

## 1<sup>st</sup> Meeting of Ad-hoc Expert Group for Capacity Allocation

28-11-2009 from 10:30 to 16:00 hours

SOFITEL BRUSSELS EUROPE  
Meeting room Konrad Adenauer  
Place Jourdan, 1  
1040 Brussels

### List of participants

Name	Signature
Andrew PEARCE	
Mike YOUNG	
Friedrich von BURCHARD	
Daniel MELZANI	
Dirk-Christof STÜDEMANN	
Bernard CHASSIN	
Francis BRETNACHER	
Frank ROESSLER	
Steinar SOLHEIM	
Pamela TAYLOR (ERGEG)	
Erik SLEUTJES (ERGEG)	
Benoit ESNAULT (ERGEG)	
Stefanie NEVELING (ERGEG)	
Michael SCHMÖLTZER (ERGEG)	
Alexandre SOROKO (ERGEG)	
Fiete WULFF (ERGEG)	
Kerstin WERNIG (ERGEG)	
Johnatan AMOS (ERGEG)	
Ester TUCEKOVA (ERGEG)	

## **1. Opening**

### **1.1. Approval of the agenda**

The agenda was approved without changes.

## **2. Introduction to process for preparing pilot framework guideline**

### **2.1. Pilot Framework Guideline process**

According to the 3<sup>rd</sup> Package provisions the Agency for a Cooperation of Energy Regulators will submit to the EC framework guidelines setting out clear and objective principles for a development of the network codes to be developed by ENTSOG. In the interim period (until set up of the Agency) ERGEG will prepare a pilot Framework Guideline, in order to test the process.

The European Commission invited ERGEG to submit a Framework Guideline on capacity allocation before the 17<sup>th</sup> Madrid Forum. This work is related to ERGEG's initial principles on capacity allocation (CAM) and congestion management (CMP). The results of the public consultation carried out on these initial principles were published in August 2009. As agreed between the Commission, ERGEG and GTE+, CMP and CAM has been split and CAM will be subject of the first pilot FG while ERGEG has proposed at the last MF that CMP will be tackled via direct comitology.

### **2.2. Role of Ad-hoc Expert Group**

The role of the Expert group is to provide support to ERGEG with regard to the pilot framework guideline by delivering expert advice on specific questions and to test the proposed arrangements. The group consist of 11 members.

For the expert group meetings "Chatham House" rules will apply. The members agree that information and documents will be kept confidential. ERGEG representative explained, that experts are allowed to report about the discussions within the expert group, but not to quote who said what during the meeting.

## **3. ERGEG's draft revised principles on Capacity Allocation and Congestion Management Presentation by ERGEG**

ERGEG representatives presented the ERGEG revised document on CAM and CMP principles. ERGEG announced that they are currently working on the revised principles on capacity allocation and congestion management, the Framework Guideline on capacity allocation and the respective Initial Impact Assessment and ERGEG's proposal for comitology on congestion management and the respective Impact assessment. These documents will be approved at the ERGEG's General Assembly meeting in December.

ERGEG representatives presented the "toolbox" approach, which was initially proposed by ERGEG in its principles. As requested by stakeholders during the public consultation, ERGEG changed this approach in order to allow for more harmonisation. A "target model" has thus been developed which is based on a long-term vision for the European gas market and focused on interconnection points. The background of this target model is to have the same capacity products all over Europe simultaneously allocated via the same capacity allocation procedure on the two sides of interconnection points.

Experts underlined the close link between CAM from CMP and that the proposed CAM should be coherent with the CMP.

According to ERGEG, the overarching aim of the pilot framework guideline is to implement harmonised capacity products and procedures at every interconnection point and this should be achieved through extensive TSOs cooperation. A small set of capacity products of various durations should be offered. The design of these capacity products should be specified in the network codes. With respect to the capacity products, the target is to offer bundled capacity products at every interconnection point. The interim step to achieve the target could be combined entry-exit products based on TSOs cooperation. The interruptible capacity products would be specified in network codes.

According to the target model, periodic auctions would be held at interconnection points for the same type of capacity products. Pro-rata allocation could also be used, when the conditions for efficient auctions are not (yet) met.

## 4. Discussion

### 4.1. Auction versus pro-rata

The main point of discussion was the respective advantages and disadvantages of auction and pro rata allocation mechanisms. A majority of the experts preferred auctions, although some of them recognised that auctions could be problematic under some circumstances. Other experts were in favour of pro-rata. All of them supported the application of the same allocation mechanism on each side of a given interconnection point.

Experts underlined the following advantages of auctions and disadvantages of pro-rata:

- Auctions reveal the value of capacity and allocate the capacity according to shippers' needs.
- Auctions allow avoiding the "over-bidding" behaviours, which sometimes occur with pro-rata.
- In case designed properly, the results of auctions represent reliable investment signals and could thus replace open seasons.
- The potential high prices, i.e. higher than the regulated tariff, for capacity achieved through auctions could be non problematic if the additional revenues are used for developing capacity or decreasing tariffs.
- Risks related to auctions, e.g. the exclusion of shippers from capacity allocation, can largely be mitigated through properly designed auctions.
- The process to move towards auction is complex; the procedure could be learnt i.e. from the UK's experiences. The right design of the auction is crucial.
- Existing auctions in Europe show that it is possible to design such a market-based method which is highly welcomed by users active in this market (UK). The method has proven to be sufficient.
- The application of only auctions in the EU would not require that NRAs need to agree on which allocation method shall be applied across the border and already reach the target model of only applying auctions (especially because only very few TSOs use pro-rata for marketing existing capacity). Otherwise great efforts for coordination required between adjacent NRAs which can be avoided.
- Pro-rata may only allocate a certain share of the requested capacity to the user which can be contradictory to his contractual commodity obligations.
- Pro rata allocations tend to favour incumbents with diversified portfolios and put new market entrants at a competitive disadvantage since in congested systems there is a risk of

being allocated a capacity not sufficient to fulfil supply obligations which the new entrant cannot mitigate.

Experts also underlined the following advantages of pro-rata and disadvantages of auctions:

- Pro-rata allocations guarantee all shippers a minimum access to capacity
- It should be considered if properly designed pro-rata allocation mechanisms could mitigate the fact that shippers are not allocated the capacity they need
- Properly designed pro-rata could guarantee new entrants a minimum amount of allocated capacity without taking risk on transportation prices.
- The potential high and volatile prices resulting of auctions will mainly be supported by the final customers and could go against the competitiveness of natural gas,
- Auctions are only appropriate between liquid hubs
- In case of a price differential between two hubs, the auction price for capacity connecting these two hubs would approximately amount to the price differential. Thus, with auctions, the end consumer would not benefit from this price differential, but the transmission system operator. This would not be the case with pro-rata and capacity sold to the regulated price.

It was also mentioned that a single allocation mechanism to be applied across Europe would not properly take into account regional differences. Some experts suggested implementing first steps on regional level. Other experts answered that it will be nearly impossible to identify criteria which would defined different regions and clearly underpin if either pro-rata or auctions should be applied in such an area.

The case of a price difference for the same capacity products, the one being bought at the regulated price and the other at a higher price achieved through auctions was evoked:

- This difference was deemed as problematic, especially for new entrants who would pay more than incumbents for the same capacity
- This was not considered as prohibitive for implementing auctions.
- Different solutions can be envisaged in order to solve this problem: For example, the price paid originally, i.e. the regulated price, could be totally or partially aligned on the price achieved through auctions. One expert said the final customer would support the difference between the both prices achieved through auctions and regulated. This alignment would nevertheless incentivise the first capacity holders to bring back to the market some of their capacity.

### Other issues

Concerning the capacity products the experts were in favor of firm products. Interruptible product is considered as an addition to the “normal” firm products. One of the expert recalled that it should be avoided that capacity becomes a business and that speculations related to it should be avoided.

Experts largely supported most other ERGEG’s proposals:

- Implementation at interconnection points of a small set of harmonised capacity products and simultaneous allocations of capacity. This harmonisation should be mainly achieved through TSO-cooperation
- Maximisation of the capacity offered through a more dynamic capacity calculation and through the possibility for TSOs to use mechanisms such as capacity buy-back and purchase of physical energy
- Importance of transparency, especially with regard to transactions on the secondary market
- Long term use-it-or-lose-it. Some experts asked for underutilisation to be defined more precisely and to clarify that shippers have the possibility to contest a capacity withdrawal.
- Support for the provision of day-ahead firm capacity. Two experts express their scepticism with regard to a restriction a renomination rights if it places new entrants at a disadvantage because of their usually low level of flexibility facilities.

#### **4. General discussion and way forward**

The experts and ERGEG agreed that this meeting had been particularly fruitful. It was agreed to meet again at the beginning of December. The exact date will be fixed later. The minutes will be circulated to each expert for comments before publication. Participants considered it useful that further comments on the issue should be circulated via email among this group for further debate as the timeline to finalise the work is very short.