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Towards efficient and effective congestion management of the European gas transmission network:

Difficulties with the current implementation approaches and possible solutions

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EFET position paper – 1 October 2014

Efficient and effective cross-border congestion management is a key prerequisite for the development of a well-functioning internal European wholesale market for gas. The European Federation of Energy Traders (EFET)[1] welcomed the adoption of the Commission Decision on amending Annex I to Regulation (EC) No 715/2009 on conditions for access to the natural gas transmission networks[2] as an important step in tackling contractual congestion at cross-border interconnection points. However, we are concerned that the implementation process has not been handled with the required degree of coordination among Transmission System Operators (TSOs) and National Regulatory Authorities (NRAs), and that some of the measures are based on the extreme, rather than on the most-likely scenarios, to the effect of unnecessarily distorting the market. Realistic timetables, more inclusive project-planning and most importantly, closer cross-border cooperation are urgently needed, as key issues remain unresolved.

Imprecise definition of 'contractual congestion'

One of our main concerns is that the definition of 'contractual congestion' is not precise. Article 2.1.(21) of Regulation (EC) 715/2009 defines 'contractual congestion' as 'a situation where the level of firm capacity demand exceeds the technical capacity.' **This definition**, however, **does not distinguish between physical congestion where demand exceeds the technical capacity, but all capacity is being used; and contractual congestion where demand exceeds the technical capacity, but not all capacity is being used or being offered to the market**. As written, the definition would mean that there was contractual congestion whenever

[1] The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent, sustainable and liquid wholesale markets, unhindered by national borders or other undue obstacles. We currently represent more than 100 energy trading companies, active in over 28 European countries. For more information, visit our website at www.efet.org.

[2] Hereafter, Guidelines on Congestion Management Procedures, or CMP Guidelines.

there was an auction premium, which is not correct. Where supply is fixed, all capacity is being used and there is still demand for more capacity, there will be an auction premium. This does not mean that the market is not functioning properly, but that additional investment is necessary, or that TSOs are setting the level of technical capacity too low. (See the section on "Setting Technical Capacity Levels" below.)

We do understand that the Commission and NRAs operate within the constraints of the existing legislative framework, but **a small technical change to this flawed definition would solve the problem while maintaining the structure and logic of the legislative text**.

Conclusions on the first ACER Annual report on contractual congestion at interconnection points

We welcome the first *Annual report on contractual congestion at interconnection points* prepared by the Agency for the Cooperation of Energy Regulators (ACER), as an essential mechanism for monitoring the implementation and effectiveness of congestion management procedures. The report rightly highlights that although oversubscription and buy-back (OSBB) schemes should have been put in place across the EU as of 1 October 2013, as required by Article 2.2.2. of the CMP Guidelines, at most interconnection points the mechanisms have not been applied yet. Moreover, lack of essential data, or data of poor or questionable quality remain a major obstacle to the proper monitoring of the implementation process and to the development of a clear and reliable strategy for taking the process forward. Appreciating the difficulty of monitoring congestion in the absence of adequate information, we are fully supportive of the recommendation of ACER for TSOs to increase the availability, quality and consistency of data, and for NRAs to check the consistency and validity of the information, which was also reflected in the conclusions of the 25th Gas Regulatory (Madrid) Forum.

Furthermore, the analysis conducted for the Report is based on the imprecise definition of what constitutes 'contractual congestion', set in Regulation EC 715/2009 and discussed in the previous section. The use of this definition has resulted in the identification of false positives. This exposes shippers to an unnecessary risk, as it could lead to the imposition of restriction of re-nomination rights as of 2016 when there is no contractual congestion.

Last but not least, this first report covers only a three-month period, during which OSBB mechanisms, as highlighted in the document itself, were not even implemented at most of the interconnection points under review. Therefore, at this point it cannot serve as an objective basis for analysing the effectiveness of OSBB in releasing unused capacity back to the market, and we would caution against a possible unfair bias in favour of the implementation of short-term use-it-or-lose-it (UIOLI) as of 2016. Moreover, the fact that the data for compiling this report comes predominantly from Austria and Germany – two areas which have decided against the implementation of OSBB, and that data from other regions is largely unavailable, could also contribute to such a bias.

Conclusions on the Commission Guidance on best practices for congestion management procedures in natural gas transmission networks

We also support the continuing efforts of the European Commission on the subject of congestion management, most recently reflected in the *Guidance on best practices for congestion management procedures in natural gas transmission networks*, a Commission staff working document published in July 2014. The document rightly highlights the role of OSBB schemes as 'the basic instrument to prevent contractual congestion'. In observing that firm day-ahead use-it-or-lose-it (FDA UIOLI) is considerably more restrictive with respect to the use of capacity rights than OSBB, the Commission also points to the fact that FDA UIOLI 'was meant as a fall-back measure to oversubscription and buy back in case oversubscription and buy back could not deliver effectively in eliminating contractual congestion by 1 July 2016', as also set out in the Impact Assessment of the CMP Guidelines.

We fully agree with the concern of the Commission about to the interaction between the two mechanisms. We are confident that NRAs on both sides of an IP would benefit significantly from agreeing on the joint introduction of OSBB schemes. Theoretically, OSBB and FDA UIOLI mechanisms could be applied on the opposite sides of an IP before capacity bundling is introduced. However, as the Commission recognises, **the application of FDA UIOLI on one side of the border and OSBB mechanisms on the other would require the application of the 'lesser rule'** (due to the downward renomination restrictions embedded in FDA UIOLI), **to the effect that less capacity will be made available than if OSBB mechanisms were applied on both sides of the border**. Moreover, the bundling of cross-border capacity will become mandatory as of 1 November 2015, which means that the inefficiencies resulting from the inconsistent and uncoordinated application of congestion management mechanisms will become a reality only in a year's time.

OSBB mechanisms are clearly the more efficient way of managing cross-border congestion, as they *facilitate* the release of capacity further in advance of the day-ahead timeframe. However, their implementation and success across the EU are jeopardised by the use of a flawed definition of 'contractual congestion' and by the fact that the legislation allows for the direct implementation of FDA UIOLI. Whilst we recognise the set of constraints under which the Commission operates, we believe a small technical change to the imprecise definition of 'contractual congestion' would enhance considerably the functioning of congestion management processes.

Furthermore, we welcome the fact that the Commission urges TSOs to ensure the firmness of capacity released through OSBB and highlights the need for setting the baseline capacity at an appropriate level, which are also approved by NRAs. However, we caution against several of the recommendations made in the Guidance:

- Encouraging TSOs to check for alternative/ more cost efficient technical/ commercial measures before applying buy-back mechanisms and using buy-back mechanisms only as a last resort creates the risk of undermining the financial firmness of capacity sold via OSBB.

- Allowing for the introduction of explicit price caps on buying back capacity at the discretion of NRAs could also undermine the firmness of capacity rights and the application of OSBB. First, it is not clear which price spread would be used to set the cap, and second, setting such a cap is not consistent with the operation of markets. Moreover, any possibility for market abuse in that context would already be covered by the relevant market abuse legislation.

- The recommendation that network users should not benefit from surrendering capacity by receiving even part of the auction premium (should there be any), based on the understanding that that would create perverse incentives for network users to book more capacity than necessary, overestimates the ability of a market participant to block capacity. This would be an extreme, rather than a most-likely, case. It is equally possible that such an approach would undermine the surrender mechanism by encouraging shippers to hold onto capacity for as long as possible in case they might use it, rather than surrendering it and receiving the market (cleared auction) price for it.

Further cooperation between the Commission, ACER and regulators on developing a fit for purpose regime is certainly essential. It is important that the various trade-offs in the design of CMP are properly considered with input from stakeholders, and we welcome further consultation with the Commission on the subject.

In addition to these more general remarks, in the sections below we restate a few key principles in relation to congestion management, which should be implemented as soon as possible. Moreover, in support of these principles, in the Annex we offer concrete examples of actual and potential obstacles to trading resulting from inefficient, inconsistent, or delayed CMP implementation.

Key principles and pending issues

❖ ***Aim of CMP***

The aim of CMP should be to maximise the amount of unused capacity available to the market. Unused capacity can be made available to the market as firm capacity via the following mechanism:

- Secondary trading by shippers – selling capacity they have booked but no longer need
- Over Subscription and Buy Back (‘OSBB)
- Short-term Use It or Lose It (‘UIOLI’)
- Surrender of capacity
- Long-term Use It or Lose It (‘UIOLI)

It should be noted that the development of secondary capacity markets, which allow for much greater flexibility, would render the capacity surrender mechanism redundant. The successful development of secondary capacity markets, however, especially in a world where the bundling of capacity products becomes mandatory,

would require ***consistency of primary capacity products, and contractual terms and conditions***.

In addition to the CMP mechanisms listed above, TSOs are required to offer day-ahead interruptible capacity when firm capacity is sold out. We believe a zero reserve price for this product will incentivise shippers and TSOs to maximize the amount of firm capacity that can be offered to the market.

When deciding how mechanisms should be used and how they should be designed, regulators need to consider which approaches maximise the availability of capacity to the market. It should also be considered that a one-off capacity reset option may be a very efficient tool to remove in one step a large part of the congestion across Europe, which would allow CMP measures to focus on a more limited number of contractually congested Interconnection Points (IPs).

- ***Oversubscription and buy-back mechanisms***

As required by the CMP Guidelines, Section 2.2.2, and reiterated in the ACER 'Issue paper' on the need for coordinated decisions at the EU level for the implementation of the CMP Guidelines from August 2013, TSOs shall propose and, after approval by the respective NRA, implement an incentive-based OSBB scheme to offer additional capacity on a firm basis. Considering that the implementation deadline for OSBB schemes was 1st October 2013, Regulators should take immediate steps towards the development and introduction of such mechanisms. Any delays risk implementing a regime of restriction of re-nomination rights by default.

Given that the CMP Guidelines were adopted a while ago, it is disappointing that some TSOs and NRAs have not made sufficient effort to develop OSBB schemes. Indeed, it is conceivable that they are using the lack of progress on the development of OSBB schemes as a reason to implement only short-term UIOLI mechanisms. We welcome the declaration of ENTSOG presented at the last Madrid Forum that 28 of its members have implemented CMP mechanisms, and that 4 are in the process of doing so. However, we remained concerned that progress on OSBB implementation remains slow.

Moreover, the ACER monitoring report, which will determine whether short-term use-it-or-lose-it will be implemented in 2016, is proposed by ACER to be published in June 2015, with data until March 2015. By then, some EU Member States (MSs) may not have had OSBB schemes in place for a period sufficiently long to counteract any contractual congestion. Thus, the findings of the report may be unfairly biased against the mechanism.

Furthermore, it is not clear how much consultation and communication has taken place between those NRAs (e.g. BNetzA and E-control) who have decided to implement only short-term UIOLI schemes, and neighbouring regulators. The CMP Guidelines explicitly require NRAs to consult with neighbouring regulators and to take the opinion of their counterparties into account. Such consultation is essential, as mismatches between the CMP regimes on either side of an IP would create

barriers to cross-border trade. This point was highlighted by the EU Commission at the 24th Madrid Forum, which took place in the autumn of 2013.

Failure to implement OSBB mechanisms would be a missed opportunity for achieving greater efficiency, as by definition short-term UIOLI can *oblige* to release capacity only on a day-ahead basis. OSBB schemes *facilitate* the release of capacity further in advance of the day-ahead timeframe. The amount of capacity released by TSOs via OSBB mechanisms will, of course, depend on the incentives put in place and the way the baseline is set, e.g. a very high baseline may give TSOs less room to release additional capacity as capacity will already be released by the auctions. EFET has developed an Implementation Guide on an 'Appropriate design for an oversell and buy-back scheme', which addresses all these issues in further detail.

❖ ***Setting technical capacity levels ('baselines') and the interaction with OSBB***

Baselines are the quantities of capacity which TSOs have to offer to the market. TSOs should be required by NRAs to set the baseline as high as reasonably possible whilst still being able to honour firm capacity rights. As a result of the integrated nature of entry/exit systems, it is possible to set baselines in a variety of ways. From a CMP point of view, however, the baseline level will have a key impact on the risk that TSOs face when releasing additional firm capacity under OSBB. If the baseline is set too low, TSOs will receive considerable extra revenue through OSBB mechanisms with little or no risk. In such a case it is questionable whether TSOs should benefit from any OSBB incentives. On the other hand, a very high baseline limits the amount of OSBB capacity that TSOs can make available, as this capacity is already provided via the normal procedures for capacity allocation set in the EU Network Code on Capacity Allocation Mechanisms (CAM).

The amount of OSBB capacity made available should be based on a probability that buy-back is necessary, consistent with the incentive mechanism and cost/sharing mechanism between TSOs and shippers; this would create certainty and limit the exposure of TSOs. That being said, once OSBBs are in place, a prudent and efficient operator would be expected to maximise the quantity of capacity offered to the market. It is also important that OSBB capacity is not confused with, and does not replace, interruptible capacity.

❖ ***Treatment of OSBB capacity***

Firm capacity sold via OSBB should be treated as firm capacity, i.e. there should not be any differentiation in terms of the way it is treated. Interruption of firm/OSBB capacity should occur only if there is a danger to the system, not as a means to avoid paying for buy-back capacity.

❖ ***Bundled capacity products and implications for CMP***

TSOs have a duty to maximise the quantity of bundled capacity. However, it is important to recognise that capacity on either side of an IP will not necessarily match. Capacity on the 'exit' side of an IP is a function of flows and network design

of the entry/exit zone upstream of the IP. Similarly capacity on the 'entry' side of an IP is a function of flows and network design of the entry/exit zone downstream of the IP. It is also the case that TSOs may change the amount of capacity available at one side of an IP as a result of changes in their network, whilst the capacity available on the other side of the IP remains unchanged. Thus, the amount of bundled capacity that can be offered will be set by the lower of the two capacity values on either side of the IP.

At the same time, the purpose of OSBB is to maximise the quantity of available firm capacity, irrespective of whether it is bundled or not, as the more capacity is available, the more gas can flow between markets. Shippers will then be in a position to decide how to flow gas between hubs, what types of capacity to use, and how to match capacity at an IP.

In view of the above, it can be observed that the requirement to offer only bundled capacity raises a number of issues of concern for the efficient functioning of gas markets and CMP:

- Bundled capacity cannot be sold on more than a day-ahead basis if on one side of the IP the rules are based on an OSBB scheme and on the other they follow the short-term UIOLI principle. If one side offers OSBB capacity for more than day-ahead, but this is not matched on the other side where OSBB is not implemented, this could create lost opportunities to maximise the amount of capacity on offer. Therefore, the decision of some Regulators to implement short-term UIOLI does not help the internal market.

- Bundling of capacity raises the question how OSBB revenues and risks should be shared between TSOs at IPs where the amount of baseline capacity which a TSO can offer is different on one side of the border from the other. For example, TSO A has firm capacity of 100 units to offer, and TSO B has 50 units to offer. They can offer a bundle of 50 units, and offer a further 50 units bundle if TSO B offers 50 units as OSBB. Where this is the case, the need to buy back may only be triggered on one side of the border, but, because the capacity is bundled, capacity on both sides of the border has to be bought back. Either both TSOs are exposed to buy-back costs for the bundled capacity, even though it is only the conditions of one TSO that have caused the buy-back, or the TSO which triggered the buy-back costs is exposed to all the buy-back costs for the bundled capacity. This may prevent TSOs from offering OSBB capacity, due to this asymmetric risk. To avoid problems of buy-back cost allocation, TSOs should be encouraged to offer as much capacity as they can under OSBB for up to one year ahead, on an unbundled basis, as allowed under the CAM Network Code.

- Following from the rule that TSOs must sell other capacity before they sell surrendered capacity, it is possible that a TSO may sell one part of the bundle, leaving the shipper to pay for the other half of the bundle. We, therefore, agree with the ACER Issues Paper that when selling bundled

surrendered capacity, the TSO allocates this before it allocates unbundled capacity, which avoids the problem that shippers may find only half its bundle reallocated. TSOs should then offer any unbundled capacity that may be available.

- Terms and conditions for surrender of capacity and trading on the secondary market are not aligned. On the secondary market shippers can only sell bundled capacity, whereas TSOs are allowed to sell unbundled capacity. However, once capacity is surrendered, the shipper has no control over *when* and *how* the capacity is sold, and surrendered capacity can only be sold once all other capacity has been sold. Shippers should be allowed to sell unbundled capacity if this enables them to match this capacity with unbundled capacity on the other side of an IP, where there are differences between the technical capacity available on each side of the IP.

❖ ***Surrender of capacity***

Shippers should be able to take back surrendered capacity if the capacity has not been sold in the auctions, i.e. prior to each auction, shippers would need to confirm that they still wish to surrender capacity which they had previously surrendered, but which had not been sold in the previous auction. The rationale behind this is that circumstances may change between auctions and as shippers are still paying for the surrendered capacity that has not been sold to other shippers, they should have the certainty that they still have this capacity. OSBB, short-term UIOLI, and long-term UIOLI should be sufficient to prevent any gaming of this rule.

Furthermore, shippers should receive the entire premium that a TSO receives when it resells surrendered capacity, even if the premium is more than the initial amount that the shipper paid for this capacity. It should also be clear that the surrendering shippers are relieved of their obligations once the capacity has been re-sold. As shippers have taken both the risk of buying the capacity in the first place and the risk that they cannot re-sell it or surrender it, they should enjoy any upside from capacity resale on the secondary market or from resale by the TSO after the capacity has been surrendered. As the amount of revenue that TSOs are allowed to earn is regulated, TSOs should not receive revenue from the sale of regulated capacity which is above the regulated price of that capacity. We, therefore, disagree with the statement in the ACER Issues Paper that shippers should make no profit from surrendered capacity.

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ANNEX

EU Member State	Priority	Affected part of the CMP Guidelines	Issue	Proposed solution
Across the EU	High	Art. 2.2.1(4)	**Delayed implementation of CMP Guidelines** In a number of EU Member States, TSOs have not yet fully implemented mechanisms for tackling contractual congestion at cross-border points, although **the legally-binding CMP Guidelines require that OSBB schemes should be put in place as of 1st October 2013**. **Examples:** • Austria and Germany have decided not to implement OSBB, with limited or no consideration of market participants' concerns, or of the negative impact of this decision on the functioning of the wholesale European gas market. • Italy has delayed the implementation of OSBB mechanisms. • The Netherlands has not yet fully implemented OSBB mechanisms for all products.. • Denmark has delayed the implementation of OSBB mechanisms.	The European Commission and ACER should **encourage greater cooperation and coordination** among neighbouring TSOs and NRAs **for the immediate implementation of OSBB mechanisms**, as required by Article 2.2.1(4) of the CMP Guidelines.
Austria [NRAs: E-control] **Germany [NRAs: BNetzA]**	High	Art. 2.2.2	**Inconsistent implementation of CMP mechanisms** The application of OSBB on one side of an IP and ST UIOLI on the other (1) creates a risk that shippers would not be able to use firm capacity on the ST UIOLI side when capacity is bought back on the OSBB side; (2) would result in an inability to use fully the additional capacity sold on the OSBB side when it becomes subject to renomination constraints on the other side of the IP.	ACER should **urge and facilitate greater coordination and cooperation among neighbouring TSOs and NRAs, in cooperation with market participants,** for the immediate implementation of harmonised congestion management mechanisms across the EU, as per para. 2.2.2.1 and para. 2.2.3.7 of the CMP Guidelines; Art. 1.2 and Art. 7.3 of Regulation 713/2009; Art. 16.1, Art 16.3, Art 24 of Regulation (EC) 715/2009; and Art. 7.1 and Art. 7.2 of Directive 2009/72/EC.

			Thus, the decision of the German and Austrian TSOs not to implement OSBB mechanisms, but to go directly into the application of ST UIOLI, which was supported by the respective NRAs, creates serious obstacles to the efficient allocation of cross-border capacity. The negative impact of this decision will become particularly clear at IPs involving Austria or Germany (e.g. NL-DE, FR-DE, DE-BE, DE-PL, AT-IT) when the capacity bundling provision of the CAM Network Code enters into force in 2015. In the case of the Obergailbach (FR) -Medelsheim (DE) interconnection point, for instance, at Obergailbach, where OSBB mechanisms are applied, the allocable capacity is greater than at Medelsheim, where OSBB mechanisms are not applied.	**The decision of the Austrian and German TSOs not to implement OSBB should be reversed as soon as possible**. **Failure to implement OSBB is a missed opportunity for achieving greater efficiency**, as by definition ST UIOLI can only release capacity on a day-ahead basis. OSBB presents the opportunity for more capacity to be released further in advance of the day-ahead timeframe.
France **[NRA: CRE]**	High	Art. 2.2.2	**Reduced firmness of oversold capacity** Imposing a cap for capacity buy-back by the TSO reduces the firmness of the oversold capacity and creates a reference price for the buy-back auction (e.g. in France at a price 1.25 x the capacity reserve price). It is very likely that **the cap would work as a *target price*** in any case in which buy-back is triggered.	The ***financial*** **firmness** of the capacity can be ensured **ONLY if there is no cap**.
The Netherlands **[NRAs: ACM]** **Italy** **[NRAs: AEEGSI]**	High	Art. 2.2.2	**Lack of transparency** The methodologies for setting the baseline capacity differ considerably among EU Member States. They are rarely consulted on or made available to the public. In particular, the process in the Netherlands is not sufficiently transparent, while details on the methodology applied in Italy are not available at all.	ACER and NRAs should encourage **greater TSO transparency and coordination** in relation to the methodology for calculating the baseline capacity. In this relation, the EFET Implementation Guide for an 'Appropriate Design for an Oversell and Buy-back Scheme', which, among others, offers some key principles for setting the baseline capacity, could serve as a useful reference.
Across the EU	High	Art. 2.2.4	**Inconsistent application of capacity surrender mechanisms** **Capacity surrender is not applied in the same way** across the EU, which creates **little incentive to use the mechanism**. • The **premium arising from surrendered and**	**Full transparency and consistency of application of the mechanism** is required across the EU, and the Commission and ACER should streamline such efforts. The regional initiatives should be used as a platform for running pilot projects to implement more coordinated capacity surrender mechanisms. **As a matter of principle**, a market participant should

			auctioned capacity is either given back to the primary capacity holders (e.g. IT and BE), or not given back to the primary capacity holders (e.g. NL, AT, and DE). In France a further mechanism applies, i.e. the potential premium is smeared on transportation tariffs and negative differentials with the initial clearing price being paid by the original capacity holder. • The **possibility to dispose of surrendered capacity** before the auction round takes place is constrained in different ways, i.e. different approaches to how long in advance of the auction a shipper can surrender capacity before the right for the surrendering shipper to dispose of this capacity is revoked). • In some countries **day-ahead capacity** cannot be surrendered (e.g. NL and PL). If more than one shipper surrenders capacity, different methods to re-allocate the capacity are applied: ***pro-rata*** (e.g. IT and NL) or ***timestamp*** (e.g. BE, FR, DE, and AT). In the case of bundled products this issue becomes insurmountable. • German TSOs give back the capacity which has not been sold only at 18:30 Day-ahead, which is very late, while other TSOs offer the possibility to recuperate the capacity after each auction (Y, Q or M). This means that shippers will never be interested to surrender bundled products if one side of the product is German capacity.	know at the time of surrendering capacity *when* and *in what form* that capacity will be reallocated. The primary holder should be allowed to claim back the capacity at any time with the exception of the time when the capacity is auctioned.
Belgium [NRA: CREG]	Medium	Art. 2.2.4	**Administrative fees for selling surrendered capacity** Shippers are charged an administrative fee of 3% of the regulated tariff on the credit that they receive when their surrendered capacity has been resold. This practice contradicts the principles of cost-reflectivity and TSO remuneration.	The TSO should apply a **fixed fee reflecting the actual administrative expenses** related to the sale of surrendered capacity.