Responses to CAM Network Code – second formal consultation on new or modified concepts

Consultation Response Sheet

Please complete the fields below and send via email using the subject title, "Response to the CAM NC consultation" to **info@entsog.eu** by 14 November 2011.

Name
First and Last Name: Alex Barnes

Organisation
Company/Organisation Name: Gazprom Marketing & Trading
Job Title: Head of Regulatory Affairs

Contact details
Email: alex.barnes@gazprom-mt.com
Tel: ++44 20 7756 0301
Mobile: ++44 774 775 6032

Address
Street: 20 Triton Street
Postal Code: NW1 3BF
City: LONDON
Country: UK

Countries in which your organisation operates: EU

How would you describe your organisation?	
	Association (please specify type)
	End user
X	Network user
X	Trader
	Other (please specify)

In the questions below, ENTSOG would be grateful if respondents could clearly indicate their preferred option and provide a brief but **fully reasoned justification** for their choice. This applies equally whether you agree or disagree with any ENTSOG proposal as it is important that ENTSOG is able to extract the clear views of all respondents. If you do not respond to a question, ENTOSG will assume that you have no view on this issue.

Question 1 (Standard Capacity Products to be auctioned): which option do you prefer, and why?	
X	Option 1: Quarterly only
	Option 2: Integration of yearly product (Post consultation proposal)

Please justify your choice. ENTSOG would particularly welcome any views on why the alternatives to your preferred option may not be technically feasible.

GM&T supports Option 1 as the most flexible approach to the sale of long term capacity rights. It enables shippers to profile their capacity requirements according to their seasonal profiles. It makes it easier to match capacity booking periods to supply contract periods and therefore avoids the problems of different capacity years / contractual years. Shippers will still be able to book annual products by simply booking a series of quarters. As long as a shipper is prepared to pay the clearing price for each quarter then he will receive the capacity unless it is pro rated. (In this event the problem of lack of capacity would apply equally to yearly products as to quarterly products). Concerns that "speculators" will be able to squeeze "genuine" shippers are misguided since "speculators" who try to book capacity but do not have gas to flow against it will be undermined by the Congestion Management Procedure proposals. TSOs will have the option of selling additional

capacity rights and there is long term Use it or Lose it. In the new environment it is less likely that shippers will pay for capacity that they do not intend to use because the economic argument for doing so will no longer exist.

We do not support Option 2 for the following reasons.

- The Option 2 proposals significantly lessen the ability to profile capacity bookings according to needs across a year. As much gas flow can be seasonal, the restriction to booking only yearly products in the long term auctions automatically creates a potential problem of contractual congestion as shippers will be booking annual products based on their peak demands which necessarily means they will have excess capacity booked in non peak periods. To avoid contractual congestion shippers will have to offer capacity on the secondary market or rely on congestion management procedures. Both are less efficient than not booking capacity unnecessarily in the first place.

- Option 2 only enables quarterly profiling for one year in advance, whereas shippers with longer supply contracts may wish to book further ahead than this. Shippers would then face the choice of having to book capacity that they know they will not need via the yearly product to gain longer term certainty, or risk not being able to book sufficient capacity in the quarterly product auctions ahead of the gas year.

- Option 2 removes the ability to book monthly capacity for a year in advance. Again this reduces the flexibility available to shippers to book capacity according to their projected needs.

- Option 2 restricts when the 10% of capacity held back for short term use is released. In Option 1 this capacity would be released in the annual monthly auctions ahead of the relevant gas year; in Option 2 it would be released only a month ahead. This would make it less useful for new entrants (for whom it was designed) as they would only have certainty of their capacity holdings a month in advance. As a result it would heighten regulators' concerns about access to capacity enabling competition.

- Option 2 increases the need for harmonisation of gas years across the EU. Whilst this may be desirable in itself, it would be better to have in place a capacity booking regime which is able to accommodate different gas years.

In light of the above, it would be better if Option 2 was changed to reflect the following:

- Instead of having annual quarterly auctions there should be annual monthly auctions in June of each year for the year starting the following October. Shippers would then be able to profile by using months as the building blocks instead of quarters.

- The 10% of capacity held back from the long term auctions should be made available from the annual monthly auctions onwards, together with any other additional capacity that TSOs can make available as a result of capacity surrender and oversubscription and buyback.

We do not see how it would be possible to combine the sale of both yearly and quarterly products in the long term auction without rules determining the priority of allocation between annual products and quarterly products in a given quarter. A rule automatically prioritising annual product allocation could be seen as discriminatory, and as noted above, could create additional risk of contractual

congestion. For example Shipper A might wish to book quarter by quarter to match his expected off-take profile, whilst Shipper B wants to book a flat annual product. Both are legitimate bookers of capacity but the question arises as to how to allocate the capacity and at what price.

The only fair way to allocate capacity would be by price. Either it could be automatically assumed that those booking yearly products were assumed to match the clearing price for each of the constituent quarters; or shippers would have to bid a unit price based on what they thought the highest unit price would be in any quarter in the relevant year. However the former is no different from shippers using a bidding strategy that had the same effect in quarterly product auctions, whilst the latter would mean that the shipper could be overpaying for quarters where the clearing price for that quarter was lower. The only way to avoid this complication would be to sell the capacity in separate auctions and therefore charge different reserve prices for the different auctions. However this would mean reserving a certain amount of capacity to sell in yearly strips, and the remainder to be sold in quarterly strips. This could result in price distortion if the relative demand for yearly strips and quarterly strips is different to the reservation quantities. E.g. if demand for annual strips was higher than the quantity reserved for annual strips it would result in high prices or pro rating even if there were plenty of capacity still available but reserved for quarterly strips.

Question 2 (Start date for yearly product): which option do you prefer, and why?

	Option 1: Yearly product starts on 1st January
X	Option 2: Yearly product starts on 1st October

Please justify your choice. ENTSOG would particularly welcome any views on why the alternatives to your preferred option may not be technically feasible.

This coincides with the usual gas year.

Question 3 (Auction algorithms: overall methodology): which option do you prefer, and why?

	Option 1: Multiple round ascending clock auction
X	Option 2: Single round volume based auction

Please justify your choice. ENTSOG would particularly welcome any views on why the alternatives to your preferred option may not be technically feasible.

In many ways the two auction mechanisms lead to similar results. However the auction workshop on 3rd November revealed some peculiarities because of the specific designs of the mechanisms (e.g. the price steps in the multiple round auction and the early close out rules in the single round auction).

One drawback of the multiple round auction is means that a capacity auction at cross border point A can close before the auction at cross border point B. This means that a shipper has no way of adjusting the amount of capacity he wishes to buy at point A in the event that he does not obtain what he wants at Point B. For example the closing price at Point B may mean that, due to budgetary constraints, the shipper cannot buy the same quantity of capacity that it has bought at Point A, and therefore the shipper will have a mismatch of capacities.

The proposed multiple design auction, whereby there are 3 price steps within a round, also leads to complications. For example the proposed rules mean that a shipper cannot bid at a lower price in a round than it bid in a previous round. In the auction workshop on 3rd November, the team representing a producer wishing to buy capacity from Hub A to Hub B, and then from Hub B to Hub C, submitted bids for decreasing volumes in the first round for B to C, whilst booking its maximum capacity for A to B. this can be illustrated as follows:

Total Budget:

€ 510,000.

Capacity required:

100,000.

Bundled capacity A-B

			Capacity Bids
P_{14}	4.74	€	0
P_{13}	4.63	€	0
P_{12}	4.52	€	0
P_{11}	4.41	€	0
P_{10}	4.3	€	0
P_9	4.19	€	0

Bundled capacity B-C

				Capacity Bids
	P_{14}	4.90	€	0
	P_{13}	4.80	€	0
	P_{12}	4.70	€	0
	P_{11}	4.60	€	0
	P_{10}	4.50	€	0
	P_9	4.40	€	0

P_8	4.08 €	0
P_7	3.97 €	0
P_6	3.86 €	0
P_5	3.75 €	0
P_4	3.64 €	0
P_3	3.53 €	0
P_2	3.42 €	100,000
P_1	3.31 €	100,000
P_0	3.20 €	100,000

P_8	4.30 €	0
P_7	4.20 €	0
P_6	4.10 €	0
P_5	4.00 €	0
P_4	3.90 €	0
P_3	3.80 €	50,000
P_2	3.70 €	45,405
P_1	3.60 €	49,722
P_0	3.50 €	54,286

The shipper maximises the quantity of capacity it bids for at A to B, as this is the first hub in the chain. He then optimises the quantity of capacity he bids for at B to C based on his remaining budget (Budget minus Cost of Capacity at A to B divided by Price step for B to C). However the auction for A to B clears at P0 whilst the auction does not clear for B to C, and therefore goes to the second round. The shipper has €190,000 to spend (€510,000 - €320,000) which would allow him to buy 50,000 units of capacity at P3 for B to C. However the auction rules mean he cannot bid for more capacity than in the preceding price step (45,405 units). This leads to the sub optimal case where the shipper can only book 45,405 units even though he has the money for 50,000 units and ideally would like to buy 100,000.

This problem can be solved in two ways. Firstly by only having one price step in each round. This would mean that the maximum capacity the shipper could book for B to C would be 54,286 units which is what he bid for at P0 for B to C. Secondly if the differences between the price steps were smaller then it would minimise the differences between the quantities of capacity that a shipper could buy different price steps for a given budget.

For example price increments of €0.01 rather than €0.10 and only a single price step per auction would mean that the shipper could buy 50,997 units instead of 45,405 units using the same scenario as above.

With regards to the single round auction the key difference is that there is no formal price discovery until the auction closes. The advantage of this is that it enables shippers to adjust their bids for capacity as they see what the aggregate market demand is e.g. if it looks as if the auction is going to clear at a high price, the shipper can either adjust its budget to be able to make the higher bids or can reduce its bid volumes so that the auction clears at a lower price. However the non binding nature of the auction until it closes has prompted the use of early closure rules and limitation of bid revision. The former raises the problem that, as with the multiple round auction, that a shipper aiming to buy capacity across several interconnection points would face the difficulty of having an auction at one IP close before another, making it difficult for that shipper to optimise its capacity purchases.

The limitation of bid revision also leads to bidding behaviour which undermines the advantages of the auction design. It was observed in the workshop on 3rd November that shippers only bid at P0 in the first bid window, and therefore it was not possible for a market demand curve to be derived, and therefore not possible for the shippers to see overall demand for capacity at given price steps. This

was because shippers can increase their bids at price steps on the second day of the auction but cannot reduce them. Therefore, given at this stage they do not know at what price the auctions would clear it makes sense for them only to bid at P0, rather than bid a whole price stack.

Much of the debate on early closure rules seems to have arisen for two reasons:

- A concern that without them the auctions will go on forever which is not desirable given the number of IPs and the auctions that will occur.
- A sense that bidders will not bid "real" bids until just before auction closure, either because there is no point bidding if shippers do not expect to change their bids, or because of fears that bidding will reveal shippers' individual strategies.

The first point can be addressed by limiting in advance the number of bid windows. Whilst the UK has used 10 bid windows of a day each, there is no reason why this cannot be reduced, and bid windows last less than a day (whilst still allowing TSOs sufficient time to calculate the potential allocation after the closure of a bid window).

The second point ignore the advantages that shippers, especially those who are bidding at multiple IPs and aiming to secure capacity across more than one country, can gain by seeing the state of demand for capacity at each IP thought the bidding process. Given that the allocation information that TSOs publish at the end of each bid window is aggregate, there should be no concern that shippers own strategies will be revealed. Only individual shippers receive their own allocation information, which helps them refine their bid strategy. If all shippers participate in the auction by submitting their bid stacks, then all benefit by seeing the true state of demand for capacity at that IP.

Based on the above we propose the following:

- A single round volume based auction with multiple bid windows
- Limit the time taken by the auction to a maximum of 5 days; if there were 2 bid windows per day, then this would still allow a maximum of 10 bid windows.
- No early closure rules or bid revision limitations.
- To participate in the auction all shippers are required to submit a full bid stack on the first day.
- Shippers may change their bid stack on subsequent days, both to reduce their bids or to increase them in light of results at other IPs.
- TSOs publish results at the end of each bid window, and inform individual shippers of their allocations.
- Auction closes at the end of the final bid window, and bids in that window are final and binding.

Whilst this approach may not be perfect, we believe it is the best compromise taking into account the comments made above. Much will depend on shippers acting in the "spirit" of the rules as well as observing the "letter" of the rules. However we believe that as shippers become used to the new approach they will do this of their own accord.

Question 4 (Limitation of price steps): which option do you prefer, and why?	
X	Option 1: Do not limit number of price steps (Post consultation proposal)
	Option 2: Limit number of price steps

Please justify your choice. ENTSOG would particularly welcome any views on why the alternatives to your preferred option may not be technically feasible.

Following the comments on the multiple round auction above, we believe that smaller price steps will help avoid some of the drawbacks of the design. However this could mean a large number of price steps are required. This could be mitigated by having large price steps in the early part of the auction, and then use small price steps to avoid the problem described above where a shipper is unable to bid for as much capacity as he can afford.

Question 5 (Minimisation of unsold capacity): which option do you prefer, and why?	
	Option 1: Minimise unsold capacity (Post consultation proposal)
X	Option 2: Draft CAM NC proposal

Please justify your choice. ENTSOG would particularly welcome any views on why the alternatives to your preferred option may not be technically feasible.

It is not clear why there is a need to minimise unsold capacity in the long term auctions when any unsold capacity can simply be "rolled over" to the next auction. Pro rata introduces an unnecessary degree of uncertainty as to what shippers will be allocated. Whilst we recognise that shippers can opt out of receiving pro rata allocation their preference may depend on the circumstances of the individual auction, and therefore it will not be possible to state their preferences in advance.

Nonetheless we do support the use of smaller price steps.

Question 6 (Sunset clause/ choice of default rule): which option do you prefer, and why?

	Option 1: Maximum default rule with cap at technical capacity
X	Option 2: "Partially unbundled" default rule

Please justify your choice. ENTSOG would particularly welcome any views on why the alternatives to your preferred option may not be technically feasible.

We prefer the partially unbundled rule as long as one of the TSOs can sell unbundled interruptible capacity to allow the commodity contracts to be delivered where there is a mismatch of capacity on either side of the border.

The maximum default rule fails to resolve which party should buy additional capacity from the TSO when there is a capacity mismatch. Given TSOs will only be able to sell firm bundled capacity, whichever shipper buys the capacity from the TSO will be left with 10 additional units in country 2 that it does not need. This "capacity hoarding" is exactly what the CMP measures are trying to avoid and therefore, the maximum rule would not be the ideal default rule in that respect. The maximum rule would also be difficult to implement at congested interconnection points, where shippers would have to pay significantly more to try to secure the capacity or the TSO would have to come up with ways to release more firm capacity via investing.

Question 7 (Sunset clause: further questions): Please provide any views, information or evidence in relation to the further questions raised by ENTSOG in section F.2 regarding the sunset clause.

The "sunset clause" workshop on 6th October highlighted how difficult it will be for different counter-parties to agree a settlement to bundle capacity, particularly where there is a mismatch of capacity on the different sides of a congested interconnection point. For this reason we believe the "sunset clause" is at best a distraction, and at worst could lead to sub-optimal outcomes. Therefore we would prefer that capacity becomes bundled only as it becomes un-contracted rather than by forcing the issue.

Question 8 (Tariffs: split of auction premium from bundled products): which option do you prefer, and why?

X	Option 1: Keep split of auction premium proportional to reserve prices as default (Post consultation proposal)
	Option 2: Split of auction premium into equal shares as default

Please justify your choice. ENTSOG would particularly welcome any views on why the alternatives to your preferred option may not be technically feasible.

Given at present, the capacity prices vary from one side of an interconnector point to another, once capacity is bundled this issue will still remain and therefore splitting the auction premium from bundled products proportional to reserve prices would seem the fairest way to re-distribute the premium given the under recovery will be apportioned in this way. Therefore if in any year, there is an over-recovery of auction revenue, then reserve prices should be adjusted proportionally in the next year to ensure that the over recovery is passed back to customers. The same should apply with the under recovery. However NRAs will need to ensure that TSOs are not incentivised to load costs onto congested interconnection points in order to maximise the share of any auction premiums.

The best way to avoid an auction premium would be to include a mechanism for the release of incremental capacity in the long term auction, as we have previously indicated. This would mean that all capacity would be sold at a regulated price; where demand exceeded existing capacity additional capacity would be sold at a regulated price.