

ACER OPINION n° 04-2012

**REASONED OPINION ON THE NETWORK CODE ON CAPACITY
ALLOCATION MECHANISMS FOR THE EUROPEAN GAS
TRANSMISSION NETWORK**

THE AGENCY FOR THE COOPERATION OF ENERGY REGULATORS,

HAVING REGARD to Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing an Agency for the Cooperation of Energy Regulators (hereinafter referred to as the 'Agency Regulation' and 'Agency', respectively)¹ and, in particular, Articles 6(4) and 17(3) thereof;

HAVING REGARD to Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005 (hereinafter referred to as the 'Gas Regulation')² and, in particular, Article 6(7) thereof;

HAVING REGARD to the Revised Pilot Framework Guidelines on Capacity Allocation Mechanisms adopted by the European Regulators' Group for Electricity and Gas (ERGEG) on 7 December 2010, E10-GWG-71-03;

HAVING REGARD to the Agency's Framework Guidelines FG-2011-G-001 on Capacity Allocation Mechanisms for the European Gas Transmission Network of 3 August 2011;

HAVING REGARD to the favourable opinion of the Board of Regulators of 5 June 2012;

WHEREAS

- 1) Already in 2008, Capacity Allocation Mechanisms (CAM) were identified as a priority topic by ERGEG, which, at the request of the European Commission, adopted pilot Framework Guidelines on CAM on 7 December 2010. On the basis of these pilot Framework Guidelines, the European Commission invited the European Network of Transmission System Operators for gas (ENTSOG), with letter dated 27 January 2011, to establish a Network Code on CAM within 12 months.
- 2) On 3 March 2011, the Agency became operational and started immediately the formal process for developing the Framework Guidelines on CAM. The Framework Guidelines FG-2011-G-001 on Capacity Allocation Mechanisms for the European Gas Transmission Network (the 'Framework Guidelines') were adopted by the Agency on 3 August 2011.

¹ OJ L 211, 14.8.2009, p.1

² OJ L 211, 14.8.2009, p.36

- 3) On 17 August 2011, the European Commission, considering that the Framework Guidelines do contribute to non-discrimination, effective competition and the efficient functioning of the market, reiterated its invitation to ENTSOG to submit a Network Code on CAM and extended the deadline for this submission to 9 March 2012.
- 4) In drafting the Network Code, ENTSOG has endeavoured to extensively involve stakeholders in a transparent process by organising several “Stakeholders Joint Working Sessions” (SJWS), workshops, and public consultations.
- 5) ENTSOG officially submitted the Network Code on CAM (the ‘Network Code’) to the Agency on 6 March 2012.
- 6) According to Paragraph 1.1 of the Framework Guidelines, the Network Code has been evaluated on the basis of the degree of compliance with the Framework Guidelines and the fulfilment of the objectives of maintaining security of supply and of supporting the completion and well-functioning of the internal market in gas and cross-border trade, including delivering benefits to the customers.

HAS ADOPTED the present REASONED OPINION:

The Network Code on Capacity Allocation Mechanisms submitted by ENTSOG to the Agency on 6 March 2012 generally shows a high degree of compliance with the Agency’s Framework Guidelines FG-2011-G-001 on Capacity Allocation Mechanisms for the European Gas Transmission Network of 3 August 2011, since most of the fundamental principles of the Framework Guidelines have been further elaborated and implemented in the Network Code. Notably, the introduction of a defined small set of standard capacity products, a common gas-day, bundled cross-border products, Virtual Interconnection Points and a harmonised auction design (including an auction schedule and detailed auction rules) are important steps towards efficient and non-discriminatory capacity allocation. This, in turn, will facilitate cross-border gas trade and the further development of competitive and efficient wholesale gas markets in Europe.

Notwithstanding the above, some specific provisions of the Network Code are not in line with those of the Framework Guidelines or with the objectives set out therein or are out of scope, as indicated in the following sections.

1 Definitions

In Article 1.2(y) of the Network Code, the definition of “virtual interconnection point” does not reflect the wording of the Framework Guidelines (Section 2.4.3), as the Network Code refers to “transmission network” instead of “entry-exit system”. The wording of the Framework Guidelines takes into account that there can be more than one Transmission System Operator within an entry-exit system, i.e. more than two adjacent transmission networks/systems, but clarifies as well that a virtual interconnection point connects only two adjacent entry-exit systems. Article 1.2(y) of the Network Code and the related Article 5.1(10) should be amended in line with the Framework Guidelines.

Furthermore, the definitions of “additional capacity” and “capacity contract” in Article 1.2(a) and (f) of the Network Code are not consistent with those of the Gas Regulation and Directive 2009/73/EC, and should be adapted accordingly.

2 Application of the Network Code to New Technical Capacity

Articles 2(3) and 5.1(1) of the Network Code exempt new technical capacity from the provisions related to the allocation of firm capacity, bundling requirement, interruptible capacity, tariffs and booking platforms. However, the Framework Guidelines only state that new capacity is exempted from its Section 3 on capacity allocation. The rationale of this provision is to allow for the allocation of new capacity possibly through a different mechanism than the auction for allocating existing capacity. Consequently, other sections of the Framework Guidelines apply to both existing and new capacity.

Considering that new capacity made available by Transmission System Operators ultimately becomes existing capacity, the scope of the exemption foreseen in the Network Code is too wide and should be limited to the use of the allocation mechanism and other provisions mentioned in Section 3 of the Framework Guidelines. Consequently, new capacity made available by Transmission System Operators shall be offered as bundled products, since this provision is necessary to achieve the objective of progressive bundling of all technical (existing) capacity set out in the Framework Guidelines. Similarly, the rules related to the breakdown of capacity products with different durations need to be applied to new capacity as well, in order to avoid long-term congestion and promote short-term cross-border trading.

Articles 2(3) and 5.1(1) of the Network Code are, therefore, not in line with Section 1.2, paragraph 3, of the Framework Guidelines. They should be amended in the sense that the respective provisions shall also apply to new capacity.

3 Standard Contracts

Article 2(4) of the Network Code states that “This Network Code sets out the minimum requirements that shall be implemented by transmission system operators through their Capacity Contracts”.

Although the Network Code defines standardised capacity services³ and a standardised capacity allocation mechanism⁴, it does not set out a fully standardised capacity contract. For instance, it is silent on credit status of network users and on liability rules. However, Section 1.4 of the Framework Guidelines requires the Network Code to define a standardised content of transmission capacity contracts and general terms and conditions for capacity allocation and capacity services.

ENTSOG argues that differences in the national legal frameworks make it difficult to define a standardised content for transmission contracts. ENTSOG is asked to provide the Agency

³ See for instance, Article 4(2) of the Network Code.

⁴ See Section 4 of the Network Code.

with an assessment of whether a full standardisation can be implemented in the future, taking into account the current differences in the national legal frameworks and the development of Framework Guidelines and Network Codes in other areas, and a timeline for carrying out this task.

4 TSO Cooperation

Article 3 of the Network Code does not comply with the Framework Guidelines regarding the specific information which has to be exchanged amongst Transmission System Operators to ensure cooperation. The Framework Guidelines provide a list of specific pieces of information to be shared between adjacent Transmission System Operators, e.g. entry and exit flow forecasts, availability of network components and potential congestion. In the Network Code, however, part of this information is explicitly mentioned only so as to be shared with network users. With respect to Transmission System Operators, the Network Code merely sets out the principle of exchanging relevant information.

The technical management of interconnections requires Transmission System Operators to exchange some technical information. This should generally be defined in an interconnection agreement. However, such agreements are not yet mandatory and may not include the specific details set out in the Framework Guidelines. Precisely in order to avoid possible discrepancies and regulatory gaps, the Framework Guidelines (Section 1.5) require that a minimum level of information to be exchanged between Transmission System Operators is defined in the Network Code, irrespective of and complementary to the interconnection agreements. As ENTSOG did not provide any further justification as to why it needed to deviate from this provision, and for the reasons stated above, merely stating the obligation to exchange relevant information is not sufficient to comply with the Framework Guidelines.

Therefore, with respect to the information to be exchanged between Transmission System Operators, the Framework Guidelines are more specific than the Network Code. ENTSOG should amend the Network Code by elaborating the information to be exchanged between Transmission System Operators in order to comply with the Framework Guidelines. In doing so, it shall include at least the specific pieces of information listed in the Framework Guidelines.

5 Capacity Breakdown

With respect to the allocation of short and long-term capacity products, the Network Code specifies, in Article 4.1(6), that at least 10% is set aside for short term services, whereas Article 4.4(3) states that the remaining capacity shall be offered for the upcoming 15 years, that is, through yearly Standard Capacity Products, from one up to 15 years ahead. The article does not provide any additional breakdown of capacity.

Auctioning up to 90% of the capacity in just one instance for a period of 15 years raises serious concerns, also voiced by some stakeholders during the public consultation run by ENTSOG, as it carries the risk of long-term contractual congestion and/or of creating barriers for potential new entrants over a significant (15-year) period. Auctioning up to 90% of the

capacity in one instance will also run the risk of leaving no room for learning lessons between auctions. If a problem occurred, it could lead to undesirable results, potentially impacting the market for the upcoming 15 years. In this respect, the provisions in the Network Code may be detrimental to the completion and well-functioning of the internal market in gas and cross-border trade.

Furthermore, the Framework Guidelines require that “the Network Code(s) shall set out the way in which the breakdown of available firm capacity between the different long and short-term capacity services is determined” and that National Regulatory Authorities are responsible for reviewing “the amount of capacity for each capacity service” (Section 2.3, own underlining). The Network Code does not comply with the Framework Guidelines in this respect, as Article 4.1(6) in conjunction with Article 4.4(3) imply only one long-term and one short-term capacity service to which the quota is applied, without any further breakdown.

The concerns about any potential anti-competitive effects of the provisions contained in the Network Code would be appeased if the Network Code were to envisage that, besides the at least 10% share of the technical capacity set aside for short-term products, a significant proportion of the capacity allocated through Standard Capacity Products as specified in the Network Code is allocated only over a shorter time horizon⁵.

Additionally, quarterly capacity products could also be offered for more than one year alongside the yearly products. This solution would allow for capacity being offered on more than just one instance, giving shippers a second chance to acquire the capacity that they need without altering the auction calendar/design or the product setup. As the network configuration may in some instances make successful bidding in independent, concurrent auctions challenging, such an offer of additional quarterly products for a longer time horizon (than just for the upcoming four quarters) would also provide sufficient time (i.e. 3 months, according to the auction calendar) for analysis and learning from the once-per-year auctions for yearly products before the (“second chance”) once-per-year auctions for quarterly products are held.

Finally, the Network Code should provide flexibility to implement a further breakdown at Interconnection Point level for monthly or shorter term products subject to stakeholder consultations, agreement between the concerned Transmission System Operators and review by the relevant National Regulatory Authorities, as otherwise the Network Code may not allow for sufficient capacity to be offered for shorter durations, for instance at the day-ahead stage, which could hamper the introduction of potential market coupling projects. Moreover, the application at individual Interconnection Points of more stringent national provisions requiring higher minimum capacity levels to be reserved for different short and medium-term time horizons shall be aligned between the concerned Transmission System Operators and be subject to approval by the concerned National Regulatory Authorities. The provisions in Article 7(4) of Regulation (EC) No 713/2009 apply. In any case, the majority of the capacity at each Interconnection Point shall be allocated using the breakdown of available capacity defined in the Network Code.

⁵ For example, 4 or 5 years.

6 Sale of Unbundled Firm Capacity

Article 5.1(5) of the Network Code provides for the possibility to offer unbundled firm capacity in the case of a (technical) mismatch. Article 5.1(1) of the Network Code explicitly exempts new capacity from the bundling requirement. The Framework Guidelines set out the objective of progressively bundle the entire technical capacity, including new capacity.

This objective cannot be achieved if the Network Code provides for the possibility to offer and allocate available excess firm capacity resulting from a technical mismatch as an unbundled capacity product for, potentially, up to 15 years ahead. The implementation of this provision would maintain the current situation and slow down the bundling of capacity on one side of an Interconnection Point with any capacity that can or will be provided at the other side of the same Interconnection Point.

To achieve the objective to maximise the offer of bundled capacity and to progressively bundle all the capacity at an Interconnection Point, close coordination and cooperation of adjacent Transmission System Operators is necessary in the areas of capacity calculation (to determine the “technical” capacity that can be commercialised) and in the field of investments, where the previous approach is already exhausted. A “technical mismatch” of technical capacity between the two sides of an Interconnection Point can be the result of, for example, different or differently applied (technical) capacity calculation methods or different approaches to assign entry or exist capacities to certain Interconnection Points when optimising each single entry-exit system (which is also dependent on the size and complexity of the connected entry-exit systems, which are often different). Next to insufficient coordination of Transmission System Operators in the latter areas, also differently applied (or not applied) congestion management procedures may lead to a “technical mismatch”.

The possibility envisaged in the Network Code to allocate the exceeding capacity, resulting from a “technical mismatch” of firm capacity, as unbundled firm capacity for a long period of time (up to even 15 years) prevents the bundling of capacities whenever additional technical capacity (be it from re-calculation/re-assignment/optimisation or investments) becomes available, which can also happen on a short-term basis, and therefore contrast with one of the explicit objectives stated in the Framework Guidelines.

Therefore, the Network Code should be amended in a way that it does not obstruct the goal of progressive bundling within a reasonable time horizon. This could be achieved by limiting the duration of the offer of firm unbundled capacity, for instance, up to the rolling monthly auction. Additionally, in order also to reflect the requirement of bundling any new capacity, the second sentence of Art. 5.1(1) of the Network Code shall be deleted.

7 Amendment of Existing Capacity Contracts

Article 5.2(9) of the Network Code specifies that NRAs “shall” mediate between the parties affected by that article, whereas the Framework Guidelines (Section 2.4.2) explicitly refer to “may” mediate.

To ensure compliance, the Network Code needs to be modified accordingly.

8 Interruptible Capacity

Article 6.2(2) of the Network Code sets out the minimum interruption lead times for interruptible capacity, while, at the same time, giving adjacent Transmission System Operators the possibility to agree on a different lead time.

This Article should be amended to include the requirement for a duly justification and approval by the relevant National Regulatory Authorities for any downward deviation from the default minimum interruption lead time, as such a deviation would negatively influence shipper's flexibility and is strongly related to nominations/re-nominations timing.

9 Tariffs

Article 7.3 of the Network Code specifies that reserve prices (which are regulated tariffs) are set according to a revenue equivalence principle, although fixing or approving tariffs is a task of the National Regulatory Authorities⁶. This provision goes beyond the requirements of the Framework Guideline, as the latter is silent on how the regulated tariffs/reserve prices should be determined.

The revenue equivalence principle is not the only way to ensure revenue recovery. ENTSOG argues that, without this provision, there is a risk of having "unattractive" reserve prices for bundled capacity due to (higher) multipliers applied on only one side of the Interconnection Point. The introduction of bundling does not create any difference compared to today's situation where the corresponding exit and entry capacity are booked separately at different prices. Additionally, since Article 7.4 of the Network Code specifies that the total reserve price of bundled capacity is the sum of the reserve prices for the capacities in the bundled capacity and the reserve prices themselves are determined at national level, the Network Code can be implemented without the need to describe further principles on how the different products are to be priced. Therefore, Article 7.3 of the Network Code is not required to implement the Network Code.

Furthermore, there is a balance to be struck between the level of long-term and short-term reserve prices, in order to create sufficient signals for long-term investment while promoting short-term trade. This issue has not been addressed in the Framework Guidelines on CAM, nor fully explored in the CAM Network Code; it will be considered in the Framework Guidelines on rules regarding harmonised transmission tariff structure.

Therefore the reference to the revenue equivalence principle should be removed from Article 7.3 of the Network Code. This does not preclude the possible application of multipliers or any other mechanism per Interconnection Point and per direction, subject to agreement and approval by the concerned National Regulatory Authorities.

Article 7.5 of the Network Code provides for a default rule for the attribution to the Transmission System Operators of the revenues from the auction premia from bundled capacity. This rule envisages that, if no agreement between the Transmissions System

⁶ cf. Art 41(1)(a) Dir. 2009/73/EC.

Operators is concluded before the auction and approved by the relevant National Regulatory Authorities, the revenues from the auction premia are attributed proportionally to the reserve prices. In order to avoid any possible strategic behaviour when setting the tariffs (reserve prices) for the individual Interconnection Points (potentially leading to distortions), a simpler default mechanism is recommended. This mechanism should stipulate an attribution of the auction premium revenues independent of the individual reserve prices of the bundled capacity product, i.e. an equal split of the auction premium revenues between the concerned Transmission System Operators.

Article 7.6 of the Network Code includes a provision specifying that National Regulatory Authorities shall recognise revenue shortfalls, where allowed revenues are set, by adjusting tariffs accordingly. This sentence however seems inappropriate, as typically in tariff regimes where allowed revenues are set, National Regulatory Authorities would not set or adjust the actual tariff, but only the allowed revenues. Therefore, as this provision is not covered by the Framework Guidelines and seems out of the scope of the Network Code, the last sentence in Article 7.6 of the Network Code shall be removed.

Finally, Article 7 of the Network Code deals with “Tariffs” issues which are not covered in the Framework Guidelines and which will be addressed in future Framework Guidelines on rules regarding harmonised transmission tariff structures, as indicated in Section 3.1.2 of the Framework Guidelines. In order not to prejudge decisions to be taken within the Framework Guideline/Network Code process on rules regarding harmonised transmission tariff structures the application of Articles 7.3, 7.5 and 7.6 of the Network Code must be regarded as temporary. They will be repealed with the entry into force of the relevant provisions of the rules regarding harmonised transmission tariff structures. Therefore the Network Code should specify that market participants may not invoke frustration of legitimate expectation following the (possible) revision of Article 7 of the Network Code by the Network Code developed on the basis of the Framework Guidelines on rules regarding harmonised transmission tariff structures or another Annex to the Regulation on this topic.

10 Incentive Regimes

Article 9.2(d) of the Network Code specifies that appropriate incentive regimes with associated methodologies shall be decided at cross-border level, and shall be subject to stakeholder consultation. This article goes beyond the Framework Guidelines, as the latter only require stakeholder consultation for decisions regarding the breakdown of capacity services or the detailed aspects of the capacity allocation methodology not defined in the harmonised design. Incentives are not covered⁷.

Although the Agency recognises the merits to consult on the incentive regime when it will have an effect on cross-border capacity offer, there is no reason to explicitly include this aspect in the Network Code. Therefore, Article 9.2(d) of the Network Code is not in line with the Framework Guidelines and should thus be deleted.

⁷ The introduction of incentive regimes as part of an oversubscription and buy-back scheme (to be approved by NRAs) is covered by the amended Annex I to Regulation (EC) No 715/2009.

11 Interim Period

Article 10.3 provides for a general interim period for applying auctions subject to approval by the relevant National Regulatory Authority, whereas Section 3.1.6 of the Framework Guidelines leaves the decision on interim measures to the Comitology process. Therefore, this section seems redundant.

Moreover, the text is also ambiguous with respect to the "characteristics" of any interim arrangement. The wording "harmonised allocation mechanisms", used in the Framework Guidelines, is not reflected in the Network Code, where reference is made to "compatible allocation mechanisms". The term "compatible" might be interpreted in a very broad sense allowing current practices to be maintained, as it leaves too much room for individual interim decisions that might circumvent or postpone the achievement of the harmonisation of capacity allocation. Therefore, the Agency recommends deleting Article 10.3 from the Network Code.

Done at Ljubljana on 5 June 2012.

For the Agency:


Alberto Pototschnig
Director