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## **E.ON Position on**

# **ERGEG's Assessment of Capacity Allocation Mechanisms and Congestion Management Procedures for Effective Access to Storage and Proposals for the Amendment of the GGPSSO**

**Ref: E10-GST-09-06, 28 July 2010**

**Düsseldorf, 8 October 2010**

## 1 General Comments

Harmonized procedures for storage capacity play a crucial role in achieving the objective of a single European gas market. Harmonized market rules would create synergies for market participants, enhance transparency, facilitate trading and supplying of end consumers, and create an improved framework for new investments and competition within the storage market. Accordingly, in respect to negotiated and regulated third part access (TPA)<sup>1</sup>, E.ON supports measures which promote harmonized arrangements across member states.

E.ON further believes that market-based storage access is essential to ensure further market integration, appropriate investment signals and liquidity on the flexibility markets. We are of the opinion that markets will deliver the most efficient portfolio of flexibility instruments (flexible production, domestic and foreign storage flexibility, flexible procurement contracts, and intraday products) at lower costs than any regulated regime. Allocation mechanisms such as "capacity goes with the customer" limit storage capacity to a specific target group and hamper cross-border transactions and efficient allocation of flexibility across the EU as a whole. Additionally, this is detrimental for competition development in the wholesale market as it encourages vertical integration and deters new entries. Taking these arguments into account, E.ON clearly supports auctions as the standard allocation procedure for storage capacity and FCFS in the absence of congestions.

Any assessment of appropriate capacity allocation mechanisms (CAM) and congestion management procedures (CMP) should not only consider the effectiveness of existing TPA, UIOLI and flexibility instruments within a member state but also consider the wider impact of these arrangements in the integration process and on the European gas market as a whole.

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

## 2 Specific Comments

### (1) To what extent do you agree that auction is the best allocation mechanism for storage and what will be the implications?

- In case of congestion, E.ON agrees with ERGEG's opinion that auctions are the most effective, market-based and non-discriminatory method for allocating storage capacity and therefore represent E.ON's preferred allocation method. Market-based prices have a signaling function for the usage of storage capacity and reveal whether investments in the enhancement of existing facilities or in new storage facilities are reasonable. A market based balancing regime is also crucial to ensure the effectiveness of price signals. A set of yearly, monthly or rolling monthly auctions with a clearing price mechanism shall apply. A reserve price should be defined by the SSO in order to avoid SSOs facing disadvantages in the context of the auctions by less binding demand than originally identified in the Open Subscription Period (OSP).

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<sup>1</sup> In some member states an efficient market for flexibility (including storage) may already exist. In such markets TPA exemptions are often granted to particular storage operators in relation to the position in the flexibility market. For avoidance of doubt we assume that storage facilities explicitly exempted from regulation are not in the focus of these GGPSSO.

- Where the supply exceeds the demand, storage capacity should be allocated to market prices in a transparent and non-discriminatory way. Booking methods such as "Click & Book" should be possible in this context. The identification of a potential congestion could be done by an OSP as suggested by ERGEG.
- "Pro rata" is an unsuitable method as it is unlikely to accurately satisfy an individual user's requirements, especially in the absence of any liquid intraday (balancing) market and thus alternative flexibility instruments to make-up any imbalance. Pro rata allocation is a severe barrier to entry for trading companies and hence a barrier to developing liquidity. Pro rata might be used as a congestion management tool in case contracted storage users with equal contractual rights need to be partly interrupted.
- We object the method "capacity goes with the customer" (CGWC). Priority storage access favors incumbents as it is typically linked to domestic customers which invariably continue to be supplied by such parties. CGWC also favors vertical integration and compresses wholesale and retail markets. New entrants are disadvantaged as they will tend to wish to acquire business and industrial customers first but this can be hindered by an inability to obtain storage flexibility, especially in the absence of a liquid intra-day market or because of an inability to transfer flexibility across borders. In order to create a level playing field across Europe, E.ON would like to see a policy change in those countries where regulators or national legislation impose non-market based and discriminatory allocation methods on SSOs. CGWC also adds complexity when defining the amount of capacity "needed" by each customer, complicates the switching procedure in retail markets, and introduces uncertainty in cases when investigations to assess the "correct" use of allocated storage capacity are undertaken.
- Regulated TPA can coexist with auctions; additional measures would be needed to decide upon the allocation of congestion rents (e.g. to lower storage tariffs, payback to network/storage users). For this reason, E.ON recommends to delete from the proposed text at 4.1g 1 the following passage: "and unless national legislation stipulates differently".

**(2) In your opinion, what are the most important aspects regarding transparency that should minimally be addressed by SSOs for both CAM and CMP?**

- E.ON fully agrees with ERGEG's proposal in section 4.1a. In order to gain the maximum market awareness, the details of timing, organization, terms and conditions, and results of CAM should be published in the Internet in the local language and in English. In addition, shortly before the capacity allocation procedure takes place, market participants should be informed by newsletter and print media.
- Terms and conditions of CMP should be published in the Internet in the local language and in English and for completeness be included in the contract.
- CAM and CMP should be clearly described in the contract terms and also be published in the Internet to ensure users are fully aware of their storage access rights and obligations.

**(3) In your opinion, what is most important when designing UIOLI (including products and contracts) as to leave a storage user the flexibility to use its storage capacity when needed?**

- Forward looking, UIOLI will be in place through entry into force of the 3rd Energy Package, requiring SSOs to offer unused capacities day-ahead at least on an interruptible basis. Since flexibility is crucial for storage users, any short term measure to optimize the usage of the existing storage capacity has to allow for remuneration rights. Any offer of short term products based on not nominated capacity should exclusively be marketed on interruptible basis. By publishing day-ahead nomination, users are able to assess the associated risk for interruption on their own.
- As stated above, storage capacity is used for several reasons and competes with other flexibility instruments. Not using the booked storage capacity could therefore not automatically present capacity hoarding, but rather implies that other flexibility instruments such as the intraday market might have been cheaper or weather conditions were not like as expected.
- For the long term UIOLI process, a clear and well-defined signal needs to be defined ex-ante to initiate the review process by the SSO. Such a threshold could be e.g. a percentage of non-injected gas in relation to booked firm capacity for a predefined time period. Furthermore, a detailed list of criteria has to be defined upfront, stating when unused capacity has to be offered to the market. These criteria should carefully take into account the specific regional reserves for climate risks and the security of supply as well as import outages.
- The SSO will approach the respective shipper to clarify the reasons if the non-usage exceeds the previously defined threshold. There might be reasons - such as security of supply - that justify the non-usage of a certain amount of booked capacity. In case the explanation meets at least one of the previously defined criteria, the storage user should offer a certain percentage of their unused capacity on the secondary market for a certain time period.

**(4) In your opinion, to what extent should offered services and terms & conditions on secondary markets be standardised as to improve secondary trade of storage capacity? Is standardisation a way forward to enhance liquidity of secondary markets? What aspects of secondary markets (products, contracts, etc.) are the priorities to be harmonised?**

Initially, we would like to point out that standardized products very likely lead to an inefficient and uneconomic utilization of storage. Furthermore, a liquid market will certainly provide individual storage products required by and attracting the market.

- It is of foremost importance to first create a level playing field in the primary market, i.e. standardized products and allocation mechanisms. Any harmonization on the primary market will eventually entail similar harmonization on the secondary market. The focus should be on the standardization of products first.
- As for transport capacity, encouraging new entry, and adding market depth, E.ON believes CAM and CMP shall foresee that a ratio of short term ( $\leq 3$  years ahead) should not be below 20%.

- Standardized products should contain bundled and unbundled products as required by the GGPSSO. The bundled products usually reflect the type of storage and individual physical/geological restrictions and an optimization regarding maximum use of the capacity.
- To facilitate secondary marketing, the primary capacity holder should be allowed to split their bundled product into its adequate component parts. That is, where products are sold in bundled form (i.e. x units of injectability, y units of space and z units of deliverability), these should be capable of being unbundled for resale in the secondary markets without customer switch.
- The full assignment of storage capacity should be possible in order to facilitate the market even further. This option of transferring the capacity and the corresponding procedures should be subject to the individual SSO. The direct contractual relation between SSO and capacity buyer would require the security to be provided by the buyer to the relevant storage operator and the charges to be paid by the buyer as well to cover the transaction costs.
- Another possibility to enhance secondary marketing and trading could be a single EU platform for storage capacity, like store-x with harmonized terms and conditions as well as products.

**(5) To what extent do you agree that (next to probability of interruption) pay-as-used can be applied as a pricing strategy for storage prices that are not regulated and what other pricing strategies would be suitable? How can pricing strategies incentivise new investment in storage and efficient use of storage?**

- Market-based prices will give sufficient market signals on whether investments in the enhancement of existing facilities or in new storage facilities are reasonable.
- In the future, long term bookings still have to be possible not only from a security of supply point of view but also for reducing investment risk.

**(6) In your opinion, to what extent do you consider that combined products (i.e. storage services offered at virtual hubs) of storage and transport capacities are a useful and efficient service?**

- Booking transport capacities without knowing about storage users' needs would create an unjustifiable financial risk to the SSO. It would also not solve the problem arising if the amount of transport capacity differs from the storage capacity. However, if the market asks for such combined products, the transport and storage capacities correspond to each other and the SSO is willing to take the risk, the SSO may offer the product on a voluntary basis.
- A fixed reservation of transport capacity for storage purposes in an Entry-Exit-system is difficult as it discriminates storage users against other shippers. However, the aspiration should be that the timing of the storage and the transport capacity allocation are compatible.

**(7) In your opinion, what market mechanism (incentive) should be in place to stimulate a storage user to offer any unused capacity on the secondary market?**

- The activities on the secondary market would be stimulated if
  - terms and conditions are standardized and could be easily offered on a secondary market platform.
  - an efficient UIOLI resp. UIOSI is in place that promotes the secondary marketing of storage products in the forefront to avoid any contractual loss of storage capacity.
  - a market based balancing regime is in place to support a mark-to-market evaluation of available storage capacity. This gives the correct price signal to avoid storage capacity hoarding.
  - there are sufficient alternative flexibility instruments in the market (e.g. non-discriminatory TPA of production/LNG storages, introduction of liquid day-ahead and intraday markets, enhancement of interconnection capacity, elimination of administrative burden for gas import) and storage capacity is not the single and scarce source of flexibility.

**(8) In your opinion, to what extent is the (cross-border) offering of storage products/combined transport-storage products useful to market parties and what should these products (e.g. minimum requirements) look like?**

- Storage sites are already used across borders. Therefore, any mandatory obligation for storage products is not necessary. But to strengthen the possibility for an efficient usage of European infrastructure, a standardization of market rules according to market needs is essential.
- National market rules which hamper the utilization of storages across borders have to be redrafted in the sense ERGEG has already described in this document as to be non-discriminatory. That means the use of storage should not be connected to nature or size of the users' customer portfolio, and should be market based.
- Equally, parties should not be obliged to procure storage or other forms of flexibility based on the nature or size of their customer portfolio.

**(9) To what extent do you consider the proposals will facilitate allocation and congestion management of storage capacity? What other measures should be in place?**

- In many countries, there are still a lot of regulatory rules and national laws describing allocation methods for storage capacities in place that have been recognized by ERGEG as discriminatory (e.g. Italy, France) and not market-orientated. These arrangements would not be affected by ERGEG's proposals.
- The proposals would only create noticeable improvements if the same principles were applied in every member state and products and procedures were standardized. Certain groups of storage users should not be preferred.

**(9.1) In particular, what possibilities do you see to enhance efficient use of storage, reserved for public service obligations like e.g. strategic storage or other reserved storage? Under which conditions would additional use of such storage as (interruptible) short-term product or remarketing on secondary market be acceptable? Could you give examples from your day-day experience?**

- Storage clearly plays a crucial role in maintaining the security of supply in Europe. However, national requirements for 'strategic' storage often imply barriers to entry and distort competition in the flexibility market. Where in place, costs should be recovered in a non-discriminatory way (paid by tax payers or by transport/storage tariffs) without additional complexity for market players<sup>2</sup>.
- During the Ukraine crisis last year, the market has proved to be able to deliver adequate gas flows. More standardized and market based allocation procedures in all member states are needed as these would further improve the effectiveness of the market. Therefore, a combination of encouragement for commercial storage projects, improved interconnections, and a combined pipeline system operation in case of emergency will more efficiently deliver both a secure and an integrated, competitive EU gas market.

**(9.2) In particular, what best practice for CAM and CMP should be in place for specific cases when parts of LNG terminal facilities potentially function as storage capacity? Could you give examples from your day-day experience?**

- Storage at LNG facilities should be viewed as a temporary buffer stock into which cargoes are unloaded and from which then, shortly after, they are delivered into the gas transmission system. From our day-to-day experience, the commercial drivers on LNG terminal operators and their users show that its use as a proxy storage facility is unlikely, as this may delay or hinder opportunities for cargoes to be unloaded. Nevertheless, it is helpful to the market to

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<sup>2</sup> e.g. the "declaration of origin" requested by Italian authorities on where the gas has been extracted in order to assess whether the strategic storage capacity has to be allocated and the related fee paid by the authorized importer.

understand the aggregate amount of buffer stock held in store from day to day as this aids market participants' understanding of the prevailing gas supply-demand fundamentals.

**(10) To what extent would you agree NRAs should be endowed with additional competences in developing CAM and CMP?**

- As stated above, the European gas market would profit from harmonized CAMs, CMPs and market rules across the EU instead of national individual solutions developed by NRAs. NRAs should ensure that efforts are undertaken and storages are open for every market participant and not restricted to national purposes.
- No further powers need to be granted to NRAs to develop the necessary changes to CAM and CMP. However, in the case of regulated storage and allocation rules introduced by primary laws, reforms to storage market rules could be better facilitated by giving users the right to formally propose access rules. Such proposals would then be approved or rejected by the relevant NRA with an appeals process to provide a safeguard for affected parties if a decision of the NRA is necessary.

**3 Text proposal**

ref	Current text	Proposed change (new text bold)	Justification
4.1.c	c. ensure compatibility (i.e. regarding timing / lead time) with the transport capacity allocation mechanism(s) of the connected TSO(s) and the organization of the gas trading market(s). Consequently, this also requires to align at least a basic set of storage products (with regards to duration and lead time for regular allocation) to transport products.	c. ensure compatibility (i.e. regarding timing / lead time) with the transport capacity allocation mechanism(s) of the connected TSO(s) and the organization of the gas trading market(s). Consequently, this also requires to align at least a basic set of storage products (with regards to duration and lead time for regular allocation) to transport products, <b>and vice versa.</b>	Should be aligned bidirectionally.
4.1.e	Take into account the needs of balancing markets		Unclear
4.1.f	start with an open subscription period (OSP).	start with an open subscription period (OSP).	OSP procedures should be standardized



ref	Current text	Proposed change (new text bold)	Justification
	<p>At least during the OSP, SSO's shall provide all relevant information including specific storage product descriptions, contract durations, (reserve) prices and the conditions for the respective CAM(s) to be applied according to the results of the OSP to the potential customers.</p> <p>The timing of the OSP should be fixed and aligned to the duration of the respective storage contracts.</p>	<p>At least during the OSP, SSO's shall provide all relevant information including specific storage product descriptions, contract durations, (reserve) prices and the conditions for the respective CAM(s) to be applied according to the results of the OSP to the potential customers.</p> <p><del>The timing of the OSP should be fixed and aligned to the duration of the respective storage contracts.</del></p>	
4.1.g	<p>g. with respect to the applicable mechanism be determined by the results of the OSP:</p> <p>1. If demand exceeds supply - and unless national legislation stipulates differently - auctions should be implemented for allocation of all of the capacity offered with this storage product or service in the preceding OSP.</p> <p>2. If supply exceeds or is equal to demand, allocation is straightforward.</p>	<p>g. with respect to the applicable mechanism be determined by the results of the OSP:</p> <p>1. If demand exceeds supply - and unless national legislation stipulates differently - auctions should be implemented for allocation of all of the capacity offered with this storage product or service in the preceding OSP.</p> <p>2. If supply exceeds or is equal to demand, allocation is straightforward.</p>	<p>Straightforward means a fair and transparent applied allocation method based on first come first served</p>
4.2.e	<p>e. The terms and conditions for access to a storage, operation of the site for both the secondary market and interruptible products should be standardized, timely accessible for (potential)</p>	<p>e. The terms and conditions for access to a storage, operation of the <b>website</b> for both the secondary market and interruptible products should be standardized, timely accessible for</p>	<p>Choice to provide information in local language should be a decision by the SSO.</p> <p>See also 4.1.a</p>

ref	Current text	Proposed change (new text bold)	Justification
	customers and published at least on the internet in both English and local language.	(potential) customers and published <del>at least</del> on the internet <del>in both</del> <b>at least</b> in English <del>and local language</del> unless the NRA provides otherwise.	
4.2.f	f. A primary customer makes, at best effort, a timely nomination to the SSO on the capacity that will be used. In case a primary customer, holding a significant part of capacity, has not made a nomination on a specified date, the involved SSO will (since the Regulation 715/2009 says that the SSO must offer unused capacity at least on a dayahead and interruptible basis) ask this primary customer to relinquish its renomination right by selling back capacity to the SSO and offer the unused capacity on the secondary market on firm basis or SSO will offer non-nominated capacity on interruptible basis.	f. A primary customer makes, at best effort, a timely nomination to the SSO on the capacity that will be used. In case a primary customer, <del>holding a significant part of capacity,</del> has not made a nomination on a specified date, the involved SSO will (since the Regulation 715/2009 says that the SSO must offer unused capacity at least on a dayahead and interruptible basis) <del>ask this primary customer to relinquish its renomination right by selling back capacity to the SSO and</del> offer the <b>non-nominated unused</b> capacity on the secondary market <del>on firm basis or SSO will offer non-nominated capacity at</del> <b>least</b> on interruptible basis.	Storage users would be treated differently. By back obligation for SSO would negatively effect investments and cash flow predictions.
4.2.g	g. Based on the received nominations and their own forecast, SSOs shall strive to maximise interruptible capacity products offer on a short-term basis, and in particular, on a daily basis (comment: the Regulation 715/2009 requires SSOs to offer unused capacity on at least a day-ahead and interruptible basis) by	g. Based on the received nominations and their own forecast, SSOs shall strive to maximise interruptible capacity products offer on a short-term basis, <del>and in particular, on a daily basis</del> (comment: the Regulation 715/2009 requires SSOs to offer unused capacity on at least a day-ahead and interruptible basis) <del>by</del>	SSO's do not have information available to predict user behaviour. Interruptible deals and demand forecasts are by its nature more a business for users amongst each other.

ref	Current text	Proposed change (new text bold)	Justification
	dynamically calculating available capacities taking into account actual temperatures, counter-flow nominations, any other information means available influencing capacity use.	<del>dynamically calculating available capacities taking into account actual temperatures, counter-flow nominations, any other information means available influencing capacity use.</del>	
4.2.j	j. SSOs will take efforts to facilitate the transfer of working gas between a primary and secondary customer at the start and end of the duration of the interruptible or firm (bought at secondary market) contract. In case of a working gas transfer, the price should be market-based.	j. SSOs will take efforts to facilitate the procedure of transfer of working gas <b>in storage</b> between a primary and secondary customer at the start and end of the duration of the interruptible or firm (bought at secondary market) contract. <del>In case of a working gas transfer, the price should be market-based.</del>	Transfer price for gas is subject to users.
4.2.l	l. In case a storage facility has a high minimal flow and/or other technical constraints for relatively small users, SSOs will use reasonable endeavours to aggregate customers nominations and/or to administratively approach the largest user with request to flow gas to overcome the technical constraints of the storage.	l. In case a storage facility has a high minimal flow and/or other technical constraints for relatively small users, SSOs will use reasonable endeavours to aggregate customers nominations <del>and/or to administratively approach the largest user with request to flow gas to overcome the technical constraints of the storage.</del>	Storage users should not be restricted in their storage rights