

# Vision Paper

## LT UIOLI

# 1 Introduction

The CMP Guidelines<sup>1</sup> introduced new and more detailed obligations on transmission system operators (TSOs) and National Regulatory Authorities (NRAs) regarding the design of congestion management procedures.

Article 2.2.5 of the CMP Guidelines describes the procedure of Long-term Use-it-or-lose-it (LT UIOLI). This is a mechanism with the specific intention of deterring capacity hoarding over the longer term. LT UIOLI dictates that NRAs require their TSOs to fully or partially withdraw systematically underutilised capacity when certain criteria are met.

The European Commission explained in a staff working document<sup>2</sup> how the provisions of the CMP Guidelines are to be or could be applied in practice. However, regulators CREG, Ofgem and ACM consider that it may be useful to elaborate on how they intend to apply the criteria in practice, in view of the importance of transparency and consistency on the application of this measure across the interconnection points between their respective member states.

Moreover, since the CMP Guidelines are only applicable on interconnection points (IPs) one would expect that in case of a capacity withdrawal, the application of the measures is aligned on both sides of the border as much as possible. CREG, Ofgem and ACM (hereafter: the regulators) have therefore developed a common interpretation of the criteria for invoking LT UIOLI and its application.

This vision paper describes the current joint vision of the regulators on all the relevant elements of LT UIOLI in as much detail as possible *ex ante*. It is stressed, however, that individual cases may require a case specific assessment.

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<sup>1</sup> Commission Decision of 24 August 2012 on amending Annex I to Regulation (EC) No 715/2009.

<sup>2</sup> Commission Staff Working Document, Guidance on best practices for congestion management procedures in natural gas transmission networks.

## 2 Applying LT UIOLI

Article 2.2.5 of Annex I of the Regulation 715/2009 reads as follows:

### 2.2.5. Long-term use-it-or-lose-it mechanism

1. *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. Contracted capacity is considered to be systematically underutilised in particular if:*
  - (a) *the network user uses 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 could be provided; or*
  - (b) *the network user systematically nominates close to 100 % of its contracted capacity and renominates downwards with a view to circumventing the rules laid down in point 2.2.3(3).*
2. *The application of a firm day-ahead use-it-or-lose-it mechanism shall not be regarded as justification to prevent the application of paragraph 1.*
3. *Withdrawal shall result in the network user losing its contracted capacity partially or completely for a given period or for the remaining effective contractual term. 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.*
4. *Transmission system operators shall regularly provide national regulatory authorities with all the data necessary to monitor the extent to which contracted capacities with effective contract duration of more than one year or recurring quarters covering at least two years are used.*

In summary, the TSO is required by the NRA to fully or partially withdraw systematically underutilised capacity when the criteria as mentioned in this mechanism are met. To assess whether the criteria are met, the process outlined below is to be followed.

A key principle of the LT UIOLI mechanism is that it only applies where there is contractual congestion, where there has been unmet demand for capacity and where a shipper's average utilisation rate is below 80%. If there is no contractual congestion at an IP, there is no need to assess the utilisation rate of individual shippers at that IP. If there is contractual congestion and a request for firm capacity but the utilisation rate of a shipper is 80% or higher, there is no need to assess whether or not the shipper has offered unused capacity under reasonable conditions.<sup>3</sup>

If all criteria are met, the relevant shipper will be required to justify its underutilisation to the relevant NRA. Where the NRA considers that no proper justification has been provided, the TSO will be required by the NRA to withdraw part of the contracted capacity from that shipper and re-offer this capacity to the market. Only to the extent this capacity is resold, the shipper loses its rights and obligations. In the figure below the various steps of LT UIOLI are depicted.

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<sup>3</sup> The criterion in 2.2.5(1b) is not further detailed in this vision paper. This condition refers to the Firm Day-ahead Use-it-or-lose-it, which has not been implemented in Belgium, the Netherlands and the United Kingdom.

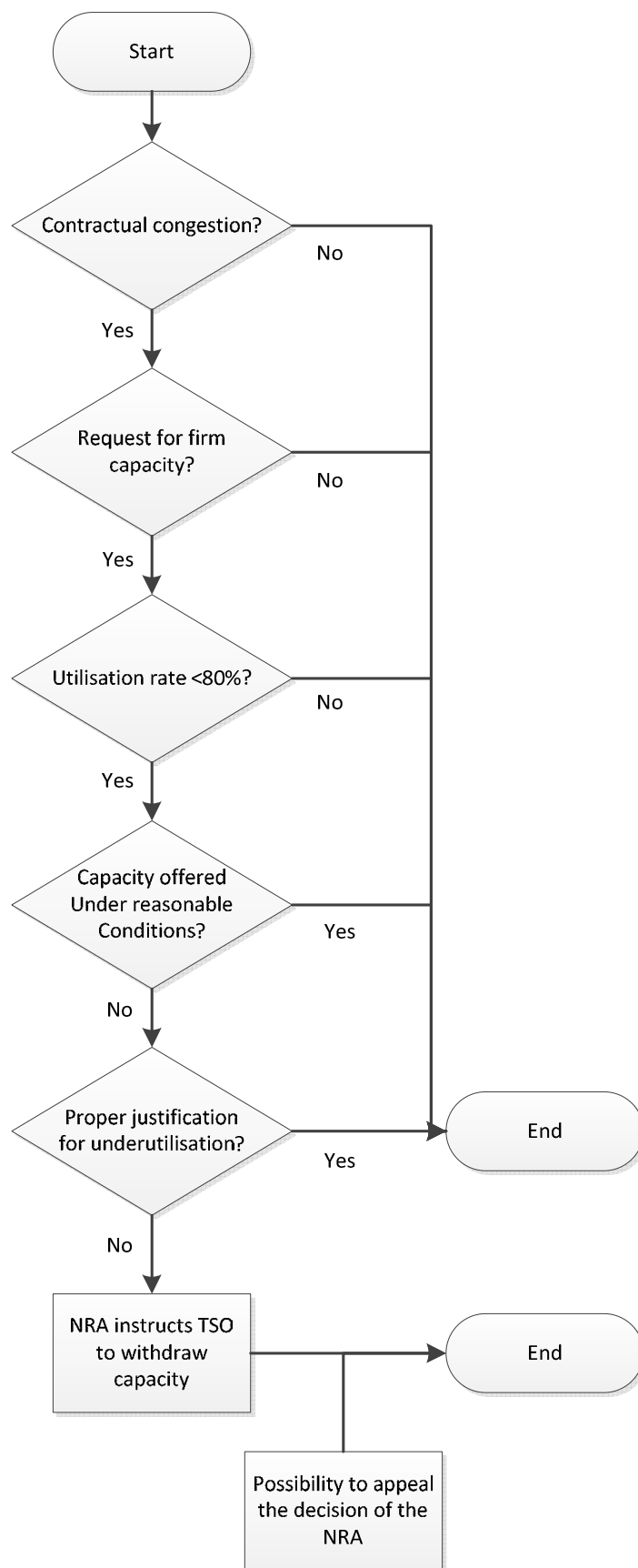


Figure 1: Process for LT UIOLI

### 3 Clarification of the criteria

In this chapter the regulators wish to explain how they intend to apply the criteria listed in figure 1 in practice when making their decisions on the application of the LT UIOLI mechanism.

#### 3.1 Contractual congestion (in the context of LT UIOLI)

The CMP Guidelines are applicable to situations of contractual congestion. Contractual congestion is defined in the Gas Regulation as “a situation where the level of firm capacity demand exceeds the technical capacity”.<sup>4</sup> Technical capacity is defined as “the maximum firm capacity that the transmission system operator can offer to the network users, taking account of system integrity and the operational requirements of the transmission network”. This is the level of firm capacity the TSO can offer, without the capacity offer via oversubscription (OS capacity).

In the light of the ‘long-term’ aspect of the LT UIOLI mechanism the regulators will only take yearly and quarterly auctions into account when assessing contractual congestion on IPs. After all, it does not seem proportional to withdraw long term capacity when in one or two day-ahead auctions the demand for firm capacity exceeds the technical capacity offered.

##### Conclusion

The regulators consider there to be contractual congestion in the context of applying LT UIOLI<sup>5</sup> when in the monitoring period:

- all technical capacity offered in the yearly or quarterly auctions was sold out; or
- technical capacity in the yearly or quarterly auctions was sold at a premium<sup>6</sup>; or
- the TSO did not offer any capacity in the aforementioned auctions.

#### 3.2 Request for firm capacity

If there is contractual congestion on an IP, the LT UIOLI mechanism only applies if “other network users request firm capacity” (article 2.2.5(1)). Since TSOs are incentivised to offer OS capacity, the offered firm capacity in the yearly and quarterly auctions could be higher than the technical capacity. A situation could therefore arise in which the demand for firm capacity exceeds the level of offered technical capacity, but does not exceed the total offer of firm capacity, including OS capacity. Therefore, a request for firm capacity is not the same as the existence of contractual congestion and needs to be established on top of the latter. The criteria for the assessment of requested firm capacity are similar to the criteria for the assessment of contractual congestion, the only difference being that contractual congestion is related to *technical* capacity, whereas a request for firm capacity is related to *offered* capacity.

<sup>4</sup> Article 2 of Regulation (EC) No 715/2009.

<sup>5</sup> The interpretation of the definition of contractual congestion for the purpose of LT UIOLI is without prejudice to the interpretation of contractual congestion in other cases.

<sup>6</sup> ‘Premium’ refers to a payable price higher than the reserve price.

#### **Conclusion**

The regulators consider there to be a request for firm capacity in the context of applying LT UIOLI when in the monitoring period:

- all offered capacity in the auctions for year-ahead or quarterly products was sold out; or
- a capacity product in the auctions for year-ahead or quarterly products was sold at a premium; or
- the TSO did not offer any capacity in the aforementioned auctions;

### **3.3 Effective contract duration of more than one year**

The CMP Guidelines indicate that the usage level of contracted capacity with an effective contract duration of more than one year should be monitored (article 2.2.5(1)(a)). Taking into account the purpose of the LT UIOLI mechanism, this only includes multiannual contracts and a series of one year contracts of at least two years. This view corresponds with the guidance issued by the Commission.

#### **Conclusion**

The regulators consider that the withdrawal of capacity under LT UIOLI only applies to multiannual contracts, or a series of one year contracts of at least two consecutive years.

### **3.4 Systematically underutilised**

The CMP guidelines state that contracted capacity is considered to be systematically underutilised if the network user uses less than 80% on average in both periods; from 1 April until 30 September and from 1 October until 31 March, for which no proper justification could be provided (article 2.2.5(1)(a)). If in one of these periods the average degree of utilisation is 80% or higher, the capacity is not systematically underutilised. In this section we will discuss the interpretation of the average degree of utilisation. Section 3.6 below sets out the regulators' interpretation of what may constitute 'proper justification'.

Regarding the degree of utilisation the question arises as to how LT UIOLI relates to the situation in which a network user has multiple capacity contracts for the same period. In the case of profiled capacity bookings a shipper could have quarterly, monthly, and daily capacity bookings on top of its yearly contracts. The use of capacity is not solely from yearly contract(s), but the possible withdrawal does aim at only these contracts. This raises the question how much of the used capacity should be allocated to the yearly contract(s).

In case of profiled capacity bookings the usage of capacity should be allocated first to the long term capacity products. Although this could lead to overestimation of the degree of utilisation of the long term contract(s), regulators do not wish to introduce a possible disincentive to profile capacity bookings.<sup>7</sup>

The regulators consider that the utilisation rate is calculated based on the average utilisation per gas day. The utilisation per gas day is the quotient of the average hourly allocation<sup>8</sup> and the contracted yearly or multiannual

<sup>7</sup> A shipper may profile its capacity bookings by contracting a different amount each month and each day, depending on the expected needs. This is opposed to a flat capacity booking where the amount is equal for the whole year.

<sup>8</sup> Note that the utilisation rate could be higher if it were calculated on the basis of the peak hourly allocation rather than the average hourly allocation. This difference can be taken into account as a possible proper justification, if a shipper can prove it needs the peak capacity (see section 3.6).

capacity on that day. This utilisation per gas day is averaged for the two monitored periods separately.

#### **Conclusion**

The regulators consider that capacity is not liable to be withdrawn under the LT UIOLI mechanism if the utilisation rate is 80% or higher in at least one of these periods: from 1 April until 30 September and from 1 October until 31 March.

In case of multiple contracts with bookings for usage in the same period (profiled bookings), the capacity in contracts with a duration of one year or longer is assumed to be used before any other contracts with shorter duration. The utilisation rate is equal to the average utilisation per gas day.

### **3.5 Unused capacity sold or offered under reasonable conditions**

The CMP Guidelines state that capacity could be withdrawn if the user has not sold or offered under reasonable conditions its unused capacity (article 2.2.5(1)). Where the shipper has sold unused capacity, that shipper is no longer the owner of the capacity. Utilisation rates and possible withdrawal are therefore not applicable in this case.

The criterion ‘capacity could be withdrawn only if the user has not offered this under reasonable conditions’ consists of two elements: the offer of capacity (where, in what form, how much?) and the conditions which apply to the offer (when are the conditions reasonable?).

#### *The offer*

The LT UIOLI mechanism does not make any distinction as to where capacity should have been offered, which means that capacity that is offered on any secondary platform or bulletin board should be taken into account. For the monitoring process however, it makes sense to use the data from the PRISMA secondary platform and data from the surrender of capacity (pursuant paragraph 2.2.4 of the CMP Regulation) in this step. If a shipper has nevertheless offered capacity on another platform while there was congestion in the monitoring period, this will be taken into account at the next step in the process, where shippers are given the opportunity to provide a proper justification (see section 3.6).

The CMP Guidelines do not stipulate how much unused capacity should be offered, and for which period. In this step only the *period* for which capacity is offered should be taken into account. The *amount* of capacity that is offered should only be taken into account when determining the part of the contracted capacity that the TSO should withdraw, since these amounts should be linked to each other: the more capacity is offered (under reasonable conditions) the less capacity should be withdrawn. This is further detailed in section 3.7 of this vision paper.

The regulators consider that the period for which capacity is offered should be related to the ‘long term’ aspect of LT UIOLI. Therefore a shipper should offer capacity for a period of at least three consecutive months.

#### *The conditions*

The most important condition to consider is the price at which the capacity is offered. The applicable reserve price in the latest yearly CAM auction or a tariff lower than that should always be considered as reasonable, since the starting point is a situation of contractual congestion. The regulators consider an offered price higher than the applicable reserve price to be unreasonable. In that case it cannot be excluded that there was a demand for the

offered capacity at the reserve price, which is not met. Note that this does not mean that a shipper is not allowed to sell capacity at a price higher than the reserve price - this point only pertains to the case in which a shipper has offered but not sold a certain amount of capacity.

Other conditions could be unreasonable as well, such as limiting the counterparts to whom capacity is offered.

#### **Conclusion**

The regulators consider that – in case of contractual congestion - contracted capacity is not liable to be withdrawn under the LT UIOLI mechanism if the shipper has either surrendered capacity to the TSO or has offered this capacity on the PRISMA secondary platform for at least three consecutive months ahead (or a combination of the two), against a price up to the reserve price in the latest yearly CAM auction within the monitoring period. The capacity offer should be accessible for all interested counterparts registered as a trader on the PRISMA platform.

### **3.6 Proper justification**

The CMP guidelines state that contracted capacity is considered to be systematically underutilised in particular if the network user uses less than on average 80% of its contracted capacity in both periods: from 1 April until 30 September and from 1 October until 31 March, for which no proper justification could be provided ( article 2.2.5(1)(a)).

For the regulators this means that if capacity is utilised at an average degree of less than 80%, a shipper should provide a proper justification to the relevant NRA(s) for this in order to avoid withdrawal in case of contractual congestion. This step gives the shipper the opportunity to prove that it still requires the capacity concerned, even though it utilised its capacity with an effective contract duration of more than one year at an average degree of less than 80%. Following the previous step, the shipper may also use this opportunity to prove that, even though there was contractual congestion in the monitoring period, it has offered unused capacity at a secondary platform other than PRISMA, under reasonable conditions.

The regulators consider a utilisation rate of less than 80% to be properly justified when the shipper proves it needs the capacity it contracted. Whether or not the justification that the shipper provides is proper, will be assessed in each individual case. However, an example of a proper justification could be the existence of a contract with a third party, such as a delivery contract or a security of supply contract. The regulators find it important to stress that a proper justification should be provided for the amount of contracted capacity up to the threshold of 80%. Holding capacity solely for trading opportunities is not considered a proper justification.

## Conclusion

The regulators will ensure that a shipper is given the opportunity to properly justify a utilisation rate lower than 80%. Contracted capacity which the shipper can prove it needs is not to be withdrawn. Justifications will be assessed on a case by case basis, but could typically be deemed proper through, for example, the existence of a delivery contract. A shipper may also use this opportunity to prove that it has offered unused capacity at a secondary platform other than PRISMA, under reasonable conditions.

### 3.7 The capacity to withdraw

If a shipper systematically underutilises its contracted capacity at a contractually congested IP (and a request for firm capacity has been received) and does not offer enough unused capacity under reasonable conditions, capacity shall be withdrawn. The LT UIOLI mechanism states that the shipper loses its contracted capacity partially or completely for a given period up to the remaining effective contractual term. The regulators are of the view that in case a shipper has for instance a utilisation rate of 79%, it is unreasonable to withdraw all contracted capacity for the remaining duration. The conclusion is therefore that the amount and period should be proportionate to the gravity of the breach of this regulation.

#### *Part to withdraw*

The part of the contracted capacity to withdraw depends on three criteria:

1. the degree of utilisation
2. the amount not offered under reasonable conditions
3. the amount for which the shipper has no proper justification.

The LT UIOLI mechanism states that if a shipper uses 80% of its contracted capacity or more, no capacity will be withdrawn. The regulators see the 80% as a threshold, above which no capacity should be withdrawn. For instance if a shipper has a utilisation rate of 60%, has no proper justification and it has not offered any capacity under reasonable conditions, the part up to the 80% is open for withdrawal (20% in this example). In another case where the utilisation rate is 40% and the shipper has a proper justification for 75% of his contracted capacity, the part open for withdrawal is the remaining 5% up to the 80% threshold.

Next to the mentioned criteria any change in contracted capacity should be taken into account. After all, only capacity contracts for future use can be withdrawn, while the assessment is done on the monitored period (in the past). The regulators recognize that the contracted capacity for future use could be higher or lower than the contracted capacity in the past. If, for instance, the long term capacity contract is amended to the level for which the shipper has a proper justification, it makes no sense to withdraw capacity.

Where the LT UIOLI mechanism is applied to a shipper who holds different types of capacity (e.g. bundled and unbundled capacity) with an effective duration of more than one year, the regulators are currently indifferent as to the order in which these different types of capacity should be withdrawn. Where a capacity withdrawal is to take place, the relevant NRA(s) will have a discussion with the shipper on a case-by-case basis. Following this discussion, the relevant NRA(s) will then instruct the relevant TSO(s) which type of capacity to withdraw.

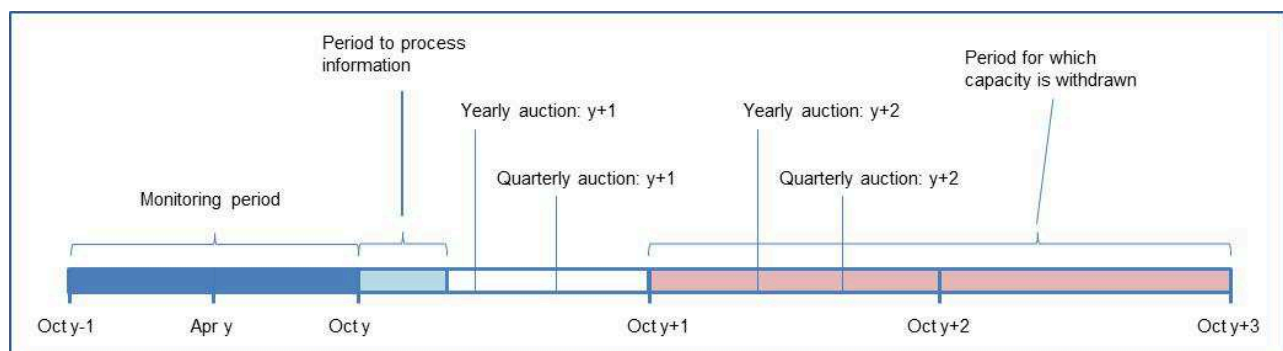
### Period to withdraw

As for the “given period”, as mentioned in the LT UIOLI mechanism (article 2.2.5(3)), the regulators deem it proportionate to limit the withdrawal of capacity to effectively two years in the future. The TSO will be required to re-offer the determined part of the long term contracted capacity in the first possible yearly and quarterly auctions. If the monitored period is for instance 1 October 2014 – 30 September 2015, NRA(s) and TSO(s) should aim to process the information such that the capacity withdrawn, can be offered at the yearly auction in March 2016. The period for which the capacity is offered is for two years in the future, thus for the gas years October 2016 until October 2018 (see also the timeline in figure 2 below). Capacity not sold in the auction of the year-ahead product is rolled on to the auction of quarterly products, i.e., it is offered to interested shippers in the regular allocation process. For the capacity that is not sold in these auctions, the shipper keeps its rights and obligations. This also means that if a shipper has voluntarily sold a certain amount of capacity after the monitoring period, this will be taken into account in setting the capacity to be withdrawn.

### Conclusion

The regulators will consider that if capacity is systematically underutilised *and* the capacity offered under reasonable conditions added to the capacity for which the shipper has a proper justification is still less than 80%, the long-term capacity contracts of the shipper on the specific IP should be withdrawn for the part up to the 80% threshold, for an effective duration of two gas years. If the amount of contracted capacity for future use is altered with respect to the contracted capacity in the monitored period, this should be taken into account.

The regulators will aim to have the withdrawn capacity offered at the earliest opportunity. Capacity not sold in the auction of the year-ahead product is rolled on to the auction of quarterly products. If not sold entirely, the shipper keeps its rights and obligations for the capacity that has not been sold.



**Figure2: Timeline for offering withdrawn capacity**