



**GEODE Position Paper on ERGEG Public Consultation Document
“ERGEG principles: Capacity allocation and congestion management in natural
gas transmission networks” (Ref: E08-GFG-41-09)**

26 January 2009 ERGEG launched a public consultation on the document: “ERGEG principles: Capacity allocation and congestion management in natural gas transmission networks” (Ref: E08-GFG-41-09). As transparent and non-discriminatory capacity allocation and congestion management rules are prerequisites for a competitive and efficient gas market, GEODE fully appreciates ERGEG’s commitment to these important issues as well as the given document and is keen to make its contribution towards creating a transparent capacity allocation mechanisms (CAM) and congestion management procedures (CMP) in natural gas transmission networks.

I. GEODE’S approach to ERGEG CAM and CMP principles

1. Present CAM and CMP system – a case for reconsideration

GEODE would like to underline the importance of effective CAM and CMP principles for the frictionless and competitive gas market in the EU. Unsatisfactory CAM and CMP rules as they stand for the moment, could contribute to market fragmentation and barriers to competition. The change is therefore absolutely essential. The question that arises in this context is, whether the present system is at all worth of rescuing.

The solution proposed by ERGEG focuses in the first place on contractual congestions. These congestions are to be dealt with by the shippers by the means of capacity bookings and congestion management mechanisms such as for instance UIOLI principle. Better and more effective though, is to yield the contractual capacity bookings to the TSOs, so that shippers are no longer involved in these mechanisms.

The problems of the contractual capacity management by the shipper are obvious: if contractual bookings constitute the foundation of a capacity system where there is not enough free capacity to fulfill all the contractual request, the shippers are inclined to overbook in order to have a free room for future deliveries (new clients gaining). furthermore this system enables to the market incumbents the achievement of the market foreclosure and barriers for the potential newcomers. Consequently the contractual congestions are either strengthened or at least cannot be dissolved.

These measures constitute solely a remedy in an insufficient system and rely mostly on two methods which have already in the past shown little successful: the voluntarily release of the capacities by the shippers to the secondary markets and mandatory



withdrawal through the TSO (i.e. UIOLI). These instruments turn capacity to a commodity without any risks for the shippers. Both secondary trade, as well as UIOLI mechanisms provides normally a compensation for the shippers on the basis on the primary capacity prices. As for the secondary market, additional revenues are not excluded.

GEODE would like to suggest an **alternative approach** to the existing system. The need to rethink the present system is attributable to the market dynamics. There are many examples both European and German that the booked capacities lapses without substitution, i.e. fusion of networks (Gasunie) and merging to market zones. Potential capacity problems within a market zone are solved by the TSOs. In this context GEODE requires to go a step further. TSO must be obliged to consolidate transmission lines between European gas hubs, if technically possible and economically reasonable. The result would a big European market where no capacity bookings are needed. This means restricting capacity management practices to the events of physical congestion.

Therefore GEOEDE believes that a workable definition of physical congestion should be developed. The TSOs should be in charge and under obligation to remove contractual congestions from the networks they are operating i.e. by pipelines consolidation.

Accordingly subject to capacity allocation mechanisms and congestion management should be in the first place the physical congestions, defined as a state when all transmission paths from one European hub to an other European hub, regardless the ownership borders are at the same time overloaded and thus the flow of gas is physically impossible. According to this model the gas trade as well as allocation of the cross boarded capacities takes place simultaneously, so that the rule applies – who has the gas, also has the capacity.

The approach for congestion management favoured by GEODE, to couple gas capacity products with the gas quantity products (e.g. in the sense of the market coupling model) is already well known from the electricity sector, so that the flow based capacity determination – also in the gas sector possible and beneficial. The traders on the neighbouring markets give their offers for purchase and sale and the ‘market coupling office’ determines on the basis of available capacity between the markets the maximal quantity balance and price adjustment.

GEODE strongly believes that this approach is feasible already today, since there are no legal obstacles impeding introduction of this new model. GEODE sees the need for an immediate action on capacity allocation and congestion management, given the current level of development of the gas market in Europe, prevail, GEODE accepts that this



solution be considered for a middle term approach. For GEODE the approach presented is not just wishful thinking but a firm objective and a roadmap for the future more comprehensive reform. GEODE claims therefore, that this approach and thus the future developments of the access model are incorporated into the Guidelines **at least as a goal**. It is important that the dynamics is not impeded by the outdated Guidelines.

II. GEODE's comments on ERGEG principles and guidelines amendments

GEODE welcomes the opportunity to comment on the ERGEG CAM and CMP principles. As for the comments order, the structure of the ERGEG paper will be followed. Consequently GEODE after making preliminary remarks (point 1) will address issues related to facilitating of the third party access (point 2), capacity offer and products with relation to product determination (point 3) further allocation of capacity products (point 4), congestion management procedures (point 5) and finally for transparency (point 6).

1. Preliminary remarks

GEODE wishes to highlight several points from the ERGEG proposal and so emphasise their essential importance:

- The offer of the “bundled products” and consolidation of diverse transportation paths in order to link the European gas trading points.
- Expand the option for the TSOs in terms of capacity calculation and allocation of the physical capacity.
- Minimal offers by TSOs of short term contracts (one year and less)
- Obligation on TSOs to offer interruptible capacity along with the firm one (not subsidiary) as well as TSOs obligation to justify interruptions
- Enhancing of the transparency obligations for TSOs (compare the Annex of the ERGEG document).

These points should not be left to the discretion of TSOs and should be prescribed by the Guidelines possibly far-reaching and at the earliest convenience.

In this very context, GEODE wishes to advert to an important issue. First of all, GEODE greets ERGEG effort to have drafted the principles in a quite detailed manner. Nevertheless, there are still passages, leaving considerable desire for more specification. What is especially striking in the Guidelines presented by ERGEG, is the fact of conferring too much discretion powers to national regulatory authorities. The wording of the Guidelines amendments brings about danger of market splitting, since NRAs are given discretion powers on all important issues (i.e. capacity calculation, incentivisation,



the offer of bundled products, booking platforms, methods for secondary trading, nomination schedule). Consequent problems arise as to which rules apply, if two or more regulatory provisions of adjacent NRAs are “drifting apart” (i.e. in the EGT market zone which encompasses France, Belgium, Netherlands and Germany bears a danger of 4 different regulatory acts applicable at the same time). The guidelines itself have to contain clear and binding regulations for the TSOs.

2. Third party access services

GEODE strongly supports ERGEG in its effort to increase the available capacities on the market in order to facilitate third party access, since this can reduce congestion related problems. In this context GEODE wishes to reiterate that the bulk of the congestions origins from contracts and not from physical constraints. The main obstacle to TPA services is congestion in the gas networks. The contractual congestions, according to GEODE’s approach, can be removed by TSOs and therefore their enhanced cooperation is indispensable. The reason behind the cooperation obligation is to allocate the maximal capacity. Obligation of enhanced cooperation will allow for better control of gas flows intensity and directions as well as the level of used capacities.

With regard to the provisions on **capacity calculation** GEODE welcomes, ERGEG dynamic approach, obliging TSOs to re-calculate available capacity on regular basis. It is indeed of essential importance to develop common and binding calculation rules for all EU member states. The discretion left to NRAs in this regard should be minimised in the light of risks likely to arise as a result of diverging calculation provisions. GEODE reckons, that along with this dynamic approach, statistical capacity consideration should be applied. Accordingly, TSOs, especially based on past considerations and prognosis, if necessary timely staggered, should be able to allocate more capacity.

Another valuable tool for advancing of the gas market is appropriate **incentivisation**. Incentives for TSOs are for sure an effective instrument to encourage TSOs to allocate the maximum of the capacity. On the other hand it should be a matter of course that TSOs are allocating the maximum capacity at not an extraordinary task they should be additionally incentivized, especially as the incentivisation constitutes a certain inconsistency with the regulatory system. Incentives are economically attractive if they are granted for new costly or risky procedures, which TSOs normally would not be likely to refer to. At the same time it remains obvious, that the TSOs, when referring to special capacity enhancing instruments (i.e. load stream commitments, storage use or capacity buy-back) must have their cost reimbursed. Of course, according to the ERGEG principles, it should be ensured that “any associated costs do not exceed an economically efficient level”.



The text proposed by ERGEG does not seem sufficiently prescriptive on this issue. Therefore it appears to GEODE especially important to develop very precise provisions for incentivisation, in particular provisions *de minimum*, listing circumstances under which incentives should be granted. Notwithstanding GEODE's approach to the particular issue of effective capacity allocation, the increase of capacity by the means of commercial instruments shall under no circumstances have any negative influence on the security of supply.

GEODE supports ERGEG's endeavour to **align transportation contracts** and codes as well as to encourage the implementation of **standardised communication procedures** meets GEODE's full support. Both **network security** and **emergencies** in energy supply are important aspects, rightly captured by ERGEG. However in GEODE's view the most problematic and calling for prompt solution are the issues of capacity calculation and incentivisation.

3. Principles on capacity offer and products - determination

GEODE supports approach of ERGEG aimed at ensuring that the **full range of capacity products** is present on the market. The duration of the capacity contracts should not exceed the duration of the capacity supply contracts according to the principle: "who has gas, has also the capacity". GEODE would welcome a market analysis and consequently binding figures what percentage of which product should be, in any case, achievable on the market.

GEODE sees the need for **precise definition of capacity products** as well as emphasizes the importance of **minimum standards** concerning the products in order to ensure gas liquidity on the market. GEODE argues in favour of EU wide standardization of capacity products, which will lead to more effective capacity usage practices and enable more accurate prognosis of the future capacity use. Through the capacity release to the markets in all possible lengths hoarding problem could be addressed.

GEODE welcomes particularly the ERGEG proposal to set aside a realistic proportion of available capacity for short term capacity. However, it seems necessary to set a common percentage margin prescribed to be traded as a short-term capacity product.

Additionally to this, it is of basic importance that the **price – product relation** is well-conceived and commonly applied, leaving the short capacity products cost-effective in comparison to long term products. For the time being, the fees required for short term capacity compared to long term capacity prices are much too high. This seem fairly illogical, since the latter ones offer to the shippers a stronger planning security and flexibility.



GEODE supports the strengthening of the **interruptible capacity** offer. However, in order to avoid further incongruence, emphasis has to be made on developing of a common, clear and practicable definition of firmness and interruptibility. This is essential in order to make this kind of capacity product attractive to the shippers. From the GEODE point of view, it seems especially important, that TSOs are under obligation to communicate and prove the grounds for interruption occurred.

GEODE strongly supports the idea of offering **bundled capacity products** at interconnection points to facilitate cross-border market integration. This applies for the agreed bundled entry exit capacity and in the first place for unifying of the alternative transportation paths between European has trade places. Offering of bundled capacity products will not only simplify transactions, more importantly they constitute an essential step to connect European gas marketplaces. Therefore, the offer of bundled products should be an obligation for TSOs and not only a possibility.

4. Principle on capacity allocation mechanisms

In the long-term the adoption of GEODE's optimal approach would lead to the situation where capacity allocation and capacity bookings by the shippers become fully obsolete. Accordingly any capacity allocation measures conducted by TSOs should be reserved for absolutely exceptional cases and not be applied as a rule. Nevertheless, in the course of remedying of the actual system, the principles of capacity allocation mechanisms were rightly addressed in the ERGEG paper.

Among the market-based allocation methods, GEODE favours **auctions**, since they provide most fair distribution of capacities. With regard to the **pro-rata** method, GEODE sees the risk, that this allocation method factually favours bigger shippers. GEODE shares ERGEG approach, presented in the draft principles text, that as an *ultima ratio* means, NRAs shall be entitled to impose restrictions on **dominant market participants**.

GEODE accepts the **booking platforms** for **primary capacity** as a good solution and supports the idea that primary capacities of different TSOs are offered jointly in order to increase liquidity of capacity trading. As in the view of GEODE the secondary capacities shall not be traded by shippers but traded back to TSOs and allocated as the primary ones, the idea behind the joint secondary and primary booking remains questionable.

Should however (despite objections presented above by GEODE), the idea of joint offer of secondary and primary capacities prevail; GEODE would like to draw attention to the approach introducing the **subsidiarity of secondary capacity trading**. Nevertheless GEODE believes that this subsidiarity of trade is not a sufficient means to avoid the side effects caused by the sales of the secondary capacities above the primary capacity prices,



since the subsidiarity of capacity offer does not obliges the capacity owners to any price limits.

5. Principles on congestion management procedures

GEODE supports the ERGEG proposal for **short-term UIOLI** mechanism as a useful intermediary step to a physical capacity management. The interim goal of a liquid gas market trading short term capacities is a limitation of renomination rights – being a tough yet necessary measure. GEODE believes that the “2+2 rule” as proposed by ERGEG is an appropriate approach to reduce the interference to the necessary scope. Alternatively, a firm rate for the booked capacities could also be discussed. Through enabling to the third parties the use of the unused capacities, the capacities owners are incentivized to trade them on the secondary market.

Therefore, GEODE considers necessary to introduce price caps in order to discourage abusive overbooking. Additionally, the secondary trade should be reduced to a singular further marketing of capacities. It must be guaranteed that the charges from the UIOLI trading either lower the network tariffs or contribute to financing of incentivisation mechanisms.

The **long-term UIOLI** principle as presented in the ERGEG paper seems rather complex. GEODE suggests caution with regard to the withdrawal of underutilized capacity. The suggested provisions as they stand can easily be avoided by a chain of balancing zones.

6. Transparency

GEODE supports the approach of ERGEG to enhance the TSOs’ **transparency obligations**. Transparency is not only essential in order to control TSOs’ actions (i.e. cases of under using of the capacities) but also constitutes a basic element for good capacities and price development prognosis through the shippers. In this context GEODE would like to point at the paper on transparency minimum standards presented by many groups of interest during the last Madrid Forum. TSOs must be under an obligation to comply with the transparency provisions and regulatory authorities must be in charge of respective monitoring.

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