

**Draft Explanatory note of DG Energy & 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 (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**

**THIS DOCUMENT IS NOT BINDING ON THE COMMISSION**

**ERGEG 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 20 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 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, ERGEG 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 EC has provided a number of indications suggesting that the Directive and the Regulation apply to all contracts<sup>1</sup>.

In any case it should be clarified that against the background of the Regulation already published in the Official Journal the Regulation would also apply to contracts concluded short-timed before the entry into force of the Gas Regulation especially in case of long term contracts with the main part of their contract duration after 1<sup>st</sup> July 2006.

As the Gas Regulation was already published in the Official Journal market participants are assumed to have taken notice of its upcoming entry into force and its provisions. It should therefore not possible to conclude contracts short-timed (i.e. after the publication of the Gas Regulation in the OJ) before the entry into force of the Regulation which do not fulfil the requirements of the Regulation.

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

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<sup>1</sup> See e.g. the Conclusions of 10th Madrid Forum, n°36 : "Transit contracts concluded before the entering into force of this Directive remain valid, while the relevant provisions of the Regulation on conditions for access to the gas transmission network and the said Directive apply to those contracts too".

## **(2) Determination of capacity**

ERGEG is convinced that capacity allocation mechanisms (CAM) and congestion management procedures (CMP) can 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 (Task Force Capacity) is working in this area.

In this context, the explanatory note considers the technical capacity rather as static. Evaluation of the capacity situation is not just a question of adding the capacity requests and confronting it with the technical capacity. As explained, the available capacity varies continuously and it would be more appropriate to consider the available firm capacity rather than the technical capacity in order to determine the capacity situation.

## **(3) Importance of preventive congestion management**

We would like to stress that a good congestion management should be based on the obligation for the network user to offer his unused capacity on the secondary market. This seems to be a balanced counterpart of all the obligations put on the TSO. The firm use it or lose it (UIOLI) could then also be established as a sanction for network users who usually infringe this obligation. The role of the TSO consists in facilitating the trade on the secondary market. For the network user it should be as easy to offer unused capacity on the secondary market as nominating capacity for own use. The offer of unused capacity on the secondary market is not a panacea against market abuse. CEER already mentioned the danger that rTPA would be bypassed<sup>2</sup>. It is difficult to rule out that a network user offers as interruptible his unused firm capacity. One possible solution is to state that network users may not book more capacity than needed to comply with the supply contract. In any case, these are just thoughts for future amendments of the Regulation.

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<sup>2</sup> « Position on the Proposal for a Regulation of the European Parliament and the Council on Conditions for Access to the Gas Transmission Networks, April 2004 », article 5.3, motivation (2) (available on site [www.ceer-eu.org](http://www.ceer-eu.org)):

*“The Third Party Access imposed by the Directive 2003/55/EC implies a reduction of the rights of the owners of transmission infrastructure. The owners are no more absolutely free to do what they want with their network: they have to grant access to third parties on a regulated basis. The counterpart is that these third parties, the shippers, must also accept limitations in their rights. The network user who objectively does not use the capacity he has booked, should not be allowed to hoard it and to speculate.*

*Without the proposed provision 5.3, there would be an imbalance between the rights of the shipper and the owner of the infrastructure. Even worse, the whole principle of TPA laid down in the Directive could be by-passed. An owner could sell all his capacity to one shipper, on the primary market against regulated tariffs, and this shipper could resell the capacity against abusive prices on the non-regulated secondary market.”*

#### **(4) Importance of investments**

Generally, physical congestion has to be considered as a symptom of an inadequate investment policy of the TSO. 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”. 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 market demand – long term congestion therefore has to be sorted out by adding new capacities. Therefore, the monitoring of TSO’s investments by the regulatory authority contributes to an efficient preventive congestion policy.

Two remarks: (1) it is logic that the system converges to physical congestion when the load reaches the design of the system, cf. the 1 in 20 years rule; (2) if one entry point faces physical congestion while spare capacity is still available at other entry points, it is not straightforward to ask reinforcements. The lack of market signals (e.g. differentiated entry tariffs) may be at the origin of this problem. Obviously, there is a risk of stranded costs if individual entry points are reinforced as soon as physical congestion appears because of moving arbitrage patterns in the market. This has to be kept in mind when assessing whether the physical congestion is a long term one requiring new investments.

#### **(5) Risk of over-stressing the role of incentives**

The TSO has a number of obligations for which he is rewarded, and it seems not appropriate to suggest continuously that he needs to be incentivised. This could be (and is already) interpreted by TSOs in the following way: we do nothing as long as we do not receive an additional (special) reward. The existence of a regulated system as such should facilitate investment by reducing the investment risk through guaranteed pay back of cost-reflective regulated tariffs. However enhanced rates of return are in force in some member states because this tool can be a very useful instrument to promote investments which can favour the development of gas to gas competition and/or investments which would not have been made otherwise. This could also avoid the need for derogations.

#### **(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/congestion management; in particular whether there are ex ante responsibilities (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) Missing measures**

“Innovative” commercial instruments contribute to the “creation” of capacity (efficiency improvements) and are therefore a valuable counterpart for investing in the “hardware” of a

network. These commercial instruments (new TPA services) become more and more important and deserve appropriate attention in addition to new constructions.

(a) Buy-back principle: the possibility that the TSO could buy back firm rights. This principle is also important for the distinction between interruptible and firm.

(b) Physically firm vs. financially firm: if the TSO does not comply with the firm capacity commitments, he has to compensate the network user financially

(c) Capacity/flexibility conversion: the management of the capacity/flexibility ratio given the capability of the pipeline system, is an instrument for congestion management.

(d) “Correlated capacities” – “commitments to nominate on request”: this commercial tool improves the predictability of flows and therefore contributes to the level of available capacity and is therefore also an instrument for congestion management.

#### **(9) Miscellaneous**

(a) There should be a mention of the ECJ decision of 7 June 2005 on capacity allocation for electricity.

(b) It might be opportune to include a definition of first come, first served” in the context of capacity allocation; the following wording is proposed: *“The first come first served principle in context with capacity allocation would mean a ranking of capacity requests according to the time of receiving them at the locations and conforming to the requirements clearly specified by the TSO and communicated in a prior announcement in a non-discriminatory manner to all potentially interested market participants. All capacity request received prior to the announcement can not be given priority.”*

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## 1. INTRODUCTION

- (1) On 28 September 2005, the Presidents of the Council and the European Parliament signed Regulation 1775/2005 of the European Parliament and of the Council on conditions for access to the natural gas transmission networks, published in OJ L289 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. November 23, 2005 and shall apply from 1 July 2006. The Regulation, and hence this explanatory note, is also applicable to the long-term contracts covered by Article 32 of the Directive 2003/55.

**Comment:** 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*).

- (2) With a view to ensuring consistent application of the provisions of the Regulation, in particular on the matter of congestion management procedures, the services of DG Energy & Transport issue this document, which intends to provide explanatory comments on Article 5, paragraphs 3, 4 and as well as Annex 2.2 of the said Regulation. Some relevant aspects of these provisions may also be touched upon in the note on Article 5, paragraph 1 and 2 on capacity allocation mechanisms.

**Comment:**

- the starting point of CMP has to be a capacity level resulting from an adequate calculation procedure (*see general remark (2)*)
- A separate paragraph should address the role of NRAs (*see general remark 6*).

## **2. CONGESTION MANAGEMENT PROCEDURES IN REGULATION 1775/2005**

### **2.1. Introduction**

#### **2.1.1. Scope of the Regulation**

- (3) 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;”*

- (4) 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>3</sup> or are primarily used in the context of local distribution of natural gas, with a view to its delivery to customers. ~~part of a local distribution system.~~ The scope of the Regulation is therefore not limited to cross-border trade, but also includes high-pressure pipeline systems ~~operating at regional scale transporting gas to other transmission systems.~~<sup>4</sup> The Regulation encompasses also long-term contracts covered by Article 32 of Directive 2003/55.

<sup>3</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>4</sup> In theory, Directive 2003/55/EC would allow regional transmission pipelines (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.

**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 proposal above*).

For last sentence, *see general comment 1*.

- (5) In a number of Member States, transmission systems not involved in imports of gas or cross-border trade exist. Thus, the scope of the regulation includes these systems, too excluded 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.-

**Comment:** reflecting the scope of Art 2(1) Regulation

## 2.2. Relevant provisions

- (6) The relevant provisions of the Regulation with respect to congestion management and congestion management procedures may be the definition of congestion management in Article 2(1), point 5 reading

*‘congestion management’ means management of the capacity portfolio of the transmission system operator with a view to optimal and maximum use of the technical capacity and the timely detection of future congestion and saturation points;*

- (7) the definition of contractual congestion in Article 2(1), point 21:

*‘contractual congestion’ means a situation where the level of firm capacity demand exceeds the technical capacity;*

- (8) the definition of physical congestion in Article 2(1), point 23

*‘physical congestion’ means a situation where the level of demand for actual deliveries exceeds the technical capacity at some point in time.*

- (9) In addition, the definition of “unused capacity” in Article 2(1), point 4 might also be relevant in this respect

*‘unused capacity’ means firm capacity which a network user has acquired under a transportation contract but which that user has not nominated by the deadline for nominations specified in the contract;*

- (10) Finally, the main provisions on congestion management procedures are laid down in Article 5 paragraphs 3-5:

*3. When transmission system operators conclude new transportation contracts or renegotiate existing transportation contracts, these contracts shall take into account the following principles:*

*(a) in the event of contractual congestion, the transmission system operator shall offer unused capacity on the primary market at least on a day-ahead and interruptible basis;*

*(b) network users who wish to re-sell or sublet their unused contracted capacity on the secondary market shall be entitled to do so. Member States may require notification or information of the transmission system operator by network users.*

*4. When capacity contracted under existing transportation contracts remains unused and contractual congestion occurs, transmission system operators shall apply paragraph 3 unless this*



would infringe the requirements of the existing transportation contracts. Where this would infringe the existing transportation contracts, transmission system operators shall, following consultation with the competent authorities, submit a request to the network user for the use on the secondary market of unused capacity in accordance with paragraph 3.

5. In the event that physical congestion exists, nondiscriminatory, transparent capacity allocation mechanisms shall be applied by the transmission system operator or, as appropriate, the regulatory authorities.

(11) They are supplemented by point 2.2. of the Guidelines annexed to the Regulation:

(1) In the event that contracted capacity goes unused, transmission system operators shall make this capacity available on the primary market on an interruptible basis via contracts of differing duration, as long as this capacity is not offered by the relevant network user on the secondary market at a reasonable price.

(2) 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.

(3) A reasonable price for released interruptible capacity may be determined by the relevant regulatory authorities taking into account the specific circumstances prevailing.

(4) Where appropriate, transmission system operators shall make reasonable endeavours to offer at least parts of the unused capacity to the market as firm capacity.

**Comments:** it is not straightforward that this level of firmness would correspond to the firmness of firm capacity offered on the primary market. Variable levels of interruptability contribute conceptually to network efficiency but further analysis is needed in this respect. First of all, transparency on the firmness of firm capacity is needed. These issues should be part of the CCP.

### **2.3. Considerations on capacity allocation mechanisms with relevance for congestion management procedures**

(12) In order to facilitate comprehension and understanding of the following considerations emerging from the relevant provisions on congestion management procedures laid down in Regulation 1775/2005, it is important to recall that the Regulation introduces “non-discriminatory and transparent capacity allocation mechanisms not only as a general rule, but also and explicitly “in the event that physical congestion exists” (Art 5(5) of the Regulation). Considering the current situation, in particular with regard to the existing capacity bookings<sup>5</sup>, this remains an ambitious objective, if the existing contracts should not be questioned. DG TREN services take the view that, at least for the time being, alternative options can be conceived based on the relevant provisions of Regulation 1775/2005. This would mean that capacity should be made available to new market entrants under economic conditions. Non-discriminatory and transparent capacity allocation mechanisms would therefore aim at excluding any undue entrance barriers resulting from the fact that incumbent market players could contract capacity in the past under monopoly conditions, i.e. under capacity allocation mechanisms that would not necessarily comply with the requirements of non-discrimination and transparency. It should be noted that also

<sup>5</sup> See the Preliminary report of DG Competition on the Sector Inquiry on gas, available from [http://europa.eu.int/comm/competition/antitrust/others/sector\\_inquiries/energy/#16022006](http://europa.eu.int/comm/competition/antitrust/others/sector_inquiries/energy/#16022006)

contractually agreed nomination procedures which are different between connected pipeline systems could hinder the efficient use of capacity and should be eliminated by TSOs.

- (13) In order to outline and demonstrate the link between capacity allocations mechanisms (CAM) and congestion management procedures (CMP), it is necessary to introduce some general considerations partly also reflected in the explanatory note on CAM. They mainly concern
- the different situations that could occur at a given point of a transmission system, where capacity has to be allocated and
  - some additional principles applied under a given capacity allocation mechanisms,
- (14) Almost as a matter of course, the scope of the Regulation requires that capacity allocation and congestion management mechanisms 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.

### 2.3.1. Different kind of capacity situations

~~(14)~~(15) 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:

- (I) **Offer exceeds requests**: there is more capacity offered than requested, so the offer (supply) of capacity 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 would 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. Such a situation would be characterised by congestion<sup>6</sup>, which would be defined as short term congestion, i.e. is not supposed to economically justify any investment with a view to increasing capacity and sorting out the congestion problem.
- (III) **Requests exceed offer (long-term)**: as for II., the demand for capacity exceeds the offer of capacity. 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 to ~~However, the capacity requests resulting in congestion would be of a nature that justifies economically viable investments, so that the congested situation could~~ be sorted out by adding new capacity, i.e. by undertaking investments (new project or

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

enhancement of existing projects). The capacity requests resulting in congestion would be of a nature that justifies economically viable investments.

**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 market demand – long term congestion therefore **has to** be sorted out by adding not, it is no option.

### 2.3.2. Additional principles applied under capacity allocation mechanisms

~~(15)~~(16) With respect to CMP, a number of instruments/tools can be identified, which are currently applied in a varying manner in different Member States:

- (I) the “rucksack” or “capacity goes with customer” principle (RS): it means that capacity held by shipper A and used to supply customer Z or held by end-user A can not be claimed by shipper A in case customer Z changes from shipper A to shipper B, but would remain with customer Z who would “give” it to shipper B for supply to customer Z.

**Comment:** the application of the “rucksack” principle may encounter legislative difficulties in MS (e.g. GB).

- (II) Firm use-it-or-lose-it (firm UIOLI) (Uf): it would mean that a network user holding capacity which he has contracted on the primary market from the TSO would lose the capacity, if it is not used over a certain period of time<sup>(a)</sup> and hence would give rise to suspected capacity hoarding. Under the firm UIOLI principle, the capacity could be temporarily or definitely taken away from the capacity holder. In the former case, he would temporarily lose the right to use the capacity, in the latter he would finally lose it and would need to re-contract it, in order to make use of it. The justification for such an approach must be seen against the wish to introduce competition. Hoarding of capacity is thought to be an effective means to keep competitors out of the market, however, firm UIOLI rules would certainly discourage such kind of behaviour<sup>7</sup>.

**Comment:** <sup>(a)</sup> (how to determine this period?)

- (III) Interruptible UIOLI (Ui): contrary to the firm UIOLI principle, it would not mean that the capacity holder would lose any unused capacity, but that the TSO would be requested to offer any unused capacity on the primary market on an

<sup>7</sup> It has to be pointed out that the responsibility to ensure efficient system use by making unused capacities available to the market is not only an obligation of the TSO, but likewise obliges network users. In order to allow the TSO to meet his responsibility this role of network users has to be clearly set out in transportation contracts.

interruptible basis, thus constituting interruptible capacity in the sense of Article 2, point 13 of Regulation 1775/2005, at a price which reflects the probability of interruption. Thus, interruptible UIOLI could be better spelt out as “use-it-or-lend-it”, i.e. any capacity not nominated for use would be offered to other network users, but falls back to the initial capacity holder at the moment he nominates it for use. Interruptible UIOLI could offer capacity at short notice (day ahead) for a short period (daily contracts) thereby allowing exploiting market opportunities occurring at short notice. However, interruptible UIOLI is not necessarily limited to short term deals; it could potentially also be offered for monthly contracts or a multiple thereof. The principal difference between firm and interruptible UIOLI is that in the case of the former, the capacity holder having contracted capacity on the primary market would definitely lose it, while in the case of the latter, he would only lend unused capacity to other network user without getting involved in the deal, which would be arranged by the TSO.

- (IV) **Secondary markets (SM)**: they represent an important instrument to balance short-term capacity needs, to optimise capacity portfolios, minimise overall capacity costs and provide flexibility in terms of capacity. TSOs would have the obligation to facilitate secondary capacity markets with and without title transfer of capacity, in accordance with Article 5(3)b and Article 8 of the Regulation (trading of capacity rights). It is important to note that trading on the secondary market is only carried out among system users. The TSOs shall assure that there is a single web based trading platform for non-discriminatory and transparent trading activities in the secondary market. The TSO might be informed on trades in line with the procedures set up and, where appropriate, in line with qualitative features of capacity trading (e.g. title transfer or not).

## 2.4. Distinction between contractual and physical congestion

~~(16)~~(17) Article 5(3) and (4) of Regulation 1775/2005 deal with contractual congestion, while provisions on physical congestion are contained in Article 5(5). In order to determine the scope of the relevant provisions with respect to the relevant congestion management procedures, it seems necessary to define the situations characterised by contractual congestion on the one hand and physical congestion on the other.

~~(17)~~(18) The relevant provisions on congestion management have also to be seen in the light of the principles laid down in Article 5(1) and (2). This means that non-discriminatory and transparent capacity allocation mechanisms must be applied: ~~TSOs would receive the capacity requests of network user under an open season procedure and would decide on the relevant CAM in function of the capacity situation prevailing at the end of the open season.~~<sup>8</sup>.

**Comment:** as mentioned in the comments of the draft interpretative note on CAM, the CAM can be fixed already in advance – whether first come – first served, an auction or pro rata allocation will be used does not depend on the result of the open season.

~~(18)~~(19) Against this background, it is worth recalling that an open season as the starting point of non-discriminatory and transparent capacity allocation mechanisms has to be conducted not only once a year, but as a requirement accruing from the duration of the

<sup>8</sup> See the (draft) explanatory note on Capacity Allocation Mechanisms.

transportation contracts at offer. While capacity for multi-annual and annual contracts may be allocated only once a year<sup>9</sup>, shorter-term contracts (monthly, weekly and as required by the Regulation also daily) will require allocation procedures in line with their duration and for this reason, CAMs have to be conducted accordingly. These procedures should be organised transparently and in such a way that enough time could be given to the market to prepare offers. When organising this procedure, the TSOs need to coordinate with upstream TSOs.

~~(19)~~(20) Capacity situation I would by definition not entail any situation characterised by congestion<sup>10</sup> and would therefore accommodate all capacity requests. Capacity situations II and III entail – at this stage - a situation, which would comply with the definition of contractual congestion, i.e. a situation, where the level of firm capacity demand exceeds the technical capacity.

~~(20)~~(21) In this context, it is also important to bear in mind the transparency requirements laid down by Regulation 1775/2005 and the Guidelines annexed to it<sup>11</sup>, according to which TSOs have to publish, among other things, information on

- the maximum technical capacity for flows in both directions, with technical capacity defined as

*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<sup>12</sup>*

- the current and future available capacity defined as

*the part of the technical capacity that is not allocated and is still available to the system at the moment<sup>13</sup>*

**Comment:** the Regulation requires TSOs not only to publish currently but also future available capacities.

- the historic use of contracted capacities

**Comment:** publication of historic usage rate of contracted capacities is required by the Regulation and provides essential information to both the TSO and 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.

- the total contracted capacity defined as

*capacity that the transmission system operator has allocated to a network user by means of a transportation contract<sup>14</sup>*

<sup>9</sup> This is not necessarily the case considering that annual contracts may start at 1<sup>st</sup> April or a possible other date in the gas year usually running from 1 October to 30 September.

<sup>10</sup> See the (draft) explanatory note on Capacity Allocation Mechanisms.

<sup>11</sup> See Regulation 1775/2005/EC, Annex: Guidelines on 3. Definition of the technical information necessary for network users to gain effective access to the system, the definition of all relevant points for transparency requirements and the information to be published at all relevant points and the time schedule according to which this information shall be published.

<sup>12</sup> Article 2, point 18 of Regulation 1775/2005

<sup>13</sup> Article 2, point 20 of Regulation 1775/2005

- the total available interruptible capacity defined as

*gas transmission capacity that can be interrupted by the transmission system operator according to the conditions stipulated in the transportation contract<sup>15</sup>*

~~(21)~~(22) On the basis of this information, network users are thought to submit their capacity requests in line with their needs <sup>(a)</sup>. The accumulated amount of requests would allow the TSO to decide on the prevailing capacity situation, which would be consistent with the information published.

**Comment:** <sup>(a)</sup> see general remark 3

~~(22)~~(23) Putting aside capacity situation I, the demand for firm capacity would always exceed the available capacity or, taking into account existing capacity contracts, the technical capacity<sup>16</sup> and thus comply with the definition of contractual congestion.

~~(23)~~(24) On a stand-alone basis, however, this could theoretically also apply to physical congestion and thus would not be entirely sufficient to decide whether congestion management under Article 5(3) and (4) (contractual congestion) or Article 5(5) (physical congestion) should be employed. In order to come to a final conclusion on this matter, the concept of unused capacity has to be taken into account.

#### 2.4.1. Contractual Congestion

~~(24)~~(25) Article 5(3) provides an indissoluble link between contractual congestion and the existence of unused capacity. It is actually the existence of unused capacity, which constitutes the difference between contractual and physical congestion. In practice, the two features characterising a contractually congested situation would therefore be

- a situation where the level of firm capacity demand exceeds the technical capacity and
- where unused capacity exists.

~~(25)~~(26) The unused capacity -has to be made available on the primary market by means of the at least interruptible UIOLI principle as set out in paragraph (14) III.<sup>17</sup>

**Comments:** 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 interruption. In praxi capacities beyond the “technical capacity” are of course usually offered as interruptible services – but one should not ex ante limit

<sup>14</sup> Article 2, point 19 of Regulation 1775/2005

<sup>15</sup> Article 2, point 13 of Regulation 1775/2005

<sup>16</sup> It is worth recalling that according to the definition of “firm capacity”, firm capacity is guaranteed as uninterruptible by the transmission system operator, while the “technical capacity” means the maximum firm capacity the TSO can offer without jeopardising system integrity or operational requirements of the network.

<sup>17</sup> This is notwithstanding the fact that TSOs have to offer interruptible services irrespective of the existence of unused capacity or contractual congestion according to Article 4(1)b of Regulation 1775/2005. However, as long as firm capacity is available, i.e. no contractual congestion exists, interruptible capacity might be priced almost the same manner as firm capacity in line with the principle that the price of interruptible capacity shall reflect the probability of interruption (see Article 4(1)b of Regulation 1775/2005).



them to interruptible offers. The term “at least” is as well in line with Art 5 of the Gas Regulation (see also general comment 4).

~~(26)~~(27) The question may arise to which extent the Regulation addresses the matter of capacity hoarding. Capacity hoarding –occurs in connection with contractual congestion. Without additional measures, it may not be made available anymore to other users. This fact has also been confirmed by the recent sector inquiry on the gas market carried out by DG Competition of the European Commission<sup>18</sup>.

~~(27)~~(28) Sometimes, contractual congestion just occurs due to the need to meet fluctuating demand. While therefore contractual congestion does not necessarily mean that capacity is hoarded with a view to keeping competitors out of the market, it would always mean that liquidity of capacity is restricted and capacity to transport gas is withheld from the market. For this reason, it is safe to say that contractual congestion would result in an inefficient and sub optimal use of the technical capacity of the network concerned and would not correspond to efficient or maximum use of capacity. It is therefore important to note that the scope of contractual congestion does not only include capacity hoarding, but also addresses that kind of contractual congestion which might not be avoidable due to the specific characteristics of natural gas demand.

~~(28)~~(29) Provided regulators allow the necessary incentives, properly unbundled TSOs the commercial interests of which are completely separated from any supply interest should hopefully be geared to ensuring efficient and maximum use of capacity, as otherwise potential revenues could not be realised.

**Comment:** it is not straightforward that legal and functional unbundling will result in a market situation equal to ownership unbundling.

~~(29)~~(30) In an event where capacity situation II or III prevails, a TSO would first need to try accommodating the capacity requests by making use of the unused capacity in line with the procedure laid down in Article 5(3)a<sup>19</sup>. This would apply to all unused capacity, no matter whether it accrues from “old” or “new” contracts<sup>20</sup> (see below). As a consequence, the TSO has to offer the total unused capacity on an accumulated basis with a view to accommodating as many capacity requests as possible.

~~(30)~~(31) It is worth noting that as a general principle, all means available to the TSO to accommodate the submitted capacity requests should be employed. This would include the possibility to contract capacity against the prevailing flows (counter flows), but also, where appropriate, the application of the rucksack principle, as set out above.

**Comments:** the capacity buy-back principle is also relevant in this context.

~~(31)~~(32) The overall success of such efforts may depend on a number of factors beyond the competence and responsibility of the TSO. While the overwhelming majority of network users may seek firm capacity, which – as pointed out above – can usually not be made

<sup>18</sup> Preliminary report available from

[http://europa.eu.int/comm/competition/antitrust/others/sector\\_inquiries/energy/#16022006](http://europa.eu.int/comm/competition/antitrust/others/sector_inquiries/energy/#16022006)

<sup>19</sup> This is without prejudice to Article 5(3)b; see below chapter 2.4.

<sup>20</sup> As for existing contracts, this would however go subject to provisions in Art 5(4).

available by making use of unused capacity, i.e. by offering interruptible contracts, the value of making use of unused capacity by means of interruptible contracts should not be underestimated for the following reasons:

- ***The needs of the network users***: some users submitting capacity requests may only aim at short term contracts (for example daily, weekly, monthly contracts or a multiple thereof). Such contracts might relatively easily be accommodated by means of making unused capacity available on the basis of interruptible contracts. Taking into account information available from historical flow patterns and nomination procedures (see below) is likely to reduce the risk of interruption and offer the interruptible contract on a relatively firm basis. Network users, notably those who may be interrupted, shall be advised about the type of circumstances that could affect the availability of contracted capacity, such information being indicative. Information on interruption should reflect the level of information available to the TSO.
- ***The extent of the congestion in terms of duration and capacity shortage***: a marginal capacity shortage emerging from the capacity requests may also be likely to be sorted out by making use of unused capacity without facing a high risk of interruption. On the other hand, it is obvious that a significant shortage of capacity may go beyond the means available to the TSO in that respect. The duration of the congested situation is also likely to play a role, when it comes to overcoming contractual congestion: the shorter the duration of the congestion, the higher the probability that use of unused capacity could sort out the problem, i.e. the risk of interruption becomes more and more acceptable in function of this ratio.
- With a sufficient ***overall level of liquidity in terms of capacity on the primary (here interruptible capacity is meant) and secondary market***, network users may be more inclined to accept the risk of interruption at a given point A, if they can make up for the interrupted capacity at this point by contracting alternative capacity on the secondary market at another point B or making use of other means of both supply and capacity portfolio optimisation. The more liquid the capacity market (including interruptible capacity) the higher might interruptible capacity be valued or the better can interruptible capacity make up for the lack of firm capacity.
- The decision of a network user to accept a contract on an interruptible basis will also very much depend on the ***price of the interruptible capacity***, which should reflect the probability of interruption. Such a flexible approach might provide a further incentive to exploit market opportunities.

(32)(33) The CAMs to be applied in order to allocate the unused capacity in a situation characterised by contractual congestion should be similar to those described in the note on capacity allocation mechanisms: in cases where all capacity requests can be met by making use of unused capacity, there is no issue at all. In cases where the demand for capacity cannot be met, even if unused capacity is fully taken into account, the (interruptible) capacity should either be allocated by means of a mechanism like auctions or pro-rata or by taking into account the duration and the amount of capacity requested and allocated to the contracts on an interruptible basis.

**Comment:** this guideline deserves more explanation.



~~(33)~~(34) Once all unused capacity is allocated and in the event that there are still capacity requests not accommodated, the situation is likely to be characterised by physical congestion, which will be treated below.

~~(34)~~(35) The definition of “congestion management” as laid down in Article 2(1) point 5 takes the approach described fully into account by stipulating, among other things, “optimal and maximum use of the technical capacity”. As a consequence, it can be concluded that an obligation of TSOs accrues from the definition of congestion management, to manage their capacity portfolio with a view to optimal and maximum use of the technical capacity.

#### 2.4.2. *Physical Congestion*

**Comment:** this section needs also to tackle the issue of coordination between TSOs when making investments.

~~(35)~~(36) Contrary to contractual congestion, a situation characterised by physical congestion indicates that the capacity of the pipeline concerned is fully used in the sense that the capacity is fully nominated for use *and* that ~~incremental~~*all* capacity is needed in order to accommodate all physical gas flows, which are actually occurring or are likely to occur on the basis of the contracted firm ~~and interruptible~~ capacity.

(37) The definition of physical congestion as laid down in Article 2(1) point 23 of the Regulation does not require that the situation described above has to occur on a permanent basis, in order to establish physical congestion. It would be sufficient if it happens “at some point in time”, which ~~obviously means sometime during the duration of a transportation contract for the relevant pipeline could be taken as the peak day likely to occur 1 in 20 years (cf. SoS Directive and Regulation 1775/2005, Annex, 2.1.(2)).-~~

**Comment:** it would be useful then to explicitly introduce the concepts of “short term physical congestion” and “long term physical congestion”.

~~(37)~~(38) DG TREN services also take the view that physical congestion in the sense of the Regulation would also be given, if there is a sufficient probability that the level of demand for actual deliveries would exceed the technical capacity at some point in time as a result of the capacity contracted on a firm ~~-basis~~. This would also be the case, if and when capacity requests cannot be accommodated anymore by making use of unused capacity on the primary market.

~~(38)~~(39) In this context, it is also important to distinguish between an efficient use of capacity and physical congestion: both would be characterised by full use of technical capacity (technical capacity fully nominated), but in the case of physical congestion, the technical capacity is not sufficient to allow the physical flows of the gas in line with the nominations. ~~As for contractual congestion, the possibilities emerging from counter flows and the application of the rucksack principles should be fully exploited with a view to alleviating a physical congested situation.~~

**Comment:** the Rucksack principle reduces contractual and not physical congestion. The message of this paragraph is not very clear.

~~(39)~~(40) It is worth highlighting that physical congestion is not likely to be sorted out by other measures than either capacity increases or refusal of access to the system. Which of these

two means may be employed will very much depend on the question whether the respective physical congestion is a short or long-term event. In case of long-term congestion the situation can only be sorted out by adding new capacity, i.e. by undertaking investments (new project or enhancement of existing projects) unless existing congestion management mechanisms do remain the most appropriate and efficient way of managing the constraint and ensure that all reasonable demands for capacity can be met the congestion. Directive 2003/55/EC commits transmission system operator to be responsible for ensuring the long-term ability of the system to meet reasonable demands for the transportation of gas. It can be assumed that unbundled TSOs in pursuing the interests of a network operator would have a natural tendency to invest in new infrastructure provided the investment is economically viable and the regulatory framework is right.

#### Comments:

■ 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 market demand – long term congestion therefore **has to be** sorted out by adding not, it is no option. If the TSO is not willing to realize the new investment the countermeasures may differ from country to country. The TSO could be threatened to lose his monopoly concession; or the project could be subject to a tender process open for interested investors to finance the capacity extension.

■ Firm capacity buy-backs may be an alternative measure.

## 2.5. Requirements of new transportation contracts (Art 5(3)) and relevant provisions of the Annex

~~(40)~~(41) The provisions of Article 5(3) apply to all new contracts and those that may expire and for this reason may be due for prolongation<sup>21</sup>. As a consequence, all transportation contracts concluded or prolonged after the 1<sup>st</sup> July 2006 would need to comply with the requirements emerging from the provisions of Article 5(3) including the Guidelines on Congestion Management Procedures in the event of contractual congestion contained in point 2.2 of the Annex of Regulation 1775/2005.

**Comment:** *see general remark 1*

~~(41)~~(42) Paragraph 3a of Article 5 of the Regulation establishes the obligation of the TSO to offer unused capacity on the primary market in the event of contractual congestion. For a TSO geared at marketing capacity in order to maximise its revenues, this obligation would not create any additional burden, but just confirm what it would do in its own economic

<sup>21</sup>

At this stage, it is worth noting that prolongation of existing contracts would need to undergo the same procedure with respect to capacity allocation as new contracts. The Regulation does not allow tacit prolongation on the basis of existing contracts, since this would clearly conflict with the principle of non-discrimination.

interest. As mentioned, unused capacity must be offered as interruptible capacity by means of the interruptible UIOLI system as explained above.

### 2.5.1. *Specific requirements of Article 5(3)a: unused capacity on the primary market*

~~(42)~~(43) The provisions of Article 5(3)a define certain minimum requirements to be met by services offered by the TSO in relation to interruptible capacity<sup>22</sup> emerging from the use of unused capacity in the case of contractual congestion.

~~(43)~~(44) Article 5(3)a confirms the application of what has been described as interruptible UIOLI system: unused capacity shall be offered on an interruptible basis. This, however, is a minimum requirement (“at least”) reinforcing the fact that the initial capacity holder shall not lose the capacity that he has contracted on the primary market. It does, on the other hand, not exclude that the capacity could be offered under more firm terms, as ~~suggested~~ below.

~~(44)~~(45) The second requirement of Article 5(3)a as for the offer of unused capacity concerns the timing. The unused capacity must be offered to the market “at least” on a day-ahead basis. In order to allow network users to ask for the unused capacity, the TSO has to publish it accordingly, i.e. at least the day before the capacity can be used.

~~(45)~~(46) It is important to bear in mind that “day-ahead” and “interruptible” represent only minimum requirements. Point 2.2.4 of the Guidelines annexed to the Regulation requires the TSO to

*...make reasonable endeavours to offer at least parts of the unused capacity to the market as firm capacity.*

~~(46)~~(47) An example for “reasonable endeavours” may be seen in the use of historical flows allowing TSOs to identify—unused capacity with sufficient reliability. Where and if appropriate, a nomination process consisting of different stages and entailing ascending levels of probability concerning the final nomination of gas flows by the holder of firm capacity could complement the approach.

~~(47)~~(48) Available information on historical flows possibly in combination with nomination processes underpinning this information are thought to predetermine the ability of the TSO to market unused capacity on a relatively firm or relatively interruptible basis. In the light of Article 5(3)a and point 2.2.4 of the Annex of the Regulation, DG TREN services take the view that TSOs have to use the potential of this information and processes (as well as other means at their disposal) in order to turn unused capacity as firm as possible.<sup>23</sup>

<b>Comment:</b> Capacities offered according to various probabilities of interruption contribute to network efficiency but needs further discussion ( <i>see general remark 2</i> ).
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~~(48)~~(49) Regulatory authorities would certainly have a clear role to play when it comes to exploiting the potential of these measures and possibly other means in this respect.

<sup>22</sup> This wording corresponds broadly to the definition of interruptible services, which in the context of the current explanatory note, will be used in an identical meaning as “interruptible capacity” if not otherwise indicated.

<sup>23</sup> It is worth noting that the approach set out would not contradict the Common Business Practices (CBP) on Nomination rules as agreed by EASEE-gas (European Association for the Exchange of Energy – Gas). However, it is likely that these rules may need to be supplemented and completed in the light of the above.

~~(49)~~(50) In this context, it is worth recalling point 2.2.1 of the Guidelines annexed to the Regulation, according to which interruptible contracts “of differing duration” shall be offered by the TSO. It is the understanding of DG TREN services that TSO by making full and unrestricted use of the potential accruing from, for example, appropriate nomination schemes and the information on historical flow patterns, interruptible contracts of differing duration (daily, weekly, monthly and a multiple thereof) can be offered at a relatively firm basis, thereby rendering the contracts more attractive to users.

~~(50)~~(51) It is comprehensible that under an interruptible UIOLI system, as described above, a certain relation between the duration of such an interruptible contract and the probability of its interruption cannot be refuted. This means the longer the contract the higher the probability of interruption <sup>(a)</sup>. This notwithstanding would the liquidity of short and mid term capacity significantly be increased by the application of the interruptible UIOLI system, thus promoting the transition to a more competitive and integrated internal market for gas.

**Comment<sup>(a)</sup>** this statement is not straightforward since it surely depends upon the day in question that the long term contract is being compared to

~~(51)~~(52) All this would however not mean that the rights of the original capacity holder are infringed.

### **2.5.2. Specific requirements of Article 5(3)b: Secondary market**

~~(52)~~(53) Article 5(3)b of the Regulation establishes the right of network users to re-sell the capacity on the secondary market, i.e. to another network user. The provision has several effects:

- It would allow network users to optimise their capacity portfolio by reselling unused capacity on the secondary market (i.e. from one network user to another and without active involvement of the TSO) and thus minimising the capacity costs of network users;
- Furthermore, capacity trading will enhance liquidity on the capacity market, as in fact not only one capacity offer exists, but several, albeit of different quality.

~~(53)~~(54) While Article 5(3)a and (3)b are presented as alternative and equal options, Point 2.2.1 of the Guidelines annexed to the Regulation establishes a preference of the secondary market over unused capacity offered on the primary market on an interruptible basis. Pursuant to this provision, the offer of unused capacity on the primary market by the TSO should depend on whether the unused capacity in question

*...is not offered by the relevant network user on the secondary market at a reasonable price*

This means that a network user having contracted capacity on the primary market can fully dispose of this capacity, as long as it is not withheld from the market. In a competitive market, a network user (or capacity holder) would either nominate his capacity for use or would try to resell it in line with his needs, in order to reduce his overall capacity costs. The secondary market would, in this respect, take precedence to the interruptible capacity available from the primary market.

~~(54)(55)~~ The reasonable price at which the network user is expected to offer capacity is very much likely to be set in the light of the demand level for capacity. In a competitive and liquid capacity market, the reasonable price is deemed to be market based. ~~For this reason, there should not be any pre-fixed limitations as far as prices of secondary market capacity are concerned.~~ However, DG TREN services take the view that secondary market capacity would always be sought, even if there is only a very small level of demand on condition that the price of the capacity is “reasonable”.

**Comment:** the delete phrase is in contradiction with paragraph 55 (no unreasonable price) unless you want to assess the reasonable character ex post.

~~(55)(56)~~ Against this background, one could argue that the UIOLI approach embedded in Article 5(3)a may work as a corrective in the event that network users do not allow capacity trading on the secondary market to properly develop, for example by offering capacity at “unreasonable” prices, which could be considered another form of capacity hoarding. This would also apply in a situation, where a new market entrant may prefer contracting capacity on an interruptible basis on the primary market to purchasing it on the secondary market, in particular, if secondary market capacity can in practice only be offered from the incumbent due to the fact that the incumbent has contracted all firm capacity on the primary market. ~~In these cases, the TSO would not only have the obligation (as discussed above), but should also have an appropriate incentive to offer unused capacity not sold on the secondary market, on the primary market on an interruptible basis.~~ It is obvious, however, that the price of the interruptible capacity would reflect the probability of interruption<sup>24</sup>.

**Comment:** see general remark 5. Concretely, regulators can decide on the charges for handling transactions on the secondary market.

~~(56)(57)~~ Such a scheme – precedence to the secondary market over marketing unused capacity on the primary market as a corrective for the secondary market – appears to call – among other things – for a certain level of transparency to be introduced to secondary market capacity trading, however, without infringing the necessary confidentiality requirements. Pursuant to Article 8 of Regulation 1775/2005 on “Trading of capacity rights”, TSOs have a role to play in order to facilitate the capacity trading among network users.

~~(57)(58)~~ The second sentence of Article 5(3)b is thought to provide the necessary legal basis to Member States, respectively the relevant regulatory authorities, requiring network users to notify capacity trades to TSO, where considered appropriate. The reason why this provision is not mandatory may be seen in the fact that it would not be necessary, if competition has reached a sufficient level or, in other words, if capacity hoarding on the side of capacity holders can reasonably be excluded.

<sup>24</sup>

It is worth mentioning that in theory interruptible capacity could always be sold, as long as the relation between its price and the probability of interruption is maintained, and the contractual conditions for interruption are met. Against this background, it would not really matter, whether a network user sells capacity on the secondary market, since nominating and subsequently using this capacity would only oblige ~~prevent~~ the TSO to ~~honour/reduce/interrupt~~ the interruptible capacity services that he has sold on the primary market. As a consequence, there would always be a sort of “natural” precedence of firm capacity on the secondary market over interruptible capacity sold on the primary market. This goes, however, without prejudice of the considerations described.

**Comments:** in this chapter (secondary market) we have the impression that there is some confusion between different kind of notifications: (a) the notification of the offer of capacity on the secondary market (which should be published by the TSO when requested by the seller), (b) the notification to the TSO when necessary to validate a deal (e.g. in case of title transfer to someone who is not yet known by the TSO), (c) the notification that a deal has been concluded (which does not need approval by the TSO, but the TSO has to be informed).

### 2.5.3. *Revenue and price issues in the context of interruptible capacity*

~~(58)(59) TSOs will need certain incentives to offer and market unused capacity on an interruptible basis, as otherwise the costs of making this service available may render it economically not attractive.~~ Point 2.2.2 of the Guidelines annexed to the Regulation acknowledges this fact by stipulating that

**Comment:** see general comment 5

*Revenues from released interruptible capacity shall be split according to rules laid down or approved by the relevant regulatory authority.*

~~(59)(60)~~ As a consequence, the additional income cannot be entirely used for one specific purpose, but has to serve at least two different objectives. It is the understanding of DG TREN services that, at least one of these objectives should provide a sufficient incentive to TSOs to resell unused capacity in the manner and under the scheme described above. The allocation of the total revenue from released interruptible capacity will be approved or determined by the relevant regulatory authority, as this contains the ability of the regulator to determine appropriate incentives. Examples in this respect could be reducing the overall level of tariffs or reducing capacity bottlenecks<sup>25</sup>. This approach is endorsed by the requirement that

*these rules shall be compatible with an effective and efficient use of the system.*<sup>26</sup>

~~(60)(61)~~ Point 2.2.3 of the Guidelines annexed to the Regulation confirms the role regulatory authorities will have to play with respect to the price of interruptible capacity.

## 2.6. **Requirements of existing transportation contracts (Art 5(4))**

~~(61)(62)~~ Article 5(4) of the Regulation stipulates that, as a general rule, the provisions of Article 5(3) also apply to existing contracts

*...unless this would infringe the requirements of the existing contracts.*

~~(62)(63)~~ DG TREN services take the view that the requirements of the existing contracts would only be infringed, if

- the contract in question could not be properly executed anymore by applying the interruptible UIOLI approach as required by Article 5(3)a, or

<sup>25</sup> As mentioned in the chapter on “System integrity” in the draft explanatory note on “Tariffs”, remedies to congested points in the system could also emerge from the ordinary tariffs approved by the relevant national regulatory authority.

<sup>26</sup> Last sentence of Point 2.2.2 of the Guidelines annexed to the Regulation.



- explicit provisions in existing transportation contracts concluded before 1 July 2006 forbid the application of Article 5(3) of the Regulation.

~~(63)~~(64) DG TREN services tend to consider the former case a reinforcement of the interruptible UIOLI principle meaning that the initial capacity holder would not finally lose the capacity contracted, but can dispose of it by nominating the gas flows meant to serve his customers.

~~(64)~~(65) As for the latter case, the contractual provisions in question would have to comply with the general competition rules. Where this is not the case provisions would be void and thus could not infringe the requirements of an existing contract.

~~(65)~~(66) In the event, however, that such provisions comply with the general competition rules, Article 5(4) establishes an obligation for the TSO to call on the capacity holder for offering his unused capacity on the secondary market in line with the provisions laid down in Article 5(3)b.

## 2.7. Article 5(5): physical congestion

### 2.7.1. The difference between short- and long-term (physical) congestion

~~(66)~~(67) Article 5(5) of the Regulation explicitly deals with physical congestion and requires that

*In the event that physical congestion exists, non-discriminatory, transparent capacity allocation mechanisms shall be applied by the transmission system operator or, as appropriate, the regulatory authorities.*

~~(67)~~(68) The principal difference between short-term and long-term congestion can be seen in the capacity allocation mechanism applied. As explained in the note on Capacity Allocation Mechanisms, it is determined as a function of the prevailing capacity situation emerging from the capacity requests submitted. Capacity situation II would therefore result in auctions or pro rata allocations, when contracted capacity expires <sup>(a)</sup> while capacity situation III would -call for investments, as far as the investment is considered economically viable.

**Comment:** <sup>(a)</sup> we suppose that existing contracts are not put in question; the present text supposes that situation II is still there when a contract comes to an end and that the corresponding capacity can be offered to the market.

~~(68)~~(69) The question what actually makes up the difference between long-term and short-term congestion, and thus constitutes capacity situation II or III has been initially discussed in chapter “2.3.1 Different kind of capacity situations” and will be completed by the following.

~~(69)~~(70) In this regard, the driving principle and underlying idea of what constitutes in the view of DG TREN services a non-discriminatory and transparent capacity allocation mechanism including in the event of congestion has to be borne in mind (see no 12 above).

~~(70)~~(71) It is obvious that with respect to the decision on whether capacity situation II or III is prevailing, circumstances in various Member States may differ considerably and may also depend on a number of factors, such as the maturity of the market, the role natural gas plays in the overall energy supply of a Member State, the level of competition and how it is

thought to further develop etc. A very important element in this respect, however, is the extent and the duration of physical congestion, which is very much linked to the question, whether potential investment could turn out to be economically viable. There is of course a difference between laying a new pipe and adding a new compressor station in terms of both economic and time related requirements. While the former may take several years (including authorisation procedures etc), the latter might be done much quicker.

**Comment:** maybe the situation prevailing during the lead time of new investments is not clearly dealt with.

~~(71)~~(72) Due to the differences among national gas markets and transmission systems of Member States, a certain amount of discretionary is likely to be inevitable, when it comes to making a decision on the prevailing capacity situation. For this reason, the national regulatory authorities ought to define criteria enabling the TSOs to take this decision in the event of physical congestion. While these criteria at national level may need to take into account, in line with Article 1 of the Regulation “the specificities of national and regional markets”, they should be based on principles at European level that- fully reflect

- the need for full consistency and compatibility with adjacent systems;
- necessary incentives for investments;
- the need to promote competition and
- the requirements of security of supply.

The application of these criteria should allow the TSO to finally determine which capacity situation prevails. The national regulatory authority should approve the decision.

#### **2.7.2. Capacity situation II: Requests exceed offer (short-term congestion):**

~~(72)~~(73) In this situation, the demand for capacity exceeds the amount of technical capacity available. Congestion would arise from transportation requests, the extent of which, however, would not justify new investments.

~~(73)~~(74) Such a situation could occur, for example, if the technical capacity is not fully contracted and a certain amount of available capacity on a firm basis and for a limited period of time is left. Network users may submit their requests, on the basis of which the TSO learns that not all capacity requests can be accommodated, even when making use of all unused capacity, and for this reason, the situation is likely to turn into physical congestion. Applying the relevant regulatory guidelines or criteria would qualify the situation as short-term congested, i.e. investments on the basis of binding capacity requests submitted to the TSO would not turn out to be economically viable.

~~(74)~~(75) In such a situation, the appropriate capacity allocation mechanism is deemed to be characterised by auctions, pro-rata allocation or, where appropriate other means approved by the regulator<sup>27</sup>. Auctions might be the preferred approach, since their outcome is likely to reflect best the market value of the capacity in question, while on the other hand, non-

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<sup>27</sup> Such means could occur in the framework of regional markets, as envisaged by the ERGEG road map.



discrimination, in particular with respect to new entrants, might be better ensured by pro-rata allocation. The general principle that everybody should get what he wants should be accommodated as far as possible.

**Comments:** the assertion with respect to non-discrimination, in particular in relation to new entrants, needs to be explained.

~~(75)(76)~~ When deciding on auction or pro rata allocation, the objective to ensure efficient use of capacity should also be taken into account.

~~(76)(77)~~ It is obvious that in such a situation the involvement of regulators is indispensable, but may depend on the level of unbundling. Depending on the entry (exit) point of the system concerned, a preference for one or another mechanism might be appropriate. Also in the event of conflicting objectives, e.g. efficient use of capacity vs. competition, regulators may have to decide on what should be given preference.

(78) A situation likely to turn into capacity situation II calls for full application and implementation of relevant instruments for capacity allocation. This means, among other things, the effective application of the rucksack principle, at least at exit points, but where appropriate also at entry points on a firm basis <sup>(a)</sup>. ~~The necessary mechanisms to employ it should be set up by the national regulatory authorities, which also have to ensure its compatibility with adjacent systems.~~

#### Comment

■ <sup>(a)</sup> This sentence should be included in paragraph (15,I).

■ It is up to the TSOs to coordinate their actions. This should be said at the beginning. It needs to acknowledge the legislative difficulties with application of the Rucksack principle.

### 2.7.3. Capacity situation III: Requests exceed offer (long-term congestion)

~~(78)(79)~~ Capacity situation III would be characterised by a number of transportation requests on top of existing firm capacity contracts the aggregated capacity of which would exceed the technical capacity available during the period of time requested. It would result in congestion, the extent of which would economically justify increasing the capacity by means of investment. The regulatory guidelines introduced above (see 2.7.1.) should provide the necessary criteria for TSOs to decide on the economic viability of the investment.

~~(79)(80)~~ While the Regulation does not explicitly establish an obligation to invest, Directive 2003/55/EC commits transmission system operator to be responsible for ensuring the long-term ability of the system to meet reasonable demands for the transportation of gas. It can be assumed it is submitted that properly unbundled TSOs in pursuing the interests of a network operator would have a natural tendency to invest in new infrastructure provided the investment is economically viable and the regulatory incentives are set right. If the TSO is not willing to realise the new investment, it should be subject to a tender process open for interested investors to finance the capacity extension. Capacity allocation mechanisms designed to clearly characterise a given capacity situation are thought to fully allow the identification of long-term congestion and thus, ~~on the basis of binding capacity requests,~~ trigger new investments.

**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 demand 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 (*see also* §39).

*See also remarks in the note on CAM*

~~(80)~~(81) In such circumstances, i.e. the potential investment is thought to be economically viable on the basis of capacity requests submitted and according to the regulatory guidelines, any refusal to invest may constitute a presumption of abuse of dominant position and should be checked by the relevant competition authorities.

~~(81)~~(82) In reality, situations could occur that are not clear-cut. For instance, in order to accommodate a specific capacity request, more capacity is requested than can be made available during year 1 to 4, however from year 5 onwards, all capacity requests could be accommodated. Whilst such a situation cannot be excluded, it is rather unlikely to occur in a growing market. The decision on investments in such an event may very much depend on the actual situation prevailing.

~~(82)~~(83)

If a certain amount of capacity firmly contracted on the primary market, goes unused for a considerable time and if there are reasons to believe that this capacity would not serve seasonal modulation, but deliberately restricts the liquidity of capacity on the market, a temporary application of the firm UIOLI principle as set out above should be considered. It should, however, only be employed if approved and backed by the relevant national regulatory authority.

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