

Our date  
2010-02-08

Our reference  
EREGE consultation CAM

Administrative officer  
Davide Rubini

Your date  
2010-02-26

Your reference  
**Statoil's response**

EREGE

Attn.: Mrs. Fay Geitona

[Fg\\_pilot\\_gas@ergeg.org](mailto:Fg_pilot_gas@ergeg.org)

1000 Brussels  
Belgium

**Object: Consultation on Capacity Allocation on European Gas Transmission Networks Framework Guideline**

Dear Mrs. Geitona,

We appreciate the opportunity to comment on EREGG consultation document “Capacity Allocation on European Gas Transmission Networks Pilot Framework Guideline” and we trust the opinions expressed in this letter will be duly considered. We also hope this consultation will not represent the last chance to contribute to this process and that a solid dialogue will be maintained in the future with all stakeholders and not only with market organisations and other institutional actors.

We regard the position presented by EREGG as a good starting point towards a set of guidelines whose importance we consider as crucial in the development of the European gas market. The procedures addressed in this document are likely to improve access to the European grid for new and existing players. In particular, we appreciate the long-term vision EREGG has defined and we trust that this will stay as guiding principle in the future. However, it is important that the opportunities offered by the Third Liberalisation Package are fully followed up. To this end we believe that a number of improvements and changes of pattern are necessary.

Please find our comments and views in the document that follows this letter. Should you need further clarification, we would be ready to respond to your request by mail as well as in person.

Kind regards

Statoil ASA

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### ***Linking CAMs and CMPs***

It is important to recognise the link between capacity allocation mechanisms and capacity congestion procedures. Decisions taken in one respect will inevitably influence and, to some extent, constrain decisions in the other one. For this reason we believe the two guidelines drafting processes should be aligned and should take one and other into account. The high level of integration of the two topics is why we have chosen to include in the following paragraphs comments on both CAM and CMP. In fact, what we advocate is the implementation of an integrated system that does not treat separately the two and takes into account a methodology to allow TSOs to respond to users' request for new capacity.

### ***Contracts adjustment***

Existing Contracts have been agreed upon on the basis of the existing market conditions at the time the contract was signed and taking into consideration the value of the capacity such conditions being given. To maintain firmness of capacity and a stable investment climate, existing contracts should not be subject to change. Any forced contract alteration could change the value and firmness of each capacity contract and could remove the ability to utilise this capacity for firm commodity commitments.

Contractual changes should only be the result of a negotiation between the parties involved in the contracts themselves. Managing the transition to the new regulatory system is a delicate exercise. Any requirement in this respect should make sure that confidence in the market is not undermined to avoid creating inter alia undesired disincentives in booking long-term capacity, which would ultimately jeopardise the prospects for investment in new infrastructure.

Quite importantly, any measure deemed necessary to manage the transition towards the new system should be taken in a non-discriminatory and transparent manner. Where necessary, i.e. where the implementation of new rules implies a direct net loss for one of the parties, forms of compensation should be foreseen.

### ***Scope of the guidelines***

We believe that adding a regularly updated list of network points within the scope of the guidelines would add to clarity.

With respect to CMPs it is also important to note that any distinction between congested and non-congested points, as well as between existing and new points, creates confusion and uncertainty in that it seems to imply that an assessment of congestion will have to be performed periodically.

CMPs should be designed in a way that allows them to kick in automatically as soon demand goes beyond the maximum available capacity. This would be easy to apply where oversubscription and buy-back mechanisms are implemented, while it is not in contradiction with the implementation UIOLI mechanisms because these rely on the definition of unused capacity rather than on the congestion at a given point. In fact, it remains unclear to us what the advantages are of specifying that CMPs applies to congested points only. Therefore Statoil suggests including all interconnection points, as mentioned in the CAM framework guideline, in the scope of the CMP guidelines.

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### ***Proper consultation***

A definition of what is meant with proper consultation is necessary. This should include at least the following obligations for ENTSOG and separate TSOs:

- Provide a description of the issue at stake;
- Provide a transparent set of alternative proposals to address the issue;
- Allow a response period for market parties of at least 4 weeks;
- Provide arguments based on a sound qualitative and, where possible, quantitative basis when stakeholders' proposals are rejected.

### ***An integrated model***

We believe that an integrated model for market based capacity allocation, which is able to signal ex-ante the capacity price levels that represent existing grid costs, investment triggers – tariffs and minimum booking – for new capacity, as well as to encompass the potential for overselling capacity by TSOs, is the best way forward. The model aggregates capacity demand at each entry and exit point and puts a price on different levels of demand factoring the need of the TSO to invest in new capacity to satisfy all requests for access to the network or to oversell beyond technical available capacity.

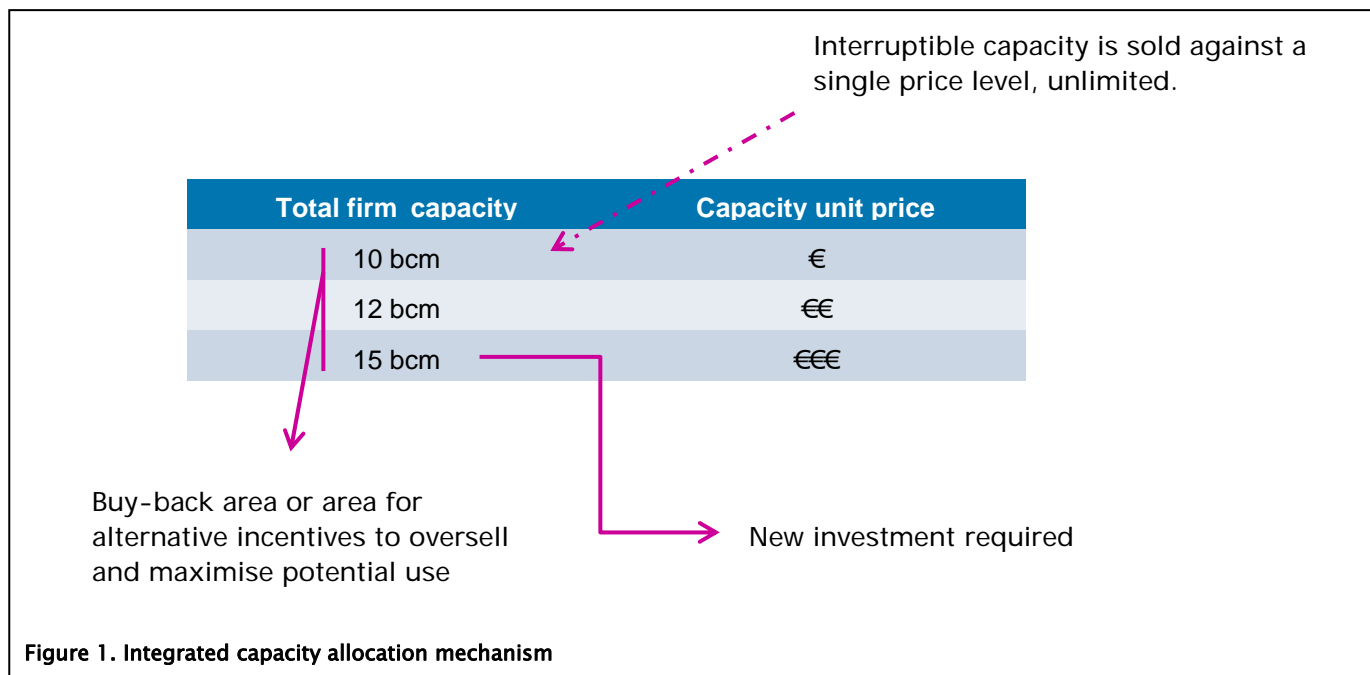
For long term capacity bookings, the auction should ensure that shippers can help supporting and securing investments and that they can do so under transparent conditions regarding investment trigger levels and prices levels. On this basis, the bidding process should require shippers to indicate the amount of capacity they wish to book against which the pre-set price levels covering TSOs' costs and allowed revenue are set. In such a model, long term capacity is requested by network users at pre-defined price levels auctions that are designed to:

- Capture the ability of regular auctions to attribute capacity in the amount desired by network users at a price close to the one indicated for that specific booking level;
- Ensure that all demand for primary capacity is met where it is economic and efficient to do so;
- Ensure a high level of predictability both in the short and long run of available capacity;
- Avoid non-transparent and discriminatory capacity allocation as they imply no priority order;
- Reduce pressure on second best options, such as anti-hoarding rules and interruptible capacity.

Short term auctions should be designed to reflect the market value of capacity. Such auctions could be set up the same way as the long term capacity bookings. However, the nature of short term products and the utilisation by shippers could suggest a pay as bid auction mechanism, possibly with a zero or low reserve price, where capacity goes to those who value it most.

In any case, there would need to be a mechanism to deal with the TSO losses and profits from this process. Scarcity is likely to lead to higher prices and therefore higher profits for the TSO, not providing TSOs the incentives to invest, where congestion occurs.

The auction process should take place on a regular basis, becoming a systematic feature of the investment planning cycle. It should provide a flexible mix of products and transparent allocation rules. A pre-defined percentage of capacity should be reserved for short term auctions, to ensure the large variation of needs of the commodity markets are met.



Setting these auctions up on a regular basis (yearly for long term products and quarterly, monthly, daily for the shorter term products, depending on the type of product) will ensure the TSO has a good overview of the needs for investment and it will allow shippers to factor in these regular allocation rounds in their operations.

We support the suggestions made by EFET regarding the timing and product range. An adequate minimum and maximum time lag between booking and start of the capacity contract should be guaranteed to enable market parties to book capacity in line with their commodity activities. Setting the products and booking opportunities up in the way, as described in the picture below, would allow market parties to book several blocks of a shorter term product to create a capacity booking with a sufficiently long duration to match the underlying commodity.

In general it can be said that 3 main capacity products would be necessary to cover all market parties' needs:

- Daily – can be booked day ahead and up to the start of the month ahead
- Monthly – can be booked for next month, up to 2 or 2½ years out
- Quarterly – can be booked long term: between 1 – 20 years out

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The short term monthly product, due to its booking lag of up to 2 years out, would allow for booking of capacity for medium term needs, such as end user supply or hub deliveries. The Quarterly product, set up for long term commitments, would allow for a booking of any capacity duration between 3 months and 20 years, for a contract start anywhere between Q1 of the following year and Q4 of year 20. This would allow for long term investment planning and security of supply needs. Capacity offers should occur in a coordinated manner throughout Europe. Procedures should be regularly reviewed.

It would be advisable to reserve capacity for short term bookings and potential market entrants. Statoil envisages somewhere between 80% – 90% of firm available (technical max –/– operational) capacity reservation for long term bookings. The remaining 10% – 20% will be made available in the Monthly and shorter allocation process, in addition the monthly process can sell the unsold from the long term booking.

### ***Overselling and buy-back***

Shippers do not always use the capacity they have booked. To ensure an efficient use of the network alternative measures can be worked out, e.g. selling of interruptible capacity, systems of incentives and penalties and different ways to allocate the risk of physical congestion.

A preferred solution consists in a commercial mechanism that maximises firm capacity availability by incentivising the TSO to sell more capacity than it is physically available and potentially buy-back in case of congestion, based on an educated assumption that not all shippers utilise 100% of their capacity rights, 100% of the time.

This system does not represent a way to re-allocate unused capacity, but rather to allow the TSO to increase its sale of firm capacity by assessing the grid situation. Combined with a transparent mechanism to calculate the available firm capacity, it incentivises TSOs to optimise capacity utilisation, without decreasing the level of firmness of already booked firm capacity.

The accompanying buy-back mechanism is initiated only if and when the system unexpectedly does encounter physical congestion. It allows the TSO to buy back capacity rights from those shippers that do not value it enough, without impacting the rights of those that really see value in using it. It allocates the risk of physical capacity overrun to TSOs. In other words, it moves the risk of interruptibility from shippers – who would otherwise buy interruptible capacity – to TSOs – who sell firm capacity up to a level that better reflects actual utilisation. It does so, on the assumption that TSOs have a better insight of the overall system utilisation – they know what percentage of bough capacity is actually used at a certain point in time – and that the increased risk for the TSO is compensated by the additional income from capacity sales above the physically available capacity.

The overselling and buy-back option complements the integrated model presented above. However, for such option to work properly and serve the purpose of ensuring a more efficient use of existing capacity a number of issues would need to be addressed:

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- Capacity overselling by TSOs should be done in a way that does not create uncertainty. A clear ex-ante indication of price of capacity should be provided. Incentives to oversell should be well calibrated, for instance by describing how revenues beyond the regulated rate of return should be used and redistributed;
- Information on technical available capacity and historical flows should be sufficient to evaluate the rationale behind the overselling performed by the TSO;
- Clear principles to set pricing to capture both the value of the capacity bought back and of the related delivery should be developed;
- Timing of buying-back should be well aligned with market dynamics and should occur while trading activities are still taking place to allow coherent adjustment of volumes in the market.

### ***Limitation of re-nomination rights***

A way for TSOs to release day-ahead firm capacity and potentially reduce commercial congestion and enhance the level of utilisation of the network could consist of a limitation of the rights of market parties to re-nominate their flows on a within day basis.

We believe that increasing availability of firm day-ahead capacity by means of restricted re-nomination rights may have undesired and unintended results. This mechanism would reduce the flexibility to balance shippers' portfolio and to make use of potential geographic arbitrage opportunities for traders utilising the spread between bordering markets. It removes some of the inherent advantages of natural gas that is that it can be stored in pipes to manage diurnal demand swings.

Restricting re-nomination right may interfere with trading decision making process from one made on the day to a day-ahead process. Also, one could argue that the limitation of re-nomination rights could become a threat to security of supply where a particular country relies substantially on the spot market in that it may reduce available liquidity.

A further collateral effect of nomination restriction would be to increase the need for flexibility within day within the relevant markets, as this flex would no longer come from outside the market. Ultimately this would seriously reduce liquidity in European markets, rather than enhancing it, inevitably affecting the flexibility market in Europe by increasing the need to reserve storage and other flex for this purpose.

### ***Secondary capacity market***

A market based approach to ensure an efficient use of existing capacity consists of setting up a market for secondary capacity trading. The main benefit implicit in such a system consists of a continuous commercial and voluntary opportunity to solve situations of contractual congestion. Shippers who hold capacity are enabled to sell when they do not plan to use the capacity or are not commercially required to hold it, while shippers who need capacity are enabled to buy when primary capacity is not available. However, by no means secondary trading can be seen as the sole and exclusive CMP or as a sufficient measure to ensure an efficient use of capacity or to avoid anti-hoarding.

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Secondary capacity trading is a tool that has a function in the time between the sale of primary capacity and the release of additional capacity from new investments and offers an opportunity for congested points to reveal the value of alternative optimisation solutions. Yet, for this tool to be fully exploited a number of conditions should be in place. To ensure that market participants make use of secondary markets, access should be maintained simple and cheap, the possibility to split and combine (bundled) products, i.e. fragmentation in time and volume, should be foreseen, and secondary capacity prices should be allowed to compete with primary capacity prices.

Statoil believes that the principles enshrined in the EASEE-gas Common Business Practices on Secondary Capacity Trading provide adequate guidelines.

### ***Long-term UIOLI and capacity release programs***

Use It Or Lose It (UIOLI) and capacity release programs are measures that address the inability of the market to capture the value inherent to unutilised capacity. They differ in that, while UIOLI merely look at the use of capacity at a relevant entry or exit point indifferently of the competitive position of the relevant stakeholder, capacity release program may embrace a wider goal and provide a response specifically aimed at a possible abuse of dominant position in the market.

In a fully functioning liquid market UIOLI and capacity release programmes are unlikely to be used, as shippers have no desire to miss market opportunities, carry imbalance positions, not deliver on contracts, nor do they wish to pay for capacity, which they no longer require, provided they have the confidence that a proportion of capacity is available to meet shorter term requirements.

Capacity release programs should only be used in a long-term perspective, on a case-by-case basis and reflecting a clear definition of unutilised capacity as well as historical usage data. In any case relevant parties should be appropriately consulted before the procedure is publicly triggered by the regulator. UIOLI, considering the impact on existing contracts and underlying commitments, should never be used on a firm and long term basis.

To determine if a shipper is holding on to 'unutilised' capacity, it should have had the opportunity to sell his capacity on the secondary market. The development of a standardised secondary market for capacity, a near-immediate lead time for capacity transfer with the TSO, and a high level of capacity transparency are fundamental to an optimised utilisation of existing capacity and should be realised as a first priority. No firm CMP measure should be applied until the opportunity to sell or trade capacity is available for all market parties.

Firm UIOLI should not be applied and capacity release programmes should remain measures of last resort, as they entail a serious process likely to lead to a negative impact on the commercial market for capacity. Depending on the definition of 'unutilised capacity', these measures could reduce the incentive on parties to enter into the secondary market as buyers of secondary capacity know that unutilised capacity would have to

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be sold. Moreover, the use of these measures to deal with contractual congestion could hinder market development and should be avoided. The definition of 'unutilised' capacity should reflect this.

In addition to the above, Statoil believes these are measures intended to support the development of the commercial gas market through increased capacity utilisation in a market that is not fully developed. Hence, they should be constructed and utilised as an incentive for network users to use the commercial market for capacity, rather than discouraging it.

Finally, Statoil believes that income from the application of such measures should be invested in solving the issues in the market that prevent a commercial optimisation of capacity utilisation. This includes the facilitation of the secondary market for capacity and the development of new capacity at the congested point. Part of the income should be used to cover the costs of the TSO, although these are expected to be minimal expenditure on IT system and operation.

Substantial over-recovery of revenues from the release of additional capacity need to be managed carefully so as to avoid market distortions. This can be achieved through a number of methods, such as amending transportation charges, flow based compensation to holders of capacity and refunding of the over recovery to successful bidders.

### ***Interruptible capacity***

We believe that defining classes of interruptible capacity is not compatible with the release of additional short term capacity, as in order to do so TSOs will have to recalculate the risk of interruption, and hence re-assess the pricing of all interruptible capacity when new capacity is released. We would urge the guidelines to oblige TSOs to sell a single interruptible capacity product, with equal risk of interruption for all parties, while enhancing the obligations for TSOs to provide a transparent and accurate set of data. This would leave market parties with the responsibility to assess the interruptibility of the capacity they own. The interruptible capacity product offered by all TSOs should be a universal product and interruption undertaken to all holders of the product on a pro-rata basis. This would:

- Avoid discriminatory interruptions on a first come last interrupted basis;
- Incentivise market parties to book firm capacity as it becomes available and allow TSOs to release additional short term firm capacity without having to re-assess their other contracts.

### ***Transparency and capacity calculation***

Any capacity allocation and congestion management procedure can work in an efficient manner only where a sufficient level of transparency on capacity offer/demand and actual physical use is provided. In particular it is felt that TSOs should be regularly providing information on:

- Historical flows / levels of utilisation at each entry/exit point
- Maximum technical capacity
- Available firm capacity at each entry/exit point
- Booked firm and interruptible capacity
- Historical interruption data



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— Prices and tariffs / charging methodologies for capacity allocation

Moreover, any decision related to capacity allocation should be communicated in a timely manner so that stakeholders are given sufficient time to comply with internal decision making procedures, in particular with respect to booking long-term capacity.

In particular a set of rules and principles to describe how capacity calculation should be performed is necessary. In this respect we invite EREG to instruct ENTSOG to include in their Network Code a basic time schedule. On a longer term basis (every 1–4 years) the TSOs should calculate the minimum available firm capacity for each point, based on the technical maximum of the system. This level of firm capacity should always be marketed by the TSO, according to a pre-set fragmentation in short, mid and long term products.

Additional firm capacity should then be calculated by the TSO on a regular, shorter term basis (matching the capacity products of the primary market, f.i. yearly, monthly and daily), for the marketing of additional firm products. The calculation and re-calculation methodologies, as well as the timelines for performing these calculations should be set after consultation on the product needs of the market, should be applied consistently and must be monitored by the regulator.