

Position Paper

ERGEG principles: Capacity allocation and congestion management in natural gas transmission networks

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General Remarks

The German Association of Energy and Water Industries (BDEW) represents 1,800 members of the electricity, gas and water industry. In the energy sector, we represent companies active in generation, trading, transmission, distribution and retail.

We welcome the opportunity to comment on the ERGEG Consultation Paper. We agree with the general pre-requisites set by ERGEG that capacity allocation mechanisms (CAM) and congestion management procedures (CMP) must be transparent and non-discriminatory and that they must combine technical and economic efficiency while addressing the various needs of market participants.

We understand that the ERGEG paper is only addressing contractual congestion and that dealing with physical congestion is beyond the scope of the present consultation. We would, however, like to point out that the present development of enlarging entry-exit market areas, which is an important pre-requisite for liquid gas hubs and the changing gas flows make it necessary that transmission system operators (TSOs) also make substantial investments. The current tariff regulation in at least some member states, such as Germany, is not entirely suited to ensure the necessary investments. Therefore, any solution to increase capacity needs to address the issue of appropriate incentives for investments. Providing a safe climate to foster investment into gas transmission networks is a key component for establishing a non-discriminatory and efficient market for transmission rights.

We would like to make the following general remarks regarding the consultation:

- The consultation paper rightly addresses the issue of cooperation of adjacent TSOs. Cooperation of TSOs will, however, only yield the desired results, if there is also improved cooperation of the respective regulators and harmonisation of the national laws. At present, many issues of cross-border cooperation cannot be resolved due to inconsistencies in national energy laws. Closing these regulatory gaps must be given high priority if cross-border capacity markets are to be established. In this context, we strongly support the Gas Regional Initiative as a suitable framework for developing regionally coherent measures and procedures paving the way to a truly integrated single European market.
- ERGEG rightly observes that the intended measures on CAM and CMP must not result in “unfair expropriations” of shippers. Generally, all shippers need to be able to rely on their existing contracts and the intended measures may not affect existing and valid capacity contracts. Amending these contracts, which may become necessary in implementing a new CAM and CMP regime, should not result in unduly abridging existing contractual rights.
- The continued ability to conclude long-term capacity contracts is important in order to guarantee security of supply via long-term import contracts. This market need has to be acknowledged and addressed in implementing any CAM and CMP measures.
- The consultation paper introduces in various instances the concept that undertakings with higher market shares in downstream markets should be treated less favourably than “newcomers” (e.g. point 2.5.3, G4.2, Annex 3, p. 31). It is clear that the system of capac-

ity allocation and congestion management may not discriminate against any market party and must enable more market players to access the market. In our view, it is important to have a level playing field for all undertakings active in the gas market. Such level playing field is, however, in particular ensured by competition law and the rules against abuse of dominant positions in the markets. We do not consider it appropriate to establish new rules which go beyond competition law requirements, as this would constitute market regulation and discrimination against certain undertakings with doubtful value for competition. In competition law there is general agreement that a dominant position as such is not illegal, but only the abuse of such position. Any abuse has to be addressed by the relevant competition authorities, but there is no need for additional energy regulations.

- Some of the measures considered in the consultation paper (e.g. capacity buy-back mechanisms) will lead to increased financial risks for TSOs. This means that the solution also needs to cover effective incentives for TSOs in order to set off these risks. As mentioned before, the present tariff regulation framework is not fit to address this issue in all member states. As a consequence, tariff issues need to be addressed in the present context. In this instance, we welcome the DG TREN's initiative, as mentioned at the Brussels workshop, to analyse the use of tariffs to achieve better incentives and hope that the future proposals will incorporate such measures.

Answers to the consultation questions to market participants

1 Do you agree with the problems that ERGEG has identified with capacity allocation and congestion management? Are there other aspects that should be taken into account?

BDEW agrees, that both capacity allocation and congestion management in the gas market allow for further improvement. We would, however, like to point out that there have been many positive developments since the Sector Inquiry was published to which the consultation paper refers. While we agree with the general assumptions, we would like to point out additional prominent issues, which we feel have not been sufficiently addressed.

ERGEG identifies the difficulty of new entrants obtaining capacity as the main problem of capacity allocation and congestion management in gas markets. As ERGEG notes, this originates from shortages of available capacity at many cross-border points and from potentially discriminatory aspects of allocation mechanisms. ERGEG further believes that this results in an imbalance in the market opportunities available to new entrants contributing to an inefficient use of existing capacity and a lack of liquidity in most markets.

As set out above, we think that apart from the need to deal with contractual congestion, the support of investments for expansion of capacity is crucial as well, because physical congestion can only be remedied by investment in more physical capacity. Consequently, the ERGEG proposals should not be seen as a replacement for the essential requirement of an increase in investment in gas networks. Furthermore, in order to give the market an overview

where contractual and where physical congestions exist, transparency on congestions (flows, available capacities, used capacities) is needed.

In addition, overcoming the regulatory gap is an essential issue, which currently makes it often difficult to find suitable cross-border solutions. In this respect, BDEW welcomes the Gas Regional Initiatives. Furthermore, we expect that the coordination of regulators and regulatory frameworks is facilitated by the implementation of ACER.

One missing aspect is the treatment of cross-border points at the border to non-member states. With regard to these entry-exit points, BDEW would like to stress that existing as well as future import contracts need the possibility of long-term capacity booking. We see this as mandatory to ensure long-term security of supply.

2 The scope of ERGEG's principles and of the derived proposals covers bringing capacity to the market where there is currently contractual congestion. Do you agree with this approach?

As we have already pointed out, we see the principles and derived proposal as being designed to tackle contractual congestion. The proposed measures will only to a limited extent be able to increase the available physical capacity.

Dealing with the issue of contractual congestion the following aspects have to be addressed: Capacity rights have to be defined and sold efficiently; the system shall include incentives that ensure that capacity rights are efficiently used; and regulators provide TSOs with incentives to manage their system efficiently.

Measures fulfilling these criteria will help to redeem aspects of contractual congestion and will foster the release of capacity by historic capacity holders. Such an approach is also likely to create a liquid and transparent primary market in transmission capacity rights and further create an effective secondary market in order to optimise utilisation of capacity.

3 In principle, European regulators consider FCFS allocation potentially discriminatory. Do you share this view? What do you think about the proposed mechanisms (OSP with subsequent pro-rata allocation or auctioning)?

In general, we would like to point out that FCFS mechanisms have their merits, in particular in cases where there is no congestion. Shippers make one bid and receive capacities at a fixed price. This guarantees low transaction costs and is a fundamental component of reliability for planning processes. FCFS does not have any bias towards any market party. For the allocation of intra-day capacity, FCFS still seems to be the suitable system.

For the allocation of day-ahead capacities or other capacities (free, becoming free by expiring of existing contracts or newly built) with a duration of less than one year, auctions should be implemented. The goal should be to establish coordinated auctions of the TSOs concerned. Fostering cooperation between adjacent TSOs also requires further cooperation between the involved regulatory authorities. The auction dates have to be published well in advance (at

least a year) and the auction deadlines have to be in line with gate closure times of the relevant gas exchanges. TSOs also have to publish in advance, which capacity products are available at the respective auction. Lot sizes must be aligned with current market practises. We propose auctioning with a market clearing price, which means that all shippers of the auction pay the same marginal price which is determined by the highest capacity offer which is successful in the auction. All participants in the auctions have to be treated equally.

The additional revenues from capacity auctions shall primarily be employed to remedy existing bottlenecks in the network.

Capacities with duration of more than one year should also be allocated by auctions. The proposed Open Subscription Period (OSP) does not constitute a Congestion Management Procedure, but is only a method to assess whether there is congestion. In case of congestion, a second step, either an auction or a pro-rata allocation is necessary. We do not think that the combination of OSP with pro-rata allocation, as suggested in G3.1.2, is a suitable solution. The main disadvantage of pro-rata is that the scarce good “capacity” is not being distributed by a market-based approach, but instead by an institutional process. This might entail strategic behaviour of bidders, which will divert allocation from the economically most viable solution. Nevertheless, pro-rata could potentially be employed for the allocation of newly built capacities in open season procedures.

It is important to note that after an OSP or an auction any residual capacity which eventually has not been sold should be allocated FCFS. Equally, the allocation of intraday capacity may only be achieved by FCFS mechanisms.

In order to increase efficient sale of capacities, a high level of transparency is necessary. Expanding existing initiatives (GTE+ transparency platform and GRI NW transparency initiative) seems to be a sensible approach. We would suggest that the transparency requirements as listed in Annex I of the consultation paper should be aligned with the results developed by the “transparency” work stream of the GRI North-West.

In the long run, a common auction platform would be highly desirable. Such a common auction platform could be developed from already existing platforms, e.g. in Germany Trac-x.

We also think that implicit auctions should be considered for short-term allocation at a later stage. In implicit auctions, capacity and commodity is sold together. However, a pre-requisite for implicit auction is the existence of liquid market places at both sides of the congested points.

4 In your view, what is the future importance of the proposed capacity products (firm, interruptible, and bundled) and of the proposed contract duration (intra-day up to multi-annual)?

BDEW agrees that there will be a need for multiple capacity products with different terms ranging from intra-day, daily, weekly, monthly to multi-annual specifications. In particular, long-term capacity bookings are necessary for ensuring security of supply and for hedging market risks in trading. We agree that the demand of market parties should develop the ac-

tual capacity products. With regard to short-term capacity, the development of new products (e.g. hour blocks) should be considered. Such development is, however, dependent on corresponding commodity products at the commodity markets and in particular gas exchanges.

The NRA's approval for the capacity products should therefore not deviate from the market-based approach. The NRAs do however have the responsibility that the product design allows bundled products and efficient use of cross-border capacities.

Taking into account the needs of the market and the diversified products and durations identified by consultations we support the suggestion to set aside a reasonable proportion for short-term capacity products to be offered on a firm basis.

The ERGEG proposals also include interruptible products. Generally, interruptible products are only helpful to shippers in a limited amount of cases, in particular where demand is flexible (e.g. dual fuel production/ generation). Consequently, interruptible capacities and interruptible Use-It-Or-Lose-It procedures (UIOLI) should not be considered as an efficient tool to increase liquidity.

We welcome the establishment of bundled products, which are an important step for more liquidity on the gas markets as they allow easier trading from hub to hub. Bundled products should be a top priority in the process. TSOs must allow and implement bundled products at all booking points. This means that it will not be necessary to procure entry and exit capacities at a single booking point separately. Instead, it must be possible for a participating company to offer a border crossing or a transfer between market areas as a complete bundle and for the TSOs to implement the package in operational terms. As set out above, besides the need of enhanced cooperation of TSOs, the offer of bundled products has to be supported by the respective regulators and consistent regulatory frameworks in the states concerned. In cases, where additional investments are necessary for offering bundled products, the question how these investments are reimbursed in the tariff regulation framework also needs to be addressed adequately.

5 What is the role of secondary capacity trading?

Measures aimed at the primary capacity markets will help to close the gap between the volume of contractual congestion and the technical maximum. The secondary market is a useful tool for maximising utilisation of the available physical capacity. Concrete incentives for releasing unused capacity into the secondary market are therefore needed to improve its functioning.

There should be no restrictions or discrimination for holders of capacities to market them in a secondary market. Market participants have to be able to adapt their capacity holdings to changes in their underlying production, purchase, sale and consumption decisions over time. An active secondary market in the capacity rights is therefore essential to realign capacity rights between users over time and to ensure the optimal use of the transmission network. To trade capacity freely in secondary markets, shippers must have the possibility to divide capacity into its constituent parts, to be able to sell an individual season, month, day or even hour taken from e.g. an annual capacity booking. The original shipper shall have the choice

either to transfer only the right to use the capacity or - with the consent of the TSO - to transfer the complete contract including all rights and obligations. The whole process must be facilitated by TSOs by ensuring that contractual rights to capacity can be transferred freely between market participants in the secondary market.

It is important that a common platform of the TSOs for secondary trading is established. The target must be to include all the entry and exit points at market area boundaries and national borders in this platform. In order to enable seamless and efficient operations the operational setting (i.e. processes, tools and contracts for capacity booking, trading and usage) should be standardized, fit for purpose and very efficient.

6 How do you assess the proposed measures to enhance the availability of firm capacity and to improve short-term and long-term congestion management?

In general, BDEW sees many proposed measures as suitable to deal with problems of contractual congestion. Some of the proposed measures, however, have serious drawbacks, which should be carefully considered. In addition, a “toolbox” approach, leaving it to the regulator to choose between the proposed measures, may lead to inconsistent systems and may endanger the goal of a level-playing field in regulation.

BDEW welcomes solutions, which will help to close the gap between contractual congestion and the technical maximum. However, interference with existing contracts, which could be especially harmful with regards to security of supply, must be avoided.

In the following, we provide a short assessment of the various proposals:

G1.2.1 Increase of available capacity by enhanced cooperation

We fully support further cooperation of TSOs. As set out above, the cooperation of adjacent TSOs must be accompanied by closer cooperation of the relevant NRAs and the abolishment of inconsistent national regulation. Furthermore, tariff regulation must set the right incentives for closer cooperation of TSOs

G1.3 Capacity Calculation

TSOs presently have to be prudent in capacity calculation, as they have to guarantee shippers' gas transport. They currently use an approach which ensures smooth operation of nominated flows even under unfavourable circumstances, like a sudden drop in temperature, unplanned outages of production field or storage (worst case scenario). Inability to perform the gas transport - in the absence of force majeure - exposes the TSO to the risk of compensating shippers. At least in some countries, this risk cannot be accommodated in the present tariff regulatory background.

In accordance with a calculation methodology provided by the NRA, TSOs may be able to employ statistical methods of capacity calculation, provided that the CRM gives them methods to deal with situation where they cannot fulfil their contractual obligations (e.g. through

capacity buy-back mechanisms) and tariff regulation gives them possibilities to employ such mechanisms. Such an approach requires that revenue regulation of TSOs is adjusted accordingly in order to compensate for resulting costs or to allow for symmetric risks *and* chances. Excess revenue, which the TSOs receive by selling additional capacity, will be available to compensate the costs of capacity buy-back. Any additional over-recovery or under-recovery of regulated revenues may require a method to return money/ costs to capacity holders in the least distortionary manner possible. However, it must be ensured that the TSO receives appropriate risk compensation. In any case, new calculation methods cannot be implemented shortly, but require extensive IT preparation.

G2.2.3 Interruptible capacity

As already set out above, additional offers of interruptible capacity are only to a limited extent suitable to solve the shortcomings of present capacity markets. In particular, short-term interruptible capacity is not able to satisfy market needs. In general, we believe that interruptible capacity should be seen as the exception rather than the rule.

G2.3 Increase of available capacity by commercial means

The proposed guidelines explicitly refer to the possibility to procure physical energy in order to maximise and manage the offer of additional capacity. Such “flow commitments” have proven as a very useful tool to increase the free amount of firm capacity available. However, in order to employ this tool, it is essential that the costs incurred by the network operator in connection with flow commitments be covered and that NRA support the implementation of flow commitments. For this purpose, flow commitments must be standardized in such a way as to allow calls for tenders to be issued and commitments to be acquired at market conditions.

In capacity buy-back mechanisms, the TSO offers more firm capacity than the maximum technical capacity. The TSO anticipates that booked capacity is in general not used fully or simultaneously by shippers and that normally the used capacity is below booked capacity. On the basis of statistical considerations, the TSO analyses whether this effect is visible during a defined timeframe and to which extent the under-usage of capacities occurs. This analysis has to be made separately for every relevant entry/ exit point, considering the specific conditions at this point, and cannot be made for the whole network in general.

After determining the statistical load at each point, the TSO has to weigh the possibility of full usage of capacities at this point against the possibility of buying back capacity at this point, in order to fulfil all nomination of shippers.

If there is a high risk of congestion without a realistic possibility of buying back capacity in the market, the TSO will not offer additional capacities.

On the other hand, if the possibility of congestion is rather low and if there are realistic options to buy back capacity, the TSO will market the additional firm (statistical) capacity.

Such offer of statistical capacity is e.g. conceivable in situations where transport capacity is booked during the whole year for the filling of a storage facility. The TSO may, however, as-

sume that the Shipper will typically inject gas into the storage facility in summer and extract gas from the storage facility in winter.

The TSO must be able to cover the costs of buying back capacity. Tariff regulation must offer incentives for the TSO to assume a higher risk.

G4.1 Firm day-ahead UIOLI procedure

The proposed compulsory restriction of existing rights of re-nomination could have serious impacts for standard business cases of gas supply. Restrictions of re-nominations potentially have the following effects:

- Trading companies would face restrictions on their flexibility and could no longer react at short notice to trading operations and transfer gas quantities between the various trading hubs. This would have corresponding consequences on the liquidity and price convergence of hubs.
- Shippers would be constrained in offering short-term balancing energy.
- The possibility of using storage facilities to provide short-term flexibility would be restricted.
- Companies supplying consumers would no longer be able to react to short-term demand fluctuations. This would lead to imbalances with increased demand for balancing energy.
- The cancellation of renomination rights would significantly impair supplies to gas-fired power stations with highly volatile gas demand.
- Reactions to restrictions on gas supply by producers would be possible with a time delay only.

Other than the UIOLI described under G4.1 an improved secondary capacity marketing enables the capacity holders to sell capacities in line with their business needs and individual planning assumptions. In order to achieve more liquid secondary markets, a Use-It-Or-Sell-It procedure (UIOSI) should be established which is not affecting the gas supply business in the aforementioned way. Prerequisite for UIOSI is an improvement of secondary capacity trading by establishing tools and procedures for an efficient market, such as standardized capacity products, standard contracts and a central booking platform.

We would suggest the following UIOSI procedure to improve liquidity in secondary markets:

- Capacity holders are generally obliged to bring unused capacity to the secondary market to a very large extent based on their individual planning assumptions. If liquid secondary markets exist, capacity holders have a strong incentive to optimise their capacity portfolio by selling in the secondary market.
- For every entry-exit point which is actually or potentially subject to contractual congestion, the aggregated allocated flows and the auction results for secondary capacity, including bids and offers, are published D+1. The publication must enable market participants to make an assessment of the effectiveness of the UIOSI principle.
- The effectiveness of the secondary market is assessed for each relevant entry-exit point separately: If capacity demand is predominantly fulfilled by offers on the second-

dary markets, no further action is needed. Entry-exit points where demand is not predominantly fulfilled, must be examined in more detail:

- If more than 90 % of the technical capacity is used on the days in question, there is a case of physical congestion.
- In all other cases, the causes for the lack of offers of secondary capacity have to be examined. In this examination, it also has to be taken into account whether the demand reflected market conditions.
- The described UIOSI-procedure shall be subject to an evaluation of the regulatory authorities. The competent regulatory authority has to assess after a reasonable implementation period (e.g. six months) whether capacity holders at a given entry-exit point make sufficient use of the UIOSI procedure in order to meet market demand. If this is not the case, further measures, such as the restriction of renomination rights have to be investigated.

G4.2 Withdrawal of underutilised capacity

We support the revision of existing UIOLI procedures but do not think that it is appropriate to connect the UIOLI with the position of the shipper in gas markets. This constitutes a mix-up of energy regulation and competition law which does not seem suitable. In this respect, we also want to point out that the concept of releasable capacity set out in Section 2.5.3 including ‘freeing up’ capacity *regardless of whether the capacity is utilized by its holder* is not acceptable to shippers as it introduces uncertainty into capacity contracts thereby opposing the aim of creating stable and liquid markets which deserve market participants’ confidence.

In general, UIOSI provisions seem more suitable to achieve the intended results.

7 What are your views on the proposals? Do they address the problems? Will they lead to more effective capacity allocation methods being developed?

We refer to our answer to question 6 and want to point out that the CAM and CMP proposals address only one aspect of the problem. It is also necessary to consider the tariff issues involved and to address incentives for necessary investments.

We support an EU wide harmonization of market design through EU-wide binding rules. In contrast, the measures proposed by ERGEG leave wide discretion to the NRA. The concept of the “tool box” would inevitably lead to inconsistent national regimes. Any cross-border rules should be consistent at least throughout large regions. We therefore propose the implementation of few selective mechanisms for all cross-border entry and exit points, which are binding and coherent throughout the EU.

8 Are the needs of shippers performing supply activities properly taken into account?

For shippers it is essential that existing capacity bookings remain unaffected. In particular the existing long-term capacity bookings are essential for the conclusion and performance of long-term import contracts ensuring secure gas supplies for the European market. Therefore,

the proposals which interfere with existing contractual rights (e.g. G3.2, G4.4, Section 2.4.4) are critical.

This is in particular true for the compulsory curtailment of existing renomination rights considered in the proposed principle G4.1.2. This proposal would entail severe disadvantages for the majority of European gas suppliers as described in our answer to question 6.

9 Are the proposed measures suitable to facilitate development of liquid gas markets?

We refer to our answer to questions 6 and 7.

10 In your view, how important are compatible booking and operational procedures between adjacent systems?

BDEW regards compatible booking and operational procedures as a critical feature for establishing a transparent and liquid market. This necessitates a high level of cooperation between TSOs, but also between the respective NRAs.

11 Do the proposed measures increase the efficient use of the system? What aspects would you support and like to see further developed?

As we have answered in various forms above, we do see the fundamental problem, that existing physical congestion will ultimately only be solved by construction of new physical capacity. Therefore, any approach will need to incorporate incentives for further investment so that system operators will build more transmission capacity.

BDEW also sees the urgent need to harmonise regulatory frameworks in European gas transport markets. The best approach, in our view, is to strengthen the Gas Regional Initiatives. Only when the regulatory gap is overcome and every market participant is bound by the same set of rules will the outcome be truly market-based. Of course, TSOs will have to continue on their path of cooperation as is already happening. But it is a pre-requisite that regulators do harmonise their initiatives.

Finally, we would like to stress that the guidelines may not interfere with existing rights in contracts. Manipulating terms which have been agreed to by market parties would lead to a direct and immediate transfer of transport risks to shippers, which would potentially lead to a significant loss in liquidity and competition.

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