arm's length and in accordance with the transfer pricing rules, and the Danish Utility Regulator will also supervise the Availability Agreement.

The specifications concern various conditions aimed at countering the risk of cross-subsidisation between the Upstream Unit's revenue and expenses in connection with the negotiated third-party access and the non-transmission tariff and the transmission tariff, respectively. It has thus been specified in the Availability Agreement with appendices that

- any revenue from the allocation of negotiated third-party access to the upstream pipeline will accrue directly to the Upstream Unit. However, in the event that part of the capacity in the upstream pipeline is sold to a third party in accordance with the rules set out in the Executive Order on Negotiated Third Party Access, the payments for the availability of capacity must be reduced proportionately to the reduction in available capacity and at the capacity unit price forming the basis of the transmission unit's payment for the availability of capacity.
- costs for administration of negotiated third-party access are not included in the non-transmission tariff or in the transmission tariff.

3.2 New economic regulation of Energinet Gas transmission A/S

In the Danish Utility Regulator's decision on the establishment of a joint market zone of 14 February 2022, reference is made to section 2 of Executive Order no. 1609 of 27 June 2016 on economic regulation of Energinet, in accordance with which Energinet could only include necessary costs of efficient operations and a necessary return on capital in the prices (i.e. the charged tariffs) for Energinet's price-regulated activities, including gas transmission activities, at the time at which the decision was made.

As mentioned above, the Danish Utility Regulator also states in the summary of the decision on pages 46 and 47 that, in continuation of the methodology approval and as part of the Danish Utility Regulator's supervisory tasks, it requests Energinet to submit documentation for the following:

“1) that the Energinet's performance of the activities is in compliance with the requirement for separate accounting in section 12(1) of the Danish Act on Energinet, 2) that the envisaged Availability Agreement is concluded at arm's length and in accordance with the transfer pricing rules, see section 28 c of the Danish Gas Supply Act, and 3) that the pricing in the Availability Agreement only includes necessary costs for efficient operations and a necessary return on capital, see section 2 of Executive Order no. 816 of 27 June 2016 on economic regulation of Energinet.dk.” (Energinet's underlining).

It follows from section 12(3) of Executive Order no. 1605 of 28 December 2022 on economic regulation of Energinet and its wholly-owned subsidiaries (which has replaced Executive Order no. 816 of 27 June 2016 on economic regulation of Energinet.dk) that section 2 of the Executive Order on the inclusion of necessary costs of efficient operations and a necessary return on capital in the prices is no longer applicable to Energinet's gas transmission activities as from 1 January 2023, as the gas transmission activities are subject to revenue cap regulation from that date.

As from 1 January 2023, the provision in section 2 of the Executive Order is therefore not relevant for the pricing in the Availability Agreement between the Transmission Unit and the

Upstream Unit. The Danish Utility Regulator's methodology approval should therefore be updated so that it is based on the current principles for economic regulation of Energinet.

Energinet therefore requests that the methodology approval be changed so that the reference to section 2 of Executive Order no. 816 of 27 June 2016 on economic regulation of Energinet.dk and the principle of inclusion of necessary costs for efficient operations and a necessary return on capital are omitted from the decision and that it be approved that the pricing in the Availability Agreement is based on recovery of the Upstream Unit's costs for efficient operations of the upstream activities and a risk-adjusted return on the invested capital, in the same way as for the gas transmission activities pursuant to section 37 of the Danish Gas Supply Act.

The applied for amendment meets the requirement that the upstream activities are subject to an arm's length and transfer pricing principle, which basically corresponds to the principle applicable to pricing of the gas transmission activities under the new economic regulation.

3.3 Calculation of the consequences of the applied for amendment to the non-transmission tariff in 2023

As mentioned, the applied for amendment to the Danish Utility Regulator's methodology approval of 14 February 2022 is a result of Energinet's discussions with the Danish Utility Regulator.

However, Energinet is still of the opinion that Energinet has had access to charge a risk-adjusted return on the invested equity in the EP II Branch Pipeline in the non-transmission tariff since the entry into force of the new revenue cap regulation as of 1 January 2023.

Energinet must state that the use of a risk-adjusted return on capital precisely forms part of the new revenue cap regulation of Energinet, which contains an approach based on a more commercial framework, see Danish Act no. 2211 of 29 December 2020. Energinet hereby notes that, regarding Energinet's contribution to the Danish Utility Regulator's work to prepare the Danish Utility Regulator's Executive Order no. 1609 of 28 December 2022, no questions have ever been raised about the application of a risk-adjusted return on capital pursuant to the new regulation, see Danish Act no. 2211 of 29 December 2020.

Energinet has thus fixed the tariffs for 2023 in May 2022 and in September 2022, respectively, based on Energinet having access to charge a non-transmission tariff based on a risk-adjusted return on the invested equity in the EP II Branch Pipeline. Correspondingly, Energinet has used a rate of return which reflected Energinet's expectations for the Danish Utility Regulator's determination of a risk-adjusted rate of return, see the Danish Utility Regulator's decision of 22 December 2022 on a rate of return for 2023 and 2024.

The consequences of the applied for amendment for 2023 for the non-transmission tariff are described in the following. It is noted in this connection that it appears from NC TAR, Article 4(4)(a), that non-transmission tariffs shall be "a) cost-reflective, non-discriminatory, objective and transparent" (Energinet's underlining).

In June 2023, Energinet has calculated the theoretical difference between the application of the rate of return in the historical break-even regulation of Gastransmission A/S, i.e. a break-even rate of return, and the rate of return in the current revenue cap regulation of Gastransmission A/S, i.e. by application of a risk-adjusted rate of return in accordance with the Danish Utility Regulator's decision of 22 December 2022. The difference between the two regulatory regimes can be calculated at DKK 31 million for 2023.

When applying the same assumptions about volumes for 2023 on which the current non-transmission tariff for 2023 of September 2022 is based, the amount of DKK 31 million corresponds to a tariff change of DKK -0.98/KWh/h/year, see the tariffs below.

Based on the knowledge available in June 2023, the non-transmission tariff for 2023 can subsequently theoretically be calculated at:

- DKK 10.84/KWh/h/year, charged non-transmission tariff for 2023, i.e. under the new economic regulation of Gastransmission A/S³, i.e. by applying a risk-adjusted return. (The tariff has been calculated on the basis of assumptions set in June 2023. Assumptions concerning volumes for 2023 are from September 2022).
- DKK 9.86 KWh/h/year, calculated non-transmission tariff for 2023, i.e. under the historical break-even regulation of Gastransmission A/S⁴, which means a break-even rate of return. (The tariff has been calculated on the basis of assumptions set in June 2023. Assumptions concerning volumes for 2023 are from September 2022).

The current non-transmission tariff for 2023 from September 2022 is DKK 8.46/KWh/h/year, see Energinet's price sheet⁵, and, as mentioned, this corresponds to Energinet's expectations for the rate of return determined by the Danish Utility Regulator as well as Energinet's assumptions about costs at this time.

The current non-transmission tariff of September 2022 is not directly comparable with the calculated non-transmission tariffs of June 2023, even though the same assumptions about volumes for 2023 have been used. This is ascribable to the expected rate of return being lower in September 2022 than in June 2023, see the Danish Utility Regulators decision of 22 December 2022, and to Energinet's expectations of June 2023 for the other costs for the EP II Branch Pipeline having increased since the current non-transmission tariffs, which were announced in September 2022. See also Energinet's expectations of a deficit for 2023 and derived tariff increases for 2024, see Shippers Forum 8 June 2023.

It should be noted separately that the Danish Utility Regulator's decision will not affect the announced non-transmission tariff for 2023. However, the decision may affect the calculation of differences for the non-transmission tariff for 2023 and thus affect the future tariff level of the non-transmission tariff.

4. Energinet's assessment of the applied for amendment

4.1 Initial considerations

By way of introduction, Energinet refers to the general comments on the establishment of a joint market zone model in Energinet's application of 15 September 2021, see section 6.1., pages 16-18, as well as the Danish Utility Regulator's introductory comments on the grounds for the decision on pages 35-37 of its decision of 14 February 2022.

³ The calculation has been based on a return on equity of 7.49%, see the Danish Utility Regulator's decision of 22 December 2022 on rate of return for 2023 and 2024. The Danish Utility Regulator determines two rates for the return on equity, Cost of Equity (CoE), which is used to determine revenue caps for the transmission system owner for the period 2023-2024. 1) A COE rate for equity up to 50% of the total rate of return basis. This is fixed at 7.49% before tax. 2) And a COE rate for the part of the equity that exceeds 50 per cent of the total rate of return basis. This is fixed at 0 per cent. When determining the rate of return on equity, the Danish Utility Regulator has used a CAPM (Capital Asset Pricing Model) method.

⁴ Here, the calculation has been based on a rate of return of 2.75 per cent on long-term debt (50 per cent) and an inflation correction of equity (50 per cent) of 4.5 per cent for 2023. In the nature of things, the calculated value has been based on Energinet's best estimate.

⁵ Prices for transport in the gas transmission system. Effective as of 1 October 2022: https://en.energinet.dk/media/mhchphwrv/price-list-2022-2023_may2023.pdf

Energinet notes that the applied for amendment of the Danish Utility Regulator's methodology approval does not change the fundamental principles for the joint market zone, the methodology of which was approved by the Danish Utility Regulator in its decision of 14 February 2022.

The methodology application only expresses a wish for clarification and updating of the requirements laid down by the Danish Utility Regulator in its methodology approval for the Transmission Unit's (Gastransmission A/S) charging of a non-transmission tariff (as well as the pricing in the Availability Agreement), so that they comply with the economic regulation of Energinet's gas transmission activities in force from 1 January 2023. All other substantive elements in the approved methodology are maintained.

In the enclosed application for approval, Energinet has used as a basis that the "necessary costs of efficient operations" stated in the decision of 14 February 2022 aims precisely at the recovery of costs by the Transmission Unit (Gastransmission A/S), see section 2.3.

Energinet should note that, legally, the Availability Agreement is in the nature of an internal service-level agreement between two business segments (entities) rather than a legal agreement. However, this solution had already been taken into account in the original methodology approval application, see section 2.1.

Energinet is of the opinion that the Danish Utility Regulator's processing of this submitted application should thus only concern the request for an amendment of the Danish Utility Regulator's methodology approval, so that the reference to section 2 of Danish Executive Order no. 816 of 27 June 2016 on economic regulation of Energinet.dk and the principle of inclusion of necessary costs for efficient operations and a necessary return on capital are omitted from the decision.

4.2 Amendment pursuant to new revenue cap regulation of Gastransmission

The Danish Utility Regulator's decision on the establishment of a joint market zone of 14 February 2022 was made with reference to the provision in section 2 of Executive Order no. 1609 of 27 June 2016 on economic regulation of Energinet. This provision no longer applies to Energinet Gastransmission A/S.

At the time of the Danish Utility Regulator's methodology approval of 14 February 2022, Energinet's regulated activities, including the gas transmission activities, were subject to a break-even regulation, which only allowed Energinet to recover necessary costs for efficient operations and a necessary return on capital, see section 2 of Executive Order no. 1609 of 27 June 2016 on economic regulation of Energinet.

The decision to grant methodology approval of the establishment of the joint market zone was made with reference to this provision. Energinet has understood that the background for this was that the Danish Utility Regulator assessed that it was necessary to regulate the Transmission Unit's (Gastransmission A/S) charging of the tariff for a non-transmission service, as the non-transmission tariff must concern a so-called "regulated service" in accordance with NC TAR.

However, it follows from section 12(3) of Executive Order no. 1605 of 28 December 2022 on economic regulation of Energinet and its wholly-owned subsidiaries that section 2 of the Executive Order no longer applies to Energinet's gas transmission assets as from 1 January 2023, as, from that date, the gas transmission activities are subject to the revenue cap regulation. With effect from 1 January 2023, the provision in section 2 of the Executive Order should not apply to the pricing in the Availability Agreement between the Transmission Unit and the Upstream Unit either.

To enable compliance with the requirement that the non-transmission tariff charged for the EP II Branch Pipeline pursuant to NC TAR is to be subject to pricing corresponding to that applicable to the gas transmission activity (as also recommended by ACER), the pricing in the Availability Agreement as from 1 January 2023 must instead be based on recovery of the costs of efficient operations of the activities and a risk-adjusted return on the invested capital in the same way as for the gas transmission activities pursuant to section 37 d of the Danish Gas Supply Act.

5. Consultation procedure

[The application for amendment of the decision on the joint market zone was submitted for consultation in the period 18 August 2023 to 8 September 2023 based on a Danish version of the application as well as an unofficial English translation thereof (this document).]

6. List of Appendices

Appendix 1. Legal basis

Appendix 2. The Danish Utility Regulator's decision of 14 February 2022 on "Establishment of a joint market zone".

[Appendix 3. Consultation response to the application

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[Appendix 4. Energinet's consultation memo]