

How Balticconnector capacity allocation mechanism works from shipper's perspective?

Balticconnector capacity allocation mechanism was approved by NRAs of Finland and Estonia in the end of June. The mechanism is the first of its kind in Europe due to fact that Balticconnector capacity has no price, because Finnish, Estonian and Latvian TSOs signed the agreement which enables the removal of tariffs between the countries' borders. Balticconnector ("BC") is an interconnection point, which connects entry-exit system of Finland and entry-exit system of Estonian-Latvian integrated market area. Thus, according to EU legislation, capacity shall be allocated at BC – either using auctions or via implicit capacity allocation. From these two, implicit capacity allocation was chosen for BC.

Market participants have asked questions about the mechanism and the firmness of capacity allocated by TSO. This article gives the answers to these questions.

Balticconnector capacity shall be allocated in part of day-ahead and within-day products on the basis of:

1. Shippers' confirmed nominations (OTC trading)
2. Cross-border trades on the gas exchange.

TSO defines the share of capacity offered to the gas exchange and the share offered by TSO itself taking into account the market situation. This article focuses on the OTC trading at Balticconnector. From the beginning of 2020, GET Baltic as an exchange operator will offer implicit capacity via its trading platform. Regarding the detailed allocation principles of GET Baltic, please contact info@getbaltic.com.

The key points of BC capacity allocation mechanism for shipper (OTC trading)

- **Capacity is implicitly allocated based on confirmed nominations. Shippers need only to nominate.**
- **Day-ahead and within-day capacity products are offered according to the nomination and renomination submission schedule.**
- **All offered capacity at BC is firm. Already confirmed nominations and renominations are NOT changed by TSO except in unexpected technical faults.**
- **If BC is congested, shippers' nominations are reduced pro rata proportionally to nominated quantities before confirming them. If congestion occurs during renomination period, already confirmed nominations stay as such.**

General principles of BC capacity allocation

Two main principles relevant for shippers can be identified:

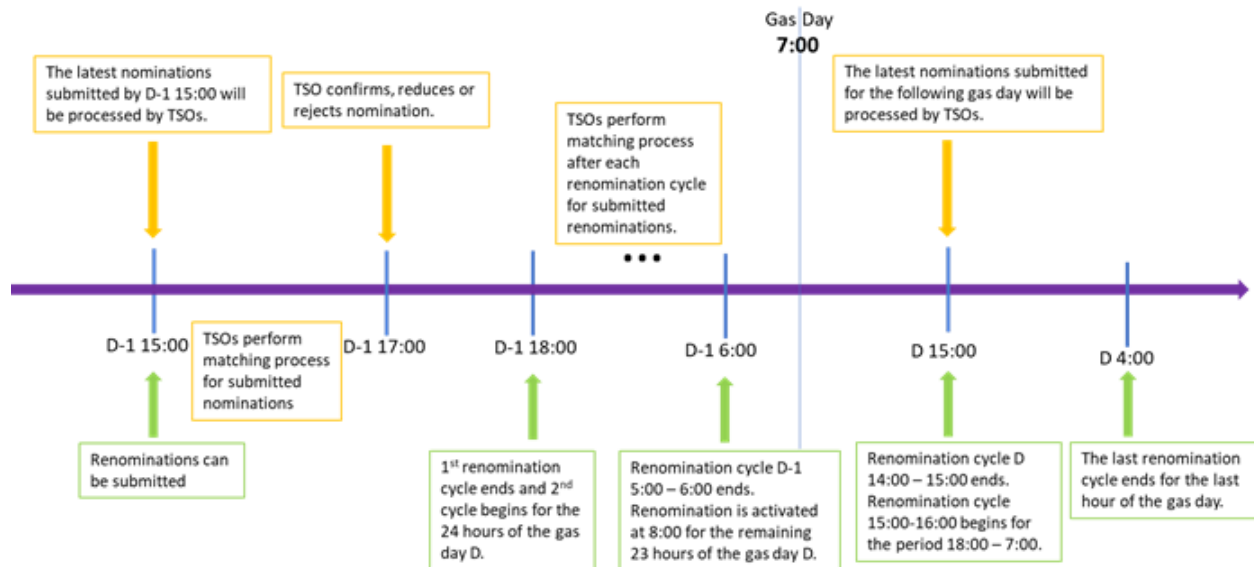
- Only nominations and/or renominations shall be submitted.

- When shipper has received confirmed nomination from TSO, this can be considered as allocation of same amount of firm capacity, which will NOT be changed by TSO except in unexpected technical faults.

At Balticconnector, capacity is allocated based on confirmed nominations which means shippers' nominations and renominations are requests of corresponding amount of capacity. TSO offers day-ahead and within-day capacity products according to the nomination submission schedule. Double-sided nomination principle applies which means that shippers both sides of Balticconnector submit nominations.

Day-ahead nominations can be submitted until D-1 at 15:00 EE(S)T. Shippers are entitled to correct their nominations as many times as they want before the abovementioned deadline. The latest nomination received by the deadline is the one which will be processed by TSO.

Starting D-1 at 15:00 EE(S)T, TSO offers within-day capacity according to renomination schedule. There are renomination cycles, which are performed every hour starting on D-1 at 17:00 EE(S)T. The renominations are required to be flat for all hours until the end of the gas day. It takes two full hours to perform the matching process by TSO. This means the renomination submitted on gas day D at 11:18 EE(S)T would be activated at 14:00 EE(S)T. The last possible renomination for the last hour of the gas day can be submitted on gas day D by 4:00 EE(S)T.



All capacity products offered at Balticconnector are firm

Confirmed nominations equal to allocated firm capacity. Once TSO has confirmed shippers' nominations and/or renominations, TSO has allocated the same amount of firm capacity. Allocated capacity (which equals to allocated quantity) will not be changed except in unexpected technical faults. In these exceptional cases, the TSO who is causing the interruption will compensate the direct costs for affected shippers operating in the system of the causing TSO.

Matching – the process between Finnish and Estonian TSOs

Finnish and Estonian TSOs perform matching process which aligns the shippers' nominations each side of Balticconnector. The purpose of matching process is to maximize the utilization of Balticconnector. If the nomination of the shipper pair differs, lesser rule principle is applied meaning that lower nomination value is used as a default. Matching is the process of the TSOs, so this does not require any actions from shippers.

Case example: Shipper nominates 100 units/hour and its counterparty nominates 110 units/hour. There has been some misunderstanding, because the nomination values differ. Assuming there is no congestion at BC, the confirmed nomination is 100 units/hour, because of lesser rule.

Congestion management

Only physical congestion may occur at Balticconnector. There is physical congestion situation, if the aggregated matched nominations or renominations exceed the available Balticconnector capacity. In this case shippers' nominations or renominations are reduced **pro rata**, i.e. proportionally to the nominated quantities. It is important to note that already confirmed nominations and renominations stay as such. It should also be noted that received nomination is not allowed to exceed the initial available capacity.

If only a part of renominated quantities can be transported, remaining available capacity shall be divided between all renominations on a pro rata basis insofar as the quantity renominated by each shipper differs from the shipper's effective confirmed nomination.

Case example: Shipper and its counterparty shipper on the other side of BC (forming a shipper pair) have nominated 100 units/hour for the following gas day. TSO confirms the nomination. Later, during renomination cycles, BC is congested. What happens to our confirmed nomination?

- Nomination stays as 100 units/hour, because confirmed nominations will not be changed whatever happens after confirmation. If TSO has confirmed the shippers' renomination of 100 units/hour, and BC is congested after the confirmation, allocated gas quantity will stay as 100 kWh/hour. Only the nominations and renominations not confirmed by TSO may be reduced due to congestion.

Case example: Available capacity is 100 units for the upcoming renomination cycle. For simplicity it is assumed that shippers in question have not submitted nominations. Shipper A renominates 60 units, shipper B 100 units and shipper C 20 units during the same renomination cycle. Capacity is allocated as follows.

Incentives for the efficient use of BC capacity

Shippers may renominate downwards at Balticconnector free of charge within the tolerance defined in the TSOs price list. For amounts exceeding this limit, shippers shall pay an underutilization fee in accordance with the price list. The underutilization fee is effective to Shippers only on all hour of those gas days when Balticconnector is congested, i.e. on days when

shippers' nominations or renominations have been reduced on a pro rata basis. Underutilization fee calculation is hourly.

If you have questions related to BC capacity allocation mechanism, please contact:

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Why implicit method for Balticconnector capacity allocation in 2020-2021?

Gas transmission capacity at Balticconnector is allocated on the basis of nominated quantities starting from the beginning of 2020. The allocation methodology has been approved by the national regulatory authorities after public consultation in Estonia and Finland.

The Finnish transmission system operator has been approached by market participants with questions on the capacity allocation methodology. These questions stem from a need for shippers to reserve capacity products beforehand to secure transportation for a longer term than only day-ahead and withinday. With this text, the transmission system operator provides a background for the selected methodology and factors that affect its present and future design.

Capacity allocation methodologies of interconnectors in the EU context

Finland will waive derogation as the last country in the EU in the beginning of 2020. This means the full adoption of the EU Gas Directive, Network Regulation and Network Codes that include, e.g., regulation on the capacity allocation methodologies of interconnection points. The Network Code on Capacity Allocation Mechanisms (NC CAM, 459/2018) determines two possible capacity allocation methodologies as follows:

- Implicit capacity allocation methods, in which case national regulatory authorities may decide not to apply Articles 8 to 37 of the NC CAM; and
- capacity auctions with standard products and schedule defined in NC CAM.

Implicit allocation method means a capacity allocation method where, possibly by means of an auction, both transmission capacity and a corresponding quantity of gas are allocated at the same time. Furthermore, Network Code on Tariffs (NC TAR, 460/2017) sets out the principles for the calculation of reserve prices for standard capacity products. Setting a reserve price for standard capacity products is required for all interconnection points between two Member States.

Market integration between EU Member States in the EU context

Market integration is generally set as an objective in the EU policy^[1]. While this objective is presented in the Network Codes, its regulatory enforcement remains at one entry-exit system level. Firstly, there is no regulation to support the abolishment of tariffs between two or more systems. For example, the Network Codes lack a definition for inter-transmission system operator compensation (ITC) mechanism that is in place in the electricity network codes. An ITC agreement between two or more transmission system operators enables the monetary compensation of tariffs between the transmission system operators so that the reserve price at the interconnecting points can be removed.

Secondly, the establishment of a single balancing zone between two or more transmission system operators lacks the definition of intermediary steps in the Network Code on Balancing (NC BAL, 312/2014). Intermediary steps would allow harmonization and implementation between two or more Member States through controlled steps over time rather than all at once. A few Member States have managed to develop their own versions of joint balancing zones. These include Belgium-Luxemburg and Denmark-Sweden. In both cases, the latter country is reliant on the first as the sole importer of gas to the other.

Unique starting point of Balticconnector

From the above perspective, a joint balancing zone between Estonia and Latvia, an ITC agreement between Estonia and Finland, market liberalization in Finland and the commissioning of an interconnector at the same time constitute a unique starting point for the commercial operation of Balticconnector.

From the perspective of the current Network Codes, an ITC agreement means that the reserve price in capacity auctions would be set to zero and/or capacity is allocated implicitly at zero tariff.

From the market integration perspective, Balticconnector is defined as an interconnector for as long as Finland and Estonia belong to different balancing zones. In view of a potential joint balancing zone between these countries in the near future, an alternative to strictly following the Network Codes is to consider intermediate steps that would serve the transition and provide cost-efficiency to the market. There are several possibilities how to do this. The alternatives discussed during the design phase were:

- a) Capacity allocation through first-come-first-served based on standard capacity products
- b) Capacity allocation through pro rata based on standard capacity products
- c) Implicit capacity allocation on gas exchange and based on nominations in the case of bilateral trades and having only day-ahead and within-day capacity products available to the market

Following the Network Codes would require an auction system, while alternatives a) and b) would require an explicit capacity reservation system. Furthermore, alternatives a) and b) pose

an additional design challenge under an ITC agreement with zero tariff. This concerns how to prevent shippers from reserving the entire available capacity without cost and exploiting this opportunity in the secondary market. Solving this would require a use-it-or-lose-it mechanism. The above leaves two options: capacity auctions from the start or alternative c).

Alternative c) can work over the long-term only under the assumption that Balticconnector is not congested. If there is congestion, capacity should be allocated to the highest bidder, i.e., through capacity auctions or via implicit capacity allocation on a gas exchange. According to the transmission system operators' suggestion and approval by the national regulatory authorities, Balticconnector will start its commercial operation under the option c). This decision by the national regulatory authorities is in force at maximum for two years and is intended only as a transitional solution for a newly established market. During this period, the transmission system operators and regulators in Estonia and Finland will closely monitor the market development. Changing the capacity allocation mechanism will require the development of a replacing model, an approval from the national regulatory authorities and public consultation in both countries in addition to technical implementation. For the above reasons, major changes to the existing mechanism will take several months. The transmission system operator will launch public discussion on the capacity allocation mechanism after option c) as soon as there is data indicating or a strong opinion at the market or by the regulator that the allocation mechanism should be changed already before 2022.

[1] https://ec.europa.eu/growth/single-market/strategy_en