

## **ACER guidance to ENTSOG on the development of amendment proposals to the Network Code on Capacity Allocation Mechanisms on the matter of incremental and new capacity**

### **1. Introduction**

- a) The Network Code on Capacity Allocation Mechanisms (NC CAM)<sup>1</sup> focuses on the allocation of existing capacity at interconnection points (IPs) in gas transmission systems. The Madrid Forum recommended that processes are established by which capacity demand beyond the offer of existing capacity can be satisfied in a market-based manner, if the necessary investments are efficient and financially viable.
- b) Accordingly CEER and the Agency were requested to outline processes for the market-based identification and allocation of capacity at existing IPs and at possible new IPs or at IPs concerned by projects of great size and complexity. As a result, CEER published its Blueprint on Incremental Capacity<sup>2</sup>, which has provided the foundation for further work on the topic, including by ACER. The goal is to develop binding EU rules through the comitology process. In addition, the Agency has commissioned an “Impact assessment of policy options on incremental capacity for EU gas transmission”<sup>3</sup>.

The present ACER Guidance to ENTSOG provides a framework for the development of a concrete NC CAM amendment proposal (including technical rules) by ENTSOG.

- c) The Agency invites ENTSOG to draft and consult on such a draft amendment proposal (“the CAM NC amendment”) and to submit it to the Agency together with the draft Network Code on Harmonised Transmission Tariff Structures. In accordance with Article 7(2) of Regulation (EC) 715/2009 the Agency will then consult it and make a reasoned proposal for amendments to the Commission. This includes explaining how such proposals are consistent with the objectives of the network codes set out in Article 6(2) of Regulation (EC) 715/2009.

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<sup>1</sup> 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: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:273:0005:0017:EN:PDF>

<sup>2</sup> CEER Blueprint on Incremental Capacity, Ref. C13-GIF-06-03, 23 May 2013, [http://www.energy-regulators.eu/portal/page/portal/EER\\_HOME/EER\\_PUBLICATIONS/CEER\\_PAPERS/Gas/Tab3/C13-GIF-06-03%20CEER\\_blueprint\\_on\\_incremental\\_capacity\\_final.pdf](http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/CEER_PAPERS/Gas/Tab3/C13-GIF-06-03%20CEER_blueprint_on_incremental_capacity_final.pdf)

<sup>3</sup> Frontier’s Final Report for ACER: [http://www.energy-regulators.eu/portal/page/portal/EER\\_HOME/EER\\_WORKSHOP/CEER-ERGEG%20EVENTS/GAS/CEER-ACER\\_Gas\\_Incremental\\_Capacity/Agenda/Impact%20assessment%20of%20policy%20options%20on%20incremental%20capacity%20for%20EU%20gas%20transmission.pdf](http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_WORKSHOP/CEER-ERGEG%20EVENTS/GAS/CEER-ACER_Gas_Incremental_Capacity/Agenda/Impact%20assessment%20of%20policy%20options%20on%20incremental%20capacity%20for%20EU%20gas%20transmission.pdf)

- d) The scope of application for the CAM NC amendment should be the same as the scope defined in Article 2 of the NC CAM, i.e. limited to physical or virtual IPs connecting adjacent entry-exit systems or connecting an entry-exit system with an interconnector, in so far as these points are subject to booking procedures.
- e) The elements relating to tariff issues (tariff levels and economic test) should be considered as inputs to the capacity allocation procedures and will be developed in the framework of the network code on harmonised transmission tariff structures.

## **2. Amendment Guidance**

The CAM NC amendment should cover the following sections 2.a) - f). It should be drafted as text elements to be inserted into the Commission Regulation No 984/2013 of 14 October 2013 constituting the NC CAM. The new provisions should apply to all incremental and new capacity, where the decision to invest is market-based, i.e. based on binding user commitments made during a CAM auction or an open season. Changes to the NC CAM should be restricted to those necessary for enabling market-based identification and allocation of capacity beyond existing capacity and should be kept to the minimum necessary.

The CAM NC amendment should stipulate that a capacity expansion offered in an integrated auction or an open season procedure shall be considered economically feasible if an economic test applied to it is passed. This means that a predefined level of binding network user commitments necessary to justify the investment from a financial perspective is obtained. If the economic test is passed, the project should proceed with the next phases of project development towards commissioning<sup>4</sup>. An economic test is not necessarily required when the decision to build capacity is based on legal requirements or national infrastructure planning requirements. Such capacity shall be offered in the normal allocation mechanism for existing capacity.

Economic feasibility is not equivalent to and does not presume efficiency in the execution of an investment, as assessed within the respective regulatory regimes.

### **a) Definitions**

The CAM NC amendment should contain the necessary definitions. These include at least the following:

- 'Existing capacity' means the technical capacity at an existing interconnection point which is already in place before the time of the capacity allocation.

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<sup>4</sup> If the economic test is passed for more than one expansion step, the one creating the largest volume of capacity should proceed with the next phases of project development towards commissioning.

- 'Incremental capacity' means capacity that could be made available at existing interconnection points beyond the level of existing capacity based on an investment or a long-term capacity optimisation<sup>5</sup>.
- 'New capacity' means technical capacity that could be created at a new interconnection point where no capacity existed before, as well as physical reverse capacity at an existing interconnection point, which has not been offered before.
- 'Open season procedure' is a procedure where a transparent and non-discriminatory call for binding commitments of any party for capacity is made by a group of TSOs together spanning two or more market areas, which may be preceded by non-binding expressions of interest of any party, in order to base an investment decision for a capacity expansion on the obtained commitments.

***b) When to offer incremental and new capacity***

The CAM NC amendment should, as a minimum requirement, require a formal offer of incremental or new capacity, where there is likely to be significant unsatisfied demand for capacity. An offer of incremental or new capacity should be made by the existing TSOs or new entities certifiable as TSOs when at least one of the following conditions is met. This does not preclude more frequent or regular testing of demand.

- The ENTSOG Ten Year Network Development Plan (TYNDP) identifies a physical capacity gap in the sense that an area is undersupplied in a reasonable peak demand scenario and incremental or new capacity at the IP in question would be able to close the gap; or a national network development plan identifies a concrete and sustained physical transport requirement;
- No yearly capacity product based on existing capacity will be on offer (as the yearly product is fully booked) in the year when incremental capacity could be offered first and in the three subsequent years (capacity set aside for the short term is considered not offered). In the case of several IPs between two entry-exit systems the requirement refers to all IPs between these entry-exit systems taken together.
- Network users indicate in a non-binding manner to TSOs their need for and their willingness to underwrite incremental or new capacity for a sustained number of years and this transport need leads to physical constraints after exhausting all other mechanisms to maximise the availability of existing capacity.

ENTSOG should propose draft provisions for NC CAM for a cost efficient, transparent, European process, for instance on the allocation platform(s), including a time window in each year when such interest can be expressed. The CAM NC amendment should require TSOs to individually make public what information they require within this process. The minimum data required for an indicative capacity request should be well-founded and should include the location, an indication of the amount of capacity required and an indication of the number of years for which a network user considers a binding offer or bid. When specifying their needs, network users should have the

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<sup>5</sup> Under long-term capacity optimisation it is understood that a capacity offer at a specific point or points is reduced to enable an incremental offer at another or other points in the system as yearly annual products, if physically possible. For the CAM NC amendment only the fact that an offer of incremental capacity is made is relevant and not the detailed methodology the offer might be based on.

possibility to indicate whether they would be interested in buying incremental or new capacity at several IPs along a 'hub-to-hub' route. TSOs should report to affected NRAs whether or not they have received expressions of interest. If they have received any, TSOs should indicate whether these are sufficient for a formal offer of incremental or new capacity and propose coordinated solutions for addressing these indicative requests.

A failure to test market demand for incremental or new capacity, when indicative demand is identified as above, is deemed to be in breach of the TSOs' existing obligation to assess market demand for investment, enshrined in Regulation (EC) 715/2009, e.g. in Article 16 (5).

### ***c) Co-ordination requirements***

The CAM NC amendment should require TSOs and NRAs to closely co-operate and co-ordinate across borders in order to enable offers of incremental or new capacity as bundled products according to the existing NC CAM. The CAM NC amendment should outline the overall process and which co-ordination results should be reached at what stage.

In the course of this co-ordination, agreement should at least be reached on:

- Co-ordinated timelines for the project;
- How delays in the provision of capacity are dealt with contractually;
- How effects of delays on other systems can be mitigated;
- The capacity volumes and characteristics of bundled yearly products for which demand can be tested;
- The common procedure to be used for securing network users' binding commitments, taking into account the selection criteria defined in section 2.e) and 2.f);
- The way in which the requirements for triggering the investment decision in each regulatory system can be combined in a single economic test, and when the test would be satisfied<sup>6</sup>;
- Simultaneous or common information provision and a co-ordinated or single point of contact for network users.

In addition, the CAM NC amendment should define whether additional (and if so which) specific coordination requirements need to be fulfilled in the situation where an investment project spans across more than one interconnection point.

### ***d) Information provision***

For each considered capacity expansion, TSOs should provide to the other TSOs involved or affected and to each relevant NRA at least the following information on a provisional basis as early as possible<sup>7</sup>:

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<sup>6</sup> Provisions on the elements of the economic test and its input parameters, relating to the determination of tariffs and factors such as cost sharing, are to be set in the draft Network Code on Harmonised Transmission Tariff Structures.

- For each considered capacity expansion at the relevant IP, the volume of annual yearly standard bundled capacity products offered and the contractual details and terms and conditions of the capacity contracts;
- The detailed rules used for securing network users' binding commitments, i.e. the specific allocation design, in line with the provisions of section 2.e) and 2.f);
- Detailed information on what level of network user commitment is necessary to enable the investment from an economic perspective (economic test);
- A reference to the applicable tariff and methodology as published by the TSOs;
- The timeline of the full process, including of the publication of economic test results and final capacity allocations, and possible approval procedures by national authorities.

This information should be provided to the NRAs for approval, with a sufficient lead time before an offer of incremental or new capacity is made for binding commitments. Moreover, the CAM NC amendment should outline the process steps and which information should be provided at each step.

After NRA approval, TSOs should publicly provide at least this information with a sufficient lead time, before an offer of incremental or new capacity is made for binding commitments.

The CAM NC amendment can list any other pertinent information that is to be exchanged or published in order to ensure a user-friendly and non-discriminatory process.

The CAM NC amendment should also outline principles on post-allocation reporting and the type of information TSOs should publish by a specified date.

***e) Integration of incremental and new capacity into the NC CAM annual yearly capacity auctions***

The CAM NC amendment should stipulate the integration of incremental and new capacity into the annual yearly capacity auctions of the NC CAM for existing capacity. This should apply at least in the case where a capacity expansion between two adjacent market areas is considered.

ENTSOG is requested to develop, test and consult a detailed amendment to the NC CAM's allocation procedure for existing capacity, keeping the integrity of the ascending clock algorithm. The amendment should enable the integrated offer, testing, and allocation of bundled new and incremental capacity to take place together with existing unsold yearly capacity. The same service for the same period will have the same value for network users if acquired at the same time.

ENTSOG should apply at least the following principles for the development of the methodology:

- offer and allocate bundled incremental and new capacity in a cost effective, non-discriminatory, transparent procedure that enables taking into account willingness-to-pay, on the booking platform that promotes competition;

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<sup>7</sup> The information provision requirements as per Framework Guideline on Harmonised Transmission Tariff Structures will provide network users with information regarding the tariff setting, calculation and efficiency of costs.

- ensure efficient allocation of existing capacity, irrespective of the outcome of the economic test for the incremental and new capacity under consideration;
- the possibility to accommodate different reserve prices if a tariff adjustment is justified; and
- the possibility to test network users' differentiated willingness to pay for more than one level of incremental and new capacity in an auction, e.g. no increment (allocate existing capacity only because the economic test is not passed), small increment (allocate incremental and existing capacity), large increment, very large increment, etc....

ENTSOG is requested to consider:

- the possibility for network users to revise their bids if the economic test fails for incremental and new capacity;

ENTSOG should focus in its proposal on providing a recommended technical approach of integrated bidding for existing and incremental capacity (drawing on the model of parallel bidding ladders).

#### ***f) Open Season Procedures***

The CAM NC amendment should limit the use of open season procedures for incremental and new capacity to those cases where the likely capacity demand, as identified in section 2.b) or in any informal or non-binding assessment phase:

- i) extends across more than two market areas; or
- ii) requires an investment project of such size and complexity (e.g. where the investment decision for incremental and new capacity is predicated on associated simultaneous investment decisions in respect of related projects) that the procedure described in section 2.e) could appear not to be a robust approach.

ENTSOG is requested to elaborate on provision (ii) in terms of when this is the case.

The decision whether the criteria are met and an open season can be used is subject to NRAs approval.

The terms of the open season and in particular the design of the binding commitment phase of the open season should be approved by all NRAs affected. The terms should comply with the following principles, in addition to the coordination and information provision requirements in 2.c) and d):

- It should offer non-discriminatory opportunities to make commitments for capacity products.
- The capacity expansion should aim at satisfying all commitments, as far as this is overall efficient and economically feasible; where satisfying all commitments would not be economically feasible, or not efficient in the broader geographical context, an allocation rule based on willingness-to-pay should be used in priority. This may lead to using an algorithm modelled on the CAM auction algorithm, for example as described in section e).
- Pro-rating is the only other fall-back allocation rule that should be allowed in order to arrive at an efficient investment size that maximises the degree to which user requests

are fulfilled. Its usage should be conditional on the demonstration that the (sole) use of willingness-to-pay would be impractical (e.g. pro-rata needed in combination with willingness-to-pay when demand curves are used or when flat bookings are obtained from network users which cannot be economically met simultaneously).

For binding commitments in any open season procedure, all relevant provisions of the NC CAM on capacity products should hold, particularly with respect to capacity product design, bundling and the capacity set aside for short term allocation. Only the following deviations from the NC CAM are admissible:

- Network user commitments for capacity can be obtained for 15 years as of the capacity becoming useable. Beyond that, commitments for an additional period of up to 5 years can be obtained<sup>8</sup>. The requirement of additional commitments has to be shown to and assessed by the concerned NRAs.
- If existing capacity is still available at an IP for the years for which binding bids for new capacity are invited, these capacity products can be included in the offer of incremental and new capacity.
- Conditional commitments, for instance across a number of years requested, including or excluding bids at other IPs, or for a minimum amount of capacity required (fill-or-kill) can be obtained in open season procedures.

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<sup>8</sup> This does not necessarily mean allocation of the capacity beyond 15 years. NRAs can require that TSOs secure unilateral commitments from network users to bid for the capacity at the reserve price as soon as it is eventually offered for allocation. Any allocation for the additional 5 years beyond 15 years requires an analysis of the effects on competition by the relevant NRAs with the NRAs' decision in favour of allocation relying on the analysis not identifying detrimental effects on competition.