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E.ON remarks on Joint E-Control-AEEG Guideline on a day-ahead capacity allocation mechanism at the Austrian/Italian border

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1 General Remarks

E.ON appreciates that E-Control and AEEG (NRAs) consult with market participants on the pilot-project for implementation of day-ahead capacity allocation at the AT/IT interconnection Point. We are in favour of pilot projects as they should speed up implementation of the CAM provisions and we hope that it will be the first of many more consultations on how the capacity, balancing and interoperability arrangements will need to adapt for a proper implementation of the forthcoming European Network Codes. Nevertheless we believe that the arrangements of the pilot project should at least not undermine the results achieved with the current unbundled interim arrangements for allocation of interruptible capacity and ideally improve them.

The consultation includes also other topics in addition to the day-ahead capacity allocation, such as the role and functionality of a capacity booking platform, surrendering of capacity, revenue shortfalls and management of interruptible capacities. Since some of the provisions relating to these topics will be implemented separately, our comments should be considered in the context of the operational arrangements currently in place at the IT/AT border and the respective markets arrangements prevailing at this time.

We believe that it is crucial to define correctly the type of product to be allocated. We note that the NRAs use the term 'bundled product', although the provisions in the draft guideline (DG) designate a product that appears to be subject to a diverse set of regulatory and commercial provisions on either side of the border. For instance, the DG distinguishes between the capacity TAG and the SNAM capacity and makes reference to the provisions in the relevant network codes. A bundled capacity product should ideally be subject to a single set of rules and it should facilitate transport from one hub to another, thereby solving the possible inconsistencies related to unbundled allocation schemes. Whilst we understand that the harmonisation process will require time, we believe that the capacity offered by the two TSOs for a bundled product must be of the same amount and it must be of same quality. The DG should clarify this.

Reference in the DG to the provisions of the respective network codes of the two TSOs may be appropriate in relation to this pilot project, however the conditions laid down in these codes, and sometimes in national legislation, are not always fully consistent with the framework for the allocation of daily capacity products. For instance, the SNAM network code requires that a network user has in place an 'import contract' when submitting a request for capacity allocation. In addition, Italian legislation requires network users to declare at least 30 days in advance their intention to 'import' gas into Italy. These provisions are inconsistent with the operational model underlying the CAM NC and AEEG should address them with the aim of exempting from these requirements at least network users who intend to participate in the daily allocation process.

Furthermore other current operational and market arrangements should be taken into account. In particular, in the Italian market at present, network users are not able to renominate entry capacity at the Austrian/Italian border after 13:00 CET on D-1. In the DG it is not mentioned what effect bundling entry and exit capacity will have on this restriction. SNAM should offer network users at least a one hour window after conclusion of the day ahead bundled auctions to renominate against any bundled day ahead capacity they have required. Without such renomination possibility any network user acquiring day ahead bundled capacity would effectively be unable to use it.



In the same way network users are currently only able to register day ahead trades on the PSV between 06:00 and 12:00 CET of D-1. So network users would not be able to sell gas day ahead at the PSV. This represents a basis risk, therefore, SNAM should also offer network users and traders a time window after conclusion of the day ahead bundled auctions to register transactions at PSV.

These two recommendations are an absolute minimum to ensure that the proposal in the DG could at least retain the benefits gained with the interim arrangements currently in place.

For avoidance of doubts the DG should clearly specify the auction mechanism i.e. the auction mechanism that should be used by the TSOs to identify the 'successful' Registered Network Users. As this is a pilot project under the CAM Network Code we would expect the auction mechanism to be the uniform-price algorithm as described therein for daily capacity products.

Although the topic of capacity tariffs is still under discussion at EU level, we note that the DG does not give any guidance on the reserve price. This topic is a crucial element to be taken into account when evaluating possible compensation schemes in favour of primary holders surrendering capacity, hence we provide some comments in this respect.

NRAs mention that TSOs have expressed their willingness to participate in a European Platform for capacity allocation and to use it to perform the joint allocation. We recommend the NRAs to urge TAG and SNAM to define a clear timeline for joining the single EU wide platform and to provide a view (to be regularly updated) on when the different cross-border products at the AT/IT border will be available on such platform. Indeed shippers need a view of what they should expect at least in the coming year in order to modify their IT systems and complete the necessary operational and contractual arrangements in order to participate.

Q1. What kind of secondary market functionalities would you recommend to be made available to market participants? How should the outcomes of secondary trading be integrated in the primary capacity auctions?

Primary capacity allocation and secondary capacity trading should remain distinct. As this proposal relates just to day ahead allocation of bundled capacity at the interconnection point between Austria and Italy, we do not see the need to establish secondary market functionalities for this product alone. In our view it is far more important that SNAM and TAG provide a flexible facility whereby longer term entry/exit capacity in their respective systems can be efficiently and quickly assigned to another registered user, in response to bilateral secondary trades.

Q2. The timing of the auctions will follow the current timing set in the network code on CAM (15.30 – 16.00 CET), do you consider it appropriate according to the usual trading activities at the interconnected hubs?

Our understanding is that the current version of the CAM Network Code envisages TSOs holding auctions for bundled day ahead capacity between 16:30 and 17:00 CET and results published at 17:30 CET. We have asked ENTSOG to work in order to make possible the publication of auction results at the latest at 17:00 CET.

Considering the intention to introduce the pilot project while maintaining most of the current market arrangements – e.g. SNAM does not allow continuous renomination – we would favour a



slightly earlier timing of the auctions (for instance, 15.00-15.30). This would in turn allow traders to act on the basis of the auction results when day-ahead markets are still open, granting shippers more flexibility and ultimately increasing market efficiency and liquidity. However the general comments expressed in the introduction of this document should be taken into account in order to allow proper utilisation of the capacity acquired.

Q3. With reference to point 7.3, do you consider appropriate the proposed economic arrangement in case of surrendered capacity?

Q4. Do you consider instead more appropriate, that the whole clearing price of the auction will be granted to the primary shippers in order to stimulate their surrendering of unused capacity?

Our understanding is that any surrendered capacity will be allocated only after all available primary capacity¹ has been allocated and the surrendering network user cannot be released from payment if available capacity has not been fully allocated first.

More in general, in order to evaluate the economic arrangement it is necessary to consider whether a reserve price different from the short run marginal cost (SRMC, assumed very close to zero for simplicity) is applied to the d.a. auction or not.

We believe as well that the economic arrangements in case of surrendered capacity should be evaluated in light of the potential impacts primarily on:

- (i) maximum use of (technical) pipeline capacity,
- (ii) disincentives to retain unused capacity
- (iii) secondary market functioning,
- (iv) availability of risk management instruments.
- (v) TSO neutrality in respect of auction revenues

On the basis of these elements, a balance approach should be sought. Therefore, if primary holders surrender capacity to the TSOs to be made available in an auction for day-ahead *firm* capacity, where the *reserve price* is equal to the SRMC, it seems appropriate a compensation at the clearing price for the proportion of the capacity surrendered that has been allocated after the allocation of the remaining capacity. However we support arrangements that maintain a clear incentive on primary holders to offer unused capacity on the secondary market well before the day ahead stage. Therefore, if a reserve price different from the SRMC is applied (e.g. regulated tariff in proportion for the day, 1/365th of reserve price of yearly product or worse if multipliers are applied), we believe that any compensation to the primary holder could have a distortionary effect and the incentive to offer unused capacity on the secondary market would be removed. It should be avoided in particular that shippers are incentivized to book long term capacity in excess to their needs on the basis of the fact that this activity produces extra-profits in case they release capacity at day-ahead although it was not planned to be used.

¹ Unsold primary capacity, capacity created from over-selling-and-buy-back and capacity released by restriction of day ahead nomination rights.