

**Capacity Allocation Mechanisms**  
**Draft Explanatory note of DG Energy & Transport**  
**on Article 5, paragraph 1 and 2 as well as Annex 2.1. of**  
**Regulation (EC) No 1775/2005 of the European Parliament**  
**and of the Council**  
**of 28 September 2005**  
**on conditions for access to the natural gas transmission**  
**networks**

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**EREGEG comments on the draft explanatory note of DG Energy & Transport on Article 5,  
paragraph 1 and 2 as well as Annex 2.1. of Regulation (EC) No 1775/2005 on conditions for  
access to the natural gas transmission networks**

[Version submitted by DG TREN to the Madrid Joint Working by 17 March 2006]

*Note:* Comments and proposed modifications are included in [tracked version](#)

## General comments

ERGEG welcomes the opportunity to react on the present draft explanatory note of DG TREN on Capacity Allocation Mechanisms. The general comments hereinafter summarize the key aspects of ERGEG's remarks; detailed comments and proposals for amendments/modifications on the individual paragraphs are included with the relevant paragraphs.

### (1) Status of the Regulation and the explanatory note

It is necessary that DG TREN clarifies the status of the Regulation as well as the explanatory note in an unambiguous way. The Regulation is directly applicable to member states. It is the view of the ERGEG that the contracts on which the Regulation is applicable should be all capacity contracts. This regulation is of "public order" and applies also to contracts signed before the entry into force of the Regulation. The Regulation does not repeat the "exemption" of article 32.1 of Directive 2003/55/EC, whereby it applies also to "historic" transit contracts. ERGEG underlines the importance for the sake of competition that the Regulation is applicable to long-term contracts covered by Article 32.1 of the Directive 2003/55/EC. However, since the Directive makes an exemption by article 32.1, the GFG understands that the Regulation may not jeopardise the normal execution of historic contracts. In other words, parties may only claim that the Regulation is not applicable to their historic contracts if they can demonstrate a conflict between the Regulation and the contractual commitment that makes a normal fulfilment of the contract impossible.

The regulatory framework should generally leave no room for by-passing rTPA rules. Secondly, stability of this framework is important.

### (2) Determination of capacity

ERGEG is convinced that Capacity Allocation Mechanisms (CAM) and Congestion Management Procedures (CMP) may only be implemented successfully if the nature of capacity, in particular the calculation of the capability of a pipeline system, is controlled. The capability of a network is dynamic and any capacity figure is a snapshot. The available capacity in a network varies continuously according to the network operation (by the TSO) and the network use (by the shippers). Hence, consistent capacity calculation both over time and across networks is not guaranteed (not straightforward). ERGEG is in favour to devote appropriate attention to capacity calculation principles (CCP). CCP are necessary to guarantee the effectiveness of CAM and CMP. CEER's task force on capacity (TF CAP) is working in this area. To ascertain non-discriminatory capacity allocation methods are applied, transparency of method and underlying assumptions is required.

### (3) Importance of flexibility services besides capacity services

The explanatory note is focussed on the offer of transportation capacity and does not mention the offer of operational flexibility (call it line-pack or otherwise) to allow shippers to comply with the

balancing requirements. There is an obvious trade-off between both and the market participants need capacity as well as operational flexibility. Furthermore, it is well-known that the offer of flexibility is crucial for the development of competition since especially new entrants need flexibility.

#### **(4) Long-term interruptible contracts**

There is no clear view on how long term interruptible capacity (as opposed to interruptible UIOLI) should be offered on the primary market. By offering such services, overbooking of capacity could be allowed.

#### **(5) Day-ahead capacity**

The issue of day-ahead offer of capacity (related or not to UIOLI) requires a very tight scheduling of the nomination and re-nomination processes. Some principles concerning this should be included.

#### **(6) Role of NRAs**

There should be a specific paragraph at the beginning explaining clearly the competence of NRAs in the area of capacity allocation (reference to article 10 of the Regulation). In this context it is required that Member States clearly define the responsible national authority.

#### **(7) Coordination of operations**

It is necessary for TSOs to coordinate operations with upstream TSOs. This issue deserves appropriate attention in the explanatory note. Obviously, this coordination is needed in light of both security of supply and competition, and to prevent possible regulatory gaps.

#### **(8) Conditionality of investments on binding commitments**

Securing new investments through binding transportation contracts is too much emphasised in the note. Such binding commitments may e.g. not be required for investments for the national market if costs are anyway covered through tariffs.

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## 1. INTRODUCTION

- (1) On 28 September 2005, the European Parliament and the Council adopted Regulation (EC) No 1775/2005 on conditions for access to the natural gas transmission networks (OJ L 289 of 3.11.2005, page 1). According to its Article 17, the Regulation enters into force on the 20<sup>th</sup> day following its publication, i.e. 23 November 2005 and shall apply from 1 July 2006.
- (2) With a view to ensuring consistent application of the provisions of the Regulation, in particular on the matter of capacity allocation mechanisms, the services of DG Energy & Transports issue this document, which intends to provide explanatory comments on Article 5, paragraph 1 and 2 as well as on Annex 2.1 of the said Regulation. The remaining provisions of Article 5, namely paragraphs 3, 4 and 5 as well as Annex 2.2 are not explicitly covered by the current document, although some relevant aspects of these provisions may also be touched upon in the current note. Issues arising from them will be fully covered by separate notes dealing with congestion management procedures and transparency requirements.

### Comment:

- The starting point of CAM has to be a capacity level resulting from an adequate calculation procedure (*see general remark (2)*).
- A separate paragraph should address the status of the Regulation and the interpretation of DG TREN put forward in this explanatory note (*see general remark (1)*).

- A separate paragraph should address the role of NRAs (*see general remark 6*).

## 2. STARTING POINT: LEGAL UNBUNDLING OF TRANSMISSION AND SUPPLY

- (3) Directive 2003/55/EC (the Internal Gas Market Directive or IGM Directive) requires the legal and functional unbundling of transmission system operators (Art 9). The underlying objective of the provisions on legal and functional unbundling of network operators is to create a structure of interests of network operators which is focused on transporting gas, no matter on whose behalf and no matter for which purpose <sup>(a)</sup>. The main interest of a network operator should be to offer transportation services ensuring efficient use of the network, which means to contract all the capacity available ~~as much as possible on a firm basis and, once the firm capacity is sold out~~ in a customized manner to meet the market needs, and to market unused contracted capacity<sup>1</sup> to the extent possible. ~~The aim of the directive is that~~ Legal and functional unbundling should result in an must aim at creating a configuration of interests of the network operator that is very similar, if not identical to that of a network operator also separated from any supply interests by ownership, i.e. the network would not be owned anymore by any vertically integrated company with supply interests <sup>(b)</sup>.

### Comments:

- <sup>(a)</sup> This objective implies that inland transportation and transit are treated equally. However, the possibility of different contracting and tariff regimes (financial rewards) may influence TSO's interests which are e.g. reflected in investment initiatives.
- <sup>(b)</sup> It is not straightforward that legal and functional unbundling will result in a market situation equal to ownership unbundling. In this context, the industrial merging trend in Europe is not innocent.

- (4) While the functional unbundling might be considered more important in terms of achieving such an objective, legal unbundling, which provides the necessary prerequisite for functional unbundling to work properly, brings about new contractual requirements for the system users, such as shippers, suppliers, traders etc. In the system prior to liberalisation, the supply branch of a vertically integrated company usually concluded a supply contract and subsequently made sure that capacity to transport the gas under a respective supply contract would be available. There were no contractual relations involved between the incumbent supplier and the network operator, because both were part of the same company. It is obvious that this ~~integrated approach bundling~~ would constitute a considerable competitive advantage vis-à-vis any newcomer or competitor in an open market. Under the new regime

<sup>1</sup> The term “unused capacity” is defined in the Regulation as “firm capacity which a network user has acquired under a transportation contract but which that user has not nominated by the deadline specified in the contract”.

with access regulated and based on ex-ante approved tariffs following legal and functional separation of the network and supply business, there is now more of a level playing field<sup>2</sup>.

**Comment:** there was not a question of new entrants before market opening.

- (5) As a consequence, each system user, including the incumbent supplier, now has to conclude two contracts, in order to serve a given customer: a supply contract between himself and the final customer and a transportation contract between himself and the TSO providing transportation service.<sup>3</sup> This does not preclude the appearance of the intermediate role of a shipper, which would create a contractual chain: a shipping contract between the supplier and the shipper who has to conclude a transportation contract with the TSO. A supplier may act as a shipper, and a shipper is not necessarily a supplier.

**Comment:** there is some doubt whether a TSO can be allowed to offer shipping services while guaranteeing non-discrimination.

### 3. THE CAPACITY ALLOCATION MECHANISM IN REGULATION 1775/2005

#### 3.1. Introduction

##### 3.1.1. Scope of the Regulation

- (6) Pursuant to Article 1 (“Subject matter and scope”), the Regulation

*“... aims at setting non-discriminatory rules for access conditions to natural gas transmission systems...”*

This means that the scope of the Regulation in practice depends on the definition of “transmission” which is provided in Article 2(1), point 1 and reads

*“‘Transmission’ means the transport of natural gas through a network, which mainly contains high pressure pipelines, other than an upstream pipeline network and other than the part of high pressure pipelines primarily used in the context of local distribution of natural gas, with a view to its delivery to customers, but not including supply;”*

<sup>2</sup> This does, however, not necessarily apply to all elements of a functioning internal gas market.

<sup>3</sup> In reality, it might often be the case that transportation contracts do not exactly underpin a specific supply contract, in particular if the market becomes more liquid in terms of capacity and capacity trading becomes more common. Bundled capacity (capacity contracted to underpin more than one supply contracts), in particular at entry and exit points and in a well-established entry-exit capacity system might be more conducive to and flexible for a competitive internal gas market. In such a situation, exploiting short notice market opportunities might not be possible, if a request for transportation, also on the primary market, has to be linked to a supply contract.

**Comment:** more explanation is needed to make the scope unambiguous. See also next paragraph - what does e.g. “high pressure” and “local distribution” mean?

- (7) As a consequence, the concept of transmission in the Regulation encompasses all high pressure pipelines, unless they are used for production or processing of gas<sup>4</sup> or are ~~part of a local distribution system primarily used in the context of local distribution of natural gas, with a view to its delivery to customers~~. The scope of the Regulation is therefore not limited to cross-border trade, but also includes high-pressure pipeline systems transporting gas to other transmission systems operating at regional scale.<sup>5</sup>

**Comment:** The passage “or are part of a local distribution” is contrary to the wording of the Regulation (“primarily used in the context of local distribution of natural gas”) – the Regulation addresses high pressure pipelines used in the context of local distribution, not distribution systems. The wording of the Regulation should be used.

See also general remark 5.

### 3.1.2. *Different kind of capacity situations*

- (8) The capacity situation at a given entry (or exit) point to (from) the gas grid may be characterised by one of the following three situations:

**Comment:** OK but we have to keep in mind the complexity of the assessment, taking into account the various services. E.g. there may be enough entry capacity for assigning a specific contract (e.g. specific duration, specific exit) but at the same time there may be not sufficient capacity at that entry point for another kind of contract.

See also general remarks (3) and (4).

- (I) **Offer exceeds requests**: there is more capacity offered than requested, so the offer of capacity (supply) exceeds the demand for capacity. Such a situation is thought not to create any problems in terms of capacity allocation, since all parties requesting capacity should get what they seek.
- (II) **Requests exceed offer (short term)**: the demand for capacity exceeds the offer of capacity, or in other words, more capacity is demanded than can be made available.

<sup>4</sup> See the definition of “upstream pipeline network” in Directive 2003/55/EC, which pursuant to Article 2(2) of the Regulation is also applied in the Regulation.

<sup>5</sup> In theory, Directive 2003/55/EC would allow regional transmission pipelines **(Comment: what is a regional pipeline?)** to be covered by the definition of “distribution” contained in the Directive (see Article 2, point 5 of Directive 2003/55/EC). According to this definition, “distribution” means the “transport of natural gas through local or regional pipeline networks...” The definition of “transmission” used in the Regulation does not allow such an approach.

Such a situation would be characterised by congestion<sup>6</sup>, which would only occur in the short term, i.e. is not supposed to economically justify any long-term solution, and thus would not result in new capacity, but only in new supply of commodity.

**Comment:** the term “but only in new supply of commodity” is confusing as it could relate to gas flows rather than capacity. We suggest the following...”would not result in new capacity but the rationing of existing capacity...”

- (III) **Requests exceed offer (long-term)**: as for II., the demand for capacity exceeds the offer of capacity. However, the congested situation would occur in the long-term. In case existing congestion management mechanisms do not remain the most appropriate and efficient way of managing the constraint and ensure that all reasonable demands for capacity can be met, the congestion has ~~and should~~ to be sorted out by the TSO by adding new capacity, i.e. by undertaking investments (new project or enhancement of existing projects).

**Comment:** expanding the transmission system in order to meet the market demand is an obligation of TSOs according to Directive 2003/55/EC: Art. 2.4 requires TSOs to “develop the transmission system [...] and ensure the long-term ability of the system to meet reasonable demands for the transportation of gas”; Art. 8 of Directive 2003/55/EC moreover requires TSOs to “develop secure, reliable and efficient transmission facilities”. Achieving security, reliability and efficiency requires a number of steps - one of them is to ensure that transmission facilities are capable of meeting market demand. TSOs are therefore legally obliged to expand their system according to the reasonable market demand – long term congestion therefore has to be sorted out by adding; not is no option as long as investments are reasonable under economic conditions.

### 3.1.3. *Different kind of capacity allocation mechanisms (CAM)*

- (9) As also indicated in the CEER report on “Investments in gas infrastructures and the role of EU nation regulatory authorities”<sup>7</sup>, it is possible to conceive several capacity allocation mechanisms (CAM):

- (I) **first come, first served (fcfs)**: shippers would be served in the order of contracting or requesting capacity;

**Comment:** it is important to note that it is not just shippers that request exit capacity but also e.g. gas distribution networks as it is the case in the UK. We suggest the inclusion of a footnote to this effect.

<sup>6</sup> At this point, it does not matter whether it concerns contractual or physical congestion.

<sup>7</sup> Council of European Energy Regulators (CEER), Investments in gas infrastructures and the role of EU national regulatory authorities, final version 12.5.2005, available under <http://www.ceer-eu.org/>

(II) *pro rata (PR)*: all shippers requesting capacity would be able to contract it, but none of them would be able to contract 100% of its request in the event of congestion. The requests of shippers would be curtailed according to a specific mechanism; in most cases, it would mean that the proportion of capacity requested by a certain shipper in relation to the total requests would correspond to the proportion of available capacity allocated to this shipper.

(III) *Auction (AU)*: the available capacity would be auctioned and allocated to the shippers paying the highest price for the capacity. Revenues from auctions should be used for capacity investments subject to regulatory decision. The allocation of profits generated by auctions is discussed in the explanatory notes on tariffs.

Irrespective the CAM applied the capacity offer has to meet the long-term market demand. In order to assess the relevant market demand, the TSO shall conduct an open season inviting all interested shippers to submit their requests on the basis of which the capacity would be determined.

(IV) ~~*Open season (OS)*~~: ~~all interested shippers are invited to submit their requests on the basis of which the capacity of new infrastructure would be determined.~~

**Comment:** an open season is no allocation mechanism but an instrument used to determine the capacity demand **prior** to the capacity allocation. It should be applied in every case where new capacity is offered to the market and not only for new infrastructure (see also §26/open season) in order to assess the market demand. The final capacity offer shall be based on the market demand evaluated from this perspective. In case the open season identifies a long term congestion based on a reasonable demand, an expansion is required (see 8.III).

(10) As set out in the progress report<sup>8</sup> of the European Commission, “first come, first served” is by far the most common capacity allocation mechanism on the European market, while auctions and pro rata may represent the exceptions rather than the rule. While an open season should be applied in every case new long term capacity is offered in a congested market in order to assess the market demand, Currently, an open season is only applied for new infrastructure in the present practice.

**Comment:** see above 9.III; unless DG TREN would include a valuation – as e.g. amendment above – this paragraph could be as well cancelled as it does not add much in terms of interpreting the Gas Regulation but is merely a description of currently applied CAM (see as well § 26/open season).

<sup>8</sup>

Communication from the Commission to the Council and the European Parliament “Report on progress in creating the internal gas and electricity market” (COM)2005) 568 final of 15.11.2005, available from [http://europa.eu.int/comm/energy/electricity/report\\_2005/doc/2005\\_report\\_en.pdf](http://europa.eu.int/comm/energy/electricity/report_2005/doc/2005_report_en.pdf); the technical annexes of the report are referred to as SEC(2005)1448 and are available from [http://europa.eu.int/comm/energy/electricity/report\\_2005/doc/2005\\_report\\_technical\\_annex.pdf](http://europa.eu.int/comm/energy/electricity/report_2005/doc/2005_report_technical_annex.pdf)

An important issue regarding open season CAM is the duration of the binding commitments. This issue deserves further explanation, e.g. what is the maximum duration of a commitment that a TSO may request?

- (11) Any open season shall be announced on the TSO's website, prior to the publication of final terms and condition for a capacity tender allowing potential shippers to indicate the intake and offtake points where capacity should be allocated at and the relative amount of capacity requested at each point; the minimum lot size to be offered in order to meet their respective demand; the products to be offered in order to meet their respective demand (long term/short/firm/interruptible services).
- (12) The open season process should already inform potential users about: the product portfolio the TSO plans to offer (long term/short term/firm/interruptible services); the allocation procedure the TSO plans to apply, including the possibility of further expansion of the capacity offered; the terms and conditions of allocation procedure; rules in case any capacity remains un-allocated; terms of transportation contract; the indicative tariff to be applied.
- (13) The results of the open season should be made available to the relevant Regulatory Authorities on request. In addition market demand shall be evaluated and updated on a regularly basis (i.e. long-term planning process) by the TSO and overviewed by the national regulatory authorities.

### 3.2. The relevant provisions of the Regulation

~~(11)~~(14) One of the fundamental elements for introducing competition to the EU natural gas market is non-discriminatory and transparent third party access to the network. Non-discriminatory and transparent capacity allocation mechanisms play a key role in this respect, a fact that has recently been confirmed by the progress report of the Commission<sup>9</sup>. Regulation 1775/2005 requires such capacity allocation mechanisms. By that, it also responds to a wish by European regulators calling for more convergent capacity allocation procedures and a harmonisation of regulatory practices.<sup>10</sup>

~~(12)~~(15) In the following, the features and requirements of non-discriminatory and transparent capacity allocation procedures from the point of view of DG TREN services will be described in more detail. This does not necessarily mean that other capacity allocation mechanisms would not comply with the requirements of the Regulation and its relevant provisions as far as in line with the relevant provisions of the Regulation.<sup>11</sup>

<sup>9</sup> Cf the progress report referred to in footnote 8;

<sup>10</sup> see footnote 7

<sup>11</sup> The 3<sup>rd</sup> subparagraph of Article 3(1) of the Regulation acknowledges the right of Member States to determine tariffs through market-based arrangements, such as auctions. It is therefore submitted that the underlying CAM

**Comment:** not any other CAM can be in line with the Regulation; *general remark 1* has to be reflected in both previous paragraphs.

### 3.2.1. *Maximum and technical capacity*

- (16) For the purpose of the current analysis, Article 5(1) and 5(2) in connection with No 2.1 of the Annex represent the relevant provisions of the Regulation. Article 5 is titled “Principles of capacity allocation mechanism and congestion management procedures”. Its paragraph 1 reads:

*The maximum capacity at all relevant points referred to in Article 6(3) shall be made available to market participants, taking into account system integrity and efficient network operation.*

- (17) The most important message conveyed by Article 5(1) is that TSOs have to make maximum capacity available to market participants. They must not withhold any capacity they may dispose of and have to commercialise the available capacity in such a way to meet market needs to the extent possible. This is a fundamental requirement and – although it may come across as a matter of course or a banality – of utmost importance, above all for two reasons: first, TSOs – albeit legally and functionally unbundled – may still not have sufficient incentives to offer maximum capacity. Secondly, without exploiting all possibilities to enhance liquidity on the capacity market, it might be very difficult and probably impossible for newcomers to get any capacity at all. All transmission systems in Europe have been designed in line with the needs of the incumbent integrated gas companies controlling not only supply, but also the grid. Against this background, it is easily conceivable that without an obligation for the TSO to offer maximum capacity via efficient use of existing capacities <sup>(a)</sup> to the market, there might not be any capacity left for the newcomers.

**Comment:** The conclusion is somewhat less dominant since shippers may not book more capacity than needed.

<sup>(a)</sup> Offering maximum possible capacities to the market requires efficient use of existing system resources.

- (18) For the sake of clarity, it seems important to highlight the difference between the term “maximum capacity” used in Article 5(1) and the term “technical capacity”. While Article 2(3) defines “capacity” as

*the maximum flow, expressed in normal cubic meters per time unit or in energy unit per time unit, to which the network user is entitled in accordance with the provisions of the transportation contract*

the term “technical capacity” means pursuant to Article 2(18)

in these Member States is compatible with the corresponding provisions of the Regulation contained in Article 5.

*the maximum firm capacity that the transmission system operator can offer to the network users, taking account of system integrity and the operational requirements of the transmission network.*

- (19) The obvious difference between the concepts of *technical* capacity and *maximum* capacity is that “technical capacity” explicitly refers to “firm capacity”, while the term “maximum capacity” as used in Article 5(1) does not introduce any specific idea of “capacity”. As a consequence, DG TREN services take the view that “maximum capacity” in Article 5(1) encompasses each kind of capacity (including flexibility services) that can be marketed and contracted on the primary market. As such, the idea of maximum capacity as used in Article 5(1) is broader than the concept of “technical capacity” and takes account of the fact that TSOs might have a certain range of flexibility in determining what could be made available ~~as interruptible capacity in addition to what is made available as firm capacity~~<sup>12(a)</sup>. As such, the idea of maximum capacity as used in Article 5(1) is the capacity still available in the network after assigning contracts (technical capacity minus booked capacity). The technical capacity is the maximum available firm capacity before any capacity is booked by shippers. The technical as well as the maximum available capacity vary continuously according to the way the network is operated (by the TSO) and used (by the shippers). The technical capacity is the calculated maximum firm capacity but this does not imply that this capacity is marketed as firm capacity, e.g a share may be offered as flexibility services for balancing purposes. However, the technical capacity is the upper-bound of the capability of the network (taking into account the operational margin). Article 5(1) therefore obliges TSOs to make capacity available beyond ~~what is usually made available as firm capacity and which would fall under the definition of the~~ “technical capacity” using. ~~It can be assumed that TSO would always have a certain range of flexibility to offer capacity beyond the technical capacity. This the that flexibility would~~ accrues from the size of the network concerned, the respectively prevailing capacity situation as a result of actual nominations, the overall structure of the network, pressure conditions, the balancing instruments available to the TSO, capacity emerging from system resources such as line-pack etc.

#### Comments

■ <sup>(a)</sup> Available capacities shall at the best be offered on a firm basis to the market. Interruptible capacities tend to bring only limited benefit to new and small market entrants with a usually only limited portfolio to balance interruptions. In praxi capacities beyond the “technical capacity” are of course usually offered as interruptible services – but one should not ex ante limit them to interruptible offers!

■ The technical capacity corresponds to the maximum flow performance; no more flows can be transported. From this technical capacity, the TSO reserves some capacity for system integrity and operational requirements. The remaining capacity has to be brought to the market in such a way to meet the market needs (various kinds of transportation services). This does not necessarily mean

<sup>12</sup> It is important to note that the term “interruptible capacity” in the current context does not concern that kind of interruptible capacity that would arise by making unused capacity available.

that all the available capacity has to be offered as firm capacity, a share may e.g. also be offered under the form of flexibility services (available capacity has to be offered in a customized way). Furthermore, the amount of available firm capacity depends also on the duration that capacity may be offered as firm, e.g. the available short term firm capacity may be considerably higher than long term firm capacity. These network capability matters deserve CCP.

■ As long as there are no CCP, concerns regarding the definition of maximum/technical capacity remain. There is currently no clarity on how technical capacity should be calculated. We do not agree that interruptible capacity is capacity arising from linepack. Linepack is generally used to provide flexibility products which reflect within day diurnal flow variations. The relationship between firm/interruptible in the context of availability of capacity is also somewhat contrary with the observed practice where e.g. networks are built to accommodate firm capacity requirements according to the 1 day in 20 years rule assumption that anyone with interruptible status would be interrupted on that peak day.

(20) The maximum capacity that TSOs have to offer pursuant to Article 5(1) of Regulation 1775/2005 would therefore consist of the technical capacity as defined by Article 2(18) of the Regulation and capacity that can be made available in addition to the technical capacity and at interruptible terms. The latter one can be understood as capacity emerging from linepack<sup>13</sup>. The only restriction to this concept is that system integrity must not be endangered and efficient network operations must be ensured. There is no physical capacity beyond the technical capacity that can be brought to the market. Any capacity offered more than the technical level amounts to capacity overselling. CCP should avoid that TSOs decide arbitrarily what can be offered as available capacity<sup>(b)</sup>. Therefore, it is obvious that in the day-to-day business there is hardly anybody else than the TSO to decide what can be offered beyond the technical capacity whilst taking into account its obligation to ensure efficient TPA by offering maximum possible capacity to the market.<sup>(a)</sup>

#### Comments

■ <sup>(a)</sup> The requirements of offering maximum possible capacity to the market and system integrity have to be balanced – one shall not be used for excuse of not complying with the other.

■ <sup>(b)</sup> There exists no additional capacity beyond the technical level (*see general remark 2 and 3*).

(21) That means that in order to make Article 5(1) really effective, the TSO should have incentives to offer this capacity at terms and conditions that allow both the TSO and the network user to really benefit from marketing and using such additional capacity.

**Comment:** this holds for all the available capacity. All the available capacity must be brought to the market in a customised way in order to meet market demand. This must rather be seen as a basic

<sup>13</sup> The definition of line-pack contained in Directive 2003/55/EC (see Article 2, point 15) would apply.

task of the TSO and rewarding according to the general price settlement and does not require specific incentives.

- (22) In this context, it is very important to highlight the crucial role regulators have to play in this respect. It is obvious that they have to ensure that TSOs comply with the requirements emerging from Article 5(1). For this reason, TSOs have to demonstrate to regulators the correct amount of technical capacity and maximum available capacity. They have to ensure compatibility of the different systems across the European market in terms of capacity allocation mechanisms and all matters related to them.

**Comment:** ERGEG is aware of this task. However, NRAs are only able to monitor the calculation of available capacities if appropriate definitions are agreed. There are currently no industry-wide definitions regarding the procedures for calculating the level of capacity. Therefore, the need of CCP is stressed and this is part of the activities of CEER's Task Force Capacity (*see general comment 2*).

- (23) Against this background it is worth underlining that DG TREN services take the view that Article 10 of the Regulation would constitute the necessary competences for regulators "to ensure compliance" with the Regulation and the Guidelines in its annex or adopted pursuant to Article 9 of the Regulation. The actual role of regulators in this respect is likely to depend very much on the effectiveness and practical implementation of the unbundling provisions of Directive 2003/55/EC. Properly unbundled TSOs with interests completely separated and independent from any supply interests may require less regulatory intervention than in the case of TSOs bound to a less stringent and less effective unbundling regime. In the latter case, compliance with the Regulation may require more direct intervention from regulatory authorities than it would be the case of TSOs the interests of which are exclusively devoted to marketing transportation services and thus are likely to act in full compliance with the objective of Article 5(1) of the Regulation: to make the maximum capacity available to the market.

**Comment:** the role of NRAs in setting CAMs should be clarified earlier in the text (see general remark 6). The reference to article 10 is very important but does not concern only capacity. In some countries, the powers of NRAs are limited by national regulation.

- (24) The concept of "maximum capacity" concerns all relevant points as referred to in Article 6(3) of the Regulation.

### 3.2.2. *The Requirements of Capacity Allocation Mechanisms laid down by the Regulation in Article 5(2) and Annex 2.1 including the matter of capacity hoarding*

- (25) Article 5(2) lays down the requirements of capacity allocation mechanisms (CAM), which TSOs have to implement. In the following, these requirements are recalled, before their implementation in practice will be discussed. It is worth noting that point 2.1 of the Annex to the Regulation complements the provisions of Article 5(1) and 5(2). Qualitative

requirements from both Article 5 of the Regulation and point 2.1 of the Annex are treated in the following.

- (26) First of all, CAM have to be non-discriminatory and transparent and must be published (Art 5(2)). In addition, they have to
- provide economic signals for efficient and maximum use of technical capacity (Article 5(2)a and Annex 2.1. point 4)
  - facilitate investment in new infrastructure (Article 5(2)a and Annex 2.1. point 4),
  - be compatible with market mechanisms including spot markets and trading hubs (Article 5(2)b and Annex 2.1. point 1),
  - be flexible (Article 5(2)b and Annex 2.1. point 1),
  - be capable of adapting to evolving market circumstances (Article 5(2)b and Annex 2.1. point 1),
  - facilitate the development of competition and liquid trading of capacity (Annex 2.1. point 1),
  - take into account system integrity and security of supply (Annex 2.1. point 2)
  - avoid undue barriers to market entry (Annex 2.1. point 3)
  - and must neither hamper entry of new market participants (Annex 2.1. point 3)
  - nor hamper new market entrants from competing effectively (Annex 2.1. point 3)
  - be compatible with the network access system of Member States (Article 5(2)c)
  - allow network users to be advised about the type of circumstances that could affect the availability of contracted capacity (Annex 2.1. point 5)
  - ensure timely information of network users by TSOs in the event of difficulties in meeting contractual delivery obligations. (Annex 2.1. point 6)
  - ensure that TSOs consult network users regarding procedures prior to their implementation and agree them with the regulatory authority. (Annex 2.1 point 6)

### 3.2.3. *Description of non-discriminatory and transparent capacity allocation mechanisms*

- (27) In the following, the requirements of non-discriminatory and transparent capacity allocation mechanisms will be described. The underlying idea and driving principle of these

considerations is the wish to allow all capacity requests to be met to the very extent possible. Bearing in mind that

- the European natural gas market is in transition from a market characterised by integrated companies controlling essential parts of the gas chain including the network to a competitive market with network users enjoying non-discriminatory and transparent access to the grid,
- the incumbent companies enjoy a significant competitive advantage vis-à-vis newcomers simply due to the fact that they may benefit from the past in that they have contracted capacity under quasi monopoly conditions<sup>14</sup>;
- the existing infrastructure is to a large extent likely to be tailor-made to the needs of the incumbent companies due to the fact that they have developed this infrastructure in line with their needs,

it is of utmost importance that non-discriminatory and transparent capacity allocation mechanisms acknowledge the circumstances emerging from the past and provide the necessary mechanisms and procedures to create a level playing field, also in terms of capacity allocation, for newcomers and incumbents alike.

**Comment:** an important element in this discussion is the fact that the concept of transportation contracts has been emerged from the unbundling. Up till then, transportation was covered by supply contracts in a general manner without a specific link to transportation clauses which are currently used. This element has to be considered in the discussion of the applicability of the Regulation to historic contracts. This observation advocates e.g. that historic contracts have rather no clauses which may exclude the applicability of the Regulation (see general remark 1).

(28) This, however, does not mean, subject to considerations accruing from relevant competition rules that existing transportation contracts are generally put in question. But it does mean to provide for the necessary capacity allocation mechanisms designed to level off competitive disadvantages resulting from the past to new market entrants.<sup>15</sup>

**Comment:** does it mean that the explanatory note suggest some kind of “positive” discrimination for new market entrants? This paragraph must be clear on this matter.

(29) In the view of DG TREN services, the following description would result in a non-discriminatory and transparent capacity allocation mechanism fully complying with the relevant provisions of the Regulation. This, however, does not exclude that existing CAM in some Member States could also comply with the requirements of the Regulation.

<sup>14</sup> This fact has been highlighted, among other things, by the Marathon case.

<sup>15</sup> It is worth noting that the term “new market entrants” and similar terms do not exclusively mean complete newcomers to the European gas market, but would also encompass incumbent gas companies entering markets of other Member States.

### 3.2.3.1. Requirements of non-discriminatory and transparent capacity allocation mechanisms

(30) The following principles and elements are considered to form an integral part of a non-discriminatory and transparent capacity allocation mechanism:

1. **Overall transparency on future available capacity:** The TSO has full information on the technical, booked and available capacities. These capacities must be calculated according to transparent standards guaranteeing that maximum capacities are brought to the market in a consistent way over time and across networks. It should publish this information, as soon as it is available to the TSO. The period of time to be covered must extend well in the future, in order to allow comprehending how and when capacity is allocated. For this reason, publication of available capacity should cover all years where capacity is contracted up to the first year where no capacity has been contracted, i.e. the first year, where 100% of the technical capacity can be made available to system users and where this would also go for the subsequent years. For instance, if a TSO has contracted a certain portion of the capacity in its system up to x years ahead from today, but has not yet sold any capacity in year x+1 and following years, it should publish available capacities for the next x+1 years to come. Users would then actually be informed about the capacity situation for the whole foreseeable future: it would be explicitly indicated for the next x+1 years implying that for year “x+1 plus x” the entire capacity is available. If a TSO has allocated capacity up to 25 years in the future, he should publish the capacity situation for the next 26 years and so on.

**Comment:** this paragraph makes abstraction of the fact that available capacities varies continuously and should be updated on a rolling basis. CCP are necessary for the sake of accurate information.

This transparency requirement is crucial for non-discriminatory and transparent capacity allocation. It would exclude the tacit prolongation of existing contracts and would provide the necessary transparency for network users. In addition and with respect to imports from external sources, it would deliver valuable insight in the overall security of supply situation of the EU.

2. **Overall transparency on historic use of contracted capacities:** publication of historic usage rate of contracted capacities provides essential information to both the TSO and the system users. While it allows the TSO to comply with its obligation to make contracted but unused capacities available to the market and thereby ensure for most efficient TPA.
3. **Open season:** The core element of non-discriminatory and transparent CAM is an open season for capacity requests to be applied for existing and new capacity. Its objective is to accommodate all requests for capacity on condition that they turn out to be economically viable. Regulatory guidelines have to provide guidance in this respect.<sup>16</sup> Transparency is

<sup>16</sup> It is obvious that in particular in the case of existing infrastructure, such an approach will almost necessarily result in short term congestion (capacity situation II) or long-term congestion (capacity situation III). The procedures to be applied in these situations will be explained in the draft “Explanatory note of DG Energy &

crucial and announcement should be made well in advance. The TSO must publish the accurate deadline for submitting capacity requests, until the expiry of which each interested network user is invited to indicate his interest in contracting how much capacity. This period should be considered an open season for submitting capacity requests. The open season shall provide system users with sufficient information in advance. This shall among others cover the CAM that will be applied in including the relevant General Terms and Conditions and the product portfolio that shall be offered (e.g. long term/short term/firm capacities/interruptible capacities/in- and offtake points/ minimum lot sizes). The requests must be submitted in a manner allowing the TSO to decide on the appropriate allocation mechanisms, once the deadline for submitting requests has expired.

**Comment:** system users have to be provided with maximum possible information about the allocation procedure to allow them for reasonable decisions. Without comprehensive information, results of open season risk to be distorted.

It is worth noting that the open season is not meant to jeopardise existing transportation contracts. Its objective is rather to ensure that new capacity requests can be accommodated in a non-discriminatory and transparent manner without questioning existing transportation contracts. Of course, this means that unless capacity situation I prevails, congestion management procedures, as described in the note on the relevant provisions of the Regulation (see footnote 16) would need to be applied.

Depending on the duration of the contracts, the open season procedure is a permanent process. It is assumed that the open season for annual contracts or a multiple thereof may expire each year at the same time, while open seasons for short-term contracts (less than a year) may be set on a rolling basis and are considered to be independent of those for annual or multi-annual contracts.

The way how open seasons are implemented for existing and new capacity may differ.

43. **End of open season and date of allocating capacity:** The TSO has to publish both the end of the open season and the date of allocating capacity in relation to each open season. The end of the open season is followed by the date of allocating the capacity. The time between the end of the open season and the date of allocating capacity must not be too long, ~~since its main purpose is to allow the TSO to decide on the basis of all capacity requests received which capacity allocation mechanism should apply in the given capacity situation (see below).~~

Transport on Article 5 “Principles of capacity allocation mechanisms and congestion management procedures” paragraph 3, 4 and 5 as well as Annex 2.2. of Regulation (EX) No 1775/2005 of the European Parliament and of the Council of 28 September 2005 on conditions for access to the natural gas transmission networks”.

**Comment:** the CAM can be fixed already in advance – whether first committed, first served, an auction or pro rata allocation will be used does not depend on the result of the open season. In case of congestion all three CAMs allow for aliquot allocation.

45. ***Relation between end of open season and start of the contract:*** It is obvious that there must be an appropriate relation between the publication of available capacity, the allocation of available capacity and the duration of the contract. Long-term transportation contracts require a long preparatory phase often involving upfront investments and commitments not directly related to transportation. A contract running over a period of 10 years and more is not likely to be decided on a short term or ad hoc basis becoming effective already a couple of month after the decision on the contract has been taken. On the other hand, short-term contracts (less than one year) are not likely to emerge very long in advance, but would presuppose the possibility to book capacity at short or at least shorter notice than it would be the case for long or longer-term contracts.

**Comment:** this paragraph suggests contracts running over a period of 10 years and more. Some explanation of the duration of contracts is needed.

A non-discriminatory and transparent CAM must reconcile the different requirements of transportation contracts underpinning supply contracts with various durations in line with the principle of treating equal things equally. That means that the allocation mechanism must be non-discriminatory in allocating capacity for a long-term contract to various users as well as in allocating capacity for short-term contracts.

The period between the allocation of capacity and the start of the transportation contract must differ for the following reasons:

1. If short and long term capacity requests were allocated at the same time and under the same timing schedule for the same contract time, there would always be considerable and inevitable shortcomings to be attributed to the capacity allocation mechanism. Efficient use of capacity cannot be ensured, for instance, in the case that allocation of capacity to short-term contracts would render it impossible to allocate capacity to long-term transportation contracts; on the other hand, long-term contracts might constantly exclude short- or shorter-term contracts, since they promise a more efficient use of capacity. Abuse of the system should also be denied. It would, for instance, occur in the event that a shipper books all available capacity of a certain pipeline for a short term contract (e.g. one month) inappropriately in advance (for instance a number of years). This would have the effect that long-term contracts could not be allocated anymore, thereby possibly jeopardising security of supply. While, theoretically, the economic problem occurring for the TSO in this event could

be sorted out through the price<sup>17</sup>, such behaviour would not comply with the requirement laid down in the Regulation to make efficient use of capacity<sup>18</sup>.

2. For the same reasons, either security of supply or competition would suffer depending on whether long or short-term contracts would take precedence at a given allocation mechanism.

In order to safeguard and preserve the principle of non-discrimination, but also with a view to ensuring the efficient use of capacity and denying any misuse of the system, the deadline for submitting capacity requests has to be set with respect to the presumed duration of the contract. The deadline to express interest in a long-term transportation contract (for example, ten years and more) would need to be set a number of years in advance <sup>(a)</sup>, while that for a short term contract (e.g. one-month or less) may only be set a couple of days (or in the case of daily contracts day-ahead) before the contract starts.

**Comment** <sup>(a)</sup> this would only be true in case capacity expansion is necessary

Such a CAM would prevent a short-term capacity request to compete with a long-term request. If a short- and a long-term capacity request would be subject of the same end of notice period or allocation of the respective capacity would take place at the same time, they would in any case have various starting points and thus various waiting periods. In such a case, it is very likely that the short-term contract has already expired before the long-term contract starts. If both a short-term and a long-term contract would start at the same time, the allocation procedure took place at different times in the past; meaning capacity of the long-term contract has been allocated years before the capacity request for the short-term contract was submitted.

56. **Waiting or investment period**: this is the period between the allocation of capacities/signing the transportation contract and the start of the contract. ~~Bearing in mind the necessary relation between submitting and allocating a capacity request on the one hand and the start of the contract on the other (see point 4 above), the waiting period would very much differ depending on the duration of the contract: for a short term contract (less than one year), it might only be a month or less, a mid term contract (one year, but less than five years) may entail a waiting period of approximately one year, while a long term contract (five years and more) may easily require a waiting period of two years and more, depending on a number of reasons, among others on how much time may be needed, if case may be, in order to provide the capacity requested by means of investments.~~ The TSO has to set the waiting or investment period in function of the time needed to carry out the necessary investments. The scope of the investment may depend on the amount of incremental capacity required, which means that the waiting period may differ and

<sup>17</sup> The price for such a service under the circumstances described would then include also the price of the capacity which cannot be used efficiently anymore.

<sup>18</sup> See Article 5(2)a

consequently either the allocation of capacity may need to be brought forward or the start of the contract may need to be shifted towards the future.

**Comment:** the waiting period depends rather on the question whether the capacity request would require capacity expansion than on the duration of the contract. In case long term congestion would require expansion the waiting period is in any case longer – irrespective short or long term capacity is requested.

### 3.2.3.2. The various capacity situations determining the capacity allocation mechanisms

(31) In the preceding chapter, the various stages of the CAM have been set out and described. The capacity request submitted during the open season would allow the TSO to decide on the prevailing capacity situation. The capacity allocation mechanism should then be determined in function of the prevailing capacity situation.

(32) As set out above, there are three different capacity situations conceivable:

◆ **Capacity situation I: Offer exceeds requests:**

(33) All capacity requests can be met, the capacity could be allocated through the first-come-first-served mechanism without compromising the principle of non-discrimination, as long as the various stages of the CAM set out above are properly executed, in particular with respect to transparency and the deadlines for the various stages of the CAM. The difference between long- and short-term contracts is honoured, i.e. if capacity for both types of contracts is allocated at the same time, they could not start at the same time, or, if capacity is allocated at different times, they would start at the same time. In none of these cases, they would impede or negatively affect each other, all contracts can be properly and in an unimpeded manner executed.

(34) TSOs should also employ interruptible UIOLI rules with a view to making maximum capacity available, even if firm capacity has not yet been fully contracted. This would increase the liquidity of capacity on the market. This goes without prejudice to Article 4(1)b providing that the price of interruptible contracts shall reflect the probability of interruption. The probability of interruption, the underlying risk circumstances and the time notice for interruptions have to be communicated to the market.

**Comment:** it has to be recognised that transparency regarding the probability of interruption is required and also firm capacity has a certain probability, although “extremely” low, of interruption. The concept of “force majeure” intervenes in this discussion and it would be inappropriate if e.g. contractual force majeure definitions differ significantly across TSOs. These notions have to be further elaborated in the CCP.

(35) Secondary markets or trading of capacity rights between network users must also be possible for network users, even if firm capacity is still available on the primary market. It would

allow network users to optimise their capacity portfolio on very short notice and in a very flexible manner.<sup>19</sup>

◆ **Capacity situation II: Requests exceed offer (short-term congestion):**

- (36) In this situation, the demand for capacity exceeds the amount of capacity available. Congestion would arise from transportation requests, the extent of which, however, would not justify new investments. How to deal with this situation is subject to the note on congestion management procedures (see footnote 16).

◆ **Capacity situation III: Requests exceed offer (long-term congestion)**

- (37) Capacity situation III would be characterised by a number of competing transportation requests the aggregated capacity of which would exceed the capacity available during the period of time requested. The question of whether capacity situation I, II (short term congestion) or III (long term congestion) is prevailing would need to be decided by the TSO and supervised by the regulatory authority. The decision on the prevailing capacity situation can only be done at the end of the notice period or open season, when the TSO has a clear picture on all capacity requests submitted. As for capacity situation II, details on how to deal with capacity situation III will be set out in the note on congestion management procedures.

**Comment:** it is not clear – the final sentence appears to refer inconsistently to both capacity situation 1 and 2.

### 3.2.3.3. Summary on Principles and General Features

- (38) In the following, the main principles and general features of CAM complying with the requirements of non-discrimination and transparency, as laid down in Article 5(2) of the Regulation can be summarised as follows:

1. Full transparency on the current and future capacity situation at any relevant point of a given transmission system
2. Distinction between long-term and short-term capacity contracts when allocating the capacity
3. Efficient use of capacity, i.e. no capacity hoarding

<sup>19</sup> In the light of the findings of DG COMP's sector inquiry (see issue paper from November 2005), it seems necessary to define a number of minimum requirements for secondary capacity trading, in order to exclude any misuse or undue behaviour of primary capacity holders. [The minimum requirements could build on sections 3.2 and 3.3 of the Regulation's Guidelines which contain a number of measures essential to network use in general, but also to secondary trading more specifically.](#)

4. Clear and transparent rules and procedures, in order to determine the capacity situation;

**Comment:** this is still missing. There is a need for standardised calculation methods in order to guarantee consistent capacity calculation over time and across EU gas networks (see general remark 2).

5. The actually applied CAM is determined ~~as a~~ function of the actually prevailing capacity situation;

(39) These principles and features should contribute to ensuring the overall objective, i.e. make ~~as much capacity available as possible, so that~~ everybody gets what he wants to the extent possible.

#### 3.2.4. Detailed Requirements

(40) In the following, the various requirements emerging from the Regulation in addition to those discussed above will be examined in detail. The order corresponds broadly, but not strictly to their appearance in the Regulation.

##### 3.2.4.1. Appropriate economic signals for efficient and maximum use of ~~technical~~ capacity (Article 5(2)a and Annex 2.1(4))<sup>20</sup>

(41) The CAM must be designed in a manner that provides appropriate economic signals for efficient and maximum use of capacity. While the TSO is interested in selling 100% of its ~~technical~~available capacity at any time, it also ought to seek efficient use of capacity, i.e. to market unused capacity.

**Comment:** this paragraph would benefit from clarification – note that 100% capacity may not be available for sale at one specific time but that 100% should be made available in advance of its release.

(42) Article 5(2)a and Annex 2.1(4) of the Regulation call for CAM entailing appropriate economic signals for efficient and maximum use of technical capacity. This requirement does not concern the maximum capacity addressed in Article 5(1) and would only relate to the technical capacity in the sense of the definition laid down in Article 2(18).

(43) Efficient use of capacity would mean that capacity is effectively utilised to the extent possible. This excludes any kind of capacity hoarding, but would also mean that capacity on the primary market must not be withheld, but offered at a tariff providing network users with efficient access to the system<sup>21</sup>.

<sup>20</sup> In the following, the matter of secondary markets is not taken into account, which means that the following would only apply, if the capacity holder does not sell unused capacity on the secondary market.

<sup>21</sup> As for tariffs, see separate note on Article 3 „Tariffs for access to networks“ of Regulation 1775/2003

**Comment:** it is not clear what this paragraph is trying to address. If the implication is that long term interruptible products are not necessary/desirable then this would not be appropriate.

(44) Efficient and maximum use of technical capacity would mean that the level of unused capacity in the sense of the definition laid down in Article 2(4) would be reduced to the **very maximum** extent possible. The provision of Article 5(2)a translates this consideration into a legal requirement. As a consequence, TSOs have to ensure that unused capacity is also offered to the market under terms and conditions as attractive as possible.

(45) Regulators would have a very important role to play in this respect, since they have to decide upon the “appropriate economic signals” addressed by Article 5(2)a. In this context, Annex 2.2(2) reading

*Revenues from released interruptible capacity shall be split according to rules laid down or approved by the relevant regulatory authority. These rules shall be compatible with the requirement of an effective and efficient use of the system.*

is of utmost importance. Pursuant to this provision, the relevant regulatory authority is responsible for setting the appropriate economic signal to the TSO by deciding on the share of additional revenues gained from selling unused capacity that would be left with the TSO and how much must be allocated to other objectives, such as the reduction of congested points in the system, lowering overall transport tariffs etc.

#### 3.2.4.2. Investment in new infrastructure (Article 5(2a) and Annex 2.1.(4))

(46) In order to allow the CAM to facilitate investment in new infrastructure, a sufficient level of transparency in combination with certain procedures, as described above, is indispensable. It must allow all network users to come forward with their capacity requests via an open season, as outlined above, and so enable the TSO to take a timely decision which and from when new capacity will be needed in order to match supply and demand.

(47) This seems to be best ensured by the procedure described above. A situation characterised by capacity situation III would allow identifying the new investments required. In that respect, it would at first not matter whether the new investment concerns the increase of existing capacity or a new route/facilities.

(48) The main features of a CAM facilitating investments in new infrastructure would be to establish an open season followed by an allocation period and, where appropriate, an investment period in line with the procedures described above and taking into account the time requirements emerging from the capacity requests. This would lead to a situation, where the TSO can clearly identify the need for new investments ~~underpinned by binding transportation contracts~~.

**Comment:** the underpinning of new investments by binding transportation contracts is too much emphasised in the note. Such binding commitments should not be conditional for investments for the national market.

**Comment:** it is not clear what procedures are being referred in paragraphs 44, 45, 46.

3.2.4.3. Compatibility with market mechanisms including spot markets and trading hubs (Article 5(2)b and Annex 2.1(1))

- (49) The Regulation requires CAM to be compatible with spot markets and trading hubs, which represent indispensable ingredients of a well functioning internal market for gas. This presupposes at least that
- short term contracts as well as provisions for capacity trading must be possible and must be made available to network users
  - nomination/re-nomination procedures must be as flexible as possible and must correspond to the relevant hubs
  - negative impacts of gas quality requirements on market liquidity must be reduced to a minimum
- (50) Albeit in general very flexible, there may be differences among trading hubs and spot markets with respect to certain technical requirements. It is obvious that CAM cannot take into account all these technical requirements emerging from trading hubs and spot markets on the European market. However, what ought to be taken into account are those requirements which are most relevant for a given TSO system. The most relevant hubs are those to which the system is directly connected or provides effective access.
- (51) In the case that a TSO system is connected to more than one hub (for example at both ends of the system), the interests of the hub operators should ensure that trade can be effectively arranged at both hubs and that for this reason, the technical requirements of both the CAM and the hubs are made compatible. Where appropriate and necessary, regulatory oversight may finally remedy any kind of incompatibility.

3.2.4.4. Being flexible and capable of adapting to evolving market circumstances (Article 5(2)b and Annex 2.1.(1)) and facilitate the development of competition (Annex 2.1.(1))

- (52) The same provisions as discussed in the preceding chapter also stipulate that CAM shall be *flexible and capable of adapting to evolving market circumstances*.
- (53) CAM may be carried out in a way entailing different level of flexibility<sup>22</sup>, as set out in a study carried out for the European Commission<sup>23</sup>. In this study, three different capacity systems<sup>24</sup> with various levels of flexibility are described:

<sup>22</sup> see footnote 16 p 56ff

<sup>23</sup> idem

– point-to-point:

*A point-to-point transportation contract gives shippers the right to enter gas at a particular entry point and to take it off at a particular exit point. ...If a shipper held a contract for transportation, it would not be able to switch either entry or exit points unless it obtained a new transportation contract<sup>25</sup>.*

*Point-to-point ... is always unnecessarily restrictive, because of the availability of alternative approaches that preserve all the advantages imputed to point-to-point while allowing greater flexibility to shippers.<sup>26</sup>*

In a point-to-point capacity allocation system, there is no switch to other entry or exit points possible.

– entry-exit:

*An entry capacity contract ties shippers to specific entry points, ~~but gives them access to customers who have booked exit capacity at any exit point~~ and an exit capacity contract ties shippers (or other parties as appropriate) to specific exit points of the system concerned.<sup>27</sup>*

A shipper might be bound to a specific entry point (or entry zone), but once his gas has entered the system, it can be delivered to any exit point of the system concerned.

– postage stamp

*A postal transportation contract gives shippers the right to enter gas at any entry ... and take it off at any exit point... Under this system, shippers can change entry or exit points without the need to sign new transportation contracts.<sup>28</sup>*

The key trade off between less and more flexible systems is seen in “greater flexibility [that] fosters competition, but can reduce the amount of capacity that can be made available.”<sup>29</sup> The appropriate choice depends inter alia on the extent of congestion in the system <sup>(a)</sup>.

<sup>24</sup> In this context, it is more appropriate to refer to capacity systems. This corresponds to the underlying objectives and intention of the Regulation bearing in mind that it has to be considered a direct result of the Madrid process (see consideration 2 and 3 of the Regulation) and the discussions conducted there. The technical and commercial aspects of capacity systems have always been discussed under the heading of capacity allocation. As a consequence, also the requirements of capacity systems are covered under the heading of capacity allocation (see point 4 of the “Guidelines for Good TPA Practice – revised version; annexed to the conclusion of the 7<sup>th</sup> Madrid Forum, see [http://europa.eu.int/comm/energy/gas/madrid/doc-7/00\\_madrid7\\_conclusions.pdf](http://europa.eu.int/comm/energy/gas/madrid/doc-7/00_madrid7_conclusions.pdf)

<sup>25</sup> see footnote 16 p 57

<sup>26</sup> idem p 63

<sup>27</sup> idem, p 56

<sup>28</sup> idem

<sup>29</sup> idem, p57

**Comment:** <sup>(a)</sup> this paragraph touches an important issue which deserves more attention: the trade-off between less and more flexibility in route choice & more and less capacity. It has to be noticed that the available firm capacity differs from model to model and asks for appropriate CCP. It has to be indicated that a similar trade-off exists between offering operational flexibility to shippers in order to comply with the balancing requirements and the amount of available transportation capacity.

(54) The benefits of flexibility accruing to network users can be set out as follows:

*Shippers with a large portfolio of customers have a competitive advantage. A large customer base enables the shipper to perform internal swaps that maintain high utilisation of the particular entry and exit points identified in its transportation contracts. By contrast, a shipper with only one customer may waste transportation capacity if the customer consumes much less gas than anticipated. The shipper may try to sell the transportation capacity that is no longer needed, but a point-to-point system makes it difficult to find a buyer. The transportation capacity will only have value to another shipper who is interested in precisely the same combination of points. By contrast, postal capacity rights offer value to all shippers on a network, regardless of the location of their customers or the entry points used. Postal capacity rights therefore facilitate trading, and reduce the likelihood that a small shipper may end up wasting transportation capacity.<sup>30</sup>*

(55) Flexibility of capacity allocation systems permits new market entrants to enter the market without having a large portfolio (which would be unrealistic to assume) and to compete with the incumbent companies. In the absence of flexibility, a new market entrant is likely to experience a serious competitive disadvantage vis-à-vis the established companies disposing of a large portfolio.

(56) Against this background, it is also obvious that the development of competition can be best facilitated by the introduction of flexible capacity systems.

**Comment:** as such correct but the loss of capacity for the sake of flexibility has to be solved (cf. the above discussed trade-off). Capacity availability is, of course, not less important than flexibility for the development of competition.

(57) This is the background against which the relevant provisions of the Regulation have to be seen. The stipulation for flexible CAM adapting to evolving market circumstances finds its justification in the need for non-discriminatory CAM providing a level playing field for all network users to compete effectively on the internal market for gas. As the different capacity systems entail various levels of flexibility, it is obvious that a point-to-point system implying no flexibility would not comply with the requirements of the Regulation. On the

<sup>30</sup> idem, p 57f

other hand, a postage stamp system, as briefly set out above, might not –be appropriate across the entire internal market due to a number of technical and economic constraints. Therefore and given the current state of the market, a capacity allocation mechanism based upon an entry-exit system as set out above complies most with the respective provisions of the Regulation.

3.2.4.5. No undue barriers to market entry nor hampering new market participants, but effective competition among market participants (Annex 2.1(3))

(58) Capacity allocation mechanisms and congestion management procedures shall neither hamper the entry of new market participants nor create undue barriers to market entry. In terms of capacity allocation, this means:

- The system must not be inflexible to an extent that would prevent new market participants from exploiting market opportunities. New market entrants would usually not dispose of a large customer portfolio, but have to acquire customers successively. They need a certain level of flexibility in the capacity system, as otherwise they could not develop their business or would be forced into contracting more capacity than actually needed, in order to accommodate possibly upcoming capacity demands implying a quite high commercial risk. These requirements seem to be best met by an entry-exit capacity system as set out above.
- The capacity allocation mechanisms must allow market participants to contract capacity. In this respect, this provision reinforces the principle of non-discrimination when it comes to allocating capacity. A level playing field in terms of capacity allocation is therefore indispensable.

(59) In the light of the findings contained in chapters 3.2.4.4 and 3.2.4.5, it can be concluded that the relevant provisions <sup>(a)</sup> of the Regulation and the Guidelines annexed to it ~~prefer~~require the ~~mandatory~~ introduction of a capacity system based on entry-exit.

**Comments:**

- <sup>(a)</sup> Please mention the list of references
- The introduction of an entry-exit system is clearly the preferred model. We have some doubts whether an obligatory introduction can be deducted from the Regulation and would not mean a too extensive interpretation. A possible solution would be that the TSO should convince the regulator that his alternative proposal is better.
- The application of entry-exit to different transportation services e.g. inland versus transit, infrastructure with long term capacity commitments (cf. new infrastructure constructed on the basis of long term commitments) versus infrastructure financed by the TSO, etc. needs additional guidelines (e.g.: introduction of “correlated capacities” or “commitments to nominate on request”. Because of the impact on the available capacity, the need of appropriate CCP becomes more urgent and these principles have to cope with the problem of predictability of gas flows (network use of shippers).

3.2.4.6. System integrity, efficient network operation and security of supply (Article 5(1) and Annex 2.1(2))

- (60) Paragraph (2) of point 2.1 of the Annex stipulates that capacity allocation mechanisms and congestion management procedures shall take into account the integrity of the system as well as security of supply. From the above, it is clear that there is a trade off between the flexibility offered by a certain capacity allocation mechanism and the capacity that can be made available on a firm basis. However, this trade-off could be managed to a certain extent with mechanisms for the provision of capacity.

**Comment:** see also general remark 2 and 3.

- (61) While a postage stamp system in terms of capacity would bring about most flexibility for system users (see above), a TSO would not be able to offer that amount of firm capacity which could be made available by means of an inflexible, but more stable capacity allocation mechanism, such as point-to-point. In a point-to-point system, the flows of gas are more predictable and as a consequence, the TSO could optimise the physical flows with a view to making as much firm capacity available as possible.
- (62) In a postage stamp system, however, the physical flows are far less predictable, since shippers may change entry and exit points at rather short notice<sup>31</sup>. This means that a TSO can only offer firm capacity to the extent that can be held firm under all potentially possible combinations of physical flows between the various entry and exit points, which may possibly occur in line with the actual nominations of shippers. As a consequence, the TSO may offer a large proportion of capacity on an interruptible basis, though not on a firm basis, as otherwise changing nominations may easily lead to physical congestion at certain entry or exit points, but also within the system. In such an event, firm transportation capacity could not be honoured anymore.

**Comment:** the distinction drawn between “interruptible” and “firm” in this paragraph does not recognise the possibility that the TSO could buy back firm rights (see also comment on CMP). Is the buy back of firm rights viewed as being equivalent to an “interruptible” product? The issue of physical firm versus financially firm intervenes also in these matters (comment holds also regarding CMP, cf. need for CCP; *see as well general remark 2*).

- (63) For these reasons, there is a clear trade-off between the level of flexibility and the amount of available firm capacity in a given transmission system. The extreme poles of both can be seen in a point-to-point system (least flexibility, maximum capacity) on the one hand and a postage stamp system (maximum flexibility, least capacity) on the other.

<sup>31</sup> Although this is not likely to affect the physical flow at the entry and exit points, new combination of entry and exit points accruing from the flexibility offered by a postage stamp capacity system may result in congestion occurring at some points in the system.

- (64) The relevant provisions in the Annex of the Regulation must be seen against this background. The inherent flexibility of a capacity allocation mechanism is restrained by the necessity to maintain system integrity and security of supply. In other words, the CAM must not jeopardise the technical operation of the system. The minimum and maximum pressures, the line pack necessary for its operation etc must not be affected by the capacity allocation mechanism in a manner that would endanger the integrity of the system.
- (65) Neither must security of supply be endangered. This means that firm capacity must be honoured. It must not be harmed or reduced on the grounds of flexibility requirements.
- (66) It is therefore clear that a TSO has to strike an appropriate balance between flexibility and available firm capacity. Regulatory authorities would need to closely oversee the actual approach applied by the TSOs, since they might tend towards increasing firm capacity at the expense of flexibility. However, as set out above, flexibility accruing from the capacity allocation mechanism is a legally binding requirement and indispensable in order to arrive at a competitive internal market for gas. Article 10 of the Regulation does not only grant the right, but imposes the duty on regulatory authorities to “ensure compliance” with the provisions of the Regulation and the Guidelines in the Annex.

**Comment:** when discussing the issue of predictability of flows, it seems advisable to mention the commercial possibility to ensure a level of predictability by buying “commitments to nominate on request”.

#### 3.2.4.7. Liquid trading of capacity (Annex 2.1(1))

- (67) Article 8 of the Regulation titled “Trading of capacity rights” concerns measures aiming at the free trade of capacity rights among capacity holders. Notwithstanding Article 8, Annex 2.1.(2) stipulates that CAM “shall facilitate ... liquid trading of capacity...”. Against this background, it is important to identify how CAM could facilitate trading of capacity bearing in mind that a full list of features and requirements for liquid trading of capacity might only be made available through a note explicitly dealing with Article 8 of the Regulation.

**Comment:** TSOs should be obliged to publish the offer of secondary capacity when requested by the seller. The TSOs should be urged to organise a bulletin board where this is not organised in another market place.

- (68) In compliance with previous considerations (see above), CAM must be non-discriminatory and transparent, as otherwise capacity trading is restricted and would never attain the level of liquidity possible. Contracting capacity on the primary market should entail the right to both trading capacity on the secondary market and receiving relevant information on the capacity available for trade on the secondary market. It should also be possible for parties not contracting capacity on the primary market to have access to it on the secondary market.
- (69) Capacity trades among users must be fully acknowledged by the TSO, if notified to the TSO. This also means that the TSO must put a mechanism in place to make it fully aware of

capacity trades, if they result in a transfer of title of the relevant capacity. This requirement would be best met via restriction of secondary market trading to a single web based platform implemented by the TSO in order to ensure non-discrimination and transparency. This would require network users to offer their unused capacities solely via TSO's web based platform. Facilitating capacity trades also means to provide network users with the possibility to be fully informed on the capacity available for trade on the secondary market. With respect to the duration of capacity rights acquired on the secondary market, they should not be more restrictive than those acquired on the primary market. Furthermore, there must not be any un-proportionate fee for capacity trades carried out on the secondary market.

**Comment:** In order to ensure non-discriminatory and transparent secondary market trading, capacities have to be offered transparently to every interested party; any underhand offer to only a limited circle of interest clearly results in market distortions: even if not regulated TPA to secondary markets have to be non-discriminatory. Therefore the best solution would be an organised bulletin board for secondary market capacities implemented by the TSO; shippers would be obliged not to set trading activities outside this platform.

The explanatory note on CMP mentions the need for such single trading platform (*see section 2.3.2. §15,IV*).

(70) For the sake of clarification and with a view to avoiding misunderstandings, it is worth noting that a holder of capacity acquired on the primary market can only sell such capacity on the secondary markets that he has contracted on the primary market, but cannot go beyond.

**Comments:** it is questioned whether this paragraph is necessary as it may restrict future market developments.

#### 3.2.4.8. Compatibility with network access system of the Member States (Article 5(2)c)

(71) Almost as a matter of course, Article 5(2)c of the Regulation stipulates that CAM have to be compatible with the network access systems of Member States; efficient use and allocation of capacity require co-ordinated cross border measures. This certainly calls for a minimum level of harmonisation of TSOs to coordinate operations with upstream TSOs and coordinated regulatory implementation of CAM on a cross-border basis. This coordination is moreover needed in light of both security of supply and competition, and to prevent possible regulatory gaps. This provision refers to the fundamental requirements of access based on ex-ante approved tariffs as laid down by Directive 2003/55/EC.

**Comment:** s. general comment 7

- (72) As a consequence, the tariffs for contracting capacity must be set up in line with Directive 2003/55/EC and must not be put in question by the CAM emerging from the Regulation and the explanatory notes of the relevant Commission services.

3.2.4.9. Circumstances affecting the availability of contracted capacity, information on interruption (Annex 2.1(5))

- (73) For network users, it is important to be informed about any circumstances affecting the proper execution of their transportation contracts as close as possible to the occurrence of these events, in order to adapt to the new circumstances and, if case may be, limit potential or actual damages accruing from these events to his commercial and contractual obligation vis-à-vis customers.

- (74) Annex 2.1(5) imposes an obligation on the TSO (without naming it explicitly) to advise his customers, the network users, prior to the start of the contract about the type of circumstances “that could affect the availability of contracted capacity”. While the first sentence of this provision is rather general and is supposed to include overall difficulties related to system integrity (see also chapter 3.2.4.11.), the second sentence explicitly addresses a specific case, namely interruption of supply. It stipulates that

*Information on interruption should reflect the level of information available to the transmission system operator*

**Comment:** Circumstances affecting interruption need to be as clear as possible and this holds also for firm capacity. Only main force majeure circumstances may be invoked for interrupting firm capacity contracts (\*). Consequently, force majeure events have to be defined and communicated. It has to be encouraged that contractual force majeure clauses are consistently applied over time and across TSOs. CCP have to give guidance on force majeure events applicable in an entry-exit model. Furthermore, once force majeure events occur, rules have to be agreed regarding the impact on the different contracts. This guidance is nothing else than the interpretation of common law in the complex case of network operation.

(\*) foreseeable interruptions e.g. like for maintenance are no force majeure events and have to be specified in the contract as accurately as possible in time and impact. Obviously, the foreseeable interruptions have to be reasonable and reflect necessary works. Anyway, these foreseeable interruptions may not have a risk component as the interruptible contracts where the exact moment of interruption is not known beforehand.

- (75) As a consequence, the TSO has to provide all relevant information to his customers that is available to himself. The TSO must not withhold any information on interruption or probability of interruption. In this context, it is important to highlight that the provision in Annex 2.1.(5) deals with information to be given ex ante, i.e. prior to the start of the contract. Furthermore, information on interruptions continue be communicated to customers even after the start of the contract. It has to be stressed that this information should not only correspond to the level of information available to the TSO, but should also be communicated in a timely way.

#### 3.2.4.10. Notification of network users in the event of difficulties in meeting contractual delivery obligations (Annex 2.1.(6))

(76) Annex 2.1.(6) reads

*Should difficulties in meeting contractual delivery obligations arise due to system integrity reasons, transmission system operators should notify network users and seek a non-discriminatory solution without delay.*

(77) The purpose of this provision is to ensure non-discriminatory treatment of all network users by the TSO, if system integrity cannot be maintained and, as a consequence, the TSO cannot anymore meet his contractual obligations. In such circumstances, it is of utmost importance for all system users to learn as quickly as possible about the new situation, in order to be able to take the necessary measures at the same time.

(78) Without such an obligation imposed upon the TSO, it cannot be excluded that only the affiliated supply company, usually the incumbent, would be informed or would be informed considerably in advance compared to the remaining system users. As a consequence, the affiliated supply company could react earlier and limit potential damages more effectively than other network users. The above provision requires informing all network users by the same means and schedule. Furthermore, it obliges the TSO to seek a non-discriminatory solution rather than one advantaging any particular network user.

#### 3.2.4.11. Consultation of network users (Annex 2.1.(6))

(79) The last sentence of Annex 2.1.(6), i.e.

*Transmission system operators shall consult network users regarding procedures prior to their implementation and agree them with the regulatory authority.*

The provision imposes a duty on the TSO to consult and thus involve network users in the design and establishment of capacity allocation procedures. The consultation has to be carried out prior to the implementation of the procedures in question and aims at ensuring that the views of network users is properly taken into account, when it comes to defining and setting up CAM. While the Regulation does not suggest any specific procedure on how the consultation process should be organised, it is clear that its result have to be agreed with regulatory authority following the consultation process among TSO and system users.