

E.ON position towards

ERGEG principles: Capacity allocation and congestion management

in natural gas transmission networks

ERGEG Public Consultation Document

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Introduction

The efficient use of transmission capacities plays a crucial role in achieving the objective of a single European gas market. Securing the maximum usage of transmission systems will enable markets to profit from diverse gas supplies. Accordingly, E.ON clearly supports all measures which maximize firm capacity and which allow for efficient capacity usage. As a guiding principle for any improvement of capacity allocation and congestion management the acceptance by market participants is crucial. Therefore, capacity allocation and congestion management mechanisms have to respect the requirements of all shippers, suppliers and consumers likewise.

We thus appreciate the opportunity to comment on the proposed ERGEG principles by presenting our thoughts regarding the questions put up for discussion.

1. Do you agree with the problems that ERGEG has identified with capacity allocation and congestion management? Are there other aspects that should be taken into account?

E.ON supports the aim of facilitating a single European gas market by efficient utilization of existing transmission capacities (cf. Sections 1.1 and 1.2). In view of the present bottlenecks in European gas transmission systems, we clearly endorse all measures to maximize available transport capacity. E.ON believes that in order to do so it will not only be necessary to increase available primary capacity, but also to optimize secondary trading. Furthermore, the ERGEG proposal focuses solely on contractual congestions at cross-border points. We would like to point out that besides solutions to overcome contractual congestions a sound investment climate for TSOs is crucial to overcome physical congestions within the European gas infrastructure.

Furthermore, it should be noted that the problems ERGEG identifies in the consultation document are mainly derived from the conclusions of the sector inquiry carried out in 2005. ERGEG thereby disregards any positive developments since then, for example the measures agreed to in the Gas Regional Initiatives, such as the secondary capacity pilot at Bunde/Oude Statenzijl in the GRI North-West. These successful projects show clearly that the Gas Regional Initiatives represent the

suitable framework for developing regionally coherent measures and procedures, paving the way to a truly integrated single European market.

In order to achieve this objective we expect that regulators will cooperate more closely and establish harmonized rules for cross-border solutions: As pointed out in more detail in our answer to question 7, the proposed “toolbox” approach in the current initiative is certainly not an adequate instrument for that.

Existing long-term import contracts should continue to guarantee long-term security of gas supply within Europe. Therefore, long-term capacity bookings should still be admissible.

2. The scope of ERGEG’s principles and of the derived proposals covers bringing capacity to the market where there is currently contractual congestion. Do you agree with this approach?

As a general principle any existing system should be used to its maximum physical capacity before the network is physically extended. But as Europe witnesses a growing demand in importing / transporting gas from East to West, as pointed out before physical congestion occurs which needs to be met with additional investments. Unfortunately, NRAs generally tend not to support with due endeavor and in a coherent manner infrastructure investments. We therefore believe that not considering physical congestions and necessary investment incentives would disregard an important requirement for a European market.

The ERGEG principles shall focus on harmonized rules for cross-border interconnection points. The process of this harmonization would be slowed down by including interconnection points within Member States.

The transparency requirements as listed in Annex I should be aligned to the results developed by the “transparency” work stream of the GRI North-West led by Ofgem.

3. In principle, European regulators consider FCFS allocation potentially discriminatory. Do you share this view? What do you think about the proposed mechanisms (OSP with subsequent pro-rata allocation or auctioning)?

Especially for long-term bookings, the principle of first-come-first-served (referred to Section 2.4.3) has been shown to be a workable procedure with the following advantages: The shipper receives capacities at a fixed price, allowing reliable planning supported by a direct booking confirmation. Little administrative work is required and the cost to the TSO is therefore low. Like any other possible CAM, FCFS can also potentially be used in a discriminatory way if TSOs collude with shippers and provide them with confidential information. However, for not congested points FCFS is still a suitable and cost effective approach as noted above.

In case of congestions, new capacities may primarily be allocated via auctions instead of FCFS (cf. 3.1). The auction dates, procedures and products should be published well in advance. The auction dates and lot sizes should take the gate closure time and common products of the relevant gas exchange into account. In order to treat all auctions participants equally, the capacity price should be determined by the market clearing price. Any capacity not sold via auctions should be sold by FCFS. Pro rata

allocation has the disadvantage that in general none of the participating shippers receives capacity according to his needs – thus also resulting in strategic bidding behavior. Nevertheless, this method might be suitable within the allocation procedure for new built capacities (Open Season Procedures).

In the long term, the objective should be to establish a general capacity exchange and to ensure that all primary and secondary capacities are offered on the exchange in order to make capacity trading more liquid and more effective. For this purpose, the trac-x secondary trading platform should be extended to include primary capacities, too.

4. In your view, what is the future importance of the proposed capacity products (firm, interruptible, and bundled) and of the proposed contract duration (intra-day up to multi-annual)?

The variety of different capacity products and contract durations from intra-day to multi-annual is in general necessary for a diversity of market needs. E.ON agrees to the approach as described under G 2.2 to develop capacity products which accommodate market needs by means of market consultation. However, any market consultation would be pointless if the consultation or the decision to offer products and durations at market needs is “subject to the national regulatory authorities’ approval” (G2.2, similar in 2.2.1, 2.2.2, 2.2.3, 2.3, 2.4). The national regulatory authorities shall be appropriately bound to the market wishes.

- Taking into account the markets’ needs and the diversified products and durations identified by consultations, we support the suggestion to set aside a reasonable portion of available, not yet booked capacity for short-term capacity products to be offered on a firm basis. Clarification is needed with respect to the term “technical capacity” (e.g. in Section 2.3.2).
- In order to improve the attractiveness of short-term products, capacities can be linked to the commodity gas by implementing within-day two-hour ahead auctions (“market coupling”).
- With reference to interruptible capacity (G2.2.3), this generally does not aid the further development of markets. Interruptible capacities may only play a role where demand is flexible (e.g. dual fuel production/generation). However, interruptible capacities and interruptible UIOLI should not be considered as an efficient tool to increase liquidity.
- E.ON welcomes ERGEG’s move towards mandatory cooperation between TSOs in the realm of booking procedures (i.a. G 1.2, G 2.4). This should as soon as possible lead to, inter alia, bundled products at all relevant interconnection points. This should be merely a question of investment in IT tools and thus a question of how to be reimbursed for these investments.

5. What is the role of secondary capacity trading?

In addition to the improved allocation of primary capacity, the optimization of secondary capacity trading is of crucial importance. Trac-x needs to be optimized to make it more attractive to users:

- Firstly, more TSOs need to participate in the platform to allow secondary trading at additional booking points apart from those that are already included. The target must be to include all entry and exit points at market area boundaries and national borders.
- Secondly, the portfolio of standard products must be expanded. Apart from the day-ahead deals which are already available, it should be possible to trade weekly and monthly products at short notice.
- Thirdly, action must be taken throughout Europe to ensure that shippers can trade parts of the capacity booked (with reference to volumes and periods) on the secondary market. In particular, it must be possible to sell capacities for individual days, weeks and months on the secondary market.
- Fourthly, TSOs must allow and implement bundled products at all booking points. This means that it will not be necessary to procure entry and exit capacities at a single booking point separately. Instead, it must be possible for a participating company to offer a border crossing or a transfer between market areas as a complete bundle and for the TSO to implement the package in operational terms.

The implementation of these measures would make secondary trading more attractive to buyers and purchasers and significantly improve liquidity in this market segment. The secondary market may be supported further by strong price incentives as further described in our answer below to Question 6 “Interruptible capacity (G2.2.3)”.

6. How do you assess the proposed measures to enhance the availability of firm capacity and to improve short-term and long-term congestion management?

Enhancement of capacities (G1.3)

Whereas E.ON believes that integrating European markets does require the release of additional technical transmission capacity, E.ON also believes that there may be significant potential in maximizing available firm capacity through means of improved methods of capacity calculation.

When calculating maximum technical system capacity (cf. G1.3), TSOs currently use an approach which ensures smooth operation of nominated flows even under disadvantageous circumstances, e.g. sudden drop in temperature, unplanned outage of production field or storage.

It is basically because of this approach that interruptible capacity still plays a major role in continental gas transport: it releases additional capacity to the market without putting TSOs at risk of having to compensate buyers in the unlikely event that capacity is technically not available. But as the likelihood of full availability can be statistically calculated by TSOs, there is a realistic possibility to allocate this risk fairly *while still* maximizing the available technical (i.e. firm) capacity. E.ON believes

that all TSOs should move to such a maximum scenario approach. TSOs should in turn be entitled to buy back capacity at a market price in the – unlikely – event that they cannot fulfill their obligations (capacity buy back mechanism). Such an approach requires that revenue regulation of TSOs is adjusted accordingly in order to allow for symmetric risks *and* chances. Excess revenue which the TSO receives by selling additional capacity will be available to compensate the costs of capacity buy back. Any additional over-recovery or under-recovery of regulated revenues may require a method to return money/costs to capacity holders in the least distortionary manner possible.

Interruptible capacity (G2.2.3)

As already noted, interruptible capacity helps shippers to optimize flows on short notice. It is not what shippers need to base a business case upon and an enhancement of interruptible capacity will therefore not necessarily increase liquidity in the European gas market.

That objective will only be achieved by offering firm capacity. In order to set incentives for firm capacity holders to offer unused firm capacity on the secondary market, the charge for interruptible capacity should only be a very small percentage of the charge for firm capacities and should be linked to the probability of interruption. This should further incentivize primary capacity holders either to use their firm capacity or to sell any unused capacity at a market price in order to prevent holders of interruptible capacity – which will not be interrupted in case firm capacity is not used – to have an undue competitive advantage.

Firm day ahead UIOLI-procedures (G4.1)

Firm day-ahead UIOLI procedures according to G 4.1 have to be analyzed in more detail in consultation with market participants. There are various alternatives to increase the usage of primary capacity in an efficient way:

In addition to the standard capacity product with full renomination rights, capacities without or with restricted renomination rights may be introduced. Another alternative may be improvements of secondary marketing. The capacity holder is in this model generally obliged to bring unused capacity to the secondary market on a big scale based on their individual planning assumptions.

However, there is a risk that offering primary capacity with restricted as well as full renomination rights may fragment the market for capacity which may in turn undermine wholesale energy trading at particular locations. Liquid capacity trading is best facilitated through a limited number of products with standard, well understood terms and conditions. Firm capacity rights can of course be sold across various time periods, but it is surely best that contractual rights that apply on the day are consistent. Therefore, a deeper analysis of the impacts of these alternative proposals is necessary.

In all cases shippers should be entitled to choose the options based on their individual needs. A compulsory gate closure for nominations day ahead would, in contrast, entail severe disadvantages for the majority of market players.

- Trading companies would face restrictions on their flexibility and could no longer react at short notice to trading operations and transfer gas quantities

between the various trading hubs. This would have corresponding consequences for the liquidity and price convergence of hubs.

- Traders would be constrained in offering short-term balancing energy both to counterparties to balance their portfolio and also to TSOs to balance their grid.
- Companies supplying consumers would no longer be able to react to short-term demand fluctuations. This would lead to imbalances with increased demand for balancing energy.
- The cancellation of renomination rights would significantly impair supplies to gas-fired power stations with highly volatile gas demand.

Besides the above mentioned consequences for the functioning of markets, ERGEG needs to take into account that any restriction of flexibility will make long-term import contracts less attractive for importers as well as for producers. Europe cannot afford to reduce the economical attractiveness of such contracts, as they constitute a main pillar of the security of European supply.

Freeing up capacity (Section 2.5.3)

The concept of releasable capacity, including ‘freeing up’ capacity *regardless of the utilization of capacity by its holder*, is not acceptable to shippers, as it introduces uncertainty into capacity contracts and thereby undermines the aim of creating stable and liquid markets which deserve market participants’ confidence. Any infringement of existing contractual rights cannot be accepted.

7. What are your views on the proposals? Do they address the problems? Will they lead to more effective capacity allocation methods being developed?

E.ON supports a harmonization of market designs through EU-wide *binding* rules. ERGEG, in contrast, proposes a “tool box” with a large variety of mechanisms and procedures which can be implemented “where appropriate” by National Regulatory Authorities. This would not lead to efficient regional integration. Cross-border rules should be consistent at least within regions. E.ON therefore suggests implementing only few, but detailed mechanisms for all cross-border entry and exit points, mechanisms which are binding and coherent across the EU.

8. Are the needs of shippers performing supply activities properly taken into account?

The compulsory curtailment of existing renomination rights considered in the proposed principle G4.1.2 would entail severe disadvantages for the majority of European gas suppliers, as already outlined in our answer to question 6.

Furthermore, the validity of existing capacity bookings must remain unaffected (see G3.2, section 2.4.4 and G4.4). The existing long-term capacity bookings are essential for the performance of long-term import contracts ensuring secure gas supplies for the European market.

9. Are the proposed measures suitable to facilitate development of liquid gas markets?

As already pointed out in relation to questions 8 and 6, the compulsory curtailment of renomination rights would diminish the shipper portfolio of intraday flexibility. Sources of flexibilities would be limited to national purposes. Storage facilities would therefore lose their European character. Intraday activities of traders would be hampered in response to actual market demands. The liquidity of national markets would definitely be reduced by limiting renomination rights. Furthermore, the introduction of the toolbox would not facilitate the liquidity of gas markets (see also our answer to question 7).

10. In your view, how important are compatible booking and operational procedures between adjacent systems?

Compatible booking and operational procedures and EU-wide compatible bundled products would certainly facilitate European trading activities.

11. Do the proposed measures increase the efficient use of the system? What aspects would you support and like to see further developed?

We would like to stress once more our explicit support for further investigation into the mechanism of maximizing capacity via a maximum calculation approach including capacity buy-back (see above).

Additionally it is necessary to facilitate regulatory approval of load flow commitments by sufficient standardization. Load flow commitments by shippers will enable TSOs to maximize the extent of freely allocatable capacity. In this context, it is essential that all costs incurred in connection with load flow commitments by the network operator should be covered by regulated revenues. For this purpose, load flow commitments must be standardized in a way to allow calls for tenders to be issued and commitments to be acquired at market conditions.

To conclude, to reach the objective of a single European Market it is crucial to have coherent rules within the EU. A mere “toolbox” of measures out of which national authorities can “pick and choose” cannot meet this objective.