ENTSOG Capacity

Stakeholder Workshop on Sunset Clause and Default Rule

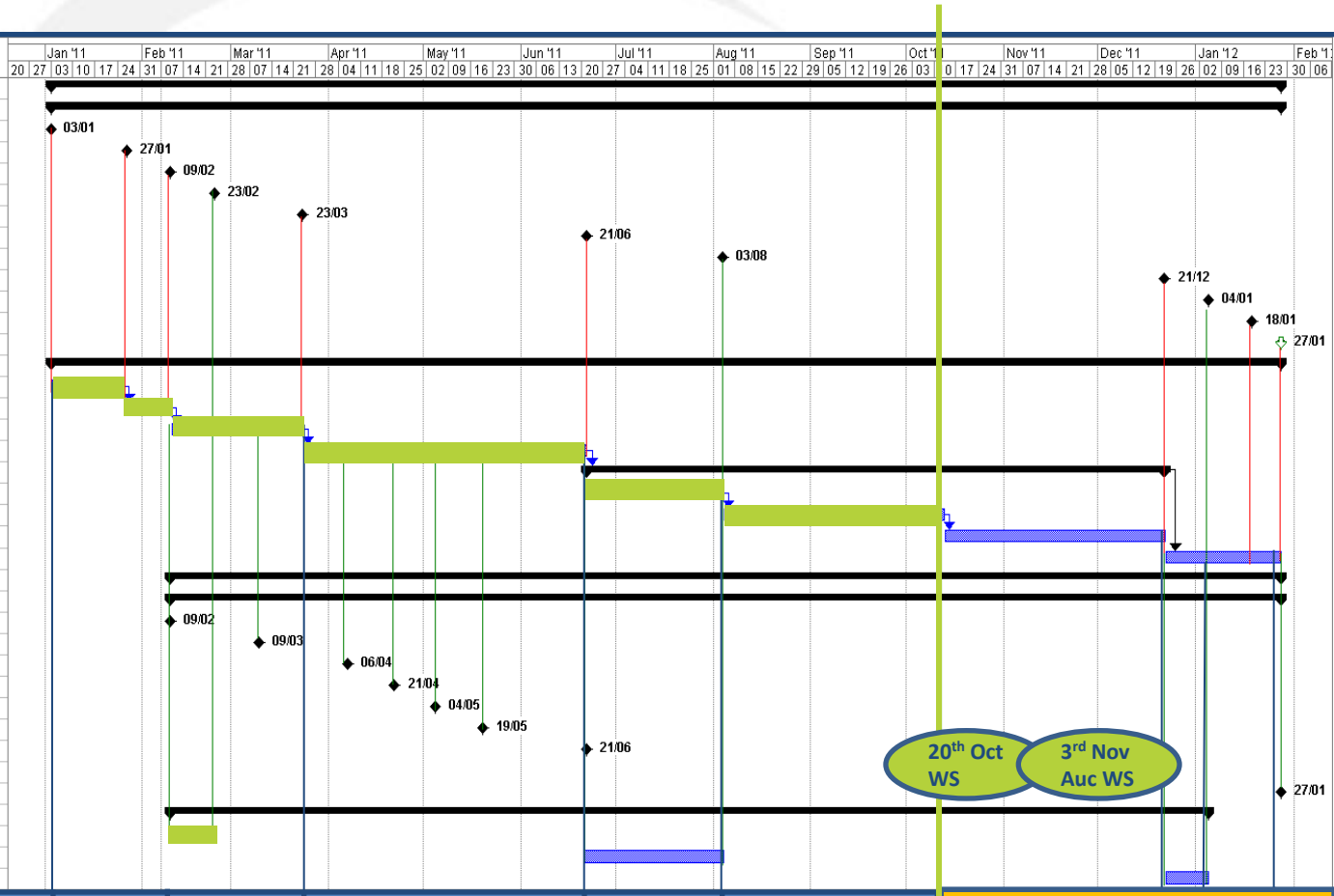
Frank Roessler

Subject Manager

Brussels – 6th October 2011

Introduction – Planning

ID	Task Name
1	**Network Code Development**
2	**Milestones**
3	Project Kick-Off
4	Invitation Letter for EC
5	Draft External Project Plan published
6	End of draft Project Plan Consultation
7	Launch Documentation published
8	Draft CAM NC published for Consultation
9	End of Draft CAM NC Consultation
10	CAM Network Code and Consultation Response Analysis Report published
11	NC endorsed by Stakeholders
12	NC endorsed by ENTSOG
13	CAM Network Code published and Recommendation to ACER
14	**Project Lifecycle**
15	Phase 0 – Preparatory Works
16	Phase 1 – Project Planning
17	Phase 2 – Launch Documentation Publication
18	Phase 3 – Interactive Draft NC Development
19	**Phase 4 – Consultation on Draft NC & Revision**
20	Phase 4a - Consultation
21	Phase 4b - Review Consultation Responses
22	Phase 4c - Produce & Endorse Final NC
23	Phase 5 – NC Finalisation
24	**Stakeholder Interaction**
25	**Stakeholder Sessions**
26	Kick-Off Meeting
27	Project Plan Feedback Meeting
28	SJWS #1
29	SJWS #2
30	SJWS #3
31	SJWS #4
32	Draft Code Presentation
33	Consultation Feedback
34	Final Code
35	**Consultations**
36	Draft Project Plan Consultation
37	Draft NC
38	Final NC Endorsement



Planned progress for reporting period

Achieved progress or delay

Under discussion – additional market interaction considered

Introduction – Agenda

No.	Description	Time
1.	Introduction	11.00-11.15
2.	Background to the Sunset Clause	11.15-11.30
3.	Update on ENTSOG work on Sunset Clause text	11.30-12.00
4.	Sunset Clause and Default Rule – simulation in groups	12.00-13.00
	Lunch break	13.00-13.45
5.	Conclusions of simulation & discussion – all participants	13.45-15.00
6.	Conclusions and additional considerations	15.00-15.30

History

Bundling concept presented at ERGEG WS
- Jan 2009 → idea broadly supported when presented

Madrid Forums

ERGEG FG consultation
- Spring 2010 → Market starts addressing concerns

ENTSOG starts work on CAM NC
- Jan 2011 → Market opposes exclusive bundling and Sunset Clause

Member States Comitology meetings
→ Ministries keep raising strong concerns with Sunset Clause

ACER FG consultation
- Spring 2011 → Market continues to reject exclusive [illegible]ling and Sunset [illegible]e

Legal Study commissioned by few NRAs
→ Study declares Sunset Clause as legally feasible

Final ACER FG
17th Aug 2011 → ENTSOG obliged to

ICIS Heren ESGM 4th October

Shippers reject sunset clause in proposed capacity rules

Shippers and traders want to scrap planned new rules that would phase out long-term natural gas capacity contracts and

are also against the mandatory bundling of existing contracts.

A total of 32 said that mandatory un-

After ACER CAM FG, ENTSOG is obliged to include the Sunset Clause

Group of NRAs commissioned Legal Study – Sunset Clause possible

Stakeholders, ENTSOG members and GIE are very concerned

Meeting is not about its appropriateness (but we will take note),

Meeting set up to explore the Default Rule

Share state of work within ENTSOG on the Bundling provision

Explain Sunset Clause drafting and raise open issues

Simulate attempt of Sunset Clause to reach contract split agreements

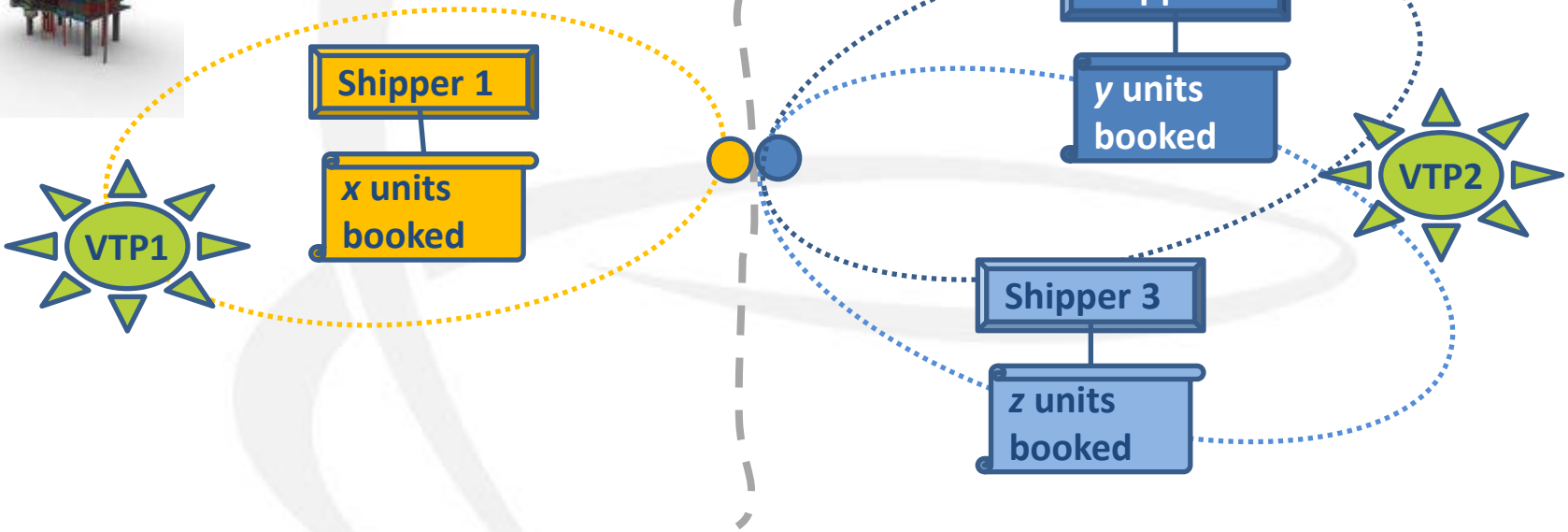
Explore and document results

Discuss possible Default Rule options to inform the NC finalisation

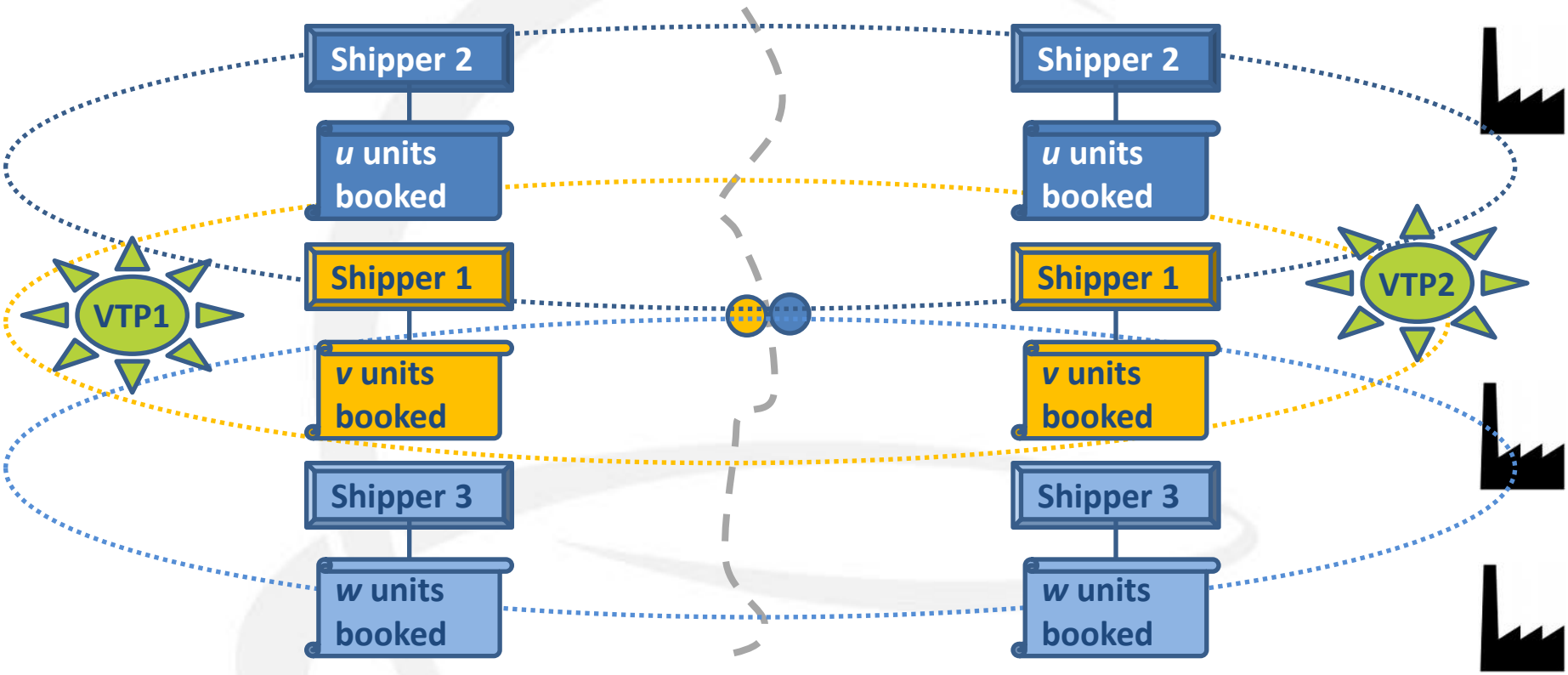
Apart from the sunset clause, shippers

code on capacity allocation mechanisms. RB

Current situation

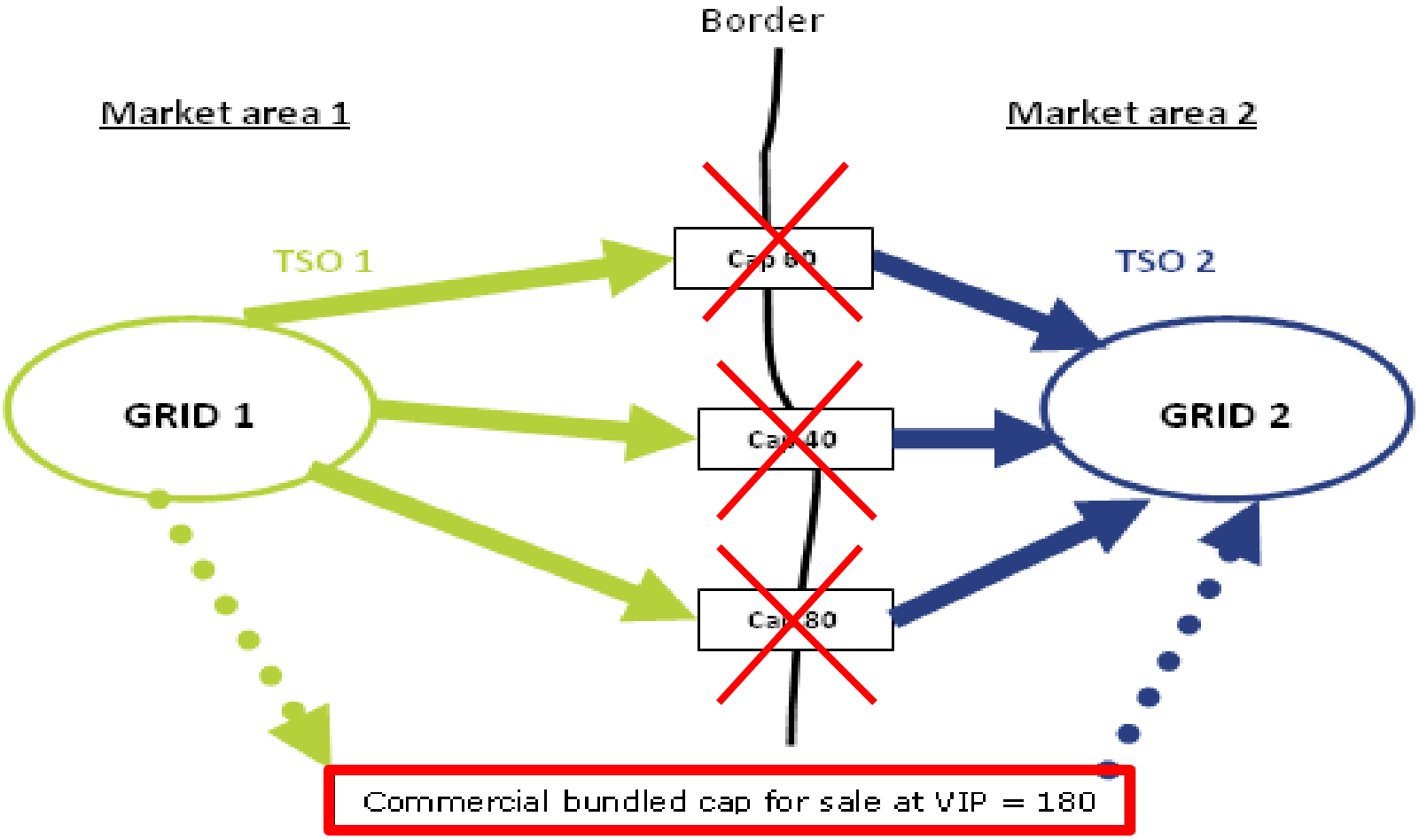


ACER CAM FG: Exclusive Bundling



- Hub-to-Hub booking required – flange booking abolished
- Common nomination for Hub-to-Hub capacity
- ACER also restricted the Secondary Market

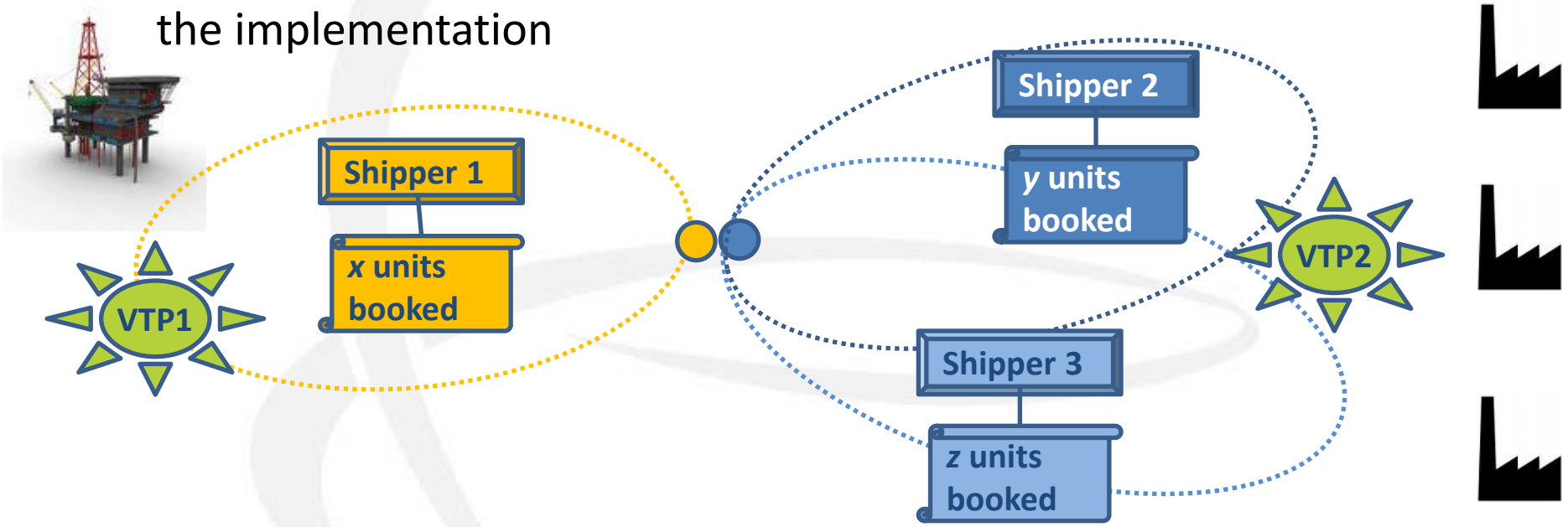
ACER CAM FG: Virtual Interconnection Points



ACER CAM FG: Sunset Clause

Sunset Clause

- All contracts to be transferred into bundled contracts 5 years after the implementation



  - First, by agreement attempt involving all parties
  - If not possible, by application of the Default Rule (splitting rule)

CAM Network Code

Update on ENTSOG work on Sunset Clause text

Cécile Marchi

Legal Advisor

6th October 2011

Sunset clause FG CAM article 2.4.2 Drafting

Update on the ongoing work to introduce such clause

- **Assumptions** taken
- **Two steps** of the process
  - Agreement on the split /default rule
  - Amendment of the existing contracts
- **Legal issues**
  - Translation of the agreement(s)
  - Non discretionary measure/ criteria > objective criteria to be defined
  - The implementation shall not result in a substantial disequilibrium in comparison with the initial commitment
  - Enforcement

Sunset clause FG CAM art 2.4.2
Open Issues

- **Feasibility to bundle the contracted capacity**
  - Technical : quantity /multiple scenarios on an IP
  - Contractual : duration /multiple actors
- **Treatment of the remaining unbundled capacity**
  - Impact on revenues TSO/Shipper
  - Introduction of various schemes in parallel:
    - contractual :bundled/unbundled product ?
    - Commercialization: auction/ other?
- **Contractual translation to pursue**
  - Contracts impacted/ amendment and new contract to foresee
  - Agreement/default rule /mix
  - Assignment and Specific mechanisms

Sunset clause FG CAM art 2.4.2
Open Issues

- **Proportionality issue**
  - Non discrimination principle
- **Role of the TSOs**
  - Consistency to implement agreements (technical/contractual)
  - Agreement among shippers / transparency
  - Cooperation of TSOs
- **NRAs' role**
  - Price of the product/ tariff/ commercialization process
  - Intervention in the process + enforcement
- **Focus on transmission contract**
  - Supply agreement set apart

➡ ***Points will be illustrated by today's simulation***

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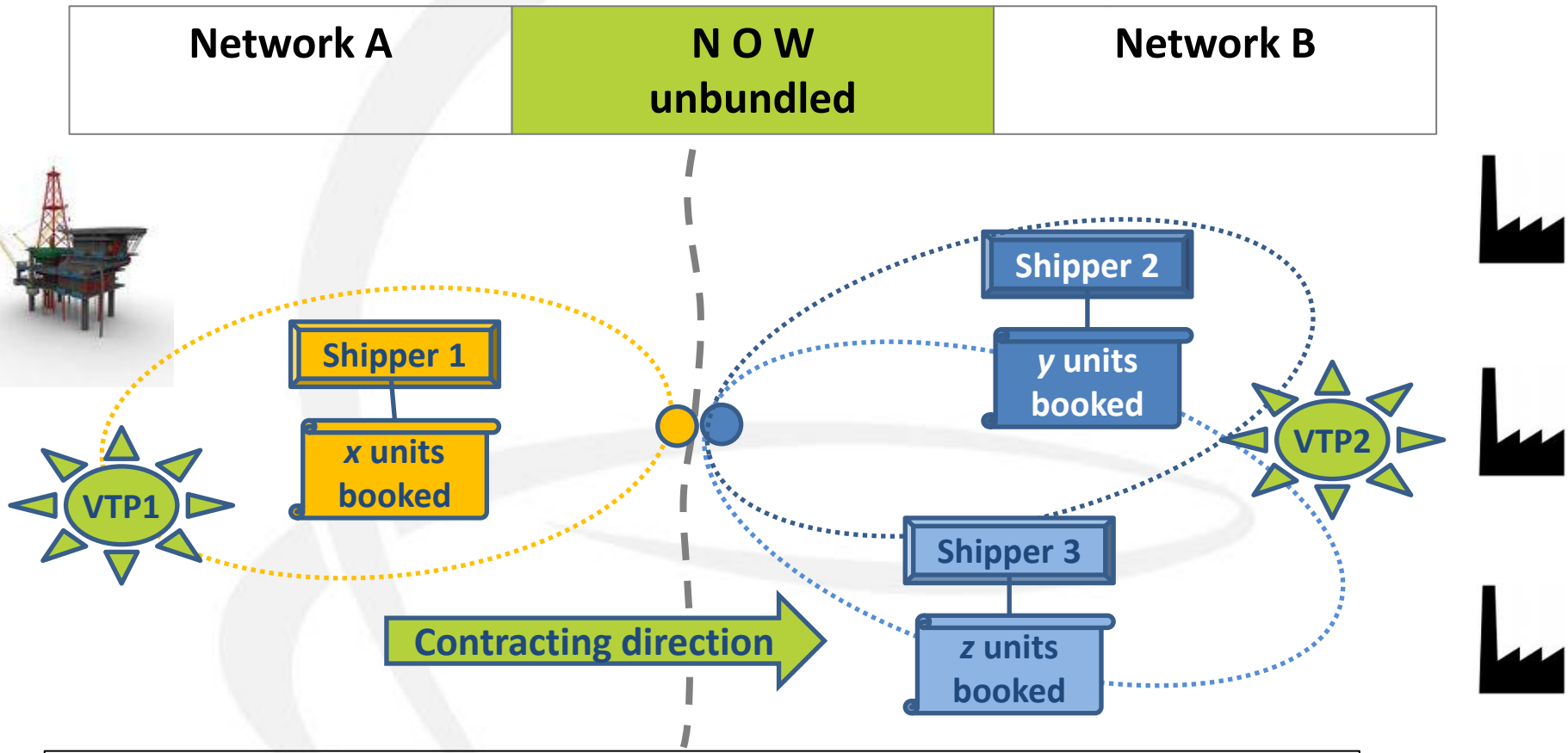
Introduction to the Sunset Clause simulation

Heather Glass

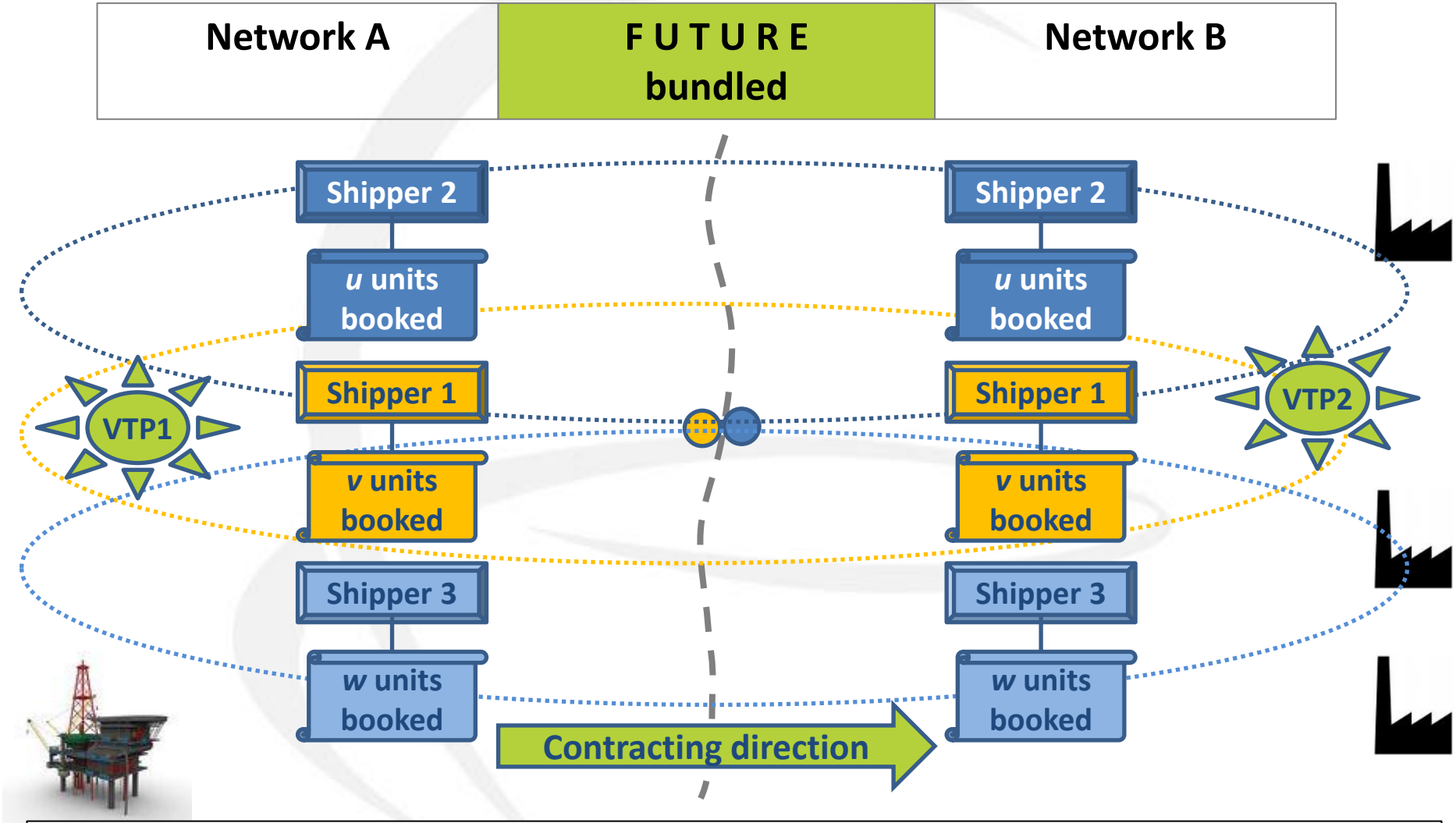
Brussels – 6th October 2011

Scenario



- Two entry-exit systems, one unidirectional IP
- Capacity initially traded at the flange

Scenario



- Capacity must be bundled after 5 years (30 minutes in the game!)
- After bundling, shipper must hold same capacity either side of IP, if available

Scenario

Assumptions

- The price of capacity should be considered irrelevant
- We are considering only one period of time, therefore the duration of contracts is not relevant
- Shippers face no barriers to becoming a contracting party on the other side of the flange
- All other Framework Guideline provisions apply: in particular bundled capacity cannot be sold unbundled in secondary market
- There are no issues with confidentiality of information: all information can be shared

The game

Groups

- Each group consists of
  - One NRA
  - Two TSOs
  - Three shippers – each with different needs

Aims

- You will be given a piece of paper showing your role and your needs
- Participants must try and reach agreement on bundled capacity split within the time available (30 minutes)
- If no agreement can be reached a default rule will be applied
  - Different groups have different default rules
  - Some groups face capacity constraints (congestion), others do not

The game

Outcome

- The template provided shows the allocation that will take place if you don't reach agreement (default rule)
- Please indicate whether your group has reached agreement
- If you have reached agreement please enter your agreed allocations in the green boxes

Group 1

Bundled capacity A-B

Agreement reached? Yes

If agreement reached:

Shipper	Unbundled capacity		Bundled capacity	
	A	B	A	B
1	90	0		
2	0	50		
3	0	50		
Total	90	100	0	0

If no agreement reached

Shipper	Unbundled capacity		Bundled capacity	
	A	B	A	B
1	90	0	43	43
2	0	50	24	24
3	0	50	24	24
Total	90	100	90	90

The game

Outcome

- Please pick a spokesperson for your team who will talk about your experiences after lunch
- Please make a note of your discussions:
  - What were the most challenging issues you had to overcome when trying to reach agreement?
  - Were any group members difficult to please and why?
  - What are the advantages of the default rule you were given?
  - What are the disadvantages of the default rule you were given?

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Conclusions of simulation & discussion

Henrik Schultz-Brunn

Brussels – 6th October 2011

Default rule – What to bundle?

"If no agreement on the split of the bundled capacity is reached […] bundled capacity shall be considered split between the original capacity holders ***proportionally to their capacity rights****.*

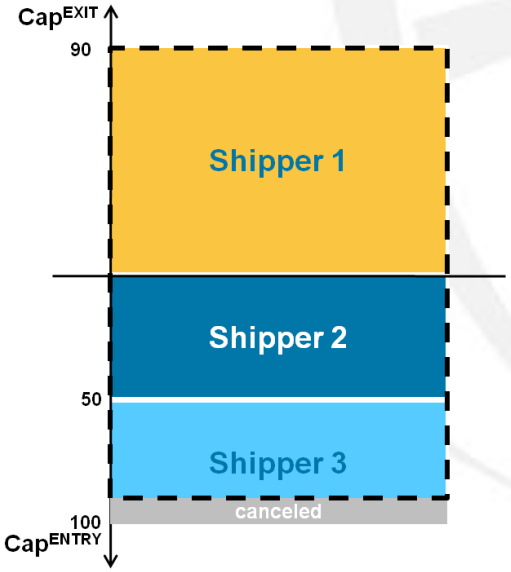
The parties to an existing capacity contract ***shall adjust the original capacity contracts*** *[…] to the agreed split of the bundled capacity or, if no agreement is reached, to the above proportionality rule, as further detailed in the network code(s)."*

- Before solving the problem of <u>how</u> to split capacity between capacity holders, the problem of <u>what</u> to bundle needs to be solved especially when booked amounts do not match
- Basically three interpretations existent, trying to answer the question of how to deal with "not matching capacity"
  - Minimum rule approach
  - Maximum rule approach
  - Partially unbundled approach

Default rule – What to bundle?

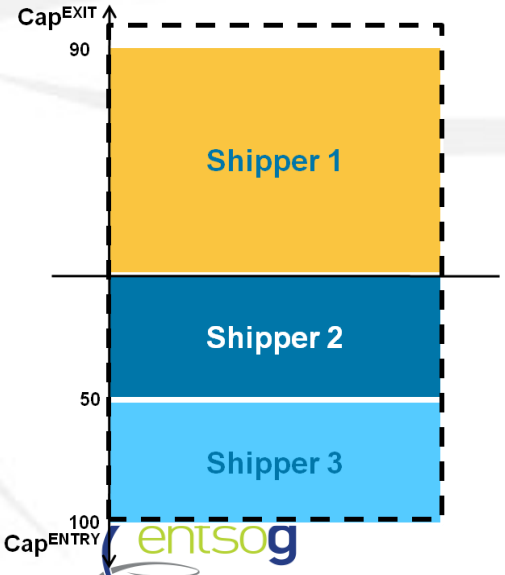
Minimum rule

- Bundled capacity is determined by the lower of the two bookings on either side of the IP
- Unbundled contracts are cancelled



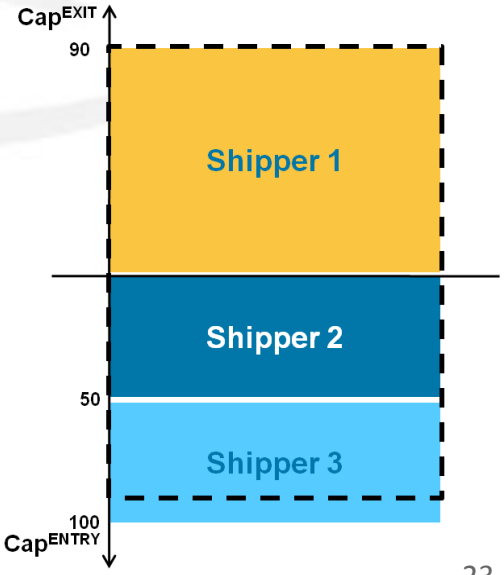
Maximum rule

- Bundled capacity is determined by the higher of the two bookings on either side of the IP



Partially unbundled

- Bundled capacity is determined by the lower of the two bookings on either side of the IP
- Remaining booked capacity remains unbundled



Capacity to be bundled

Default rule – How to split?

"If no agreement on the split of the bundled capacity is reached […] bundled capacity shall be considered split between the original capacity holders ***proportionally to their capacity rights****.*

The parties to an existing capacity contract ***shall adjust the original capacity contracts*** *[…] to the agreed split of the bundled capacity or, if no agreement is reached, to the above proportionality rule, as further detailed in the network code(s)."*

- ENTSOG's proposal is a pure mathematical formula in order to ensure a proportional split and to eliminate any room for interpretation at the same time

$$\text{Capacity holdings Shipper}_i \text{ after bundling} = \frac{(\text{Capacity bookings Shipper}_i \text{ before bundling})}{\sum(\text{Capacities booked at both sides})} * \text{ Capacity to be bundled}$$

Default rule applied

Group 1 – Minimum rule (capacity constraints)

$$\text{Capacity holdings Shipper}_i \text{ after bundling} = \frac{(\text{Capacity bookings Shipper}_i \text{ before bundling})}{\sum(\text{Capacities booked at both sides})} * \text{ Capacity to be bundled}$$

- According to the minimum rule, 90 units have to be bundled

S1's position after bundling
- Exit: 90/190*90=42.5
- Entry 90/190*90=42.5

S2's position after bundling:
- Exit: 50/190*90=23.75
- Entry 50/190*90=23.75

S3's position after bundling
- Exit: 50/190*90=23.75
- Entry 50/190*90=23.75

	TSO 1 (network A) before bundling	TSO 2 (network B) before bundling	TSO 1 (network A) after bundling	TSO 2 (network B) after bundling
Techn. Cap.	90	120	90	120
Cap. to be bundled	90	90	90	
Booking S1	90	0	42.5	42.5
Booking S2	0	50	23.75	23.75
Booking S3	0	50	23.75	23.75
Sum	90	100	90	90

Default rule applied

Group 2a – Maximum rule (capacity constraints)

$$\text{Capacity holdings Shipper}_i \text{ after bundling} = \frac{(\text{Capacity bookings Shipper}_i \text{ before bundling})}{\sum(\text{Capacities booked at both sides})} * \text{ Capacity to be bundled}$$

- According to the maximum rule, 100 units have to be bundled

S1's position after bundling
- Exit: 90/190*100=47.5
- Entry 90/190*100=47.5

S2's position after bundling:
- Exit: 50/190*100=26.25
- Entry 50/190*100=26.25

S3's position after bundling
- Exit: 50/190*100=26.25
- Entry 50/190*100=26.25

	TSO 1 (network A) before bundling	TSO 2 (network B) before bundling	TSO 1 (network A) after bundling	TSO 2 (network B) after bundling
Techn. Cap.	90	120	90	120
Cap. to be bundled	100	100	100	
Booking S1	90	0	47.5	47.5
Booking S2	0	50	26.25	26.25
Booking S3	0	50	26.25	26.25
Sum	90	100	100	100

Default rule applied

Group 2b – Maximum rule (no capacity constraints)

$$\text{Capacity holdings Shipper}_i \text{ after bundling} = \frac{(\text{Capacity bookings Shipper}_i \text{ before bundling})}{\sum(\text{Capacities booked at both sides})} * \text{ Capacity to be bundled}$$

- According to the maximum rule, 100 units have to be bundled

S1's position after bundling
- Exit: 90/190*100=47.5
- Entry 90/190*100=47.5

S2's position after bundling:
- Exit: 50/190*100=26.25
- Entry 50/190*100=26.25

S3's position after bundling
- Exit: 50/190*100=26.25
- Entry 50/190*100=26.25

	TSO 1 (network A) before bundling	TSO 2 (network B) before bundling	TSO 1 (network A) after bundling	TSO 2 (network B) after bundling
Techn. Cap.	120	120	120	120
Cap. to be bundled	100	100	100	
Booking S1	90	0	47.5	47.5
Booking S2	0	50	26.25	26.25
Booking S3	0	50	26.25	26.25
Sum	90	100	100	100

Default rule applied

Group 3 – Partially unbundled (capacity constraints)

$$\text{Capacity holdings Shipper}_i \text{ after bundling} = \frac{(\text{Capacity bookings Shipper}_i \text{ before bundling})}{\sum(\text{Capacities booked at both sides})} * \text{ Capacity to be bundled}$$

- According to the maximum rule, 100 units have to be bundled
- Not matching units remain unbundled

S1's position after bundling
- Exit: 90/190*90=42.5
- Entry 90/190*90=42.5

S2's position after bundling:
- Exit: 50/190*90=23.75
- Entry 50/190*90=23.75
- Unbundled entry: 5

S3's position after bundling
- Exit: 50/190*90=23.75
- Entry 50/190*90=23.75
- Unbundled entry: 5

	TSO 1 (network A) before bundling	TSO 2 (network B) before bundling	TSO 1 (network A) after bundling	TSO 2 (network B) after bundling
Techn. Cap.	90	120	90	120
Cap. to be bundled	90	90	90	
Booking S1	90	0	42.5	42.5
Booking S2	0	50	23.75	23.75 + 5 unb.
Booking S3	0	50	23.75	23.75 + 5 unb.
Sum	90	100	90	100

Default rule applied – Summary of results

Group 1: Minimum rule (capacity constraints)				
	Exit (before bundling)	Entry (before bundling)	Exit (after bundling)	Entry (after bundling)
Techn. Cap.	90	120	90	120
Cap. to be bundled	90	90	90	
Booking S1	90	0	42.5	42.5
Booking S2	0	50	23.75	23.75
Booking S3	0	50	23.75	23.75
Sum	90	100	90	90

Group 2b): Maximum rule (no capacity constraints)				
	Exit (before bundling)	Entry (before bundling)	Exit (after bundling)	Entry (after bundling)
Techn. Cap.	120	120	120	120
Cap. to be bundled	100	100	100	
Booking S1	90	0	47.5	47.5
Booking S2	0	50	26.25	26.25
Booking S3	0	50	26.25	26.25
Sum	90	100	100	100

Group 2a): Maximum rule (capacity constraints)				
	Exit (before bundling)	Entry (before bundling)	Exit (after bundling)	Entry (after bundling)
Techn. Cap.	90	120	**90**	120
Cap. to be bundled	100	100	100	
Booking S1	90	0	47.5	47.5
Booking S2	0	50	26.25	26.25
Booking S3	0	50	26.25	26.25
Sum	90	100	**100**	100

Group 3): Partially unbundled (capacity constraints)				
	Exit (before bundling)	Entry (before bundling)	Exit (after bundling)	Entry (after bundling)
Techn. Cap.	90	120	90	120
Cap. to be bundled	90	90	90	
Booking S1	90	0	42.5	42.5
Booking S2	0	50	23.75	23.75 + 5
Booking S3	0	50	23.75	23.75 + 5
Sum	90	100	90	90

Conclusions

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Subject Manager

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More complex issues

- Already simple cases show complexity of the problem
- More complex cases add additional complexity to it
  - More shippers involved
  - Different number of TSOs involved on both sides of the IP
  - Same shipper holds capacity on both sides
  - Wheelings, U-Turns…
  - Various combinations of abovementioned cases
  - Users do not know the bookings of the others and don‘t want to reveal them

Experience in Group 1

Result

- Partial agreement during the negotiation
- Default rule possibly applies

Shipper	Unbundled capacity		Bundled capacity	
	A	B	A	B
1	90	0	17.5 + 10	17.5 + 10
2	0	50	22.5	22.5
3	0	50	40	40
Total	90	100	90	90

Shipper	Unbundled capacity		Bundled capacity	
	A	B	A	B
1	90	0	43	43
2	0	50	24	24
3	0	50	24	24
Total	90	100	90	90

Experience in Group 2a

- No agreement during the negotiation
- Default rule applies

Shipper	Unbundled capacity		Bundled capacity	
	A	B	A	B
1	90	0	47	47
2	0	50	26	26
3	0	50	26	26
Total	90	100	100	100

Experience in Group 2b

- Partial agreement during the negotiation
- Default rule possibly applies

Shipper	Unbundled capacity		Bundled capacity	
	A	B	A	B
1	90	0	47	47
2	0	50	26	26
3	0	50	26	26
Total	**90**	**100**	**100**	**100**

Shipper	Unbundled capacity		Bundled capacity	
	A	B	A	B
1	40	0	22	22
2	0	0	0	0
3	0	50	28	28
Total	**40**	**50**	**50**	**50**

Experience in Group 3

- No agreement reached during the negotiation
- Default rule applies

Shipper	Unbundled capacity		Bundled capacity	
	A	B	A	B
1	90	0	43	43
2	0	50	24	29
3	0	50	24	29
Total	**90**	**100**	**90**	**100**

Lessons learnt from the negotiation

- Users were very reluctant to negotiate as they have to reveal their market strategy.
  - Do not know the market position, the booked capacity, prices, opportunities, risks of the others
- Users consider their “strategy” as a great value for them which they cannot share with the others
  - Otherwise they would have split their contracts before (secondary)
  - Users have contractual obligations towards their customers (commodity)
  - They have payment obligations towards the TSOs
- Users see bundling as commercial risk instead of opportunity
- TSO has interest to keep or maximise the booking level (to maintain the revues without tariff increases)

Conclusion of negotiation attempt 1

- The result from a negotiation (or the application of the Default Rule) may be acceptable for 2 parties – but never for all
- Users remarked they will lose flexibility by the application of the Sunset Clause
- As a result, users will have to re-negotiate their commodity contracts
- Suppliers may be in a better situation to negotiate then small users

→ **No negotiation round was successful**

- Much more difficult in reality, considering the simplified simulation

→ **Default rule will always be key**

Conclusion of Default Rules

- The "Maximum Rule" was not considered as not appropriate as additional capacity would have to be allocated – this is considered as discriminatory against other potential interested parties who could only buy capacity via the official auction process. It also depends on the incentive regime within a country how much capacity could be made available in addition (vs. the risk for the TSO).
- The "Minimum Rule" was not considered as not appropriate as contracted capacity would have to be terminated at one side of the border– this would lead to a stranded capacity + increase of tariffs.

Conclusion of Default Rules

- The “Partially Unbundled Rule” was considered as most appropriate by the stakeholders and would at the same time not bring the risk of increasing tariffs of the Minimum Rule.
- “Partially Unbundled Rule” in the light of the definition of **“proportional”** (ACER FG)

Proportional to overall booking level

$$\text{Capacity holdings Shipper}_i\text{ after bundling} = \frac{\text{(Capacity bookings Shipper}_i\text{ before bundling)}}{\sum\text{(Capacities booked at both sides)}} \times \text{Capacity to be bundled}$$

Proportional to own booking

$$\text{Capacity holdings Shipper}_i\text{ after bundling} = \frac{\text{(Capacity bookings Shipper}_i\text{ before bundling)}}{2}$$

WORKSHOP CONCLUSION

- The majority of users are against the application of the Sunset Clause
- No negotiation (already with the simplified scenarios) was successful – the Default Rule would have always been applied
- With all Default Rule options it remains unclear if users would not consider legal measures – they may always state to be in a disadvantaged situation compared to the capacity contract they had initially booked
- The meeting could not identify an appropriate Default Rule (solutions seem always un-sufficient for some users)

→ **Neither, the negotiations nor any default rule satisfied the users**

- "Partially Unbundled Rule" to be further elaborated

Thank You for Your Attention

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