

## **EUROGAS DISCUSSION PAPER ON CAPACITY ALLOCATION PROCEDURES**

1. The methods of allocation of capacity in networks between competing users is a subject that is a matter of particular interest in the gas market. The EU Directives which oversee such allocations are based upon principles of Third Party Access (TPA) to networks operated by Transmission System Operators (TSOs) but with an acceptance that there may be variation between Member States as to the detailed rules around such access.
2. However, there is a level of detail below these principles that is of importance to network users in their ability to access and utilise capacity in support of their commercial needs. These are, in the initial acquisition of capacity, any future acquisition (or extension) and any subsequent secondary trading and potentially in cases of congestion management on a network.
3. In cases where there is an excess of capacity over demand, whether it is under an Entry/Exit or a Point-to Point capacity allocation model (irrespective of the Entry/Exit tariff system), there should be no problem regarding capacity acquisition or congestion management. However, (although the preference of users is normally for systems to be sized to ensure that all requirements can be met at reasonable tariffs) there are likely to be situations where there is an excess of demand over supply for transportation capacity. On these occasions a set of rules needs to be prepared that promote and support competition in the supply of gas, are not anti-competitive, and maximise the use of the system. To this end this Eurogas paper including comments on Use-it-or-Lose-it (UIOLI) provisions identifies clear rules for accessing capacity in the long and short-term. It should also be recognised that in the majority of situations, where supplier to supplier competition exists, the real issue is to ensure that capacity can be transferred between users as required to meet end consumers' needs. As such it should be required that capacity at or to the Exit Point directly connected to the end-consumer automatically transfers between suppliers/shippers when contracts for gas supply are changed by the end consumer.
4. However, there are a number of areas primarily relating to entry capacity on which it would be useful to clarify a position. These are:
  - initial allocation of new investment between competing parties
  - allocation of existing capacity between competing parties
  - congestion management
  - access to longer term capacity to prevent hoarding of firm capacity

### **Initial Allocation of New Investment**

5. The preferred form of this is an open season or booking "window" where users are required to submit their requirements supported by financial commitments (i.e. obligation to pay for booked capacity or investment). This can be carried out either as a simple volume based application (against known prices) or in the form of an auction where Users can indicate a value that they ascribe to holding capacity. Both First Come First Served (FCFS) and auction models have their supporters and detractors. What is clear is that the rules must be clear to all parties and not prevent new entrants competing, but must be capable of supporting the long-term viability of networks. As such the role of the market players must not be under-estimated. It should also be recognised that differing solutions may be appropriate even within one Member State. This has been recognised within the Directive 2003/55/EC by the acceptance that exemptions may be granted under certain circumstances with differing rules applying (Article 22).

### **Ongoing Allocation of Existing Capacity**

6. The allocation and control of existing capacity is the subject of concern in some countries due to the perception that a party or parties can restrict access to firm capacity by hoarding capacity that is not needed or not utilised. If this is occurring, it may be anti-competitive practice and if so must be prevented by procedures sent out in Member States in accordance with the Gas Directive, related EU Legislation and competition Law.
7. There are many ways to allocate capacity between competing users which are in use in different markets. The FCFS model is preferred by most, but others prefer the auction model as they argue that FCFS may frustrate competition. It is, however, essential that whatever form of allocation is chosen, there has to be an effective secondary market and UIOLI regime to ensure that concerns about hoarding are addressed (see below para. 11 ff).

### **Congestion Management**

8. Eurogas has identified the main conceivable causes of congestion, such as force majeure, contractual problems, emergencies or poor planning. The Eurogas position is that the TSO is liable for the compensation of damages in the event of any transport problems other than force majeure and emergencies. The main message is that a reasonable and prudent operator should not oversell firm capacity or otherwise he must bear the risks if his judgement is wrong.
9. The situations in which capacity congestion management may need to occur arise in a number of different ways. In promoting an acceptable regime it is necessary to recognise the differences that currently exist, including for example the over-selling of capacity by TSOs and therefore the alternatives that will need to be available to manage these variations. However, in developing a position on Capacity Allocation all aspects must be considered and addressed if a long-term solution for Europe is to be found.

### **Access to Long Term Capacity**

10. To encourage investment by TSOs in infrastructure it is recognised that long-term commitments by users give a signal to TSOs of the need to maintain and develop the system. This may be in addition to any other obligations placed upon a TSO to invest or to explain their position to a regulatory body, or other planning processes used by the TSO to inform their future investment. It should also be recognised that this should give users certainty of their arrangements. However, these long-term commitments should not be used to fetter competition by preventing capacity being used.

### **The Secondary Market and UIOLI**

11. The Eurogas UIOLI paper (attached) and its principles which met with general approval, especially by the EU Commission's DG TREN and by other stakeholders, was supported by the September 2003 Madrid Forum participants in general and its principles were incorporated accordingly into the revised Guidelines for Good Practice.
12. The paper argued for the importance of incentivising a secondary market in capacity trading by capacity holders. The paper also recognized that if a TSO perceived capacity to be unused, the TSO could sell that unused capacity on an interruptible basis only. Whilst the position provided for the release of capacity to the market in the short-term, the paper arguably did not address the requirements of network users to have long-term certainty and access to firm capacity. It is therefore necessary to address this issue in more depth.

13. The starting point as for the first paper is that there should not be the possibility for a network user to hoard capacity or restrict the availability of unused capacity to others. There are economic rationales for a capacity holder to release unused capacity. Unused capacity does not provide revenues. In a competitive market the margins for a supplier are often small, therefore hoarding the capacity will be uneconomic. Offering unused capacity on an interruptible basis would be a less rational economic response than making it available on a firm basis, as it would be provided at lower tariffs than tariffs for firm capacity, and put the new user in a stronger competitive position as long as the capacity is not interrupted. Furthermore, Eurogas recalls that if a user were to abuse a dominant position, he risks incurring a severe penalty under competition law.
14. Nonetheless Eurogas recognizes that in order to have a sufficient firm capacity available for those who have a demand for it and not to restrict them to an interruptible service, some form of UIOLI regime may have to be introduced as a fall-back approach, as is already happening in some countries.
15. This is a complex and delicate issue because it touches on matters that are properly in the domain of competition law affecting company market trading decisions. Therefore it is not possible to envisage a general rule applying in every case where hoarding might be restricting access to firm capacity but there should be an understanding on general principles underpinning the issue although it should be handled on a case by case basis. Eurogas suggests here some general principles to be taken into account.

### **The Main Principles**

- From a network user's perspective, one of the main principles is that firm capacity rights, based on legally binding contracts with due regard to competition law, must be protected and respected.
- Competition law should be the source of action in questions of hoarding, even if powers are delegated to competent authorities to determine if there is abuse of contract. An appeal against their decision must be based on competition law and related sanctions.
- If a contract is determined to be in violation of competition law, then such a contract is not legally binding and the capacity holder can be obliged to release it on the market through the legal process that could, however, involve cumbersome and lengthy procedures.
- It should be clear what mechanisms will be appropriate in different Member States and they can be expected to vary according to different national approaches. They should, however, be transparent and fair as well as operable within a reasonable timescale.
- Wherever possible and practicable if hoarding is alleged then the parties involved should be encouraged to find a solution on a voluntary basis.
- The system, however, should permit holders of firm capacity who do not need the capacity (perhaps over a period) to justify to the competent authorities why they are not using the capacity (e.g. security of supply). This would be without prejudice to any later right of appeal.
- The system should also specify the liabilities for compensation for damages in the event that a user whose capacity had been transferred without his agreement encounters as a result problems with his supply obligations.

- Any retention of exit capacity rights linked to end users should be prevented by booking conditions which are in line with supply obligations as this would be hoarding.
16. Revenues received by the TSO for resold capacity on a firm basis without title transfer but with the consent of the firm capacity holder will be passed through to the original owner of the firm capacity, as he remains party to the contract with the TSO at least until the situation can be clarified.
  17. Eurogas looks forward to discussing the issues set out in this paper.