

Capacity Allocation and Congestion management on European Gas Transmission Networks

– Importance of the persistence of existing contracts –

In the last meeting between the European Commission and ENTSOG on the 3rd of June 2010 the TSOs were invited to sum up additional arguments pointing out the importance of the security of existing contracts and their contribution to the European gas market.

In various meetings with ERGEG and the European Commission before and during the consultation process of the CAM pilot Framework Guideline and the CMP Comitology proposal ENTSOG consistently emphasised the importance of this topic.

To document ENTSOG's illustration of the importance of stable contractual arrangements the table below lists the meetings conducted as well as official statements and other respective ENTSOG work. As mentioned in the cover note, all supporting material (listed below) can be found as attachments to the email.

Date	Title	Remark
19 th March 2009	GTE Response to ERGEG principles on capacity allocation and congestion management	page 4
9 th December 2009	Meeting ERGEG / ENTSOG	page 2
14 th January 2010	Madrid Forum XVII	slides
2 nd February 2010	ERGEG Workshop on CAM/CMP	slides
3 rd February 2010	Meeting EU COM / ERGEG / ENTSOG	page 2
26 th February 2010	ENTSOG Response to Pilot Framework Guideline on Capacity Allocation	
2 nd March 2010	Meeting ERGEG / ENTSOG	page 3
3 rd March 2010	Meeting EU COM / ENTSOG	page 3
30 th March 2010	Meeting ERGEG / ENTSOG	page 2
13 th April 2010	ENTSOG Position paper on ERGEG's CMP Comitology Guideline proposal	
20 th May 2010	Meeting ERGEG / ENTSOG	page 2
3 rd June 2010	Meeting EU COM / ENTSOG	page 2

ENTSOG was specifically referring to consideration that different gas transport market needs are persisting in countries throughout Europe. Pipeline systems in some countries are predominantly used in order to:

- Satisfy the gas demand of neighbouring gas markets (non-domestic transportation)
- Satisfy the domestic gas market demand (domestic transportation).

The nature of the European gas demand defines – and will continue to define – the use of transport capacities throughout Europe. Taking this fact into account allows the affected TSOs to adequately manage the risk associated with operating a non-domestic network.

1. Differences between “non-domestic” and “domestic” transportation

The main difference between domestic and non-domestic transportation is the fact that major gas demand for which the transportation capacity has been developed and is used is located within or outside of the border of the respective country. Furthermore in countries where the percentage of transportation capacity developed for non-domestic transportation is significant it is usually very significant in comparison with the capacity developed for the domestic transportation.

Such difference was until now managed by the respective European TSOs. Historically they had been mainly investing in pipeline projects required by the market in order to bring gas from distant sources to the various domestic markets in order to cope with limited or unavailable indigenous production, projects are today being developed which are aimed at diversifying supply routes in order to enhance competition on the one hand and security of supply on the other, by creating the option to use different sources of gas supply to meet the European gas demand. This creates today an obvious difference in the risk position both types of TSOs are facing with regards to potential contract cancellation. Pipeline systems for non-domestic use are facing the risk of being substituted (at least temporarily) since alternative routes exist or are being developed to serve domestic market needs. Changes to contractual framework arrangements applying to already booked capacity, due to new CAM or CMP provisions for instance, create a realistic opportunity for shippers having booked capacity on long term basis to review their booking portfolio and look for alternative routes in order to reach their domestic target markets. This creates a significant risk of cancellation of booked capacity.

2. Consequences of cancelling Long Term Contracts (bookings)

If Shippers cancel their long-term contracts, the level of booked capacity of these pipelines will be reduced and significant stranded assets and associated costs will occur in countries where non-domestic transmission is predominant. In tariff regimes where the cost coverage is based on the booked capacity at a given time, this will lead to higher tariffs in future for the domestic and the

non-domestic pipeline systems (especially in the pipe-in-pipe use of the system) as the costs will be socialized amongst the remaining customers having booked capacity.

The possibility of cancellations of existing contracts by Shippers hinders the creation of a realistic financial scenario necessary in order to set tariffs based on steady revenue through actual capacity booked. An unpredictable loss of a certain percentage of booked long-term capacity would have to be covered in the next period of tariff regulation and this would have major effects on future tariff design. Stable long term revenues are a precondition for the TSOs in order to be able to recover already spent investment costs. Therefore any decrease in booked capacities would have to be compensated by an increase in the unit tariff.

Pipeline systems predominantly used for non-domestic transportation have been established on the basis of long-term contracts in order to ensure stable revenue during the depreciation period for the purpose of repaying the incurred investment costs (and the financial loans incurred in this respect). Cancellation of existing long-term bookings could lead to stranded costs if alternative routes are chosen in order to supply the domestic target market. Therefore after the final investment decision for an alternative route has been taken - based on long term bookings - these long term contracts should not be touched.

a) Financial consequences

The persistence of existing long-term contracts grants a solid contribution to TSOs revenues and ensures financial stability and future investments. Any obligation leading to a reallocation of booked long-term capacity will raise significantly the financial risks for the TSOs. Changing contractual agreements will change their economic value. Therefore TSOs run the risk of long-term contracts being legally challenged by shippers (possibly leading to reductions or early terminations of booked capacity).

Capacity which remains un-booked as a result of changing existing long-term contractual agreements will result in a loss of long-term bookings – loss of revenues – on which past pipeline investments have been based. This may lead to a revision of the conditions for the bank loans granted or even to an early reimbursement of said loans (for said investments). Such a loss of long-term bookings ultimately could lead to financial distress for the TSO.

b) Security of Supply consequences

In addition, existing pipeline systems, which would be thus rendered uneconomical, endanger security of supply for the domestic market as TSOs would not operate pipeline systems which do not ensure an adequate rate of return.

c) Other consequences

Another issue worth mentioning is the fact that if booked capacity becomes available after changes to existing long-term contracts, shippers (producers) may try to obtain that capacity to strengthen their market share from production to consumption. This would lead to a higher dependency of the affected domestic market and declining competition on said market. Less competition may result in

a price increase and possibly also in a decrease of Security of Supply as the willingness and ability to pay certain (high) prices on the various markets will determine the use of transportation routes and therefore also which target markets the gas will be flowing to.

3. Importance of “non-domestic” transportation contracts in affected countries

The following figures (reference year 2010) illustrate the part of the non-domestic transportation market in the countries listed below and document the importance of the persistence of existing long term non-domestic transportation contracts and their revenue share for the affected TSOs. The numbers highlighted are directly linked to the TSOs’ income.

a) Austria

→ more than 80% of pipeline capacity contracted for non-domestic transportation

b) Slovakia

→ more than 90% of pipeline capacity contracted for non-domestic transportation

c) Czech Republic

→ more than 77% of pipeline capacity contracted for non-domestic transportation

d) Belgium

→ more than 65% of pipeline capacity contracted for non-domestic transportation