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COMMISSION STAFF WORKING DOCUMENT

**Guidance on best practices for congestion management procedures in natural gas
transmission networks**

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**Guidance on best practices for congestion management procedures in natural
gas transmission networks**

1. INTRODUCTION

The Commission Decision of 24 August 2012 on amending Annex I to Regulation (EC) No 715/2009 of the European Parliament and of the Council on conditions for access to the natural gas transmission networks (hereafter, "the Congestion Management Procedures Guidelines" or "CMP Guidelines")¹ introduced new and more detailed obligations on transmission system operators (hereafter, "TSOs") and National Regulatory Authorities (hereafter, "NRAs") on how to design congestion management procedures in the event of contractual congestion² at interconnection points (hereafter, "IP"). In particular, it determined that an oversubscription and buy back scheme, a system for the surrender of capacity and a mechanism for long term use-it-or-lose-it had to be implemented by 1 October 2013. In addition, a firm day-ahead use-it-or-lose-it mechanism will have to be applied as of 1 July 2016 at interconnection points which face contractual congestion as described in Point 2.2.3.1 of the CMP Guidelines.

The present document aims to provide a comprehensive overview of these new congestion management procedures. It sheds light on the Commission services' understanding of how the provisions of the CMP Guidelines are to be applied in practice. The present note is not exhaustive, but covers specific issues for which, in the view of the Commission services, additional clarification is required. The Commission also notes that the Agency for the Cooperation of Energy Regulators (hereafter, "ACER") has already provided extensive guidance on many of the provisions in the CMP Guidelines by means of its "Issue paper" on the need for coordinated decisions at EU level for the implementation of the CMP Guidelines.³

This document aims to give guidance to optimise the congestion management in natural gas transmission networks in the light of the CMP Guidelines but does not create any new legislative rules. In any event, giving binding interpretation of European Union law is ultimately the role of the European Court of Justice. The present note is therefore not legally binding.

2. OVERSUBSCRIPTION AND BUY-BACK

2.1 Application and products

Point 2.2.2.1. of the CMP Guidelines determines that:

"Transmission system operators shall propose and, after approval by the national regulatory authority, implement an incentive-based oversubscription and buy-back

¹ OJ L 231 of 28 August 2012, p. 16;

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:231:0016:0020:EN:PDF>.

² According to Regulation (EC) 715/2009 "'contractual congestion' means a situation where the level of firm capacity demand exceeds the technical capacity".

³ http://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/ACER_CMP_Guidance%20issue%20paper%20on%20CMP%20implementation_20130808.pdf.

scheme in order to offer additional capacity on a firm basis (...) Additional capacity is defined as the firm capacity offered in addition to the technical capacity of an interconnection point calculated on the basis of Article 16(1) of this Regulation."

The oversubscription and buy-back scheme provided for in Point 2.2.2. of the CMP Guidelines can be regarded as the basic instrument to prevent contractual congestion, based on the idea that the TSO offers more firm capacity to the market than is technically available. Naturally this cannot be done in the case of physical congestion.^{4,5} The TSO thereby makes use of a statistical scenario planning in order to determine the amount of capacity that is likely to remain unused by the capacity contract holders. As such, the oversubscription and buy back scheme is a preventative measure meant to be applied continuously with a view to ensuring that contractual congestion does not occur.

Consequently, the CMP Guidelines foresee, as a general rule, that the oversubscription mechanism is applied by all TSOs at all IPs unless an NRA has taken, and notified to ACER and the Commission, a decision not to apply Point 2.2.2 (the oversubscription and buy back mechanism) pursuant to Point 2.2.3.6 of the CMP Guidelines. That in turn means that it has opted to directly apply the firm day-ahead use-it-or-lose-it mechanism.

There are differences between networks, for instance in terms of their complexity or in terms of the booking levels at respective IPs and therefore the most appropriate design of the oversubscription and buy back mechanisms can differ as well.⁶ For instance, in networks with currently relatively low booking levels, e.g. below 60%, a very simple mechanism without sophisticated scenario planning or IT infrastructure may be sufficient and an appropriate means to achieve the end. Such a mechanism should simply provide the possibility for network users to contract capacity beyond the technical capacity or "baseline capacity" level in case they are interested in doing so. Indeed, such a system would in a cost-efficient manner fulfil the objectives of the CMP Guidelines providing a preventative system to eliminate contractual congestion. Such mechanisms would naturally need to be reviewed by the respective TSO and NRA in case booking levels rise or if there are structural changes indicating that more sophisticated analysis will become necessary in order to allow the TSO to offer additional capacity.

The more complex and meshed a network is and, in conjunction, the higher booking levels are, the more sophisticated the TSO's system will need to be to support the TSO in determining the amount of additional capacity it should offer to network users. In developing such a system the TSO has to have an idea of the cost-benefit

⁴ According to Regulation (EC) 715/2009 Article 2(1)(23) "*physical congestion*' means a situation where the level of demand for actual deliveries exceeds the technical capacity at some point in time".

⁵ This was also set out clearly in the Impact assessment of the CMP Guidelines, page 27.

⁶ As set out in the Impact assessment, page 28: "[...] *the administrative costs of setting up an oversubscription and buy-back system are greatly dependent on the likelihood of contractual and physical congestion occurring. If this likelihood is low, the system will inevitably be quite simple while in the case of large and more complex systems the system may need to be comparatively more sophisticated.*"

analysis in terms of the risks it may be taking and the rewards it may be reaping through the incentive mechanism.

In case such an analysis shows that the TSO cannot or can only offer under very restricted conditions additional capacity in view of the network complexity, the NRA may need to re-consider the appropriateness in general of the oversubscription and buy back mechanism in that network and consider the possibility to instead apply a firm day-ahead use-it-or-lose-it mechanism pursuant Point 2.2.3.6 of the CMP Guidelines.

As set out above, it is clear that in particular in cases of physical congestion it will not be possible for the TSO to offer additional capacity even if it employs the most sophisticated of systems.⁷ Therefore, the CMP Guidelines place an obligation on the TSO to propose and – once approved by the NRA – implement an oversubscription and buy back mechanism in order to offer additional capacity on a firm basis. Actual additional capacity offered by the TSO may logically vary from IP to IP on the basis of the risk analysis undertaken.

The more certainty the TSO has with regard to the likelihood of capacities remaining unused, the more and the earlier it can offer additional capacity products, thereby profiting from a financial incentive upon sale. The CMP Guidelines do not provide rules on the type of products the TSO must offer. As a general rule, where a TSO offers large amounts of additional capacity the question may need to be asked whether the amount of technical (baseline) capacity or the methodology to calculate the technical capacity has been set appropriately. In this context the request for and usage of interruptible capacities by network users is also relevant especially taking into account whether such interruptible capacity has in fact been interrupted. This is a highly relevant matter and requires careful balance on the part of the NRAs as well. The CMP Guidelines are not to have the perverse incentive for the TSO to aim for the provision of "additional capacity" pursuant to Point 2.2.2.1 of the CMP Guidelines at the cost of ineffectively fulfilling their obligation to maximize capacity pursuant to Article 16(1) of Regulation (EC) 715/2009 (hereafter, "Gas Regulation").

Supposing full compliance with the provisions on maximizing capacity, evidently, TSOs can gauge with more certainty the amount of capacity they can sell in the form of additional capacity on a daily basis than on a yearly basis. Therefore it is likely that TSOs will first focus on offering such short(er) term products. It is however expected that as the system becomes more sophisticated the TSO can also extend its product portfolio to include at least monthly and quarterly products as well. Clearly, the logic of the oversubscription mechanism entails ongoing analysis by the TSO with respect to capacities contracted and used in order to provide as much additional capacity as it can. This is meant both in terms of volume (kWh) and product palette offered.

⁷ This is also set out in recital 4 of the CMP Guidelines: *"Where an interconnection point is frequently subject to the occurrence of physical congestion, congestion management procedures may often be of no avail. In those cases a solution should be examined from a network planning and investment point of view."*

Finally, in light of the possible risks the oversubscription and buy back may entail for the TSO, the NRA should ensure that the TSO is indeed incentivized in a commensurate manner so as to make all efforts to offer additional capacity it may not have been willing to offer without the incentive scheme.

The additional capacity offered under an oversubscription and buy-back regime must be of a firm nature. Recital (2) of the CMP Guidelines reads as follows:

'the practice has shown that despite the application of certain congestion-management principles such as the offering of interruptible capacities as provided for by Regulation (EC) No 1775/2005 (...) contractual congestion in the Union gas transmission networks remains an obstacle to the development of a well-functioning internal market in gas.

The text of Point 2.2.2.1 of the CMP Guidelines also emphasizes the need for the additional capacity to be of a firm nature. The reason for this emphasis has been described in the Commission's Impact Assessment accompanying the legislative proposal for the CMP Guidelines:

"Under current rules the new market entrants may acquire interruptible transmission capacities. However, interruptible capacities may only constitute an adequate alternative to firm capacity in certain situations, in particular where the risk of physical congestion is very low. Given that interruptible capacity is only a second class right, it makes competing with holders of first class rights very difficult. It does not create sufficient certainty for newcomers and does not sufficiently discourage incumbents from capacity hoarding in view of the relatively low price of capacity. Although the individual shippers' preferences differ, during the Public Consultation the stakeholders generally agreed that in order to be able to compete for customers, they need firm long term capacity rights."

The oversubscription mechanism inherently entails the risk that all capacity is sold and nominated for a flow that cannot be physically realized. The TSO is taking this – calculated – risk. Since regular remuneration models do not encourage TSOs to take such risks, an incentive-regime is to be set-up encouraging TSOs to take a proportionate risk. It is a key task of the NRAs in approving the TSOs' methodology to ensure an appropriate balance. This balance should be between an incentive that ensures an appropriate volume and form of additional capacity being offered and results neither in over-remuneration for the TSO (in the case of a system skewed toward a low-risk, high-reward structure) nor potentially heavy losses (due to a high-risk, low-reward structure). To find that balance, it is essential that an appropriate baseline capacity is set, either on the basis of approval by the NRA of the amount proposed by the TSO or an appropriate methodology for offering the additional capacity is approved by the NRA, reflecting the maximum capacity that is physically available at an IP. Evidence from the application of the oversubscription and buy back mechanism in the UK shows that setting the appropriate baseline capacity value is likely to include a learning process. Consequently, it is the view of the Commission services, that the appropriate (methodology to determine the) baseline capacity should be reviewed regularly in the early stages of implementing an oversubscription and buy

back mechanism to ensure that the system is effective and in line with the above provisions.⁸

2.2 The buy-back mechanism

Oversubscription inevitably brings along with it a certain degree of risk. If that were not the case, the TSO would be obliged to offer capacity as technical capacity pursuant to Article 16(1) of the Gas Regulation. The risk is there and in order to cope with it the CMP Guidelines prescribe a buy-back mechanism:

"6. Where necessary to maintain system integrity, transmission system operators shall apply a market-based buy-back procedure in which network users can offer capacity. Network users shall be informed about the applicable buy-back procedure. The application of a buy-back procedure is without prejudice to the applicable emergency measures."

Importantly, the buy-back mechanism put in place must be "*market-based*". In the development of the CMP Guidelines important emphasis was put on the notion that in offering and allocating additional firm capacity no distinction can be made between users that have been assigned 'technical firm capacity' and those that have been allocated 'oversubscribed firm capacity'. The Impact Assessment of the CMP Guidelines also does not refer to any differentiation but simply refers to "firm" capacity. This is a fundamental principle as many stakeholders supported this congestion management measure, over for instance to firm day-ahead use-it-or-lose-it, because of its more market-based nature. Hence, where a buy-back action is unavoidable, all network users have to have the opportunity to participate and indicate at what price they would be willing to waive their capacity rights. In the view of the Commission services, it is essential to ensure the firmness of the oversubscribed capacity insofar as ultimately the network users make the decision whether or not they want to use their capacity to flow gas or sell their rights back to the TSO. Any buy-back system whereby the TSO ultimately decides whether or not a network user's flow will be carried out or not will in practice result in a situation in which part of the allocated capacity at the interconnection point becomes interruptible. Therefore, the buy-back procedure should be structured in a way so as to assure that all – technical and additional – capacity rights are at least "financially firm", meaning that the network user willing to part with its capacity shall either receive physical gas at the destination virtual point of the entry-exit system to which he had capacity rights or, alternatively, financial compensation reflecting the damages.

Where the TSO succeeds in buying back a sufficient amount of capacity the risk has been averted. However, a situation can occur where no network user is willing to part with its capacity or is willing to do so only at a very high price. Point 2.2.2.7 of the CMP Guideline seeks to minimize such situations by obliging TSOs to "*before applying a buy-back procedure, verify whether alternative technical and commercial measures can maintain system integrity in a more cost-efficient manner.*" Such

⁸ This „learning curve“ was also set out in the Impact Assessment of the CMP Guidelines.

measures can be agreements with the adjacent TSOs with regard to the operation of flows or flow commitments with network users. Measures may also be buying the gas at the hub in the market area of destination and selling in the upstream hub so as to solve the congestion. This clearly requires corresponding licences for the TSO which, however, may be justified in such limited, clearly circumscribed situations. With such actions, the TSO can prevent the need to launch a buy-back procedure.

Where a sufficient number of network users hold capacity at an IP that connects two liquid wholesale markets with each other, it is unlikely for the established buy-back price to be higher than the price differential between the two market areas. This implicitly limits the risk of the TSO. In the view of the Commission services, this implicit cap may, if deemed necessary by the NRA, be converted into an explicit cap. In other words, putting into place a regime by which the maximum value (cap) of the buy-back price is equal to the difference between the wholesale market prices would qualify, in the Commission services' view, as a market-based mechanism. If such a system is established by the respective NRAs, a cap would provide a potentially necessary safety net for the TSO as well as network users in the context of potential risk-sharing, preventing them from incurring losses related to possible market manipulation or anticompetitive behaviour.

As set out above, it is the Commission services' view that a pro rata curtailment scheme for the buy-back mechanism should in general not be applied as that automatically converts the firm products into interruptible ones which is contrary to the objectives of the measure as set out in the CMP Guidelines. However, in exceptional cases, where the TSO has i) verified that no alternative technical and/or commercial measures are available to maintain system integrity in a more cost-efficient manner and ii) the TSO receives no offers to sell back capacity at all; or iii) the above-described market price differential cap of the buy-back price had to be applied, a pro rata scheme might be applied as ultima ratio.

Furthermore, it is the view of the Commission services that where i) risks of the TSO of offering additional capacity are deemed to be particularly high in light of the network and market situation, or ii) both the number of network users at an IP is limited, and iii) no liquid wholesale markets exist yet, the oversubscription and buy back regime may not be the most appropriate to fight contractual congestion at that IP. The Commission services recommend that in such situations the second option, based on the firm day-ahead use-it-or-lose-it principle, is taken into serious consideration as a potentially more effective congestion management method.

In the context of structuring the buy-back mechanism, NRAs may decide to set up an overall maximum "pot" capping the TSO's incentive revenues and losses. This structure does not influence individual overselling or buy-back procedures but it does provide a frame for the TSO in which to execute its overselling strategy and limits its risk. In addition to such a "pot", the oversubscription and buy back mechanism as set out in the CMP Guidelines necessitates clear boundaries as regards any possible profit- and loss-sharing between TSO and network users from the system.

In the logic of the buy-back procedure it is the Commission services' view that, in order to ensure the effectiveness of a buy-back procedure, once that is underway,

there should not be a possibility for network users to re-nominate upwards. This is necessary as once the TSO has announced a buy-back procedure, it has done so because in its view the system cannot handle all nominations to flow gas and therefore needs to get some nominations out of the system in one or the other manner described above. Where a full restriction of upward re-nomination is considered too restrictive, the buy-back mechanism could be run after the re-nomination cycle has been closed for network users according to the Network Code on Gas Balancing of Transmission Systems. This is to prevent network users from aggravating the possible situation of physical congestion for the alleviation of which the TSO has launched the buy-back procedure. It thus also limits the possible costs associated with carrying out the buy-back providing a sensible and proportionate restraint of network users' rights in using their capacity and not letting certain network users abuse their rights with a view to increasing the buy-back price. Furthermore, in order to minimize potential gaming, the buy-back procedure could be launched closer to delivery as opposed to on the day-ahead.

3. FIRM DAY-AHEAD USE-IT-OR-LOSE-IT

Firm day-ahead use-it-or-lose-it (point 2.2.3 of the CMP Guidelines) has the merit of freeing up contractual congestion in a highly effective way, but it is also more restrictive in the way in which capacity rights can be used. Therefore, as also set out in the Impact Assessment, it 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 at all IPs in the EU. At that cut-off date, information from the ACER reports pursuant Point 2.2.1.2 of the CMP Guidelines shall clearly demonstrate whether the conditions of Point 2.2.3.1 have been met or not. For IPs, where the conditions set out in Point 2.2.3.1 of the CMP Guidelines are met, the firm day-ahead use-it-or-lose-it rules will henceforth apply as from 1 July 2016.

As set out above and very prominently in the Impact Assessment, the two mechanisms of firm day-ahead use-it-or-lose-it and oversubscription and buy back are in principle alternatives to achieve the same objective of freeing up short-term capacity (possibly also longer term capacity in the case of oversubscription and buy back) at contractually congested IPs. Points 2.2.3.6 and 2.2.3.7 of the CMP Guidelines address the two distinct but related points of interaction between the application of the oversubscription and buy back and the firm day-ahead use-it-or-lose-it mechanism. Point 2.2.3.6 of the CMP Guidelines allows the NRA to decide to apply a firm day-ahead use-it-or-lose-it instead of an oversubscription and buy back scheme on the basis of an analysis it has conducted as regards the relationship of the two measures. Point 2.2.3.7 of the CMP Guidelines then seeks to ensure that NRAs take coordinated decisions as regards the application of firm day-ahead use-it-or-lose-it mechanisms at each side of an IP.

This relationship between the two mechanisms is crucially important in ensuring an effective implementation of the overall congestion management policy across Member States. It is the Commission services' view that NRAs on the two sides of an

IP benefit significantly from agreeing on one and the same measure among those two. This is also the targeted outcome of the consultations between the NRAs according to Points 2.2.2.1 and 2.2.3.7 of the CMP Guidelines. That said implementation modalities of the CMP Guideline have shown that this is not always the case. Theoretically, the two mechanisms can be applied at two sides of an IP before bundled capacities are introduced. Practically however, there is an important interaction between these congestion management mechanisms across the IPs in that pursuant to the so-called "lesser rule"⁹, capacity matching on two sides of an IP may lay open incompatibilities under specific circumstances. Specifically, this relates to the way in which the capacity pair "exit from Member State A" and "entry into Member State B" is matched by the TSOs on the two sides of an IP. If for example the network user in Member State A – where the TSO is employing oversubscription and buy back – re-nominates to 0 on his "exit from Member State A" capacity, that will not allow the TSO in Member State B, employing firm day-ahead use-it-or-lose-it, to make practical use of the downward re-nomination restriction element which in turn allows capacity to be reserved for the firm backhaul capacity. As oversubscription and buy back allows re-nominations without constraints, it also allows them to decrease to 0. However, the firm day-ahead use-it-or-lose-it specifically prohibits re-nominating below 10% and above 90%. The incompatibility arises only due to the downward re-nomination restriction as the "lesser rule" actually ensures that the upward re-nomination restriction is carried over onto the other side of the IP.

Therefore, the TSO in Member State B is not able to predict when the network user in Member State A will make use of his right to take his nomination down to 0. Consequently, it is not willing to accept the risk related to selling the firm backhaul "entry into Member State B" capacity. With the general introduction of bundled capacities, pursuant to the Capacity Allocations Mechanisms Network Code (hereafter, "CAM Network Code")¹⁰, the compatibility problems of the two mechanisms come even stronger to the fore as the (re-)nomination activity of one and the same network user may be affected differently on the two sides of the IP.

Consequently, it is the view of the Commission services that in applying the CMP Guidelines NRAs should be particularly circumspect with their decisions to implement or not firm day-ahead use-it-or-lose-it pursuant to 2.2.3.6 of the CMP Guidelines on a voluntary basis. As set out above on oversubscription and buy back, there may be instances where that mechanism may not be effective at an IP because it is not able to deliver on the expectation of network users to free up capacity due to issues related to risk and complexity. Similarly, firm day-ahead use-it-or-lose-it may not be necessary at IPs unless the conditions of Point 2.2.3.1 of the CMP Guidelines are met as of 1 July 2016. Crucially therefore, the Commission services see the

⁹ The "lesser rule" is also set out in the draft Interoperability Network Code as the so-called default rule for matching and is as such the prevailing mechanism. Cf. Article 2(1)(c) of the Interoperability Network Code submitted by the European Network for Transmission System Operators (ENTSO) (http://www.entsog.eu/public/uploads/files/publications/INT%20Network%20Code/2013/ACERSubmission/INT0352_131218_Network%20Code_Network%20Code%20on%20Interoperability%20and%20Data%20Ex%20%20%20.pdf).

¹⁰ Commission Regulation (EU) No 984/2013 of 14 October 2013 establishing a Network Code on Capacity Allocation Mechanisms in Gas Transmission Systems and supplementing Regulation (EC) No 715/2009, OJ L 273 of 15 October 2013, p. 5.

importance of Point 2.2.3.7 of the CMP Guidelines, in setting out the need for NRAs to cooperate on this matter in implementing one or the other mechanism. Implementation experience since 1 October 2013 has shown that there are indeed NRAs that have decided to implement firm day-ahead use-it-or-lose-it up-front which as such is in line with the CMP Guidelines. It is therefore likely that different congestion management mechanisms will remain on the two sides of an IP at several IPs. In those cases it is the Commission services' general view that measures have to be agreed between Member States on the basis of which their respective mechanisms are made compatible. The compatibility can effectively be achieved in two ways: i) as described above, the downward restriction of the re-nomination "functionality" is not applied by TSOs applying firm day-ahead use-it-or-lose-it which essentially means that no firm backhaul capacity can be offered on that basis at the respective IP; ii) the oversubscription and buy back mechanism is restricted to the extent that re-nominations cannot go below 10%.

On the basis of the above, the view of the Commission services is that in order to ensure the compatibility of the two systems – to the extent no decision is made to use the same mechanism at a given IP – the following protocol could be applied:

1. In case firm day-ahead use-it-or-lose-it is applied at an IP on the basis of Point 2.2.3.6 of the CMP Guideline, the firm day-ahead use-it-or-lose-it should prevail, as described above, if it can be shown that the conditions of 2.2.3.1 of the CMP Guidelines have been fulfilled on either side of the IP on the basis of the congestion data of the previous year. Given that in all probability capacity allocation did not take place via auctions, the appropriate proxy would be the fulfilment or not of criterion 2.2.3.1(d) of the CMP Guidelines, i.e. whether capacity with a duration of one month or longer was offered or not. If the criteria of 2.2.3.1 of the CMP Guidelines have not been fulfilled, the oversubscription and buy back mechanism should have precedence and consequently the backhaul capacity freed up cannot be offered as firm;
2. In case firm day-ahead use-it-or-lose-it is applied as of 1 July 2016 at an IP pursuant to Point 2.2.3.1 of the CMP Guideline, it should prevail over oversubscription and buy back meaning that the TSO applying firm day-ahead use-it-or-lose-it should be able to guarantee the firmness of the backhaul capacity even at the cost of a 10% restriction of re-nominations on the part of the TSO with an oversubscription and buy back mechanism.

4. CAPACITY SURRENDER

The CMP Guidelines foresee a further congestion management measure, capacity surrender, pursuant to its Point 2.2.4. This mechanism is intended to allow network users to offer back to the TSO capacity they do not intend to use which the TSO can then reallocate. Importantly, for network users capacity surrender is an entirely voluntary measure and it is an alternative to their rights to offer capacity on the secondary market. Furthermore, as it is a congestion management measure, capacity

surrender is only successful in case the TSO is able to reallocate a part or all of the capacity offered.¹¹

Importantly, the rules on capacity surrender in the CMP Guidelines are set out in a way so as to offer this mechanism to network users but not to incentivize them specifically. Therefore, in the Commission services' view, care should be taken by NRAs not to structure capacity surrender in a way that would perversely incentivize network users to first book more capacity than necessary only to easily hand it back to the TSO. Network users surrendering capacity should not stand to benefit from the outcome of any auction involving the capacity they have offered in that they receive (a share of) the auction premium as this could create an incentive for network users to use this mechanism or even worse incentivize strategic bookings which is certainly not in line with the objectives of the CMP Guidelines. At the same time, surrender should not be disincentivized either by the TSO. Thus it is important that the NRA and TSO find a balance in applying the capacity surrender rules so as to make it effective in reducing contractual congestion while not allowing the measure to promote excessive capacity booking in any way.

This is coupled with the TSO's legitimate expectation, on the basis of the provisions of the CMP Guidelines, not to have to allocate surrendered capacity as long as there is available capacity.¹² That said, in line with the objectives of the CAM Network Code, in the case of surrendered bundled capacities, TSOs will need to offer the bundled capacity and, to the extent there is demand for it, reallocate it in a bundled form.

Furthermore, capacity surrender is different from the secondary market in that it should provide the TSO the possibility to offer the surrendered capacity in the manner in which it can satisfy existing demand in the most effective way. If for instance a TSO was not able to reallocate a quarterly product offered for surrender, the TSO should allow the product to roll-over and it should offer monthly products at the forthcoming auctions. This logic of roll-over should continue all the way to the daily or even within day products. Surrendered capacity therefore returns to the market in the form of primary capacity having the exact same characteristics as any other capacity offered by the TSO. This is crucial as it also provides for the key difference between capacity surrender and the general secondary market transactions between network users. That said, the roll-over should not prevent the network user to – having regard to the specific lead times for capacity product offerings pursuant to the CAM Network Code auction calendar – withdraw the surrendered capacity from the TSO.

In case several network users are offering the TSO the same capacity for surrender, the TSO should reallocate the surrendered capacity, to the extent there is demand for it, in the order that the capacity has been offered to the TSO. This time stamp

¹¹ Point 2.2.4 of the CMP Guidelines reads: "[...] *The network user shall retain its rights and obligations under the capacity contract until the capacity is reallocated by the transmission system operator and to the extent the capacity is not reallocated by the transmission system operator.*"

¹² CMP Guidelines Point 2.2.4 "[...] *Surrendered capacity shall be considered to be reallocated only after all the available capacity has been allocated.*"

approach is more effective than pro rata as it promotes network users not needing capacity to offer it to the TSO early enough which in turn allows the TSO to offer a more effective capacity portfolio, perhaps having restructured it with other capacity it has on offer.

5. LONG-TERM USE-IT-OR-LOSE-IT

The final measure of the CMP Guideline, Point 2.2.5, long-term use-it-or-lose-it has the specific intention of being a strict mechanism to deter capacity hoarding over the longer term. Point 2.2.5.1 of the CMP Guideline reads:

"National regulatory authorities shall require transmission system operators to partially or fully withdraw systematically underutilised contracted capacity on an interconnection point by a network user where that user has not sold or offered under reasonable conditions its unused capacity and where other network users request firm capacity."

As set out in Point 2.2.5.1 of the CMP Guidelines, systematically underutilized capacity shall be partially or fully withdrawn. In the Commission's view, it is important that this process is set out in Member States in such a way so as to ensure that both NRAs and TSOs are able to fulfil their obligations in light of their specific roles in the energy sector. Therefore, the long term use-it-or-lose-it rules may entail a system of NRAs "requiring" TSOs to withdraw capacity, setting out a process where the NRA, in its role as the energy sector watchdog, should have the ultimate decision on the withdrawal of capacity which will be effectuated by the TSO. Alternatively, a system may also be put in place which places the responsibility for capacity withdrawal on the TSO without that being subject to an NRA decision. Both systems may be equally effective as long as the responsibilities and the process for TSOs and NRAs are clearly laid out. Point 2.2.5.4 of the CMP Guidelines sets out very clearly that TSOs need to continuously assess the capacity usage by network users and provide information to NRAs on this matter. In the Commission services' view the existence of a monitoring framework – the specific form and setup of which may vary from one Member State to another – is essential in order to ensure that any long term use-it-or-lose-it scheme can function effectively.

As point 2.2.5.1 of the CMP Guidelines sets out, network users shall offer unused capacity "*under reasonable conditions*" to avoid having to face possible withdrawal of capacity. This is understood to mean that the network user shall make all genuine efforts to sell capacity that can be expected of a network user that is indeed interested to market the product. This may entail offering it on secondary markets for a reasonable price or to the TSO as surrendered capacity.

Looking further at Point 2.2.5.1 of the CMP Guidelines, the phrase "*where other network users request firm capacity*" is very pertinent in that long term use-it-or-lose-it can only take place if there is demand for capacity by other network users. In other words, as the title of the CMP guideline also implies, "*in the event of contractual*

congestion" the long term use-it-or-lose-it mechanism only takes effect in withdrawing capacity if other network users are demanding that capacity.

Irrespective of the precise process decided on by the NRAs it should be clear that the network user engaged in capacity hoarding and vis-à-vis whom the long term use-it-or-lose-it is to apply shall bear the risk of the long term use-it-or-lose-it process while the TSO stays cost-neutral throughout.

The key test for applying long term use-it-or-lose-it is capacity underutilization, i.e. *"less than on average 80 % of its contracted capacity both from 1 April until 30 September and from 1 October until 31 March with an effective contract duration of more than one year for which no proper justification"*, (Point 2.2.5.1(a)). The average 80% utilization shall be calculated as the simple average of the actual utilization rates of the capacity of the respective network user in any given gas year both during the period 1 October to 31 March and 1 April to 30 September. Effective contract duration of more than one year refers to either a long-term contract that has an explicit duration of more than a year or a series of one year contracts booked pursuant to the CAM Network Code allocations procedures for a period of maximum 15 years.

Therefore, the NRA is best-placed to ultimately determine, possibly upon the recommendations of the TSO and based on the extent of the capacity hoarding, whether to fully or partially withdraw the capacity. In doing so, it would evaluate in particular the level and period of underutilization. In any event, as said above, there needs to be a demand for that type of capacity by network users for the withdrawal to ultimately take place.