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Dear Sir, Madam,

Capacity Allocation on European Transmission Networks - Pilot Framework Guideline

EFET welcomes the opportunity to respond to ERGEGs Pilot Framework Guideline regarding Capacity Allocation on European Transmission Networks (the Guideline). As mentioned in our response to the CAM (Capacity Allocation) and CMP (Congestion Management) consultation in March of last year[1], EFET considers that both capacity allocation and the management of congestion are crucial topics for the development of the European Gas market.
We complement ERGEG on the process of drafting the CAM framework guideline. EFET values the cooperation with a wide range of market parties and TSOs during the drafting process. We believe this is crucial when establishing a first proposal that is in line with the needs of the market. The proceeding consultation process and workshop has provide an excellent opportunity for all market parties to ask questions and provide input and we trust ERGEG will seriously consider and address the consultation responses.

Capacity allocation and congestion management both address capacity rights. As different congestion management principles can affect the firmness of capacity products and rights, the effectiveness of a CAM framework guideline is linked with the subsequent CMP. Although EFET will submit a separate response for CMP in addition to this response, some of our statements include an integrated view of both topics.

Together with this letter, setting out EFETs views on capacity allocation, we enclose a revised version of the framework guideline. We believe that this shorter version provides ERGEG with a practical proposal that clarifies and improves the effectiveness of the draft framework guideline. The document contains the essential elements for the implementation of an EU wide capacity allocation mechanism. Whilst we have removed some text, this does not necessarily signal disagreement, rather we believe that several important points are better included in other guidelines.

Scope of the CAM framework guideline

EFET supports ERGEG's focus on cross-border interconnection points between Member States and between interconnection points between national balancing zones. EFET believes that the principles of capacity allocation, as set out in the framework guideline should apply to allocation of both existing and new primary capacity at the specified interconnection points.

[1] http://www.efet.org/GetFile.aspx?File=2765 18 March 2009 – EFET response to ERGEG questions on capacity (CAM and CMP).

We recognise that there needs to be a differences emphasis between the processes of allocating existing and new capacity. For instance, large investments in new capacity might require a minimum level of long-term commitment by market parties and a longer allocation lead time, to allow the investment to be realised after the capacity is (partly) allocated. However, EFET believes that these specific characteristics do not stand in the way of applying the principles in these guidelines via proper development and execution of a network code for all primary capacity allocation. Indeed, the consistent application of a non-discriminatory and stable regime for all allocation of primary capacity, including harmonisation of the approach taken to long-term shipper commitments, is necessary to ensure access to capacity for all market parties. We believe that these framework guidelines could, and should, form the basis for this renewed regime and therefore that the network code should explicitly cover both existing and new capacity.

We also recognise that these framework guidelines should not be extensive regulation of new infrastructure investment. Instead we would suggest that when the capacity to be allocated includes or consists of new capacity, the relevant parts of the guidelines of good practice for open seasons such as the assessment of market needs and market consultation processes should be used and incorporated in the network code. To ensure full harmonisation of a non-discriminatory regime at interconnection points, this network code established by these framework guidelines must set the basis for all primary capacity allocation.

The ACER guidance for ETSOG to design suitable auctions should allow for the structure, lead time and price setting that best suits the specific capacity product it is allocating. EFET envisages that short-term product allocation is arranged as a price based auction. Long-term product auctions, whereby the requirement for new investment can also be tested and decided on, calls for a volume based mechanism with prices linked to the marginal cost of the possible investments. These structures should be designed by the TSO in close cooperation with market parties, to match the needs of the European gas markets.

Below, in the paragraph on capacity allocation auctions, EFET has specified its views on the suitable auction structures for the different capacity products.

In addition to the above, we believe it is important to clarify the limitation of the scope, We believe this clarity will be achieved by publishing a list of applicable interconnection points, in addition to a definition or description of what interconnector points are. This list should not be static and should allow changes when physical changes take place in the market. In addition, this will allow ENTSOG to include an overview of the responsible system operator for capacity allocation at each point.

Adaptation of existing contracts

To allow EFET to assess the impact of the proposed framework guideline and network code on existing contracts, we have already asked ERGEG to clarify the nature of the envisaged changes[2]. We anticipate that if the new network code does

[2] ERGEG met with EFET representatives on 18th February 2010 and explained that in their view existing contracts would need to be adapted to make them operationally compatible

conflict with a part of an existing contract then, the applicable legal framework would automatically dictate the requirements for adjustments. This removes the need to indicate this in the framework guideline.

EFET does fully support the statement ERGEG makes on expiring contracts. All primary capacity that becomes available, new and existing should be allocated in the non-discriminatory and transparent manner that the guideline aims to create.

Definitions in framework guidelines – Proper consultation

EFET believes that the guidelines should include definitions where it concerns obligations of the TSO. A general requirement that could be included in all framework guidelines is 'proper' consultation. The TSO is obliged to consult in certain situations and in a certain manner. To provide clarity to the TSOs on how they can fulfil this obligation, ERGEG should determine and define what constitutes 'proper' consultation. We have included a description of a definition of 'proper consultation' in the framework guideline.

Capacity allocation via auctions

EFET welcomes ERGEGs forward thinking in the implementation of auction based allocation at European interconnection points. EFET strongly believes that FCFS is a method that is discriminatory. In addition, pro rata allocation provides a high level of uncertainty and possibly financial risk for market parties; it cannot be deemed a market based allocation mechanism. Therefore EFET suggests including the obligation to improve the auction characteristics, in case of distorted bidding behaviour, instead of an application of pro rata allocation.

Besides being the market-based allocation method for existing capacity, an auction, if designed and implemented correctly, should be an effective non-discriminatory, transparent allocation mechanism that provides investment incentives and the opportunity to meet at least the market's demand for new built capacity[3].

The success of market-based allocation depends on the characteristics of the auction process and the underlying capacity products. These characteristics should therefore be developed in close cooperation with market parties through thorough proper consultation, as described above. EFET is more than willing to provide input in the process.

We strongly support the following characteristics, as already mentioned in the guideline;

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with new Network Code terms in areas such as standardisation of comms, interruptible products and secondary markets."

[3] TSOs and Regulators must recognise however that the long-term market demand might be only part of the information required for an investment decision in which short-term capacity allocation and socialised costs associated with security of supply might also be important factors. These additional factors must be take in to account together with auctions if the correct investments are to be made.

- TSOs must offer capacity at regular points in time, with a time-window described in the Network Code, coordinated throughout Europe
- Harmonised procedure designed to fit the market and regularly reviewed
- Primary capacity allocations shall not take place outside the above determined times and processes

In addition, the following auction characteristics promote effective competition and a well functioning market, as stated in our paper '**The Allocation of Primary Gas Capacity**
"Economic Market-based Allocation"'[4];

- ensure that all reasonable demands for primary capacity are met where it is economic, and efficient to do so
- capacity should be allocated to those who value it most
- Primary capacity holders should have clear enforceable rights to capacity

Contract description	Contract duration	Building blocks of Capacity product	Share of total calculated capacity	Auction type
Long term firm	Up to 'x'[5] years, start and end date must be between Y+1 and year 'x'.	Quarterly	Maximum 80%	Volume based – price based on long run marginal cost of investment
Annual firm	Yearly	Quarterly	Maximum is total calculated capacity minus long term firm capacity.	Price based – reserve price no more than long run marginal cost of investment. Cleared price auction.
Short term firm	Monthly, Month ahead, Daily, Day ahead, Within day	Monthly, Daily	Remaining capacity from previous auctions plus short-term re-calculated capacity	Price based – reserve price can be set at zero Cleared price auction.

[4] http://www.efet.org/GetFile.aspx?File=2825, published on 26 September 2008.
[5] X is the maximum number of years ahead that capacity can be booked in the relevant market. The value of x should relate to the investment requirements of this market and should cater for market needs.

Bundled products

Flexibility in terms of product choice and duration at the primary allocation stage, including being able to hold capacity on just one side of the border, currently provides a better opportunity to match a shipper's capacity with its needs for its commodity portfolio and reduces the reliance on second best measures to deal with contractual congestion. We share ERGEG's vision of a move towards bundled capacity products, but there are several pre-conditions for this to be viable. Meanwhile, we believe that the focus should be on ensuring that combined products are fully consistent at interconnection points and that TSOs cooperate in calculating capacity of their combined systems.

TSOs revenues from capacity allocation

If the scope of the guidelines includes specification of the use of revenues from capacity auctions then the fundamental requirement is that this should be dealt with in a transparent manner. TSOs must be incentivised to solve the underlying capacity congestion, by ensuring there is sufficient firm capacity available. Investing in additional firm capacity and decreasing contractual congestion are two ways in which this excess revenue should be used to resolve congestion. Care is needed to ensure that the TSO is not incentivised to create higher revenue by maintaining a congested situation.

EFET suggests that this issue might go beyond the scope of the framework guideline and it might be better included in the guideline for tariffication.

Interruptible capacity

EFET strongly believes that allowing, or even enforcing, classification of interruptible capacity presents a negative incentive on the release of additional firm capacity, as the TSO will have to recalculate the risk of interruption –and the pricing of the product – of all interruptible capacity sold before new firm capacity is released. The sale of interruptible capacity must not hinder the TSO from releasing more firm capacity. To ensure an efficient functioning of the market, the framework guideline should oblige TSOs to offer a single interruptible capacity product and a transparent overview of the data that market parties themselves need to assess the risk of interruption. This single product will lead to equal (pro rata) interruption of all parties with this capacity, avoiding (discriminatory) interruptions on a first come last interrupted basis, as we see with the segmented interruptible product. This will incentivise market parties to book firm capacity when it comes available and it allows TSOs to release (short term) additional firm capacity, without having to re-assess their other contracts.

In line with the above, the automated or preferred upgrade from interruptible capacity to firm, when the latter comes available, is discriminatory and should not be allowed. Any firm capacity that becomes available should be allocated in the appropriate non-discriminatory manner, through one of the prescribed auction processes.

In chapter 6, F2.2, the CAM framework guideline indicates a requirement for the Network Code to define several items, including classes of interruptibility, the sequence of interruption, the methodology to calculate the likelihood of interruption. EFET believes this article separates the party that holds the risk of interruption (the market party) and the party that determines the height of the risk (the TSO). In all cases the market party should determine the risk of interruption of their own interruptible capacity. It is the role of the TSO to provide them with all the factual information they need to assess this risk.

Secondary capacity

As the TSO will have to register all secondary capacity trades in their systems, it is natural that these trades are done in a format that fits the format of the primary market. Therefore, it is natural that the secondary market trades products that are available in the primary market, whereby market parties are able to fragment or combine products, as long as they fit an existing primary product. EFET believes the framework guideline should indicate that the TSOs must facilitate secondary capacity trading, as long as the trades are communicated in the format suitable for the primary market. The TSO should not be involved in the design of products for the secondary market, as this is an area that involves market parties only. Furthermore, the use of TSO platforms should not be mandatory for secondary capacity trading. EFET supports the efforts to increase liquidity of secondary capacity markets. However, we believe that allowing both platform and OTC trading will allow innovation and increase flexibility. Limiting the type of trades could lead to the opposite and decrease liquidity.

Capacity calculation

To increase a harmonised and stable calculation of capacity throughout Europe, EFET proposes that ERGEG instructs ENTSOG to include in their Network Code a basic time schedule. TSOs should jointly and regularly calculate the available firm exit and entry capacity for each point, based on the technical maximum and shared information of the respective downstream system. This level of firm capacity should always be marketed by the TSO, according to a pre-set fragmentation in short and long-term products. Additional firm capacity should then be calculated by the TSO on a regular, shorter term basis (matching the capacity products of the primary market, i.e. quarterly, monthly and daily), for the marketing of additional short-term firm products. The calculation and re-calculation methodologies, as well as the timelines for performing these calculations should be set after consultation on the product needs of the market. The calculations should be applied consistently and must be monitored by the regulator.

Kind regards,

Colin Lyle

Chairman of the EFET Gas Committee