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20 March 2009

**ERGEG Public Consultation:
ERGEG principles: Capacity allocation and congestion management in natural gas
transmission networks**

Dear Mrs. Geitona,

On behalf of Shell Energy Europe B.V. and Shell International Exploration and Production B.V. (Shell), I would like to thank you for the opportunity to comment on the ERGEG principles for Capacity allocation and congestion management in natural gas transmission networks.

We would like to express our appreciation for the work that has been undertaken by the regulatory authorities. We believe that the paper is an important contribution towards the development of a single, competitive gas market in the EU.

Shell has played a key role in the European gas business since its inception. With access to pipeline gas as well as LNG, we have a diverse portfolio of gas supplies for the European market - combining gas from Shell's exploration and production activities in Europe and the rest of the world with gas from third party supplies.

Shell is today a player throughout the European gas market - with companies present in many countries. Shell has more than 8000 natural gas customers in Europe - covering sales channels and segments that range from international merchants to individual industrial and commercial customers. We intend to develop and extend our customer portfolio in response to the changing circumstances and conditions in the broader European market arenas.

Before we explain our view on questions 1 to 11 from the consultation paper, we would like to make some general remarks about the issues addressed in the paper and, in addition to the principle scope of the consultation document, some related areas.

1) New investments in the European Gas Pipeline Infrastructure are necessary and essential for the functioning of the internal market. There is a lack of capacity – and congestion management is a necessary, but not a sufficient measure to overcome the challenges. The initiatives addressed in the

consultation paper will most likely bring some capacity to the market. But it will by far not be sufficient for the development of a secure and adequate European gas grid. A positive investment climate including investment friendly regulatory settings with appropriate tariff regimes is of utmost importance. That's why we believe, a pan-European statement on principles for capacity and congestion management should not exclude investment or tariff issues.

2) In order to optimise the effectiveness of inter-grid investments, TSOs need to co-ordinate their respective plans. This co-ordination must be based on the requirements signalled by shippers engaged in inter-TSO gas shipping activities. In a similar vein, investments in grid entry capacity undertaken by a TSO should be based on jointly agreed upstream (supply) and downstream (demand) signals and forecasts of different sources – including key producing undertakings – into account. These activities should be facilitated and supported by regulatory bodies.

An improved co-ordination of TSOs investments would also be very beneficial for security of supply within the European Union. Secure, expanded and interconnected gas grids are one of the most important prerequisites for a secure gas supply in Europe. They will not be achieved just by setting up new capacity allocation or congestion management procedures.

3) We very much support a level playing field in the European gas market. To that end we support the full and equal implementation of the Gas Directive as well as an enhanced European coordination of regulation of energy markets. Care must be taken, however, to achieve fit for purpose regulation that simplifies the rules and reduces the over-complication currently experienced in some Member States.

In the case of capacity management and congestion management, we see a clear case for stringent rules and principles with only minor competencies for national regulatory authorities to interpret and apply. We challenge all statements in the document where national regulatory authorities explicitly get the competencies “to set out further details” or “to review” – and as a consequence – change rules and principles of the European standard.

In addition, we would prefer to see a rather realistic timeline for the implementation of the new system. From our perspective, a 6 months transitional period starting almost immediately as outlined in principle G4.4 is inappropriate. It would most likely result in massive disturbance of current operations and almost immediately lead to further member state specific implementation levels.

4) We support regulatory powers where they are needed as a proxy for market forces. In such cases actions and interventions by the regulator need to be based on objective criteria and regulators must be accountable with a clear process in place in case of disputes. We oppose market interference in the absence of violations of competition rules.

5) Finally, we once more would like to address the requirement that existing capacity contracts have to be respected. This is true irrespective of the details of a potentially new capacity and congestion management regime for Europe.

If inconsistencies between current and future system would occur, there should be at least a migration path which compensates commercial impacts.

In the following, we will give you our view about questions raised by ERGEG in the consultation paper:

Question 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?

Answer 1: We agree with the challenges described by ERGEG. Nevertheless, we would suggest to bring them into a more general perspective, before discussing operational details.

In addition to the points made by ERGEG, we would propose to add at least the following themes on the list of challenges, too:

- Security of Supply:
 - As mentioned above, we see a fundamental need for new investments in grid infrastructure in whole of Europe. The necessary expansion (additional capacity) can't be generated just by a more intelligent management and/or usage of existing capacity.
 - Confidence and trust in Europe as business partner for suppliers from outside the EU. New regulations shouldn't put long term business relationships at risk.
- Market structure (short term vs. long term market):

While we acknowledge that there is a role for short-term business in the gas market, we also see that the gas business in Europe is fundamentally long-term orientated and this is likely to remain to be the case in future.

Long term capacity bookings are – and will be - an important factor for the market to function. As a matter of fact, long term capacity contracts are quite often a prerequisite for gas to flow to the European Union, enabling a liquid commodity market.
- Harmonization of regulation in member states: See general comment above (No. 2).
- Seamless operations:
 - Beside the harmonization of regulations in the member states we would raise awareness for the need of a standardisation of the whole operational framework: I.e. processes, tools and contracts for capacity booking, trading and usage should be standardized, fit for purpose and very efficient.
 - There is also merit in TSOs harmonising the tools available to them to offer and manage capacity rights; the resulting simplification could benefit competition between shippers and make new entry easier. However, in doing so, care has to be taken that harmonisation and simplification does not result in an inappropriate allocation of risk that damages competition. For instance, with respect to the use of a capacity buyback mechanism, we would be interested to know why a TSO should not bear the costs associated with its inability to make available it has sold?

Question 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?

Answer 2: Yes, if it is seen into the wider context. We agree that there is room for improvement and that the situation should be improved. Nevertheless, it will not overcome the issue of necessary, additional investments in the expansion of the grid.

Question 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)?

Answer 3: From our point of view, FCFS has the potential to be discriminatory only in cases where congestions occur. In other words: FCFS shall be the standard allocation method. Only if congestions are foreseen and no other means of satisfying capacity requests are realistic (e.g. by sale of capacity at secondary market), OSP could be an alternative.

Theoretically, the method of an "Open Subscription Period" (OSP) can reduce the risks of discrimination. Nevertheless, if not designed appropriately, OSP could bring more problems to shippers business than advantages.

Depending on the setting of the process, there are three types of risks which should be mitigated when designing the OSP process:

- Volatility of price for capacity: Prices in auctioning processes will be volatile - which is a new risk for the supplier and has to be mitigated.

- Access to necessary capacity: If suppliers get pro-rata allocations, they can't be sure to get all the capacity they need. If a liquid secondary market does exist, this risk could be converted to a price risk. Otherwise transport qualifications would become necessary.
- On-time availability of capacity: OSP should be run frequently in order to guarantee access to new capacity (short- and long-term) whenever needed. Otherwise, the market would develop distinct "contracting periods" which would bring unnecessary stress to the system: On a first-come-first-serve (FCFS) basis, transport qualifications can be removed almost immediately (in case of successful booking). In an OSP system, parties would have to wait until OSP process has terminated.

If these issues would be addressed appropriately, we would prefer – in the case of congestions – frequent OSP processes with auctioning. Revenues generated above the level of regular tariffs should be used to incentivize investments to remove the congestion. If no congestions are foreseen, FCFS shall be the standard.

Question 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)?

Answer 4: As mentioned above, we see that the gas business in Europe is fundamentally long-term orientated and this is likely to remain to be the case in future. That's why we see firm, multi-year capacity products as top-priority.

For the sake of a better integration of the European market, we would appreciate a closer cooperation between adjacent TSOs and offers for bundled products. This off course would also require close alignment of NRAs involved.

With respect to interruptible capacity, please also refer to our response to question 6.

Question 5: What is the role of secondary capacity trading?

Answer 5: If appropriate setting is achieved (see "seamless operation" in answer 1 - standardized, low transaction/registration fees, few and efficient trading platforms) a healthy secondary market could develop. From our perspective, this market will be more interesting for short term trading oriented activities. E.g. arbitrage and other optimization deals, seasonal opportunities and supply of balancing energy. It is unlikely that "secondary capacity" will in future play an important role in the long term supply business.

Question 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?

Answer 6: For the sake of trust in the regulatory environment it has to be guaranteed that existing commercial contracts are not impacted. All measures which would restrict the rights of the capacity owners have to be avoided. If inconsistencies between current and future system would occur, a migration path compensating commercial impacts shall be foreseen.

From that perspective, we would especially challenge the following principles:

- G4.1.2 Limitation of existing re-nomination rights.
- G4.2 Withdrawal of underutilised capacity (very vague description of conditions which would justify withdrawal, principle and definitions used offer to much room for interpretation).
- G4.4 Existing contracts (implementation within 6 months).

Instead of these principles, we would propose to implement a fundamental change of the role of interruptible capacity. In our opinion, one of the main reasons for lack of short term firm capacity has to do with interruptible capacity and respective tariffs.

- As long as almost unlimited interruptible capacity can be sold – and tariffs do not differ very much from firm capacity - there is no incentive for TSOs to stretch their firm capacity calculation. Revenues can be generated either by sale of dedicated amount of firm capacity or – at a lower risk – with reduced amount of firm capacity and substituted by almost as expensive interruptible capacity. As a consequence, there is no commercial reason for the TSO to offer maximum amount of firm capacity in a system which is fully booked.

We therefore would propose to introduce a significant price spread between firm and interruptible capacity, e.g. interruptible tariffs at 5 or 10% of price for firm capacity. Additionally, TSOs would only be allowed to offer interruptible capacity if no firm capacity is available.

- Such a measure would not only trigger new ideas on TSO side. In addition, it would be a strong push for shippers/traders to sell "unused" firm capacity on the market. Because otherwise they would risk that competitors would buy (very cheap) interruptible capacity to supply customers. As the capacity would not only be very cheap, but also with a low risk of interruption (a fact well known by the holder of the “unused” capacity). This would trigger additional activities at the secondary market, as holders of the primary firm capacity would be keen to offer their “unused” firm capacity to the 3rd parties.

If a price spread between firm and interruptible capacity would be established as described above, there would be no need to interfere with existing contracts (re-nominations rights or withdrawal) – as a liquid secondary capacity market would most likely develop almost immediately.

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

Answer 7: See comments above. Overall, it is a move in the right direction. Nevertheless, there are some fundamental issues which we believe should be sorted out before a step change improvement will be possible.

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

Answer 8: Shell is an important shipper in Europe, therefore our shipper perspective is already covered in the answers given.

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

Answer 9: There is no doubt that the measures proposed have the potential to facilitate a more liquid gas market. Nevertheless we believe that there would be measures which would have much faster and more efficient results. For example, an increased spread between interruptible and firm tariffs (as described in answer 6) would, if appropriately implemented, most likely kick-start the short term capacity market.

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

Answer 10: As already mentioned in answer 1: Harmonisation of regulation in member states and seamless operations are very important for the development of common European gas market. We very much appreciate and support the idea of a common European Gas market.

Compatible bookings and operational procedures would be beneficial for the pan-European shipping and trading activities. Moreover, they are a kind of indicator and symbol for the willingness of actors involved (Member States, NRAs, TSOs) to cooperate and align in order to develop a level playing field in Europe.

That's why we believe the compatibility of booking and operations are quite important milestones to achieve. We support activities as outlined in the consultation document and would suggest to extend proposals to include simplification of processes as a target

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

Answer 11: We would appreciate if some more effort could be spend on the following issues:

- Investment Climate: How to attract additional investment? Which supporting tariff regimes are required, e.g. price-spread interruptible/firm capacities?
- Level playing field all over Europe – alignment of regulatory and legal framework.
- Development of a realistic migration path from current regulation to a proposed, new system.
- Some more general thoughts about prioritisation efficiency vs. security of supply. How much “inefficiency” is considered acceptable for the sake of improved security of supply? How much redundancy is necessary?

I trust you have found these comments useful.

Yours sincerely,



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