Eni Gas &Power's response to ERGEG's consultation - "ERGEG principles: Capacity allocation and congestion management in natural gas transmission networks".

San Donato Milanese, 27.3.2009

Introduction

Eni Gas & Power recognizes the importance of providing a common approach to Capacity allocation management and Congestion management procedures in order to favour cross border compatibility and to promote competition and security of supply.

The relevance of an efficient usage of the available technical capacity has to be balanced with the necessity of respecting and preserving the position of firm capacity holders who have to be granted the right of using the capacity bought without incurring in unrecoverable costs.

A change in nomination rules could have a very huge impact on supply and sales contracts (revision of nomination clauses in all contracts) with the consequent reduction in flexibility, that leads to a real and effective reduction in liquidity of the market.

The risks and costs for shipper associated to different definition of firm capacity (i.e. introducing overbooking of capacity and or limitation to renominations) go well beyond the economical impact of the value transportation tariff, to affect commercial and contractual impacts: in this respect it is to consider immediately that the buy back principle is, anyway, not sufficient to cover the effective shipper's risks and costs associated with these new rules.

For these reason firm capacity release should be necessarily agreed by the initial holder: excessive limitations of the re-nomination capacity rights wouldn't be consistent with contractual upstream and downstream provisions.

Unused capacity should be released by the single shipper on the secondary market creating on the same time, a regulatory framework that incentive the utilization of the secondary market of capacity.

The responses to the main consultation points follow here below.

Questions

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?

In principle we agree with the scope of bringing capacity to the market identifying mechanisms able to remove contractual congestion. If on the one side the tools proposed could free up capacity, on the other side they could attempt to the correct functioning of the market, exposing the users to the risk of losing firm capacity rights compromising the realization of downstream and upstream contractual obligations.

In our opinion, as we will discuss in our answers to the following Questions, the aim of the proposal is to reach a balancing between the introduction of appropriate mechanisms aimed to remove contractual congestion on a short term basis, avoiding risks to undermine either the principle at the basis of firm capacity allocation, either potential wrong market signal in term of congestion, as it would happen in the case of introduction of allocation procedures implying overbooking of firm capacity.

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)?

The FCFS allocation method is the instrument utilized in order to recognize the basic principle that contracts already signed for transportation capacity remain valid; this principle is recognized even in a OSP system, considering existing capacity, normally through a system of priorities. Taking into account this premise we consider the FCFS allocation method and OSP allocation method with priorities substantially equivalent and sharable as methods able to respect existing capacity rights allocations.

Considering allocation of existing available capacity (not already booked), in case of absence of long term capacity congestion, we agree on considering FCFS allocation a potential discriminatory tool: in this case we are in favour of the OSP followed by pro-rata allocation or, always in presence of short term capacity congestion, auctioning.

In case of long term capacity congestion we refer to the open season procedure described to Question n.11.

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)?

Firm:

Firm capacity can not be interrupted or cut once it is paid as firm capacity and booked with priority and rights indicated by NRA. It could be used by other shippers if not nominated/re-nominated. Coherenlty with this principle the firm capacity should be put at disposal:

- at the end of the renomination period, that should last until few hours (two or three) before the end of the Gas Day;
- through a declaration (i.e. on a yearly – seasonal basis) of shipper provisions of unused capacity on a short and long term basis, avoiding in any case administrative regulation providing binding capacity release not in line with a liberalized regulatory framework.

Interruptible:
Interruption should take into account the priority of allocation and should have the same mechanism in all the adjacent TSO's systems.

Bundled:
It works if are implemented measures as:
- alignment of capacity booking windows between TSOs adjacent;
- same mechanism of allocation
- …

5. What is the role of secondary capacity trading?

The secondary capacity trading is the best tool in order to free up capacity without damaging existing firm capacity holders. We welcome any initiative aimed at improving the conditions under which users participate to the secondary trading capacity market.
Eni Gas & Power shares the use of voluntary auction instrument to incentive capacity trading in the secondary market. In our view auctions are suitable particularly in order to facilitate transaction of transportation products other than day-ahead ones. Moreover Trading Platforms are suitable to the introduction of innovative and flexible trading products but need time to be successful experimented.
Capacity products transactions could also benefit by the introduction, in trading procedures, of the following elements:

- standardized trading contracts as reference instruments;
- reduction of lead time for capacity transport transactions;
- easier and harmonized trading procedures;
- anonymity of the trading Parties.

Moreover secondary market of capacity could be favoured by web platforms or by quicker allocation mechanism implemented by transport operator (actually in some cases capacity releases on secondary market have to be done 7-10 days ahead)

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?

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

Following the principles above described, here below we comment in detail the measures proposed in the ERGEG document:

- *Capacity buy-back.* The fact that the TSO is allowed to offer additional capacity on a firm basis above its baseline capacity is not sharable because it implies the degradation of firm capacity to interruptible with very serious drawbacks on sale/supply contracts. The risk, always present, is that the auction called by the TSO may not receive any bids with the inevitable consequence of the pro-quota cut of the users' firm capacity rights. We notice that in the document this eventuality hasn't been taken into account. Furthermore, it's not clear either how the users would be refunded of the extra costs raised by the mentioned cut (costs deriving from supply contracts, from sales contracts, from balancing rules of different system such as penalties) or how could be implemented a tender procedure in such a short time. As we said before the costs go well beyond the mere transportation costs (as it would imply a "buy back principle") to affect commercial and contractual impacts: in this respect it is to consider immediately that the buy back principle is, anyway, not sufficient to cover the effective shipper's risks and costs associated with these new rules. For this reason firm capacity release should be necessarily agreed by the initial holder: excessive limitations of the re-nomination capacity rights wouldn't be consistent with contractual upstream and downstream provisions.
- The document is not clear on how to make consistent a tender procedure with user re-nomination right;
- The document is not clear about consequences on penalties for capacity utilization / scheduling in case of firm capacity cut.

In conclusion even if we consider necessary to agree on a congestion mechanism, we consider not acceptable the overbooking of firm capacity and the connected buy back method. In synthesis the reasons are the following:

  - shippers buy~~s~~ firm capacity and coherently organize supply and sales contracts on the basis of availability of such firm capacity;
  - costs linked to a unavailability of capacity, in case of overbooking, can not be calculated "ex ante" depending on supply and sales portfolio of each shipper;
  - does not give the right signal for open season procedures for new capacity.

- *Long term Use It or Lose It.* In our opinion this mechanism doesn't guarantee the respect of rights acquired by the firm capacity holders. The under usage of the capacity could origin from unexpected and unpredictable reasons, that shouldn't prejudice in the long term the users' faculty to employ capacity.
- *Freeing up capacity.* We do not agree with the *freeing up* instrument as described in ERGEG document, as long as it doesn't guarantee the respect of firm capacity rights; regulatory demand solutions shall be avoided in favour of market-based initiatives. The basic principle to be respected is that any *freeing up capacity* or equivalent method should be based on a voluntary choice of shippers in order to avoid administrative regulation providing binding capacity release.
- *Firm short term Use It or Lose It.* We don't consider sharable the removing of rights for re-nomination of firm capacity. In order to make firm capacity available to the market, we consider acceptable a restriction of re-nomination rights that, in case of congestion, should be exercised until some hours before the gas day starting (respect to the main contracts in force).

- *Interruptible Short Term Use It or Lose It.* We support this mechanism that is able both to preserve initial firm capacity holder rights and to create short term trading opportunities.
- *Secondary Market*. We strongly support the identification of measures to facilitate capacity trading in secondary market.

In our opinion it is fundamental that all the above principles related to congestion management should be anyway applied with the same modalities in all the Member States.

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

As specified above some of the proposed measures do not respect the need of shippers performing supply activities: if shippers lose the right of capacity re-nomination and related flexibilities, they could be not allowed to respect contractual minimum withdraw constraints

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

Some of the measures proposed in the document (specifically Capacity buy back and Long Term Use it or Lose it), if applied, would restrict significantly the opportunity to manage capacity with adequate flexibility: for example, limitations to traders willing to realize arbitrage would be imposed.
For this reason, in our opinion, these measures do not favour the increasing of market liquidity.
We would propose:

- a restriction of re-nomination rights in the way described above,
- a “declaration procedure” (described in point 4 - declaration - on a yearly/seasonal basis - of shipper provisions of unused capacity on a short and long term basis);
- incentives to resell unused capacity in secondary market capacity as the tools that best fit the objective to improve flexibility and liquidity in the market.

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

In our opinion compatible booking and operational procedures between adjacent systems are a necessary and preliminary requisite to introduce a common approach to the management of capacity and to create liquidity in the market.
Nevertheless this consistency implies the alignment of the different operational practices actually applied among Member States (we are referring for example to the timing of the nomination and re-nomination procedures that should be harmonized and aligned to a daily level; the same considerations are applicable for to the interruption procedures or to capacity allocation windows).
We reassert the necessity of a complete harmonization of congestion management procedures among Member States.

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

The increasing of the efficient use of the system could be generated by some of the proposed measures, but the critical elements described above have to be taken accurately into account.

In our opinion, exemption under article 22 of Directive 2003/55 (exemption from third-party access rules) is the key regulatory element to provide new capacity and resolve structural system congestions; thus every weakening or further complications and restrictions of such mechanism should be avoided. During the evaluation on according the exemption, where NRAs fund proper to assess market condition, this assessment should be conducted by the TSO (or the specific System Operator involved) through the market based procedure that follows the principles described below.

The TSO should apply an investment procedure in which it shall consult all actual or potential sponsors (sale operators, TSO, other sponsors) on development plans in an open and transparent public procedure.

The “open season” procedure shall determine:

- market capacity needs of each sponsor (in particular the period and the duration of the relevant capacity commitments); coherently with collected requests of capacity, TSO publishes the expected economical and financial needs level for such new capacity needs, so that the operators are able to estimate their economical and financial commitments;
- every stakeholder presents a binding offer to give economic and financial support to the investment requested;
- the investment in new capacity will be realized if the results of the auction cover the economical and financial needs determined by the TSO in relation with the requested capacity needs.

In particular, in order to allocate new capacity deriving from the above described open season procedure, the TSO will apply the most non discriminatory auction methodology based on the following principles:

- the capacities allocated in the reference period to each shipper result from the most profitable combination of the shippers commitments (binding bids) as stated in the assessment procedure above described;
- the corresponding allocation price will be the so called System Marginal Price, i.e. the lowest price among those offered by the shippers to whom capacity is allocated.

The described procedure shall be conducted taking into account technical features of the specific kind of project.

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