

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:

Please note that this response applies to questions 1, 2 and 3.

The level of details of the Network Code is high but appropriate in order to provide sufficient guidance for implementation and to ensure harmonization.

Nevertheless, taking into account the complexity and heterogeneity of national situations, it is very important that the NC can be reviewed and **adjusted regularly**, especially at the beginning of the process.

In that sense, the Network Code should be a living document, able to be adjusted following a lighter procedure such as the one foreseen in Article 7 of Regulation (EC) 715/2009 whereby interested parties can propose amendments to the Agency and such amendments are presented to the Commission following full stakeholder consultation.

Moreover, since those amendments are supposed to go through the comitology procedure, we can wonder if the process will be “light” enough to enable further adjustments and fine-tuning in due time. As a consequence, the Commission should also envisage a lighter process at this stage, if needed. In particular, it is important to make sure that only the changes (and not the whole code) will go through the comitology procedure.

Then, in order to get an efficient review process, EDF would suggest the following evolutions:

- The code must include a **feedback process** and has to stipulate **when the first review shall happen** (for example within a year after the entry into force of the code’s provisions);
- A **governance structure** with the corresponding working groups should be put in place at European level (like what exists in most countries at national level with stakeholders’ participation) in order to make proposals to review the code to the structure able to modify it. Pragmatic adaptation to national particular situations could be addressed in these working groups.

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:

Cf. Question 1.

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:

Cf. Question 1.

Question 4: How do you consider that a process to review the handbook, and to modify it where necessary, should be designed?

Response:

The handbook which aims at gathering all technical solutions adopted by ENTSOG in a single document shall be elaborated and then reviewed through a simplified and transparent process, devoted to technical details, led by ENTSOG and approved by ACER/national regulators. Moreover, ENTSOG should clarify if the handbook will include rules or information and also precise their nature.

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:

For long-term auctions, EDF would strongly advice **to propose annual products**, for simplicity and coherence with regard to supply and commercial contracts.

Indeed the ENTSOG proposal relying on independent quarters for duration up to 15 years induce complexity, and a possible fragmentation of the capacity on the long term since shippers could get capacity to flow gas, only part of the year (for example only in summer and nothing in winter...). Therefore, there is a risk for market operators not to be able to secure a continuous supply on the long term. If the risk of not getting the desired capacity (missing one or few quarters in case of quarterly products or one of few years in case of annual products) is inherent to auctions, EDF believes that it would be easier to find an alternative solution when missing capacity for one year, than for quarters, spread out over 15 years. The suggestion is thus to introduce yearly products along with quarterly products.

Another way to provide the possibility to buy yearly quantities would be to **give the option to shippers to link consecutive quarters**. This option is **crucial** for shippers who would otherwise be exposed to a significant risk to have gaps in their long-term capacity booking while trying to match their long-term supply contracts.

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:

From its own experience and the conclusion from the simulation done in the ENTISOG workshop, EDF is very much concerned about the design set out in the draft NC that cannot be implemented in this state. In particular, EDF believes that it could be improved on the following aspects :

- 1) First of all EDF considers that new measures should be added in order to **secure gas flow on an annual basis** by either introducing annual capacity products or enabling shippers to link consecutive quarterly products during the auction process. In any case, EDF considers that allowing shippers to adjust their bids (re-bidding), as proposed by ENTISOG, is **not enough** to allow them to secure consecutive quarters.
- 2) Concerning the process itself: the volume-based auction proposed by ENTISOG cannot work well in particular regarding the issue of giving relevant information to shippers (lesson learned from the ENTISOG workshop). Indeed, EDF considers that the auction design needs to achieve at the same time: **price revelation, substitutability between products and truthful bidding**. At this stage the auction design presents the following weaknesses:
 - since there is **no constraints** on the bids between the different rounds, the conditions are met so that shippers do not bid until the last round,
 - there is a **risk for gaming** (from the workshop simulation we saw that at least half of the shippers failed to get the capacity they wanted for a number of quarters and strategic bidding behaviours were observed which did not help optimal price formation).

These disadvantages could be mitigated by introducing some corrective measures:

- **Converting the auction into an ascending-clock auction:** in that kind of auctions, an initial price (or price range) is set for the first round and shippers bid a volume for this price (or price range). Bids are binding and shippers have to bid an equal or lower volume when the price rises. If the demand at this price step is superior to the capacity offered, a higher price (or price range) is proposed for the following round. As many rounds as necessary are organized;
- As a consequence of the previous measure, the auction is closed as soon as the demand is equal or lower to the capacity offered at a defined price step;
- Introduction of a global constraint on the bids in order to incentivize shippers to have a rational behaviour (see question 12).

Finally, when **predetermining the price steps**, it would be very important to decide the **methodology** to calculate them in consultation with the market participants. Moreover, a high level of precision concerning those price steps will be very important if we want a mechanism that avoids

as much as possible pro-rata and under-selling.

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:

EDF would like to underline that the within-day auction has to be designed in coherence with the EC Commission's work on CMP insofar as, according to the proposals, the capacity, coming from congestion management mechanisms, will be released to the market through short term auctions (day-ahead or within day). This will be very important since liquidity is a major issue regarding within-day allocation.

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:

If a standard auction system is implemented for all Interconnection Points (IPs) in Europe, there would be no incremental costs for those IPs where no purchases of capacity are made in within-day or day-ahead auctions over a certain period of time. Moreover, flow patterns in Europe may change and demand can reappear at those IPs. It would therefore not be reasonable to suspend these auctions, since they are not causing any additional marginal costs.

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:

As stated in question 6, **EDF proposes to apply to long term auctions a robust multi-round design** with the characteristics proposed. Indeed, in the context of a market that is not yet used to auctions, a real multi-round auction allows shippers to adjust their bids and gives them some comfort with the revealed price.

Regarding **short-term auctions**, EDF considers that the design chosen needs to **maximize the capacity allocation**. In this respect, the level of precision for price steps (being chosen by TSOs or

shippers directly) will be crucial. At the same time, it is very important for shippers that really need to get capacity for securing gas volumes (for instance shippers delivering gas to end consumers), that the design allows them to get capacity at the price level they are willing to pay. Therefore, **additivity of bids** could be a problem.

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:

For all auction products, a **clearing-price methodology** has to be applied. Indeed, a clearing price helps to reveal a single market value and protect players from the well known “winner’s curse” effect. As a consequence, EDF does not support a “pay-as-bid” methodology.

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:

If the uniform price design is chosen, the number of bids should be sufficient to allow the shippers to adjust their bids. As stated before, **additivity of bids** may be a complicated issue to manage for shippers (at least at beginning) in a context where auctions are a completely new tool.

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:

EDF considers that an effective way to provide price discovery could be to organize the auction as **an ascending clock-auction**, where prices are announced to shippers who then submit binding quantity bids. The mechanism may result in earlier closure of some auctions and shippers may encounter difficulties to secure routes built on several IPs. However, EDF wants to underline that the problem of securing complementary IPs already exists and introducing auctions will help to solve it (see question 6). In order to take into account this point that was identified as a disadvantage by ENTSG in its supporting document, EDF formulate the following proposal.

An important issue is to ensure that shippers do not submit bids that are not related to their actual needs as was observed during the workshop test. This suggests implementing **some kind of**

constraint on the bids that make earlier bids an upper bound for later bids in the ascending auction.

However, given the high degree of substitutability and complementarity between the locations and quarters of the IPs products, EDF believes that one separated constraint for each different product would be harmful. The constraint should rather **be global** and enable some opportunity to increase demand on some products as prices are progressively discovered.

EDF believes that quantity bids submitted by the shippers should be made binding and linked to earlier bids (see for instance Ausubel, Cramton and Milgrom, "The clock-proxy auction: a practical combinatorial auction design", in Cramton, Shoham, Steinberg (eds) Combinatorial auctions. MIT press Chapter 5. 2006).

In practice, this can be translated by a rule saying that the value of the bids made in the current round cannot be greater than the sum of: (a) the value of the current bids at the prices of an earlier round, and (b) the increase in value of the bids made in this earlier round, due to the change in prices between the current and this earlier round.

In any case, EDF considers that the proposals to introduce a stabilization rule (as it exists in UK) or to oblige shippers to bid from the first day will **not be enough** to mitigate the loopholes of the design identified by stakeholders during the ENTISOG workshop dedicated to the auction simulation. In particular **the risk of gaming** will still be important and the information provided by TSOs at the end of each round will still be **irrelevant** in this case.

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

Response:

The mechanism has to be fair and in line with the gas target model prescriptions. Moreover, and in coherence with the Framework Guidelines, the possibility should be given to the concerned shippers to find agreement between them before a certain date. Then, if no agreement is reached by that date, a simple back-up rule should apply.

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

Response:

As a shipper, EDF finds mandatory bundling a **pragmatic tool** to allow new entrants to effectively compete with incumbents.

Indeed, many shippers experienced in Europe the problem of having capacity only on one side of the border and not on the other one. The provision will allow gas to flow more freely within European

gas markets, in coherence with the target of having a hub to hub approach for gas trading activities.

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:

The network code seems consistent with the framework guidelines prescriptions on bundled allocation with single nomination, treatment of divergent capacity and creation of virtual interconnection points. However, as mentioned by ENTSOG, the Sunset Clause is not treated in the code which is understandable insofar as we are still waiting for the legal and economic analysis announced by regulators.

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:

When TSOs have to interrupt shippers, ENTSOG proposes that the oldest contracts prevail on the most recent ones that will be interrupted first. Then, if two shippers are on the same rank, a pro-rata system is applied.

EDF does not support this mechanism and considers that interruptibility should be based on objective, homogeneous and non-discriminatory rules. Therefore, there are two possibilities for interruptible capacity:

- if sold at the same time (for instance at auction) : a pro-rata rule should apply;
- if sold on first come first served basis: a priority could be applied to older commitments only if the tariff is reduced progressively to the last commitments. Otherwise, the pro-rata rule should be applied.

Moreover, we are not sure to fully understand the mechanism. Indeed, if interruptible capacity is allocated via auctions, all successful bidders will sign capacity contracts at the same time. How will then be possible defining the sequence of interruptions on the basis of a "first come last interrupted" principle? Does it mean that all interruptible capacity contracts signed as outcome of the same auction will have the same age and will therefore be pro-rated in case of need to interrupt them?

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:

EDF considers that **the reserve price for short term capacity auctions (day-ahead and within-day) should be 0**. Indeed, a reserve price for these auctions may lead to **spare-capacity** that will never be allocated to anyone. Thus, a reserve price for long term auctions makes sense since TSOs may consider being able to sell the capacity later at least at a certain level and therefore refuse to sell it immediately at lower conditions. However, when the short term auctions are organized, TSOs only have the choice between selling the remaining capacity at the price proposed by bidders or not allocating it and thus creating spare-capacity, loss of revenues for TSOs and shippers and operation risks for balancing.

ENTSOG concern that capacity demand would move from LT to ST auctions is, in our opinion, overdone, despite the UK experience. Compared to the UK, the prevalence of LT supply contracts in Continental Europe would deter LT shippers to take chance and risk being hit by their TOP obligations.

Furthermore, a zero reserve price for ST auctions can create significant economic surplus by facilitating additional short-term transactions: for instance, cross-border balancing that would be otherwise, discouraged by a high ST reserve price, even in situations when there is available spare capacity.

Regarding the use of multipliers, EDF considers that this could be envisaged but that it has to be further analyzed and discussed during the elaboration of the guidelines and code on tariffs.

Concerning over and under revenue, EDF considers that these issues should be tackled the same way through a decrease/increase of the capacity price (regulatory account) or in order to promote investments/costs saving. EDF would like also to highlight the importance of incentive regulation.

Like the multipliers issue, EDF considers that the over/under revenue question has to be analyzed carefully in the context of the tariffs guidelines.

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:

EDF really appreciated the way ENTSOG has involved stakeholders all process long through consultations, workshops and informal interactive sessions. In particular, the simulation of the auction process was really useful to consider the improvement to be brought to the mechanism.

The availability of all documentation on the ENTSOG website is also very useful.

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: EDF does not have any comment.

Do you have any other comments or observations you would like to make?

Response: EDF does not have any other comment.