EUROGAS
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CAM NC – consultation response sheet
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Responses to Draft CAM Network Code Consultation

Consultation Response Sheet

Please complete the fields below and send via email using the subject, "Response to the CAM NC consultation" to **info@entsog.eu** by 3 August 2011.

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Question 1: Do you consider that the level of detail in the draft NC is appropriate for an EU Regulation?
Response: Overall consider that the current draft of the NC has reached a level appropriate for an EU wide implementation. But we would recommend that if there is any interim period (e.g. 10.3.) necessary in one of the Member States that there should be a clear deadline set. The objective should be to deliver as proposal for the comitology process, that is adequate for Member States' understanding and does not leave issues open for unnecessary or inappropriate elaboration.

Question 2: Should this NC set out detailed rules? If so, do you consider that where changes are necessary, they should be made through the change process foreseen in the Third Package, or (if legally possible) through a separate procedure where modifications can be made following stakeholder request and discussion?
Response: We think that the current level of detail is the minimum necessary to make an EU wide harmonized implementation happen. As we pointed out in the past a simplified change process is requested if e.g. the market will develop in a direction which makes a change of the standard capacity products or an adjustment to the auction process necessary. But especially in such a simplified process the strong involvement of the market and stakeholders is a must. For major changes the foreseen process including comitology is appropriate.

Question 3: In your view, is it credible that principles and details of CAM mechanisms could be separately identified? What elements of this (or other) code(s) might be considered for a "lighter" change process and how might such changes be made binding?
Response: Eurogas sees currently two areas where a lighter change process should be implemented. As set out under question 2 one area should be the adjustment of the capacity products to reflect the market development. Even if comitology were not judged appropriate, because of the time it could take, decisions could not just be left to ACER and/or ENTSOG. There has to be full consultation of all stakeholders. Similar considerations apply to adjustments regarding the auction process. In the beginning of multiple round auctions it could be necessary to limit the daily rounds with the first implementation. Later on more rounds per day could make sense after a learning process (1-2 years after first implementation).

Question 4: How do you consider that a process to review the handbook, and to modify it where necessary, should be designed?
Response: A handbook in which a lot of more detail could be laid down would seem to be a useful tool, provided that that the content of the handbook is coherent with the NC and has the same binding obligation. But the handbook and future changes have to be properly consulted with the

market stakeholders´ requests should be clearly reflected. The market should be informed two months ahead if changes are introduced, with four weeks consultation time. To support the change process a yearly "market test" should be implemented.

Question 5: Do you agree with the NC proposal for long term auctions of quarterly products? If not, please explain your proposed alternative and the rationale for this.
Response: Different views are held on this question as ENTSOG will see from individual responses. Compatibility of auction products are very important as are customer needs, and a number of shippers are affirming the need for annual as well as quarterly products, because among other reasons they consider that annual products will fit better with their supply and sales contracts. Other shippers prefer the option of quarterly products, and where such a system is already running smoothly, do not wish to see change imposed.

Question 6: Do you consider that the auction design set out in the draft NC includes sufficient measures to allow system users to purchase the long-term capacity they want? If not, how could the measures be improved, while remaining consistent with the FG and keeping the complexity of the auction design to a manageable level?
Response: Yes, the ability for to place bids for 15 consecutive years is sufficient to cover long-term interests in existing capacity. Market developments will ultimately determine the use of long-term capacity, and a robust secondary market should deter hoarding. Eurogas, however, has reservations about the single round auction design with Members identifying different risks and shortcomings. These reservations were reinforced by the trials in the July workshops. Please see response to question 9 for detailed argumentation. A re-bidding and the publishing of the aggregated interim information have only a value if strategic bidding behaviour is not possible in the proposed auction design, and this does not seem to be the case. For Eurogas and other stakeholders, the issue of how to trigger the necessary investments in additional capacity has to be addressed in a way that is compatible with the auction system. In this context Eurogas has indicated its readiness to explore if the UK solution with the need for additional investment being triggered in the long term auction, could suggest the basis for a possible way forward.

Question 7: Do you consider that the within-day auction proposal set out in the draft NC could be improved from a user perspective? If so, what improvements would you suggest?
Response: When running an auction for within-day capacity it has to be considered that this would involve a considerable amount of effort relative to small amounts of capacity for both the TSO and the shipper. ENTSOG should choose a within-day allocation method for that takes account of this. Also, small steps should be followed in order to decrease the risk of underselling capacity.

Question 8: The draft NC proposes that TSOs will implement all auction systems at all Interconnection Points (IPs). However, if no purchases of capacity are made in within-day or day ahead auctions at a particular IP over a certain period of time, do you consider that it would be appropriate to suspend these auctions for some time, in order to reduce operational costs?
Response: It would not be advisable to suspend the allocation since TSOs are probably not able to predict with confidence whether there is demand for day ahead or within-day capacity or not.

Question 9: Do you consider that the auction algorithms set out in the draft NC are appropriate for the Standard Capacity Products to which they are proposed to apply? If not, what modifications would you suggest?
Response: When designing a single round auction process which encompasses such a large bidding window for long-term products as proposed by ENTSOG it has to be kept in mind that shippers will probably place their bids towards the end of the bidding window, i.e. on day ten, so as not to expose themselves too early to the scrutiny of their competitors. That way the first nine days would be a waste of resources for both the shipper and the TSO. Therefore, ENTSOG should consider a mechanism that prevents this behaviour, e.g. a provision that the auction is closed if there are no changes in the bids for two consecutive bidding windows. The possibility for shippers to withdraw their bids is only of value if the auctions for the individual IPs would end at different times. If all auctions end at the same time as proposed the possibility of dropping out would only create a way to manipulate the auction result since shippers bidding for two or more alternative routes would have to wait until the end of all auctions anyway to see whether they are successful. Therefore, to really give shippers the possibility to bid for alternative routes, i.e. dropping out of the auction of one IP if they won capacity at another IP, Eurogas suggests introducing an early closure mechanism which ends the auction if there are no significant changes to the bids within a specific time. This would speed up the process, save resources and eliminate the possibility to manipulate the auction by bidding for large amounts of capacity and then dropping out at the last moment (please also refer to answer of Question 12). The idea of auctioning a scarce good is to allocate this good to those who value it the most, i.e. are willing to pay the highest price. Eurogas explicitly supports this allocation method as it is market based and non-discriminatory. Therefore, most Eurogas members would be concerned if shippers are pro rated even though they are willing to pay the highest price. The individual price steps have to be chosen very carefully to avoid a situation in any case where there is more demand at P29 than supply. To eliminate this problem completely a possible way forward could be not to limit the amount of price steps but only to publish the price increment for each IP. In that way shippers would create their own bid curve using the price increments to state the amount of capacity with the respective price step. If a multiple-step auction is implemented, an accurate definition of the different price steps set by TSOs is needed, in particular the spread between price steps should not be too high, in order to maximize shippers' possibility to bid at the price they are willing to pay for

the capacity, given that they cannot express their own price as a uniform price algorithm.

Question 10: Do you believe that any of the potential alternatives described would be more suitable? In particular, do you consider that a Pay-As-Bid methodology would be more appropriate than uniform price, particularly for auctions of shorter duration products?

Response: Eurogas supports the cleared price mechanism as a pay-as-bid mechanism may be a disadvantage for smaller shippers and newcomers as they may not have a large portfolio to use for short-term optimization and therefore be more dependent on short-term auctions.

Question 11: Under an open-bid algorithm (whether uniform price or pay as bid), do you consider that ten bids per user is a sufficient number?

Response: Yes, ten bids are sufficient.

Question 12: Do you consider that mechanisms supporting value discovery should form part of the NC? If so, which mechanisms do you believe would be most effective?

Response: As stated in the answer to Question 9 Eurogas would prefer a provision that closes the auction if there are no significant changes to bids for a specific amount of time to speed up the process. This would eliminate the possibility to manipulate the outcome of the auction by bidding for large amounts of capacity and then dropping out at the last moment before the auction closes. This would also give shippers the possibility to bid for alternative IPs dropping out of one auction if another is successful. In addition to that ENTSOG should incorporate a provision that bidders have to participate from the first bidding window on and should not be allowed to increase their volume bids during an auction. This again would increase the value of the information provided at the end of each bidding window as there would be no “late arrivals”. The implementation of a multiple-step auction process would be the best way to go forward and would make any additional discussion about price discovery mechanisms irrelevant.

Question 13: In your view, how could a split of bundled capacity between existing holders of unbundled capacity best be arranged?

Response: Eurogas understands that ENTSOG has felt constrained to prepare the draft Code in line with the current pilot FG that proposes only bundled (hub to hub) products and seeks to prohibit trading at the flange. Eurogas, however, recalls its adamant opposition to this proposal. While Eurogas would like to see bundled products as optional products, these should be offered alongside entry/exit capacity products. There should be no question of a sunset clause requiring renegotiation of all contracts involving unbundled capacity into bundled capacity. If contract parties wish to seek changes to their contracts, then the solutions can only be agreed among them. Eurogas also rejects the proposed fall-back (50-50 split) if there is no agreement. Eurogas and other stakeholders have repeated their concerns at every stage of the consultation on CAM.

Question 14: In your view, what effect would mandatory bundling have on network users? Please provide supporting evidence, if available.

Response: An obligation in a short timescale to force renegotiations of contracts would be a high risk approach.

- If bundled products for existing contracts were imposed, it could lead to the simultaneous reopening across Europe of contractual agreements. The shift from a physical delivery point to a virtual one necessarily implies a delicate renegotiation of additional basic terms of the existing agreement, such as nominations, renominations, taxes and laws applied at the new delivery point. The impact of fuel and transport costs because of the transfers of the delivery point has to be considered too in the renegotiation.

- Furthermore producers might wish to widen discussions beyond point of delivery changes against the wish of the other party. This would create not just legal uncertainties but potentially wider implications for shifting supply structures within Europe.

- The reopening of existing contractual agreements will not necessarily lead to a successful outcome, since this depends also on the wish of a counterparty who may not be bound by European law; moreover a possibility of renegotiation is established by proper contractual clauses and many existing long term contracts have just been renegotiated under these clauses.

- There is no evidence that the exclusive availability of bundled products could have significant benefits for longer-term liquidity in the market. The churn ratio of gas traded at the flange would not necessarily increase, if traded at the hubs, and big players would likely remain dominant, although increasingly these would be upstream producers.

- Bundled products could even cause some market participants to reduce their trading activities if the administrative, credit and additional capacity costs associated with moving from the flange to adjacent Member State hubs cannot be economically justified or does not fit with those companies' commercial strategies.

Question 15: Do you consider that the approach to bundled capacity set out in the NC is appropriate, within the constraints of the FG?

Response: See the answer to Questions 13 and 14. Eurogas does not agree that bundling of capacity should be mandatory and therefore does not agree with the proposals in the FG.

Question 16: Do you consider that the process set out in the draft NC for determining the sequence of interruptions is appropriate? If not, what system would you prefer?
Response: The framework guidelines requires an option-based approach. But as interruptibility should be an optimisation tool for the TSO, it is questionable if the auction system is the right solution, The considerations applying to a cleared-price approach and pay-as-bid have to be analyzed. The logic of a cleared-price approach would require an artificial limit to be set to the amount of capacity to be offered. This would not be an ideal solution. In a pay-as-bid approach, the prices offered would determine interruptible capacity release. The base price must respect the risk of interruptibility.

Question 17: ENTSOG would welcome feedback, observations and suggestions related to this section of the supporting document and to Annex 2. Do you consider that ENTSOG has correctly identified the key tariff issues in these sections?

Response: Yes, ENTSOG has correctly identified the key tariff issues in article 7 of the draft network code on Capacity Allocation Mechanisms and in annex 2 of the supporting document. As expressed several times by ENTSOG and by shippers during the SJWS (Stakeholder Joint Working Sessions), CAM, CMP and Tariffs are linked issues and should have been assessed together to have a better understanding of the "gas target model" set by the third package. So, during the process that will define in details the tariffs structure, if one assumption made in the CAM NC is not confirmed, one should be able to change the CAM NC in consequence.

One can list the following items to debate during the next Tariffs discussion.

- Reserve price

ENTSOG's draft NC on CAM set a reserve price equal to the regulated tariff. Eurogas agrees with this solution because it is simple and fair. Indeed, the best solution would be to set a reserve price for each kind of auctions (long term, annual, rolling monthly and day ahead) based on the estimated value of the capacity at each auction but this evaluation seems very difficult and cumbersome to realize. Should it be based on the marginal cost? Market based? Should not long term auctions be promoted to provide tariff visibility and investment incentives? To simplify, it seems more expedient to apply the same reserve price, i.e. the regulated tariff, for each kind of auction. Furthermore, setting the same reserve price will avoid any cross-subsidization between different kinds of shippers buying capacities at different time, which would trigger a risk that shippers move to very short term reservations.

Regarding the "multipliers", Eurogas is in favour of regulated tariff prorated to the duration (e.g. for quarterly product, the reserve price should be ¼ of the regulated annual tariff). Setting different reserve price for summer quarter or months than for winter quarters and winter months and for different durations is a more complex issue. Cross-subsidization between different kind of products has to be avoided.

- Auction revenues from Bundled Capacity

It is certainly too difficult to launch a debate between two TSOs and NRA about the Reserve Price of each part of a bundled product (the exit of zone A and the entry of zone B). As an example, NRA from country A may argue that the exit tariff of TSO B is not cost reflective of the investment made to bring gas to the border between A and B. Making the sum and allocating the revenues pro-rata the reserve price of each part of the bundled product seems to be the easiest and quickest allocation principle to put in place.

- Under / over recovery

Eurogas agrees with ENTSOG on the fact that over and under recovery should be minimized because else it “involves all kinds of incentive issues, cross-subsidizations, hampering of trade in the case of high commodity tariffs, loss of investment signals, tariff volatility and other potential uncertainties and disadvantages both for users and TSOs”. Booking’s forecast should then be the most accurate possible.

Eurogas supports the principles for recycling over recovery or charging ex-post to recover shortfalls enunciated in annex 2 : “should avoid creating cross subsidies between different classes of network users, should promote trading/competition, and should be consistent with system users procuring the capacity they need and avoiding capacity hoarding. It should also lead to tariffs that are predictable and visible for system users and should incentivize them to procure capacity at the time when they identify a need.”

Furthermore, over recovery due to high revenues from auctions at a specific congested interconnection point should be dedicated to the release of incremental capacities at this point.

Charging shippers with a variable commodity charge as a mechanism to compensate under recovery is not a solution Eurogas will support because it changes all the time and it can lead to cross-subsidizations. Eurogas is more in favor of “a timely manner by adjusting tariffs accordingly” as written in the CAM NC.

Question 18: What is your view of the process that ENTSOG has followed in order to produce the draft NC? Would you recommend that ENTSOG use a similar process to develop future NCs? What approaches would you suggest to enable ENTSOG to improve the process?

Response: Eurogas has been very satisfied with the consultation process, the frequency of the meetings, the opportunity for inputs, the system of identifying and employing Prime Movers to stimulate the debate. If possible, however, it would be a welcome improvement to have the working papers for the different Stakeholder Sessions available a day or two before the meeting to enable Eurogas and other Associations to discuss and agree points in advance. Also, Eurogas has been sensitive to the point raised by DG ENER in the 21st June meeting, that the dominant players are NW oriented. Some efforts perhaps need to be made in particular aimed at widening opportunities to understand the work and issues. Web streaming should be considered.

Question 19: ENTSOG is developing a new website and would welcome stakeholder views on how to make it as useful as possible. What are your views about the current ENTSOG website, www.entsog.eu, and what could be improved?
Response: In general the website is well structured. It would be clearer, however, certainly for new visitors to the website, if there were a heading on the Codes to click on, instead of at present reaching the Code through Publications and Events.

Do you have any other comments or observations you would like to make?
Response: 4.1(6) and 4.1(7) The definition of "available capacity" should be clarified to indicate at which time this is assessed. Currently it is not clear if the 10% reservation is applied over the total technical capacity of an IP, or if it is reserved from the available capacity each year on the first Monday of March. Also, there should be an alignment of TSOs' capacity calculation methods.