



Congestion management on European Gas Transmission Networks

Recommendations for Guidelines Adopted via a Comitology Procedure – Impact Assessment –

**Ref: E09-GNM-10-04
10 December 2009**

INFORMATION PAGE

Abstract

This document E09-GNM-10-04 is an ERGEG impact assessment accompanying the “Recommendations for Guidelines adopted via comitology procedure on Congestion Management Procedures on European Gas Transmission Networks“, ERGEG, December 2009, Ref. E09-GNM-10-07

This document contains ERGEG’s impact assessment of the recommendations on congestion management. It is intended to serve as input for the Commission when revising the Annex of Regulation (EC) 1775/2005 regarding the rules on congestion management.

Target Audience

Energy suppliers, traders, gas/electricity customers, gas/electricity industry, consumer representative groups, network operators, Member States, academics and other interested parties.

If you have any queries relating to this paper please contact:

Mrs. Fay Geitona

Tel. +32 (0)2 788 73 32

Email: fay.geitona@ceer.eu

Related Documents

CEER/ERGEG documents

- “ERGEG principles on Capacity allocation and congestion management in European gas transmission networks“, ERGEG, December 2009, Ref. E09-GNM-10-03
- “Pilot Framework Guideline on Capacity Allocation on European Gas Transmission Networks“, ERGEG, December 2009, Ref. E09-GNM-10-05
- “Pilot Framework Guideline on Capacity Allocation on European Gas Transmission Networks – Impact Assessment“, ERGEG, December 2009, Ref. E09-GNM-10-06
- “Recommendations for Guidelines adopted via comitology procedure on Congestion Management Procedures on European Gas Transmission Networks“, ERGEG, December 2009, Ref. E09-GNM-10-07

A	BASIC REASONING	4
1.	HISTORY	4
2.	PROBLEM	4
3.	CONGESTION IN EUROPEAN TRANSMISSION NETWORKS	5
4.	DIRECT COMITOLGY PROCEDURE	15
B	PROPOSALS FOR NEW ARRANGEMENTS AS TO CONGESTION MANAGEMENT	16
1.	SCOPE OF THE ARRANGEMENTS	17
2.	BORDER SPECIFIC ADJUSTMENTS	19
3.	EXISTING CONTRACTS	22
4.	INCENTIVISATION	25
5.	CAPACITY CALCULATION AND NETWORK SECURITY	28
6.	CAPACITY INCREASE BY OVERSUBSCRIPTION AND BUY-BACK ARRANGEMENTS	33
7.	CAPACITY INCREASE BY PROCUREMENT OF SYSTEM ENERGY	37
8.	CAPACITY CHARGES	40
9.	RE-MARKETING BOOKED CAPACITY	43
10.	FIRM DAY-AHEAD UIOLI (USE IT OR LOSE IT)	46
11.	LONG-TERM UIOLI (USE IT OR LOSE IT)	54
	ANNEX	58

A BASIC REASONING

1. HISTORY

ERGEG has completed its initial consultation and evaluation on principles and proposals for capacity allocation and congestion management (the 'ERGEG consultation').¹ A new phase has now commenced, with the Commission formally inviting² ERGEG to develop non-binding framework guidelines for capacity allocation³ by March 2010, and for this to be the 'pilot project' for implementing these new provisions from the 3rd Package for the European natural gas sector. ERGEG is also developing alongside the pilot project proposals to amend, via direct comitology, the guideline on congestion management attached to the Gas Regulation⁴. Together, these projects represent an important opportunity for ERGEG to establish a clear direction for European reform in this complex area of policy.

2. PROBLEM

Competition in natural gas markets is based on opening essential facilities to all suppliers in a transparent and non-discriminatory way. Rules for third party access are therefore a key element of market functioning, in particular as far as transmission is concerned. Transmission capacity is indeed a scarce resource which must be shared among market participants in a way that promotes competition and security of supply.

Establishing common rules at a European level has been a challenge due to the differences existing between national gas systems. This situation has justified the principle of progressive market opening in the European Union, first by defining limits to the eligibility of consumers and, second, by implementing regulations offering enough freedom to national authorities to look for rules adapted to their initial market situation.

However, after ten years, the liberalisation process requires further development. Regulatory and contractual obstacles to cross-border gas flows remain a major barrier to market integration at a European level. For competition to develop effective congestion management procedures need to be in place.

On top of that, DG Competition's report on its energy sector inquiry rightly sets out some of the problems in accessing gas transmission capacity on key European pipelines. It highlighted contractual congestion, whereby the capacity is fully booked up by contracts but not being fully used, and presented evidence of this occurring on a number of key pipelines. ERGEG believes that the congestion management procedures currently applied by many European TSOs does not allow coping in a proper, i.e. transparent, fair and non discriminatory way with these contractual congestions.

ERGEG therefore have decided to develop its approach to congestion management. The proposals are based on enhancing the current existing approaches to congestion management rather than proposing a fundamentally different approach.

¹ ERGEG E08-GFG-41-09 (15 Jan 2008) and ERGEG E09-GNM-07-03 (24 August 2009)

² Commission letter to ERGEG dated 22 September 2009

³ The Commission notes in its letter of 22 September ERGEG's proposal to adopt directly through comitology the remaining issues concerning new measures for congestion management.

⁴ Regulation (EC) 1775/2005 and 715/2009

3. CONGESTION IN EUROPEAN TRANSMISSION NETWORKS

3.1. Definition of physical and contractual congestion

The basic rules for access to transmission networks in Europe cover the rules for booking freely usable capacity for the gas volumes transported by the transmission system operators (TSOs) using this capacity, nominations, renominations and setting up entry-exit systems and virtual hubs.

Unlike in the electricity grid where congestion only arises when the grid has reached its physical transportation limits, organisational problems reduce the extent to which the gas networks can be used.

- When the transport requirements of network users exceed the physical capacity of the networks, there is physical congestion.
- When network users cannot transport gas because they have not been able to make a booking but the network is capable of meeting their wishes, there is contractual congestion.

Three aspects are important in understanding the nature of congestion.

- There is neither contractual nor physical congestion in the absence of additional network user requirements for contracts and physical transportation.
- In no case can a particular point be a point of physical congestion if it is not a point of contractual congestion at the same time.
- Whether a bookable point of interconnection constitutes physical or contractual congestion is not a fixed property of this point. Rather, whether there is physical or contractual congestion depends on the particular situation at the point at the particular time.

3.1.1. Examples of physical and contractual congestion

Points that are booked and for which there is further demand for transport contracts but whose physical capacity is not exhausted are points of **contractual congestion**. One such example is the interconnector from Hungary to Austria, as seen in the chart below. Technical capacity (blue) is always fully booked (purple), but use (yellow) is far behind.

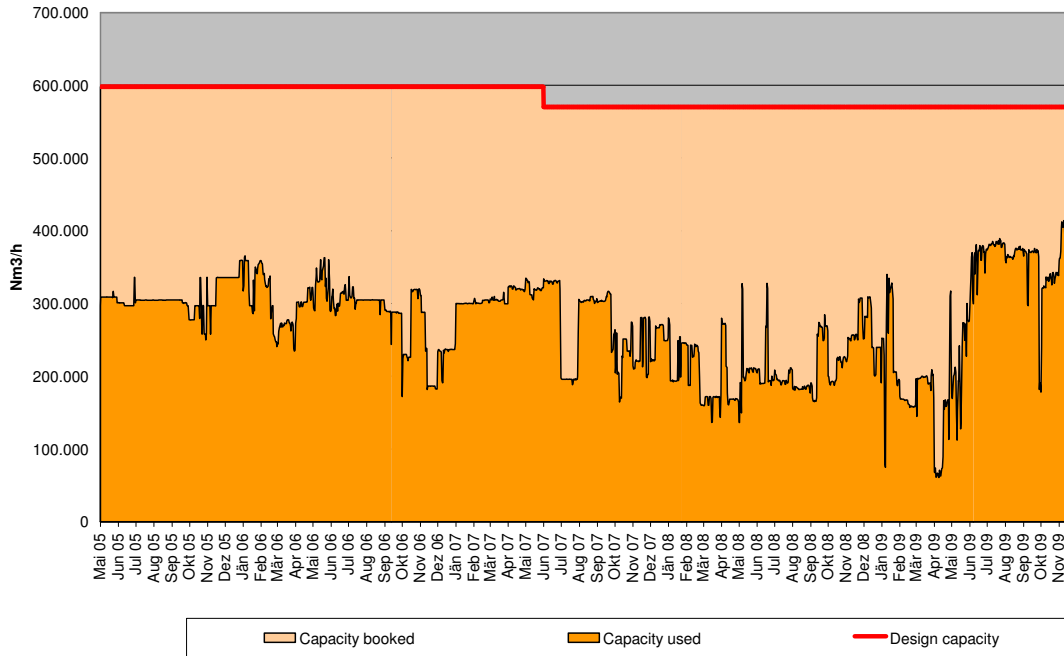


Figure 1: Historical utilisation of the HAG pipeline
Source: OMV Gas GmbH

Physical congestion exists when available capacity is not enough to meet demand for transport. This case can be seen in the chart below. Shippers have booked all the capacity available (shown here in blue). When technical capacity was increased in January 2007, there was a jump not only in booking levels but also in levels of use, which can be taken as proof of higher demand for transport.

Even if technical capacity at a particular point is not largely exhausted, contractual congestion may also exist if there are shippers that would like to use this point but cannot do so because they do not have a contract. This is the case in the following diagram in the summer months. It shows that a point does not have the static property of being a point of contractual congestion or a point of physical congestion but that this can change over time.

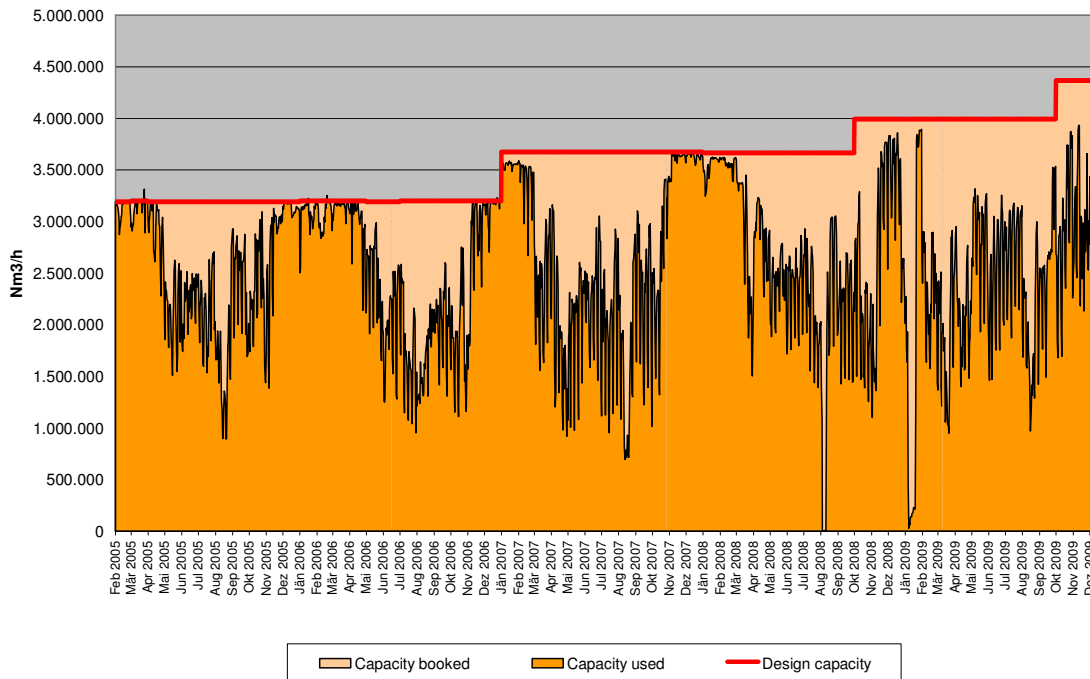


Figure 2: Historical utilisation of the TAG pipeline at the offtake point A-I Border
Source: TAG GmbH

The interconnection points between networks have often capacity to spare. Many studies show that on annual average, capacity utilisation of major cross-border points is around 50% and full capacity utilisation is a rare occurrence or never happens.

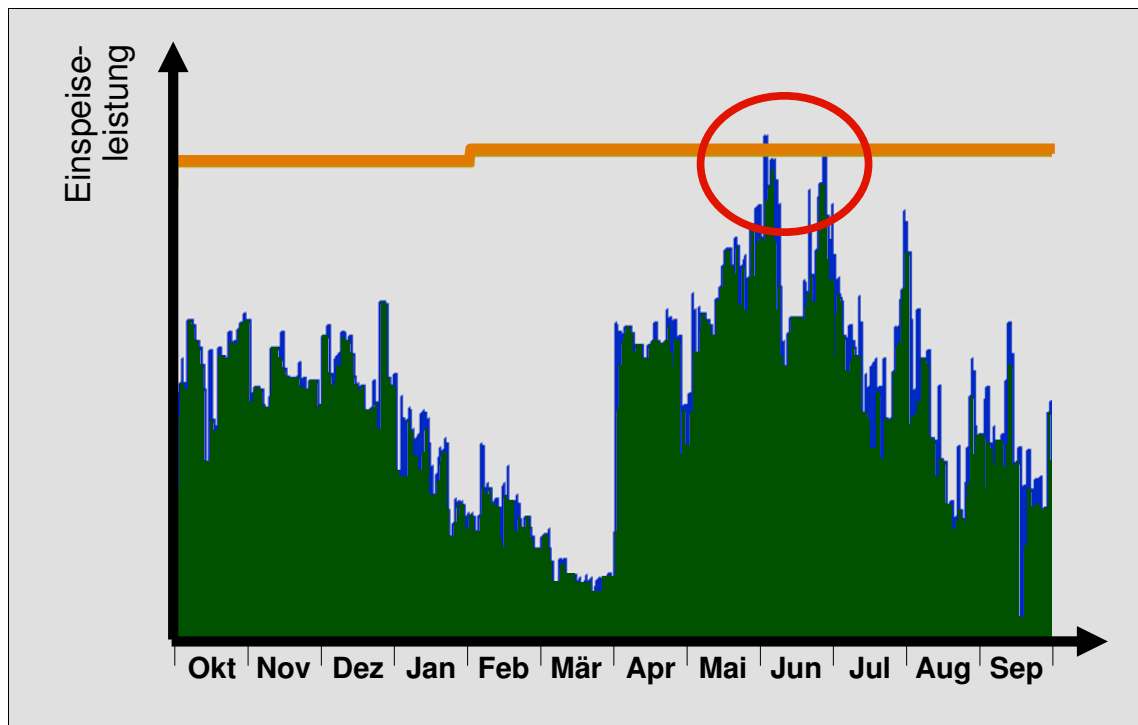


Figure 3: Historical utilisation of a border point D - NL
Source: BNetzA

The last example is the case in which capacity is used to a great extent but there are no additional requests for transport. This occurs if there is a monopoly market on the other side of a point, as possibly, for instance, on the border with countries beyond Europe.

In this theoretical case it might happen that technical capacity is fully utilised. However, at the same time no shipper is able to buy gas on the adjacent market. Thus no request for transport can come about. The point would indeed be fully utilised, but there would not be contractual or physical congestion.

3.2. Physical congestion as the result of rational TSO behaviour

TSOs are obliged to honour the firm capacity rights they have given to shippers at all events. Thus they are required to exercise caution in allocating capacity, to avoid not being able to meet firm nominations. This is also necessary in the shippers' interests.

However TSOs can be overly cautious. In particular it may happen that an affiliated trader or the TSO's largest customer has an interest in the offer of technical capacity being kept to a minimum so as not to unduly facilitate a rival's entry into the market. In such a case, some of the available technical capacity will be withheld from the market, an undesirable situation that should be avoided.

The allocation of technical capacity has been further restricted by the fact that many TSOs undertake long term capacity booking because demand has often been mainly, or exclusively, for this in the past. Short term capacity reserves that are available to TSOs as relief in many situations are not therefore available to the market.

As competition in the gas sector unfolds, the rhythm of business is likely to pick up speed, at least in some areas. That is why the lack of opportunity to book short term capacity is likely to become more and more a problem. Particularly when short term capacity is technically available but not on offer for organisational reasons, changes in current practice are possible and necessary.

3.3. Contractual congestion as the result of rational shipper behaviour

A possible reason for contractual congestion given in many discussions and analyses is hoarding. In particular incumbents are often accused of not using booking capacity, but to withhold it from the market.

Even if it is possible to do this and it should not be denied that this would be rational behaviour and does occur in practice, it should be noted that contractual congestion occurs in a liberalised environment, even without deliberate hoarding.

Contractual congestion can only occur because capacity management in the gas sector - unlike in the electricity sector - is based on a general reservation of capacity. This means that shippers must plan how to use their capacity before they conclude their contracts and must book the capacity they need. As a rule, this cannot be done without a safety margin. Also, the contracts may be for lower gas volumes than intended, render capacity booking partially unnecessary.

It follows for this reason, from the basic approach of capacity management, that practically every booking is for more than the actual volume transported under it.

The longer the bookings are made for, the stronger the effect described. A booking for a whole year, for instance, will always have times in which the gas actually supplied to the final consumer falls below the maximum level (summer, weekends, etc.). Even with booked capa-

city not used to supply final consumers directly there are reasons for this effect: the expected price signals did not happen, levels in the storage facilities were not as expected, an upstream supplier experienced capacity interruption, etc.

The aim of liberalising the gas market lies in opening up the market to competition. This implies that the number of players will rise. Most notably, there will be more shippers engaging in cross-border trading than before. The more shippers there are, the more problems will arise that each shipper will have an interest in keeping the fluctuations he expects in his business within the levels of the capacity he has booked.

It follows from this that contractual congestion is not a consequence of avoidable malpractice by the shippers but in many cases a direct result of capacity booking patterns. Thus the need for a capacity management system becomes clear.

It must not be allowed for the shippers with a long term perspective to restrict the option of securing access to the gas network for their own transport requirements. Nor may shippers that come later or that operate in the shorter term miss out because the transport rights have all been awarded. There must be a proper balance between the requirements of the different shipper groups.

3.4. Contractual congestion as the result of fuzzy division between the spheres of operation

The congestion that detracts from cross-border competition between the entry-exit systems in Europe arises in part because the spheres of operation of the shippers on the one hand and of the TSOs on the other are not sufficiently distinct.

The efficiency of the system as a whole can be maximised if the fields of tasks are clearly distinct and if every player assumes responsibility for those tasks he is best placed to perform.

As regards capacity, this is illustrated by booking specific points. If two markets are joined via more than one cross-border point, the shipper, in the current system, must decide which of the points to book. He thus determines the pipeline to be used by the TSOs to transport gas from one market to the other.

As the shipper has no knowledge of the network at all and cannot judge whether a specific point is suitable or not, it thus forces the TSO in many cases to operate inefficiently.

This inefficiency could be eliminated if the shipper did not have to state the pipeline the TSOs should use. The booking would then be a cross-border booking in which the shipper only needed to state from which market, and to which market, he would like to have gas carried.

If shippers book simply a cross-border link and not a particular pipeline, the TSOs' technical flexibility is left fully intact to decide on all the technical details of use and handling.

3.5. Congestion as the result of responsibilities at the border

It seems unlikely at first sight that congestion can occur at the borders of entry-exit systems. The border is crossed by a pipeline that does not change its diameter as it crosses the border. Pressure control or other facilities that would make a change in capacity plausible are not found at every border. Nevertheless it can happen that different capacity is offered on either side.

The reason for this lies in the methods typically used to determine capacity. TSOs calculate the capacity they make available to the market with reference to their particular network. Cross-border cooperation, agreeing or harmonising the capacity calculations does not happen, or to an insufficient extent.

3.6. The relationship between liquidity and capacity management

There is a close mutual relationship between liquid markets on the one hand and capacity management on the other.

First, capacity must be used with a view to linking markets. If shippers are to respond to the price signals of the various traded markets, they must have the transport capacity to do so. If only the established shippers that have already booked capacity can respond, there will not be sufficient competitive pressure to carry out the transport needed for effective linkage. Thus despite the existing price differences, supply and demand is absent on both markets.

Second, liquid markets replace some of the demand for capacity. If the markets themselves are liquid enough to satisfy an appreciable part of demand, there is no reason to meet this demand by using capacity from adjacent markets. This applies, for instance, when it is a matter of covering peak requirements for only a few hours a year. If these requirements can reliably be met by the "domestic" market, the capacity booked at the border can be reduced by the amount of this peak.

There is a third, indirect, connection between liquidity and capacity management. Currently, liquidity is reduced by the fragmentation of the European market into a very large number of hubs. Gas is currently traded at all cross-border points. Some of these have been created as a transparent hub, while most of the others are not transparent, for the most part. This fragmentation can be countered by uniting capacity management on both sides to form a common cross-border capacity. Then all the trading activities would be concentrated on the virtual trading points, which is likely to greatly boost their liquidity.

3.7. Terms

3.7.1. Capacity management, Capacity allocation mechanism, Congestion management procedure

Regarding capacity, many diverse procedures are required for access to the gas networks. The area as a whole should be designated "capacity management", which can be understood as an umbrella term for the individual aspects. "Capacity allocation management" and "congestion management procedure" have become established as terms to describe the individual aspects. However it is not possible to assign the processes to one of the two easily and distinctly. For instance, processes that aim to maximise technical capacity also serve to reduce congestion.

Nevertheless, the following division should apply:

- Capacity management: umbrella term for the entire spectrum of capacity-related activities and arrangements,
- Capacity allocation mechanism: every activity from determining capacity down to allocation to individual shippers,
- Congestion management procedure: response of TSOs and shippers to a situation in which capacity is booked but not used including arrangements that aim reducing this.

The two perspectives related to capacity allocation and to congestion management require different measures, but could not be discriminated neatly.

- **Capacity allocation:** from the point of view of current and future shippers the use of capacity is linked with the need to be able to book capacity that reflects their requirements for transport.
- **Congestion management:** from the point of view of cross-border competition it is necessary to have arrangements in place on use of capacity at borders so that congestion does not result in a separation of the markets. Contractual congestion should be avoided completely, as far as possible.

These two points of view, particularly in the short term, are not easily reconcilable. Shippers want to be able to use the capacity they have booked flexibly, whereas avoiding contractual congestion may make it necessary for this flexibility to be clipped to enable technical capacity to be used to the full.

3.7.2. Capacity bookings

The TSOs determine the technical possibilities of their network for transporting gas, taking into account that shippers should be able to use the capacity freely, without prior assignment of the entry / exit points. Gas transferred to a shipper at one point can be taken off by the shipper at any exit point.

The TSOs publish the capacity determined for their network and offer it to the shippers for booking. Booking entitles the shipper to use the level of capacity booked.

Capacity is offered for both firm and interruptible booking.

3.7.3. Nomination and renomination

Shippers that have booked capacity inform the TSO of how they intend to use the capacity, hour by hour, by means of their nomination. As a rule, through their nomination they are requesting the TSO to make the necessary technical adjustments in its network so that nominated use can go ahead.

If a shipper nominates, for instance, 100 energy units at a point of interconnection he has booked, he causes the two adjacent TSOs to adjust their system control so that his 100 units are included in the total flow.

As the shipper has no interest in the technicalities of the gas flow itself, it is enough if it is provided as if the flow had taken place. It is all the same to the shipper whether the particular amount is put into a storage facility in the market of origin and the same volume is withdrawn from storage in the target market.

Nomination of intended flows typically takes place the day before transport (D-1). However in most Member States shippers have the right to change their nomination of the previous day up to two hours before transport actually begins. These subsequent changes are known as renomination.

Firm capacity booking nominations must always be carried out by TSOs and may be usually restricted only in the case of force majeure. Interruptible booking nominations can be interrupted at any time if technical reasons make it impossible to carry out the nomination.

3.7.4. Entry-exit systems

Free usability of booked capacity is a central element of booking. However it is not always possible. The larger a network area is and the wider the range of shippers' transport wishes, it will be more difficult to provide free usability.

In networks built to supply final customers with gas directly and in which shippers have few other options such as offtake in adjacent networks or storing large volumes, free usability is relatively easy to provide, as the shippers' wishes do not vary much. In more complex systems this is harder.

It is necessary to determine the extent of free usability and to define entry-exit systems. There are cases in which the extent of free usability is greater than the network areas of individual TSOs. Then it is possible, and makes sense, to merge these networks to create a common entry-exit system. In other cases, the extent may be smaller than an individual network. Then it may be necessary to sub-divide the network into several entry-exit systems.

3.7.5. Virtual hubs

Capacity bookings give shippers the right to input gas onto an entry-exit system and to take it off. Bookings at more than one point in the entry-exit system are independent of one another, or decoupled. This provides the opportunity to sell the gas, after input, to other shippers and to buy gas from other shippers prior to offtake.

The place of performance that must be imagined for such trading is in many countries called the "virtual trading hub". Virtual trading hubs are at the heart of the development of gas competition in the European internal market. The greater the liquidity at these virtual trading points, the better the shippers can carry on their business on the basis of market mechanisms.

A large number of framework conditions must be met before the liquidity of these trading points can grow. A fundamental one is that the underlying entry-exit system is as large as possible. The larger the size of an entry-exit system, the more final consumers, storage facilities and production facilities it encompasses.

3.8. Particularities of congestion at specific borders

Contractual and physical congestion is prominent at many borders in Europe and slows the development of cross-border competition in the gas sector.

- In some cases, networks linked via cross-border points are pure supply networks whose capacity requirements cannot exceed the technical capacity of the link in any flow scenario.
- In other cases physical congestion is conceivable because the networks are linked by a large number of points of interconnection with other complex entry-exit systems and have large storage facilities.

In Europe, both cases are found at national borders and at balancing zone borders within the Member States. Capacity management clearly needs to create instruments that properly reflect the difference between the two situations.

Capacity management to date does not distinguish between the two; consequently, the use of capacity is greatly restricted and unnecessarily constrains shippers' options.

3.8.1. Particularities of congestion at borders with supply-only networks

When linkage includes networks used purely for supply purposes, in no case may the capacity acquired in transport rights exceed the physical capacity because no shipper can buy more gas than is consumed by final consumers in the particular network. While the distribution of these volumes among the shippers can change, the total remains unchanged.

If the supply network has storage facilities, the situation will not change as long as the injection capacity does not lead to maximum entry capacity in the network being exceeded. Only when there are storage facilities in a network otherwise used purely for supply purposes whose injections are greater will the network lose its character as a supply-only network.

In these cases the adequate form of capacity management would be to merge the two adjacent entry-exit systems, although legal issues and questions of how to handle balancing, etc, could cause problems if the two systems are in different Member States.

As long as the entry-exit systems are not merged in this way, unlimited firm capacity can be allocated because the use of capacity will never be able to exceed physical capacity for the simple logical reasons given.

3.8.2. Particularities of congestion at borders between complex entry-exit systems

More rigorous capacity management is needed between complex entry-exit systems, in which shippers' behaviour is not automatically restricted as described above in networks serving supply purposes only.

Consideration must be given to the case of shippers possibly wanting transport on a scale exceeding the physical capability of the networks. If volumes in an entry-exit system can be bought for a good price for storage in an adjacent system, this may be more than the capac-

ity at the interconnection point allows. This is particularly likely when the system transports large volumes anyway.

Unlimited firm transport rights cannot be awarded in this case, but must be limited to the extent of physical availability. At any rate, mechanisms are needed to ensure that nominated transport can be carried out on the basis of booked capacity. These mechanisms can include static procedures as well as buy-back options.

Summing up, the booking capacity on borders between complex entry-exit systems is one possible way of showing shippers the inevitable limits to the volumes that can be transported and conversely, to make sure that trading is unhindered within these borders.

The limited availability of firm capacity rights at such border points means that capacity management procedures are necessary to ensure that these rights are properly allocated in every situation. The aims of capacity allocation at these points are thus:

- To maximise the use of capacity: capacity should be allocated in such a way that the entire physical capacity, as far as possible, can be used on a firm basis and is not left unused for organisational reasons.
- To maximise the planning of capacity use: the conclusion of cross-border gas supply contracts makes it necessary for the shippers to book the capacity they need to transport the gas for the same periods as those on which the contracts are based.

Both aims call for different capacity management measures specific to the particular case.

The two aims are not entirely consistent with each other. As section 3.3 shows, long term capacity bookings always have points in time where booked capacity is not fully used. On the other hand, if physical capacity is to be used to the full, action at short notice is typically needed.

For these reasons, managing capacity on borders between complex entry-exit systems will require a number of measures to accommodate shippers' long term needs and to optimise the use of capacity at short notice.

Care should be taken that the measures are consistent and not only do not contradict, but also to complement. This should be the yardstick for ERGEG's recommendations for comitology and framework guidelines.

3.9. Congestion inside entry-exit systems

Congestion can also occur inside entry-exit systems. For instance, withdrawal from storage facilities in downstream networks may be limited to final consumers' simultaneous offtake in this downstream network, otherwise the surplus gas from the downstream network would have to be transferred to the upstream network. Typically, this is not technically possible on account of the pressure levels.

Congestion can also occur when large new final consumers are to be connected to the existing network.

Congestion of this nature cannot be eliminated by capacity management; it must be eliminated by other means. Thus in the case of the storage facilities in the downstream network a flow-dependent restriction may be necessary. In the case of the connection of large new final consumers it may be necessary to examine the capacity situation prior to connection. However no case is the subject of capacity management.

4. DIRECT COMITOLGY PROCEDURE

Under Article 9 of the current Regulation (EC) No 1775/2005 and Article 23 of the new Regulation (EC) No 715/2009 the Commission has the possibility of changing the capacity management rules by amending the Guidelines in the Annex to the Regulation. To do so, it must follow the comitology procedure detailed in Articles 14 or 28 respectively. This means that the revised arrangements of the 3rd Package have not changed the possibility of implementing the Regulation by adopting or amending its non-essential elements after the new Regulation (EC) No 715/2009 has taken effect. The arrangements decided in this procedure become directly applicable law in all the EU Member states and do not need implementation into national legislation.

The Commission made use of the possibility of doing this for the electricity sector in 2006 and announced to propose an amendment to the existing transparency guidelines.

The ERGEG working paper contains proposals on new capacity management arrangements to be realised in a 'direct' comitology procedure. It does not cover those elements of a comprehensive set of capacity management arrangements which are covered by ERGEG's input to framework guidelines. In the context of this pilot framework guideline ERGEG has been invited by the Commission to assume the role assigned to the Agency under Article 6 (2) of Regulation (EC) No 715/2009 and to submit a non-binding framework guideline within six months of receipt of the Commission's notification letter (cf. Annex).

4.1. Assignment of the proposed arrangements to direct comitology

The arrangements proposed in this document are designed to prepare a direct comitology procedure. The direct comitology procedure will bring about the application of harmonised procedures in every Member State, as far as this is appropriate for the gas industry.

The proposals assigned to direct comitology cover matters of congestion management:

- Reduction of physical congestion by means of proper capacity calculation and maximisation
- Reaction to contractual congestion for long-term and short-term capacity.

B PROPOSALS FOR NEW ARRANGEMENTS AS TO CONGESTION MANAGEMENT

Below are proposals for a set of new arrangements which will be able to reduce congestion at borders on a sustained basis and will be flexible enough to respond to changes in the market.

ERGEG has drafted a proposal for restructuring congestion management from the problems and general conditions described in Part A. Essentially, this proposal consists of the following elements:

- Increasing the availability of technical capacity by optimising the processes of the individual TSOs (direct comitology) and by more intensive cooperation between TSOs (framework guidelines).
- Concretising long term and short term congestion management procedures.

This document contains detailed discussion of each proposed arrangement:

- The set of problems for the solution of which the proposals have been drawn up is depicted exhaustively.
- The solution options are set out and analysed. Options that ERGEG ultimately rejected are also described.
- The most important findings of the consultation are set out for each proposed arrangement.
- Reasons are given for ERGEG's decisions on suitable options and amendments to the arrangements in light of the responses to ERGEG's Public consultation document E08-GFG-41-09 of 15 January 2009

1. SCOPE OF THE ARRANGEMENTS

1.1. Proposed arrangement

C1 General issues

C1.1 Scope

The rules on congestion management procedures in these guidelines apply to cross-border interconnection points between Member States, as well as interconnections between adjacent entry-exit-systems within the same Member State, insofar as the points are subject to booking procedures by shippers. Exit points to end consumers and distribution networks, entry points to supply-only networks, as well as entry- and exit-points to LNG-terminals or storage facilities are not subject to these Guidelines.

The rules on congestion management procedures in these Guidelines shall not apply to interconnection points which are not congested. The concerned national regulators shall jointly decide that an interconnection point is not congested and is thus exempted from the rules of these Guidelines. Transmission system operators and shippers may request such an exemption.

These Guidelines will be applied by transmission system operators without prejudice of the regulatory regime for cross border issues pursuant to article 42, of Directive 2009/73/EC and of the responsibilities and powers of regulatory authorities established according to article 41, paragraph 6, of Directive 2009/73/EC.

1.2. Problem

In some Member States it is necessary to book capacity both at cross-border interconnection points connecting the particular entry-exit systems with adjacent ones, and at points to which end consumers, storage facilities and LNG terminals are connected.

There are significant differences between the two types of point. While physical congestion normally cannot occur in supplying an end consumer and contractual congestion can occur only under very special conditions, it can regularly happen on the borders of the entry-exit systems.

Not all border points of entry-exit systems are equally susceptible to physical and contractual congestion. It is necessary to differentiate between points with and points without congestion.

The area of application of the proposed arrangements must be defined for the sake of clarity.

1.3. Options

1.3.1. Uniform arrangements for all the bookable points

Making uniform rules for all the bookable points is not a desirable option. The points within entry-exit systems at any rate, would not be part of the area of application of these proposals. The procedures for booking and using points to end consumers, storage facilities and LNG terminals may follow country specific procedures but must nevertheless satisfy the general requirements of efficient and non-discriminatory access.

1.3.2. Extension of the scope to all bookable cross-border interconnection points

The option of extension of the proposed arrangements to all border points of entry-exit systems was discussed in detail above. Generally unifying the rules has the following distinct advantages:

- Shippers can operate in every market without having to observe specific arrangements each time. Thus the transaction effort for the shippers would be minimised.
- The scope of the proposed arrangements ensures that basic terms and conditions are applied the same in all countries.

For proposals particularly referring to congestion it is suitable to apply them only in case of actual or potential congestion. This can be achieved by setting application condition in these arrangements. An exemption from the general scope is not necessary.

1.3.3. Applying the rules at congested cross-border interconnection points only

Congestion management rules need only apply at congested cross-border interconnection points, whereby the bar should be set high in respect of when a particular point experiences so little congestion that the rules need not apply. At any rate, the possibility of contractual congestion emerging must also be taken into account.

As set out in section A-3.8, in specific situations of entry-exit systems physical congestion can be ruled out so clearly that contractual congestion could be prevented by simple means. In these cases the proposed arrangements need not apply.

There were the possibilities to limit the scope of the proposals generally to points which experience congestion or are likely to do so. On the other hand this limit of scope would sort out any general arrangement to be applied. This would rather result in heterogeneous access conditions.

If the proposed guidelines are to be applied differently depending on whether there is congestion or not, it must be decided who would make this assessment. The only authorities that are in a position to do so are the regulatory authorities responsible for the two entry-exit systems connected via the point in question. This might cause complex efforts for the respective NRAs.

1.4. **Public consultation findings**

Most of the responses of the market players to this question in the consultation were clearly in favour of uniform rules at all the cross-border interconnection points and ask for a wider definition of the scope. The reasons given were typically transparency, reduced transaction effort and the simplification that would result. For the same reasons, some respondents proposed to extend the rules to LNG and storages, too.

Only a few respondents pointed out that unifying the rules at points that currently had good arrangements could also lead to deterioration.

Numerous comments bemoaned the fact that the regulatory authorities had too much power. It was not appropriate to put the details of the capacity management rules into the hands of the national regulatory authorities.

For further details of consultation cf. ERGEG Evaluation of Comments E09-GNM-07-03.

1.5. Selected options and changes in light of the public consultation

Of the possible options, ERGEG has chosen to extend the scope of the proposals to congested interconnection points between entry-exit systems. This decision was reached after weighing up the interests of the option to apply specific rules only where necessary and the shippers in having the same rules at all the points, as far as possible.

1.6. Impact of the proposed arrangements

The scope of the proposed arrangements will result in changes to congestion management and some general arrangements at all border-points. In case a proposed rule could only cause considerable progress at congested points, this fact will be respected in this ruling.

2. BORDER SPECIFIC ADJUSTMENTS

2.1. Proposed arrangement

C1.2 Border specific adjustments

In order to foster compatibility with the methods applied in the adjacent systems national regulatory authorities may request transmission system operators adjoining more than one system to apply different terms and conditions at the interconnection points to different systems.

2.2. Problem

At present, shippers have to familiarise themselves with a number of rules for the different entry-exit systems. This greatly increases the transaction effort for them. Such organisational hindrances can be serious barriers, particularly when it comes to small trading volumes and short term operations in the market. Day-ahead activities of shippers are always short-term and in most cases of relatively small volumes and thus subject to such hindrances.

Particularly problematic is the fact that the rules on one side of the cross-border point differ from those on the other side. The effect is to provide another barrier for crossing such a border, a barrier that has nothing to do with the technical circumstances.

This applies to both the contractual arrangements and the underlying rules for handling the arrangements.

Another consequence of applying different rules that is detrimental to completion of the internal market is that much trading is done directly at the cross-border points. Every shipper is specialised in the rules of one ("his") entry-exit system where he can find his way around easily and organises his transactions with foreign trading partners in such a way as to avoid needing rules he is not familiar with.

This typically happens by doing business at the cross-border points. The providing shipper books exit capacity from his entry-exit system, while the receiving shipper books entry capacity in his entry-exit system. Trade thus takes place in no man's land after exit and prior to entry.

Such trading thus lacks the liquidity of the virtual trading point of both markets. As the number of cross-border points is much larger than the number of entry-exit systems, trading liquidity is fragmented at many points (this link has already been mentioned in section A-3.6.)

2.3. Options

2.3.1. Uniform arrangements for every bookable point

Uniform rules applied on all the cross-border points will sort out the need for border-specific adjustments. As discussed in the analysis of the scope of these proposals (cf. B-1.3.1), there is the possibility of setting uniform rules for every bookable point.

To achieve this, common contractual standards and uniform codes would then need to be specified. Unified allocation procedures would be necessary as well. This is out of scope of these proposals for direct comitology.

The analysis already shows that this option would not automatically produce the best outcome in a first step, since it requires close cross-border cooperation and a setting of Europe-wide standards. The option of uniform arrangements clearly exists on the basis of agreed codes on the basis of framework guidelines.

2.3.2. Border specific adjustments of contracts and codes

If the barriers between adjacent entry-exit systems are to be lifted, the rules on either side of the cross-border points will have to be converged. This means that the applied rules, defined according to the proposals recommended for national implementation on the basis of direct comitology, are to be slightly changed at specific borders. Consequently, the option is for the details of the rules applied at the borders of particular entry-exit systems to differ so that more compatibility is achieved there. This could reduce differences at these borders and thereby to ease cross-border competition.

The option of border-specific adjustments can allow for sensible progress while implementing harmonised terms and conditions under the regime of framework guidelines and network codes entered into force via comitology.

2.3.3. Assignment of responsibilities to the national regulatory authorities

According to the step-by-step approach the setting of detailed rules is assigned to NRAs. This results in different solutions to be found in different Member States. The NRAs, competent to set the rules, should be entitled to adjust the details of the rules at specific borders.

2.4. Public consultation findings

Many respondents were in favour of generally unifying the arrangements. Some TSOs objected to the possibility of applying different rules at different borders. These TSOs clearly preferred unifying the rules to applying different ones.

For further details of consultation cf. ERGEG Evaluation of Comments E09-GNM-07-03.

2.5. Selected options and changes in light of the public consultation

Despite the respondents being clearly in favour of unifying the arrangements, ERGEG continues to favour the possibility of applying arrangements whose details differ until full harmonisation is reached. ERGEG also proposes that compatible arrangements should be applied on both sides of a border, even if this means different arrangements at the different borders of an entry-exit system.

The TSOs should be required to apply fully harmonised rules under the regime of codes developed under the rules proposed for framework guidelines. To achieve progress regarding cross-border alignment ERGEG proposes to give competency to the NRAs for border specific adjustments of rules applied.

2.6. Impact of the proposed arrangement

The impact of the proposed arrangement depends on the use, that NRAs make of it. Concerning the arrangements proposed for direct comitology the adjustments mainly refer to the congestion management procedures of long-term and short term UIOLI. Both procedures shall be applied in a coordinated way at cross-border points.

In case adjustments are initiated and implemented, the differences between the congestion management procedures existing between the individual entry-exit systems are reduced. Then differences move away from the edge to the middle of the entry-exit systems: compatible rules should be applied at each individual border of an entry-exit system, but the rules may differ at the various borders of the entry-exit system.

The alignment of rules at the border will suitably facilitate cross-border traffic. However, gas transport over a number of borders will not be simplified to the same extent. Be that as it may, gas transports from "A" to "C" via "B" might not need three arrangements as today (the arrangements in place at A, B and C), but only the two arrangements at the borders AB and BC. Only under the regime of fully harmonised arrangements this is reduced further.

3. EXISTING CONTRACTS

3.1. Proposed arrangement

C1.3 Existing contracts

All capacity management clauses in capacity contracts existing prior to the application of these Guidelines shall be amended in line with the implemented provisions within 6 months of the respective provision entering into force. During this period, network users shall be entitled to reduce or terminate their capacity contracts, provided that TSOs, other users and final customers are not inadequately affected by an increase of their costs as a consequence of the application of this provision.

3.2. Problem

Changing the rules of the game will bring changes only if the rules are also applied to existing contracts. Problems of congestion management derive crucially from the fact that:

- existing contracts are interpreted in a way that makes it difficult or even prevents, new competitors from entering the market,
- many existing contracts contain evergreen-clauses that extend the related problems,
- capacity is largely, if not fully, booked and insofar bound to existing contracts.

The levels of capacity booked under the current system are higher than they are expected to be under the proposed regime for a number of reasons. This is why considerable problems could arise for the shippers if they did not have the possibility during the transition to adapt their contracts in respect of levels and duration. The reasons for high bookings under the current system are given below:

- Use of a continuous allocation process means that shippers have to decide very quickly whether to book capacity suddenly becoming available. A shipper not doing so will find himself empty-handed later on. Bookings have to be made without time for consideration, which leads to substantial safety margins being built in.
- In some Member States bookings are still taken in units of volume (m³/h). Account therefore has to be taken of fluctuations in calorific value.
- At present, short term capacity is hardly available. Thus there is as good as no opportunity to offset peaks by booking additional capacity. A shipper's own booking must cover the theoretical maximum flows.
- The liquidity of the virtual hubs is underdeveloped in nearly every European country. Short term improvements are not possible through trading but only through the scope of the "own" booking.
- To date, storage facilities have very rarely been used for arbitrage. It follows that the storage facilities, provided they are not used for technical operation of the networks, are part of the supply chain of those shippers that were able to book storage capacity. Other shippers cannot make use of this flexibility tool at the moment and have to transport their flexibility across the borders.

In case when some or all of these reasons no longer apply, shippers will have overbooked capacity. There will be a necessity for reducing the bookings.

3.3. Options

3.3.1. Adapting existing contracts after the proposed arrangements take effect

A clear, complete solution to the question of existing contract adaptation would be full adaptation of all the contracts at a suitable time after the amended guidelines have taken effect.

However, this is not possible in practice in a first step. Using the step-by-step approach for the proposed arrangements means that not all the arrangements will take effect at the same time but, in most cases, only after a decision by the national regulatory authority. This is a problem in respect of simultaneous adaptation; as regards many details it will not be clear to begin with which arrangement is applicable and what this will look like exactly.

3.3.2. Adapting existing contracts after the individual arrangements take effect

Capacity contracts can be adapted in a first step after the individual arrangements have taken effect and been detailed by the national regulatory authorities. This option reflects the step-by-step nature of the proposals but has the drawback that, in individual cases, the contracts may need to be modified more than once. This means that, if needed, the relevant clauses of existing contracts would be amended if they contradict the new individual arrangements have taken effect.

3.3.3. Enabling contract adaptation during the period of change

The introduction of new congestion management measures will crucially change the calculations on which booking is based. In many cases, restructured congestion management is likely to cause a desire for reduction of bookings. It is only right to give shippers the possibility of responding by adapting their contracts accordingly.

The shippers would be able to put contracted capacity they no longer needed onto the secondary market; however, there is no guarantee that they would find a buyer.

3.4. Public consultation findings

In their comments, shippers were emphatic that existing contracts should not be touched. There was broad agreement in the consultation as a whole that changes to the rules were necessary and there was also agreement on many of ERGEG's proposals, but this consensus came to an abrupt end at the question of adapting existing contracts. At least long transitional periods were recommended.

However, this common opinion is due to the fact that there was hardly one respondent not being party in existing contracts.

For further details of consultation cf. ERGEG Evaluation of Comments E09-GNM-07-03.

3.5. Selected options and changes in light of the public consultation

ERGEG has decided to keep to the proposed arrangement despite the concerns raised in the consultation and to propose that all the existing contracts be adapted in order to reflect the new capacity management arrangements.

Linking the time of adaptation to the time that the proposed arrangement should take effect as decided by the particular national regulatory authority is in keeping with the step-by-step nature of the arrangements. This is proposed for direct comitology.

3.6. Impact of the proposed arrangement

The proposed measure has consequences for the legal certainty of a contractor since it retroactively changes existing contracts. Such a measure is necessary since the effective implementation of new arrangements and timely completion of the internal energy market requires that the proposed arrangements will be applied not just to the small part of the capacity for which new contracts have been signed but will at the end cover the entire area of booked and available capacity.

Another possible effect is that capacity holders will rethink their portfolios and return appreciable amounts of capacity to the TSOs, enabling TSOs to reorganise their offer and provide primary capacities.

4. INCENTIVISATION

4.1. Proposed arrangement

C1.4 Incentivisation

National regulatory authorities shall ensure transmission network operators have incentives to achieve the aim of these Guidelines and to properly comply with the requirements resulting from these guidelines, in particular to maximise available capacity and to actively manage network congestion.

4.2. Problem

An incentive for network operators to minimise the costs of capacity management is inherent in a system revenue cap regulation, which is applied in some Member States. TSOs tend to show as few capacities as possible which they allocate to as few shippers as possible over the longest possible term. This enables TSOs to minimise their handling expenses and to eliminate the financial risks of capacity utilisation since they can expect a guaranteed and constant revenue stream.

Improvements in congestion management are aimed in the opposite direction in all respects: as many capacities as possible are to be allocated to as many shippers as possible for many different durations, some also at short notice.

TSOs are supposed to support the growing dynamics of network utilisation and foster it by adopting suitable processes. Of course, it needs to be ensured that TSOs can claim any costs incurred within the framework of cost regulation. This would rule out the negative incentive not to use measures because these might influence the profit situation negatively.

Some TSOs regularly quote the lack of economic incentives to proactively enhance capacity management as the reason why they are unable to support the further development of capacity management.

4.3. Options

4.3.1. Decision not to create financial incentives

It is conceivable that a decision will be taken not to create any financial incentives in relation to the fulfilment of tasks by network operators. The vast majority of requirements set forth in these proposals and in other statutory regulations are clear and binding so that non-fulfilment would be equivalent to a breach of duty. The regulatory authorities are responsible for keeping an eye on this and may be required to intervene and insist that obligations are met.

This approach appears to be cumbersome or perhaps even impossible in many of the finer details.

4.3.2. Creating incentives for all activities undertaken by TSOs

With this option all activities undertaken by TSOs would be subject to financial analysis and would have to be backed up by relevant incentive systems. TSOs are given little or no opportunity to generate revenue that does not come about on the basis of incentives.

With this model, even basic activities undertaken by TSOs such as the acceptance of nominations or the publication of network data would have to be backed by relevant incentives.

This model can become very unwieldy. It would certainly be the most complex. There is a risk that TSOs might enhance their financial results by performing tasks that are really not particularly important. This means the system has the potential to create conflicting results.

4.3.3. Targeted incentives for particularly important activities undertaken by TSOs

TSOs can be given the incentive to perform particularly important tasks with particularly good results if they are offered the prospect of generating additional revenue. This applies especially to the tasks that are important in terms of market integration.

It is also a complex task to set out the details of any such incentives because this incentive system also has to be multi-dimensional and creating inverse incentives must be avoided at all costs. At the same time, it seems to be reasonable to eliminate the potentially negative incentives of the underlying costs systems.

4.3.4. Assigning competency for setting out the details of an incentive system to the regulatory authorities

It is not suitable in these proposals to set out the details of the incentive system to ensure that TSOs comply with the underlying aims of these proposals. This would result in excessive regulatory depth.

It is also necessary to ensure that the incentives used are compatible with the cost regulation regime of the respective Member State. Setting out details for the incentive system that are too generalised would harbour the risk of contravening other incentives resulting from incentive regulation that applies in some Member States.

There is the option of transferring responsibility for setting out the details of the respective incentive system to the national regulatory authorities who are in a position to assess all of the above-mentioned general conditions.

This option can be given without any further specification or alternatively more precise regulation can be issued determining which goals these incentives are aimed at. As it is not an independent goal, for instance, to determine short-term capacities, the incentive effect can only be oriented to the underlying goals of these proposals which are to eliminate contractual congestion and to foster dynamic market development and the cross-border integration of commercial markets.

4.4. Public consultation results

A large number of TSOs have insisted that the costs resulting from the application of regulations contained in the Guidelines be taken into account. A large number of other respondents thought it would be reasonable to have more extensive incentives for particularly efficient fulfilment of obligations. However, some persons have warned against creating too many incentives for the regular fulfilment of obligations.

For further details of consultation cf. ERGEG Evaluation of Comments E09-GNM-07-03.

4.5. Option chosen and changes made in the light of the public consultation

ERGEG suggests giving the regulatory authorities the possibility of creating incentives from the obligations ensuing from these proposals. The incentive system is intended to encourage TSOs to meet the requirements set forth in these proposals.

As the incentives are to be oriented to the basic goals defined in these proposals, special attention must be paid to ensure that no inverse incentives are created and that they only refer to the TSOs' core areas of activity.

4.6. Impact of the proposed regulation

The main impact of the proposed regulation consists in the financial reasons that have hitherto mitigated against the TSOs participating in active congestion management being reversed and in the TSOs having relevant financial benefits if they meet their obligations well.

This can align the interests of network operators and the market more effectively.

5. CAPACITY CALCULATION AND NETWORK SECURITY

5.1. Proposed arrangement

C2 Third party access

C2.1 Capacity calculation

When assessing technical capacity, transmission system operators shall consider the maximum amount of capacity that can be offered for use without restrictions.

Technical capacity must be calculated through transparent methodologies, using best available and cost-efficient procedures by transmission system operators. Transmission system operators shall identify all capacity that can be physically used in order to maximise the offer of capacity to the market. When forecasting system use for the purposes of identifying technical constraints, transmission system operators may also consider market trends, historical flow data and data on results of allocation processes.

In case of short-term congestion national regulatory authorities shall define further details of capacity calculation. In particular this may cover the calculation of short-term capacity down to daily and intraday capacity, to be based upon transmission system operators' current knowledge of, inter alia, the actual calorific value of the gas, expected consumption, climatic conditions, system configuration and the availability of network components.

C2.2 Network security

In applying the rules of these guidelines, transmission system operators shall take into account the network security requirements, possible public service obligations and the integrity of the system concerned. The services provided shall take into account the facilities' technical constraints. Any limits on the services offered shall be made public and duly substantiated.

C2.3 Emergencies

Should difficulties in meeting contractual delivery obligations arise due to system integrity reasons beyond the transmission system operator's control, transmission system operators shall notify network users and seek a non-discriminatory solution without delay, e.g. proportionate reduction of nominated flows. Where possible, transmission system operators shall consult network users on procedures prior to their implementation and agree them with the national regulatory authority.

5.2. Problem

No matter where capacity management is discussed, the question of correctly calculating the amount of firm capacity available is at the heart of every discussion. The use of a pipeline to transport gas is so obvious and seems so simple that the complexity of calculating and managing capacity in a meshed network of such pipes is underestimated. The calculation of the flows even in a single pipe is possible only by using considerable simplification.

The introduction of entry-exit systems with freely usable capacity makes this more complex than it already is with a system of point-to-point management.

Nevertheless, the gas market is rightly entitled to have TSOs put all available capacity on the market. At the same time, this capacity should be provided on a firm basis, as a general rule. TSOs must therefore weigh up between maximising capacity on the one hand and minimising the risks that firm capacity booked will not be able to be provided for technical reasons on the other.

Today, there is still no industry standard for calculating capacity. The methods are typically based on computer-assisted simulations which simulate a particular scenario only and do not contain a capacity optimisation algorithm.

Simplified assumptions are also needed for the simulated calculations so that the computer can cope with the complexity. Some of the results are linked directly with these assumptions. Work is often done with so-called static assumptions that disregard intraday changes in network load and other dynamic effects e.g. resulting from the very low velocity of flows. In these cases the calculations are performed for peak hours; which are not directly relevant to capacity at the cross-border points since intraday peaks are partly offset by the linepack capabilities of the system.

The shippers often call for the methods of calculation to be made more transparent. This is possible and meaningful for the fundamentals, at least, of the methods used and for the main assumptions made by the TSO in his calculations. But, the calculation itself is by far too complex for public understanding.

Calculating capacity in its entirety is at present too cumbersome to ensure the theoretically available maximum offer of short term capacity. It does not seem possible at the moment to calculate capacity a new each day, for instance, so as to offer the calculated maximum daily capacity.

TSOs conclude from this that they should only state as technical capacity, what they can offer long term at least on a yearly basis. Improvements at short notice in the offer of short term capacity are not made. This is unsatisfactory in light of the growing dynamic of the gas markets and fails to reflect the requirement in Article 5(1) of Regulation (EC) 1775/2005.

Use is not made of the possibility of maximising capacity at short notice by assessing the situation in the networks at the given time. This means available capacities are being withheld from the market. TSOs typically have additional capacity available in times of peak utilisation because the predictability of flows increases along with the utilisation of capacity. This is demonstrated in the following consideration:

- Shippers are active in a system with exactly two entry capacities of 50 units each. If shippers want to safeguard the supply with a total offtake of 100 units during the winter, they need to fully exhaust the two capacities of 50 units respectively. Shippers' behaviour is fully determined and is hence predictable for the TSOs.
- If consumption falls to 50 units systemwide in the summer, TSOs have no predictability whatsoever: the gas can only come from the one capacity, only from the other or in any quantities coming from both capacities, e.g. 10 and 40 units.

This results in the surprising fact that more capacities tend to be technically available in the winter than in the summer.

5.3. Options

5.3.1. No ruling on capacity calculation

The responsibility for maximising the capacity on offer lies with the TSOs. TSOs cannot be told how to proceed, as this would entail an assumption of risk for the prescribing authority. The risk of technical problems in the network must be borne by the TSOs, being one of their core tasks under Article 8 of Directive 2003/55/EC.

Doing without a specific ruling on the requirements of Article 5(1) of Regulation (EC) 1775/2005 would mean forgoing the opportunity to improve the methods for determining technical capacity.

5.3.2. Specifying use of state of the art calculation instruments

Dynamic simulation is currently the state of the art with regard to the network calculations, while static simulation is regarded as outdated. Thus it makes sense to specify use of the latest software in each case.

5.3.3. Inclusion of current and historic flow situations

Calculating capacity for a theoretical extreme case will indeed lessen the risk of booked firm capacity being shortened, but will result in considerably less firm capacity being on offer. Thus the current arrangements will be significantly widened if the possibility of taking account of up to date data can be included in the requirements for capacity calculation. Such data could cover the following:

- Market trends: Shippers' behaviour is largely predictable for the TSOs. The TSOs have the best possible insight into shippers' behaviour as a result of their nomination and balancing data. Moreover, in the gas as in every other market there are traditions and typical patterns of behaviour that the TSOs can easily predict. Even if liberalisation generally and capacity management in particular aim to influence and change behaviour in the market it is still possible for the TSOs to say how shippers will behave. The relative importance of temperature may lessen over time and the importance of pricing information may increase. Both are recognisable for the TSOs.
- Historical flow data: Historical flows show just as clearly as simulation based on theoretical assumptions the limits and possibilities of capacity allocation. However they produce different outcomes. As a result of the TSOs explicitly being given the possibility of basing capacity calculation on historical flow data, the volume of firm capacity that they can offer is likely to rise.
- Results of allocation processes: If the results of allocation processes are used as the basis for calculating capacity, the congestion signals given by these processes can be used not just to determine the network expansion requirements but also to calculate capacity. For example if - contrary to expectations - demand at a particular point is seen to be low, the assumptions can be modified accordingly when capacity is calculated again.

If capacity is calculated on the basis of these data, it can have implications for firmness. These procedures can affect the trade-off between the certainty of nomination and the level of capacity that can be allocated. In an extreme case, nominations of firm capacity may then be curtailed. No procedure can ever completely rule this out and the probability rises only marginally if the above data are included. The responsibility for this remains with the TSO and increasing risks should be compensated by incentivising TSOs to take the risk if the cases of curtailment were supervised by the regulatory authorities they would have to remember that the arrangement proposed for direct comitology obliges TSOs to use the above data to calculate their capacity.

5.3.4. Maximisation at short notice

Updated technical information provided to the TSOs is not currently assessed in terms of its effect on capacity. Should capacity have been calculated for a set of scenarios encompassing an extreme winter scenario, then it will not be necessary in the autumn and in the spring to apply the limits resulting from this scenario.

In a similar way, capacity calculation is based on assumptions about the calorific value of the gas. The calculation of long term capacity is based on pessimistic assumptions. If the actual calorific value is 3 % higher, technical capacity will be 3 % more.

Updated information cannot be taken into account in today's technological environment in the form of daily capacity calculations (cf. above B-5.2). However it can be assessed and used by the TSOs as parameters. For instance, a matrix showing the effect of the individual parameters on capacity can be created. The assessment of all parameters produces a net effect on capacity. Depending on the length of time for which the parameters are reliably known, additional capacity can be provided to the market without harming the system's stability.

5.3.5. Transferring capacity calculation related decisions to the regulatory authorities

Assessing the parameters is a considerable job for the TSOs and it is especially useful if the particular cross-border point experiences physical congestion or is likely to do so. However, the point should not be physically congested at any time but liable only to contractual congestion it will not, as a rule, be necessary to put any great effort into maximising capacity.

Yet allocating additional short term technical capacity will have benefits even if the congestion is purely contractual. Any congestion that can be relieved will help to ease a critical situation.

Given the complex effects of determining additional firm short term capacity it would be a sensible move to give the regulatory authorities the option of asking TSOs for applying short term capacity maximisation measures. The involvement of NRAs is sensible particularly against the background of congestion management measures which can also serve to release firm short term capacity. It should be avoided to regularly gain a large oversupply with short term capacity.

Further, the national regulatory authorities should be entitled to analyse the TSOs' capacity calculations in greater detail.

5.3.6. Specifying TSOs' system integrity and network security responsibilities

Application of the proposed capacity calculation arrangements should not lessen the TSOs' system integrity and network security responsibilities. These responsibilities should remain entirely in the hands of the TSOs. The powers of the regulatory authorities to set requirements for the TSOs in respect of their capacity calculations find their natural limits in the matter of competence and liability for the network.

TSOs shall develop and apply action plans for emergency situations. This covers information and technical reactions of TSOs. Both shall be prepared and agreed with network users.

5.4. Public consultation findings

In the consultation some TSOs rejected the possibility of daily capacity calculation, citing disproportionately great effort and relatively small effect. Further, they firmly emphasised their sole responsibility for the systems. They rejected in no uncertain terms a division of responsibilities between regulatory authorities and TSOs.

On the other hand the shippers, made clear that they were very interested in capacity maximisation and also considered short term capacity a plausible result of more efficient capacity calculation methods. In particular cross-border cooperation was seen as valuable instrument of capacity maximisation.

No comments were received on the proposal to provide short term capacity not as the result of new calculations but of parameter assessment.

For further details of consultation cf. ERGEG Evaluation of Comments E09-GNM-07-03.

5.5. Selected options and changes in light of the public consultation

ERGEG has decided to take up all the above options that could actively increase the long term and short term capacity provided by the TSOs, without taking the responsibility for establishing capacity away from them. These measures directly reduce contractual and physical congestions at cross-border points and therefore are proposed for direct comitology:

- Allowing the capacity calculation methods to include TSOs' historic and current knowledge and expectations, even if this entails a slightly lower level of firmness.
- Possibility for the regulatory authorities to check the capacity calculations and to specify details for the calculation.
- Possibility for the regulatory authorities to prescribe the use of short term optimisation methods.

5.6. Impact of the proposed arrangement

The proposed arrangement will increase the long term technical capacity available. Given that capacity has typically been calculated on a very conservative basis in the past and that large safety margins have been built in to deal with technically problematic network conditions, a slight shift in the risks is considered appropriate.

The arrangement has been drafted in such a way that it leaves responsibility for the firmness of the capacity with the TSO. Hence in the seldom event of having to curtail a firm capacity nomination, the TSO will have to prove that he had no way of fulfilling the shipper's needs.

The proposed arrangement may also bring about an increase in firm short term capacity, provided that the regulatory authorities concerned initiate use of short term optimisation. This will not entail a shift in the risks but will fill in the gaps in the procedures currently applied.

In economic terms, offering firm capacity that has been determined at short notice will stimulate the short term gas market. This is likely to be highly significant in terms of market integration.

6. CAPACITY INCREASE BY OVERSUBSCRIPTION AND BUY-BACK ARRANGEMENTS

6.1. Proposed arrangement

C2.4 Oversubscription and capacity buy-back

Transmission system operators shall implement an oversubscription and buy back mechanism in order to offer additional short-term and longer term capacity on a firm basis. Based on statistic scenarios about the probable amount of unused capacity they shall make available an extra amount of capacity exceeding the capacity calculated. When determining the oversubscribed capacity transmission system operators shall also estimate the possibility and the costs of buying back capacity on the market and reflect this in the amount of additional capacity made available. In case of actual or potential physical congestion transmission system operators shall tender for buying back capacity.

The mechanisms and possible transition periods for the implementation of these mechanisms are subject to review by the national regulatory authority. National regulatory authorities may set the proportion of additional capacity to be made available.

6.2. Problem

The proposed measures for allowing to bring unused capacity back to the market and for the implementation of a firm day-ahead UIOLI mechanism will undoubtedly have consequences on the availability of longer term capacity. The underutilisation of booked capacity will result in a withdrawal of that unused part which will be an incentive for capacity holders to release their capacity to other users. Considering the important part of unused capacity during most periods it can be expected that the prospects to pass capacity to other users at an attractive price will decrease during the period running up to real time. Therefore, capacity holders are likely to increasingly release their capacity on a longer term basis. This effect might be accelerated by the expected increase in liquidity on the gas markets throughout Europe which will reduce the role of booked capacity as flexibility instrument since shippers can react on unexpected events on the gas markets.

However, all these effects might not be sufficient to improve availability of long-term firm capacity in the near future. Liquid gas markets are evolving but considering the current state of the European gas markets new entrants need clarity on the long term capacity they can acquire. This is why an oversubscription and buy-back mechanism is proposed.

6.3. Options

6.3.1. Over-subscription and buy-back arrangements

The capacity buy-back option is an instrument to improve the efficient use of existing capacity because of the opportunity for increased utilisation and better access to the market. The TSO can be required to offer more capacity than the technically available capacity at a certain interconnection point would allow. This is based on the fact that the TSO can anticipate that not all of the booked capacity will be used and the regularly used capacity is below the contracted capacity. Based on statistic scenarios the TSO can estimate the use of the booked capacity and the probability and amount of unused capacity and should offer the unused capacity on a long term basis.

However, physical congestion can occur if the actual nominations are significantly higher than the estimations at a given border. In these cases the TSO will have to buy capacity back from the shippers.

The capacity buy-back option therefore consists in two integrated parts:

- an allowance for oversubscription of technical capacity as well as,
- an option to buy back the use of capacity in situations where and when the fulfilment of the nominations made is not possible.

6.3.2. Releasing additional long-term firm capacity through oversubscription

The basic idea of the over-subscription is to maximise access to longer-term capacity by selling more capacity than might be technically available and relying on diversity of flows and the assumption that not all capacity booked by long-term contracts is used by the shippers at all times.

This enables TSOs to offer additional longer-term capacity on a firm basis by oversubscribing the system's capacity. To this end, TSOs shall estimate the possibility of buying back capacity on the market and the economic effects and reflect this in the amount of additional capacity made available.

The more dynamic the markets will be the lower is the risk that shippers who have booked capacity at one point submit full nominations at the same time. This means the mechanism of capacity over-subscription uses capacity that would otherwise remain unused. More firm capacity can be offered at congested interconnection points.

The volume of additional capacity that can be determined using this mechanism depends on the specific circumstances at the particular border. In many cases additional long-term capacities can be released using the capacity buy-back mechanism and the part of capacity that has not been used to larger amount during previous periods shall be made available if there is a low probability that this capacity will be used.

At some interconnection points, all capacity is sold to only one or very few shippers. Therefore, the estimation of the statistically unused capacity might be more complex as it depends on the behaviour of a smaller group of shippers. It must also be taken into account that the simultaneity effects are strong in the gas sector because customers supplied with heat account for the majority of offtakes at least as far as gas supply to final customers is concerned. These customers have a relatively high level of simultaneous usage patterns.

It could be considered to set an amount every interconnection point has to be oversubscribed; for example this part could amount to 5 to 10%. The exact percentage could also be set differently at different points in order to properly reflect capacity demand. Congested points could require a higher amount of additional capacity than non-congested points. On the other hand, the oversubscribed part will be the result of an analysis, where capacity usage estimation, potential additional capacity sales and related income, possible buy-back needs and price signals will play a role. Moreover, the mechanism should be flexible to evolve over time and TSOs should have comfort in how they run their systems.

This is why setting the exact amount in legally binding guidelines does not seem to be appropriate. In principle, the decision on the amount of additional capacity offered through oversubscribing should stay with the TSO. However, there must a possibility for the national regulatory authority to set the amount in cases it finds the TSO does not offer the additional capacity which could be offered.

In order to facilitate the system's oversubscription to the extent possible financial incentives for the TSOs could be created and costs incurred should to be approved. The incentive mechanism will determine outcomes and can be used to "tease out" the availability of capacity. An example could be the target allowance in the UK. Within this mechanism the TSO has a certain target allowance per year to spend on buying back firm capacity. If the TSO spends less than this target allowance it receives 50 % as additional revenue. If it spends more than the target allowance in one year the TSO incurs an additional cost of 50 %.

Compared to the use of system energy, capacity buy-back offers the benefit of costs only being incurred if and when physical congestion occurs. The use of this system also indicates the potential need to invest in network expansion.

6.3.3. Buy-back mechanisms

For the rare event that TSOs are unable to fulfil firm nominations TSOs have to make the organisational arrangements necessary to buy back capacity. The mechanism foresees that they offer to pay shippers if they waive the fulfilment of their nominations. In doing so, it is not only the holders of the additional capacity who will be requested to sell back their capacity utilisation rights, but all shippers who have booked capacity at the point in question.

Buy-back tenders could cover different durations from short term to longer term. This implies that TSOs buy-back capacity as soon as they reasonably expect physical congestion.

In order to work efficiently the mechanisms might require a diverse shipper structure at the cross-border point in question. A diverse shipper structure ensures a capacity buy-back mechanism that is not influenced by dependency of one or few shippers. Otherwise the resulting risks for the TSO could be higher and there might be a danger of misuse by shippers.

At the very latest when the price potentially incurred by the waiver exceeds imbalance charges resulting from the unmet nominations, it does make sense in financial terms for any shipper to accept the offer. Shippers with cost-effective flexibility tools are able to waive fulfilment at a lower price.

It could be considered to propose an arrangement where shippers signal the price for which they would be willing to waive the fulfilment of their nominations when nominating the use of their booked capacity. For the TSO this would simplify the buy back mechanism. However, the proposed buy-back mechanism is based on price signals given by the holding shippers and the price paid will clearly result from the market situation. In many critical situations shippers are most likely not willing to sell their capacity back due to the fact that on such critical days the arbitrage spread could be high and therefore all shippers have the same strategic interest in the capacity. This might lead to higher prices for the capacity compared to the prices asked by the nominating shippers. Moreover, this mechanism is not compatible with the idea of allowing for longer term buy back mechanisms.

6.3.4. Assigning approval competency to the regulatory authorities

The problem associated with the method of maximising longer-term capacity by oversubscription and buy-back mechanisms is that in these methods the shippers receive payments from the TSOs. Therefore, it is essential that the regulatory authorities monitor and approve the development and application of the proposed mechanism. This applies likewise to the costs incurred by application of these methods. Obviously, a large number of additional firm

capacities can be generated at very high costs. Vice versa, TSOs might not implement means although they are economically efficient. Therefore it needs to be examined whether the methods can be developed and applied in a way that places the costs incurred in a meaningful proportion to the capacity effects in macroeconomic terms.

As a criterion for determining the adequacy of any such methods, it can be investigated whether the potential profits generated from the sale of additional capacity correspond to the costs incurred by using any such mechanisms.

6.4. Public consultation results

The respondents of the consultation the majority was clearly in favour of oversubscription and buy back mechanisms, but asked sensible questions about the detailed design of this means. On the one hand this tool is already applied in Europe and shippers made their experiences with it. These aspects caused an extensive and in depth discussion in the answers to the consultation.

For further details of consultation cf. ERGEG Evaluation of Comments E09-GNM-07-03.

6.5. Option chosen and changes made in the light of the public consultation

ERGEG seized the options available and proposes to enable TSOs to use the capacity buy-back mechanism, because the mechanism is likely to be effective in creating additional firm capacity and to be the most compatible with the development of gas competition.

In the light of the broad input from consultation concerning the buy-back mechanism there was a need for further prescriptiveness within the proposed arrangement. This has been done.

Monitoring and supervision by the regulatory authorities is of paramount importance for these methods because there is a significant risk of discrimination if these methods are used.

6.6. Impact of the proposed regulation

Most of the congestion occurring at the border of entry-exit systems are of a contractual nature. The application of the proposed method enhance the capacity that can be offered to the market.

One benefit of using oversubscription and buy back mechanisms is that this would create additional, long-term firm capacity. Another benefit is the fact, that these mechanisms does not touch existing contracts but enables capacity holders to waive the fulfilment of their nominations. Indirectly it is considered delicate that in the mechanism TSOs pay to shippers for waiving their right. However, the payment only occurs in case of physical congestion and is expected to be rather low compared to the benefits it clearly implies.

7. CAPACITY INCREASE BY PROCUREMENT OF SYSTEM ENERGY

7.1. Proposed arrangement

C2.5 Increase of available capacity by Procurement of System Energy

Subject to the national regulatory authorities' approval, transmission system operators shall apply cost-effective measures in order to maximise capacity and to alleviate congestion like procurement of system energy. It shall be ensured that any associated costs do not exceed an economically efficient level.

7.2. Problem

Even if the main using behaviour of shippers is still well predictable (cf. above 5.3.3), the introduction of entry-exit systems reduces the ability to plan shippers' network usage in European networks compared to point-to-point model or integrated use.

- TSOs continue to be able to plan many usages correctly. This applies above all to gas supply to final customers.
- Other usages are harder to predict. This applies above all to the use of large pore storage facilities that continue to be used for compensation of seasonal effects.
- The use of entry and exit points at market borders is above all hard, if not impossible, to predict if the technical capacity of these points greatly exceeds the supply requirements of final customers in the entry-exit system.

Network operators need to take this into account when calculating capacity. This can lead to a reduction in technical capacity at the borders. In order to safeguard the performance of long-term contracts and to be able to offer available capacities, TSOs avail themselves of a number of tools, not all of which are non-discriminatory in the same way, or which are indeed conducive to cross-border competition. This could potentially create new barriers to market entry.

7.3. Options

7.3.1. Securing the allocation of capacity through procurement of system energy

The predictability of the usage of gas networks can be enhanced if TSOs are able to initiate the input of additional gas or to reduce the actual flow. The TSOs ensure that they have the option at all times of influencing actual flows in network sectors they know have experienced problems in a way that prevents or eliminates problems.

This would enable TSOs to actively intervene if the actual flows or pressures reach critical limits. This function of TSOs' influence on gas flows is just the same as what is needed for balancing reasons. Both reasons for TSO action are to be integrated to avoid contradictory effects. In particular TSOs should not inject gas for capacity reasons and withdraw gas for balancing reasons at the same time.

The additional gas volumes they require and the input of which they need to avoid do not constitute regular trade volumes as they apply to local level in nearly all cases and cannot be

withdrawn or transferred at virtual hubs. The markets for this type of energy are particularly small and TSOs are always the only counter part on these markets. As capacity-driven and balancing-driven requirements converge technically and as in any case injections or withdrawals are only triggered by actual or expected pressure problems, the procurement of gas for both reasons shall be integrated. This prevents from splitting up an already small market.

Because these markets are nevertheless small ones, special measures must be taken to avoid discriminatory effects when the procurement of system energy is specified.

When establishing capacities, the TSOs can factor in the possibilities of increasing the predictability of actual flows if they can make use of system energy. This enables them to determine and offer additional firm capacity.

7.3.2. Assigning approval competency to the regulatory authorities

The problem associated with the method of maximising capacity by commercial means is that in these methods the shippers receive payments from the TSOs. Any such methods are always particularly delicate in terms of the risk of abuse and discrimination.

This means, for instance, that shippers who are able to offer local system balancing energy at particularly critical points may be tempted to do the same at particularly high prices.

For the above-mentioned reasons, it is essential that the regulatory authorities monitor and approve the development and application of these mechanisms. This applies likewise to the costs incurred by application of these methods. Obviously, a large number of additional firm capacities can be generated at very high costs. Vice versa, TSOs might not implement means although they are economically efficient. Therefore it needs to be examined whether the methods can be developed and applied in a way that places the costs incurred in a meaningful proportion to the capacity effects in macroeconomic terms. As such, it is important to ensure that possible market-distorting effects of payments shippers receive from TSOs are taken into account. This does not mean to take the responsibility for the application of those means from the TSOs.

As a criterion for determining the adequacy of any such methods, it can be investigated whether the potential profits generated from the sale of additional capacity correspond to the costs incurred by using any such mechanisms.

7.4. **Public consultation results**

The respondents of the consultation clearly saw the reasons for application of commercial means. The purchase of system energy was supported as a simple tool for capacity maximisation.

For further details of consultation cf. EREG Evaluation of Comments E09-GNM-07-03.

7.5. **Option chosen and changes made in the light of the public consultation**

EREG seized the options available and proposes to enable TSOs to use system balancing energy, because this option is likely to be the most compatible with the development of gas competition.

7.6. Impact of the proposed regulation

Most of the congestion occurring at the border of entry-exit systems is of a contractual nature. The application of the proposed methods enhances technical capacity that can be offered to the market. Nevertheless, the application of the proposed regulations would lessen congestion because any increase in supply would lead to an improvement at congestion-ridden points.

One benefit of using commercial means is that the proposed mechanism does not touch the possibility of the respective shippers to sell their gas at the virtual trading point. The mechanism therefore is not directly a problem to the development of competition. Indirectly it is considered delicate that TSOs pay for gas to shippers which tends to occur on a regular basis.

8. CAPACITY CHARGES

8.1. Proposed arrangement

C2.6 Capacity charges

Capacity charges shall be set in a way that do not distort capacity markets and encourage users to book capacity according to their actual need. The charges for firm capacities with contract periods of more than one day shall not be higher than the added daily charges during the contract period.

Interruptible capacity shall be charged sufficiently below charges for corresponding firm products.

8.2. Problem

The current charging system leads to inefficiencies in capacity management. Long term bookings are the norm in several Member States. Short term capacity is priced as an exception to the rule.

In a more dynamic market the daily value of capacity would not be differentiated by the duration of the underlying contract. However this differentiation is a prominent feature of the current charging system. Short durations are normally much more expensive than long durations, which gives holders of long running capacity contracts a clear advantage over other shippers.

Pricing according to duration can also mean that business can be done with capacity solely on this basis: simply reselling long term capacity in the form of short term products can yield revenue if the TSO's published charges are used in all the transactions.

Interruptible contracts have a considerably lower value even when it transpires at the end of the term that there has not been a single interruption. The shipper has always had to expect interruption and factor in this risk into his transactions. Contracts needing absolute fulfilment are not possible with this capacity. The lower value of interruptible capacity is not sufficiently reflected in the price at present in many Member States.

8.3. Options

8.3.1. Setting of capacity charges aiming at needs-related bookings

As described above the main problem resulting from actual charge-setting is the inadequate rebate for long-term capacity products. Because this charging model incentivises excessive bookings it causes contractual congestion. The basic change can be reached by linking the charging model directly to the aim of needs-related bookings. But this might not ensure a correct understanding of the given possibilities and it does not specify the rule of Article 4 (2) of regulation (EC) 1775/2005.

8.3.2. Charges proportionate to duration

It could be prescribed that capacities of different durations should always be proportionately equally expensive. This could be achieved by every capacity being as expensive as the sum of the daily charges for the duration of the contract. This would negate the economic preference that long running contracts enjoy and suitably reflect the growing dynamic of the markets.

It would also put an effective stop to the option of business being done with capacities.

8.3.3. Seasonally staggered daily prices

Gas consumption shows typical fluctuations over the twelve months of a year: the consumption is much higher in winter than in summer. Admittedly, this is evened out by the use of large storage facilities, but as far as the supply function is concerned, all the consumption-related fluctuations must be handled by technical means.

The result is that capacities in winter are often used to a much greater extent and have a higher value than in summer. It is therefore appropriate for the daily charges to differ seasonally. If the duration covers more winter days the charge would be higher than if there are more summer days in the duration.

Daily charges could be staggered on an ex ante basis. Therefore the course of the charges cannot be based on actual weather or climate data. Instead, they are to be estimated and planned in advance on the basis of typical parameters. That is why only the average expectations of the course of the flows in the network and of the capacity value can be used as a basis.

8.4. **Public consultation findings**

The proposals presented in January 2009 for consultation did not include a proposal on charges. However this did not stop the respondents from urgently requesting their inclusion in the guidelines. Both the charging system for firm capacity and the relative level of the prices for interruptible capacities were discussed at length: The respondents asked for sharply reduced charges for short-term and interruptible capacities.

For further details of consultation cf. ERGEG Evaluation of Comments E09-GNM-07-03.

8.5. **Selected option and changes in light of the public consultation**

Under the proposed arrangement, the charges for access to the networks would orient directly at the value of capacities. It is necessary to underline the role of capacity charges in the endeavour of reducing congestion. The charges should not incite shippers to book more than they really need.

It seems sensible to put this in more concrete terms. So the arrangement states that this may require to no longer determine charges according to duration but according to the sum of the daily charges during the booking period.

The charges of interruptible capacity will be considerably more favourable than under current practice, facilitating this form of capacity use.

In 2008, ERGEG decided after lengthy consideration against including charging proposals. However in light of the consultation, ERGEG revised its opinion, considering it essential to put forward at least rough arrangements.

This should neither pre-empt nor interfere with the substantially more detailed work of the ERGEG Working Group Tariffs. Rather the rough arrangements for inclusion in these proposals should form one basic elements of a viable tariff system as this - in the view of most of the respondents - is an integral part of capacity management.

8.6. Impact of the proposed arrangement

The proposed arrangement will mean that it is no longer cheaper to book long term than short-term capacity. The dynamic development of the gas market will thus be properly reflected.

The incentives to buy capacity with a relatively long duration produced solely by the price signals can lead to capacity being booked without a clear intention to use it. This practice can be eliminated by a more suitable charging system.

The charges set on the proposed basis will thus contribute to easing congestion on the capacity markets.

One of the results of the proposed significant reduction in the price of interruptible capacity will be better last-minute use of unused capacity – again a strong means of reducing congestion.

9. RE-MARKETING BOOKED CAPACITY

9.1. Proposed arrangement

C2.7 Surrender of capacity

Transmission system operators shall define terms and conditions for network users to surrender booked capacity to them. Surrendered capacity products are offered and allocated anonymously by transmission system operators together with primary capacity products. Transmission system operators are entitled to split and combine surrendered capacity products. The terms and conditions for surrendering capacity and the methods of rewarding initial capacity holders for the capacity sold are subject to the national regulatory authorities' decision.

9.2. Problem

Secondary markets are supposed to be a highly effective instrument for opening the market because they provide the opportunity to pass capacity on to shippers that need it. Generally speaking secondary capacity is regarded as inferior to primary capacity for several reasons most of which depend on the specific design of this market:

- Logically, the duration of the secondary capacity products is always shorter than the duration of the primary capacity product on which it is based. Thus at congested points competitors can be given short durations, without any great economic risk.
- Secondary markets are likely to be illiquid when the economic interest in using capacity is high, e.g. on peak days or when price spreads between markets are high. Buyers on the secondary markets therefore only get capacity when market conditions are less attractive.
- The price of a secondary capacity product can be higher than the price of the original primary capacity product, allowing business to be done with the capacities themselves.
- The providing shipper can have a say in which shippers will receive capacity from him and which will not. This can be discriminatory.
- The seller of secondary capacity will be given an insight into the behaviour of the buyer; with sub-letting without nomination rights, the original capacity holder will even be given an insight into how the buyer uses the capacity.
- The offer of secondary capacity shows that the shipper currently has no use for the capacity. Not every capacity holder likes his business to be disclosed in this way.
- Booked capacity that is offered and sold on the secondary market is not available for any new or improved capacity determination by the TSO.
- Secondary markets run the risk of being subject to less oversight by the regulatory authorities and of the rules possibly being less rigorous. This can lead to discrimination.
- Shippers might be able to get round the abolition of the continuous allocation of capacity by sticking to unchanged continuous allocation on the secondary market.

9.3. Options

9.3.1. Enable shippers to surrender unused capacity to the TSO

Many of the drawbacks of secondary markets result from the fact that it is not the TSO who acts as counter part of the shippers. Neither offering shippers nor buying shippers like to give insight into their specific activities. Therefore, there is a need for an intermediate body operating the transfer. This body can be the TSO, being involved in capacity allocation anyway.

Shippers can decide to surrender booked capacity to the TSO who integrates this capacity into the process of primary offer and allocation.

9.3.2. Slice and dice surrendered capacities

TSOs shall be allowed to freely treat surrendered capacity like primary capacity. They can split the surrendered capacities or integrate them with other surrendered capacities or with primary capacity. Unsold long durations can be split into shorter durations and offered accordingly.

9.3.3. Assigning competency for capacity surrender to the national regulatory authorities

The terms and conditions of capacity surrender have to be revised by the NRAs. In particular the way of paying for sold surrendered capacity to its initial holder needs close approval by NRAs.

9.4. Public consultation findings

Some of the respondents asked whether further measures were necessary besides favourably priced interruptible capacity and well-functioning secondary markets. They indicated that offering capacity on secondary markets alone could solve the capacity problem. These respondents assume that in practical terms there are always enough unused capacities available which are simply not being identified in the current capacity offer mechanism. Others disagreed and pointed out that capacity should not be sold as secondary but that there should be an option to release capacity directly back to the TSOs.

For further details of consultation cf. ERGEG Evaluation of Comments E09-GNM-07-03

9.5. Selected options and changes in light of the public consultation

Against the background of the general drawbacks of secondary markets (cf. above B-9.2) ERGEG decided to propose some design elements safeguarding that re-marketing of booked capacity could evolve in an appropriate manner for direct comitology.

TSOs shall allow for capacity surrender. ERGEG expects that capacity surrender could play an important role due to the fact that the incentives for shipper not to sell their unused capacity could be reduced via the UIOLI-processes as proposed in B-10 and B-10.2. Therefore it is of great importance to have a suitable option for doing so in place.

9.6. Impact of the proposed arrangement

The proposed arrangement will increase usability and the liquidity of the market for unused capacity. It will also make it possible for the inherent disadvantages of the secondary market to be reduced.

The proposed integration of markets for primary and surrendered capacity is of great importance for congestion management since it represents a step towards ending the fragmentation of the capacity markets.

10. FIRM DAY-AHEAD UIOLI (USE IT OR LOSE IT)

10.1. Proposed arrangement

C3 Congestion Management

C3.1 Firm day-ahead UIOLI procedure

In case the demand for firm day-ahead capacity regularly exceeds the offer, national regulatory authorities may ensure that a transparent and non-discriminatory firm day-ahead UIOLI procedure is established, which brings unused firm capacity back to the market on a day-ahead basis.

C3.1.1 Nomination schedule

National regulatory authorities shall set the time of nomination so that any resulting day-ahead capacity can be allocated in due time prior to the start of the main trading activities on the last trading day preceding the day of delivery.

Day-ahead-firm capacity is nominated separately after the close of the main trading activities.

C3.1.2 Limitation of existing re-nomination rights

National regulatory authorities may reduce or remove rights for re-nomination of firm capacity where the right exists and is applied. If a reduction of existing re-nomination rights is applied, the amount of firm re-nomination rights granted shall reflect, in particular, the requirements at specific points, the share of the booking of particular network users and their objectively justified needs.

C3.1.3 Offer and allocation of firm day-ahead capacity

The aggregated non-nominated capacity shall be offered as combined firm day-ahead capacity. Possibilities for firm re-nomination shall be taken in to account. Both offers shall be integrated with other offers of available firm day-ahead capacity.

Firm day-ahead entry-capacity is allocated by implicit or explicit auction only. Establishing reserve prices in these auctions may be disallowed by the national regulatory authorities. The offer and allocation of firm day-ahead entry-capacity shall be performed in such a way that buyers can take part in daily gas trading. The detailed auction design applied shall be subject to approval by the national regulatory authorities.

10.2. Problem

Under the present arrangements in most of the Member States, firm capacity covers both the right to use the capacity and the right not to do so. Any unused parts of firm capacity booked can be used by other shippers at best on an interruptible basis.

This two-fold right of the capacity holder results from his entitlement to change his nominations at any time. A shipper that has initially nominated e.g. only 10% of his booked capacity can change the nomination at any time to 100%. This change is designated a renomination. It applies at least in two different manners:

- either with a two-hour lead time for the rest of the gas day, or

- retroactively for the whole of the gas day.

Renomination rights give preference to the holders of firm capacity over all other shippers. And if a business needs to be done on a firm basis, only the holders of firm capacity have the opportunity to do so.

In the short term area, trading at the virtual trading points needs a firm planning basis. The more strongly competition develops, the smaller the margins will be. Risk premiums to price in the risk of interruption will not then be enforceable – above all because in most situations there are some market players that do not need this risk premium, having booked capacity on a firm basis.

In the current situation in which most capacity is booked on a long term, firm basis the number of shippers able to take part in burgeoning short term competition is largely fixed and will change only slowly, if at all.

Interruptible capacity holders are directly affected by renomination rights. Firm capacity holders, particularly if they have booked most of the technical capacity of the point in question, can specifically influence how their competitors' interruptible nominations are fulfilled.

Renomination rights are a strong contributory factor in keeping the number of players capable of engaging in a cross-border market low. For the shippers operating in this market this means that the current access system is securing the market for them and protecting them from competition. It also explains why secondary markets currently have such low levels of liquidity. By selling their capacity on the secondary market, shippers would give their potential competitors the capacity they need.

Nomination procedures are currently oriented towards the needs of the holders of firm long term capacity. Besides renomination rights, these also include the time of nomination. In many Member States and according to the EASEE-Gas recommendations initial nomination takes place in the middle of the gas day that is between the beginning and the end of trading. Initial nomination is therefore neither a precondition for trading, nor its outcome. It simply reflects a random intermediate position that can change further as a result of further trading activities.

An additional difficulty for new players seeking to enter the market is that the procedures are not the same at every point.

As long as firm capacity holders have unlimited rights to renominate their flows – to any extent, up or down – competition will not become established on the short term market. The dynamic of this competition is especially high because the market responds to the daily changing price signals. Accordingly, it is particularly prone to disruption. However given liquidity, the day-ahead market is expected to provide the strongest price signal. Its disruption through foreclosure mechanisms such as unlimited renomination rights is particularly harmful to the emergence of competition.

10.3. Options

10.3.1. Blanket arrangement for short term capacity release

It would be conceivable to provide only a blanket arrangement for short term capacity release in the guidelines and just to state the aim that shippers should lose unused capacity to competitors. Generally, such a restriction to the essentials is preferable against the background of European procedures for setting rules that can be changed only seldom and with difficulty.

However, this is not applicable in the specific context of short term capacity release. The blanket aim of such release has been directly applicable Community law since Regulation (EC) 1775/2005 took effect. Thus a blanket ruling would not be able to bring about any change in the present situation.

Blanket arrangements are not enough for unified cross-border short term capacity release.

10.3.2. Use it or sell it (UIOSI)

Shippers could be given the opportunity to offer their unused capacity back to the market. To achieve this, shippers could be required to give their unused capacity back to the TSO for the TSO to offer it to the market. TSOs should offer this unused capacity via market-based mechanisms, which allows new entrants fair and non-discriminatory access. Shippers will then receive a payment for the capacity that is sold. This payment could be below the price at which this capacity is sold. The price at which this capacity is sold should reflect the value of the unused capacity to the market. The value of the capacity may differ depending on whether capacity is scarce (in which case the price may be high) or plentiful (in which case the price may be low). By allowing shippers to sell on the capacity it provides them an incentive to offer the capacity back for sale to the market.

However, UIOSI will be more effective if any used capacity is ultimately withdrawn. Shippers not giving their capacity back to TSOs to be sold or selling their capacity to other shippers (via secondary markets) or using it themselves will lose the right to it. In this case there will be an incentive to offer the capacity back to the TSO for sale to others before it is withdrawn, so as to recoup at least some of the use of system charges.

10.3.3. Use it or get paid for it

In the electricity market there is a mechanism whereby shippers that have booked capacity at places of physical congestion receive compensation in the case of non-use if the capacity is bought by another shipper. This model could be adopted in the gas market, too. Loss of the right to booked capacity would thus be compensated for,.

This model presupposes that the interests of the shipper holding the capacity and those of the substitute user are the same. However this would mean that the economic value of long term capacity booking was equated with that of day-ahead booking, which does not reflect economic reality,.

Further, this model would remove an incentive that arises from UIOLI without compensation. If shippers receive compensation for not using capacity, they will have correspondingly less interest in making capacity they do not foresee using available to other shippers.

The situation is different in the electricity market because the aim of the procedure is not management of contractual congestion. Moreover, in the electricity market flows beyond the market boundaries are not base load flows, but primarily give shippers the opportunity for arbitrage between the markets. For this reason, long term and short term capacity contracts can be more easily compared in the electricity than in the gas market.

10.3.4. Specification of basic elements of short term UIOLI

Given the great importance of short term capacity release, it is appropriate to propose a solution containing the basic elements of short term UIOLI. These basic elements are described in the following.

10.3.4.1. Restricting renomination

The central element of short term congestion management is the restriction of firm renomination rights. This is the only way non-nominated capacity can be allocated to other shippers on a firm basis.

However not every Member State has such firm renomination rights.

Besides doing away with firm renomination altogether, which is possible in principle, renomination rights could be suitably restricted. The restrictions could relate to an individual shipper's booking or to his nomination. The aim is to find an arrangement that properly reflects the more difficult situation of smaller shippers. Large portfolios have considerably greater portfolio effects and can thus be forecast much better. The intraday corrections to flows needed in large portfolios are smaller in relation to the size of the portfolio than in small portfolios. Moreover, small shippers have had to use interruptible capacity more often, as firm capacity was fully booked. As an indication of the relevant size of the portfolio might serve the share of the individual booking in the technical capacity of the point in question

The size related effect described applies particularly to portfolios supplying end consumers and to those using interruptible capacity. Shippers not supplying end consumers or using interruptible capacity have practically no forecasting risks because the planning for the delivery day can be effected without changes in these portfolios.

For these reasons it makes sense to restrict firm renomination rights in such a way that, as booking size decreases, relative renomination rights increase. Bookings that are small in relation to the technical capacity should be entitled to subsequently lower the nomination to zero or to increase nomination to 100% of their individual booking, whereas bookings with a large booking share should be accompanied by a considerably tighter renomination limit.

Differentiating renomination rights according to the size of the booking share can be done by every shipper being granted firm renomination rights that make up, e.g. the sum of 2% of booked capacity and 2% of the technical capacity of the point. With small booking shares it is the second sum and that is dominant, and often larger than the own booking. When the booking shares are large the renomination rights are correspondingly smaller. This formula is not the only way to define the renomination window. More complex formula might factor in the initial nomination.

For two reasons, restrictions must apply not only in upward direction but also in downward direction:

- Restriction downwards makes it possible for firm capacity to be allocated in the backhaul direction.
- Without any downward restrictions, there would be an incentive to submit a very high nomination first of all and to correct this downwards in the course of the day. This would be detrimental to the aim of obtaining firm capacity for allocation to other shippers.

However, there are specific situations in which restricting renomination rights in this way would not be appropriate:

- With particularly small entry-exit systems it can happen that the intraday flexibility requirements of the system are large and cannot be met by internal flexibility sources. In this respect a thought can be given to widening the renomination area. However, such entry-exit systems are used primarily to serve final consumers. As a result, physical congestion cannot theoretically occur here either, in line with the considerations in A-3.8.

- Some borders coincide with national borders, but are more arbitrary in gas industry terms. For instance, a single storage facility or power plant can be situated behind a border. In these cases too, application of the strict rules of congestion management might not be appropriate.

For this reason it is necessary to analyse the specific situation at the border in each case and to frame the restriction accordingly.

10.3.4.2. Specifying a nomination schedule

The timing of the day-ahead gas market and initial nomination must be such that the UIOLI principle still makes sense. Taking capacity away from a shipper will only be useful if the lost capacity can be offered, acquired and used by another shipper. As all these processes have to be scheduled, initial nomination should take place so that shippers are able to participate on the day-ahead gas-market.

Resulting from this initial nomination is made to some extent without consideration of the market conditions on D-1 and reflects the forecasts, expectations and decisions made by the shipper on day D-2. At the same time the shipper's forecasts will require greater accuracy in light of the proposed restrictions on renomination rights, for the initial nomination will be more binding as subsequent cross border changes will be possible only to a limited extent.

To cap the risk of imbalance shippers will have in increased demand for flexibility tools at the virtual hubs as these flexibilities are not subject to the restrictions proposed. This additional demand will stimulate respective offers and thereby increase short-term liquidity of virtual hubs.

10.3.4.3. Allocation procedure for day-ahead capacity

Capacity that has not been initially nominated and not reserved for permissible firm renomination can be allocated on the basis of firm day-ahead capacity.

The real firm day-ahead capacity must be allocated in quick and efficient procedures:

The first step is to allocate the capacity as combined product. This means that only the entry-side of the borders' two sides is allocated directly to shippers as a combined product. The exit side of the border will be booked by the entry-side's TSO. This implies a slightly enhanced function of the TSO: It will do daily bookings with adjacent TSOs. The price paid for this needs to be integrated into the entry-charges.

The offer and allocation of day-ahead capacities as combined products reduces the transaction effort for shippers and allows for application of the firm short-term UIOLI at borders with different regimes on the two sides of the border.

A straightforward auction would appear appropriate. Allocation should also be completed in a way so that the shippers can do the business for which they need this capacity afterwards.

A minimum bid should not be stipulated in an explicit auction of day-ahead capacity, otherwise it could not be used on many days in the year. This capacity is used to exploit the price differences in adjacent markets. If a minimum price is given, this price will define the minimum price differential enabling use of the day-ahead capacity. However, the aim is for the markets to converge and the price differences to be reduced to zero, there must not be a minimum price for this capacity. When the price differences are tiny it can happen that firm

day-ahead capacity can be used without use of system charges. As this capacity has already been paid for once, this is not a problem on the TSOs' earnings side.

10.3.5. Restricting the application to congested points

Day-ahead firm UIOLI is not required where shippers can easily book day-ahead capacities. Because at many cross-border points the capacity offer differs on the two sides of the border the longer side regularly does not experience contractual congestion.

It is therefore an integrated part of the proposed arrangement that there is no need for application in cases without contractual congestion.

10.3.6. Assigning responsibilities to the national regulatory authorities

Several detailed arrangements (e.g. auction design, size of renomination window) are required before the procedures for short term UIOLI can be applied. It is better not to settle the details in the Guidelines but to leave this to the national regulatory authorities. As restricting the renomination rights has implications for the existing contracts such rules cannot be drawn up and enforced by the TSOs.

The fundamental question of whether the procedure is to be applied at a particular border must be answered in the first instance by the national regulatory authorities.

As short-term UIOLI will normally not serve as a basis for transports from market "A" throughout market "B" to market "C" these procedures do not need to be harmonised Europe-wide. Harmonisation can in this case directly result from the options given in proposed arrangement C1.2 border specific adjustments (cf. B-2).

10.4. Public consultation findings

Hardly any of ERGEG's proposals prompted so many responses as its proposal to restrict renomination rights. An appreciable number of the responses, including those from several shippers, supported ERGEG's proposal, emphasising that this would help open the markets to competition.

Some of the capacity holders, in particular, protested strongly against the change. Yet hardly one comment picked up the differentiated proposals on appropriate restrictions; most protested outright against a removal of the renomination rights, which ERGEG had not actually proposed.

For further details of consultation cf. ERGEG Evaluation of Comments E09-GNM-07-03.

10.5. Selected options and changes in light of the public consultation

ERGEG is keeping to its proposals to find a suitable balance between the short term requirements of capacity holders on the one hand and of those interested in capacity on the other. As result from the consultation input, the proposals have been simplified in comparison to the proposals included in ERGEG's Public consultation document E08-GFG-41-09.

But, the proposed arrangements still contain several options for a focused response to particular circumstances and do not remove renomination rights, contrary to what was expressed by some shippers in their criticism.

The decisions on applying the arrangement and the details of the arrangement should be made by the regulatory authorities in line with the step-by-step approach.

10.6. Impact of the proposed arrangement

The proposed arrangements are likely to have a positive effect on both shippers' behaviour and the liquidity of the trading markets. The consultation showed that the shippers feared the proposals on restricting renomination would have a negative effect on access to the networks; these fears could be shown to be unfounded, however.

10.6.1. Impact on shippers' booking patterns

Without the application of procedures for short term UIOLI many shippers, whose unused capacity are reserved until the end of the gas day, could thus refer their competitors to the use of interruptible capacity. This will no longer be possible for short term products with the proposed arrangement. Booking capacity will no longer give shippers the possibility of keeping the arbitrage option open only for themselves.

As a result, the shippers' strategy of not offering capacity on the secondary market because this is likely to weaken the competitors' position, will lose some of its attraction. Conversely, it could become more important that unused capacity causes costs that are not offset by matching benefits for the shipper. This could make the shippers decide to offer a large part of their anticipated unused capacity on the secondary market or to surrender it to the TSO. This offer of anticipated unused capacity would also concern durations of clearly more than one day, as only these make marketing sense.

The proposed arrangement can be expected to boost sales on the secondary markets and availability of longer term capacity products, may grow as a result, too. Withdrawing short term capacity would thus act as a catalyst of better capacity allocation altogether. The possible problem of hoarding (cf. B-10.2 below) is reduced in this way.

10.6.2. Impact on the liquidity of the traded markets

Making use of day-ahead capacity provides arbitrage opportunities. Different prices in adjacent markets can be exploited by holders of day-ahead capacity, making it possible to narrow the gap in prices on the two markets. As long as there is neither physical nor contractual congestion in the day-ahead capacities the price differences can even be reduced to zero. In this case the day-ahead capacity would be allocated without use of system charges, as a result of which very small price differences can also be used for arbitrage.

The arbitrageur's demand for gas on the cheaper of the two markets and the supply of gas on the more expensive market have the direct effect of increasing liquidity on both markets. This increase is not the only effect emanating from the proposed arrangements in their entirety.

The availability of day-ahead capacity has also another central effect. If the price differences between two markets are at zero levels, the liquidity of the two markets will de facto coincide. Supply and demand on both act jointly to stabilise the price because every difference between the two markets will make a transport possible that offsets the difference. Strong demand on one of the two markets will therefore affect the prices on both.

Fundamental to the proposed procedure is that it makes transport such as this on the basis of price differences available to practically every shipper, whereas so far this has been possible for capacity holders only. As these shippers typically carry on at least a part of their business in the form of supply chains and thus have little interest in minimising short term price differences in the markets, arbitrage opportunities are often neglected at present.

The greater liquidity of the trading markets means that more shippers will be able to buy and sell gas directly at the virtual trading point for "their" entry-exit system. They do not need capacity for their business. Ultimately, in this way congestion management will lower contractual congestion as a result of the liquidity factor.

10.6.3. Impact on the technical operation of the networks

In the discussion of the proposed arrangements in the consultation the holders of firm capacity rights, declared that restricting renomination rights could lead to technical problems.

To this it should be said, ERGEG believed, that there was no proposal to abolish shippers' flexibility rights, but only to restrict renomination rights and to improve the flexibility instruments generally at the same time.

The arrangements on restricting renomination will lessen the individual response options of shippers that have been able to book capacity. However they will improve the collective response options of the shippers as a whole. This will make it possible to neutralise any problems arising from fluctuating gas flows or other events by the shippers joining together to respond to the price signals generated.

In this way, competition for gas will become a front-line instrument for the resolution of gas-related problems.

The limitation of renomination rights concerns the question of system stability and the provision of system balancing energy. The question is whether a situation can arise in which a shipper wishes to supply system balancing energy but is prevented from doing so by restricted renomination rights. Ultimately, the technical safety of the system could be threatened. This question was also posed in the consultation.

A closer look shows that this problem does not exist for several reasons.

- The capacity that a shipper can no longer renominate is bought by another shipper who is now able to supply the system balancing energy needed.
- System balancing energy can always be supplied on the basis of interruptible capacity because the TSO will never interrupt a gas flow he needs for the safety of his network.
- Much of system balancing energy can and should be bought at the virtual trading points. These markets are still very illiquid in many Member States, so that TSOs cannot buy any system balancing energy there. This should change in the near future i.a. as a result of the proposed congestion management measures. As renomination restrictions are not intended for nominations at the virtual trading points TSOs will be able to buy system balancing energy there at any time, without any restrictions.

ERGEG's proposals will bring about a great improvement in the availability of system balancing energy as a result of greater liquidity and the increase in the number of market players.

11. LONG-TERM UIOLI (USE IT OR LOSE IT)

11.1. Proposed arrangement

C3.2 Withdrawal of underutilised capacity

Relevant national regulatory authorities may establish procedures for applications for withdrawal of systematically underutilised capacity. An application for withdrawal of systematically underutilised capacity procedure requires:

- shippers request capacity bookings at the particular interconnection point and are unable to obtain this capacity on the primary or secondary market;
- the capacity holder systematically underutilizes at least part of his allocated capacity with a contract duration of more than one year during a specific period covering at least one winter month;
- the capacity owner has not sold or offered in due time and at a reasonable price its unused capacity and
- the capacity owner is unable to satisfactorily justify his behaviour. The application of a short-term UIOLI mechanism shall not be regarded as justification for the purpose of long-term UIOLI.

The procedure shall describe the roles of the network users, the transmission system operators and the national regulatory authority and must be published. If two Member States are involved, coherent procedures shall be applied.

C3.2.1 Definitions

Systematic underutilisation and capacity hoarding will be defined by the national regulatory authority; technical features of the interconnection point and market environment will be taken into consideration.

C3.2.2 Specific procedures

In order to withdraw capacity determined to be systematically underutilised or hoarded, transparent, non-discriminatory procedures shall be established by the relevant national regulatory authority defining

- the responsible body for deciding if systematic underutilisation of capacity occurs;
- the way in which the capacity holder is consulted, if appropriate;
- underutilised capacity to be withdrawn;
- the duration of the withdrawal of the capacity;
- the responsible body for withdrawing the underutilised capacity;
- the appeals procedure.

C3.2.3 Withdrawal

The capacity holder can lose his capacity rights, partially or completely, without prejudice to other prerequisites established by the national regulatory authority, for a given period or for the remaining term. Furthermore, the capacity holder can be limited in his nomination

rights for a given period to the maximum flows of the previous year. The capacity withdrawn or subject to limits to the nomination rights shall be offered on the primary market by the respective transmission system operator.

11.2. Problem

Capacity can be booked without a real intention to use the amount that has been booked. The purpose of booking can be to secure future business or to preempt other competitors. In both cases, booking constitutes an obstacle to competition that would justify accordingly harsh measures.

ERGEG supports efforts to re-negotiate the legacy contracts. As an over-arching longer term goal European energy regulators call for the break-up of the legacy contracts in order to try and bring more long-term capacity into the market which remains particularly difficult in the presence of such contracts. Breaking up the legacy contracts may require policy intervention by other stakeholders such as governments or the European Commission, for example including anti-trust investigations and may not be something that NRAs can resolve fully of their own accord. So far, the European Commission has not taken a clear policy stance on the legacy contracts in gas.

In the meantime, ways need to be found of making some progress in the continued presence of the legacy contracts. Some Member States have arrangements in place for withdrawing idle capacity. However, these are often not applied.

Long-term UIOLI provisions are one potential solution but may in some cases be difficult to enforce as it could be complex to design workable rules for determining when capacity is being systematically under-utilised. It may also be easy for network users to 'game' around such rules protracted legal proceedings may result in case of disputes, and prevent concrete improvements being achieved.

11.3. Options

11.3.1. No ruling on long-term UIOLI

Withdrawing idle capacity on more than a temporary basis impinges seriously on contractual freedom. Unambiguous reasons would therefore need to be given for any such step. As the criteria that determine the existence of hoarding must be known beforehand, capacity holders could usually make sure that the criteria are not met and that capacity is not therefore taken away from them.

If a shipper does not try to avoid having capacity withdrawn, he could be doing so deliberately to terminate a capacity booking before the duration expires.

For these two reasons together it would be conceivable to do without a ruling. However this would mean that there was no direct legal basis in any unambiguous case.

11.3.2. Details of the requirements for withdrawing capacity

If capacity is to be withdrawn on the grounds that it is idle, the criteria needed to determine whether proceedings should be opened to withdraw the capacity in question must be formulated clearly and unambiguously: the capacity has not been used for a relatively long period of time, there is contractual congestion and the holder of the unused capacity has not offered the capacity back to the market.

Exact procedures for examining these requirements must be defined and followed.

11.3.3. Definition of hoarding

So that shippers can assess as accurately as possible whether they are likely to lose their capacity an exact definition of all the applicable criteria and procedures is required. This covers in particular the possibility for the capacity holder to justify the underutilisation by e.g. showing that the capacity is needed for the fulfilment of supply contracts or that a mild winter resulted in underutilisation of capacity which would otherwise have been used. The application of a short-term UIOLI mechanism however shall not be regarded as justification for the purpose of long-term UIOLI

11.3.4. Drawing up the withdrawal process

Legal certainty can only be guaranteed if the procedures for withdrawing capacity have been clearly drawn up. This means determining who is to withdraw the capacity, on what grounds, and what legal remedies the capacity holder has.

11.3.5. Determining the capacity to be withdrawn

Clarity is also required as to what exactly constitutes capacity to be withdrawn. Decisions will be needed on procedures for measuring the capacity that the holder is to lose. For instance it would be possible to withdraw capacity at the level at which hoarding was established, or to allow use of the booked capacity only at the levels of the previous year.

11.3.6. Transfer of the responsibility for the details to the national regulatory authorities

Application of the procedures for long term UIOLI will need to be carefully detailed if this kind of UIOLI really is to happen. If it is to be an effective instrument for reducing contractual congestion, it will need to be drawn up in such a way that allows regular application.

Only then will it be an effective deterrent for capacity holders, motivating them to offer unused capacity back to the market.

The national regulatory authorities will have a major role to play in detailing the procedures and processes, as compliance with the legal situation in the particular country will be essential.

11.4. **Public consultation findings**

The withdrawal of capacity was not opposed to by all respondents. On the contrary even capacity holders were inclined to propose this as a valuable means of freeing up capacity. On the other hand, the respondents spent some effort on gathering reasons which allows shippers to prevent a concrete withdrawal. All in all the statements recommended applying this arrangement with an appropriate cautioness.

For further details of consultation cf. ERGG Evaluation of Comments E09-GNM-07-03.

11.5. **Selected options and changes in light of the public consultation**

ERGG has incorporated the given options to produce a comprehensive arrangement on national level. It provides a clear framework for the national regulatory authorities to fill in the

details on the one hand, and gives the shippers maximum legal certainty as regards possibly losing booked capacity on the other.

11.6. Impact of the proposed arrangement

The aim of long term UIOLI is to make idle capacity directly available to the market. However, the indirect effect of this is likely to be greater than the direct effect: simply the threat of losing capacity will encourage shippers to offer their unused capacity back to the market.

Nevertheless, the direct effect will also be important in a given instance: capacity that had been booked but not used will become available at a border. This will bring about an increase in the liquidity of the capacity market and the number of shippers may rise.

ANNEX

The European Commission's letter to ERGEG, 22. September 2009:

“Subject: Invitation to draft a pilot framework guideline on capacity allocation in gas transmission networks

Dear Lord Mogg,

ERGEG, GTE+, the stakeholders involved with the European energy market, including those active in the Florence process, and the European Commission all underline the importance of the Framework Guidelines and the Network Codes for the establishment of a European integrated energy market. At the 16th Madrid Forum, we reached agreement to work on a pilot code on gas capacity allocation. This pilot follows a dual goal: It should prepare the implementation of the third package by applying the package's provisions during the interim period before their actual applicability on the one hand, and make substantial progress in the area of gas capacity management on the other.

Therefore, the Commission, ERGEG, and GTE+ agreed to draft a Framework Guideline and subsequent codes on capacity allocation. Based on this agreement, the Commission, ERGEG, and GTE+ decided that the issues to be worked out in a pilot Framework Guideline and Network Code process will be those that require TSO cooperation or joint TSO action, and they primarily address capacity allocation procedures. The document by ERGEG of 15 January 2009 shall therefore serve as the basis for this work.⁵

ERGEG has declared its readiness to anticipate the application of the Third Package rules and to use the transitional period of 18 months for working on Framework Guidelines.

In the context of the intended pilot project, I therefore invite ERGEG to assume the role assigned to the Agency under Article 6 (2) of Regulation (EC) 715/2009 ("Gas Regulation") and to submit a non-binding Framework Guideline within 6 months of receipt of this notification. In order to best facilitate the further trial process and to ensure optimal stakeholder participation, ERGEG is kindly requested to submit a first draft to the Commission at least two weeks ahead of the 17th Madrid Forum.

In developing the Framework Guideline, I would ask you to apply the procedures and obligations as defined in the Gas Regulation as if they were already binding and as if you were the Agency, in particular with regard to transparency and consultation obligations.

The goal of the Framework Guideline and Network Code on Capacity is to optimise the use of network capacity across borders, the integration of markets, and enhancement of hub to hub trading through harmonisation of the way capacity is offered and marketed at interconnection points.

On 06 July 2009, my staff met with representatives from GTE+ and ERGEG in order to define more clearly the scope of the Framework Guideline. It was discussed that the scope of the trial Framework Guideline and Network Code process could be as follows:

⁵ *ERGEG principles: Capacity allocation and congestion management in natural gas transmission networks.* ERGEG has proposed at the 16th Madrid Forum that those remaining issues concerning new measures on congestion management be adopted through comitology directly. It is planning to present a way forward at the next Madrid Forum.

The Framework Guideline should describe general principles and the scope and level of TSO cooperation in capacity allocation. It should indicate more specific fields of TSO cooperation, including in particular the joint/coordinated offering of capacity on interconnection points of borders and/or systems (e.g. nature, and level of bundling of products), the optimisation of available capacity by enhanced operational coordination, the harmonisation of transportation contracts and codes, and relevant communication procedures.

For a reasonably small set of capacity products to be offered to network users, the Framework Guideline should set the framework for harmonisation of the range of capacity products to be developed and applied by all European TSOs, the nature and level of bundling of such products, and the contents, structure, and duration of harmonised capacity contracts, including possible quotas (withhold an amount for shorter term).

Finally, the Framework Guideline should describe the relevant procedures and tools to be applied in the process of contracting capacity (booking procedure), including the timeline to be followed (e.g. number of rounds per product, requesting periods, reaction time), the allocation mechanisms to be applied (e.g. auction, open subscription window, first come first served), and the facilitator (e.g. booking platforms) to be used.

This approach would be agreeable to us. I would be grateful if you would confirm that it is also agreeable to you.

The agreement to work on a pilot code is based on the proactive and cooperative spirit in the Madrid Forum, and in particular of ERGEG and GTE+. I wish all actors involved good success with this ambitious task.

I will send a copy of this letter to all associations present in the Madrid Forum, in order to apply the high standards for transparency the new Regulation requires from the Agency and ENTSO-G to the Commission itself. I look forward to working with you as we enter a new era of European gas market cooperation.

Heinz Hilbrecht”