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**COMMISSION STAFF WORKING DOCUMENT**

**EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT**

*Accompanying the document*

**Commission Regulation (EU) No .../....**

**on establishing a Network Code on Capacity Allocation Mechanisms in Gas  
Transmission Systems**

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## EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT

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#### Commission Regulation (EU) No .../....

#### **on establishing a Network Code on Capacity Allocation Mechanisms in Gas Transmission Systems**

### **1. INTRODUCTION**

The EU has committed itself to completing the internal market in electricity and gas by 2014<sup>1</sup>, which means the building of an integrated and interconnected market in gas allowing all market players to compete on a level playing field while creating the framework for securing supplies. Such an internal market for energy aims at ensuring that energy is generated, transported and consumed as efficiently as possible, avoiding losses along the value chain. But in order for our gas market to deliver these benefits, Europe's gas transmission networks need to be able to facilitate trade and accommodate changing flows patterns. The key to an open and well-connected grid that promotes cross-border trade within the internal market lies at the cross-border interconnection points ("IPs") of the transmission networks.

Improving competition in the natural gas sector, a network industry, hinges primarily on granting access to all suppliers (incumbents and entrants alike) to all gas infrastructure – and most notably to the IPs – in a transparent and non-discriminatory way. In large parts of Europe, the equal and transparent access to capacity continues to be a major obstacle for true competition on the wholesale market to occur. Furthermore national rules continue to differ from one Member State to another which also hampers the creation of an efficient internal market for gas by 2014.

A more transparent, efficient and non-discriminatory system of allocation of scarce transmission capacities needs to be implemented for Europe's high-pressure gas grids, so that cross-border competition can further develop and market integration can come about. Developing such rules has been consistently supported by essentially all stakeholders.

In the process of the developing the harmonized rules for Capacity Allocation Mechanisms (CAMs) there have been numerous and extensive consultations, workshops and studies, aimed at better understanding the nature and extent of the problem and the possible benefits and drawbacks of the various options which could be considered to improve the current EU rules for capacity allocation mechanisms in the gas sector.

### **2. BACKGROUND**

This Impact Assessment has been prepared in the context of a proposed Network Code on Capacity Allocation Mechanisms (CAM NC). European Network Codes are introduced by the Third energy package. Their goal is to set detailed rules on the coordinated technical or commercial operation of gas and electricity transmission networks. Three main stakeholders –

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<sup>1</sup> The political objective of completing the internal market for electricity and gas is set out in the European Council Conclusions of 4 February 2011.

the Commission and the representative bodies of energy regulators (ACER<sup>2</sup>) and transmission network operators (ENTSOG<sup>3</sup>) – are responsible for proposing the text to Comitology.

The existing legal framework already underlines the essential nature of access to gas infrastructure. The notion of third party access plays a central role in current internal energy market legislation, notably the Third energy package.

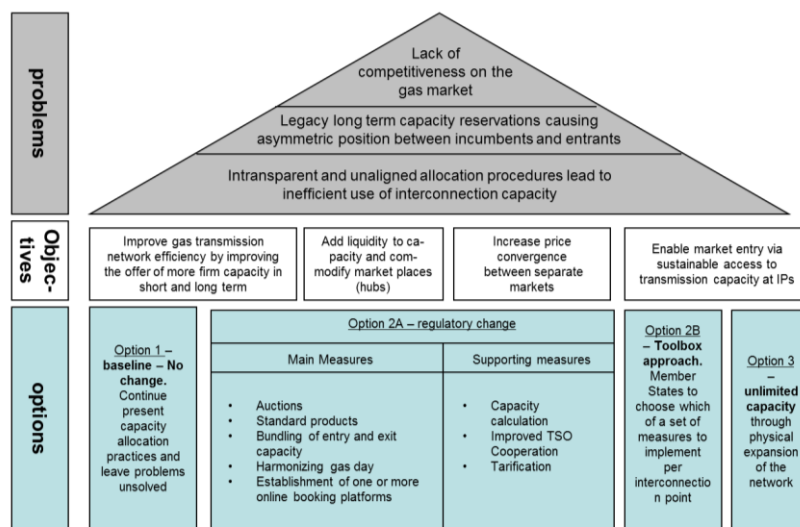
Even though the principles in the Gas Regulation aim at implementing market-based capacity allocation procedures by all TSOs, they do not prescribe the mechanism as such. The principles stem from the previous Gas Regulation (EC) No. 1775/2005 and have not been amended. The reason is that the European legislator expects more detailed rules on capacity allocation to be laid down in a Network Code according to Article 8.6(g) of the Gas Regulation. These rules will be laid down in the new Regulation.

### 3. PROBLEM AND OBJECTIVE

Figure 1 below graphically illustrates the relationship between the *problem*, *objectives* and *policy options* in the context of capacity allocation mechanisms.

The CAM NC focuses on improving access to gas transmission systems. True competition on the European gas markets can only come about when energy companies have equal opportunities in trading gas across the borders with a view to its delivery to customers. Today, one of the main difficulties shippers face is acquiring access to cross-border transmission capacity, which translates into a sub-optimal functioning of the market. The efficient use of existing transmission capacity is a pre-requisite for a well-functioning internal market.

**Figure 1: Schematic representation of problem, objectives and policy options**



The problems that have been identified are:

- Shippers have problems to access cross-border markets due to inefficient use of the interconnection capacity
- Intransparent and discriminatory allocation procedures which do not provide investment signals are still applied

<sup>2</sup> Agency for the Cooperation of Energy Regulators, a Commission Agency established by Regulation (EC) No. 713/2009.

<sup>3</sup> ENTSOG is the acronym for the European Network of Transmission System Operators for Gas

- Different TSOs are selling different products with different mechanisms leading to a diffuse and fragmented framework and high monitoring costs for shippers
- EU hubs not used to their full potential

#### 4. POLICY OPTIONS

When considering the general policy options to tackle the problem of suboptimal capacity allocation at IPs there are essentially four main choices. **Option 1:** no further EU action (baseline scenario), **Option 2a:** implement harmonized EU rules on capacity allocation, **Option 2b:** toolbox approach (Member States to decide on what further capacity allocation rules to apply) and **Option 3:** (unlimited) capacity investments to solve bottlenecks to allocation of capacity.

##### **Option 1 – "No further EU action" – Description and Impacts**

This policy option does not foresee any further rules on capacity allocation beyond what has already been enshrined in the Gas Regulation.

This would mean that even in the backdrop of existing general policy aims set out in the Gas Regulation 715/2009, current practices would continue and improvement in the CAMs – if at all – would at best take place in a fragmented manner, likely on a national level only, without taking into account the cross-border aspects of efficient capacity utilization.

##### **Option 2a – "implement harmonized EU rules on capacity allocation"**

An alternative to the baseline (No further EU action) scenario is to follow the stipulations of the Gas Regulation with respect to the drafting of binding EU-wide harmonized, technical market rules. The NC CAM is precisely such a measure. The rules contained therein would, once implemented, lay down a completely harmonized regime of simultaneous capacity auctions for a relatively small set of bundled cross-border capacity products. In practice, for a shipper interested in cross-border gas trade, this means complete information as regards availability of capacity and the timing and the rules of allocation for all of IPs in Europe.

The core measures contained in the CAM NC are:

- (a) the **introduction of harmonized auctions**,
- (b) the harmonization of the gas day and **standardizing of products** and
- (c) the **bundling** of capacity products.

##### **Ad a) harmonized auctions**

The currently widely applied allocation mechanism, first-come-first-served (FCFS), is not a transparent one. Who offers what, when, where and under what conditions, is unclear and differs per Member State. This creates enormous problems for shippers interested in trading across borders. The FCFS-mechanism has been subject to wide and justified criticism and its replacement by a harmonized, more efficient CAM is widely supported.

Firstly, the CAM should be objective, transparent and non-discriminatory in order to safeguard the absolute equality of all aspiring parties. Secondly, it should offer regular opportunities for capacity allocation. Thirdly, from an economic perspective it is important that the mechanism, in case demand is higher than supply, rewards the shipper that values capacity most. As such, the mechanism should allow shippers to identify the relative value of the capacity. The auction honours these principles as it is a very transparent and non-discriminatory allocation process, whereby all contenders are able to participate on equal

footing in an effort to secure the goods and in the end the highest bidder wins. In addition the Network Code also foresees the EU-wide harmonization of auction schedules.

### **Ad b) the harmonization of the gas day and standardizing of products**

The introduction of auctions also requires the alignment of the time schedules governing the gas markets. Capacity markets interact with commodity markets, because in order to trade one needs to have both capacity and gas. As short term trade becomes more important from a competition and a security of supply perspective, so does the alignment of the gas days. The lack of synchronisation of the gas days in some Member States constitutes a barrier to trade. Thus the Network Code proposes to harmonize the EU-wide gas day for the period 5h-5h UTC time.

In some Member States capacity product characteristics, such as the duration or the starting date are neither defined in advance nor published in advance. Instead, as noted above, capacities are allocated immediately. This causes problems for shippers especially when they want to cross borders and find that capacity products are not aligned in terms of quantity and timing, or only available at one side of the border. This results in the essential European cross-border capacities at IP points to become highly fragmented and used inefficiently.

The set of standardized products that is part of the NC CAM reflects both the needs for long term stability and short term flexibility that gas trading brings about. It consists of *yearly, quarterly, monthly, daily* and *within-day* products. In order to assure that at least short term capacity is always available to market players the Network Code also foresees a quota of 10% for short term products. In order to ensure that in the mid-term capacity is at all times available, a further 10% is reserved for these products. These two reservation quota also apply for new to be built capacity. The Commission notes that the risk of foreclosure in gas markets, given recent history, is a substantial threat to market opening. Therefore national regulatory authorities shall consider whether higher quotas may not be necessary in order to avoid such foreclosure of retail gas markets in their respective Member States.

### **Ad c) the bundling of capacity products**

Today shippers have no choice but to separately book entry and exit capacities to transport their gas through an IP across a border. This often results in unaligned bookings and as a result in inefficient use of the interconnection. The solution to this problem is the bundling of exit- and entry-capacities into one single capacity product with which a shipper can move from one entry-exit system to the next<sup>4</sup>. Simply stated, the shipper can move its gas from anywhere in Member State A to anywhere in Member State B in one click.

The bundling of capacities on two sides of a border into one cross-border product needs intensive TSO cooperation. Moreover, there are existing capacity contracts in place with delivery point at the border (“flange”). These capacity contracts are often underpinned by long term supply contracts between network users. Hence, the choice is to be made whether to apply the bundling immediately to the entire cross-border capacity<sup>5</sup> or to gradually introduce the concept, starting from the capacity that is currently available and then step by step increasing that proportion whenever an existing contract expires or when new capacity becomes available to the market.

In the course of conducting its IA the Commission has evaluated several options relating to capacity bundling, from the fully optional approach to bundling, to the bundling of all existing

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<sup>4</sup> The concept of bundling may be compared to the pre-Schengen system of border crossing within the EU where one had separate exit checks out of Member State A and into Member State B.

<sup>5</sup> Introducing immediately in the context of the Sunset Clause would also mean a five-year implementation period for contracted capacity.

and new capacity (after a five year “sunset clause” period). The impact assessment shows that the most appropriate measure as regards bundling is to bundle all currently available and new to be built capacity as a first step and in addition to that institute a process by which contracting shippers on the two sides of an IP are obliged to make best efforts to bundle the existing capacity. This will, as set out in this IA, ensure more efficient capacity allocation, reduce capacity mismatches, avoid potentially harmful market foreclosure and increase market liquidity and with it lower entry barriers for new competitors.

That said, the Network code should clearly set out that also contracted capacity shall be obligatorily bundled as of the effective expiration date of the capacity contract upon entry into force of the Network Codes.<sup>6</sup> Finally, in order to maximize and optimize the offer of the bundled products, the Network Code shall oblige TSOs sharing IPs to cooperate more intensely on the subject of capacity calculation.

**Option 2b – toolbox approach (Member States to decide on what further capacity allocation rules to apply)**

Under this approach the measures as described under Option 2a could be introduced in a non-binding way in that Member States or national regulatory authorities can pick and choose from these instruments and implement those measures that in their view address the most important issues on the country's borders. The measures contained in the NC CAM are not nearly as effective individually, as they are when implemented together, as a package. For example, auctions will not be facilitating trade if capacity products remain unbundled and separate auctions continue to be needed. Also, bundling of capacity is impossible without the standardization of capacity products at an IP.

**Option 3 – Capacity investments to solve bottlenecks to allocation of capacity**

This mechanism would essentially solve the problem via investment. The Commission Services are of the view that it appears disproportionate to the extent that the problem at hand remains inefficient capacity allocation methods at IPs leading often to contractual congestion but not necessarily physical congestion. The efficient economic solution thus cannot be that of investing into new capacity instead of improving market rules. At the end of the gas value chain, it is the consumer who would need to pay for this extra cost.

**5. CONCLUSION**

Summary Table of Effects				
Option	Effectiveness	Efficiency	Coherence	Competitiveness
1: Do Nothing	--	--	+	--
2a: New harmonized CAM rules	++	+	++	++
2b: Toolbox Approach	+	-	-	+
3 Unlimited Capacity	-	--	+	--

Option 2a is the option that is expected to most effectively address the issue of transparent, non-discriminatory and objective access to capacities that is now deemed insufficient on all three aspects. The measures proposed in the NC CAM are the result of a balanced and thorough process of preparation by regulators and transmission system operators. Within Option 2a, the core measures are the introduction of auctions, the standardization of capacity products and the bundling of entry and exit points into a single cross-border product.

<sup>6</sup> Therefore, tacit or explicit capacity contract renewals shall not be accepted from that point on as a reason not to bundle.

*Auctions:* auctions are a *market-based*, transparent and objective way to allocate scarce products, and less prone to discrimination than for example FCFS. Harmonizing the rules and the timing across the EU facilitates trading enormously, as it lowers monitoring and transaction costs for network users. The increase in trade on the capacity market is expected to have beneficial effects on the commodity wholesale market.

*Standardization:* where products on two sides of one border point differ, chances are high that cross-border capacities cannot be used efficiently, because shipper portfolios do not match. Both measures ensure that cross-border mismatches cannot occur anymore. Together with the CMP measures, this means that scarce EU-transmission capacity will always be used to the benefit of the internal market. The fact that at least 10% of the capacities is reserved for the short term, assures that shippers can rely on last minute flexibility needs, lowering barriers to entry.

*Bundling:* all technical and new capacity should be systematically bundled. Capacity currently locked up in existing capacity contracts however, shall be subject to a process by which the contracting shippers on the either side of an IP are obliged to undertake reasonable efforts in an attempt to bundle the existing capacity.